Pay Now or Pay More Later: St. Paul's Experience in Rehabilitating Vacant Housing

by Edward G. Goetz, Kristin Cooper, Bret Thiele, and Hin Kin Lam

Editor's Note: ***In March of 1996 the St. Paul City Council, eager to reduce government spending, cut in half the allowable subsidy for housing rehabilitation from a maximum of $40,000 per single-family house to a maximum of $20,000. The St. Paul Coalition for Community Development, a group of nonprofit corporations that implement the program, argued that it could not operate on that little amount of money, and that the reduction in funding was no better than eliminating the program altogether. Indeed, the number of renovations undertaken fell dramatically. In an effort to demonstrate a fiscal benefit to the city, the coalition solicited this study through NPCR. NPCR agreed to sponsor the study and as a result of its findings the council decided in August of 1997 to raise the maximum subsidy back to $35,000 per single-family house. Additionally, the council raised to $50,000 the maximum amount for a multiple-unit dwelling being converted to single-family use, which had been slashed the previous year from $60,000 down to $25,000.***

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An abandoned house is one of the most powerful symbols of urban decline, a visual reminder of the reluctance of families and institutions to invest their time, money, and futures in a community. It represents the abandonment of hope as well as of a physical structure. But despite the consensus that vacant homes are problematic for communities, there is far less agreement on what ought to be done about them.

By the time housing abandonment becomes a visible problem in most places, the levels of neighborhood decline, private sector disinvestment, and public sector neglect are usually well-advanced. Additionally, the level of investment necessary to turn around such properties is generally much greater than their market value, and thus the subsidy necessary to return abandoned homes to the marketplace may make local governments reluctant to invest in them. Given limited public funds available for housing and neighborhood revitalization, one may question whether local governments can afford such investment. However, as we will show, it may be equally important to ask whether they can afford not to.

There are three possible outcomes for an abandoned house in St. Paul: it can be demolished, it can be reoccupied by the owner or a new tenant in the private market, or it can be rehabilitated

The house on the left is the same house shown on page 12. It was rehabilitated with city funds under St. Paul's Houses to Homes program.

(or demolished and replaced) using funds from the city's Houses to Homes program. In a recently completed study of Houses to Homes, we examined the fiscal benefits and costs of a rehabilitation. Through the program, the city had been spending an average of $42,000 more on purchasing and restoring vacant homes than it had been receiving back on the sale of the properties, and in this study we attempted to determine how much of that $42,000 comes back to the city in other forms.

Using a variety of data sources, we were able to estimate and compare several costs and benefits over a twenty-year period for each of the three outcomes. There were many areas of financial impact to consider and, when possible, we produced a wide range of estimates. All monetary values are calculated at a 5 percent discount rate—the approximate cost of capital to the city of St. Paul according to December 1996 municipal bond rates.

The Tax Base

Perhaps the most obvious cost of vacant housing is the immediate loss of tax revenue because of the depressed value of the property itself. While the average estimated value of homesteaded residences in 1989 was $67,584 according to the Ramsey County Tax Assessor, vacant properties and lots are valued at a much lower level, thereby lowering the property tax assessment. We estimate that an inhabited, rehabilitated property would produce the current equivalent of $13,145 in total property taxes over twenty years, compared to only $1,148 for a vacant lot, and $5,650 for a reoccupied but unrenovated house. St. Paul's portion of these tax revenues would be $5,258 for rehabilitation, $459 for vacancy, and $2,260 for reoccupation. Rehabilitation of the property would thus yield more than double the revenue to be expected from an unrenovated reoccupation and more than eleven times the revenue of a vacant lot.

Neighboring Property Values

The decline in property value of an abandoned house may also depress the value of surrounding properties, further lowering the city's tax revenue. By constructing a price model of property values using county tax assessor's data, we were able to gauge this impact in the case of each outcome. We estimate that a property's value falls by $1300 if a demolition has occurred on the same city block and $1191 if a reoccupation has occurred. Rehabilitation, on the other hand, seems to stabilize nearby

This duplex was restored to a single family home (see opposite) under the Houses to Homes program.

property values and is not associated with any change in their level. Consequently, the depressive effect of a demolition costs the public sector an estimated $26,397 in lost property tax revenue over a twenty-year period, while $24,165 is lost from a reoccupation. St. Paul's share of these losses would be $10,599 for each demolition and $9,666 for each reoccupation, with no loss at all for a rehabilitation.

Private Investment

An abandoned home may discourage development in its area as well as deter surrounding property owners from investing in improvements to their properties. By analyzing data on building permits issued from 1986 through the summer of 1996, we were able to estimate the impact of the three outcomes on the rate of nearby private investment. An analysis of the permit data showed that rehabilitation spurred an increase while demolition and reoccupation did not. We took into account two factors that adjusted our estimates: typically only 30 percent of the total investment translates into market value in the neighborhoods, and building permits undercount the total amount of private investment that takes place. Making these adjustments, we estimate that the renovation of a property generates $13,507 in enhanced property tax revenues from private investment over a twenty-year period, while the absence of renovation produces no similar benefits. Of this revenue, $5,403 goes directly to the city.

Sales Tax Revenue

If rehabilitation generates greater levels of private investment than demolition or reoccupation, then it will also generate economic spin-offs from that investment that the other two outcomes do not. Chief among these is the money spent on building materials and the sales tax revenue to the state and the city that results from these purchases. We estimate that 30 percent of the value of the construction generated by rehabilitation goes to materials. Given an aggregate increase in investment over a twenty-year period, a total of $67,211 in sales tax revenue will be generated, $3,361 of which goes to the city.

Maintenance and Security

Once a vacant property is identified by the city and placed on its vacant housing list, health inspectors visit the site every two months. As a result of these visits, or in response to calls from concerned citizens, the city may perform maintenance tasks such as cutting the grass, picking up garbage, or shoveling the sidewalk. Because of health and safety concerns, the property may also be boarded up, and the city may incur costs in responding to police calls to the property. By analyzing data on service and police calls, we were able to estimate the cost savings associated with each of the three property dispositions. Using budget figures on per-call costs, we estimate that rehabilitation saves $7,141 in maintenance costs over a twenty-year period, while demolition saves $4,697 and reoccupation saves nothing. In terms of police costs, only demolition results in a sizable reduction in police calls, saving $4,169 in service costs over twenty years. All of these savings accrue to the city.

Tax Default and Foreclosure

When homes are abandoned by their owners, they frequently become tax delinquent, as the cost of paying property taxes can exceed the value of the

Rehabilitation of properties like this end up costing the city roughly half of the up-front renovation costs when the benefits of having the property restored are factored in. And the restoration actually produces a net gain in public benefits when all government units are considered.

property. After the property goes into tax forfeiture, ownership is transferred to the state and any outstanding taxes must be written off. While some of these losses may be recouped at the auction sale of the property, it is the experience of St. Paul that 83 percent of the balance due is lost on foreclosed properties. By examining the tax history of land parcels where homes have been demolished, we estimate that the typical demolition costs the city $8,043 in unpaid taxes.

Taking all of these areas into account, our estimates suggest that a housing rehabilitation costing $42,000 up front actually produces a net gain of over $59,000 in public benefits, while a demolition produces a total cost to the public sector of $24,426, and reoccupation costs $18,515. This amounts to a dramatic endorsement of public investment in the decaying housing stock. It is important to note, however, that the initial investment is made only by the City of St. Paul while the savings are shared across governmental units. For the city alone, rehabilitation ends up costing $20,837 (having recovered roughly half of its renovation costs), while the costs of demolition and reoccupation are $9,277 and $7,406, respectively. This is a compelling rationale for partnerships between different levels of government to combat the problem of housing abandonment.

In our analysis, the remedy for abandoned housing becomes much more obvious, for public sector funding creates a return that more than pays for itself. And the hidden costs of doing nothing, or of demolition, make the choice even more compelling in favor of rehabilitation. Paying for abandoned homes is unavoidable, but a proactive, development-minded approach can turn that payment into a profitable investment.

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This article is based on the full report of the St. Paul study—*The Fiscal Impact on the St. Paul Houses to Homes Program* (NPCR 1997)—available on NPCR's website (http://Freenet.msp.mn.us/org/npcr) or by calling 612/625-5584.

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