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Memorandum

To Mayor Michael A. Nutter
Council President Anna C. Verna
Members of City Council
From BRT Governance Working Group
Date September 11, 2009
Re **The Actual Value Initiative and Property Tax Relief**

Background

In June 2009, two working groups, both comprised of staff members from City Council and the Nutter Administration, began meeting to develop options regarding the Board of Revision of Taxes (BRT) for the Mayor and City Council's review. These options are intended to address long standing concerns regarding the BRT's governance and property assessment procedures. The working groups were asked to report back to the Mayor and City Council in September 2009, to coincide with the resumption of the City Council legislative session.

This memo details the options regarding the Actual Value Initiative drafted by the BRT Governance Working Group. The BRT Governance Working Group has also developed a separate memo entitled "BRT Governance Options," which addresses governance options as they relate to the broader issues of agency structure and function. The other working group, the BRT Data Working Group, will provide options to the Mayor and City Council regarding property assessment procedures in a separate memorandum.

The Board of Revision of Taxes and The Actual Value Initiative (AVI)

The Board of Revision of Taxes (BRT) is the City agency responsible for determining the value of real property as the basis for real estate taxes levied by the City of Philadelphia and the School District of Philadelphia. The BRT is a seven-member panel appointed by the Judges of the First Judicial District of Pennsylvania. The BRT also hears all appeals of property valuations filed by City property owners. As currently constructed, the BRT exists outside the direct authority of the Mayor and City Council.

The BRT's job is to determine the market value of Philadelphia real estate. But it is an undeniable fact that for many years, the BRT's assessments have not kept pace with changes in the Philadelphia real estate market. In fact, Philadelphia's assessment inaccuracy has "worsened dramatically during the last five years," according to a study by Wharton economists.

If the BRT simply under-assessed or over-assessed all properties by the same percentage amount, then each property owner would still be paying his or her fair share of real estate tax. But that is not the case. As the system exists today, homes in poorer neighborhoods tend to be over-assessed compared to homes in wealthier neighborhoods, which tend to be under-assessed. And even looking at groups of equally wealthy (or equally poor) neighborhoods, some neighborhoods are under-assessed and some are over-assessed

DRAFT

compared to others within the group. Simply put, the failure to assess all properties accurately calls into question the fairness of the Philadelphia property tax system.

The current assessment system is also confusing to taxpayers. To determine the real estate tax due on a property, the tax rate (currently 8.264%) is applied to the “assessed value” of a property. The “assessed value” of a property is not the same as the “market value” assigned by the BRT. Instead, the BRT determines “assessed value” by multiplying “market value” by a “predetermined ratio,” currently 32%. For example, if the BRT assigns a market value of \$100,000 to a property, the property will have an “assessed value” of \$32,000, and the property tax bill will equal \$32,000 multiplied by the tax rate of 8.264%, or \$2,644.48.

In order to eliminate confusion, fix the inequities in the assessment system and modernize Philadelphia’s assessment system, the BRT has undertaken the “Actual Value Initiative” (AVI). AVI has the goals of improving uniformity and increasing equity and transparency in the property tax assessment system.

There are two key components to AVI. The most significant is the creation of a system to determine “market value” with greater accuracy and thereby eliminate the assessment inaccuracy that has plagued Philadelphia in recent years. This would be accomplished through the use of statistical models and a computer-assisted appraisal system, and the use of physical property inspections to complement and confirm the statistical models’ projected values.

The second component of AVI is to set assessed value equal to market value, so that the 32% assessment ratio would become a relic of the past. Taxpayers would pay property tax based simply on the market value of the property. Tax rates would need to be adjusted to reflect the new 100% assessment ratio. It is important to note that eliminating the 32% ratio does nothing to change the relative property tax burden, as each property owner would still pay the same share of taxes as with a 32% ratio. However, moving to a 100% ratio, and basing taxes simply on market value, makes the system easier to understand.

Interventions to Transition to AVI: Caps, Smoothing and Other Buffers

If adopted, the transition to an actual value assessment system will present unique challenges because while some of Philadelphia’s property owners will benefit by experiencing a decrease in their property tax burden, others will face a sudden, and in some cases dramatic, increase in the assessed value of their homes (and therefore the amount of property tax homeowners will pay). This is true even if the property tax millage rate is adjusted so that AVI is “revenue neutral” as a whole. Thus, there is an interest in developing policies – such as caps, smoothing and other buffers – to mitigate significant increases in property tax burdens resulting from implementation of the Actual Value Initiative.

It should be noted that before caps, buffers and smoothing could apply to the 60% of the real estate tax imposed by the school district, state legislation likely would be needed to address the “Act 46” issue. Act 46 requires that as long as the School District remains under a declaration of “distress” and is run by the School Reform Commission, the City is

DRAFT

obligated to provide certain financial support to the School District, including continuing to authorize taxes at specified levels. *See* 24 P.S. § 6-696(h). State legislation also likely will be needed to address that portion of the School District real estate tax that is directly authorized by the State; the City has no authority to change this millage *or* to impose buffers without State authorization.

In order to help the Mayor and City Council address the very real issues raised regarding AVI and its potential impacts, the Governance Working Group has developed a number of options related to the Actual Value Initiative.

Those options, including the pros and cons of each, are described below.

ISSUE: SHOULD THE CITY PROCEED WITH THE ACTUAL VALUE INITIATIVE?

Question	Pros	Cons
<p>What are the pros and cons of implementing the Actual Value Initiative (AVI)?</p> <p>[NOTE: Concerns about the quality of the data and statistical models underlying the proposed AVI values released by the BRT earlier this year are beyond the scope of the BRT Governance Working Group and will be addressed in a separate memorandum to be issued by the BRT Data Working Group. The AVI analysis in this document presumes that the underlying data/modeling would meet appropriate standards before AVI is implemented.]</p>	<ul style="list-style-type: none"> • Actual values simplify the property tax system and increases transparency for taxpayers. • There is inequity in the current system; AVI treats all property classes the same way, which will improve fairness in the system. • Actual values provide accurate, up-to-date, fair, uniform and predictable values. • AVI modernizes the appraisal system: <ul style="list-style-type: none"> ○ Assessments will conform with national assessment standards ○ Philadelphia would join most major cities, counties and other PA counties in having a modern, transparent system • State law requires Philadelphia to assess properties at actual values.¹ • Allows elected officials to be responsible for property tax policy; reduces potential for courts mandating how assessments will be performed in Philadelphia. • Assessing properties at their actual value (100% of market value) on a regular basis is considered a best practice. 	<ul style="list-style-type: none"> • Change to AVI represents a departure from the status quo. • Some taxpayers will oppose AVI because they will have to pay a larger property tax burden. [NOTE: Policy interventions including buffering or phasing in tax changes can be part of the implementation to mitigate large and/or sudden tax increases.]

¹ Pursuant to 72 P.S. § 5341.13(a), which applies to assessments in Counties of the First Class, “[a]ll property within the county now or hereafter made taxable by law, shall be valued by the assessors and assessed by the board at the actual value thereof. In arriving at actual value the county may utilize the current market value or it may adopt a base year market value.”

ISSUE: IF THE CITY IMPLEMENTS AVI, FOLLOWING THE NECESSARY RATE RE-SET IN THE FIRST YEAR, HOW SHOULD RATES BE SET IN SUBSEQUENT YEARS?

Options	Pros	Cons
<p>Annual, budget-based rate changes</p> <p>[NOTE: Under AVI, all property values will be updated annually.]</p> <p>[Pending Bills Nos. 090356 and 090360 would specify an annual real estate tax rate that is dependent on total taxable assessed values.]</p>	<ul style="list-style-type: none"> • Allows for more finely-tuned determination of the amount of the City’s revenue that will come from property taxes. • Avoids perception of “backdoor” tax increases following from increased assessed values. • Most equitable determination of property tax burdens (when millage rates are updated at the same frequency as assessments) 	<ul style="list-style-type: none"> • Requires annual assessments to occur before millage rates are set for the following fiscal year – a departure from the current schedule. • Requires City Council and the Mayor to legislate real estate millage rates every year. • May require State enabling legislation to address “Act 46” issue relating to School District taxes.
<p>Occasional rate changes (for example, to take place if property tax burden increased significantly over a number of years due to increased property values under annual reassessments)</p>	<ul style="list-style-type: none"> • Maintains current practice (i.e., reassessments establish the revenue available). • Would not require a change in the assessment schedule. • Would not require City Council and the Mayor to legislate real estate millage rates every year. 	<ul style="list-style-type: none"> • Perception of “backdoor” tax increases resulting from increasing assessed values. • May require State enabling legislation to address “Act 46” issue relating to School District taxes. • May become more difficult to effectuate rate changes because it deviates from the status quo. [NOTE: Provisions that require revenue neutral rate changes if aggregate property values increase by a certain amount can be established to mitigate this risk.]

ISSUE: IF THE CITY IMPLEMENTS AVI, WHAT PROPERTY TAX RELIEF MEASURES SHOULD BE IMPLEMENTED?

Relief measure/ authorizing legislation	Pros	Cons
<p>Low-income senior citizen tax relief</p> <p>Philadelphia Code (“Code”), § 19-2900 (based on state enabling legislation codified at 72 P.S. § 4751.21)</p>	<ul style="list-style-type: none"> • ALREADY AUTHORIZED • Protects seniors over 65 who are eligible for PACE/PACENET from real estate tax increases resulting from either increased assessments or increased real estate tax rates. • Permits low-income seniors to benefit from property tax decreases resulting from AVI. 	<ul style="list-style-type: none"> • Decreases revenue received from property taxes. • May be construed by some residents as unfair treatment (e.g., does not apply to all seniors, does not apply to all low-income, does not apply to disabled).
<p>Installment Payments (without interest)</p> <p>Code, § 19-1305</p>	<ul style="list-style-type: none"> • ALREADY AUTHORIZED • Allows low-income and low-income seniors to pay real estate taxes in installment payments without interest for up to two years. • Provides low-income residents an opportunity to pay real estate taxes when they may otherwise become delinquent. 	<ul style="list-style-type: none"> • The costs of interest are borne by the government, decreasing total revenue.
<p>Installment Payments (with interest)</p> <p>Code, § 19-1302</p>	<ul style="list-style-type: none"> • ALREADY AUTHORIZED • Allows residents to pay real estate taxes on a quarterly basis (interest and penalties apply). • Provides residents the opportunity to pay real estate taxes when they may otherwise become delinquent. • Minimizes cost to government because interest and penalties are borne by the taxpayer. 	<ul style="list-style-type: none"> • Assessing interest and penalties increases cost to taxpayer.

Relief measure/ authorizing legislation	Pros	Cons
<p>Deferral of real estate tax assessment increases (deferrals accrue interest at 6% annually, and are due upon the sale of the property but may be paid at any time prior to sale)</p> <p>Code, § 19-1307</p>	<ul style="list-style-type: none"> • ALREADY AUTHORIZED • Allows residents to defer increases in real estate taxes greater than 15% resulting from assessment increase, based on need. • Provides property owners the opportunity to pay real estate taxes when they may otherwise become delinquent. • Minimizes cost to government because interest is borne by the taxpayer. 	<ul style="list-style-type: none"> • May present a significant financial burden to homeowners upon time of sale. • Assessing interest increases cost to taxpayer. • Predetermined interest rate may be excessive in comparison to market rates. [NOTE: This can be mitigated by proposing a floating interest rate tied to economic indicators.]
<p>“Cap” on tax increases</p> <p>[NOTE: Although a 4% cap is set forth in Code, § 19-1306, the cap is subject to state enabling legislation.]</p>	<ul style="list-style-type: none"> • Limits the percentage of real estate tax increase to a taxpayer in any one year. • Provides residents facing a sudden and dramatic increase in assessments the opportunity to gradually pay their share of real estate taxes when they may otherwise become delinquent. • Provides homeowners predictability for the level of future real estate taxes. • Allows those who are currently over-assessed to receive immediate tax relief. 	<ul style="list-style-type: none"> • May require State enabling legislation to authorize caps and to address “Act 46” issue relating to School District taxes. • Too low a cap may violate the uniformity requirement of the Pennsylvania Constitution. • A cap on tax increases only (and not also tax decreases) could be expensive. [NOTE: Increasing the tax rate could limit the cost but at the price of slowing down property tax relief for those who are now over-assessed.]
<p>Homestead exemption</p> <p>[NOTE: Code, § 19-1301.1, and Pending Bill No. 080723 contain a homestead exemption – with the exemption amount left</p>	<ul style="list-style-type: none"> • Would exempt a specified amount of the value of owner-occupied housing from property taxes. • Treats all owner-occupied 	<ul style="list-style-type: none"> • Requires State enabling legislation. • Commercial property owners will bear more of the property tax burden,

<p>blank – that is contingent upon state enabling legislation.]</p>	<p>properties equally.</p> <ul style="list-style-type: none"> • Makes property taxes less regressive. 	<p>and they may construe the exemption as unfriendly to businesses, which already also pay wage, BPT, U&O taxes, as well as other fees.</p>
<p>Relief measure/ authorizing legislation</p>	<p>Pros</p>	<p>Cons</p>
<p>“Smoothing” of tax increases</p> <p>[Pending Bill Nos. 090357 and 090358 would enact a “five year smoothing” provision so that property owners would be taxed based upon the current year and prior four years’ assessments.]</p>	<ul style="list-style-type: none"> • Provides property owners are to be taxed based on the average of their assessments over some period of time (e.g., 5 years). • Provides residents facing a sudden and dramatic increase in assessments the opportunity to gradually pay their share of real estate taxes when they may otherwise become delinquent. • Provides homeowners predictability for the level of future real estate taxes. • Equally applicable to all residents. 	<ul style="list-style-type: none"> • May require State enabling legislation to authorize caps and to address “Act 46” issue relating to School District taxes. • May violate the uniformity requirement of the Pennsylvania Constitution. • Smoothing is likely to have less effect on City revenues than a cap since it affects both increases and decreases. [NOTE: Increasing the tax rate could limit the cost but at the price of slowing down property tax relief for those who are now over-assessed.] • Smoothing will slow down property tax relief for those who are now over-assessed.
<p>Gentrification relief</p> <p>72 P.S. § 4749.1 et seq.</p> <p>[NOTE: Amendments to state law would be needed to allow City to consider financial need and age in determining eligibility.]</p>	<ul style="list-style-type: none"> • Defers or exempts certain real estate tax increases on the principal residence/domicile of longtime owner-occupants in areas defined as gentrifying. • Protects those homeowners who moved into a low-value home that, over time, has appreciated to become a high-value home. 	<ul style="list-style-type: none"> • State law currently prohibits Philadelphia from basing eligibility on either financial need or age (cities of the Second Class are permitted to take these characteristics into account). • Program may be too expensive unless eligibility can be limited based on need and age.

		<ul style="list-style-type: none">• May be construed by some residents as unfair treatment: Long-time homeowners benefit from their increased home value• May not affect those most in need of assistance (if eligibility cannot be limited by age and need).
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ISSUE: IN THE FUTURE, WHO WILL HAVE RESPONSIBILITY FOR OVERSEEING AND COMMUNICATING INFORMATION ABOUT PROPERTY TAX RELIEF PROGRAMS?

Options	Pros	Cons
Assessment entity (either a new assessment entity or the BRT)	<ul style="list-style-type: none"> • Centralizing function within one entity. • Information about senior citizen property tax “freeze” currently sent out with assessment notices. • Citizens might expect to continue to receive this information with their assessment notices. • Assessment notices go out prior to property tax bills: having additional time to apply for relief programs might increase uptake rate. 	<ul style="list-style-type: none"> • Although assessment entity could manage the information-sharing function, because it is not responsible for billing/collecting property tax bills, it would be difficult for it to manage the implementation of the relief programs. • If the Revenue Department continues to administer the property tax relief program, and to maintain the most current information about available programs and eligibility criteria, it is best positioned to communicate with the public about these programs.
Revenue Department	<ul style="list-style-type: none"> • Centralizing function within one entity. • Revenue Dept. has experience administering these programs and currently has responsibility for notifying taxpayers re some, but not all, of these programs. • Potential for increased participation in relief programs if outreach and implementation handled by a single entity. 	<ul style="list-style-type: none"> • Taxpayers accustomed to receiving notice re programs in their assessment notices from BRT. • Time lag between assessment notice mailing and property tax bill mailing may result in fewer participants.