NATIONAL
MULTIFAMILY
HOUSING
COUNCIL

Tool: Tax Abatement

THE HOUSING AFFORDABILITY TOOLKIT

Developed in Partnership with
HR&A Advisors

Property Tax Incentives

Property tax incentives improve affordability by directly lowering rents or increasing the supply of rental housing.

What Are Property Tax Incentives?

Property tax incentives are state or local policies designed to reduce the tax burden on properties in order to support a public policy goal. The specific mechanisms vary by state and local municipality, but often fall under three broad categories: **tax abatements, tax rebates, and tax exemptions**. All three mechanisms have similar results – a net reduction in property taxes paid and lower operating costs.

TAX ABATEMENTS

Direct reduction in the amount of taxes owed.

TAX REBATES

A reduction in taxes applied after taxes are paid.

TAX EXEMPTIONS

A reduction in the appraised value of a property – thereby reducing overall taxes owed.

> **"Tax incentives can enhance development feasibility by allowing operators to reduce their operating costs."**
>
> – Urban Land Institute

How Tax Incentives Work

Tax incentives can work in two ways – a direct approach that provides incentives in exchange for rents at a certain affordability level and a supply approach that focuses on increasing the overall supply of rental housing to reduce the demand pressure on existing units.

DIRECT APPROACH

A well-run direct incentive program can increase affordability by requiring a reduction in rent in exchange for a commensurate reduction in property taxes. These incentives can be achieved either through negotiations between the developer and the municipality or through established government programs.

SUPPLY APPROACH

A well-run supply incentive program focuses on increasing the overall supply of housing by providing an incentive for an overall property, which would reduce the market rents required for new development and make more development feasible. Increased supply in a market can stabilize or reduce rents and decrease the likelihood that existing residents are displaced.

Effective Policies:

1. Define a clear and feasible approach

2. Balance affordability requirements with incentives

3. Enable simple administration and developer participation

Considerations

Tax incentives are flexible tools that can be adapted to support affordability.

Impact

Tax incentive policies vary greatly depending on how they are structured and targeted. It is important to ensure that the units developed due to an incentive would not have been built otherwise. This is typically referred to as a “but for” test and is an important analysis to ensure that limited public resources are used effectively.

DIRECT APPROACH

A direct approach functions as an operating subsidy – each dollar of tax abatement provided can result in an additional dollar of affordability per unit. This is an expensive option for municipalities, especially in areas with a substantial number of lower-income households where there is a large gap between what households can afford and the rent required to build and operate the unit. In these cases, a direct approach is most effective when complemented by other sources of subsidy.

SUPPLY APPROACH

A supply approach has an indirect impact on affordability by increasing the overall supply of housing through incentivizing a developer to build by removing the tax liabilities for a set period on an entire property. The new market-rate units help prevent rents in existing properties from rising. Depending on a jurisdiction’s existing market conditions, the impact of increased supply on affordability can be substantial.

Market

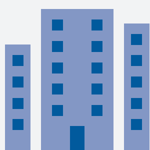
DIRECT APPROACH

A direct approach can work in any market. Municipalities need to decide if the net benefit of an incentive outweighs the cost of the foregone revenue.

SUPPLY APPROACH

A supply approach is more effective in a weaker market where rents do not support new construction. Providing tax incentives reduces the amount of financing a project would require, lowering required rents.

Housing Goals



UNITS PRICED AFFORDABLY

AVOIDING DISPLACEMENT

INCREASING QUALITY OF HOUSING STOCK

MIXED-INCOME NEIGHBORHOODS

Tax incentives are a flexible tool and can help meet a variety of policy goals. Carefully targeted requirements and policy design are key to ensuring that tax incentives work effectively.

Recommendations

1. Effective tax incentives have a defined and feasible approach to increase affordability.

Tax incentive policies should not only be limited to units that receive other federal and state subsidy sources. Combining tax incentive policies with other public funding sources like discounted loans, federal funding, or a local housing trust fund can leverage funding and allow a local government to set rents that are affordable for households with very low incomes. However, allowing apartments that are not receiving other public funding to access tax incentives expands the number of units that are available at below market rents. These tax incentives may be targeted toward middle-income households.

Tax incentives should be geographically targeted based on market conditions. Like other affordability tools, tax incentives should be responsive and adaptive to the market. Incentives that require high levels of affordability will not be effective in weaker markets, while there is a risk of over-subsidizing low levels of affordability in stronger markets.

Using incentives to drive investment in Philadelphia, PA

Philadelphia's tax incentive policy is designed to induce development by applying a 10-year tax incentive to address weak market conditions coupled with the fourth-highest construction costs in the country.[1] The program started in 2000 and applies across both rental and for-sale communities. Development increased by 376% in Philadelphia since the incentive took effect,[2] while Philadelphia suburbs without the incentive saw an 11% decrease in building activity. A report by JLL found that every $1 in tax revenue foregone through initially abated property results in $2 of net revenue through the resultant effects of the policy.

Philadelphia's program offers a blueprint for relatively weak-market cities looking to boost development and increase housing supply.

The flexibility of tax incentives should be used to create an approach customized to a market. In markets where the supply of housing is limited by a lack of developable land, a direct approach is best. However, a supply-based approach may be most effective in markets where housing is not being created for middle-income renters because prevailing market rents cannot support development costs. In these cases, an operating subsidy reduces the rent required for a project to be feasible and supports new production.

Tax Incentive "tiers" in Jersey City, NJ

Jersey City, NJ has had a development boom since 2000. However, growth has been uneven – neighborhoods with existing transit have developed the most, while others are still losing residents.

In response, the City enacted a tiered tax incentive in 2013 that grouped neighborhoods into four tiers, based on prior development activity. Tier 1, with the most development, has a tax incentive term of 10 years and 10% set-aside for affordable housing. Tier 4 neighborhoods have a tax incentive term of 30 years with 15% set-aside for affordable housing to protect existing residents. This program is designed to allocate tax-incentive dollars to maximize development and equitably distribute affordable and market-rate housing.[3]

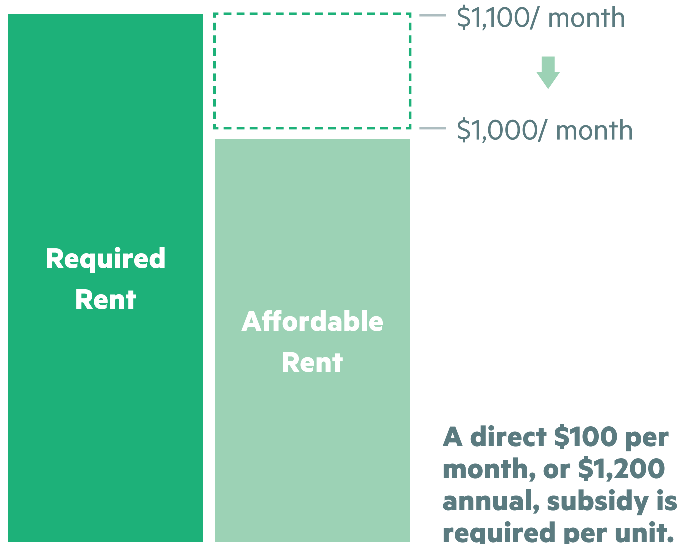
1 ENR.com
2 BIA Building Industry Association, 2017
3 Misra, Tanvi. Citylab, 2015

Recommendations

2. Effective property tax incentives are balanced with affordability requirements.

Successful tax incentives can have economic, fiscal, and policy benefits that outweigh the implementation costs and foregone tax revenue. Property tax incentives should be considered like other economic development-focused tax incentives that cities employ to attract business and investment. Residents that have lower housing costs are likely to stay in their neighborhoods and reinvest their income into the local economy, creating a multiplier effect that can benefit the entire community.

Property tax incentives with a direct approach should set the incentive to match the level of affordability the policy is aiming to achieve. Without an equitable match, a developer would not be incentivized to participate in the program. For example, consider a hypothetical policy designed to reduce rent by $100 per month for a targeted income group. An effective tax incentive to support housing for this group would have to be approximately equal to the reduction in rent. In this instance, if the tax incentive is valued at less than $100, then developers are not incentivized to produce the affordable unit, while incentives valued more than $100 would not be an efficient use of public revenue.



Effective direct property tax incentives carefully evaluate the time period of the incentive to ensure that it aligns with the larger policy goals of the incentive. Programs may have an initial period that can be extended through a longer-term exemption. Many cities also designate the timing of the incentive based on the specific geographic area in which the development is taking place.

To target deeper levels of affordability through a property tax abatement, incentives should allow tax reductions for market-rate units to cross-subsidize units at deeper levels of affordability. In strong markets, market-rate units can shift tax incentives allocated toward a mixed-income building toward deeply affordable units, allowing for the unit to be affordable at lower incomes.

Cross-subsidizing Affordability in New York

As the quintessential "strong market," New York City has always tried to reconcile high demand with limited land. The 421-a program allows full property exemption for 35 years if 25-30% of the units are reserved for low- to moderate-income tenants. The property exemption on the market rate units allows for deeper levels of affordability for the subsidized units, which have a larger gap between the rent required and what households can afford to pay. This program has been a significant part of Mayor de Blasio's affordable housing plan and is important to achieving the City's goal to build or preserve 200,000 below-market-rate apartments by 2022.

Recommendations

3. Effective property tax incentives enable simple administration and developer participation.

Tax incentives should rely on a rule-based approval process. These programs should be designed to work in tandem with an existing development process that is predictable and limits discretionary review. Clear and consistent affordability requirements can keep tax abatement programs from being an additional regulatory hurdle for developers. If tax exemptions require a negotiation, developers and city stakeholders should have clear guidelines over the terms of such a negotiation.

Administrative simplicity influences the effectiveness of tax incentives. Administering policies with greater complexity and difficulty requires more time and resources. An onerous process also discourages developers from participating in a program and developing units.

Policies should keep income documentation and reporting requirements simple and should not replicate burdensome federal requirements. Tax incentive requirements are locally controlled and are not required to follow the complex requirements of federally funded programs. Many local governments default to existing federal requirements for income documentation and monitoring requirements. Complying with overly complex income documentation and monitoring requirements can require additional staff and training, creating a significant cost for developers to participate in the policy.

Resident selection processes should not impede the process of filling rental housing. Resident screening requirements for eligibility to occupy an income-restricted unit should be clear and easy to incorporate into the standard screening process. Identifying income-eligible residents can be a significant added cost for property owners. To reduce costs, local governments should work with a nonprofit partner to identify a pool of eligible residents from which property owners can draw. Policies must also manage the legal regulations of the incentives. They need to ensure that developments that do not adhere to policy requirements lose incentive status and pay back the abated tax revenues to the city through a process known as a “clawback.” This type of feature can help assuage local opposition to tax incentives, which are sometimes perceived as a “giveaway” to developers.

Recommendations Summary

To design effective property tax incentives, a city should take a three-tiered approach.

1) EFFECTIVE TAX INCENTIVES HAVE A DEFINED AND FEASIBLE APPROACH TO INCREASE AFFORDABILITY.

- Tax incentive policies should not only be limited to units that receive other federal and state subsidy sources.
- Tax incentives should be geographically targeted based on market conditions.
- The flexibility of tax incentives should be used to create an approach customized to a market. In markets where the supply of housing is limited by a lack of developable land, a direct approach is best.

2) EFFECTIVE PROPERTY TAX INCENTIVES BALANCE AFFORDABILITY REQUIREMENTS WITH INCENTIVES.

- Successful tax incentives can have economic, fiscal, and policy benefits that outweigh the implementation costs and foregone tax revenue.
- Property tax incentives with a direct approach should set the incentive to match the level of affordability the policy is aiming to achieve.
- Effective direct property tax incentives carefully evaluate the period of the incentive to ensure that it aligns with the larger policy goals of the incentive.
- To target deeper levels of affordability through a property tax abatement, incentives should allow tax reductions for market-rate units to cross-subsidize units at deeper levels of affordability.

3) EFFECTIVE PROPERTY TAX INCENTIVES ENABLE SIMPLE ADMINISTRATION AND DEVELOPER PARTICIPATION.

- Tax incentives should rely on a rule-based approval process. These programs should be designed to work in tandem with an existing development process that is predictable and limits discretionary review.
- Administrative simplicity influences the ability of tax incentives to be effective.
- Policies should keep income documentation and reporting requirements simple and should not replicate burdensome federal requirements.
- Resident selection processes should not impede the process of filling rental housing.

Economics of the Tool

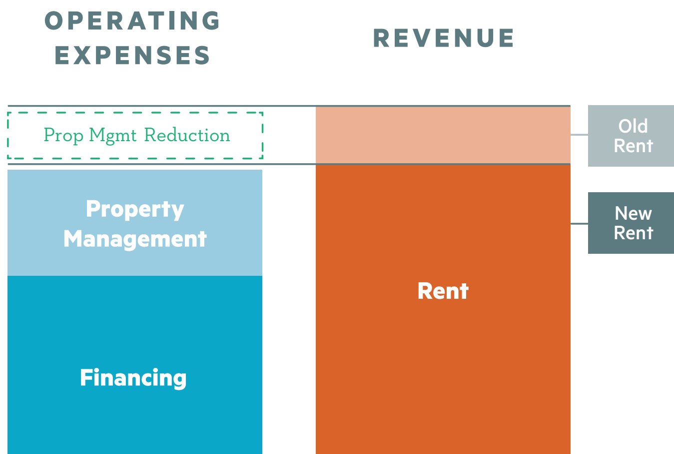
Tax incentive policies are designed to reduce operating expenses and the resulting rent required.

Direct Approach: Reduced Operating Expenses

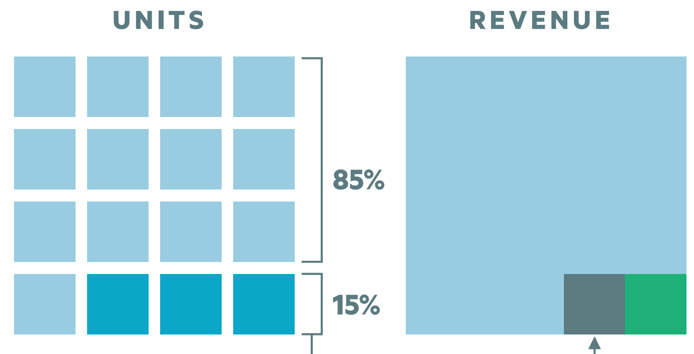
Tax incentives impact property management expenses directly by reducing the annual property tax paid by an owner. Lower property management expenses may also help underwrite more favorable financing terms.

A reduction in these costs leads to a lower amount of operating expenses required and a lower required rent to make the project viable. Policies that require affordability as a condition of tax incentive must ensure that the reduction in rent can be offset by the savings in operating expenses.

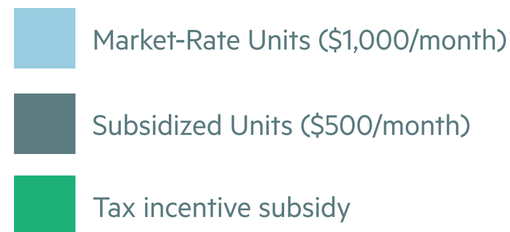
If the required rent for a project is $1,000 per month and a program is designed to create units that are affordable for households earning $30,000 or less, tax incentives must account for $250 per month per unit to make the project feasible. For this program to help 1,000 households, it would cost the city $3 million annually, plus additional administration costs, for each year that the units remain affordable.



For a mixed-income building, direct property tax incentives can be used to increase affordability for some of the units. For a hypothetical 100-unit building, if the required rent for a project is $1,000 per month and a program is designed to ensure that 15% of the units are affordable to households earning $20,000 or less (at $500 per month), a tax incentive could provide a tax incentive of $75 per unit. The market-rate units would be able to reallocate these savings toward the 15 units to account for their reduced rents.



With tax incentives, 15% of the units only need to account for 7.5% of the required rent



Economics of the Tool

Tax incentive policies are designed to reduce operating expenses and the resulting rent required.

Supply Approach

Tax incentives can increase affordability indirectly. As supply increases, it reduces competition for existing housing and leads to lower rents. This indirect impact can be significant. Below is the estimated[1] impact of a 1% increase in housing supply on rents and the number of households who would be able to afford rental housing as a result.

City	Decrease in share of units <$800 since 2000 (percentage points)	Effect of 1% increase in supply: Reduction in rent	Effect of 1% increase in supply: Increase in affordability (by households)
Atlanta	15.7	0.63%	690
Sacramento	19.5	0.98%	720
Minneapolis	15.1	0.95%	780
Denver	20.9	0.98%	1,300
Pittsburgh	21.1	1.19%	730
San Antonio	19.3	0.82%	720
Seattle	14.5	1.02%	1,500
Tampa	26.8	1.00%	580

1 A 2018 study by the Bay Area Council Economic Institute ("Solving the Housing Affordability Crisis") evaluated the effect of various housing policies based on the number of households for which housing would become affordable as a result of the policy, using a 30% housing cost burden assumption. The report evaluated the responsiveness of price to changing the supply through policy. Using a similar method, HR&A evaluated the number of households for which housing would become affordable, given a 1% increase in the overall supply of the eight case-study cities.