

# **Pennsylvania Intergovernmental Cooperation Authority**



## **From Virtual Realty to Full Value Realty: Preparing for Reassessment**

**PICA Issues Report**

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**PENNSYLVANIA INTERGOVERNMENTAL  
COOPERATION AUTHORITY**

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## **From Virtual Realty to Full Value Realty: Preparing for Reassessment**

Within the next year, the assessed value of every property in Philadelphia is likely to change. How the Mayor and City Council manage that change will have broad implications for taxpayers and City government for years to come.

Assessed values will change because the Board of Revision of Taxes (BRT) is doing a reassessment of all properties. After the BRT is finished, all properties will be assessed at their full value instead of at the fractional value at which properties are now valued.

Moving to full value is a key step towards making the real estate tax system more fair and more understandable. If done correctly, this change will bring about a marked improvement to the real estate tax system. The change, however, also raises important issues including:

1. Will the Mayor and City Council use the switch to change the amount of Property Tax revenues collected?
2. Will the switch result in an increase in the amount of debt that the City issues?
3. Will the City be able to get necessary state legislation to allow it to change the School District's portion of the millage rate?

As this report will detail, PICA's key recommendations are:

1. The City should not use the increase in assessed values to increase property tax revenues unless those increased revenues are used to reduce other taxes. Any attempt to use the reassessment to increase the overall amount of taxes collected by the City would likely increase opposition to an essential change to how property taxes are levied in Philadelphia.
2. The City should not use the increase in assessed values to issue more debt.
3. The City must work with the Pennsylvania General Assembly and the Governor's Office to change a law that prohibits the City from reducing the School District portion of the property tax millage rate.

### ***What is the Board of Revision of Taxes Doing?***

The BRT plans to reassess every property in the City and base the assessment on the full value of the property. This will be a dramatic change from the current approach under which owners are given assessments that equal only a portion of their full values.

Under the BRT's current procedures, a property's assessed value is different from its full value in a couple of ways. First, the market value that the BRT assigns to a property is typically equal to about 70 percent of the value of that property. Second, that reduced market value is multiplied by the pre-determined ratio, which is equal to 32 percent of the reduced market value, to get the assessed value. The end result of that process is an assessed value that is less than a quarter of the market value of a property. This makes it

unreasonably difficult for taxpayers to understand how the assessed value relates to the actual value of their homes.

Once the new method is in place, homeowners will get assessments that make sense to them. The assessment values will relate directly to the market value of a property.

**The current Process looks like this:**

$$\text{(Actual BRT Value)} \times \text{(70\% BRT adjustment)} \times \text{(32\% predetermined ratio)} \times \text{(millage rate)} = \text{tax owed.}$$

*Results in a confused taxpayer*



**The Full Value Process will look like this:**

$$\text{(Actual BRT Value)} \times \text{(millage rate)} = \text{taxes owed}$$

*Results in a knowledgeable taxpayer*

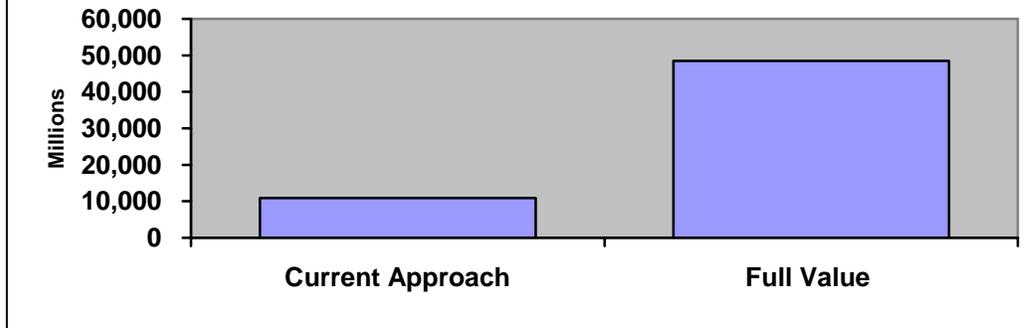


***What Issues Will The Change Create?***

**Assessments will Increase**

The dramatic increases in assessed values resulting from the elimination of the adjustments to market values will create a firestorm of protest unless taxpayers understand that the increased assessments will not necessarily lead to increased taxes. The tax bill will be dependent on the millage rate set by the City's elected officials. Depending on what those officials decide to do with millage rates, taxpayers could see their property's assessed values increase, but their tax bill decrease. The BRT has already begun an educational campaign to explain the new system and the Administration and Council should help explain the importance of the change and its likely impact on voters.

## The BRT's New Assessment Approach Will Dramatically Increase the Assessed Values of Properties in the City



If millage rates are not changed, property tax bills will increase dramatically. If, for example, the full value assessment approach had been in place in FY2005, but millage rates had not been changed, combined School District and City property tax revenues would have been about \$3.4 billion – roughly \$2.6 billion higher than actual FY2005 collections. Of that \$2.6 billion in increased collections, about \$1.5 billion would have gone to the School District and approximately \$1.1 billion would have gone to the City's general fund.

While it is unlikely that the City will pursue a policy that leaves millage rates unchanged and increases total general fund tax revenues by over 30 percent, the City has several options for dealing with the increased assessments, including the following:

1. Council and the Mayor could agree to set the millage rate at a level that will ensure that the General Fund and School District will each receive the amount of revenue that they would have received under the current assessment system including natural growth in tax collections (Attachment A shows an example of how this could work). Using this approach would allow taxpayers to know that any changes in the amount of taxes they pay are solely the result of the change in assessments and not part of a plan to increase the amount of revenue that the City's general fund or the School District receives.
2. Council and the Mayor could agree to set the millage rate at a level that will allow the General Fund and/or the School District to generate more revenue than they receive under the current assessment methodology and could use that added revenue to increase spending. If Council and the Mayor follow this strategy,

taxpayers may think the entire reassessment process was an excuse to raise taxes. This is the scenario that is likely to lead to the most negative reaction from taxpayers, and seems least justified given the current tax burden on the citizens of Philadelphia.

3. Council and the Mayor could agree to set the new millage rate at a level that would generate more revenues than does the current real estate tax system, and could use the additional revenue to change the City's distribution of tax revenues. So, for example, the City could set the millage rate at a level that would lead to an increase in real estate tax revenues and could use the added revenues for some combination of business privilege and/or wage tax rate reductions. In this scenario, total tax revenues would not change, but the amount of revenues generated by specific taxes would. The appeal of this strategy is that it would allow the City to pursue a comprehensive change to its tax structure at a time when it will have to be addressing at least part of that structure anyway.

Whichever approach the City takes, there will be strong resistance to the change. Even if the City successfully calibrates the change in the millage rate so that there is no change in total revenue from what would have been collected, there will be taxpayers who see increases in their bills. Some payers will see those increases because in addition to eliminating the previously cited 70 percent and 32 percent adjustments, the BRT plans to make its base assessments more accurately reflect market values. While these new assessments will result in a more equitable system they will result in higher tax bills for some and lower tax bills for others.

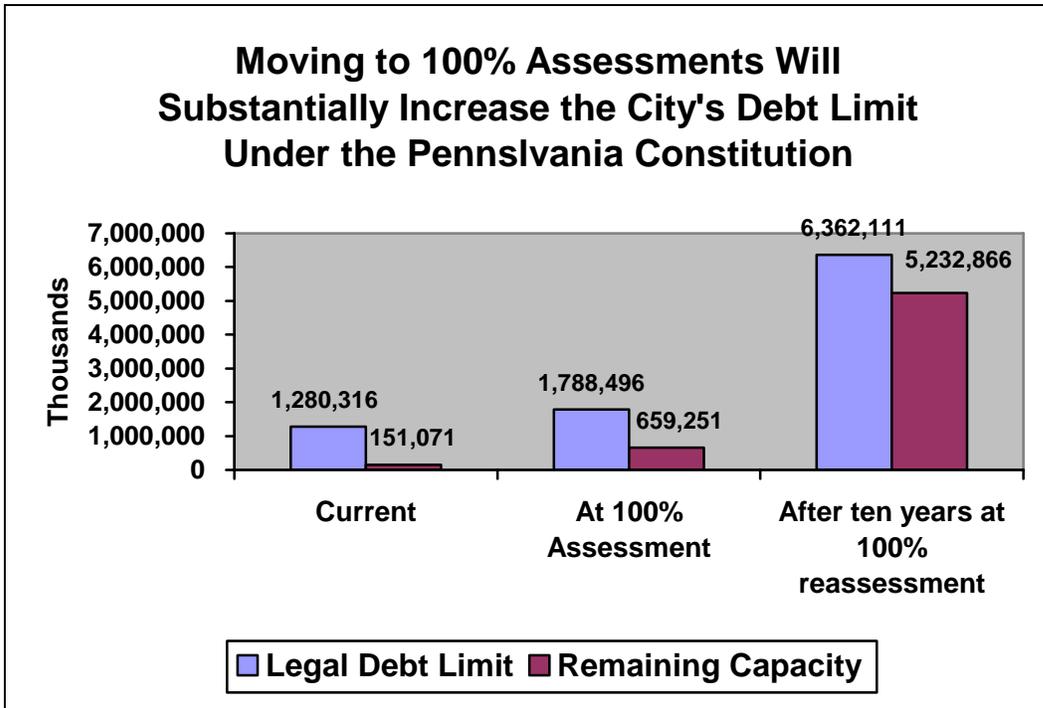
It would be unwise of the City to pursue a policy that would heighten the resistance to the scheduled change. As a result, it would not make sense for the City to use the change in assessment policy to generate additional property tax revenues, unless taxpayers could understand that the additional revenues were being used to lessen another portion of their tax burden.

### The City's Constitutional Debt Limit Will Increase

The increase in assessments would, in theory, allow the City to issue additional debt. Under the Pennsylvania Constitution, the City's debt limit is equal to 13.5 percent of the ten year average of assessments. In the City's last financial statement, the remaining legal debt margin was \$151.1 million out of a capacity of \$1.3 billion as of July 1, 2004.

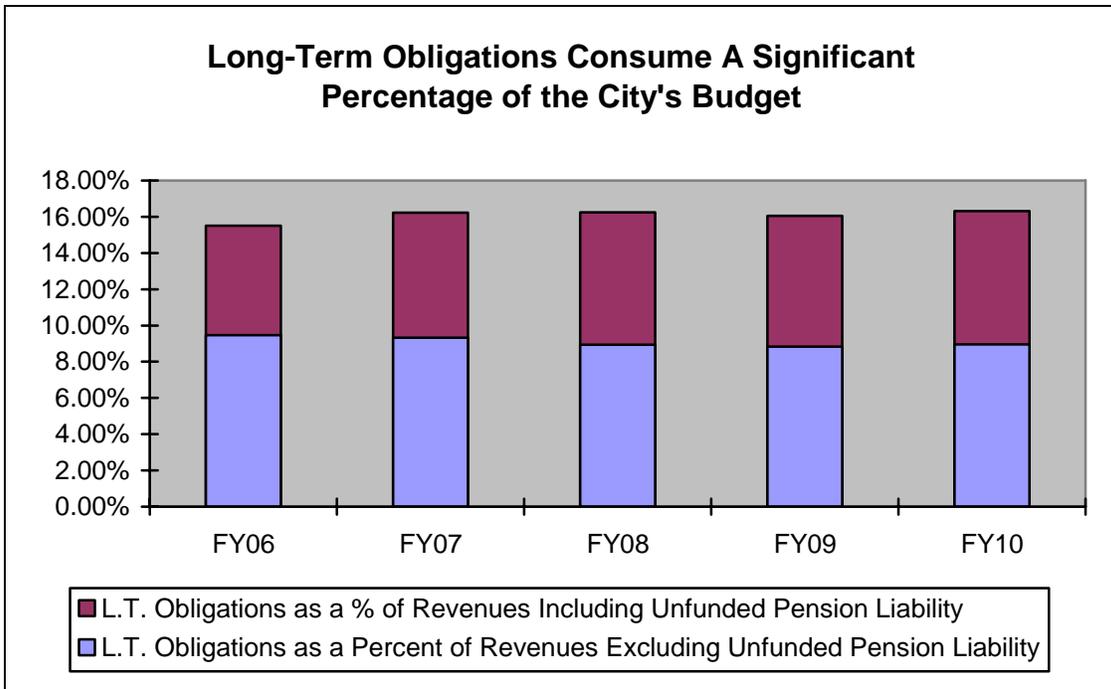
When the BRT moves to 100 percent assessments, the 10-year average assessment will increase substantially. Even though averaging the change over ten years will slow the growth of the city's constitutional borrowing capacity, the increase will be dramatic. In the first year, even without any growth in the underlying values of properties, the City's constitutional debt limit will increase by about \$500 million. In ten years, even without any growth in values, the debt limit will increase by approximately \$5 billion, which is almost a 400 percent increase in the amount of debt the City now has outstanding that is

subject to the debt limit. In essence, the constitution will no longer provide any meaningful check on the City's debt issuance.



While the constitution will allow the City to increase its debt burden, it would be a serious financial mistake for the City to pursue such a policy. As detailed in various PICA Staff reports, the City already has a dangerously high debt burden.

A good way to measure the City's debt burden is to compare the amount the City spends on debt service and other long-term fixed obligations each year to the amount of revenue it collects each year. In FY2006, the City will be spending close to 10 cents out of every dollar on debt service and other fixed obligations. In addition, the City will spend another six cents out of every dollar it collects on long-term accrued unfunded pension liabilities. Like debt service, accrued unfunded liabilities are a fixed cost; the City cannot reduce its unfunded pension liabilities during the course of a fiscal year. As more and more of the budget is dedicated to the kinds of costs that cannot be cut during the year, the City will have fewer and fewer choices when it is faced with making mid-year corrections to bring its budget into balance.



If the City uses the increased constitutional debt limit to further increase its debt, it will be adding even more strain to its budget and raising additional concerns about its financial health. Before new assessment levels are reached, the City must establish a coherent debt policy which relies more on its ability to pay than on the constitutionally mandated limit. PICA plans to issue a white paper that will address the City's competing challenges of having an excessive debt burden while at the same time failing to invest adequately in its facilities.

The City Must Ensure that the Pennsylvania General Assembly Amends the Legislation That Codified the Commonwealth Takeover of the School District

The Distressed Schools Act of 1998, as amended (commonly referred to as Act 46), set the guidelines for the Commonwealth's takeover of the School District. Under Act 46, the City is prohibited from reducing the District's portion of the millage rate. After the BRT has completed its reassessment, the taxes generated by the School District portion of the current property tax millage would increase by about \$1.5 billion.

The drafters of the School District legislation must not have intended for the bill to be used to generate an additional \$1.5 billion for the School District. Instead, they likely meant to ensure that the amount of money going to the School District did not decrease and that the share of real estate tax revenues going to the School District would not decrease. The City should work with the General Assembly and the Governor's Office to make sure that the intent of the original legislation is preserved, but in a way that allows the City to reduce millage rates for the School District.

**Appendix A**

**What Does Revenue Neutral Mean?**

	2005		2007	
	Old Approach	New Approach	Old Approach	New Approach
Market Value Base	30,845,184,528	44,064,549,326	32,854,559,349	46,935,084,785
Predetermined Ratio	32%	100%	32%	100%
Millage Rate	0.08264	0.01851	0.08264	0.01851
Taxes Levied	815,694,736	815,694,736	868,832,251	868,832,251
School District Portion	473,102,947	473,102,947	503,922,706	503,922,706
City Portion	342,591,789	342,591,789	364,909,545	364,909,545

The market value number in the 2005 column is taken from a BRT PowerPoint presentation of the full value project. The 2005 Adjusted market value number assumes that the the numbers in the 2005 column equal 70 percent of full value.

The 2007 numbers assumed the real estate tax growth rate included in the FY06-FY10 Five-Year Plan.