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# Measuring the Social and Economic Impact of Keystone Opportunity Improvement Zones and the Cira Centre in Philadelphia

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**Keywords**

Urban Studies, Philadelphia, social impact, economic impact

**Disciplines**

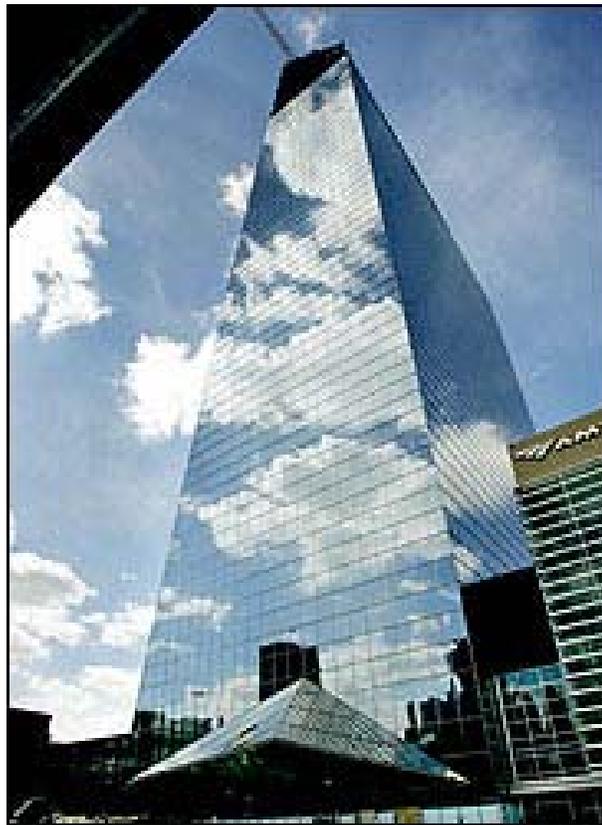
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## **PREFACE**

When initially faced with the task of deciding upon a research topic for my senior thesis, I was overwhelmed with possibilities. Writing a thesis in such a broad field with so few limitations allowed me to delve into what it was I was truly pursuing by majoring in urban studies. My preliminary task was identifying what general subject or topic in urban studies interested me most. I decided I was most intrigued by public policy and its effect on private development, economic stimulation, and real estate markets. Next, I had to isolate a disputed issue within this superset that was either lacking clarity or missing a crucial viewpoint from its arena of debate. I was able to narrow my topic to a study of the impact of Keystone Opportunity Improvement Zones (KOIZs) in Philadelphia or an economic analysis of rent regulation in New York City. I ultimately chose to study Keystone Opportunity Zone for four principal reasons:

1. I was particularly interested in learning more about the evolving relationship between Center City and West Philadelphia, and discovering whether the KOIZ ultimately helped facilitate a stronger bond between the two districts.
2. I felt that, by default, because the Cira Centre has only recently been completed, there exists less empirical research on the subject, leaving more room for original thought and analysis. Also, by shedding light on the social impact of the KOIZ I would be able to add a valuable perspective to the KOIZ argument that had previously been unexamined. On the other hand, both the social and economic implications of rent regulation had already been thoroughly vetted in previous research.

3. I was wary about the ease with which I would be able to gather primary data on a topic set in another city without visiting it with relative frequency.
4. Finally, I was concerned that my preconceptions about rent regulation would compromise my objectivity while researching and writing the paper, leading me to a foregone conclusion.

Taking all these factors into account, I decided that it would be more beneficial for me to pursue the issue of Keystone Opportunity Improvement Zones in Philadelphia more vigorously.

## I. INTRODUCTION

As the American economy has become increasingly transparent and globalized over the past few decades, city officials have had to innovate to attract new investment and prevent existing businesses from fleeing to rival markets.<sup>1</sup> What has evolved is a vicious bidding competition among urban areas across the country in order to attract and retain investment and development. In many cases, cities are even forced to compete with other urban and suburban areas within the same metropolitan statistical area (MSA). The ultimate goal of this competition of course is to stimulate economic growth and prosperity within the city, as well as alleviate the spatial mismatching of low-wage labor.<sup>2</sup> In order to entice businesses and developers, municipal and state governments have created an amalgam of lucrative economic incentives to be taken advantage of by prospective firms. These incentive programs include tax abatements, tax exemptions, construction subsidies, tax increment financing, low interest loan programs, development/empowerment zones, and general obligation bonds.

Philadelphia is no exception to the inter- and intra-regional cannibalism occurring throughout the country. Pennsylvania offers developers and investors a variety of attractive economic incentives to lure business into its cities. One of the more controversial state incentive programs is the Keystone Opportunity Zone (KOZ)

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<sup>1</sup> Walter H. Kirby, "City Needs Real Estate and Economic Incentives – Needed for Stimulation of New York, New York Construction Industry," *Real Estate Weekly*, January 24, 1994, [[http://findarticles.com/p/articles/mi\\_m3601/is\\_n25\\_v40/ai\\_14802646](http://findarticles.com/p/articles/mi_m3601/is_n25_v40/ai_14802646)].

Robert C. Turner and Mark K. Cassell, "When Do States Pursue Targeted Economic Development Policies? The Adoption and Expansion of State Enterprise Zone Programs," *Social Science Quarterly*, Vol. 88, No. 1, March 2007, pp. 86-103.

<sup>2</sup> Spatial mismatching of low-wage labor refers to the notion that lower employment rates and earnings among urban minorities can partially be attributed to their limited access to suburban jobs. As it relates to this topic, incentives can be used to draw to urban areas more attractive employers that would have otherwise located in the suburbs. See Harry J. Holzer, "The Spatial Mismatch Hypothesis: What has the Evidence Shown?" *Urban Studies*, Vol. 28, No. 1, February 1991, pp. 105-122.

initiative, which was established in 1999. KOZs are defined areas designated by local communities and approved by the state that offer reduced or no tax burden for qualifying residents and businesses over a predetermined period of time through 2018. A subset of Keystone Opportunity Zones are Keystone Opportunity Improvement Zones (KOIZs), which were established in the KOIZ Act 217 of 2002. KOIZs differ from KOZs in the designation process: in KOIZs, the areas are designated by Executive Order from the governor and subsequently approved by the local communities instead of vice versa for KOZs. KOIZs proposals were made to the local communities by January 1, 2003, and if accepted were implemented on January 1, 2004. KOIZs are eligible to run until December 31, 2018.

In order to qualify for benefits, businesses from Pennsylvania locating in a Keystone Opportunity Improvement Zone must either increase their full-time employment by 20% within the first complete year of operation, or make a 10% capital investment in the KOIZ property based on the gross revenues they generated in the prior year.<sup>3</sup> Therefore, if an existing Pennsylvania business wishes to relocate into a KOIZ, it must either substantially expand its employee base, or it must make a considerable monetary investment into the community in which the KOIZ is situated. The Pennsylvania Department of Community and Economic Development asserts the KOIZ designation is intended to attract development to areas where little to no activity or growth existed beforehand.<sup>4</sup> The goal is for this development to not only improve the economic status of the designated area, but to also produce spin-off taxable activity

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<sup>3</sup> “Keystone Opportunity Zone: Program Guidelines and Application.” Pennsylvania Department of Community and Economic Development, September 2007, 3.

<sup>4</sup> “Business Assistance Programs,” Pennsylvania Department of Community and Economic Development, 2006, 11.

outside the designated zone. In practice, opportunity zones and other similar programs have been met with only marginal success in several cities across the United States. There exists a great deal of debate over whether these incentives are actually effective long-term solutions or merely temporary fixes that are in fact detrimental to the city and its taxpayers.

In my research, I have examined the social and economic impact of the Keystone Opportunity Improvement Zone program implemented by the state of Pennsylvania in the city of Philadelphia. My investigation has particular focus on the recently constructed Cira Centre office tower in the University City area as a representative case study. Through the benefit of the Keystone Opportunity Improvement Zone incentive program, in November 2005 the Cira Centre had the privilege of becoming the first high-rise office building in Philadelphia constructed outside of Center City. Many local officials, businesspeople, and residents have expressed skepticism as to whether the use of the KOIZ to foster development indeed has a beneficial net effect on the city as a whole. My research question reads as follows:

**With specific focus on the Cira Centre, what is the social and economic impact of the Keystone Opportunity Improvement Zone designation in Philadelphia? Have these efforts succeeded in linking Center City with West Philadelphia and stimulating commercial development?**

It is important to approach this question from both a social and economic perspective. Most previous studies regarding tax incentives focus solely on direct economic

stimulation and correlation without accounting at all for possible spillover and intangible externalities related to the programs. Certainly, positive economic stimulation and realization of expected tax generation are two fundamental and obvious goals of economic incentive programs. However, it is often overlooked whether the participants in the program are able to fulfill the local and social requirements stipulated in program's guidelines. For example, the KOIZ conditions require sites to devise a plan for improvement of local schools. It is necessary to examine whether the goals of the initiative are being fulfilled, as this speaks to the success and effectiveness of the program overall. Additionally, isolated economic results do not necessarily translate into improvement of the welfare of the community or the city. I hoped to determine not only the Cira Centre's impact on Philadelphia as a whole, but also on the specific community in which it resides. Important determining factors include economic stimulation, future development and real estate appreciation, and local perception.

After examining all of the data and statistical inputs related to the issues enumerated above, I have determined that the implementation of Keystone Opportunity Improvement Zone tax benefits to aid the construction of the Cira Centre has proven to have a positive social and economic impact on the city and the surrounding community, and acted as a catalyst for the revitalization of the Philadelphia office market. Examining the Cira Centre's KOIZ designation is especially interesting and important because it is located near the heart of one of the largest and most prosperous cities in the nation. The purpose of this research is to help clarify to Philadelphian legislators, community leaders, and citizens the true effects of the Keystone Opportunity Improvement Zones on overall welfare of the city. This information can affect future decisions about whether or not to

use this incentive program to attract further development within the city. It is also useful in determining possible amendments to the program that will make it more conducive to use within Philadelphia.

The strengths and weakness of the KOIZ program (which is discussed *Section VI. Conclusion*) can usefully be applied to other cities' and states' decision-making process regarding economic incentives. On a national level, this study hopefully provides some suggestion of how opportunity zones in general fare in larger post-industrial cities. Clearly, the success of the Cira Centre does not necessarily imply that opportunity zones are the best incentive solution for every city and every circumstance. However, important conclusions can be drawn from what scenarios and situations caused the use of the KOIZ with the Cira Centre to prosper. Additionally, it is important to realize underlying tax and policy implications that could potentially dictate the outcomes of zoned incentive programs. The success of Cira Centre does show that opportunity zone initiatives can be extremely efficacious, the important questions addressed in this study relate to the set of circumstances that allowed this success to occur.

## II. LITERATURE REVIEW

Since their inception, state and municipal incentive programs have provoked a plethora of scholarly debate over whether they deliver the economic and social benefits they promise. Cities have experienced mixed success using economic incentives, so no clear consensus has been reached regarding their efficacy. While they vary from state to state, opportunity, enterprise, and empowerment zone programs like KOIZs extend federal, state, or municipal tax reductions to developers and businesses that locate in areas designated as experiencing economic distress or adversity.<sup>5</sup> Tax instruments commonly used include property tax abatements, sales tax exemptions, and income tax credits, deductions, or exemptions. The goal is to bring economic opportunity and sustainable community development into these troubled areas.<sup>6</sup> Grant applicants often include municipalities, redevelopment authorities, non-profit economic development organizations (like Community Development Corporations), or other non-profits, with newly located businesses being the ultimate beneficiaries. There has been a great deal of literature both in support of and in opposition to this particular form of incentive – the jury is still out as to its true impact. Also unclear are its effects on cities of different size and level of economic prosperity.

Zoned incentive program have been particularly controversial because of their sweeping nature. Often, instead of granting the exemptions on a case-by-case basis, the exemptions are non-performance-based and given to any and every business that locates in the zone regardless of their background. Other forms of tax incentives generally vary

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<sup>5</sup> Deirdre Oakley and Hui-Shien Tsao, “A New Way of Revitalizing Distressed Urban Communities? Assessing the Impact of the Federal Empowerment Zone Program,” *Journal of Urban Affairs*, Vol. 28, No. 5, November 2006, 444.

<sup>6</sup> Alan H. Peters and Peter S. Fischer, “The Effectiveness of State Enterprise Zones,” *Upjohn Institute for Employment Research*, October 2002, 1.

from case to case, are performance-based, and often identify a very narrow and specific goal. For example, Pennsylvania offers a Research and Development Tax Credit program that provides a 10% tax credit of a company's increased research and development expenses over a base period.<sup>7</sup> Chicago has had success with Tax Increment Financing (TIF), which issues bonds against the projected tax revenue derived from the development back into the project so that the amount of money given to the developer is directly tied to the successfulness of the project.<sup>8</sup> These kinds of incentives are typically employed state or citywide. Zoned incentives then, in a sense, are simply geographically targeted adaptations of more traditional state and local economic incentive programs.<sup>9</sup>

There is no shortage of critics with countless arguments enumerating why the implementation of tax incentives can only hurt a city. Critical literature contends that the initial tax revenues lost through these programs is never fully recovered, and that any capital generated by new businesses is not equitably reinvested.<sup>10</sup> John Anderson and Robert Wassmer believe that while according to the Tiebout hypothesis<sup>11</sup> some competition is efficient, competition between neighboring cities sometimes becomes so intense that businesses become overvalued and incentives are therefore exceedingly lucrative.<sup>12</sup> They argue that firms will purposely engage intra-regional municipalities in a bidding war to gain an incentive package with the preconceived notion of choosing one

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<sup>7</sup> "Business Assistance Programs," Pennsylvania Department of Community and Economic Development, 2006, 14.

<sup>8</sup> Craig L. Johnson and Joyce Y. Man, eds., Tax Increment Financing and Economic Development: Uses, Structures and Impact, (Albany: State University of New York Press, 2001), 3.

<sup>9</sup> Alan H. Peters and Peter S. Fischer, "Tax and Spending Incentives and Empowerment Zones," New England Economic Review, March/April 1997, 121.

<sup>10</sup> John Anderson and Robert Wassmer, "Bidding for Business: The Efficacy of Local Economic Development Incentives in a Metropolitan Area," Upjohn Institute for Employment Research, 2000, 20.

<sup>11</sup> The Tiebout Hypothesis asserts that based on game theory it is efficient for several local jurisdictions to provide local public goods because competition among jurisdictions will lead to near-optimal provision of services and improved outcomes for citizens in every jurisdiction.

<sup>12</sup> Anderson and Wassmer, "Bidding for Business: The Efficacy of Local Economic Development Incentives in a Metropolitan Area," 14.

over the other no matter what. Excess competition leads to a perilous “race to the bottom,” which would theoretically result in municipalities offering businesses tax-free residence.

Others detractors argue that incentives only provide temporary solutions until they expire and the companies attracted by the incentive move to another city with new incentives.<sup>13</sup> This is especially true when money is given leniently to smaller companies on the margin with low moving costs because they inject so little into the economy anyway. Dan Dabney reports that in reality incentives are of little importance in firms’ location decision, and that it is more important to invest this foregone tax revenue in infrastructure and social improvement that will provide long-term benefits to the city.<sup>14</sup> In turn, these changes will attract businesses because they provide firms with the resources and amenities they require to be successful. Finally, it is believed that opportunity zones are inequitable, at times, because they subjectively favor certain businesses with low fixed costs that are able to quickly move into the zone. Along the same lines, proprietors in adjacent neighborhoods in the same city are subject to potentially artificially induced competition.<sup>15</sup>

Defenders of opportunity zones assert that incentives are necessary in certain areas that have high property taxation and inadequate business services, which is a chronic deterrent to investment.<sup>16</sup> Supporters argue this shortage of new investment results in higher levels of taxes paid by the poor because of lack of mobility, and a lower

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<sup>13</sup> Alan H. Peters and Peter S. Fischer, “Tax and Spending Incentives and Empowerment Zones,” 114.

<sup>14</sup> Dan Y. Dabney, “Do Enterprise Zone Incentives Affect Business Location Decisions?” Economic Development Quarterly, Vol. 5, No. 4, 1991, 332.

<sup>15</sup> Natalie Kostelni, “Cira Centre 75% Leased Up: Lubert Adler, others lured by tax breaks,” Philadelphia Business Journal, April 8, 2005, [<http://philadelphia.bizjournals.com/philadelphia/stories/2005/04/11/story1.html?page=2>].

<sup>16</sup> Gwenelle S. O’Neal and Ronald A. O’Neal, “Community Development in the USA: An Empowerment Zone Example,” Community Development Journal, Vol. 3 No. 32, April 2003, 126.

level of local public services and employment opportunities. Thus, while municipalities would like to invest in infrastructure, they are unable to do so without significant revenue from a growing business sector. Additionally, incentives correct the market failure of mispricing of value of additional jobs in a city with high unemployment where each extra job is worth a great deal. In other words, cities with high unemployment are inherently more like to have underused public infrastructure, so each additional job is more valuable on the margin.<sup>17</sup> As it relates to tax zones, according to Terry Buss if zone policies correct market failures that inhibit efficient use of resources they can increase overall economic efficiency.<sup>18</sup>

Robert Guskind, a renowned urban planning expert, believes opportunity zones within cities can also help prevent sprawl, which moves tax revenue away from cities in need into wealthier suburban areas.<sup>19</sup> In this sense, the government is providing a check on an industry saturated by private firms that do not necessarily account for the social benefits and costs of their actions. Zoned incentives can particularly help local distressed areas be more competitive for new business locations than they otherwise would be in regards to the nature of the tax distribution system in any given state.<sup>20</sup> The idea behind these zones incentives is that as the cost of transportation and communication decreases, so does the value of the implicit urban benefit of agglomeration. Thus, as firms become more footloose, they become increasingly responsive to local costs like wages and taxes – which can be mitigated by incentives.<sup>21</sup> Guskind further argues that even if some

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<sup>17</sup> Anderson and Wassmer, “Bidding for Business: The Efficacy of Local Economic Development Incentives in a Metropolitan Area,” 9.

<sup>18</sup> Terry F. Buss, “The Effect of State Tax Incentives on Economic Growth and Firm Location Decisions: An Overview of the Literature,” *Economic Development Quarterly*, Vol. 15, No. 1, February 2001, 93.

<sup>19</sup> Robert Guskind, “Games Cities Play,” *National Journal*, March 18, 1989, 636.

<sup>20</sup> Timothy Bartik, “Incentive Solutions,” *Upjohn Institute for Employment Research*, February 2004, 16.

<sup>21</sup> Bartik, “Incentive Solutions,” 4.

incentives are inefficient, they are firmly embedded in today's public policy throughout the nation, and firms expected them. He explains that stonewalling businesses altogether usually results in economic stagnation.<sup>22</sup> The result, according to Timothy Bartik, is that without some kind of national agreement banning incentives, communities will continue to offer them with modest effect of business decisions, no added competitive advantage, and a net loss for government nationwide.<sup>23</sup>

As noted in the introduction, the most prominent recent development in Philadelphia taking advantage of Pennsylvania's Keystone Opportunity Improvement Zone incentive program is the Cira Centre on 29<sup>th</sup> and Arch Streets, adjacent to the 30<sup>th</sup> Street Station, the city's central regional train and mass transit hub. Developed by Brandywine Realty Trust, the Cira Centre was completed in November 2005, and is the first commercial office development in Philadelphia to have participated in Pennsylvania's Keystone Opportunity Investment Zone initiative. Benefits of the KOIZ package received by Brandywine Realty Trust include abatements from corporate net income tax, personal income tax, capital stock/foreign franchise tax, insurance gross premiums tax, bank shares tax, mutual thrift institutions tax, sales & use tax, business privilege tax, net profits tax, real property tax, and use & occupancy tax. Of abatements listed, the business privilege tax, net profits tax, real estate tax, sales & use tax, and use & occupancy tax are abatements from municipal taxes of the city of Philadelphia (the real estate property tax abatement is universally abated throughout the city for new development or improvement of residential and commercial properties). All of these abatements will continue in full through December 31, 2018.

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<sup>22</sup> Guskind, 635.

<sup>23</sup> Timothy Bartik, "Local Economic Development Policies," Upjohn Institute for Employment Research, January 2003, 18.

Another current development, the Comcast Center on 17<sup>th</sup> and JFK Boulevard, was denied KOIZ status by the state after it was determined that the property did not meet the program's criteria. Unlike the Cira Centre, since the project is already located in Center City, the state felt a KOIZ was an inappropriate designation and unnecessary to attract businesses to the site. Instead, the Comcast Center was given nearly \$30 million in infrastructure and construction-related subsidies. The Comcast Center is due for completion in early 2008, and is currently 96% pre-leased.<sup>24</sup>

Though state governments naturally defend the validity of their own programs, incentive zones countrywide often have been criticized for draining municipal funds without providing any economic stimulation or new job creation.<sup>25</sup> Alan Peters and Peter Fisher estimate that among the 75 enterprise zones they sampled in 2002, the effective tax rate on new construction decreased by 33%.<sup>26</sup> However, the extra incentive firms receive from the opportunity zone benefits is relatively small in terms of wage equivalent, so job creation is actually minimal. Additionally, these jobs are often filled by more affluent individuals from outside the zone.<sup>27</sup> Timothy Bartik notes that numerous studies have been done that conclude that business activity growth in zip codes with state-designated enterprise zones is only minimally higher than growth in zip codes without enterprise zones.<sup>28</sup> Wassmer and Anderson contend that competition is so fierce within each MSA that inner cities are forced to effectively engage in an arms race in order to

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<sup>24</sup> Fernandez, Bob, "Office Space in City Rebounds: The new Comcast building spurred fears of a glut," *Philadelphia Inquirer*, June 19, 2007, [<http://www.philly.com/philly/business/8064912.html>].

<sup>25</sup> Alan H. Peters and Peter S. Fischer, "The Effectiveness of State Enterprise Zones," 3.

<sup>26</sup> *Ibid.*, 1.

<sup>27</sup> *Ibid.*, 2-3.

<sup>28</sup> Bartik, "Local Economic Development Policies," 37.

lure companies away from fringe cities and suburbs.<sup>29</sup> This results in increasingly attractive offers to businesses with no regard for the negative effect on tax collection and provision for local infrastructure and education.

Therefore, it comes as no surprise that the Keystone Opportunity Zone program in Pennsylvania has received some unfriendly reviews from local economist and critics. The vast majority of literature regarding the Cira Centre development leading up to its construction was negative. One of the most vocal opponents was Kevin Gillen<sup>30</sup>, a Wharton real estate professor and Vice President of the Econsult Corporation economic consulting firm. He estimated that the development could cost the city \$44 million a year in tax revenue, much of which would “fall disproportionately on the Philadelphia School District, which is forecast to lose at least \$20 million per year regardless of how many existing office tenants the city manages to retain.”<sup>31</sup> He believes that the city is anticipating an unreasonable amount of stimulation and revenue from the building, and that for the deal to be lucrative the Cira Centre would have to perform almost impossibly well.

Similarly, in January 2004, the Philadelphia Center City District expected the city to lose between \$14 and \$24 million in tax revenue in 2007, and up to \$66 million by 2009 depending on the rate of business growth in Center City.<sup>32</sup> Both parties were concerned that Brandywine would simply fill the Cira Centre with tenants from existing

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<sup>29</sup> Anderson and Wassmer, “Bidding for Business: The Efficacy of Local Economic Development Incentives in a Metropolitan Area,” 13.

<sup>30</sup> Kevin Gillen’s studies regarding KOZs and KOIZs in Philadelphia (see bibliography) were commissioned independently of the Wharton School and Econsult Corporation and do not reflect the views of either organization.

<sup>31</sup> Kevin Gillen, “The Potential Fiscal Consequences of KOIZs on the Downtown Philadelphia Office Market,” April 14, 2004, 2.

<sup>32</sup> “The Impact of Keystone Opportunity Improvement Zones in or Adjacent to Center City,” Philadelphia Center City District, January 14, 2004, 1.

Central Business District buildings that are in search of a tax break. This in turn would decrease property values in Center City and increase vacancy rates citywide without creating any new jobs. Center City landlords complained vehemently that they were being stripped of tenants based on a subjective program that not only unfairly favors some developers and landowners over others, but also divests the city of money that it could be using to improve infrastructure.<sup>33</sup>

However, there has been very little antagonistic literature about the Cira Centre in the two years since its completion. In fact, several works have been cautiously optimistic about the future returns of the Cira Centre.<sup>34</sup> In a report commissioned by Brandywine, Econsult<sup>35</sup> estimates the Cira Centre has the potential to generate an extra \$11.9 million of local tax revenue annually between 2006 and 2018.<sup>36</sup> Furthermore, Econsult estimates that, through the Cira Centre, the KOIZ will produce an extra \$90 million in local tax revenue for the city of Philadelphia over the next 30 years compared with if the city had not implemented the initiative.<sup>37</sup> Defense of incentive programs like the Keystone Opportunity Improvement Zones normally stems from their alleged ability to create jobs. According to the Pennsylvania Department of Community and Economic Development, the KOZs in Pennsylvania have created more than 63,900 new jobs and retained more than 48,100 jobs in the zones since the first KOZ program began in 1999. Could it be that the Cira Centre has started a new trend of success among opportunity zones?

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<sup>33</sup> Natalie Kostelni, "Cira Centre 75% Leased Up: Lubert Adler, others lured by tax breaks."

<sup>34</sup> "Estimated Economic and Fiscal Impact of the Cira Centre," Econsult Corporation, January 2007.

<sup>35</sup> According to its website ([www.econsult.com](http://www.econsult.com)), Econsult Corporation is private corporation hired to provides economic research and analysis in support of litigation, as well as economic consulting services for businesses and public policy decision-makers. Econsult has extensive consulting experience in transportation economics, economic impact analysis and project valuation, economic and real estate development, and state and local policy and finance. Econsult is in no way affiliated with the Brandywine Realty Trust, and claims full objectivity in its assessment of the Cira Centre.

<sup>36</sup> *Ibid.*, 6.

<sup>37</sup> *Ibid.*, 8.

As the first commercial office development in Philadelphia to take advantage of the KOIZ, the Cira Centre provides valuable insight into the future efficacy of the program in Philadelphia. A pioneering entity of sorts, the success or failure of the Cira Centre should be indicative of a commercial push further west. Most previous literature has written-off tax zone incentives as futile or minimally effective, at best. The KOIZ program is somewhat different from the enterprise zones and empowerment zones previously studied because it is more reliant on local decision-making and project-specific decision. If the KOIZ and Cira Centre prove successful in Philadelphia, it would be useful to determine whether there are distinctive circumstances that caused it to succeed while most tax zones have failed nationally.

Opportunity zones generally are located in small developing or dying cities, as opposed to large, mature cities like Philadelphia.<sup>38</sup> Philadelphia is the fifth largest city in the United States, and the ninth richest city in the world in term of Gross Domestic Product – many would argue that tax incentives are unnecessary.<sup>39</sup> My research focuses on the Cira Centre to examine how opportunity zones perform in larger markets. Previous research has evaluated KOZs in other areas around Pennsylvania, but only speculative literature has been produced about the effectiveness of KOIZs in the city of Philadelphia. My research is intended to determine whether it is necessary for cities with the size and appeal of Philadelphia to offer significant economic incentives to attract businesses.

In addition to economic and statistical evaluation, my research provides a qualitative social evaluation of opportunity zones absent from the current collection of

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<sup>38</sup> Fritz W. Wagner, Timothy E. Joder, Anthony J. Mumphrey Jr., eds., Urban Revitalization: Policy and Programs, (USA: Sage Publications, Inc., 1995), 94.

<sup>39</sup> “Largest Cities,” City Mayors, [<http://www.citymayors.com/statistics/richest-cities-gdp-intro.html>].

work on the subject. For example, the Powelton Village neighborhood directly west of the Cira Centre has historically struggled economically. Brandywine and the Cira Centre's contribution to the local economy and civic environment is an important part of evaluating the success of the KOIZ and the Cira Centre project. According to Alen Amirkhanian "economic stimulation does not mean displacement of former residents and businesses, but rather improvement of current conditions through attraction of new investment."<sup>40</sup> The KOIZ designation should serve the dual purpose of fostering growth of existing businesses in the area and attracting new business and development to the area. Therefore, the situation opportunity zones create for the local residents and businesses of the area is an essential factor to consider, and could provide new insight into the debate over economic incentives.

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<sup>40</sup> Alen Amirkhanian, "This Works: Encouraging Economic Growth," The Manhattan Institute Civic Bulletin, No. 33 March 2003.

### III. METHODOLOGY

In order to determine the effects of the Cira Centre's KOIZ designation on the Philadelphia community and economy, I needed to create a comprehensive model that would account for numerous externalities created by the building. In order to complete this model, I compiled and evaluated the following factors that I feel best disclose the Cira Centre's net impact on Philadelphia in relation to the goals of the Keystone Opportunity Zone legislation:

- Satisfaction of the stated goals of the KOIZ program (enumerated in *Section V. Data/Discussion & Analysis*)
- Economic activity and stimulation
  - Capital flowing into the economy
  - Employment creation by sector and geography
  - Net municipal revenue gain/loss
- Effect on the local real estate market and local economic impact
  - Residential real estate prices
  - Commercial development
  - Facilitation of new or enhanced connection between Center City and West Philadelphia
- Effect on the Center City office market
  - Vacancy and absorption rates
  - Recent development
- Intangible factors
  - Aesthetic externalities

- Effect on external perceptions of the city
- Catalytic influence on other landlords and developers in Philadelphia

## **A. SECONDARY SOURCES**

I used several sources and research methods to accrue data. Secondary data included state and municipal incentive guides, stimulation and investment plans, business surveys, municipal statistics, district reports; and privately published real estate reports, economic surveys, and related research studies. The incentive guides and stimulation plans provided me with information regarding the specific terms and principles of the Keystone Opportunity Improvement Zones, as well as growth and success of KOIZs and related programs. The use of official statistics from the agencies like the Philadelphia Records Department, the Philadelphia Industrial Development Corporation, and the Pennsylvania Department of Community and Economic Development provided me with the quantitative basis of my research data. Relevant reports and papers published annually by the Philadelphia municipal government and its affiliates, including the Area Redevelopment Publications, Center City District Studies, Real Estate Surveys, and Housing and Vacancy Reports helped show how KOIZs affect occupancy, economic stimulation, and demographics in targeted regions and neighborhoods within the city.

Reports produced by private entities provided data more specifically related to Keystone Opportunity Zones in Philadelphia. For example, the Philadelphia Center City District offers methods of quantifying the effect of KOIZs on the Philadelphia economy like sorting the taxpayer data by location and form of business, calculating square foot averages by industry and company type, then finding the municipal tax revenue that is

gained or lost by new jobs created or jobs displaced.<sup>41</sup> Report cards and economic evaluations done by districts and local economists show specific project impacts and relevant spin-off effects. Articles from local news sources like the *Philadelphia Inquirer* and the *Philadelphia Business Journal* allow me to understand the different perspectives on the project over the life of its existence. Because the Cira Centre issue is so recent, these sources were important for gaining basic information and related statistics about KOIZs and the newer Cira Centre projects. Information and reports from real estate brokers like Cushman & Wakefield, CB Richard Ellis, and Grubb & Ellis provide current updates of the real estate market in Philadelphia, and shows flows and trends of housing prices, leasing trends, and real estate fundamentals. Finally, some historical sources provide a theoretical framework with which to analyze the data supplied by the aforementioned reports.

## **B. PRIMARY SOURCES**

In addition to gathering secondary data, I have interviewed a handful of economists, industry experts, and local leaders with knowledge of the subject. I also surveyed the property to examine its physical nature in relation to the community and its adherence to urban tenets.

### ***INTERVIEWS***

**1. Richard Voith:** Dr. Voith is a Real Estate professor at the Wharton School of Business, the Senior Vice President and Principal of Econsult Corporation, and was the leader of the Greater Philadelphia Transportation Initiative. Dr. Voith is expert in transportation and urban economics, and was appointed by Governor Ed Rendell to the

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<sup>41</sup> “The Impact of Keystone Opportunity Improvement Zones in or Adjacent to Center City,” 3.

Transportation Funding and Reform Commission. As mentioned earlier, the Econsult Corporation was commissioned by Brandywine Realty Trust to perform an economic feasibility analysis report to consider the potential success of the building in terms of . Dr. Voith is highly familiar with the Cira Centre and its relationship with the KOIZ initiative.

**2. John Gattuso:** Mr. Gattuso is the Senior Vice President and Director of National & Urban Development of Liberty Property Trust. Liberty Property Trust is the developer of the new Comcast Center in Center City, which was also under consideration for KOIZ status during its initial stages, but was denied designation by the state of Pennsylvania. Mr. Gattuso has a keen knowledge of the Greater Philadelphia office market, as well as an acute understanding of KOIZ legislation and its effects.

**3. Craig Zolot:** Mr. Zolot is a Principal and Director of Asset Management of Rubenstein Partners, a private equity real estate investment firm that relocated into the Cira Centre upon its completion in 2005. Mr. Zolot was able to provide me with a tenant's perspective on his company's relocation decision and the factors that were considered, as well as their intentions for the future. In addition, as a principal of a firm that invests in office properties in the Mid-Atlantic, Mr. Zolot has intimate knowledge of the local office market and spoke about the effect of the Cira Centre on the Philadelphia market.

**4. Tony Dominick:** Mr. Dominick is the President of the Powelton Village Civic Association, and a prominent Powelton Village leader. Mr. Dominick discussed with me the relationship between Brandywine, the Cira Centre, and the local community. This

interview gave me valuable insight as to the social and local impact the Cira Centre has had on University City and, more specifically, the Powelton Village community.

## V. DATA/DISCUSSION AND ANALYSIS

### A. KEYSTONE OPPORTUNITY ZONE PARAMETERS

According to the Pennsylvania Department of Economic and Community Development, to qualify for Keystone Opportunity Zone designation a targeted project and zone must possess the following qualities:<sup>42</sup>

1. A plan to target growth.
2. Area must display adverse economic or socioeconomic conditions.
3. Linkages to regional community and economic development activities.
4. A written plan discussing the implementation of quality school improvements and local crime reduction measures.
5. A demonstrated cooperation from surrounding municipalities.

These parameters indicate a necessity to stimulate economic growth, improve local infrastructure, and promote social value. In addition to these general parameters, businesses moving into the zone must abide by the following restrictions:<sup>43</sup>

1. **Business:** A business must own or lease real property in a KOZ and actively conduct a trade, profession or business from the property and remain compliant with state and local tax laws and building codes. Existing businesses that are expanding, new businesses and out-of-state businesses moving into Pennsylvania need only move into a KOZ, file a one page annual application for benefits and submit the application with a

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<sup>42</sup> Pennsylvania Department of Community & Economic Development, “What is a Keystone Opportunity Zone?” [<http://www.newpa.com/default.aspx?id=346>].

<sup>43</sup> “Keystone Opportunity Zone Program Guidelines and Application,” 1.

synopsis of the business, which contains a description of the business, job creation potential and the anticipated capital investment.

2. **Relocation:** An existing Pennsylvania business relocating into a KOZ must meet one of the following relocation provisions:
  - a. Increase full-time employment by at least 20% in the first full year of operation within the KOZ or;
  - b. Make a capital investment in the property located within the KOZ equivalent to 10% of the gross revenues of that business in the immediately preceding calendar or fiscal year attributable to the business location or locations that are being relocated to a subzone.
  - c. Enter into a lease agreement for property located within the subzone, improvement subzone or expansion subzone for a term at least equivalent to the duration of the subzone and with the aggregate payment under the lease agreement at least equivalent to 5% of the gross revenues of that business in the immediately preceding calendar or fiscal year.

These restrictions ensure that firms moving into the zones are productive, contribute directly to the local economy, and intend to remain in the zone for a significant period of time. These provisions also reduce the probability of the city getting taken advantage of by a company on the margin.

## **B. ECONOMIC STIMULATION AND ACTIVITY**

Little data has been released to exhibit the direct economic growth and tax revenue generated by the Cira Centre because it was only completed two years ago, but

there have been several forecasts projected its estimated effects on Philadelphia. Research shows that the Cira Centre will provide the City of Philadelphia with long-term returns that exceed projected revenue streams previous to its construction, even in worst-case scenario forecasts. In a study generated by the Center City District meant to oppose the Cira Centre's construction, even if the building were fully occupied *only* by top-tier firms vacating class A Center City office buildings, and the city experienced a paltry absorption rate of the vacated space at 116,000 square feet per year, the city still begins realizing positive annual tax returns in 2012, and a cumulative revenue infusion of nearly \$23 million by 2018 (See *Table 1* in Appendix A).<sup>44</sup> Of course in reality only about 60% of the Cira Centre is occupied by firms from Center City (See *Table 2* in Appendix A) , and absorption rates since 2004 have been well over 500,000 square feet annually.

Econsult completed the most recent and realistic projection of the Cira Centre's fiscal and economic impact in January, 2007. Conservative, yet more realistic projections from Econsult reveal that as a result of the Cira Centre's construction, when compared with a "no KOIZ" scenario, Philadelphia experiences positive net gains each year from completion and nearly \$50 million in cumulative income by 2018 (see *Cumulative Gain (Loss) from KOIZ* below), at which point gains increase considerably.<sup>45</sup> Based on the estimated job growth created by the Cira Centre, Philadelphia gained \$2 million in upfront revenue from construction, and will gross \$12 million annually from 2006 to 2018, and \$18 million annually thereafter once the tax abatements have expired (See *Table 3* in Appendix A).<sup>46</sup> The cumulative estimated present value of Philadelphia's cash flow from the KOIZ

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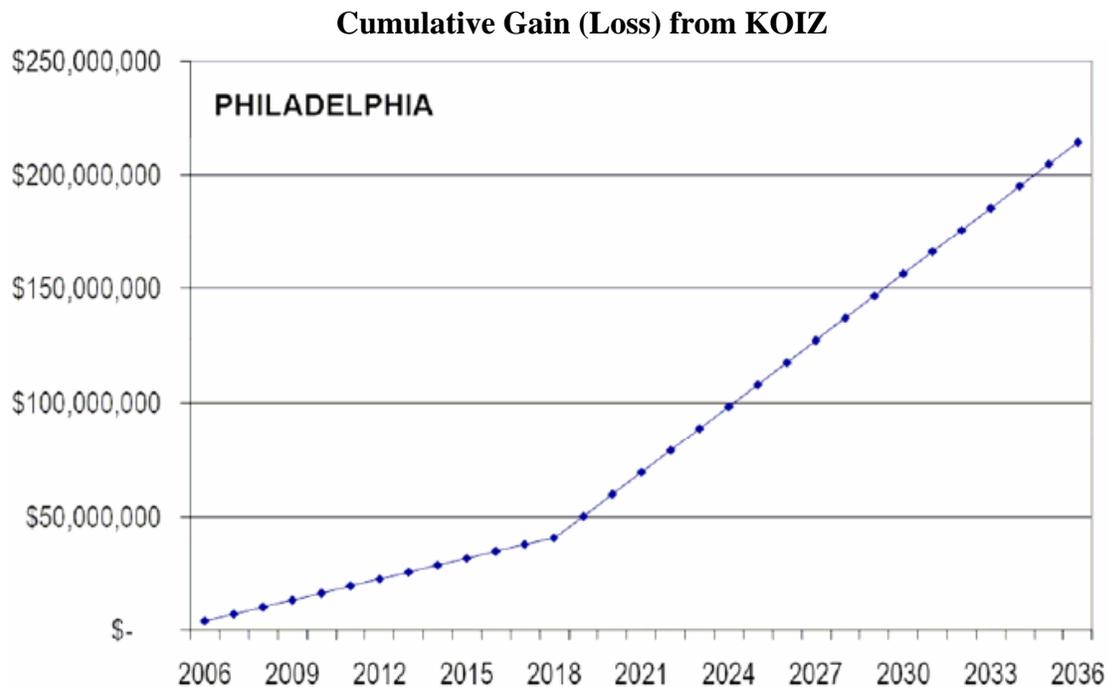
<sup>44</sup> "The Impact of Keystone Opportunity Improvement Zones in or Adjacent to Center City," 6.

<sup>45</sup> "Estimated Economic and Fiscal Impact of the Cira Centre," 6.

<sup>46</sup> *Ibid.*, 6.

versus non-KOIZ in the area between 2006 and 2036 is \$239.4 million to \$145.6.<sup>47</sup>

While this reflects more than just the Cira Centre’s impact on the city, it speaks to the overall success full of the tax zone programs in the city.



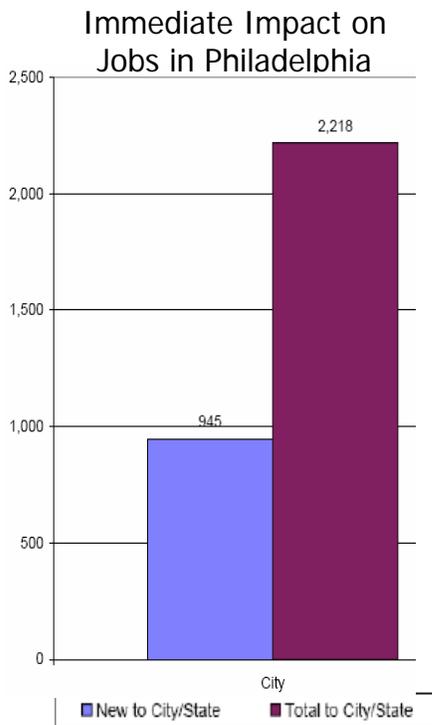
Source: Econsult Corporation.

In terms of economic output and impact on the Philadelphia economy, the projections are significant. Timothy Bartik asserts that social benefits of economic stimulation from incentives are considerably diminished if the jobs created are low-wage, or if few local workers are hired.<sup>48</sup> Through the phases of construction, lease-up, and operations, the Cira Centre has created 2,188 jobs; 1,273 of them from Philadelphia and 945 of them new to city.<sup>49</sup> 31% of the jobs created are permanent professional, scientific, and technical service jobs. Based on the amount of new jobs created by the project, Econsult approximates the annual new output derived from the Cira Centre is over \$93 million, supporting over 1,600 new jobs creating over \$80 million in earnings within

<sup>47</sup> Ibid., 37.

<sup>48</sup> Bartik, “Incentive Solutions,” 10.

<sup>49</sup> “Estimated Economic and Fiscal Impact of the Cira Centre,” 38.



Source: Brandywine Realty Trust

Philadelphia.<sup>50x</sup> Altogether, the Pennsylvania Department of Community and Economic Development reports the KOZ program has produced over 16,000 jobs and induced over \$3 billion of capital investment in Philadelphia in the past four years (See *Table 4* in Appendix A).<sup>51</sup> While this clearly is not as a result of the Cira Centre, it speaks to the success of the program on the whole.

**C. EFFECT ON LOCAL COMMUNITY**

Combined with the efforts of the University City District, the Cira Centre has helped increase foot-traffic in the immediate area, and sparked initiatives for retail and residential development. Using a blunt measurement, daily vehicular traffic in the 30<sup>th</sup> and Arch Street area jumped from 21,826 to over 35,000 in 2006.<sup>52</sup> Additionally, mass transit ridership to 30<sup>th</sup> Street Station increased 6% between 2005 and 2006.<sup>53</sup> After not having any new residential development between the years of 2002 and 2005, in 2006 and 2007 University City saw the construction of five new residential buildings, with at least two more constructions in the pipeline over the next two years. Despite being on the downside of the housing bubble, median residential sales prices in the area increased 22% (\$255,000 to \$312,00) from 2005 to 2006, and 17.7% from 2006 to 2007, after having

<sup>50</sup> Ibid., 18.

<sup>x</sup> All figures back out the amount of impact that would have happened without the project, and thus reflect the incremental impact of the project.

<sup>51</sup> “Pennsylvania Keystone Opportunity Zone 4 Year Report.” Pennsylvania Department of Community and Economic Development, 2007, 6.

<sup>52</sup> Brennan, Lori Klein and Mark Christman. “University City Report Card.” University City District, 2007, 21.

<sup>53</sup> Ibid., 26.

increased on 4% the previous year (See *University City Housing Market* chart to the right and *Q2 House Appreciation Rate by Neighborhood* map below).<sup>54</sup>

Employment has grown 10% since 2004, far outpacing the region’s 1% annual growth rate. 6.3 million square feet of commercial space has recently been developed or is in the process of being developed.<sup>55</sup>

Kevin Gillen reports that University City now has the second highest median housing prices in the city behind Center City.<sup>56</sup>

**Home Sales, 1995 - 2006**

| Year | Number of Sales | Average Price | Median Price | Annual Median Price Increase | Percent Since 2000 |
|------|-----------------|---------------|--------------|------------------------------|--------------------|
| 1995 | 73              | \$78,472      | \$72,700     | -                            | -                  |
| 2000 | 123             | \$91,180      | \$97,000     | 20%                          | 0%                 |
| 2001 | 136             | \$111,957     | \$97,125     | 12%                          | 12%                |
| 2002 | 121             | \$147,179     | \$125,000    | 29%                          | 44%                |
| 2003 | 104             | \$174,867     | \$160,000    | 28%                          | 84%                |
| 2004 | 129             | \$239,357     | \$245,000    | 53%                          | 182%               |
| 2005 | 158             | \$292,222     | \$255,000    | 4%                           | 193%               |
| 2006 | 132             | \$319,457     | \$312,000    | 22%                          | 259%               |

Source: Realtor, TREND

**New Housing Units Since 2000**

| Location                        | Completed | Type              | # of Units   |
|---------------------------------|-----------|-------------------|--------------|
| The Left Bank                   | 2001      | Apt. Conversions  | 282          |
| University Crossings            | 2002      | Apt. Conversions  | 260          |
| 4200 Pine                       | 2006      | Condo conversions | 28           |
| Spruce Hill Homes               | 2006      | Condo conversions | 10           |
| The Hub                         | 2006      | New apartments    | 101          |
| Domus                           | 2007      | New apartments    | 295          |
| Race Street Residences          | 2007      | New apartments    | 121          |
| The Plaza at Enterprise Heights | 2008      | New apartments    | 213          |
| 3900 Walnut                     | 2009      | New apartments    | 161          |
| Units Built Since 2000          |           |                   | 676          |
| Units Under Construction        |           |                   | 790          |
| <b>Total New Units</b>          |           |                   | <b>1,466</b> |

Source: University City District.

The said goal of encouraging business development in the designated zone and extending Center City westward has been significantly furthered with the recent unveiling of the expansion plan put forth by the University of Pennsylvania and Brandywine Realty Trust. “Penn Connects” is a multi-billion dollar redevelopment plan that aims to continue revitalization of the postal properties that surround the Cira Centre over the next thirty years. The plan features the construction of numerous commercial,

<sup>54</sup> Brennan, Lori Klein and Mark Christman, 23, and Kevin Gillen, “Philadelphia House Price Indices,” August 21, 2007, 24.

<sup>55</sup> Brennan, Lori Klein and Mark Christman, 12.

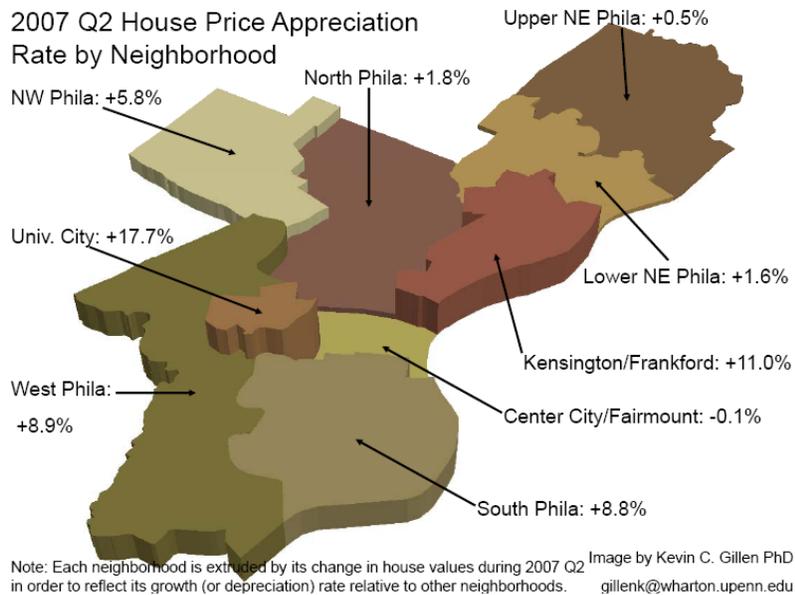
<sup>56</sup> Chris Mondics, “City Home Prices Off – Modestly,” *Philadelphia Inquirer*, November 14, 2007, [http://www.philly.com/philly/business/11263141.html.]

residential, and academic buildings over the predominately desolate 24-acre plot of land. Penn executive vice president Craig Carnaroli describes the ambitious goals of the project:

This kind of development can begin to spur not only private investment, but public investment in quality infrastructure, bridge design, sidewalk design, and lighting. I think the investment that Penn and Brandywine will be making will create the kind of elegant urban connective tissue that you're looking for—that we see in Paris and Chicago and other cities, where bridge crossings are truly celebrated events in the urban landscape, and not just prosaic ways to get from one side to the other.<sup>57</sup>

Improvements include two mixed-use Cira Centre South buildings designed by Brandywine, with an estimate cost of over \$800 million (see picture below).<sup>58</sup> The Cira

Centre South will occupy 14 acres of land, consisting of a 40- to 50-story mixed-use office tower with hotel, condominium and retail components on Walnut Street accompanied by a 25- to 30-story residential building on Chestnut Street.<sup>59</sup> Penn has already agreed to lease 20% (100,000 square



<sup>57</sup> “East Campus Rising,” *The Pennsylvania Gazette*, Vol. 124, No. 2, November/December 2007, [http://www.upenn.edu/gazette/1107/gaz01.html].

<sup>58</sup> Saffron.

feet) of office space in the tower.<sup>60</sup> Brandywine intends to have both towers completed by 2012. Also included in the project will be the redevelopment of the post office on 30<sup>th</sup> and Market Streets into a regional headquarters for 5,000 Internal Revenue Service (IRS) employees and an adjacent 2,400-space car park. The IRS has already inked a 20-year lease for the space beginning in 2010. These developments over the next thirty years will certainly bring a great deal of economic stimulation to the area and have an enormous positive impact on the University City and Powelton Village communities, both socially and economically.<sup>61</sup>

Brandywine's role in the Penn Connects effort indicates a true interest in fulfilling the goal of connecting West Philadelphia and center city and lending the neighborhood a more integrated and urban environment. Brandywine president and chief executive officer Jerry Sweeney has wanted to further integrate the community since the original Cira Centre's construction: "It represents the culmination of many years of work of trying to create a commercial mixed-use facility within University City," says Mr. Sweeney. "It validates the investment thesis for Cira Centre and provides a tremendous economic engine for West Philadelphia and University City."<sup>62</sup> Having spoken with Mr. Sweeney since the decision to continue with the project, Dr. Voith assures that "nothing gets built without KOIZ designation."<sup>63</sup>

The University of Pennsylvania had been interested in developing this land since the 1980s, but until the KOIZ tax abatement they were unable to find a willing

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<sup>59</sup> Suzette Parmley, "New Towers to Rise on 30<sup>th</sup> St.," Philadelphia Inquirer, August 31, 2007, [[http://www.philly.com/philly/news/homepage/20070831\\_New\\_towers\\_to\\_rise\\_on\\_30th\\_St\\_.html?text=xlg](http://www.philly.com/philly/news/homepage/20070831_New_towers_to_rise_on_30th_St_.html?text=xlg)].

<sup>60</sup> "East Campus Rising."

<sup>61</sup> "Penn Connects: A Vision for the Future." University of Pennsylvania, June, 2006, 5.

<sup>62</sup> Parmley.

<sup>63</sup> Interview with Richard Voith.

development partner. Penn offered Brandywine the opportunity to build the Cira Centre South with the proviso that the development is well integrated into the design of the rest of the neighborhood and conjures a lively, walkable neighborhood along the Schuylkill River.<sup>64</sup> According to Penn president Amy Guttman, the project will create a row of impressive high-rise buildings figuratively shorten the gap of the Schuylkill: “It provides a much-needed connector between our campus and Center City, and improves the urban infrastructure of the university and creates a vital new center of commerce for the whole region. It's converting a surface parking lot and eyesores into a mixed-use, greener, 24/7 neighborhood that unites and enlivens both sides of the Schuylkill.”<sup>65</sup>

As a testament to his commitment to the urbanity of the project, Mr. Sweeney has hired Sasaki Associates, a premier urban planning and design company, to create a list of changes to be made to the current Cira Centre that can better connect it to the community, as well as advise upon the new Cira Centre South development. Sasaki proposes nearly \$60 million in renovation and redevelopment of the existing Cira Centre, including the addition of a large plaza between 30<sup>th</sup> Street Station and the existing post office for improved walkability and community integration.<sup>66</sup> Mr. Sweeney has worked closely with Sasaki and local city planners on the design of the Cira Centre South to ensure that the new development adheres to the principles of urbanity. Among the most important features include a varied mix of uses and user, a great deal of involved street-level retail shops, and revamped sidewalks and streetscape for improved pedestrian maneuverability.

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<sup>64</sup> Inga Saffron, “Changing Skyline | Filling a Philadelphia Real Estate Void: The \$800 million Cira Centre South will be helpful, but not perfect,” *Philadelphia Inquirer*, October 15, 2007, [<http://www.philly.com/philly/news/homepage/10544462.html>].

<sup>65</sup> Parmley.

<sup>66</sup> Saffron.

According to Tony Dominick, one area in which the existing Cira Centre has lacked has been in its ability to connect with the surrounding community of Powelton Village.<sup>67</sup> The most notable separation is physical: the property is virtually fenced off from the community to the west, and is bordered by a highway, a train station, parking lots, and empty land. Despite its transit-oriented design, the building has a street-level disconnect. The Cira Centre is tucked neatly behind 30<sup>th</sup> Street Station, and while vehicular traffic has increased considerably, there is little foot traffic on the streets surrounding it. Even the employees who work in the building and use mass transit enter through a skywalk connected from 30<sup>th</sup> Street Station that runs above Arch Street. However, certain changes have made apparent the potential effect the development could have on its surroundings. For example, since its construction, the retail and food court portion of 30<sup>th</sup> Street Station has been revamped, and the quality of the tenants has improved dramatically. Perhaps the recommendations by Sasaki are implemented, the Cira Centre will be able to better flow with the neighborhood and encourage a more pedestrian-friendly environment.



Artist rendering of the Cira Centre South. (Source: "Penn Connects: A Vision for the Future")

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<sup>67</sup> Interview with Tony Dominick.

#### **D. EFFECT ON CENTER CITY OFFICE MARKET**

Many feared that the Cira Centre would negatively affect the Center City office market by flooding the market with excess space, then poaching tenants from existing Center City office buildings. As Kevin Gillen explains, in order for the city to absorb over 700,000 square feet of new office space one of or a combination of three things must happen to maintain market equilibrium:<sup>68</sup>

1. Capitalization rates<sup>69</sup> must decline, meaning prices of office buildings must increase relative to rents.
2. Demand, in this case office employment, must increase to accommodate the influx of new office space. This means absorption<sup>70</sup> must increase greatly.
3. Existing space with vacating tenants must exit the market or be converted into a different use.

Critics believed that, because of the suffering office market leading up to the Cira Centre's development, the incursion of new office space would place the market in disequilibrium because there was an increase in supply without an increase in demand. This would result in either older office buildings being forced off the market as their tenants moved into the Cira Centre, or increased vacancy, which in turn would cause rents and eventually property values to fall dramatically. The end result of either of these scenarios is lower tax revenue for the city, and thus, a failure of the KOIZ initiative.

However, despite the Cira Centre poaching over 60% of their tenants from Center City, the Center City office market has not suffered any losses as a result of the Cira

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<sup>68</sup> Gillen, "The CBD Philadelphia Office Market Today and Tomorrow: The Impact of KOZs," 9.

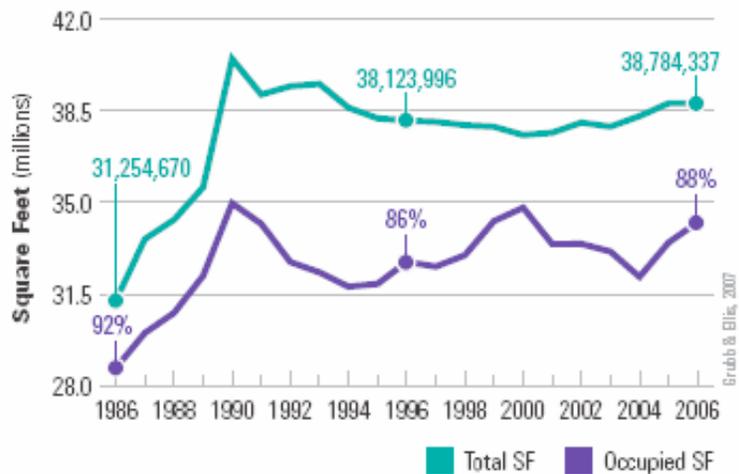
<sup>69</sup> Capitalization Rate = Rent or Net Operating Income/Price. A cap rate is a way to measure the speed at which an investment pays for itself through cash flows over a specified period of time.

<sup>70</sup> Absorption is the net amount of space leased over a given period of time.

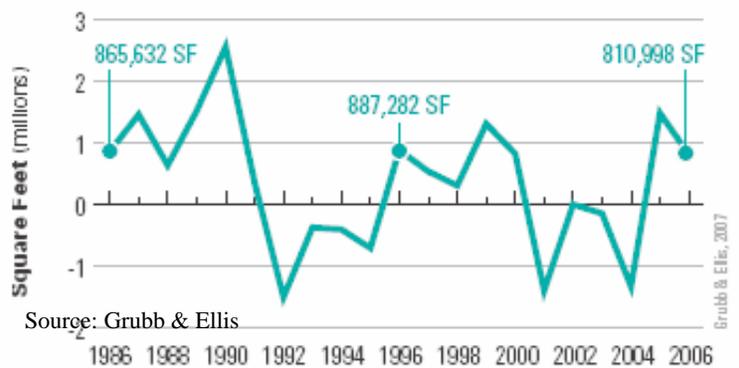
Centre’s construction. On the contrary, the city has enjoyed one of its most rapid office sector growths in recent history. What occurred was a sharp spike in property values and a concordant cap rate compression. Average price per square foot of office space in Center City increased from approximately \$85 in the second quarter of 2004, to over \$160 by the third quarter of 2006 (See *Graph 2* in Appendix C).<sup>71</sup> Nearly all of the vacancies created by the

Cira Centre were back-let within six months, and Philadelphia’s Center City has not experienced a single quarter of negative absorption since the Cira Centre’s construction.<sup>72</sup> In fact, during the quarter of the Cira Centre’s opening (Q4 2005), Center City absorbed over 1 million square feet of office space – the highest total of the millennium.<sup>73</sup>

**Office Inventory and Occupancy**



**Net Absorption**



Source: Grubb & Ellis

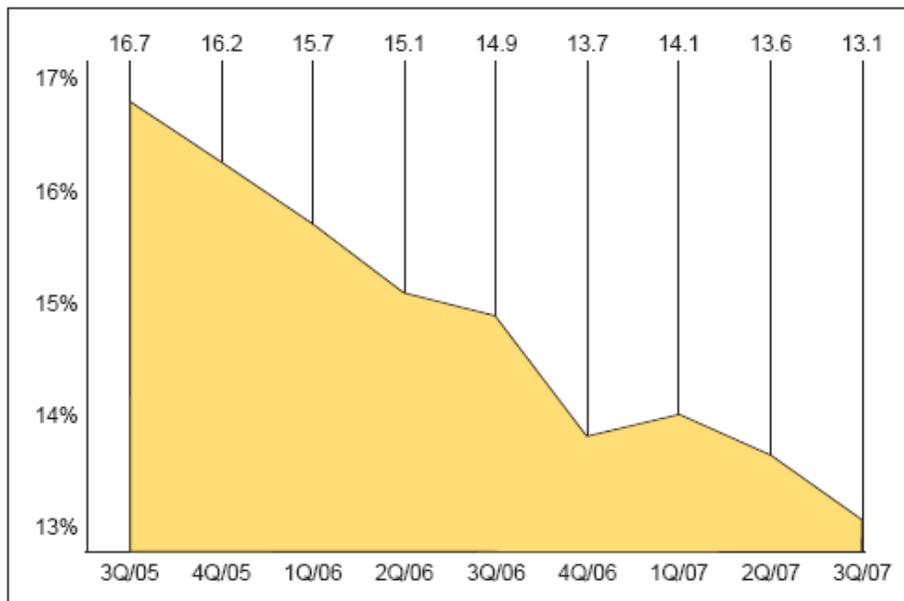
Additionally, office vacancies in Philadelphia have fallen from nearly 17% in Q2 2005, to 13% in Q3 2007, while average rents have climbed from under \$20 per square

<sup>71</sup> “Estimated Economic and Fiscal Impact of the Cira Centre,” 30.

<sup>72</sup> Interview with John Gattuso.

<sup>73</sup> “State of Center City: 2007.” *Center City District*, 2007, 7.

foot to \$25.09 in the same time period.<sup>74</sup> Even more telling is the fact that Center City’s vacancy rate has dipped below 10% for the first time since 2001.<sup>75</sup> The leasing activity and development in Center City continues to main strong through the end of 2007, even as the economy and national real estate market have slowed considerably.<sup>76</sup> In fact, in a survey issued by the Pennsylvania Department of Community and Economic Development, the number one concern sited by business executives entering the Philadelphia office market in 2006 was competition, whereas it was just the eighth greatest concern in 2003.<sup>77</sup> Taxes, on the other hand, have decreased from the fifth greatest challenge to eighth greatest in the same time period. The Cira Centre has had absolutely no negative effects on the Center City office market, mitigating fears that its short-term losses would dampen its unsure future returns.



**Office Vacancy Rate\***

Source: Grubb & Ellis

<sup>74</sup> “Office Market Trends Philadelphia: CBD & Suburbs – Third Quarter 2007,” Grubb & Ellis Company, 2007, 1 and “Market View: Greater Philadelphia Office – Third Quarter 2007.” CB Richard Ellis, Inc., 2007, 1.

<sup>75</sup> “Office Market Trends Philadelphia: CBD & Suburbs – Third Quarter 2007,” 1.

<sup>76</sup> “Studley Report,” Studley, 2007, 1.

<sup>77</sup> “Pennsylvania Business Retention & Expansion Program Report.” Pennsylvania Department of Community and Economic Development, 2007, 4.

Some may note that there have been several office-to-residential conversions in the last three years, most notably One Liberty Place, that have diluted the office market making it artificially buoyant. Although this may be true, these office spaces went off the market naturally to reach equilibrium, and are now being utilized for their highest and best use to the benefit of the city. The housing market was booming, and landlords saw an opportunity to take advantage of a hot market by converting their spaces. At the same time, they were filling a void in the supply in residential sector, where demand was increasing more rapidly than in the office sector.

It is also possible that there is a gap between the standard economic life of office buildings and technological developments in amenities. Over the past two decades, there have been unbelievable advances in the technology sector that have fundamentally changed the way business is performed, and thus changed the requisites for a functional modern office space. Historically, the normal economic life of a building is 39 years, however buildings constructed in the 1980s often do not have the amenities and infrastructure that modern businesses desire and need, especially if they are unrenovated. Therefore, it may be that the viable economic life for this generation of buildings is shorter than usual, indicating a need for new development and exiting of obsolete building models.

Others may be concerned that tenants will vacate the property as soon as the abatements cease and the Cira Centre will add to the vacant space in the Philadelphia market. Craig Zolot remarks that while initially Rubenstein Partners had intended to relocate back into Center City once the abatement terminated, he feels that the Rubenstein Partners, along with most other tenants, will now remain in building long-

term.<sup>78</sup> Mr. Zolot explains that the quality of the building, the transit-oriented location, and the proximity to downtown Philadelphia are the key attributes that will draw tenants to stay once the abatement expires. Dr. Voith agrees with Mr. Zolot, and deems the argument that the Cira Centre will bleed tenants once the abatements end “silly.”<sup>79</sup> He contends that while rents will undoubtedly decline to equilibrium after 2018, Brandywine has obviously anticipated this decline, and it is ludicrous to suggest that no one will occupy one of the luxurious office buildings in the city.

John Gattuso believes that the Comcast Center and Cira Centre have had no negative effect on the Philadelphia office market because they are differentiated products that are not in direct competition with the rest of the office space on the market.<sup>80</sup> According to the compensating variation model of urban real estate, firm and individual location decisions are made based on the amenities provided them in relation to their cost. It follows that companies would be willing to pay higher rent for superior amenities. Similarly, individuals theoretically will be willing to pay higher rents and accept lower wages in exchange for better amenities. The Comcast Center and Cira Centre are two class A-plus properties (especially when compared with the rest of the Philadelphia office stock) with technology and amenities that far exceed those of any other office property in the city. Accordingly, their rents hover around \$40 per square foot, while the Center City average rent for class A properties is just over \$28 per square foot. Firms will not relocate into these two buildings unless they believe the rent increase is justified by an analogous increase in amenity quality over the rest of the class A market. New or growing firms that desire quality amenities and can afford the increased

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<sup>78</sup> Interview with Craig Zolot.

<sup>79</sup> Voith.

<sup>80</sup> Gattuso.

rent will locate in the better buildings, and the older buildings will continue to get tenants who care more about minimizing costs than building amenities. Mr. Gattuso believes the two new additions to the skyline have helped create a “sense of positive momentum” for the Philadelphia economy.<sup>81</sup>

The most legitimate argument discrediting the success of the Cira Centre is the strength of the national office and commercial real estate markets over the past several years. Most notably, interest rate hit historic lows in 2006, causing cap rates to compress considerably nationwide based solely on the fact that money was cheaper. Therefore, in many markets prices increased a great deal without any positive changes in the market’s fundamentals (ie. increased rents, lower vacancy). However, even after the completion of the Cira Centre, the current anticipation of the Comcast Center, and the recent downturn in the national commercial real estate market, the Philadelphia office market continues to be buoyant, and Center City landlords are optimistic about the future of the market. George Cauffman, senior vice president of CB Richard Ellis notes, “The market has had a good two or three years to think about Comcast and move around it. Almost every tenant out there wants big space...It’s trending towards a landlord market.”<sup>82</sup>

Additionally, Philadelphia has outperformed the national average after lagging severely since 1994. From 1994 to 2003, Philadelphia absorbed only 1.16 million square feet of office space total, for a paltry annual average of 116,000 square feet. By comparison, over the same duration Washington D.C., Boston, and New York absorbed 13.5 million square feet, 9 million square feet, and 7 million square feet, respectively.<sup>83</sup>

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<sup>81</sup> Bob Fernandez, “Office Space in City Rebounds: The new Comcast buildings spurred fears of a glut,” Philadelphia Inquirer, June 19, 2007, [<http://www.philly.com/philly/business/8064912.html>].

<sup>82</sup> Ibid.

<sup>83</sup> Kevin Gillen, “The CBD Philadelphia Office Market Today and Tomorrow: The Impact of KOZs,” 3.

Since the Cira Centre's completion, Philadelphia hasn't experienced annual absorption below 500,000 square feet, and has continued to experience positive net year-over-year absorption despite the national market's recent downturn (32% decline nationally).<sup>84</sup> This indicates that Philadelphia's buoyancy is not exclusively tied to the success of the national office market, marginalizing claims that the success has been artificially inflated.

## **E. INTANGIBLES**

The Cira Centre bring with it numerous vital intangible factors that indirectly add to the city's overall appeal with respect to competing cities and the suburbs surrounding Philadelphia. Perhaps most important has been the creation of a new class of luxurious, sustainable office stock never before seen in Philadelphia.<sup>85</sup> The building serves as a new, visible form of infrastructure for the city. Mr. Gattuso claims Philadelphia must modernize its office stock in order to grow the sector and the economy.<sup>86</sup> Improved sustainability equates to more long-term relevance and less opportunity for obsolescence. Paul Morse, senior vice president of Office Leasing for Cushman & Wakefield in Toronto, believes building quality is immensely important in a firms location decision: "Buildings need ongoing attention and investment if they are going to remain competitive and retain the best tenants. Tenants need offices that allow their employees to work at peak efficiency. Modern communication systems, good air quality and high-tech security all play a big part in the office leasing market. Even the most prestigious of addresses can start to slide down the scale if the owner doesn't keep the building up-to-date."<sup>87</sup> The benefit of sustainable design is a widespread knowledge among leading companies, and it

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<sup>84</sup> "Office Market Trends Philadelphia: CBD & Suburbs – Third Quarter 2007," 4.

<sup>85</sup> Ibid.

<sup>86</sup> Gattuso.

<sup>87</sup> Keith Davey, "Behind Great Buildings," Office Property 2006, 2006, 46.

is a highly attractive form of design, and imperative for Philadelphia to be competitive in future.

Christopher Leinberger, a noted urban land strategist and developer, claims a vital aspect of revitalizing a stagnant urban center is the presence of a catalytic development or developer.<sup>88</sup> He argues that often a city needs to entice one developer into being the first to develop a project that establishes demand above market risk and demonstrates to the rest of the development community that investment in that city does pay dividends economically. The Cira Centre is a prime example of a catalytic development. By being a large, visible, and financial successful development, the Cira Centre has stimulated a great deal of new investment in office real estate. The most noted development is the Comcast Center, but there have been and are numerous other office developments and renovations in Center City influenced by the Cira Centre over the past several years (See *Map 1* in Appendix B). For example, currently World Acquisition Partners Corp. planning on investing between \$115 and \$140 million to add 30 to 48 stories to a 142,998 square foot, 5-story office building at 2040 Market Street.<sup>89</sup> According to Dr. Voith, “on the net, [office] building were substandard,” but landlords “don’t want to spend if they don’t have to” so for over a decade basically no improvements were made to the office stock. However, once the Cira Centre entered the market, landlords were forced to start improving their properties in order to compete with the newer, more efficient product.<sup>90</sup> This upgrading has been a large reason for the rent increase over the past several years. Those landlords unwilling to adjust to the new standards will either be forced to exit or,

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<sup>88</sup> Christopher B. Leinberger, “Turning Around Downtown: Twelve Steps to Revitalization,” The Brookings Institution, March 2005, 12.

<sup>89</sup> “Studley Report, Philadelphia, 2007 3Q,” 2.

<sup>90</sup> Voith.

like many already have, convert to a higher and better use. Either way, the city is benefiting from a more efficient use of space and improved infrastructure.

Another important intangible aspect of the Cira Centre is its aesthetically pleasing, highly visible, and transit-oriented design.<sup>91</sup> Not only does this promote the principles of urbanity, but also it better utilizes the city's well-developed transit infrastructure and reduces costs associated with vehicular transportation like deterioration of roads. It also provides for public cost savings, greater mobility, environmental stewardship, and reduced congestion.<sup>92</sup> According to Dr. Voith, an urban transportation guru, the Cira Centre is a wonderful example of an urban, transit-oriented development; it is a high-density area that serves as a nexus for jobs, retail, and transportation.<sup>93</sup> The Cira Centre's location next to 30<sup>th</sup> Street Station also lends it phenomenal visibility to businesspeople traveling along the Northeastern Corridor, most notably to and from Washington D.C., Boston, and New York City.<sup>94</sup> Mr. Zolot believes that unique design of the Cira Centre makes a profound physical statement both for University City and Philadelphia on the whole.<sup>95</sup> The Cira Centre is an immensely beautiful and alluring structure, evidenced by its 2006 American Architecture Award.<sup>96</sup> According to Keith Davey, signature buildings are one of the most important aspects of a city's image; the Cira Centre has certainly redefined the Philadelphia skyline.<sup>97</sup>

Consequently, Philadelphia has seen an increase in office occupancy and demand because it is once again being recognized as desirable, growing center of business.

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<sup>91</sup> Ibid.

<sup>92</sup> Richard Voith and Lee Huang, "Transit-Oriented Design: Using a Proven Strategy to Create more Vibrant, Livable Neighborhoods," Econsult Corporation, October 2007, 1.

<sup>93</sup> Voith.

<sup>94</sup> Ibid.

<sup>95</sup> Zolot.

<sup>96</sup> [www.ciracentre.com](http://www.ciracentre.com)

<sup>97</sup> Davey, 46.

Although slight, office sector jobs grew for the first time since 2001 (See *Chart 1* in Appendix B). Prior to the Cira Centre's construction, no businesses wanted to remain in or relocate to Philadelphia because all of the "Class A" office stock was at least fifteen to twenty-five years old. There was no impetus for a company to move into Philadelphia because it was viewed as a city declining not only in population, but also in vitality and competitive appeal.<sup>98</sup> The Cira Centre helped strengthen the declining state of the city to become one of the premier urban office locations in the entire Mid-Atlantic region by providing an advanced product seldom found in inner cities demanded by firms.<sup>99</sup> By acting as a catalyst for new development and renovation, the Cira Centre has allowed Philadelphia to offer an improved, more sustainable infrastructure, which leads to an ability to attract a new brand and better quality of tenants into its office space.<sup>100</sup>

This visibility and facilitation of urban principles is an important attraction not only for those commuting through the city, but also for the young knowledge workers that have been responsible for the "brain drain" in Philadelphia. By creating an urban-friendly, dense, alluring, transit-oriented building, the Cira Centre facilitates the technologically advanced, innovative urban landscape so attractive to entry-level knowledge workers. In 2006, a survey of recent college graduates aged 25 to 34 reported that 71% of those surveyed said that a walkable environment with unique architecture was of most importance when choosing a living location.<sup>101</sup> Another study of 1,000 young professionals conducted by Yankelovich Survey for CEOs for Cities in March

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<sup>98</sup> Gattuso.

<sup>99</sup> "Potential Economic and Fiscal Impact of the Proposed One Penn Plaza Project," Econsult Corporation, January 2004, 2.

<sup>100</sup> Gattuso.

<sup>101</sup> "Retaining College Graduates: Survey of College Graduates in Center City," Central Philadelphia Development Corporation and Center City District, October 2006, 4.

2006 revealed that 67% of college graduates between the ages of 25 and 34 choose a “great place” before a specific job, implying that a city’s image is of utmost significance.<sup>102</sup> Philadelphia, therefore, now has a unique opportunity to take advantage of the improvements made to its landscape to bolster its image in the media and attract young businesspeople.

From a purely economic standpoint, it has been proven that it often does not make fiscal sense to offer extensive economic incentives to attract business. In many regards, Philadelphia may have been lucky that there was sustained economic growth nationally that negated the possible losses stemming from the Cira Centre’s construction. However, the symbolic importance of revitalization within the city is an immeasurable positive externality of the Cira Centre. All of the aforementioned developments help Philadelphia’s image as a desirable destination location that can compete with other major cities in the Northeast Corridor. As yet, it is unclear as to whether Philadelphia’s office market will continue to grow strongly now that real estate has cooled off, but it is encouraging that there is now positive population growth and a renewed sense of innovation within the city.

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<sup>102</sup> Ibid., 6.

## **VI. CONCLUSION**

My research suggests that the implementation of Keystone Opportunity Zone tax benefits to aid the construction of the Cira Centre has proven to have a positive social and economic impact on the city and the surrounding community. There has been a great deal of controversy surrounding the effectiveness of using tax incentives to attract business and foster development surrounding Center City. Those in opposition argue that the Cira Centre's poaching of tenants from Center City will only hurt the city's office market while reducing its overall tax base, negatively affecting existing owners in Center City and taxing authorities like the School District of Philadelphia, and the Center City District. Those supporting the tax incentives believe that long-term economic stimulus and tax revenues will outweigh any short-term externalities produced by the temporary tax exemption.

Historical and current statistical data demonstrate that Philadelphia's tax base and Center City office market have not experienced any significant weakening in the wake of the Cira Centre's construction. Although there is currently a physical divide between the Cira Centre and University City, pipeline development plans seem to indicate that the goal of local stimulation is beginning to be fulfilled. Perhaps most important, the Cira Centre has seemed to have caused a tipping point for the Philadelphia office market. Since its development, there has been a strong trend towards high-end, sustainable development and renovation, which has renewed demand for office space throughout the city. This shift was a necessary change for Philadelphia to continue to be competitive in vying for business moving forward.

To what extent did the KOIZ and the Cira Centre directly affect the aforementioned economic and social indicators? What enabled the program to succeed in this particular setting? To answer these questions I will first examine what characteristics of the KOIZ program seem to be most effective. Then I will examine the scenario in which the Cira Centre succeeded, and suggest situations in which KOIZs or similar incentives would be thrive. Finally, I will recommend policy changes for both the KOIZ program and the city of Philadelphia.

### **A. POSITIVE KOIZ POLICY CHARACTERISTICS**

The Keystone Opportunity Investment Zone program exhibits many of the positive qualities most urban researchers deem most important when evaluating economic incentive plans. One of the most important aspects of the KOIZ program is its discretionary nature. Instead of providing direct assistance to firms on a first-come, first-serve basis, the KOIZ program is highly selective in awarding benefits to firms. This helps prevent inefficient allocation of government resources by allocating tax dollars to firms with little expected revenue or job growth.<sup>103</sup> In turn, quality tenants and developers are chosen to locate within the zones, increasing the potential for lucrative tax returns and substantial impact on the city's business environment.

The guidelines of the program (enumerated in Section V.A) allow for strong control over eligible candidates. There is significant interaction with prospective developers over the goals of a project and the viability of its design. For example, Jerry Sweeney's vision for the Cira Centre was reviewed thoroughly before being granted KOIZ status. It was Mr. Sweeney's intention throughout to expand the Cira Centre to try

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<sup>103</sup> Amirkhanian, 6.

to develop the West Philadelphia neighborhood into a vivacious commercial center.<sup>104</sup> Also, Mr. Sweeney was required to go through great lengths to attract companies from outside the Philadelphia area before accepting tenants from Center City.<sup>105</sup> This kind of control over potential projects is necessary for effective execution of any zoned incentive program.

Forcing firms relocating into the zone from within Pennsylvania to increase their employment by 20% or invest 10% of profits into the site guarantees at least some economic stimulation in return for tax abatements. Peters and Fischer assert that local job growth is the sign of a good incentive plan, and it is likely that if a firm must expand by 20%, a fair portion of those new jobs will be from within the urban realm. Another significant covenant is that tenants must stay for at least five before vacating in order to reap the benefits of the tax abatements. This provision acts as a type of inexplicit clawback clause for the city and state.<sup>106</sup> Insurances such as these are important, and can save the city a great deal of money.

By virtue of how KOIZs are designed, there is extensive communication with the local community to determine how the project will progress.<sup>107</sup> The governor proposes an area for designation, and the local community has to approve the status. Plans for growth are established cooperatively among the state, city, and community so that the needs of the neighborhood are held in account. According to Tony Dominick, the local community does have an important hand in deciding the projects that are undertaken and

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<sup>104</sup> Saffron.

<sup>105</sup> Gattuso.

<sup>106</sup> Bartik, "Tax Incentives," 12.

<sup>107</sup> "Keystone Opportunity Zone: Program Guidelines and Application," 1.

how they are executed.<sup>108</sup> For example, it is the local coordinator who reviews KOIZ applications and assigns approval.<sup>109</sup> Together, the groups can identify any market failures in the area that may prevent efficient use of resources and address them collaboratively.

Another important feature of the Keystone Opportunity Improvement Zone program is that it offers immediate and meaningful rewards to incoming companies. According to Alan Peters and Peter Fischer, capital incentives are more successful than credits that reduce the price of labor because companies on the margin are unable to redeem all of the credits.<sup>110</sup> It is important for the benefits to be upfront because corporations' location analysis is extremely short-termed. Long-term incentives will often prevent sites from attaining premier firms.<sup>111</sup> The variety of tax incentives offered through the KOIZ program provide immediate and substantial savings for relocating firms. This allows the area to attract top-tier companies and create maximal economic stimulation. Kevin Gillen describes the potential success of the Cira Centre South project, emphasizing the draw of the KOIZ tax incentives: "With the benefits of KOIZ designation, even in a slumping market the project still works, because it confers massive tax benefits. They'll have no problem leasing it out, just like Cira had no problem leasing [their space] out for prime rent."<sup>112</sup>

Finally, the state of Pennsylvania and the City of Philadelphia have done a good job of publicizing and marketing the program so that executives are aware of the benefits available to them. It is important not to underestimate the importance of marketing and

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<sup>108</sup> Dominick.

<sup>109</sup> "Keystone Opportunity Zone: Program Guidelines and Application," 4.

<sup>110</sup> Alan H. Peters and Peter S. Fischer, "Tax and Spending Incentives and Empowerment Zones," 128.

<sup>111</sup> Bartik, "Incentive Solutions," 23.

<sup>112</sup> "Cira Center South to Replace Eastern Eyesore."

facilitation of a positive image. Incentives can be helpful, but they are obsolete if executives and developers are unaware of them. Pennsylvania's Business Retention and Expansion Program has widely advertised its variety of incentive programs through websites, surveys, and print advertisements. The Select Greater Philadelphia marketing program has also reached many businesses and help provide momentum to the Philadelphia commercial real estate market.<sup>113</sup>

## **B. SCENERIOS FOR SUCCESS**

The timing of the Cira Centre's deliverance was somewhat fortuitous because it coincided with several positive changes in the political and economic environment, both nationally and locally. Nationally, the interest rates dropped to historic lows so that the cost of money was very cheap. Commercial real estate markets across the country were very successful. Properties in many markets appreciated simply off of cap rate compression. Locally, at the beginning of 2005 Pennsylvania unveiled its Business Tax Reform that planned to reduced the corporate net income tax. Governor Ed Rendell ramped up the Business Retention and Expansion Program, and introduced a series of incentives across the state. The city of Philadelphia has been abating all real estate property taxes on commercial developments and renovations. This program has been especially successful in tandem with the KOIZ initiative. According to a study done by Econsult in 2006, since the program was expanded in 2000, it has generated an estimated 67% of the residential development in that time period.<sup>114</sup> Appreciation of residential housing has increased 20% annually over the past several years, after appreciating just

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<sup>113</sup> "State of Center City: 2007," 24.

<sup>114</sup> "Philadelphia Tax Abatement Analysis," Building Industry Association and Econsult Corporation, June 2006, 8.

2% annually between 1990 and 1999.<sup>115</sup> This indicates that the KOIZ program has certainly benefited from a positive economic situation both locally and nationally. While these positive circumstances can help mitigate the potential negative effects of the KOIZ program, it appears as though the incentive still would have been successful in a less favorable period, only to a lesser extent. Perhaps more importantly, it also shows that the initiative thrives when complemented by other similar incentive programs.

Research has shown that a major reason for firms' flight from inner city locations is the lack of land or infrastructure for expansion.<sup>116</sup> Cities still possess important competitive advantages to suburbs, but lack of blocks of space and exorbitant costs often diminish these benefits and inflict a drain on local tax revenue. Hence, the creation of a new viable and attractive business site like the Cira Centre in Philadelphia improves the city's chances of retaining and attracting the largest and most desirable firms. The KOIZ provision that mandates 20% employment growth for firms relocating within the state to move into the zone ensures that these spaces are not filled by marginal firms, but rather firms that truly are growing and need space to expand. According to the most recent Studley Report, the number of contiguous spaces of over 50,000 square feet have decline from has decline from twenty in the beginning of 2005, to just eleven in the third quarter of 2007.<sup>117</sup> While this indicates an appetite for office space in Philadelphia, it also shows that even in a time of increasing development, the city can use the space available in West Philadelphia to accommodate growth and the necessity for large tracts of land. The Cira Centre takes advantage of an un-fragmented ready-to-use portion land in the city

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<sup>115</sup> Ibid., 46.

<sup>116</sup> Bartik, "Incentive Solutions," 7.

<sup>117</sup> "Studley Report, Philadelphia, 2007 3Q," 2.

that combines the space for growth and expansion with the positive externalities of an urban locale.

The Comcast Center, which is 87% leased to the Comcast Corporation (which translates into over 1 million square feet of office space), is another perfect example of a necessary expansion of space to accommodate a growing regional company.<sup>118</sup> Although the city and state were forced to give nearly \$30 million in aid to the developer, one of the fastest-growing companies in the Mid-Atlantic, the Comcast Corporation, would have left Philadelphia – most likely for a spacious suburban office park – had it not received a new, contiguous office space of adequate size.

An important difference between the Cira Centre and other zone incentive developments in Pennsylvania is its proximity to a legitimate central business district. Tax zones frequently are unsuccessful because they are unable to compensate for the competitive disadvantages that exist in an undeveloped or rural area, like cost of transporting goods, commuting costs, access to airports, infrastructure, and building functionality.<sup>119</sup> The Cira Centre, on the other hand, is located within the fifth largest city in the country, and two minutes from the heart of the central business district. For this reason the infrastructure is already fully developed and functional, and the building itself has no shortcomings, aesthetically or functionally. This would suggest that the KOIZ program, and zoned programs in general, seems most effective in either reviving potentially dormant cities with solid infrastructure, or spurring on development in a less economically development neighborhoods of successful cities. For example, a similar

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<sup>118</sup> Gail Kalinoski, "Comcast to Lease 87% of Liberty's 58-story Comcast Center in Philadelphia," *Commercial Property News*, February 23, 2007, [<http://www.allbusiness.com/operations/facilities-commercial-real-estate/4420175-1.html>].

<sup>119</sup> Alan H. Peters and Peter S. Fischer, "Tax and Spending Incentives and Empowerment Zones," 123.

program in the outer boroughs of Manhattan may be able to stimulate commercial development for businesses that wish to reap the benefits of urbanity but cannot afford Manhattan rents. In either capacity, zoned projects tend to have greater success in or on the fringes of a large city because their projects can continue to prosper once the abatements end. It is extremely important, though, that site is a quality structure so that tenants will want to remain there once the tax abatement is terminated. Otherwise, tenants will vacate once abatement expires because there are sites in better locations. Like Mr. Zolot remarked, Rubenstein Partners were originally planning on vacating the Cira Centre upon completion of the abatement, but after experiencing the superior amenities it offers, the company has decided to remain past the abatement deadline.<sup>120</sup>

These incentives are different from those offered in primate cities like New York and Chicago, because many of the businesses receiving tax benefits there most likely would have located in those cities regardless. Philadelphia, however, had been bleeding businesses and losing out to cities like New York, Washington D.C., and Boston.<sup>121</sup> Through the early 2000s, many businesses had sited Philadelphia's burdensome tax structure as one of its leading disincentives. Additionally, it is not considered a world-class or top-tier city, and therefore is not on the forefront of executives' minds when choosing a relocation destination. While the aforementioned cities are largely competitive without incentives, Philadelphia truly needs them to be competitive, in part due to its reputation. The incentives are, in the words of Bartik, "decisive" in businesses' decision to relocate to or remain in Philadelphia.<sup>122</sup>

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<sup>120</sup> Zolot.

<sup>121</sup> Ibid.

<sup>122</sup> Bartik, "Incentive Solutions," 12.

It has been proven that zoned incentive programs are most effective at attracting businesses intra-regionally because spatially variable factors like labor and transportation costs are only slightly different.<sup>123</sup> Therefore, the KOIZ in Philadelphia should play a large role in reversing the recent trend of businesses' flight from inner city Philadelphia into the suburbs. Over the past two decades, Philadelphia has been losing jobs to the suburbs at an alarming rate. Although the negative trend of office sector employment turned slightly positive in 2006, Philadelphia continues to lose its share of the regional employment pool.<sup>124</sup> According to a report published by the Central Philadelphia Development Corporation, between 1990 and 2005 Center City's share of regional office employment plummeted from 47% to 32%.<sup>125</sup> Likewise, the lack of downtown and commercial office development in the 1990s Center City's share of the region's office inventory dropped from 41% in 1993 to just 28% in 2004, six points below the national Central Business District average.<sup>126</sup> The flight of jobs also contributed to the housing slump because individuals followed the jobs to the suburbs. The success of Cira Centre's development demonstrates that businesses do in fact value a proximity to the business center, universities, and well-designed transit hubs as long as the costs are not exorbitant.<sup>127</sup>

In sum, there are a few different circumstances under which the KOIZ program and other programs of its ilk will thrive. First, the program is perfect for acting as a catalyst to revitalize a slumping commercial real estate market in a city with solid

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<sup>123</sup> Alan H. Peters and Peter S. Fischer, "The Effectiveness of State Enterprise Zones," 1.

<sup>124</sup> "State of Center City: 2007," 28.

<sup>125</sup> "Center City Office Sector: Restarting the Engine for Growth." Central Philadelphia Development Corporation, June 2005, 6..

<sup>126</sup> *Ibid.*, 6.

<sup>127</sup> *Ibid.*, 7.

business infrastructure. Certainly the program must exhibit the qualities enumerated earlier in the section in order to ensure that the right businesses are entering the market. The project must be a viable, sustainable building that will still have long-term value once the abatements have terminated or else it will become vacant upon expiration. It is evident though, that one successful landmark development can help persuade developers who were afraid of entering the market because of recent stagnation. This program can also serve a similar purpose of laying the groundwork for future commercial development of a stagnant neighborhood of a large city. While the Cira Centre acted in both of these capacities, each of these scenarios can be successful individually. Zoned incentives do not thrive, however, in economically undeveloped or rural areas because the incentive is rarely enough to overcome the disadvantages associated with locating in an inferior area. If the incentives are enough to lure permanent tenants, then they are probably too high for the municipality to realize gains from.

The KOIZ program also seems fit to help cities losing business to suburban sites lure expanding businesses to stay in or return to urban areas. Zoned programs are most effective in intra-regional setting because incentives play a more decisive role in firms' location decision. If the zones can take advantage of inefficiencies causing market failures in underdeveloped urban neighborhoods, they can provide large, contiguous spaces at reduced prices for expanding firms who wish to continue to take advantage of the positive externalities associated with urban economies and infrastructure. The program seems especially effective when used in tandem with other incentives that encourage growth in other aspects of commercial real estate. In fact, programs of this

sort even seem necessary in second-tier cities that do not have the technologically advanced stock and renowned reputation to prevent urban flight.

### **C. POLICY RECOMMENDATIONS**

In order to maximize the value of the tax incentive, it is extremely important that the policy is decisive in businesses' and developers' choice to locate within the zone.<sup>128</sup> In order to help ensure that the incentive is in fact decisive, the city can require businesses to legally certify, with official financial figures, that without the KOIZ tax incentive they would have decided to locate elsewhere. It is also helpful to hire a private economic consultant to generate models and projections that will provide estimates of the fiscal and labor market gains associated with attracting a particular new company.<sup>129</sup> This way, incentives can be even more personalized to each specific project or prospective participant. For example, Bartik claims incentives should be larger for developments that hire and employ local residents, especially if the residents are unemployed.<sup>130</sup> The KOIZ program also needs to do a better job of connecting with the local community and enforcing the parameters set forth in its guidelines concerning local stimulation. As Tony Dominick stated, since the initial phases, there has been little interaction between Brandywine and the Powelton Village area. The development has had little clear and direct influence on the Powelton Village neighborhood, and is physically independent of its surroundings.<sup>131</sup> Clearly, the "Penn Connects" project is an attempt to better integrate the community, however the original Cira Centre has seemed to have failed somewhat on the local social development front.

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<sup>128</sup> Bartik, "Incentive Solutions," 9.

<sup>129</sup> *Ibid.*, 21.

<sup>130</sup> *Ibid.*, 25.

<sup>131</sup> Dominick.

It is important that the city reinvest the tax revenue generated from incentive programs to improve the business environment and make it a more attractive place for businesses to locate and remain. Studies by the Initiative for a Competitive Inner City reveal that while tax rates are of utmost importance in the decision-making process for relocating businesses, existing businesses complain most about allocation of tax revenue.<sup>132</sup> Tax and regulatory policy should not restrict business growth and must be competitive with other municipalities in the region. The Philadelphia policymakers must be responsive to the concerns and needs of local businesses so that the city can adapt to accommodate varying business environments. An important way to increase efficiency is to maintain a well-funded public transportation system, and encourage transit-oriented development.<sup>133</sup> By providing a healthy urban environment with an advanced stock of office space, the city will be able to attract both young knowledge professionals and top-tier businesses. Ultimately, reinvestment in the form of infrastructure should pay for itself in attraction of businesses, reducing the necessity of economic incentives.

Crime is another important area of improvement for Philadelphia. According to Dr. Voith, it is nearly impossible to attract business and experience sustained economic growth and prosperity with a high rate of crime. Economic development will not truly be able to thrive unless businesses see opportunities that prevail over the costs and risks associated with locating in inner cities.<sup>134</sup> Included in these risk assessments is access to a high-quality labor pool, which is diminished if the city is perceived to be dangerous. In October 2006, the Philadelphia Center City District conducted a survey of recent college graduates, which showed that safety and housing costs were afforded the most

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<sup>132</sup> Amirkhanian, 7.

<sup>133</sup> "Center City Office Sector: Restarting the Engine for Growth," 8.

<sup>134</sup> *Ibid.*, 12.

importance when deciding upon a place to live.<sup>135</sup> If Philadelphia is unable establish a satisfactory labor pool, no matter how effective its economic incentives are it will not be able to attract businesses.

The city's economic development plan should try to transform the public's perception of crime and economic opportunities in Philadelphia. The battle against crime needs to be waged on two fronts. Obviously an absolute citywide reduction in crime is essential. The recent economic boom Philadelphia has experienced should have produced some extra tax revenue that could be invested in crime prevention. However, it is equally important that the city produces targeted advertisements publicizing any improvements in crime in and around the city. Interviews with business executives reveal "perception of high crime rates is a greater competitive disadvantage for inner city businesses than actual crime."<sup>136</sup> Perceptions perpetuated by the media can destroy a city's reputation, even if its actual crime and business climate statistics are not as bad as portrayed. The mayor's office can be used as a platform to bring attention to the city's friendly streets and burgeoning economic opportunities.

While the KOIZ tax incentive along with the real estate property tax abatement in Philadelphia have certainly acted as catalysts for urban rejuvenation, ultimately the city needs either to continue to lower its business privilege taxes or allocate tax revenues more efficiently in order to compete regionally. According to Peters and Fischer, research has shown that the areas that present the highest returns with incentive zones are also the areas with the highest return without them.<sup>137</sup> In other words, it is the underlying tax structure and system that fosters long-term, sustained economic growth. In order for

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<sup>135</sup> "Retaining College Graduates: Survey of College Graduates in Center City," 4.

<sup>136</sup> Amirkhanian, 12.

<sup>137</sup> Alan H. Peters and Peter S. Fischer, "Tax and Spending Incentives and Empowerment Zones," 128.

Philadelphia to reverse the trend of firms moving to the suburbs, it will have to continue to develop a more competitive tax structure.<sup>138</sup> The Keystone Opportunity Improvement Zone program with respect to the Cira Centre has been particularly successful in Philadelphia because it changed the direction of the business and development trends in the city; much of its success has been intangible.

Both the state of Pennsylvania and Philadelphia have been taking the right steps towards improving their tax structures. The Tax Foundation in Washington, D.C., shows that Pennsylvania's tax climate is one of the best and most business friendly among mid-Atlantic and New England states. In 2006, Pennsylvania ranked sixteenth overall among 50 states for tax environment, improved from twentieth in 2004.<sup>139</sup> The municipal government must continue to prove that the new firms made the correct decision in relocating and remaining in Philadelphia or the momentum derived from these new developments will dwindle and the city will once again be faced with economic stagnation. Dr. Voith advocates lower taxes across the board, directly reinforcing the Tiebout principle that residents and firms will vote with their feet: "You can't overtax at the local level because people will leave."<sup>140</sup>

If Philadelphia can continue to improve the competitiveness of its tax system while maintaining above-standard transit- and business-related infrastructure, the office sector should continue growing at a moderate pace over the next several years. Eventually, as the city regains its status as a destination location, it maybe able to begin reducing certain tax incentives or phasing them out completely. The Cira Centre has

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<sup>138</sup> "State of Center City 2007," 24.

<sup>139</sup> "Pennsylvania Business Retention & Expansion Program Report," 10.

<sup>140</sup> Voith.

provided a valuable lesson that, when executed properly, zoned incentives can play important roles in facilitating growth and stimulation in the correct context.

## VII. APPENDIX

### APPENDIX A:

Table 1 : Worst Case Scenario Returns from Cira Centre Construction with KOIZ

|   |           | Cira Centre Built w KOIZ |
|---|-----------|--------------------------|
| construction (July-Dec)                 | 2004      | \$1,379,657              |
| construction                            | 2005      | \$1,207,973              |
| construction                            | 2006      | \$1,197,668              |
| tenants move                            | 2007      | (\$8,746,118)            |
|   | 2008      | (\$8,869,140)            |
|   | 2009      | (\$4,992,162)            |
|   | 2010      | (\$3,115,183)            |
|   | 2011      | (\$1,238,205)            |
|   | 2012      | \$638,773                |
|   | 2013      | \$2,515,751              |
|   | 2014      | \$4,392,730              |
|   | 2015      | \$6,269,708              |
|   | 2016      | \$8,146,686              |
|   | 2017      | \$10,023,664             |
|   | 2018      | \$11,900,643             |
| Sum Construction thru end of KOIZ       | 2004-2018 | \$22,712,444             |
| Average Loss/Gain for each year of KOIZ | 2007-2018 | \$1,577,262              |

Table 2: Cira Centre Rent Roll – Initial lease up

| Tenant                         | Space Occupied (sq. ft.) | Previous Location   |
|--------------------------------|--------------------------|---------------------|
| Dechert                        | 245,000                  | Center City         |
| Woodcock Washburn              | 109,000                  | Center City         |
| SCA North America              | 101,000                  | Eddystone, PA       |
| Lubert Adler                   | 58,000                   | Center City         |
| Brandywine Asset Management    | 54,755                   | Wilmington, DE      |
| McKinsey & Co                  | 27,600                   | New York, NY        |
| Reger Rizzo Kavulich & Darnall | 27,600                   | King of Prussia, PA |
| Attalus Capital                | 20,000                   | Bala Cynwyd, PA     |
| Mand Marblestone Danziger      | 9,500                    | Bala Cynwyd, PA     |
| Blackrock Financial Management | 8,500                    | Wilmington, DE      |
| Capsicum Group                 | 1,800                    | Berwyn, PA          |
| <b>Total</b>                   | <b>662,755</b>           | <b>Percentage</b>   |
| <b>From: Center City</b>       | <b>412,000</b>           | <b>62.2%</b>        |
| <b>From: Pennsylvania</b>      | <b>571,900</b>           | <b>86.3%</b>        |

|   |            |  |
|---|------------|--|
| <b>Current Rental Rate, Cira Centre</b>                 | \$45.00/sf |  |
| <b>Current Average Class A Rental Rate, Center City</b> | \$28.27/sf |  |

*Table 3: Fiscal Impact of Cira Centre on Philadelphia*

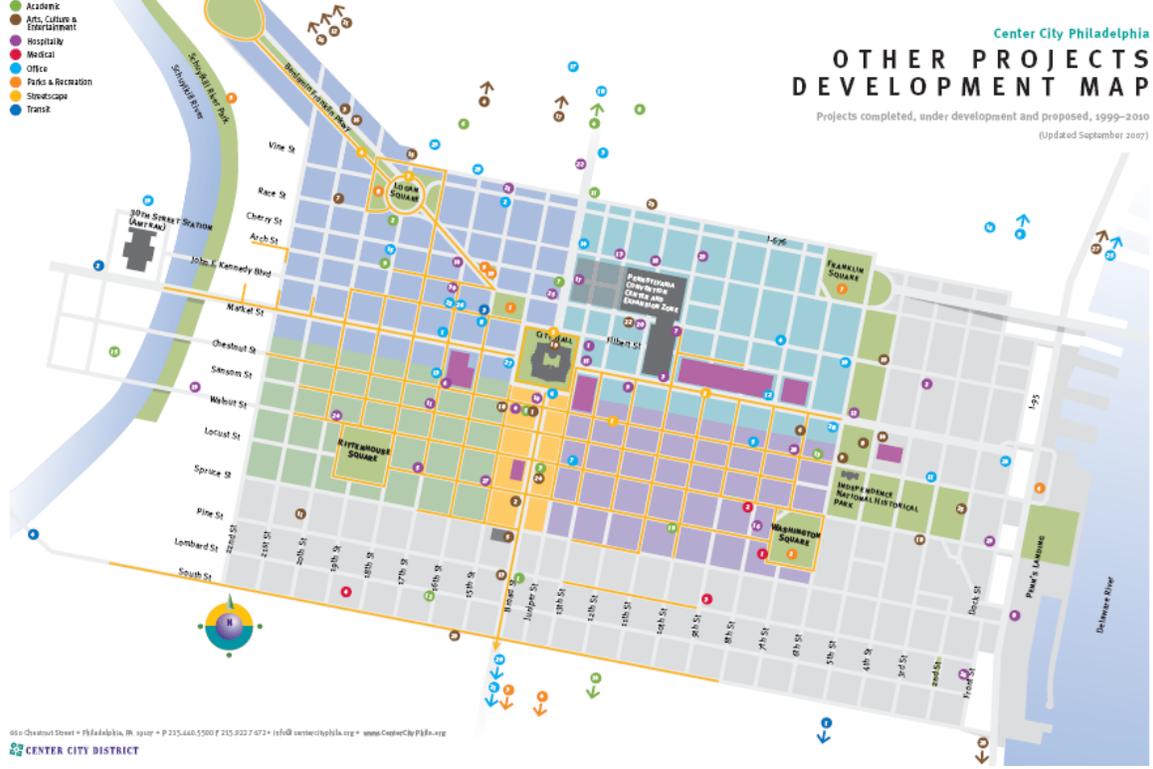
| <b>Philadelphia County</b>          | <b>Construction<br/>(one-time and<br/>completed)</b> | <b>Operating (potential and annual)</b> |                   |
|-------------------------------------|--|---|-------------------|
|                                     |  | <b>2006-2018</b>                        | <b>after 2018</b> |
| <b>Local Taxes (in \$MM)</b>        |  |   |                   |
| Wage and Earnings (Philadelphia)    | \$ 2.0   | \$ 11.9                                 | \$ 13.5           |
| Sales (Philadelphia)                | \$ 0.2   | \$ -                                    | \$ 0.6            |
| Business Privilege (Philadelphia)   | \$ -   | \$ -                                    | \$ 1.2            |
| Property - Cira only (Philadelphia) | \$ -   | \$ -                                    | \$ 3.1            |
| <b>Total</b>                        | <b>\$ 2.2</b>  | <b>\$ 11.9</b>                          | <b>\$ 18.5</b>    |

*Table 4: KOZ Economic Stimulation*

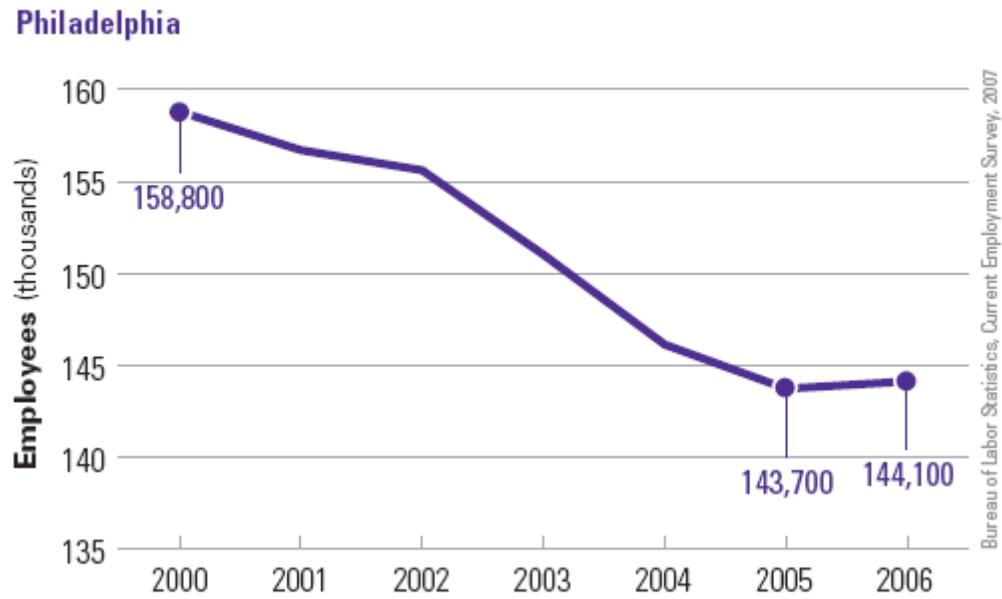
| <b>PHILADELPHIA</b>       |                        |
|---------------------------|------------------------|
| <b>JOBS RETAINED</b>      | <b>10,804</b>          |
| <b>JOBS CREATED</b>       | <b>16,102</b>          |
| <b>TOTAL JOBS IN ZONE</b> | <b>26,906</b>          |
| <b>CAPITAL INVESTMENT</b> | <b>\$3,383,729,439</b> |

# APPENDIX B

Map 1: Center City Development Map

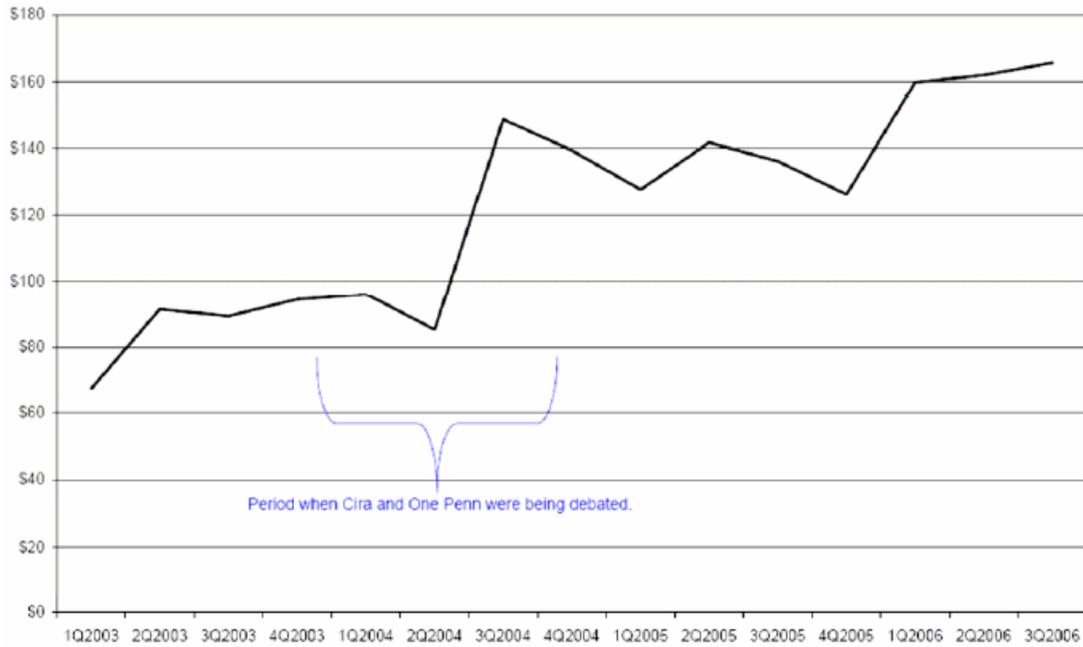


Graph 1: Office Employment  
Employment in Select Office Industries, 2000-2006



## APPENDIX C

Graph 2: Price per square foot of Office Space in Philadelphia



Source: several major commercial brokerage firms in Philadelphia

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