DELINQUENT PROPERTY TAX IN PHILADELPHIA:
STARK CHALLENGES AND REALISTIC GOALS

June 27, 2013

EXECUTIVE SUMMARY

As Philadelphia embarks on a new system to assess and tax real estate, the city's longstanding problem with property tax delinquency has taken on new urgency. Property owners whose taxes are projected to go up substantially are questioning why they should pay more when others pay nothing. As of April 2012, the city and school district were owed $292.3 million in delinquent taxes on 102,789 properties, $515.4 million when interest and penalties are included. (The numbers have increased since then.) About one-quarter of those properties had been delinquent for more than a decade.

Figuring out how much of this money Philadelphia might collect, and how, have been nagging questions for years. An analysis by The Pew Charitable Trusts estimates that the city should be able to collect at least $155 million or about 30 percent of the $515.4 million over the course of several years, assuming that well-funded tax collectors use all of their statutory powers, including foreclosure, more aggressively than in years past. But as much as 70 percent of the $515.4 million is most likely uncollectable. This year, the city levied about $1.2 billion in property taxes for itself and the school district.

Of 36 cities studied in this report, Philadelphia had the fifth highest delinquency rate in 2011, the last year for which statistics were available. Our study found that many of the cities with lower delinquency rates than Philadelphia adhere to stricter timetables for imposing enforcement measures against delinquent property-owners—timetables usually set by the state—and are more willing to take properties away from owners who do not pay their taxes. At the same time, a lot of these cities have lower percentages of poor people, stronger real estate markets, and higher shares of homeowners who pay their taxes automatically through mortgages.

The goal of the study was to understand Philadelphia's real estate tax delinquency and compare its practices to those of other cities. The collectability analysis by Pew in association with real estate economist Kevin C. Gillen is based on factors that make property tax debts collectable or not collectable, such as how long they have been delinquent.

To address the delinquency problem, Mayor Michael Nutter and City Council have taken various steps in recent months and years, including pushing more properties to foreclosure, proposing and enacting new laws at the state and local level, and naming a new city tax collections officer. Reversing the city's history of property tax delinquency could produce millions of dollars each year in additional revenue, but it will be a complicated political and administrative challenge.

Our study also found:

- In Philadelphia, 9 percent of 2011 property taxes went uncollected in that year. The median delinquency rate in the 36 cities in this study was 4.1 percent. Among 14 cities (including Philadelphia) with poverty rates over 25 percent, the median delinquency rate in 2011 was 6 percent. In the previous three years, Philadelphia's rate had been virtually the same as the median for those high-poverty cities.

- Philadelphia's delinquency rate worsened markedly from 2006 through the recession. In the past two years, however, the city has improved its record on collecting property taxes, boosting the total amount of delinquent collections from $48.8 million in Fiscal 2011 to $70.9 million in Fiscal 2012 for city services (excluding schools, which is counted separately). In addition, city officials said they reduced the percentage of same-year taxes that go uncollected to a projected 9 percent for 2012. Most of the cities surveyed for this report did not provide the cumulative amounts they are owed in delinquent property taxes, and most have not reported 2012 delinquency rates yet.

- For every one percentage-point cut in the delinquency rate in Philadelphia, the city would be able to raise an additional $13 million annually without increasing the tax rate. Or it could lower the tax rate by about one cent on the dollar and raise the same amount of revenue. For example, decreasing delinquency from 9 percent to 8 percent would enable the city to cut a $1,000 tax bill by about $11.

- Compared to laws governing delinquency collection in some other states and other Pennsylvania counties, the state statutes governing Philadelphia give city government a lot of discretion in setting policies on when to initiate foreclosures or what kind of catch-up payment plans to offer. In the past, Philadelphia has tended to use this discretion to delay taking action, put up fewer properties for sale, or let delinquents enroll and default on payment plans many times, all of which has caused delinquencies to accumulate over the years. (As of April 2012, owners of roughly one in six delinquent properties were paying on installment plans; they owed $57.6 million in taxes and penalties.) In 2013, the city adopted new rules intended to change most of those practices.

- To reduce the number of new delinquencies, Philadelphia has begun to adopt effective strategies used in some other places. The city has significantly reduced the time it takes to notify delinquents about their overdue bills, as well as property owners who are merely late and in danger of becoming delinquent. (Nonpayers are considered "late" until Dec. 31 each tax year, at which point they are considered delinquent). Philadelphia has begun centralizing all revenue collections, leading to faster and better coordinated actions on delinquencies. The city also is considering creation of a "land bank" to help acquire and redevelop tax-foreclosed properties. The city has not adopted other practices, including the selling of tax liens, which generates immediate revenue.

UNDERSTANDING PROPERTY TAX DELINQUENCY

What's at Stake

A major overhaul of Philadelphia's property tax system has focused attention on the city's long-standing problem of tax delinquency—property owners failing to pay the local taxes on their real estate. This problem has taken on new importance in cities across the country as revenue from state aid and other sources has fallen.[1]

This study aims to produce a reasonable estimate of the amount of back taxes that an improved system in Philadelphia could realistically collect, and to look at the practices and conditions in many other cities and counties, most of them with higher collection rates.

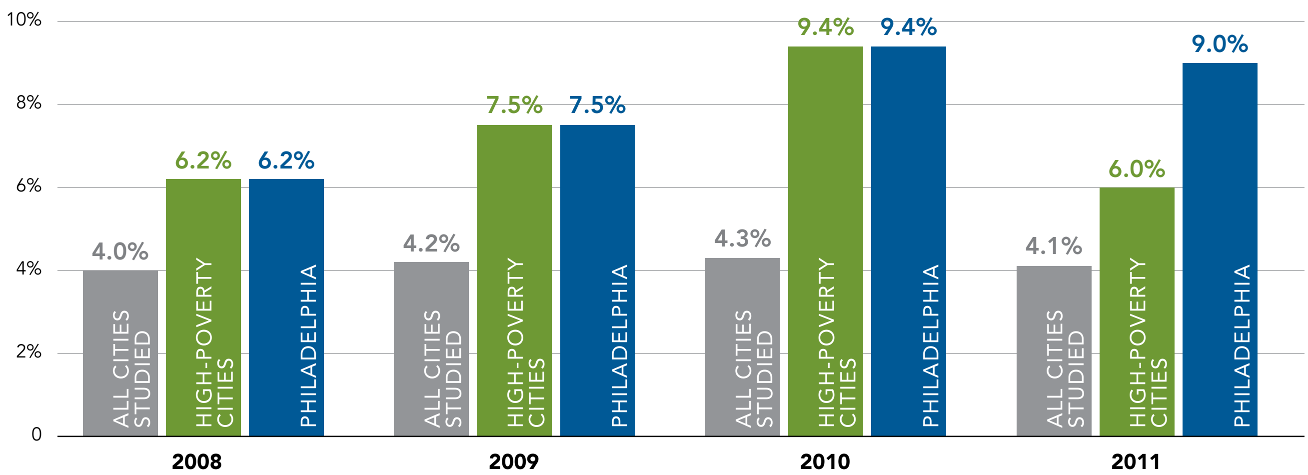
Nonpayment of taxes means less money for city services and schools, and a higher burden on other taxpayers. Delinquency also can reduce property values in a neighborhood, exacerbate blight, and stunt development prospects by locking parcels in legal and economic limbo. This has been the case in Philadelphia, as documented by news reports and City Council hearings.[2] In such an environment, taxpayers who do pay may feel jaded about city government and be tempted to become delinquents themselves, adding to what Philadelphia Controller Alan Butkovitz has called a "culture of nonpayment."[3]

In 2011, the last year that data was available for all 36 cities in our study, 9 percent of current real-estate taxes levied for city services went unpaid in Philadelphia.[4] The rate was more than double the median rate of 4.1 percent for all cities studied.[5] See Figure 1.

FIGURE 1

PERCENT OF TAX UNPAID IN YEAR OF LEVY

Philadelphia's same-year delinquency rate—the percentage of taxes that went unpaid during the year they were due—has perennially exceeded the 36-city median rate. But in recent years, the city's rate generally has tracked the median figure for other high-poverty cities. The Philadelphia rates are for the calendar year; for most other jurisdictions, the rates are for fiscal years. Median rates include Philadelphia.



SOURCES: Comprehensive Annual Financial Reports.

But it was closer to the 6 percent median for 14 cities that, like Philadelphia, have poverty rates above 25 percent. From 2006 to 2011, Philadelphia was one of seven cities with annual average same-year delinquency rates above 8 percent.[6] See Figure 2.

In most of the cities, delinquency rates were slightly higher in 2011 than in 2006. Philadelphia's rate also was higher. City officials estimate that it dropped to about 8.5 percent in 2012.[7] Comparable rates were not yet available for all cities for 2012, although Philadelphia's rate is likely to remain higher than those in most of the other cities.

Due in part to greater success collecting taxes that are less than a year delinquent, the city increased overall delinquent collections from $48.8 million in Fiscal 2011 to $70.9 million in Fiscal 2012, not including penalties and interest, according to the revenue commissioner.[8] (The amount collected for the School District was not available).

Each year, however, brings a new batch of delinquencies. If they outpace the number being eliminated, the backlog grows. Our analysis found that each percentage point gained in the city's property tax collection rate could raise an additional $13 million in taxes per year without raising the tax rate.[9] Or it would enable the city to lower overall property taxes by roughly a penny on the dollar and still produce the same amount of revenue.

The failure to pay and collect property taxes weighs most heavily on the School District of Philadelphia, which received 32 percent of its total funding from them in 2012, a higher share than in many other school districts of the cities included in this study. Philadelphia's city government uses property taxes to fund 16 percent of its general-fund operations, well below the 28 percent median for the other cities.[10]

Although the heightened concern about property-tax delinquency in Philadelphia is a relatively recent phenomenon, the problem goes back decades, as have the efforts to fix it. A few initiatives attacked the problem on a grand scale, such as the 1997 sale of thousands of tax liens in one transaction and the 2010 "tax amnesty" campaign. There also have been more targeted strategies, such as the garnishing of wages of tax-delinquent municipal employees starting in 2010.

The Nutter administration, in office since 2008, recently appointed the city's first chief revenue collection officer; reorganized the city's tax-collection staff across two departments; added a second outside tax collector; increased the number of properties facing foreclosure; and improved collections from late-payers at risk of becoming delinquent. In its proposed budget for Fiscal 2014, the administration has requested $40 million in new technology and staff over five years to track and pursue tax delinquents. The city, along with its delegation in Harrisburg, is also seeking state legislation that would make it easier for city officials to pursue liens or judgments against Pennsylvania property owners who live outside Philadelphia.

Even so, the problem has persisted. Tax-collection experts suggest that a contributing factor may have been the property tax increases the city enacted for 2011, 2012 and 2013. The theory is that any hike in tax rates will lead to some increase in delinquency, if only temporarily.

FIGURE 2

SAME-YEAR DELINQUENCY RATES

This table shows the percentage of real-estate taxes that went unpaid by the end of the year they were levied, known as the same-year delinquency rate. Listed are the cities and counties to which we compared Philadelphia in this study. They include the main cities in each of the nation's 30 most populous metropolitan areas plus six other cities that have poverty rates over 25 percent, like Philadelphia, or are considered innovators in dealing with tax delinquency. And we looked at 15 of the largest counties in Pennsylvania. For all jurisdictions, we compiled publicly available real estate tax collection data; 25 of the cities also answered our questionnaire.

COMPARABLE CITIES

	2011	2009	2006		2011	2009	2006
Flint, MI*	21.2%	17.6%	15.0%	**Minneapolis**	3.7%	2.4%	2.0%
Cleveland*	20.2%	16.3%	13.0%	**Baltimore***	3.5%	7.8%	3.7%
Detroit*	20.1%	13.2%	7.3%	**Waterbury, CT**	3.1%	2.5%	3.2%
St. Louis*	9.9%	11.8%	13.9%	**Riverside, CA**	3.1%	2.5%	1.4%
PHILADELPHIA*	**9.0%**	**7.5%**	**6.6%**	**San Antonio**	3.1%	1.7%	1.6%
Cincinnati*	8.8%	9.1%	7.5%	**San Francisco**	2.7%	4.2%	2.2%
Kansas City, MO	8.4%	8.0%	6.3%	**Dallas***	2.6%	4.3%	2.8%
New York City	8.1%	5.0%	7.7%	**Atlanta***	2.4%	4.0%	8.2%
Pittsburgh	6.9%	2.9%	1.8%	**Nashville**	2.3%	1.4%	3.5%
Miami*	6.7%	3.6%	3.2%	**Houston**	2.3%	3.5%	4.3%
Portland, OR	6.4%	7.3%	6.2%	**Sacramento****	2.2%	3.8%	2.3%
Tampa	5.6%	4.3%	4.1%	**Denver**	1.9%	1.7%	0.7%
Memphis*	5.3%	6.2%	6.3%	**Washington, DC**	1.8%	5.9%	3.1%
Buffalo*	5.3%	5.3%	6.1%	**Seattle**	1.6%	1.9%	1.8%
Phoenix	4.6%	4.2%	2.6%	**Las Vegas**	1.6%	1.8%	0.7%
Los Angeles	4.4%	6.0%	9.8%	**Orlando**	1.2%	1.7%	1.0%
Newark, NJ*	4.4%	n/a	n/a	**Boston**	1.1%	1.2%	2.0%
Milwaukee*	3.9%	3.8%	2.2%	**Chicago**	n/a	16.0%	12.3%

SELECT PA COUNTIES

	2011	2009	2006		2011	2009	2006
PHILADELPHIA*	**9.0%**	**7.5%**	**6.6%**	**Montgomery**	4.1%	n/a	4.0%
Beaver	8.9%	9.6%	9.7%	**Lancaster**	3.4%	3.8%	3.4%
Lycoming	8.7%	8.6%	8.3%	**Cumberland**	3.2%	3.0%	2.8%
York	7.7%	7.5%	3.6%	**Chester**	3.0%	3.3%	3.5%
Westmoreland	5.4%	5.0%	4.6%	**Butler**	3.0%	3.7%	3.5%
Erie	5.0%	5.6%	5.5%	**Centre**	2.3%	2.9%	2.5%
Northampton	4.6%	4.6%	3.0%	**Bucks**	2.1%	2.2%	2.1%
Allegheny	4.4%	7.7%	3.6%				

* Denotes city with 2011 poverty rate over 25 percent.

** Figures for Sacramento County, which includes the city.

SOURCES: Comprehensive Annual Financial Reports.

Basic Considerations

Understanding some basic considerations and tradeoffs is useful before digging into the details of tax delinquency.

Economic and Demographic Conditions: These are largely outside a local government's control and play a significant role in delinquency trends. Poverty is a huge factor. Cities with high poverty rates tend to have high delinquency rates. In Philadelphia, 28.4 percent of residents qualify as poor. High poverty increases the likelihood that a taxpayer is truly unable to pay his or her taxes or is a homeowner with no assets other than the building itself. This problem is magnified when a high-poverty city also has a relatively high homeownership rate, as in Philadelphia and Detroit.

When poverty is the cause of delinquency, allowing a property owner to refrain from paying taxes amounts to a form of undeclared public assistance, financed by those residents who do pay their taxes. Whether to collect on poor owners through foreclosure (if they cannot pay cash) is a civic or social policy decision more than a tax enforcement problem.

The health of the local real-estate market also matters: if there is weak demand, local authorities are less able to use foreclosures and tax-deed sales to recover the taxes owed—and owners have less incentive to pay their taxes to avoid foreclosure. In addition, the share of occupied homes that do not have mortgages affects tax delinquency. In Philadelphia, about 40

KEY TERMS

Property: For this report, the term "property" refers only to real estate or real property, such as a house, office building, storefront, apartment building, parking lot, garage, or other place or structure where people regularly live or work. In some states, however, taxable "property" also includes tangible items that produce income, such as a builder's tools or landlord's furniture.

Delinquency: Failure to pay a property tax bill in full by a certain date, after which the property can become subject to a tax claim, including a tax lien or foreclosure. Some states, including Pennsylvania, set the end of the calendar tax year as the date of delinquency, and consider missed payments during the year as merely overdue or late; other states use the date when payment is due during the year as the delinquency date.

Tax Lien: A claim for payment that takes precedence over all other claims and gives the holder of the lien basis for legal action, including foreclosure. Tax liens are imposed by a taxing jurisdiction after a property becomes delinquent and typically includes the principal tax amount, plus any interest and penalties. Some states allow local jurisdictions to sell or transfer liens as certificates, akin to bonds, as a way of recouping the lost revenue in the short term.

Foreclosure: The legal process of seizing title of a property (or the deed) and forcing its sale for the purpose of paying off a debt, such as a tax lien. In a tax foreclosure, the local jurisdiction petitions a court to award it the title based on an unpaid lien. The jurisdiction may then sell the property in a tax-deed sale or auction, hoping at least for enough to cover the tax lien. The original owner usually has the right to regain the property if she or he pays the back taxes within a set time period after the sale, called the redemption period. If nobody buys the deed, the tax lien remains unpaid, and the jurisdiction keeps the title and responsibility for the property.

percent of owner-occupants do not have mortgages through which property taxes are usually escrowed and paid. The average for the 36 jurisdictions we studied was about 30 percent. The cities and counties in our study at 30 percent and above had a median delinquency rate of 6.7 percent, compared with 3.1 percent in those with fewer than 30 percent.

Owners vs. Investors: Another consideration is the difference between owners who work or live at a delinquent property, and owners who do not, such as off-site investors or landlords. Some cities with high collection rates push hard on both groups. But many cities allow only owner-occupants to receive special payment plans or relief. A recent series in *The Philadelphia Inquirer* and PlanPhilly.com showed that a large share of Philadelphia's delinquents were remote "investor owners," rather than owner-occupants, whose financial difficulties are sometimes cited by the city in explaining a lack of foreclosures.

Collecting Cash vs. Property: Philadelphia and most cities in this study say their end goal is collecting money, not taking property; owning any property, after all, comes with maintenance and liability costs. But cities also have a stake in community development, which can benefit from assembling parcels for development through aggressive tax foreclosures. Either way, when delinquency notices fail and court judgments are not possible, it takes a credible threat of foreclosure—that is, following through with sales—to get owners to pay, according to officials and tax experts interviewed for this report. Cities with higher collection rates tend to have strict rules and timelines for carrying out foreclosures or conducting lien sales. But there is a limit to how many foreclosures a local housing market can absorb. Mass foreclosures may leave more unsold properties in city hands, unless there is a mechanism to handle the properties, and may increase homelessness.

Less Now vs. More Later: Most cities in this study offer some taxpayers limited options of paying installments on current taxes and, with more restrictions, on back taxes, too. Installment payments enable some people who otherwise might have paid nothing to whittle down their tax debts. But payment plans may also reduce the number of owners paying off the full amount due in a given year, which may create funding gaps for schools and city services. And a portion of the payers never pay.

PROPERTY TAX COLLECTABILITY

How Much Is Owed?

Nearly 18 percent of Philadelphia houses, office buildings, vacant lots, and other taxable real estate—102,789 parcels out of 579,323—were listed as delinquent on the city's real estate tax rolls in April 2012. That number has hovered around 100,000 for many years.[14]

The accumulated taxes at that time came to $292.3 million, plus $223.2 million in penalty fees, interest and other charges. A quarter of the delinquent parcels owed less than $1,000 each, and another quarter owed more than $6,000 each; the median tax bill was $2,662. About 6,500 parcels owed $100 or less each, and 150 owed $100,000 or more, with three topping $1 million each. More than half of the total tax and penalty due, $267 million, stems from delinquencies that are more than a decade ago.

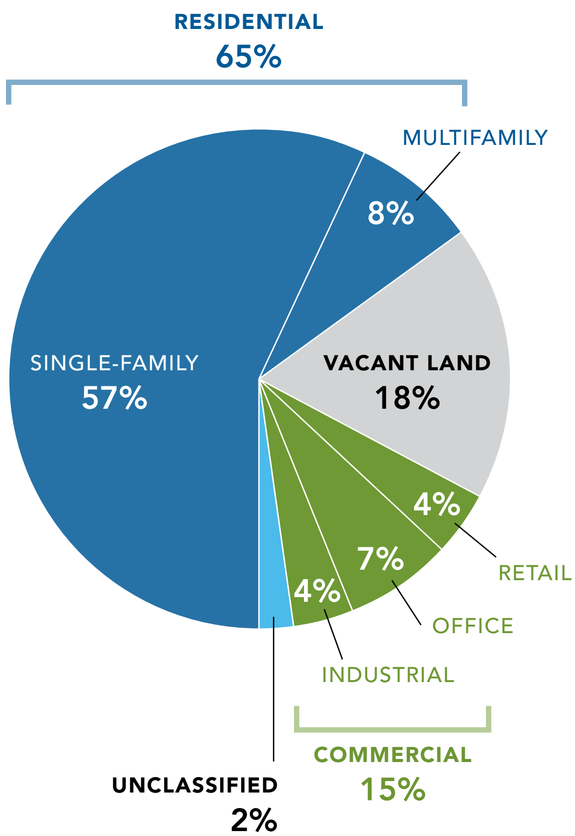
Houses, apartment buildings, condominiums and other residential structures—which account for about 86 percent of the city's parcels—represented about 65 percent of the delinquent taxes and penalties and 73 percent of the parcels; nonresidential structures—stores, office buildings, factories, parking lots and so forth—accounted for 15 percent of the amount due and 7 percent of the parcels; open or vacant land was about 18 percent of both debt and parcels. See Figure 3.

The pattern of tax-indebted parcels differs widely from one city to another. A huge piece of Cleveland's unpaid taxes in 2011 came from millions of dollars due on properties that are seeking tax-exempt status after being acquired by nonprofit hospitals.[15] On the other hand, Detroit suffers from what a newspaper investigation described as an epidemic of individual homeowners refusing to pay taxes for poor city services.[16]

FIGURE 3

DELINQUENT TAXES BY PROPERTY TYPE

Sixty-five percent of the total dollar amount of delinquent property taxes and penalties is owed on residential properties, including single-family houses, apartment buildings and condos. Most of the rest is owed on vacant land (18 percent) or commercial properties (15 percent).



SOURCE: Philadelphia Department of Revenue data as of April 2012.

How Much is Collectable?

Out of $292.3 million unpaid principal and $223.2 million in penalty and interest as of April 2012, how much might Philadelphia realistically expect to collect if it could optimize its current collection system? We set out to compute an estimate, using a model developed by Kevin C. Gillen, Ph.D, a Philadelphia real estate economist. See our methodology for a full description.

The model is based strictly on the attributes of the debts judged to be significant by officials at the city Revenue Department and six private tax-collection firms, including two with Philadelphia contracts: Texas-based Linebarger Goggan Blair & Sampson, LLP, which has worked in the city since 1997, and Pittsburgh-based Goehring, Rutter & Boehm, or GRB, which has worked in Philadelphia since 2009.[17]

Collectability of property taxes often is affected by a property's condition and value, and by the owner's economic position and ability to pay. We were able to isolate many of the property attributes from the city data but not information about individual owners, including whether or not they have mortgages. Here is a summary of the key property attributes we considered and the range of possible points in our formula. The higher the score, the greater the likelihood of collecting the debt:

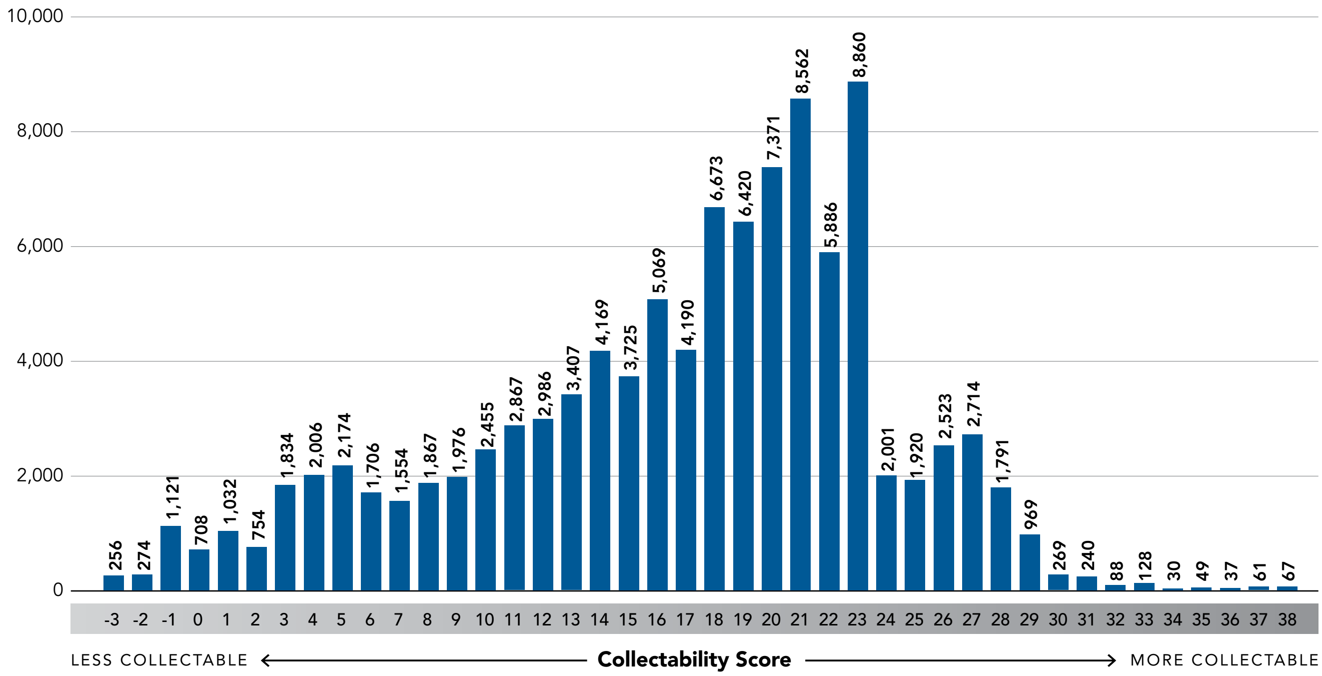
- How long the property has been delinquent: Tax delinquencies of up to three years in duration are easiest to collect; 10 years or more are very difficult (0 to 6 points).
- Property value: The higher the property's market value, the more likely the owner will pay the taxes or a bidder will purchase it, whether or not the property is vacant or has a structure on it (0 to 6 points).
- Tax debt: The lower a property's tax and penalty debt, the more willing or able its owner or buyer will be to pay off the tax (0 to 6 points).
- Physical condition: This is key if cash collection fails and foreclosure becomes necessary. Properties in poor condition—listed as "inferior" by city inspectors—are more difficult to sell at the full amount of taxes and penalties owed (0 to 6 points).
- Type of owner and property: Owner-occupants generally are more responsive to collection efforts than investor-owners, even though owner-occupants also may be more protected from foreclosure and eviction through eligibility for payment plans or help from community organizations or local officials. Residential properties, including apartment buildings, are considered easier to collect from than commercial properties (0 to 6 points).
- Neighborhood: Delinquent taxes on properties in safe and attractive neighborhoods, as indicated by nearby home prices and construction activity, are considered to be more collectable than those in struggling neighborhoods (0 to 3 points).
- Number of delinquencies: The owner of a single delinquent property, either residential or commercial, is more likely to pay than the owner of multiple delinquent properties, residential or commercial (0 to 2 points).

We gave an additional 3 points if a property had a cluster of positive attributes, such as high value, a relatively new tax debt, and good condition, and subtracted 3 points from those with a cluster of negative attributes, such as a low-value neighborhood and low net value.

FIGURE 4

NUMBER OF PROPERTIES BY COLLECTABILITY SCORE

This graphic shows the distribution of Philadelphia's 102,789 delinquent properties according to the collectability scoring system we created for this report. The higher the score, the more likely the tax debt can be collected.



Analysis performed by Kevin C. Gillen. For more detail, see our methodology.

SOURCE: Philadelphia Department of Revenue data as of April 2012.

Possible scores for each property range from a minimum of -3 for the least collectable to a maximum of 38 for the most. Out of 102,789 delinquent properties, only 256 got a score of -3 and 67 got 38, with nearly half scoring 19 or higher. See Figure 4. Nearly 92,000 properties had market values at least double the amount of their outstanding taxes and penalties; 57,803 were owner-occupied homes; and 432 were listed as "new construction," meaning those delinquent properties also may be getting property-tax abatements.[18] See the methodology for more figures.

Properties with higher collectability scores tend to be less than five years delinquent. For the most part, the owners hold no other delinquent properties. Most of these properties are worth $50,000 or more, are in decent or good condition, and are located in gentrifying or stable neighborhoods. In most cases, the outstanding total of tax and penalties is less than $2,500, although some bills go as high as $25,000.

On the other hand, many of the properties with low collectability scores are vacant lots or have structures in bad condition and are located in run-down neighborhoods with a lot of empty parcels and low home prices. Most have been delinquent five years or more, many for more than 10 years.

Owners of these properties may hold many delinquent parcels; these owners can be hard to find, and many are bankrupt. Among the homeowners, some died without wills, and their children or grandchildren may be jostling over a so-called "tangled" title and the tax responsibility that goes with it.[19] Many parcels are valued below $10,000 with tax and penalty debts exceeding that amount. Even when foreclosed, thousands of these properties have gone unsold at a sheriff's sale.

After scoring the parcels, we then assigned each one a collection probability based on its score. For example, properties with the maximum 38 points were given a 100 percent probability of being collected; properties with 0 points or negative points were given 0 percent probability. We also set different probabilities for the collection of taxes vs. interest and penalties, based on the fact that the city sometimes waives penalty charges in order to collect the principal tax.

Under what we call the "baseline" scenario, we assume that most property owners will comply with warnings and payment plans; the regional economy and housing market will not falter; and tax collectors ultimately will capture much of the feasibly collectable tax and half of the penalties and interest, either through direct payments or foreclosure. Keep in mind that owners' personal situations—assets, income, mortgage status, out-of-city residents, and so forth—are not part of these calculations.

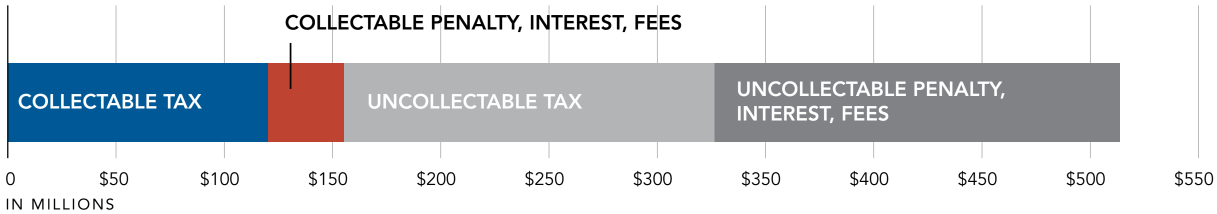
To give the analysis more nuance, we also created an "optimistic" scenario in which city tax collectors perform at optimal levels and collect more tax and penalties from a greater number of delinquent properties, and a "pessimistic" scenario, in which collectors are less effective and collect less money from fewer properties.

Under our baseline scenario, we found that the city should be able to collect, over several years, about $120 million in taxes and $35 million in penalties and fees, adding up to about $155 million or 30 percent of the $515.4 million total due. See Figure 5. Under this scenario, about $360 million—$172 million in taxes and $188 million in penalty charges—likely would go uncollected; that would be about 70 percent of outstanding tax-and-penalty debt.

FIGURE 5

HOW MUCH DELINQUENT TAX IS COLLECTABLE?

Our study estimated the probability of collecting $515.4 million in taxes and penalties, based on the collectability attributes of all 102,789 delinquent properties. This chart shows the result of our baseline scenario, in which the city collects about $120 million in delinquent property taxes and $35 million in penalties and interest. This scenario assumes that Philadelphia tax collectors mostly perform well, property owners usually comply with warnings and payment plans, and the economy and housing market do not falter. Under a more optimistic scenario, more money probably would be collected; using a more pessimistic scenario, less would be collected.



Analysis performed by Kevin C. Gillen. For more detail, see our methodology.

SOURCE: Philadelphia Department of Revenue data as of April 2012.

WHAT HAPPENS TO UNCOLLECTABLE TAXES?

In our analysis, the city has $362 million in property taxes that are likely uncollectable. So what should be done with these tax debts and tax liens?

Public finance experts say the city should not remove the liens from these properties or give up hope entirely of collecting the money. Preserving the liens costs nothing and enables the city to collect the money if someone ever tries to transfer a deed through a sale or other change of ownership, according to Virginia Rutledge, past president of the Government Finance Officers Association and now a consultant with PFM Group, a municipal finance advisory firm. Canceling the debts would not bring in more tax revenue. Nor would it affect the city's or school district's budgets, which long ago stopped counting on most of this money. "I might classify this money differently, but I would never remove it from the books," Rutledge said.

Starting in 2010, the Philadelphia Revenue Department recategorized property-tax debts that were at least 11 years old as "inactive" and has left their collection mostly to its private tax collectors. In the city data reviewed by Pew, there were 26,778 such properties as of April 2012 with a face value of $121.3 million in taxes and $146.4 million in penalties. Our analysis found that most of these properties indeed may be uncollectable—but not all. Some have other characteristics, such as a high market value, that would make their tax debt worth paying off.

Linebarger,which was handling nearly half of the city's inactive cases, had open lawsuits against owners of 4,153 inactive accounts as of April 2013.

One private consultant hired by the city in 2008 recommended that the city consider selling the liens on these properties or try to hand over some of them to a land-redevelopment agency or "land bank," an option that the state later authorized in 2010 and which is described lower in this report.[20]

In the more optimistic scenario, in which the city improves its system significantly and real-estate values rise even in struggling neighborhoods, Philadelphia should be able to collect roughly $261 million in taxes and penalties, leaving about $254 million uncollected. But in the pessimistic scenario, where both conditions and enforcement get worse, the city might only collect about $90 million, with $425 million uncollected.

All of these estimates are based on several assumptions. To collect the full $155 million projected in our baseline scenario, the city would have to obtain court judgments against some owners, including liens or judgments on their assets outside Philadelphia. For those owners who are low-income or seniors, the city would have to get more of those already in payment plans to make good on those plans, rather than default.

In cases in which owners still would not pay, the city would have to initiate more foreclosures than it currently does; clear more titles for sale; and get more owners to pay up at the last minute. It would also have to sell more properties at auction than it currently does. In addition, the baseline scenario assumes that the local economy continues to recover, or at the least does not falter and put more taxpayers at risk of delinquency.

Cost of Collections

These estimated collections would come with significant costs. The Revenue Department, Law Department, and Sheriff's Office together employ hundreds of people who devote some or all of their time to pursuing tax delinquents, and they are not the only departments involved. There also are costs associated with the phone calls they make, the letters they send out, the lawsuits they file, and the foreclosures they pursue.

In addition, the Nutter administration has proposed allocating $40 million more over five years to help the Revenue Department do a better job of collecting delinquent taxes of all types. (The cost of using private tax collectors is borne mostly by the delinquents themselves, because the collectors' 18 percent commission is charged to the taxpayer, not to the city).

There also would be increased indirect costs. The city and its nonprofit aid organizations might face greater demand for housing or homeless programs if more delinquents are forced out of their homes. There also could be higher maintenance and liability costs for the city associated with foreclosed property left in its hands after failing to sell at sheriff's sales.

Our study did not attempt to tally all of these costs, or to compare them to delinquency-collection costs in other cities, many of which rely on counties to do the work for them, an option that Philadelphia, which is a city and a county, does not have.

The city's choice is whether it considers these prices worth paying in order to produce more revenue to support schools and city services, and to reassure those who dutifully pay their taxes that others are not getting a free ride.

TAX DELINQUENCY CHALLENGES AND STRATEGIES

State Laws, Local Practice

To understand how Philadelphia's current level of property tax collection could be improved, this report also examines strategies and practices in other states and cities. Every state has its own laws on how local tax jurisdictions—cities, counties and school districts, among others—can collect property taxes and pursue delinquencies. To varying degrees, localities add their own procedures. Each place also has a unique mix of taxpayers and economic conditions.

Philadelphia operates with relatively wide latitude under the Pennsylvania Municipal Claims and Tax Lien Law (MCTLL), enacted in 1923 and amended at least a dozen times. It applies mainly to the state's "first class" and "second class" cities, namely Philadelphia and Pittsburgh. Most of the other Pennsylvania counties operate under the stricter Real Estate Tax Sale Law (RETSL) of 1947. A few counties, including Montgomery County, have taken advantage of a recent court ruling to use a hybrid of both laws.[21]

In Philadelphia, the Revenue Department sends every property owner a tax bill in November. Payment is due the following March 31 for the tax year ending the coming December 31. If an owner fails to pay by the March 31 deadline, he or she is considered a late payer and faces additional charges until the bill is paid. If the tax is not paid in full by the end of the year, the owner is declared delinquent by the city, which in turn places a tax lien on the property if it has not already done so for any previous year delinquencies. At that point, the city has various options in addition to sending notices and warnings, including foreclosing on the property, offering a payment plan, suing the owner for personal assets, or doing nothing.

In several other cities in this study, including all those in Florida, Texas, and California as well as in other counties in Pennsylvania, there is a state-mandated time frame to start various enforcement actions including foreclosure. But the 1923 Pennsylvania law imposes few explicit deadlines or requirements on Philadelphia to take any of those steps. It does not prohibit them or other measures, either. In years past, city leaders and officials did not use their discretion to impose deadlines for tough enforcement actions, such as foreclosures.

Under pressure to increase collections, Philadelphia officials in recent years have begun to emulate the strategies elsewhere by moving more quickly on new delinquencies, pushing more properties into the foreclosure pipeline, and filing more lawsuits against individual owners in court. They say it now takes about a year from the March 31 due date until cases are referred to lawyers for action, about half the time it was taking several years ago. The challenge now is following through with those actions.

Reforming the System Leadership

In response to the city's property tax collection problem, Mayor Nutter has moved to centralize and reorganize the leadership of the city's system and the tax collectors themselves.

In April, he appointed a chief revenue collection officer to coordinate every department's collection activities. The centralization follows some consolidation and coordination of the city's tax-collection functions already, including the transfer of attorneys and delinquent-property recordkeeping from the Law Department to the Revenue Department. Tax-collection consultants say the more coordination or consolidation, the better. For example, if a tax-delinquent owner applies for a construction permit, a consolidated collection office can make sure that the Department of Licenses and Inspections does not issue the permit until the Revenue Department receives the back taxes from the owner, effectively turning a construction permit into leverage for tax collection.

Among the cities in this study, only a few reported having a single office or official in charge of all delinquent tax collections. Among them are Orlando, Tampa, and Miami; under Florida law, each relies on its county's Tax Collector Office to pursue and process delinquencies. Minneapolis leaves all tax collection duties to the Hennepin County Taxpayer Services Department. Similarly across Pennsylvania, under the 1947 law that does not apply to Philadelphia, Tax Claim Bureaus handle collections for school districts and municipalities in each county.

Even while Philadelphia is moving toward greater centralization, it also has adopted the strategy of using multiple outside tax collectors, a practice used with some success by the federal government in collecting on student loans.[22] Since 2009, the Philadelphia Revenue Department has employed Linebarger Goggan Blair & Sampson, LLP (known as Linebarger), and Goehring, Rutter & Boehm (GRB). The city divides newly delinquent properties equally among itself and each of the two firms, and then monitors regularly how well the firms perform using their own written warnings and phone calls. The firm that collects on the newly delinquent properties at a higher rate has had cases reassigned to it from the other firm. Each firm is paid strictly on a percentage of the total tax and penalties it brings in, an amount that is charged to the delinquent taxpayers.

The use of multiple vendors for real estate tax collection is not commonplace among the other cities and counties we studied; most do all collections on their own, and those that use vendors said they use only one.

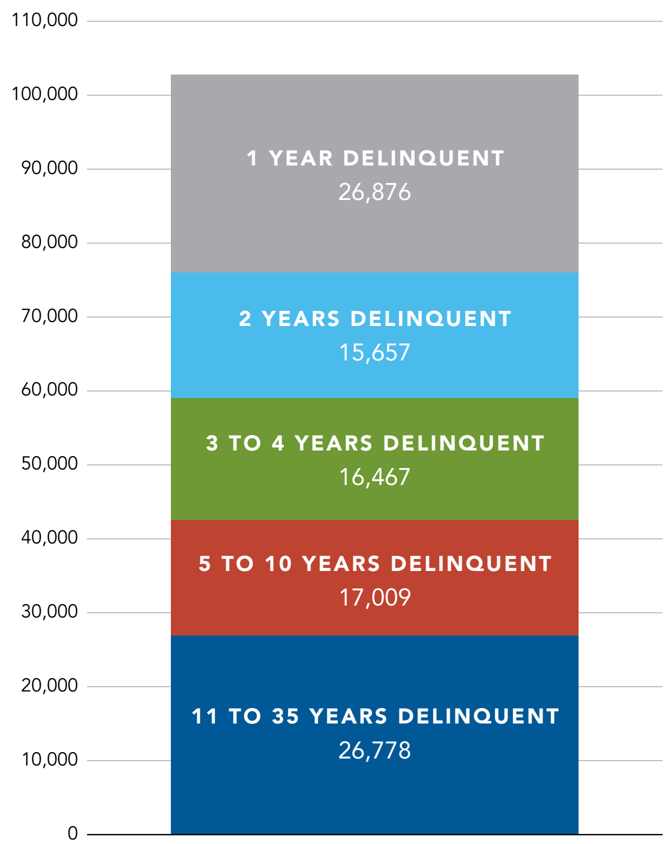
Reducing New Delinquencies

Philadelphia's delinquency problem comes from two sources: newer or first-time delinquent properties appearing every year, and longer-term, persistently delinquent properties that perennially clutter the city's ledgers. The city has large numbers of properties in both groups; reducing overall delinquency requires different strategies to address each of them. See Figure 6.

FIGURE 6

PROPERTIES BY YEARS DELINQUENT

Out of 102,789 tax-delinquent Philadelphia properties as of April 2012, more than a quarter were one-year delinquent, a group that includes first-time delinquents that tax collectors consider most likely to pay. Properties that have been delinquent for 11 years or more are considered most unlikely to pay.



SOURCE: Philadelphia Department of Revenue data as of April 2012.

In interviews, tax collectors and tax experts with local, state and national knowledge said that the 1923 Pennsylvania law under which Philadelphia operates generally gives the city adequate tools to deal with new or first-time delinquents but fewer options for coping with long-term delinquencies.

To stem the flow of new delinquencies, private and government tax collectors generally agree that the sooner a late payer can be notified or warned, the less likely he or she is to become delinquent. And the sooner a delinquent is contacted, the more likely he or she is to pay.

In recent years on its own initiative, as allowed under state law, Philadelphia has reached out to thousands of property owners between the March 31 due date and December 31, with warning letters and sometimes a phone call about the risk of becoming delinquent. By 2012, about a third of property owners who missed the March 31 due date were responding with full payment by the end of the year, and there by avoiding delinquency, according to the Revenue Department.

In addition, Philadelphia has begun sending stern notices by certified mail to newly delinquent owners within a few months of the end of the tax year. Until 2010, the city took about two years just to send notices by regular mail about delinquencies. Philadelphia officials credit both of these practices—direct notification of late-payers and sterner formal warning of new delinquents—for reducing the number of first-time delinquencies from 20,000 in 2011 to 11,300 in 2012.[23]

Even so, some other cities act more quickly both in declaring a late-payer delinquent and sending a threatening notice. Baltimore, Denver, Sacramento, and Houston, for instance, send out formal delinquency notices even before the tax year ends.

Another strategy used by many cities is allowing installment payments on current taxes, before they become late. This is particularly helpful for owners without mortgages. Several cities set installments at between two and five payments over a tax year. New York City allows taxpayers to spread tax bills over several years with a 9 percent finance charge.

Recent research at the University of Wisconsin found that Wisconsin property-tax payers who had the option of paying current taxes in two or three installments fell into delinquency much less often than those who either had to pay one lump sum or who could pay in many installments.[24]

For current-year taxes, Philadelphia allows all property owners to pay in any increments they choose from December to March 31. But the city does not promote that option, only telling taxpayers that they will get a 1 percent discount if they pay by February 28. By March 31, the tax bill must be paid in full, except in cases of low-income and senior taxpayers who have applied in advance for an installment-payment plan. After March 31 and before December 31 for all taxpayers, any remaining unpaid current-year tax becomes subject to late penalties and interest.

Payment Plans for Delinquent Taxes

Philadelphia has used its discretion under state law to allow tax delinquents to pay off their tax debts using delinquent-tax installment payments, a practice under which the city tries to collect the taxes over time rather than through foreclosure or other legal action. Plans are offered on the assumption that the owner would otherwise pay nothing. Whether or not the assumption is true, Philadelphia's use of delinquent payment plans has been more contentious and less consistent than such plans in other places, where they tend to be set by state law.

Until 2013, the city offered two main options with different down payments and installment periods: a standard plan for all payers, and a "hardship plan" with slightly better terms for senior or low-income homeowners who can prove they hold title to the property and regularly live there. Both protected tax delinquents from foreclosure as long as they stay on the plan. Guidelines for the hardship plan allowed owners to enroll up to three times in the event they default on a previous enrollment. The standard plan currently has no limit, and some delinquents reportedly have defaulted and re-enrolled many times without losing their properties, under a city policy that emphasizes revenue collection over property seizure.[25]

As of March 2012, the city and its two private tax collection firms had about 15,200 properties in standard payment plans with roughly $32.7 million in outstanding tax-and-penalty balances. In addition, about 1,930 properties were paying under a hardship or similar special agreement with about $24.9 million due. The total, $57.6 million, amounted to about 11 percent of all outstanding taxes and penalities.

Comparable figures for all cities and counties were not available, although many other cities and counties also offer installment payment options for delinquent property owners. The terms vary widely, but most require a down payment and limit participation to low-income owners, senior citizens or veterans. Like Philadelphia, they also require delinquents to keep up with current taxes at the same time.

A related strategy in some states is targeted tax relief up front to certain taxpayers, in which the tax itself is reduced. Many states, including Pennsylvania, have homestead tax relief programs, which can reduce the burden on homeowners, and Philadelphia is considering a new homestead relief program for all owner-occupied homes as part of its property tax overhaul.[26] Michigan and Missouri have tax-cap programs that limit the amount that property taxes can increase from one year to the next. Some tax-relief programs are limited to low-income or senior taxpayers, who are required to apply for exemptions or exoneration in advance of being taxed.

Permitting delinquent property owners to enroll in installment plans can be a gamble. Philadelphia's private tax collectors reported that between 30 and 40 percent of their installment-plan payers default on their first agreements, ending up in another plan or in foreclosure. Officials in Detroit and Cleveland each said about 45 percent default on payment plans. New York City reported a 22 percent default rate. Pittsburgh estimated its default rate at between 10 percent and 15 percent.[27]

In Philadelphia, community aid groups have pointed to the city's procedures and policies as explanations for the high number of defaults and low participation in the hardship plan; the groups cite unclear instructions, lack of electronic payment options, inconsistent payment terms set by different collectors, and the city's refusal to let relatives or informal co-owners of properties enroll in the payment plans.

The hardship plan's current guidelines, which are not spelled out under the 1923 state law, were written locally in the 1990s with input from Community Legal Services, a nonprofit group that provides legal assistance to low-income clients. In June 2013, in response to recent concerns about delinquency, the city codified the installment plans into local ordinance for the first time—again with input from legal aid groups. While many other cities exercise some local discretion over the plans, no other city or county in our study reported having tax-payment plans codified in a local ordinance.

Philadelphia's legislation, to take effect in October, will limit the number of times a property owner could enter into a payment plan, although he or she could ask to modify a current plan many times; make the Revenue Department and its private collectors offer identical terms; and expand the number eligible for a plan by accepting people who hold partial ownership in a property (as opposed to full or sole ownership) and raising the income limit. The new law also will require the city to begin foreclosure proceedings within one year of owners failing to pay taxes, whether or not they were in payment plans.

In contrast to Philadelphia, some other cities with very low delinquency rates do not offer installment plans. Luis Mendoza of Miami-Dade's Tax Collector Office said Florida law "allows for partial payments for current taxes only. Once the taxes become delinquent, no partial payments are allowed. They ask if we can help them with partial payments, but we cannot do anything. When the bubble burst, many people fell behind in paying their real estate taxes and subsequently lost their homes."

Bruce Moore, Denver's director of tax compliance, said: "Everything is governed by state statute. And the state statute is very clear: beyond the standard payment option for current taxes, there is no provision for installment plans."

Community and Political Involvement

Directly related to payment plans in Philadelphia is the involvement of local community advocates and elected officials. On this score, our survey and interviews with a variety of people suggests that Philadelphia may face a unique situation.

Tax officials in almost every city, including Philadelphia, reported receiving calls, appeals, or inquiries from members of City Council and other elected leaders or their staffs on behalf of individual tax delinquents—sometimes to request more time or other consideration to avoid foreclosure. Such involvement was reported in cities both with strong collection rates (Denver and Boston) and weak ones (Cleveland and Detroit). But only a few cities, including Philadelphia, Pittsburgh, and Cleveland, reported that local community-assistance groups also made such calls regularly or helped draft payment-plan guidelines. Officials in several others—Atlanta, Baltimore, Denver, Tampa, and Memphis—said they rarely deal with community organizations on tax-payment plans.

"Maybe a few people individually do it, but there is no organized taxpayer group," said Frank Derr, Baltimore's deputy chief of revenue collection.

Michael McCabe, managing partner of Philadelphia's private collector GRB, which also operates in Allegheny County, Pittsburgh, and about 150 small Pennsylvania jurisdictions, said that compared to other jurisdictions, "Philadelphia [has] a very active and engaged legal and community services network." He credited the organizations with helping expand access to and use of payment plans.

"We get requests for delays and negotiations from a wide variety of advocates, including paid attorneys, advocates for low-income taxpayers, elected officials, and others," said Sharon Humble, managing attorney in Philadelphia for Linebarger. She added that her firm "reaches agreements when possible."

Montgomery Wilson, a supervising attorney at Community Legal Services of Philadelphia, agreed that his organization's influence is unusual. But he called it a necessity due to a "lack of clear authority and guidance under Pennsylvania law" and the inconsistency and obscurity of the city's installment plans, which he said "can keep some delinquent taxpayers from entering into or even becoming aware of possible payment agreements."

Other local advocates said that their activism is a result of Philadelphia's tax-collecting inadequacies. Stefanie Seldin, managing attorney at another housing-assistance organization, Philadelphia VIP, said: "Because the city hasn't been aggressive about delinquent tax collection in the past, people are inclined to think that they can get away with not paying. … We've had clients tell VIP that 'a neighbor told me I don't have to pay.'"

Resolving Delinquencies Through Foreclosure

Clearing older delinquencies poses a different kind of challenge than reducing the number of new delinquencies. Most cities regularly reduce their pool of old tax debts by foreclosing and selling properties at auction, or by selling the liens to private investors who in turn get payments for a set period of time and the right to foreclose if the delinquency is not paid off. See Figure 7.

FIGURE 7

SELLING TAX LIENS AND TAX-FORECLOSED PROPERTIES

State laws determine whether a local tax jurisdiction, usually a county, can sell tax liens or sell tax-foreclosed property or both. This chart lists the practice in each city or the county that encompasses it. Pennsylvania law allows Philadelphia to do both, but the city has opted not to sell liens since 1997.

	Sells tax liens to private buyers	Sells tax-foreclosed property (tax deeds) to private buyers or land banks
Atlanta		•
Baltimore	•	
Boston		•
Chicago	•	
Cincinnati	•	•
Cleveland	•	•
Dallas		•
Denver	•	
Detroit		•
Houston		•
Kansas City, MO*	•	•
Las Vegas	•	•
Los Angeles		•
Memphis		•
Miami	•	•
Minneapolis		•
New York City	•	
Orlando	•	•
Philadelphia		•
Phoenix	•	
Pittsburgh		•
Portland, OR		•
Riverside, CA		•
Sacramento		•
San Antonio		•
San Francisco	•	•
Seattle		•
St. Louis	•	•
Tampa	•	•
Washington, DC	•	•

* Kansas City is part of four counties. Tax deeds are sold only on those delinquent properties located in the Jackson County section.

SOURCES: Tax officials or official websites for each jurisdiction.

Recently, Philadelphia has put about 1,200 to 1,500 properties up for sale each year, about 1 percent of its total delinquencies. By comparison, Cleveland puts up an average 2,000 properties per year, and Detroit will try to sell some 20,000 parcels this year.

Philadelphia has come under pressure from City Council to expand sales as a way of attacking the delinquency problem. In 2012, the city increased the number in some months. It hopes to reach 450 per month by the end of 2013, equal to about 5,400 per year, and eventually hit 600 per month, or 7,200 per year, at which point it might start to make a dent in the city's reservoir of delinquent properties.

All of this is within the city's discretion—a situation that is not the rule elsewhere. About a dozen cities in our study, and most other Pennsylvania counties, operate under state laws that set specific rules and deadlines under which they must initiate foreclosures, tax-lien sales, or other actions. The timetables vary widely from state to state. Operating under Colorado state law, Denver gives a delinquent property owner just five months after the final payment deadline to pay in full or have his or her tax lien offered at public auction, the shortest time period among cities we studied. Denver's same-year delinquency rate has averaged 1.7 percent since 2006, one of the lowest.

In most of Pennsylvania, but not Philadelphia, county tax collectors have two years to carry out the first step of a two-part foreclosure sale process under Pennsylvania's 1947 tax-collection law. The median same-year tax-delinquency rate was only 4.2 percent in 14 of the largest Pennsylvania counties in 2011. In Philadelphia, the 2011 delinquency rate was 9 percent. In Pittsburgh, which, like Philadelphia does not operate under the 1947 law, the rate was 6.9 percent.

Many efforts have been made to impose firm deadlines on Philadelphia tax collectors. A 1992 amendment to the 1923 state law required the city to proceed on tax claims after one year of delinquency. But the law carries no sanctions for failing to do so, and the amendment has not been enforced. In 2013, the city enacted a requirement that it abide by the state's one-year deadline.[28]

In 2012, Pennsylvania state Rep. Chris Ross of Chester County proposed a two-year deadline in a bill that did not pass. This year, he has proposed the deadline again as part of a broader bill intended to replace and update all of the state's tax-collection laws.

"Collecting taxes and dropping the hammer is not something that elected officials love doing. We like to make people happy," Ross said in an interview, later adding: "If you have clear rules from the state, you can blame the state."

City officials point out that sending a property into the foreclosure pipeline does not guarantee the collection of taxes at the other end. Officials first must sift through scores of property records to find the legal owners and holders of other liens. In some cases, a private collection firm also checks the properties and the neighborhoods carefully to determine their condition and marketability.[29] Finally the collection firm and the city choose the minimum sale price to cover the tax and penalties due, plus the cost of going through foreclosure, which averages $800 to $1,500 per parcel.[30] Fewer than one in four properties make it through these steps to the auction block in any given month, according to figures provided by the city, collection firms, and Sheriff's Office.

Once properties do get listed for auction, about 60 percent are postponed or dropped each month because owners, upon seeing their properties listed, step up to pay in full, request a payment plan, or file for bankruptcy, thereby forestalling foreclosure.[31] In many cases, the owners later withdraw the bankruptcy filings, and many break their payment promises, tax officials said. In Philadelphia, restarting the

LAND BANKS

In a handful of cities in our study, land banks have been created to acquire blighted and tax-delinquent properties for redevelopment purposes from a variety of sources, including the city or county itself.

Land banks are able to buy tax-foreclosed properties, often vacant land, for the face value of their tax liens prior to a tax auction. That enables the city to receive full payment and avoid the expense of an auction, while helping to move property toward development. In 2012, the Pennsylvania legislature enacted a law authorizing localities to create land banks specifically for the purpose of acquiring tax-delinquent and blighted property. The Nutter administration, members of City Council and other organizations have been weighing their options for creating a Philadelphia land bank.

Michigan, Missouri, and Ohio have led in the creation of land banks in recent years, giving their tax authorities a new option for removing old accounts from their delinquency rolls. However, some of their cities, such as Flint and St. Louis, still struggle with a flow of new delinquencies. In some cases, the land banks also end up holding the formerly delinquent properties for long periods.

foreclosure process after either of those developments can take months. The Revenue Department said it has been changing its case-management system to enable a faster restart of foreclosure proceedings. In contrast, Los Angeles, New York, and Miami do not let owners stop a sale process by simply asking for an installment payment plan; they must pay off the whole tax debt.

Even when sales go through, the process is not over in the cases of homes in which the owners are still residing. For nine months after the foreclosure sale, the owners retain what is known as "a right of redemption," which most other cities also offer at various lengths. Redemption allows owners to buy their property back if they pay all the taxes due and any additional amount that was bid on the home. The city gets its tax money, but the bidders lose out, which could dissuade some potential buyers from trying to purchase tax-foreclosed properties.

Resolving Delinquencies by Selling Liens

Selling properties is not the only way that cities try to deal with delinquencies. Another is selling or transferring just the tax liens to investors or to other governments.

In a tax-lien sale, the city or county receives the face value of the lien, equal to the back taxes owed on a property plus interest and penalties, and pays the buyer of the lien—also called a certificate—interest, usually at a relatively high rate, over a set period of time. Terms vary from one locale to another. Generally, though, if the owner of the property fails to pay the delinquent taxes before the lien certificate comes due, the lien-holder can foreclose on the property.

St. Louis, Cincinnati, and Cleveland, all of which have relatively high same-year delinquency rates, conduct regular tax-lien sales. Denver, Miami, Tampa, New York, Los Angeles, Baltimore, and many New Jersey cities also sell tax liens.

Tax liens generally are sold to private investors. Some cities sell or transfer them to county or state agencies that are charged with managing the payments. Minnesota bars the sale of tax liens to private parties and regularly purchases liens from Hennepin County, which includes the city of Minneapolis.

Under Pennsylvania law, Philadelphia is allowed to sell liens, but it has done so just once. In 1997, the city packaged thousands of liens together as security on a bond and then issued the bond through the Philadelphia Authority for Industrial Development, while the tax liens themselves were sold in a trust to a bank. Many of the readily collectable liens were paid off or removed from the portfolio before the transaction took place.[32] When the bond matured in 2004, many liens were still outstanding. Linebarger was hired to collect on the liens and has whittled down the properties to a few hundred.

The so-called lien securitization produced a one-time infusion of revenue for the city and its schools, but the process was politically contentious and still left the city with many delinquent properties to cope with.

Several years ago, the city looked into the idea again, that time for a more conventional process not involving bonds. But it decided not to move ahead at the time, according to a city official involved in the process. Even so, at least one local group, the Greater Philadelphia Association of Realtors, has called on the city to consider selling liens as a way to remove many old delinquencies.

Penalties and Interest

One obstacle to clearing old delinquencies can be the large amounts of penalties and interest. Every city and county slaps monthly interest and sometimes penalty charges on delinquent balances. Some people argue that all of this deters delinquents from paying off their debts, while others say it is the key to motivating them to pay.

Based on the theory that the steep charges can get in the way of collections, especially for older debts, the Nutter administration has proposed lowering the interest rate on delinquent balances as part of its proposed installment-payment legislation. Under the city's current law, a delinquent property taxpayer faces higher interest and penalties each month on his or her unpaid tax balances, with the total reaching 31 percent at the end of the first delinquent year, not including legal fees that the city is allowed to add to the bill.

Philadelphia's interest and penalty rates appear to be higher than in many other cities. We found no obvious correlation between the penalties a city imposes and its same-year collection rates. For example, Denver has one of the lowest delinquency rates and Detroit the highest, but both charge 12 percent annual interest on unpaid balances, not including other penalties.

However, the penalties and interest may have an impact on payment of older tax debts. Our collectability analysis found that the share of debt from penalties and interest is much higher on the harder-to-collect properties, many of which represent longstanding delinquencies, than on the easier-to-collect properties. The penalties exceeded the principal tax due on 25,431 harder-to-collect properties.

Sometimes the charges are reduced or waived as part of debt payoff. More than 500 property owners a year, on average, appeal their penalty and interest to Philadelphia's Tax Review Board. And in 2010, 22,000 took advantage of the city's tax amnesty campaign to have most of their interest and penalty erased in return for paying off the principal balance. In both cases, property owners must stay current on their taxes to avoid having the penalties put back on their accounts.

Improving Efficiency and Effectiveness

Philadelphia has taken other steps designed to improve efficiency and effectiveness that appear to be unique among the cities we studied. Some are more common at the state level.

One of the city's efforts is focused on information technology. Inspired by systems in West Virginia, the Nutter administration has proposed an increase in the Revenue Department's budget of $40 million over the next five years to create a call center and "data warehouse" to cross-reference and pursue delinquents. The plan includes hiring 55 new employees. City officials project that the investment will enable it to increase collection of all local taxes—not just property taxes—by $260 million over five years. They did not provide a separate projection for property taxes.[33]

Philadelphia also has proposed hiring a public relations director in the Revenue Department and increasing its use of public "shaming" of tax delinquents. The city has used the tactic to compel some tax delinquents, particularly those who have failed to pay business taxes, to make good on their debts. Some tax consultants say it can help with property tax collections, also.

In 2011, Philadelphia enlisted former middleweight boxer Bernard Hopkins, a Philadelphia native, in a publicity campaign to encourage taxpayers to stay current on their taxes. While threatening to punch out delinquents may or may not be effective, publicity campaigns in general can help raise tax collections. Publicizing names of tax delinquents, known as a "shaming strategy," also may help.

Like some states, Philadelphia regularly checks whether its public employees and pensioners are current on their property taxes. If they are not, the city garnishes wages or pension payments to make up the delinquency. One state legislator has proposed broadening wage garnishment in Philadelphia to include all delinquent taxpayers. While some states use this tactic, no city in our study reported using it to collect local property taxes.

Philadelphia was one of the few cities in our study that also regularly checks the tax-payment records of applicants for city appointments or contracts, and conditions their hiring on payment of all back taxes.

The Nutter administration also has been looking into the possibility of seizing the automobiles of tax delinquents. In New York state, Gov. Andrew Cuomo has proposed a similar tactic.[34]

POSSIBILITIES FOR IMPROVEMENT

In recent years, Philadelphia appears to have made some headway against its property tax delinquency problem, thanks in part to the economic recovery. But with 102,789 delinquent properties on the rolls as of April 2012, major improvement will be needed on two fronts: shrinking the number of delinquencies and preventing more from being added to the list.

To reduce the backlog of delinquent parcels or capture some tax revenue from them, other cities and counties have moved ahead forcefully on foreclosures or tax-lien sales. Most of them operate under state-imposed rules that give local officials little opportunity to delay action, and Philadelphia this year enacted new rules designed to impose similar deadlines on itself. But these approaches also carry risks, including the likelihood that more nonpayers lose their homes and not enough people buy the foreclosed properties. For some cities, land banks and tax exemptions for certain homeowners have helped.

To reduce the number of new delinquencies, early notification of late-payers about the risk of becoming delinquent can have a significant impact. Some cities also make it easier for owners without mortgages to pay their current taxes and avoid becoming late in the first place. A big impact also may come from increased foreclosures, which would leave no doubt about the consequences of not paying.

Establishing and enforcing clear, consistent rules on installment payments for past-due properties, as the city has proposed, may help Philadelphia recover some back taxes, as long as the plans do not undercut the city's ability to foreclose and are limited to owners who otherwise would not pay. Centralizing the city's tax-collection functions and upgrading its staff and technology will also help.

To the extent that Philadelphia's leaders make the collection system more effective, efficient, and credible, the city may be able to collect significant amounts of back taxes. Our analysis shows that up to $155 million out of the $515.4 million in outstanding taxes and penalties could be realistically collectable, and perhaps more if the city makes major changes in a robust economy.

Much also depends on the city's political will to reverse what some call a "culture of nonpayment." Philadelphia's new chief revenue collection officer, Thomas Knudsen, put his finger on part of the problem, telling a newspaper that his job will include changing public sensibility "around the responsibility of paying for civic services."[35]

Dealing more effectively with the backlog of delinquent taxes from the past will produce dividends for the city. Preventing delinquencies in the future will produce even more.

ENDNOTES

[1] Pew Center on the States, "The Local Squeeze," November 2012. See also U.S. Census Bureau Quarterly Summary of State and Local Taxes.

[2] Patrick Kerkstra, "Ravaged by Neglect," *Philadelphia Inquirer* and PlanPhilly.com, March 10, 2013.

[3] Alan Butkovitz, Facebook posting https://www.facebook.com/pages/Alan-Butkovitz/331631800256425; see also Stu Bykofsky, "Don't Pay Your Taxes," March 15, 2013, *Philadelphia Daily News*.

[4] Real estate taxes for the City of Philadelphia and the Philadelphia School District are collected together, but their levies and collection rates are calculated separately. The School District reported that its collections for 2011 were $551.3 million out of total levy of $620 million, making its non-collection rate 11.1 percent.

[5] For all cities and counties except Philadelphia, the tax collection and delinquency rates used in this report come from those cities' or counties' Comprehensive Annual Financial Reports and are based on full-year collections, either fiscal year or calendar year. The Philadelphia rates used in this study were generated by the city's Department of Revenue and are also based on full-year collections. The figures listed in Philadelphia's Comprehensive Annual Financial Reports—which show a higher rate of delinquency—are not comparable to the full-year figures found in other cities' financial reports.

[6] Cities with individual poverty rates of 25 percent or more, as measured by the U.S. Census Bureau American Community Survey 1-year estimates 2011: Philadelphia (28.4%); Detroit (40.9%); Cleveland (34.3%); St. Louis (27%); Cincinnati (29.5%); Memphis (27.2%); Baltimore (25.1%); Dallas (25.3%); Atlanta (26.2%); Miami (31%); Flint, MI (40.6%); Newark, NJ (31.6%); Buffalo (30.9%); Milwaukee (29.4%).

[7] Delinquency rate is based on the net collection rate, as reported in the Comprehensive Annual Financial Reports produced by each city or county.

[8] Revenue Commissioner Keith Richardson, City Council hearing testimony, March 19, 2013.

[9] Analysis by Kevin C. Gillen.

[10] Published budgets of the city governments and school district in Philadelphia.

[11] U.S. Census Bureau American Community Survey, 1-year sample 2011.

[12] U.S. Census Bureau American Community Survey, 1-year sample 2011. The national average of owner-occupied housing units without a mortgage was 33.6 percent, and the average among the cities in our study was 30.4 percent. We considered a high rate in this group anything over 30 percent, and a low rate anything below 30 percent.

[13] See Kerkstra. Interview with Marisa Waxman of Department of Licenses and Inspections.

[14] All numbers and characteristics of delinquent real-estate accounts based on data provided by the Philadelphia Department of Revenue.

[15] Interview with Cleveland Tax Supervisor Chris Neff. See also "Lawmaker Wants Non-Profits to Help Schools," WKYC.com, February 15, 2013.

[16] Christine MacDonald, Mike Wilkinson, "Half of Detroit Property Owners Don't Pay Taxes," *Detroit News*, Feb. 12, 2013; Matt Helms and Jennifer Dixon, "Detroit Takes Aim at Tax Deadbeats," *Detroit Free Press*, December 18, 2012.

[17] The others were: Northeast Revenue Service LLC, the private tax collector for Montgomery County and Luzerne County; Jordan Tax Service Inc., which collects taxes for Allegheny County, Pittsburgh and other jurisdictions in western Pennsylvania; TaxServ LLC, a collector in New York, New Jersey and Connecticut that participated in a Philadelphia collections contract between 1997 and 2003; and Pioneer Recovery Inc., which helped administer Philadelphia's "tax amnesty" campaign in 2010.

[18] For background, see Elizabeth Fiedler, Holly Otterbein, "Philadelphia not doing what it could to collect $8 million from tax deadbeats," Newsworks.org, March 4, 2013.

[19] When a homeowner dies without leaving a will, children and other heirs have to resolve "tangled title" issues to determine who will legally own the property and be responsible for the taxes. The city traditionally has not allowed such heirs to sign payment agreements, out of concern that such an agreement could be cited in court as evidence that the city had endorsed one individual's claim to a property over another's.

[20] Joseph A. Dworetzky, Myron A. Bloom, and Ashley M. Chan, "Best Practices Survey for City of Philadelphia Regarding Collection of Delinquent Real Estate Taxes," April 2008. This unpublished study was commissioned by the Philadelphia Law Department and produced by the Philadelphia law firm Hangley, Aronchik, Segal, Pudlin & Schiller. See also "Staff Report on FY2013-FY2017 Five-Year Plan," Pennsylvania Intergovernmental Cooperation Authority.

[21] *Pennsylvania Land Title Association v. East Stroudsburg Area School District*, Pennsylvania Supreme Court, 2006. Interviews with Montgomery County Treasurer Jason Salus and Daryl Boich of Northeast Revenue Services.

[22] Pioneer Credit Recovery Inc., "Best Practices in Revenue Collections," 2011.

[23] Revenue Commissioner Keith Richardson, City Council hearing testimony, March 19, 2013.

[24] Andrew Reschovsky and Paul Waldhart, "Property Tax Delinquency and the Number of Payment Installments," La Follette School of Public Affairs, University of Wisconsin-Madison, 2012.

[25] Interviews with Richardson and Linebarger's managing partner Sharon Humble. Installment-payment plans for back taxes are distinct from installment plans for current taxes. The latter require a formal application by a fixed date each year; payment plans for delinquent payers are granted at any time.

[26] Pennsylvania currently has a homestead tax relief program funded by casino revenue that enables most homeowners to reduce their property taxes each year. Philadelphia, however, uses the revenue to reduce the tax rate imposed on wage earners instead.

[27] Pittsburgh's estimated default rate was reported by its private tax collector, Jordan Tax Service Inc., which handles all delinquent collections. Other cities' rates were reported by tax authorities in those cities.

[28] Testimony of Andrew Toy, former Commerce Department official, Philadelphia City Council, March 20, 2013; press release from Council members Bill Green and Maria Quiñones-Sánchez, June 6, 2013.

[29] GRB uses a grading system of its own design to assess the properties and neighborhoods, a practice that it considers necessary to supplement and improve on data from city inspections and assessments.

[30] The Department of Revenue said its average cost is $800 to $1,000 for the accounts it handles. The private tax-collector Linebarger estimated its cost at $1,000 to $1,500 per parcel.

[31] Most data on tax sales provided by Philadelphia Sheriff's Office.

[32] Ben Hayllar, "Philadelphia's Tax Lien Sale and Securitization," Government Finance Review, 1997.

[33] Richardson, City Council hearing, March 19, 2013.

[34] Cara Matthews, "Cuomo targets driver's licenses to get overdue taxes," *News Journal*, White Plains, NY, February 7, 2013.

[35] Troy Graham, "Philadelphia post created to collect more taxes, fees," *Philadelphia Inquirer*, April 5, 2013.

METHODOLOGY

We performed a three-step empirical analysis to estimate how much of Philadelphia's delinquent property taxes the city realistically could collect. In the first step, we asked experienced tax collectors to identify the attributes of delinquent properties that generally indicate whether taxes are collectable or not collectable. In the second step, we scored each of the city's delinquent properties according to these attributes. For the third step, we estimated the actual amount of taxes and penalties that could be collected using a probability formula. In addition, we performed two tests to validate our findings. One test compared the collectability scores of the city's entire delinquent portfolio to those that failed to sell at sheriff's sales; the other examined how much our results varied when the attribute scores were changed slightly. Our analysis passed both tests. Detailed explanations are below.

Collectability

We began by interviewing several experienced tax collectors from private firms and local government agencies and asking them to enumerate the attributes of collectable and uncollectable property tax debt, and those of salable and unsalable tax-delinquent property. The tax collection firms and agencies interviewed were:

- Philadelphia Revenue Department;
- Texas-based Linebarger Goggan Blair & Sampson LLP, which operates nationally and has had contracts in Philadelphia since 1997;
- Pittsburgh-based Goehring, Rutter & Boehm, which has had a collection contract in Philadelphia since 2009 and also works in Pittsburgh and many western Pennsylvania jurisdictions;
- Northeast Revenue Service LLC, which has tax collection contracts for Montgomery County, Luzerne County (PA), and other jurisdictions;
- Jordan Tax Service Inc., which collects taxes for Allegheny County, Pittsburgh, and other jurisdictions in western Pennsylvania;
- TaxServ LLC, a collector in Florida, Virginia and Connecticut;
- Pioneer Recovery Inc., administrator of Philadelphia's "tax amnesty" campaign in 2010.

They generally identified the same or similar attributes of delinquent properties, including factors such as how long the property had been delinquent, the value of the property, its physical condition, and whether it was owner-occupied. All attributes are listed below. We were able to find this information in the Philadelphia Department of Revenue's dataset of delinquent properties (102,789 total records as of April 2012) and the Philadelphia Office of Property Assessment's dataset of all newly assessed city properties (579,660 total records as of February 2013).

Some collectors identified other collectability attributes related to the property owners, such as their income and debt—including outstanding utility bills and mortgage payments, which can be grounds for liens being placed on properties. However, information about these and other owner-specific attributes was not contained in the city's data as provided to us. We felt comfortable omitting mortgage debt from our analysis because we found, in checking a random sample of the delinquent properties, that a relatively small share of them carried a mortgage. Other owner-specific attributes that may indicate collectability were not available to us. (City officials lack some of this data and have asked for funding to begin compiling it.)

In the second step of our process, using the two datasets from the city, we linked the records for each parcel, and then examined how many attributes of collectability existed for each one. We awarded one or two points for each attribute that a parcel possessed. We gave three additional points when a property had a cluster of collectable attributes and took away three points when a property had a cluster of attributes associated with uncollectability. Then we summed the points for each property. The total score for each parcel ranged from a minimum of -3 to a maximum of 38.

The table below lists all of the attributes grouped by category, along with the total points that a property could get in each one. The table also shows the number of properties that possessed each particular attribute. (Because a property can have more than one attribute, the sum of these numbers in some of the categories is greater than the 102,789 actual parcels).

Attribute category	Potential score	Attribute detail	Number of properties with this attribute
Neighbor-hood values*	3	Neighborhood house prices are >50 percentile citywide (1)	17,329
		Neighborhood house prices are >75 percentile citywide (1)	7,090
		More than 10 percent of neighborhood properties have abatements (1)	26,261
Age of debt	6	Parcel is ≤3 years delinquent (2)	63,652
		Parcel is ≤5 years delinquent (2)	63,652
		Parcel is ≤10 years delinquent (2)	76,009
Property value**	6	Parcel AVI value is >1.25 of AVI value average for neighborhood (2)	14,444
		Parcel AVI assessed value >$50,000 (2)	53,453
		Parcel AVI assessed value >$10,000 (2)	83,282
Tax debt	6	Penalties/principal ratio <100 percent (1)	77,358
		Penalties/principal ratio <50 percent (1)	50,050
		Lien/AVI value ratio <25 percent (2)	83,599
		Lien/AVI value ratio <50 percent (1)	91,825
		Lien/AVI value ratio <100 percent (1)	96,849
Physical condition	6	Parcel classified by OPA as being in "superior" condition (2)	1,779
		Parcel classified by OPA as being in "above average" condition (2)	1,106
		Parcel classified by OPA as being in "new construction" condition (2)	432
Tenure and category	6	Parcel is located in neighborhood where >75 percent of parcels are residential (2)	56,542
		Parcel is listed as residential owner-occupied (2)	57,803
		Parcel is listed as single-family or multifamily residential (2)	68,417
Lien incidence	2	Parcel owner has no other delinquent properties listed (1)	89,063
		Parcel owner is delinquent on <=3 total properties, any category (1)	79,737
Uncollectable	-3	Lien-to-value ratio ≥85 percent; investor-owned; debt vintage ≥10 years; and average neighborhood house price <$50,000, or AVI value <$50,000, or physical condition listed as "below average," "inferior," or "abandoned/ sealed/condemned"	3,765
Collectable	3	Lien-to-value ratio ≤25 percent; owner-occupied; vintage ≤3 years; and average neighborhood house price > $120,000, or AVI value >$120,000, or physical condition listed as "new construction," "superior," or "above average"	10,378

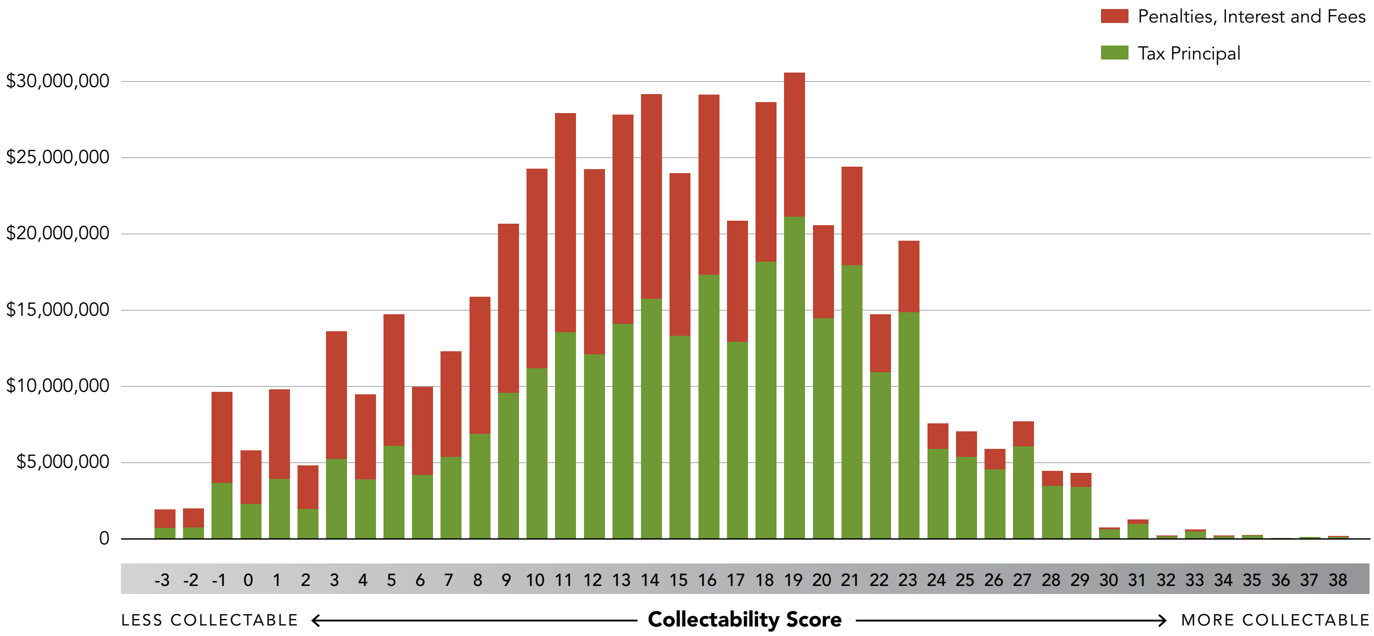
* Neighborhoods = Geographical Mapping Areas (GMA) as determined by Philadelphia Office of Property Assessment. http://www.phila.gov/OPA/Documents/OPA_Zone_Maps.pdf

** AVI value determined by Philadelphia Office of Property Assessment. http://www.phila.gov/OPA/Assessments/Pages/2012Assessment.aspx

We then ranked the properties by total score. Figure 4 in the text of the report shows how the 102,789 delinquent properties are distributed by collectability score. Figure 8 here shows how much of the $515.4 million in tax and penalties is owed by properties according to their collectability scores.

FIGURE 8

AMOUNT OF DEBT BY COLLECTABILITY SCORE



Analysis performed by Kevin C. Gillen.

SOURCE: Philadelphia Department of Revenue data as of April 2012.

The distribution of collectability follows an approximately bell-shaped distribution ranging from a minimum of -3 to a maximum of 38. The median score is 19 and the average is 17, with a standard deviation of 7. Properties in the left side of the distribution are assumed to have relatively lower probabilities of collection, while properties in the right side of the distribution are assumed to have relatively higher probabilities of collection.

Very few delinquent properties have above-average market values and/or are located in neighborhoods with above-average property values. Only 15 percent of all delinquent properties have values that exceed the Philadelphia median house price or the average AVI assessed value, or are located in neighborhoods with either relatively high average property values or significant amounts of 10-year abatements (indicating investment in the neighborhood's housing stock).

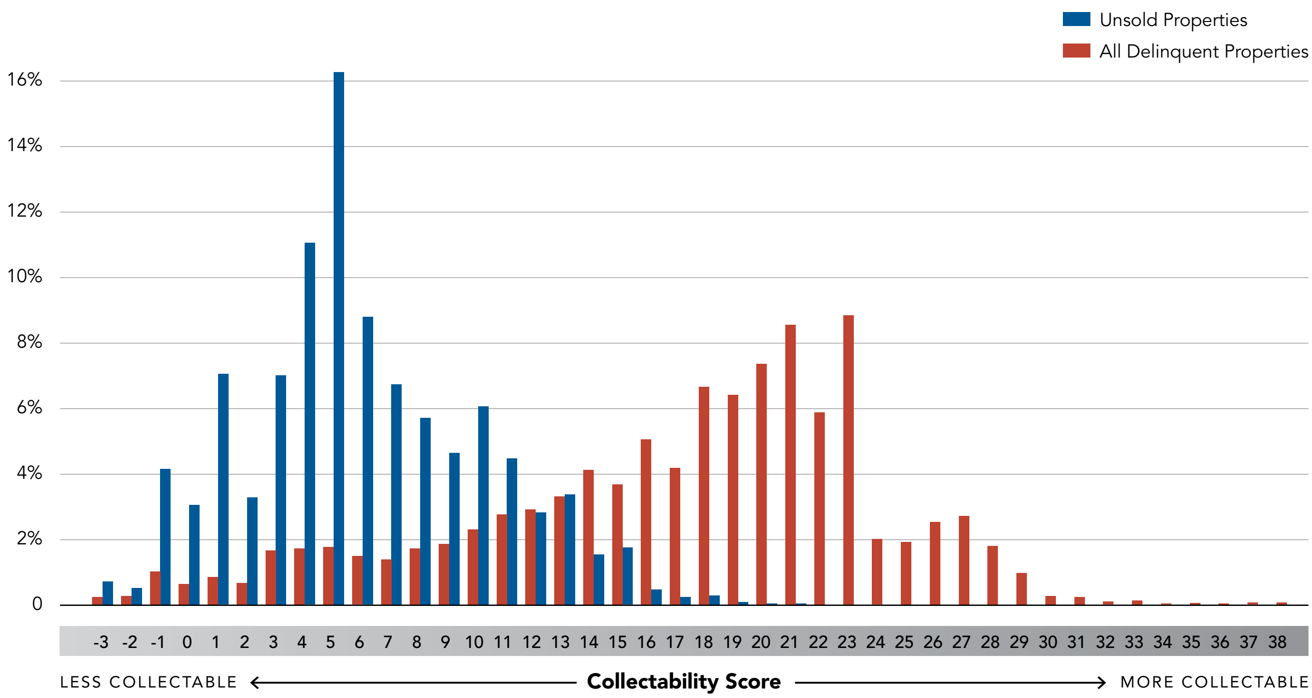
On the other hand, most delinquent properties in Philadelphia are residential parcels where the owners have title to relatively few other properties in the city, and the dollar amount owed is significantly less than the value of the property.

Validation of Collectability Scores

To check whether our collection score methodology is effectively associated with the relative likelihood of collection, we compared the collection scores of foreclosed but unsold delinquent properties to the collection scores of the entire delinquent portfolio. This was done by collecting data from one of the city's private collection firms on properties that had failed to receive any bids during auction by the Philadelphia Sheriff's Office. There were 2,528 such properties as of March 2013 (found at www.phillyvacants.com). We computed the collection scores of these foreclosed unsold, tax-delinquent properties using the same methodology that we used for the entire delinquent portfolio. Figure 9 compares the collection scores of the unsold delinquent properties to all delinquent properties in our initial analysis, labeled "All delinquent properties:"

FIGURE 9

COLLECTABILITY SCORES OF UNSOLD VS. ALL DELINQUENT PROPERTIES (IN PERCENTAGE OF TOTAL PROPERTIES)



Analysis performed by Kevin C. Gillen.

SOURCE: Philadelphia Department of Revenue data as of April 2012.

Our analysis assumes that those delinquent foreclosed properties that fail to sell at auction are relatively undesirable, and thus should have lower collection scores. The above chart supports this assumption and, by extension, our collection score methodology. The distribution of collection scores for unsold properties, represented by the blue bars, is mostly below the distribution of collection scores for all delinquent properties, the red bars. The median collection score of a delinquent foreclosed property that failed to sell is 6, compared with a median score of 19 for the entire portfolio. The maximum score of an unsold property is 21, compared with 38 for all properties.

Probability

The third step in our process to determine the collectable amount was to convert the ranking of collectability from a relative score to an explicit probability. We did this by assigning each of the 38 positive rankings (from score 1 to score 38, excluding rankings at 0 or below) an equal share of the total range by dividing 38 into 100 percent. This gives us 2.63 percent per ranking. This implies that the probability of collection increases by 2.63 percent for each unit of increase in a property's collectability score. A property with a score of 0 has a 0 percent probability of collection; a score of 1 has a 2.63 percent probability of collection; a score of 2 has a 5.26 percent probability of collection; and so on. Any property with the maximum score of 38 has a 100 percent probability of collection.

Then we created three collection scenarios based on these probabilities: a baseline scenario, a pessimistic scenario, and an optimistic scenario. This was done in two parts.

First, we shifted the entire range of collection probabilities upward or downward by a small percentage to reflect optimism or pessimism that collections could actually be achieved. For example, on the assumption that the city optimized all of its collection powers and experienced a real estate boom that raised the value of delinquent parcels, we shifted the entire collectability range up by 5 percent. This percentage is the "collectability constant." On the other hand, assuming nothing went well for the city's tax collectors and the city real estate market faltered, we slid the collectability range down by 5 percent.

Second, we changed the assumption about the collection percentage of penalties and interest (as opposed to principal), both of which the city sometimes agrees to lower in return for a commitment to pay off the debt. In the baseline scenario, we assume that tax collectors capture 50 percent of penalties and interest. This figure is the "P&I collectable percent." Under an optimistic scenario, that figure might rise to 70 percent; under a pessimistic scenario, it might fall to 30 percent.

Based on the above model, here are the probability parameters for each of the three scenarios:

PROBABILITY PARAMETERS FOR COLLECTION SCENARIOS

Scenario	Probability Constant	P&I Collectable Percent
Pessimistic	-5 percent	30 percent
Baseline	0 percent	50 percent
Optimistic	+5 percent	70 percent

These parameters were applied as follows: For a given scenario, the probability constant was added to the probability of collection associated with that collection score, and then multiplied by the principal amount owed in that category. For the penalties and interest owed for that category, the likely collectable amount was computed as the dollar amount of penalty and interest owed, times the probability constant for that category, times the percent of P&I assumed to be collectable for that category.

For example, there are 6,420 properties with a collection score of 19, which is the median. These properties collectively owe approximately $21.1 million in principal and $9.5 million in penalties and interest. In the baseline scenario, the probability of collecting is 50 percent. Multiplying a 50 percent probability of collection times the $21.1 million in principal implies that about $10.5 million of this amount owed is feasibly collectable. There is no shifting of this distribution either up or down because this is the baseline scenario. For penalties and interest, this baseline scenario assumes that 50 percent is collectable (regardless of collection score); therefore multiplying $9.5 million times 50 percent, and again times the 50 percent probability of collection yields about $2.4 million in collectable penalties and interest. The total amount likely collectable for properties in this category is the sum of $10.5 million and $2.4 million, or about $12.9 million. That is the realistic collectable amount of taxes on those properties—less than half of their official tax-and-penalty debt of $30.6 million.

Performing this exercise for each collection score category produced the total dollar amount that is feasibly collectable under the assumptions in each scenario.

Validation of Collection Probabilities

To test the robustness and stability of our collection probabilities and scenarios, we performed an exercise known as a sensitivity analysis. We intentionally "up-weighted" each attribute category—such as age of debt or property values—in order see how the predicted revenue collections changed as a result. We performed nine such tests. For each test, or iteration, we added 3 points to the particular category being tested, and took away 3 points from all the others, and then ran the resulting scores through our probability scenarios to compute the likely amount that would be collected with this re-weighting. For the nine tests, the results showed relatively little variation in the projected collectable amount. Across all nine tests, the predicted collection amount deviated from our original baseline projection by an average of 4 percent, with a standard deviation of 10 percent.

The full results of all our estimates and analyses are available from the authors upon request. Contact Thomas Ginsberg at tginsberg@pewtrusts.org.

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