Special Report

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The Importance of Economic Development in Boston

Heavy reliance on the property tax makes development a high priority

Highlights

- From FY08-13, new growth was 50% or more of the total tax levy increase in three of those six years and 49% in a fourth year
- Business value in the Back Bay, Downtown proper and Seaport District grew by $1.02B from FY08-13 representing 75% of all business growth
- Business property currently makes up 34.8% of the tax value, but pays 60.8% of the tax levy

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This report on the importance of economic development in Boston is the first of a series of reports that will be issued during this year's campaign for Mayor and City Council. Each report will provide the key facts of the topic and conclude with questions the Bureau believes the candidates should address during the campaign.

Boston relied on the property tax for 66.5% of its operating revenue in fiscal 2013. Boston's dependence on the property tax has grown over the past 20 years as state aid, the City's second largest revenue source, has declined as a share of total General Fund revenues. Under the rules of Proposition 2½, Boston depends on new growth to increase the property tax levy beyond 2.5% each year. Because of new growth, the average annual increase in the property tax levy over the six years from fiscal 2008 to fiscal 2013 was 4.8%, almost twice the Proposition 2½ limit.

Under these conditions, the City's fiscal health and its ability to balance the budget and finance new programs or initiatives relies, in good part, on new growth – new development, major rehabilitation, conversion of a property from tax-exempt to taxable status, and personal property tax growth. Based on the City's application of the classification of property, business properties generate a disproportionate share of the total tax levy due to a business tax rate almost three times larger than the residential rate and the higher absolute values of commercial properties in Boston. Through linkage, new commercial development generates additional revenue for affordable housing and job training. These properties also impose less of a cost burden for city services such as schools, public works, and parks.

Indeed, property taxes from commercial properties, especially in the downtown core, subsidize city services provided to the neighborhoods. Of the total taxable business value of $32.1 billion in fiscal 2013, $26.6 billion or 83.1% is located in Downtown Boston (Ward 3), Back Bay (Wards 4+5) and the Seaport District of South Boston (Ward 6). Business property located in these four Wards also generated 50.5% of the City's total property tax levy. In addition, commercial development contributes to creating a vibrant City through providing job growth and increasing housing demand.

The next Mayor's approach to new development, along with disciplined financial management, will play a critical role in maintaining the City's fiscal health as the demands on city services increase and unfunded liabilities are addressed. Important to development success in Boston are policies regarding the operation of the Boston Redevelopment Authority (BRA) and refinements in the City's Zoning Code. The new Administration's policy concerning real estate tax incentives, development exactions, mitigation review, Greenhouse Gas regulations and capital funds will also affect the growth of new development projects in Boston.

Overall Benefits of Development

In general terms, strong economic development contributes to making Boston a more vibrant city with the expansion of jobs and a greater demand for housing. Employment and housing growth broadens support for the City's cultural, entertainment, athletic and visitor activities. This report focuses, however, on the direct financial benefits to the City due to economic development, both private and institutional.

Reliance on the Property Tax

The property tax is Boston's largest revenue source totaling $1.64 billion in fiscal 2013, which represents 66.5% of its total operating revenue of $2.47 billion this year. Boston relies more on the property tax now than it did in 1981, the last year before the full implementation of Proposition 2½, when the property tax represented 60.9% of all General Fund revenues.

Table 1

Boston Value Summary

Values in Billions

Class	FY12	FY13	Change FY12-FY13	% Change FY12-FY13
Residential				
Condominiums	$24.1	$24.8	$0.7	2.8%
Single-family	$11.6	$12.1	$0.5	4.5%
2-3 Family	$12.1	$12.5	$0.4	3.5%
All others	$3.4	$3.8	$0.4	12.6%
Multi-Family	$6.3	$6.9	$0.6	9.3%
Total Residential	**$57.5**	**$60.1**	**$2.6**	**4.6%**
Business				
Commercial	$25.9	$26.8	$1.0	3.8%
Industrial	$0.6	$0.6	$0.03	4.8%
Personal	$4.5	$4.6	$0.1	1.5%
Total Business	**$31.0**	**$32.1**	**$1.1**	**3.5%**
Total Value	**$88.5**	**$92.2**	**$3.7**	**4.2%**

Boston's total taxable property value for fiscal 2013 is $92.2 billion, a $3.7 billion or 4.2% increase over the prior year. The net property tax levy generated from this value in fiscal 2013 totals $1.64 billion after $41.1 million is set-aside for abatements and uncollected taxes (overlay).

At $92.2 billion, Boston's taxable value in fiscal 2013 is the highest since fiscal 2009, the last year that the total value peaked at $90.4 billion.

Property Tax Levy - Under Proposition 2½, the property tax levy can increase by 2.5% over the prior year's levy limit as long as the levy is below 2.5% of the total taxable value. In addition, the levy can increase from new development, major rehabilitation of a building, or conversion of tax-exempt property to taxable status, all of which are exempt from these caps. Because Boston's property tax levy is below 2.5% of the City's total taxable value, the City's fiscal 2013 tax levy was able to increase by $40.4 million or a full 2.5% over the prior year's levy limit. Each year the City has raised the tax levy to the maximum level possible without seeking an override. New growth increased the tax levy by $28.7 million in fiscal 2013. Together, the gross tax levy increased by $69.1 million to $1.684 billion in fiscal 2013. Subtracting the overlay of $41.1 million produces a net tax levy for operations of $1.643 billion, an increase of $65.4 million or 4.1% over the prior year.

Table 2

Tax Levy Growth

Figures in Millions

	FY12	FY13
Prior Year Levy Limit	$1,540	$1,615
2 1/2% Levy Growth	38.5	40.4
New Growth	36.5	28.7
Total Levy Limit	**$1,615**	**$1,684**
Net Tax Levy	$1,577	$1,643
Levy Ceiling	$2,213	$2,305

New Growth - New growth, primarily from new construction of taxable property, is a critical component of the annual tax levy increase. During the last six years (FY08-FY13), new growth represented 50% or more of the total tax levy increase in three of those years and constituted 49% of the levy increase in a fourth year. The levy increase from fiscal 2008 to fiscal 2013 was $215.7 million from the 2.5% levy increase and $197.1 million from new development. Consequently, the average annual levy increase over the six years was 4.8%, far more beneficial than an annual increase of only 2.5% without new growth.

Table 3

% of Levy Limit Increase
FY2008 - FY2013

	2 1/2 Levy Growth	New Growth	Total
FY08	50.2%	49.8%	100%
FY09	50.3%	49.7%	100%
FY10	54.2%	45.8%	100%
FY11	49.2%	50.8%	100%
FY12	51.3%	48.7%	100%
FY13	58.4%	41.6%	100%

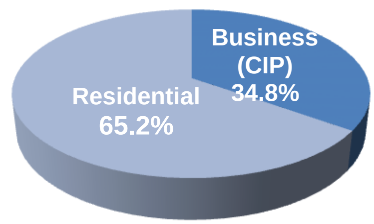
A change in the status of a property from tax-exempt to taxable also constitutes new growth. Two recent examples of this situation include the expiration of the 121A tax-exempt status of the One Beacon Street commercial tower building and the purchase of Caritas (St. Elizabeth's Medical Center and Carney Hospital) by Steward Health Care System to be run as for-profit hospitals. The upgrading or expansion of utility property and audits by the Assessing Department have resulted in new growth of personal property (mostly equipment and other business fixtures). Condominium conversions in prior years also have generated new growth. The current year values of the new growth properties are multiplied by the prior year's tax rate to calculate the levy growth for that year.

Boston experienced less new growth in fiscal 2013, partly due to Boston being in between construction cycles in 2011. The new growth total of $28.7 million is a decrease of $7.8 million or 21.4% from fiscal 2012. Nevertheless, new growth represents 41.6% of the total tax levy increase in fiscal 2013.

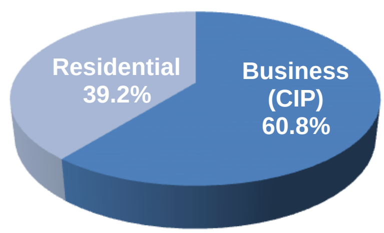
Classification – The classification of taxable property in Boston makes the development of commercial, industrial and personal property (CIP) particularly beneficial. The Massachusetts property tax classification law allows the City to shift the property tax burden to business property up to 175% of what its share would be without classification as long as the residential share of the levy is not less than 50% of its full value share. The CIP share is now set at 175% of its full value share. In fiscal 2013, business property (CIP) represented 34.8% of the City's taxable value and paid 60.8% of the tax levy. Residential property represented 65.2% of the value and paid 39.2% of the levy.

Figure 1

Property Value Distribution FY13



Property Tax Levy Distribution FY13



The consequence of the application of classification is that the business tax rate is almost three times larger than the residential rate. Thus, the property tax revenue produced by new development for CIP uses is more advantageous to the City in terms of revenue generation than for residential property. The residential tax rate for fiscal 2013 is $13.14 per $1,000 of value and the business tax rate is $31.96 per $1,000 of value. A commercial property valued at $5 million would pay a fiscal 2013 property tax bill of $159,800, while a residential property at the same value would pay $65,700.

Benefits of Business Development – While new growth has enabled the City to annually raise property tax revenue for operations over the normal 2.5% levy increase, business development has added benefits for Boston. To illustrate the impact of property classification and the City's ability to shift the tax burden to business property, it's worth noting that, if taxes were determined at 100% of value using a single tax rate, business taxes would have decreased by $439.1 million or 42.9% in fiscal 2013 and be shifted to residential property.

Business property not only pays higher taxes because of absolute values and classification, but it also imposes less of a cost burden on the City. In contrast, residents consume much more in city services than they pay through the property tax. Business, especially commercial growth, cross-subsidizes low residential tax rates.

The concentration of business value in the Downtown, Back Bay and Seaport District of South Boston indicates the importance of development in these areas of the City. Of the total taxable business value of $32.1 billion in fiscal 2013, $26.6 billion or 83.1% is located in that downtown core area of Boston. The business value of $26.6 billion in these four Wards represents 28.9% of the City's total taxable value and $851 million or 50.5% of the City's total tax levy.

The growth of taxable business value over the five years from fiscal 2008 to fiscal 2013 also demonstrates the importance of development in these four Wards. During this period, the business value in the four Wards increased by $1.02 billion which represented 74.5% of the total growth in business value in Boston.

Tax Benefits for Homeowners – Boston homeowners are the beneficiaries of the City's application of property tax classification and the residential exemption which, together, have reduced the average single-family tax bill to less than 50% of what it would have been without these tax savings. Each Boston residential unit that is the domicile of the owner is eligible for a residential exemption equal to 30% of the average value of a single-family home. In FY13, the residential tax exemption is set at $1,724, which is the equivalent of reducing the property value of the home by $131,238. In FY13, the initial average single-family tax bill would have been $7,234. However, classification reduced the bill by $2,029 and the 30% residential exemption reduced it further by $1,724, resulting in a final tax bill of $3,481, a reduction of 51.9%. The average value of a single-family home in FY13 is $396,115, which means that the tax bill represents 0.88% of the average home value. In a survey of Boston and 18 surrounding communities, Boston's average single-family tax bill ranked the 3rd lowest.

Other Development Related Revenues

The primary revenue benefit of new development for Boston is additional property tax revenue for city operations. However, other related benefits are tied to new development that provide non-property tax revenue that also supports city services or contributes to the creation of affordable and middle income housing construction.

Tax-Exempt Property - New development from Boston's large tax-exempt private institutions is also an important source of revenue for city operations through voluntary payments-in-lieu of taxes (PILOTs). Major development projects by the medical, educational and cultural institutions contribute to the local economy through jobs and the purchase of supplies and contractual services. The City's new PILOT program establishes a recommended voluntary payment based on property values. New development by the institutions would increase their value and the City's request. In fiscal 2013, the City received $23.2 million in PILOT payments from the 49 largest institutions, $8.1 million over fiscal 2011 receipts.

For large expansion or building projects, these tax-exempt institutions make Linkage payments to support affordable housing and job training programs. These institutions also pay building permits and other city charges.

Housing Creation – Economic development also contributes to the creation of affordable and middle-income housing in Boston from the City's imposition of development exactions through its

Linkage and Inclusionary Development programs. Linkage, authorized by state statute (Ch. 371, Acts of 1987), requires large-scale commercial developers in need of zoning variances to make a payment to the City or create an equivalent amount of affordable housing. Developers are required to pay $7.87 per square foot after the first 100,000 square feet which is designated for housing. From 2006 through July 2012, the Neighborhood Housing Trust, which is responsible for the distribution of the funds, awarded $47.8 million to assist in the construction of 2,950 affordable units.

The Inclusionary Development Program (IDP), authorized by Executive Order of the Mayor, requires a developer building a residential project of 10 or more units and requiring zoning relief by the City to make 15% of the market-rate units affordable to moderate and middle-income buyers or renters. In some circumstances, with the BRA's agreement, developers have complied with the IDP requirement by developing some or all of the 15% proposed market-rate units off-site and/or by paying the higher of either a per unit contribution of $200,000 or one-half of the difference between the price of the affordable unit and the price of the market unit. Since the inception of IDP in 2000, approximately 1,200 units of affordable housing have been created.

Building Permits – Revenue from building permits for development projects contributes to the City's operating revenue. In fiscal 2013, the City expected to receive $23 million from building permits. Actual building permit receipts totaled $32.6 million in fiscal 2012.

Job Creation

Linkage exactions also include an additional $1.57 per square foot after the first 100,000 square feet of a large scale commercial or institutional development project to support a variety of workforce development programs since 1987. The Neighborhood Jobs Trust (NJT) approves the distribution of these funds to nonprofit organizations which provide pre-employment job training, occupational skills upgrading to low wage workers, career counseling programs and adult literacy programs, including GED studies and English as a second language. From 2006 through July 2012, the amount of Linkage funds allocated to job training programs has totaled $4.8 million.

Other Development Tools

In order to facilitate private development in Massachusetts, the Commonwealth has authorized cities and towns to make tax incentives available under certain conditions. The City's utilization of these incentives will depend on how the Administration balances its fiscal and development policy decisions. These tax incentives include:

Property Tax Incentives – Using the BRA's authority under Chapter 121A and, to a more limited extent, Chapter 121B, the City can suspend standard property taxes, which vary year-to-year based on changes in assessed values and tax rates, and replace them with more predictable fixed payments for a term of years to facilitate project financing. In the case of Chapter 121A, payments are established by a separate agreement between the developer and the City based on a share of the project's investment return, generally for a term of 15 years. The developer also enters into a contract agreement with the City for a payment related to city services available to the development. By agreement between the City and the developer, the term can be extended to 40 years, as was done with many early subsidized housing projects. Revenue from Chapter 121A and Chapter 121B projects is additional development-related revenue not included in the property tax levy totals.

Recent projects that have benefitted from a 121A tax agreement include the State Street Bank building at Channel Center in South Boston and Boylston West in the Fenway. A similar tax agreement mechanism under Chapter 121B has been used for the Westin Hotel at the South Boston Convention Center and for Lovejoy Wharf.

Tax-Increment Financing – Authorized under state law (Chapter 40, Section 59), the TIF program allows a city or town, with state approval, to designate an area as a TIF zone because of the exceptional opportunities it provides for economic development and job creation. Once so designated, the municipality is authorized to enter into agreements with affected landowners for an exemption (abatement) from property taxes for up to 20 years in exchange for a commitment to develop or improve the property. The City's recently approved TIF agreements include the JP Morgan relocation in 2008, the Liberty Mutual headquarters in 2010, and Vertex Pharmaceuticals buildings in 2011.

District-Improvement Financing – The DIF program enacted in 2003 (Chapter 40Q) allows municipalities to designate a "development district" and pledge all or a portion of future increases in property taxes generated by development in the district to fund bonds that finance infrastructure improvements made to the district. Street improvements, water lines, and sewer systems are examples of what the bonds would support. A DIF agreement cannot exceed a period of 30 years. The DIF is intended to be utilized to stimulate private development that could not have occurred without public investment. To date, the City has not utilized the DIF for a development project.

Infrastructure Investment Incentive – I-Cubed is an economic development tool (Chapter 293, Acts of 2006) that ties the Commonwealth's payment of debt service for infrastructure bonds for local development projects to the increased state tax revenue generated from the creation of new jobs in the state from the development. If there is compelling evidence that the company would have relocated outside of the Commonwealth "but for" the I-Cubed financing, the income from retained jobs can be counted. If insufficient jobs are established to fund the debt service costs in full, the shortfall would be paid by the municipality. Because the I-Cubed program focuses on job growth, eligible development projects must include a commercial component that creates new jobs that generate new state tax revenues. I-Cubed was utilized in Boston in 2011 to assist Fan Pier Development LLC (The Fallon Company) in the Vertex development project. If the employment tax revenue from new jobs for this project fails to cover the debt service costs, the developer has agreed to assume the obligation. I-Cubed is an important alternative to tax incentives tied to the property tax, but by law is limited to only three projects for any municipality.

Capital Funding

When the Mayor submits the recommended operating budget for the next fiscal year, it is accompanied by an updated five-year capital budget that is financed by the issuance of city bonds and other resources. The capital budget can be an important tool to support economic development depending on the priorities of the Administration and how it manages the City's debt.

The Mayor's recommended FY14-FY18 capital plan totals $1.8 billion with city General Obligation bonds financing 71.8% of the total. The balance is made up from state (11.7%), federal (10.8%) and other (5.7%) sources. Capital spending by five departments represents 79.6% of the total capital budget plan over five years. The City does not devote capital funds for infrastructure improvements that would facilitate new economic development. Generally, the BRA's expectation in the Article 80 process is for the developer to provide the infrastructure improvements such as street lighting, sidewalks, roads and adequate parking, adding to the overall cost of development.

The City's high bond ratings and low interest rates make borrowing more feasible. This past February, Boston sold General Obligation bonds at 2.3%. Its credit ratings from Moody's Investors Service (Aaa) and Standard & Poor's (AA+) also were affirmed and are the highest in the City's history.

Zoning Code

The City's Zoning Code and the role of the Boston Redevelopment Authority (BRA) significantly influence what can be built in Boston and where. The Zoning Code informs real estate developers and owners what land uses, building types and sizes, heights and densities are appropriate on land throughout the city. The BRA can recommend to the Zoning Commission updates to the Zoning Code to manage growth and enhance the character of each neighborhood. The BRA is required to review, through a public process, the design of real estate developments and their effects on the surrounding community and the City as a whole, and to require appropriate conditions for approval of such projects.

The procedures and standards for the BRA review are defined by Article 80 of the Zoning Code. Article 80 review applies to Large Projects, Small Projects, Planned Development Areas (PDA), and Institutional Master Plans. The BRA serves as planning staff to the Zoning Commission. The Board of Appeal hears requests by developers for zoning relief and decides whether to grant them. How the local mitigation review process is managed and how many development exactions are imposed can have a real influence on the timeline for a project to receive final approval and on the ultimate cost and financial feasibility of the proposed development.

Conclusion and Questions

As a City that relies on the property tax for two-thirds of its operating revenue and depends on its property tax revenue to increase by more than 2.5% each year to fund its operating budget growth, Boston requires a steady flow of new development to maintain its fiscal health, balance its budget, provide basic services and finance any new initiatives.

New business development, especially for commercial development in the high-value urban core and now the Seaport District, is most beneficial to the City in terms of revenue generation. Business properties also impose less of a cost burden on their requirements for city services, thus providing a cross-subsidy to the neighborhoods of the City.

The next Mayor, intent on maintaining the fiscal health of the City and the delivery of basic services, will need to address the array of issues tied to the creation of new development in Boston and especially commercial development in the now broader downtown core. To that end, the Research Bureau offers questions that we would expect the candidates for Mayor to address during the current election campaign.

1) ***Zoning Code*** – As a base to start individual project negotiations, the code defines what land uses, building types and sizes, heights and densities are appropriate on land in Boston. What changes in the Zoning Code will you pursue as Mayor?

2) ***Article 80*** – As the section of the City's Zoning Code that defines the procedures and standards for BRA review of development projects, should Article 80 and/or the Community Review process be modified in any way?

3) ***Boston Redevelopment Authority*** – The BRA serves as the planning and development agency for Boston. Do you support the combined structure to manage the City's economic development or would you make substantive changes to this agency?

4) ***Density*** – What changes would you pursue in the allowable density and height in development projects in the downtown core or by the waterfront? Are there other areas of the city you would target for higher-density growth?

5) ***Infracture Support*** - What will be your policy in the use of available real estate tax incentives and the application of the City's capital funds to provide for infrastructure support to attract new development and jobs to Boston?

6) ***Exactions*** **–** How heavily would you rely on development exactions – project-specific mitigation measures and public benefits – in project approval decisions?

7) ***Housing Creation*** – The development of middle income or workforce housing is difficult to produce due to the high cost of land and construction. What would you do to lower or subsidize these costs?

8) ***Approval Process*** – In light of the importance of new growth to the City's economic vitality, how would you propose to streamline the approval process for development projects?

9) ***Climate Adaptation*** – What would you do to prepare the City for climate adaptation from severe storms or rise in the sea level to protect transportation, communication and energy services?