



HOUSING OPPORTUNITY FUND FUNDING STREAM ANALYSIS

Pittsburgh Community Reinvestment Group

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INTRODUCTION

Creating a successful Housing Opportunity Fund (HOF) is a goal that PCRG and its members strongly support. Affordable housing availability and preservation is major hurdle to an equitable, inclusive reinvestment strategy in Pittsburgh's neighborhoods. However, a successful HOF requires reasonably stable, predictable, and dedicated yearly funding. In May 2016, Pittsburgh's Affordable Housing Task Force (AHTF), in which PCRG participated, laid out several possible funding streams, each with varying amounts of yearly funding and ease of authorization. These options range from state-authorized increases in the hotel and local service taxes, to increasing the real estate transfer tax, tax increment financing (TIF) burnout, and a small increase in property taxes. An annual City budget appropriation was considered a non-starter.

Taking the City's budget and any state enabling legislation off the table, the most logical place to look next is a locally available tax or fee to levy. Nationally, the most common choices for housing trust funds are real estate transfer taxes (RETT), with a deed recordation fee coming in second. However, a RETT is a regressive tax, meaning that low-to-moderate income (LMI) buyers and sellers will have to devote a higher portion of their income relative to the sale value than would a higher income individual.

Another potential source of revenue outlined in the AHTF report is an increase in the City of Pittsburgh's millage rate. The report suggests a 0.50 mill increase, which would gross around \$8 million a year given current conditions. However, much like the RETT, property taxes are regressive. There is also the additional burden of political feasibility to consider when raising property taxes, especially in light of recent assessments.

Other options explored below are an anti-speculation tax and impact fees on new developments. Both options are feasible in Pittsburgh, but will be unable to stand alone as a method to meet the \$10 million goal for the HOF. An impact fee is the sole funding option that is not directly regressive, but given the scale of new development in Pittsburgh, it will not gross enough to be the primary source.



FUNDING OPTIONS

RETT

The current norm for paying the RETT in the City of Pittsburgh is as follows:

- 1) 4% of the sale price is levied; 1% goes to the state, 2% to the City, and 1% to Pittsburgh Public Schools. For example, if a home sells in Garfield for \$70,000, the RETT will equal \$2,800. \$700 goes to the state, \$700 to PPS, and \$1,400 to the City. An additional 1% would add \$700 to the closing costs.
- 2) The RETT itself is paid at closing and cannot be distributed over the life of the loan. The current convention is that the “transfer stamp” is paid in full, and split by the buyer and seller. However, a buyer or seller could offer to pay the tax in full, if an incentive to purchase or sell is needed on either side.
- 3) Should the closing costs on the property, including the RETT (either the whole or half amount) be financially unfeasible, the buyer can find a zero closing cost mortgage. However, these have become rare since 2008, and carry a higher interest rate, roughly .25%-.75% depending on the applicant’s credit. This results in paying out more than the initial closing costs over the life of the loan.
- 4) Currently, there are no exceptions for avoiding its payment, i.e. low- income/elderly/disabled waivers. Creating such a waiver would require state authorization.

Criticisms of RETTs are remarkably consistent, and boil down to just a few points:

- 1) Fairness – A high RETT puts a disproportionate burden on LMI home buyers and sellers.
- 2) Volatility – Excise taxes, which a RETT is, are notoriously volatile and subject to the whims of the market. In 2010, Pennsylvania’s RETT revenues were down 31%, while general tax revenue was only off 7%. Anything that cools the market will reduce home churn, reducing ultimately the revenue generation of a RETT. In 2015, the City received \$22 million in deed transfer taxes, \$4 million higher than was budgeted. However, over the last decade, Pittsburgh’s RETT revenue varied by as much as \$10 million. Only \$12 million was collected in 2012.
- 3) Tax avoidance – RETTs can encourage homebuyers and businesses to locate on the other sides of municipal and county borders where taxes are lower.
- 4) Housing affordability – The down payment and transaction costs associated with purchasing a home can be formidable, especially for LMI buyers. A flat 5% RETT means thousands of more dollars will have to be allocated toward the home’s closing costs, which means less money for down payment, insurance, renovations, utilities, and other acquisition and move-in costs.
- 5) Narrow tax base – Only a small percentage of Pittsburghers buy or sell a house each year, meaning that the impact is not spread equitably across the general tax base. It is hard to get an exact figure for the City, but in 2015 around 9% of housing units were bought and sold. While a property tax is regressive, it is borne equitably, and it results in the funding of programs and initiatives that benefit the public at large. While the HOF may be beneficial to the public, it is not a benefit specifically to those paying the tax.



PROPERTY TAX

City of Pittsburgh residents' property taxes (PT) total 22.88 mills, meaning nearly \$23 dollars is paid per \$1,000 of assessed total value. It breaks down thusly:

- 8.06 mills to the City;
- 9.84 to the Pittsburgh Public Schools;
- 4.73 to Allegheny County;
- 0.25 to the Carnegie Library of Pittsburgh.

Unlike the RETT, PT revenue in Pittsburgh has been reasonably stable over the last ten years. In 2015, the city received \$138 million in PT, which was close to the expected budgeted amount. The lowest amount collected over the last decade was in 2013 at \$125.7 million; the highest was in 2012 at \$139 million.

The AHTF recommended a 0.50 increase in millage, which would be dedicated to the HOF. If PT payments remain stable, this should net around \$8-9 million per year. What this would mean for the homeowner in Garfield with a house assessed at \$70,000 is an additional \$35 in taxes per year.

INCLUSIONARY ZONING AND IMPACT FEES

Inclusionary zoning (IZ), the practice of changing city and/or municipal zoning codes to encourage economic desegregation, has swept across American cities over the last 15 years. The most widely used IZ tool is an impact fee, meaning a developer must set aside a certain number of affordable units (typically pegged to a certain percentage of Area Median Income) or pay a fee. The calibration of that fee is crucial – set too low and it becomes another cost of doing business and does not adequately fund the HOF; set too high and it could result in political upset and a cooling off of the housing development market.

Cities typically structure their impact fees in one of two ways – either an amount per square foot or an amount per unit. In Philadelphia, a \$2.20/sq. ft. impact fee on new market-rate sale and rental units was proposed.¹ This is fairly modest compared to some of the fees levied in some California cities, which can top \$50/sq. ft.² If that impact fee were to pass in Philadelphia, it is expected to contribute around \$6.8 million per year to their housing trust fund.³ Considering the creation of new housing in Philadelphia is much more robust than Pittsburgh, to say nothing of the sheer size of Philadelphia's market vs. Pittsburgh's, we would have to set our impact fees higher to come close to matching the \$6 million they would net.

¹ *Housing Impact Fees: A New Strategy to Keep Communities Strong*. Rep. Philadelphia Coalition for Affordable Communities, 2016. Web.

² "San Francisco Citywide Development Impact Fee Register." *San Francisco Planning Department*. San Francisco Planning Department, 1 Dec. 2016. Web.

³ *Housing Impact Fees: A New Strategy to Keep Communities Strong*. Rep. Philadelphia Coalition for Affordable Communities, 2016. Web.



In a Brookings Institute white paper on IZ and impact fees, they found that, “while impact fees often do not reflect the full price of infrastructure improvements, fees do make the economic linkage between those paying for and those receiving benefits more direct, and so promote economic efficiency.”⁴ Additional findings indicate that impact fees do not slow job growth in the local economy, and increase the supply of buildable land.

One thing that impact fees seem unable to do is encourage the creation of affordable units by developers in their new buildings. It is incredibly difficult to compel the addition of below-market units, and cities with far more robust housing markets and stronger local governments have failed. Chicago has had in-lieu impact fees since 2007, and in the last several years it has generated \$19 million in revenue, but only 247 affordable units.⁵ The focus should be on the fee, not the creation of affordable housing within market-rate developments.

ANTI-SPECULATION TAX

Anti-speculation taxes have found limited purchase in American cities. Harvey Milk, former San Francisco Supervisor, conceived of them as a way to slow the creation of too many multi-family units (ironically, more multi-family units would actually be helping the housing crisis in that city right now). One city currently entertaining the idea is Philadelphia, though its structure bears little resemblance to the one created by Milk.

In order to prevent developers from buying up homes in gentrifying neighborhoods and selling them off quickly for a profit, the Philadelphia Coalition for Affordable Communities (PCAC) has proposed a 1.5% increase in the RETT applied to the sellers of flipped properties. “Flipped” is defined as a house bought and resold within a 24 month period.

In a large and thriving market like Philly, this will likely not deter flipping, but it will at least make something good come from the flip. PCAC estimates that this antispeculation tax could add an additional \$12 million to their housing trust fund every year. It is currently working its way through their city council.⁶ If we applied this to Pittsburgh and the HOF, it would mean an additional \$2.8 million per year.⁷ Therefore, an anti-speculation tax can be, at best, a part of the funding solution.

PA STATUTE AND OTHER AREAS’ POLICIES

Pennsylvania’s tax code includes several dozen exclusions from the 1% RETT collected (Pa. Code § 91.193); none of them deal with issues of equity or potential regressiveness of the tax. Major excluded parties include property being transferred within families, judicial sale, foreclosure, transfer to a trustee, and a transfer between religious organizations. The majority of the state’s portion of the tax goes to the General Fund, though 15% is

⁴ Nelson, Arthur C., and Mitch Moody. "Paying for Prosperity: Impact Fees and Job Growth." *Brookings*. Brookings, 28 July 2016. Web. 12 Dec. 2016

⁵ Podmolik. Marv Ellen. "Developers Face Bigger Fees If They Miss Affordable Housing Quota." *Chicago Tribune*. Chicago Tribune, 8 Dec. 2014. Web.

⁶ Hahn, Ashley. "Advocates for Affordable Communities Call for Anti-speculation Tax." *PlanPhilly | Advocates for Affordable Communities Call for Anti-speculation Tax*. PlanPhilly, 31 Mar. 2015. Web. 12 Dec. 2016.

⁷ Pittsburgh REALStats Data, 2015.



earmarked for the Keystone Recreation, Park, and Conservation Fund, a state program that gives grants for the creation of libraries and historic preservation projects.

The most common tool for preventing the RETT from being an undue burden on low-income buyers and sellers is a price floor, i.e. not taxing transfers below a certain amount. New York City sets this at \$25,000, meaning the overwhelming majority of property transfers in the city are taxed. New York sets two different RETT rates depending on value – residential property under \$500,000 pays 1%, and anything over owes 1.425%.

In New Jersey, the payment of the RETT by the seller is a prerequisite for recording the deed. The tax is typically collected at the real estate closing by the legal representatives or title insurance agents responsible for recording the deed. Not only is New Jersey's RETT very low - .5%-1% - it is split between the county and state. If the seller is a senior citizen, blind, disabled, or low-income, the state forgoes their portion.

Washington State funds their AHTF through the capital budget and is paid for by selling bonds that are paid off over time. This is on top of the state's real estate excise tax which is levied on all properties equally and is set at 1.28%.

ANALYSIS

Any sort of flat tax, by its very nature, is regressive. I have found no examples where it is assumed that the cost of the RETT be will folded into the long-term payment on the property, i.e. the burden is amortized over several years. The RETT is always paid when closing, and in full, with monetary penalties in place in bigger cities for a failure to do so. It is up to the buyer to take out a mortgage that pays for their closing costs, RETT included, if they are unable to provide the funds at the time of closing.

Finding reliable data on the impact of a higher RETT on the market is challenging, and truly depends on analyst interpretation. One study of Philadelphia's RETT found that "housing prices generally fall by an amount which covers the tax in the short-run" due to the inelastic supply of housing.⁸ Further, the National Association of Realtors has repeatedly funded studies that connect higher RETTs to lower sales prices. In a sense, a high RETT can make the market more affordable if it actually does depress sales prices. That is fine for the buyer, but is a punishment to the seller, especially if we are espousing homeownership as a way for LMI Pittsburghers to build wealth.

While a RETT is common source in other cities and states for funding affordable housing, their rates are universally lower than Pittsburgh's (or Pennsylvania's for that matter). More to the point, their lower RETT is typically dedicated to fund one thing, be it affordable housing, nature conservation, etc. Pittsburgh's RETT is already being split three ways, and soon to be four if the HOF is included. Both the high amount and degree to which our fund is split up makes it anomalous.

⁸ Chervin, Stan, Reem Abdelrazek, Theresa Gibson, and Harry Green. *Local Realty Transfer Taxes: An Analysis of SB 1250/HB 0885*. Rep. The Tennessee Advisory Commission on Intergovernmental Relations, n.d. Web.



Much like the RETT, property taxes are also regressive. The Institute on Taxation and Economic Policy selected Pennsylvania as the 6th worst state in the nation when it comes to tax inequality, meaning that incomes are less equal after state and local taxes than before. In PA, the lowest quintile loses 3.8% of their income to property taxes, while the top 1% loses only 1.6%.⁹ Despite this, Pittsburgh's population is large enough that a very small increase in the property tax – even just a 0.25 mill increase – could make a large dent in the \$10 million needed for funding the HOF.

Impact fees should absolutely be considered as part of the HOF's funding strategy, but we should leave behind the idea that the fee is given in-lieu of the creation of affordable units. When an impact fee is an option, it seems that developers almost always select it. This is not to say that below-market units should be discouraged, but we should focus more on getting the impact fee right. The Philadelphia Coalition for Affordable Communities may be a resource for Pittsburgh's own efforts.

Pittsburgh's housing market is faring well on the whole, but is highly uneven from neighborhood to neighborhood. Therefore, the RETT's impact on neighborhood markets will also be uneven and could cool the overall market slightly. While that might be a benefit in rapidly gentrifying neighborhoods like Lawrenceville and East Liberty, the cooler market areas may be resistant to a devaluation of their homes due to higher taxes. It is also unclear whether a 1% increase in the RETT will be stable and large enough to accomplish the goals of a future housing trust fund. There is also the less quantifiable impression such a high tax gives people looking to purchase property in Pittsburgh, and could further incentivize people to locate outside city bounds.

CONCLUSION

PCRG and its members want to make homeownership and its attendant wealth generation available and affordable to all Pittsburghers. We believe that relying solely on a 1% increase to the RETT to fund the HOF puts too high a burden on LMI buyers and sellers. It also locks the HOF into only one source – a volatile one – and does not build resiliency into the HOF's ability to achieve its goals. Given this, it seems like pursuing a multipartite funding strategy is the best path to take. A 0.25 mill increase in property tax, a 0.25-0.5% increase in the RETT, and the creation of developer impact fees could easily fund the HOF. The 0.25 mill increase and a 0.5% RETT increase would contribute around \$7 million per year. TIF burnout and impact fees could easily make up the additional \$3 million needed. Ultimately, a mixed stream funding strategy seems like the most prudent choice. The cost of the HOF could be successfully distributed across current homeowners, businesses, developers, and home buyers and sellers if we can accept the complication of a multi-stream funding structure.

⁹"Pennsylvania – The Institute on Taxation and Economic Policy (ITEP)." The Institute on Taxation and Economic Policy (ITEP), n.d. Web, 12 Dec. 2016.