FROM	
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AGENCY NAME & ADDRESS	Bureau of the Budget and Management Research Room 432, City Hall
SUBJECT	City Council Bill 22-0299 – Tax Credits – Historic Properties – Application Extension

CITY of BALTIMORE

MEMO

TO

The Honorable President and
Members of the City Council
City Hall, Room 400

DATE: January 30, 2023

Position: Oppose

The Department of Finance is herein reporting on City Council Bill 22-0299, Historic Properties – Application Extension, the purpose of which is to renew and extend the application period for the Historic (CHAP) Tax Credit for an additional five years. The credit is scheduled to expire on February 28, 2023 and would be extended to February 28, 2028 with the passage of this bill.

Background

The CHAP Tax Credit provides a property tax credit on the improved value of historic properties. Eligibility for the program requires the property to be in either a National Register Historic District or a Baltimore City Historic District, and for projects to be certified by CHAP. For projects with construction costs equal to or below $5 million, the credit is a 100% credit on the improved value of the property. For projects above $5 million, the credit is an 80% credit in the first five years and then declining by 10% per year to 30% in Year 10.

As part of the City's 10-Year Financial Plan, BBMR worked with Ernst & Young to evaluate all of the City's tax credits. The intent was to evaluate the City's mix of incentives and ensure a positive return on investment (ROI), cost control, and alignment with the City's development strategy. The final report, "A Comprehensive Review of the City's Tax Credits," was published in 2022 and is available at http://bbmr.baltimorecity.gov. The CHAP tax credit is discussed on pages 18-20 of the report.

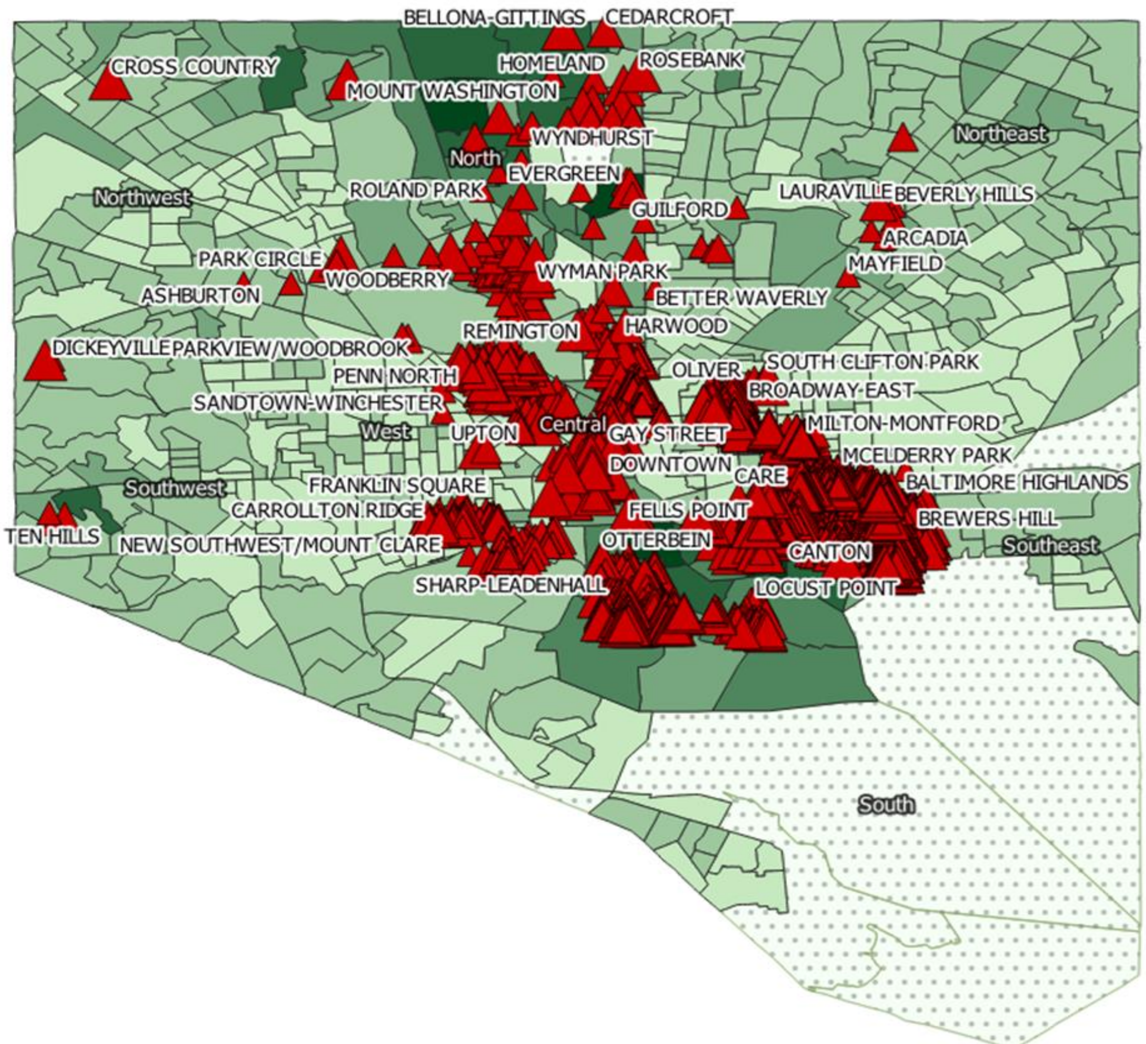
The CHAP Tax Credit has been useful in encouraging smaller-scale residential renovations. However, there are two crucial flaws in the program's design that have significantly diluted its cost-effectiveness.

First, the local and Federal historic designations for City neighborhoods, which makes a property eligible for the CHAP Tax Credit, are not at all aligned with the City's community development strategy. The City's development strategy is summarized in the City Housing Department's "Framework for Community Development" and is focused on four narrow Impact Investment Areas – East, West, Southwest, and Park Heights. These areas all have the same characteristics – they are lower to middle-income, they have a base of stable residents or other community resources, and are adjacent to strong market areas and/or anchor institutions. These characteristics make it much more likely that public investments will help stabilize the communities, encourage additional private investment, and lead to economically sustainable growth.

The CHAP Tax Credit on the other hand, by relying on the historic designation, ends up devoting resources to many neighborhoods that already have strong market indicators and are in less need of a subsidy. The historic designations largely run along a north-south corridor down the City's center and then extend to include Harbor-adjacent areas. Neighborhoods that are currently designated as historic and thus qualify for the CHAP Tax Credit include Homeland, Roland Park, Guilford, Tuscany-Canterbury, Charles Village, Bolton Hill, Mount Vernon, Otterbein, Federal Hill, Riverside, Locust Point, Fells Point, Canton, and Brewers Hill. Even outside of the central corridor, the areas that qualify as historic tend to be more stable neighborhoods such as Mount Washington, Arcadia, Dickeyville, Ashburton, Hunting Ridge, and Ten Hills.

The map below shows the distribution of properties that have been granted the CHAP Tax Credit over the last ten years:

Distribution of the Historic Rehabilitation (CHAP) Tax Credit



The second flaw with the CHAP Tax Credit is that it provides a full 100% subsidy on the improved value of the property for any project with construction costs equal to or under $5 million. ***This means that the City receives no new tax revenue on CHAP projects for ten years.*** It is unclear why such a large subsidy is needed for small-scale residential improvements. Other more complex projects such as new commercial development (via the Enterprise Zone Tax Credit) and multi-family residential developments (via the High-Performance Market Rate Tax Credit) provide subsidies that are much less generous than the CHAP tax credit and at least provide some net tax revenue to the City coffers.

The table below shows the terms and subsidy amounts by year for all of the City's development tax credits, ordered from most to least generous:

Tax Credit Percentage by Year
for all City Development Tax Credits

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
CHAP <=$5M	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Enterprise Zone Focus Area	80%	80%	80%	80%	80%	80%	80%	80%	80%	80%
Brownfield in EZ and > $250k cost	70%	70%	70%	70%	70%	70%	70%	70%	70%	70%
CHAP >$5M	80%	80%	80%	80%	80%	70%	60%	50%	40%	30%
Enterprise Zone	80%	80%	80%	80%	80%	70%	60%	50%	40%	30%
High Performance	80%	80%	80%	80%	80%	70%	60%	50%	40%	30%
Brownfield	50%	50%	50%	50%	50%	N/A	N/A	N/A	N/A	N/A
Newly Constructed	50%	40%	30%	20%	10%	N/A	N/A	N/A	N/A	N/A

Fiscal Impact

Extending the CHAP Tax Credit in its current form will result in little to no new net revenue for the City. Based on historical volume, we estimate that 206 new applications with project construction costs equal to or under $5 million will be approved annually. The improved assessments on these projects will lead to higher gross property tax revenues that will be fully offset by the 100% CHAP credit.

However, we believe that there is cost to the City of over-subsidizing projects that might have been financially feasible with a smaller subsidy. As noted above, the CHAP credit is the only subsidy offering a full 100% abatement on the improved value of the property. In addition, the lopsided distribution of the credit in many already-established neighborhoods with strong market indicators suggests that a smaller subsidy would have been enough to incent redevelopment.

To measure this cost to the City, we modeled the cost of the credit under the current terms (100% for ten years) vs. the terms that are used for the High-Performance Market Rate Tax Credit (HPMRTC) and the Enterprise Zone (EZ) Tax Credit (80% credit in Years 1-5 declining to 30% in Year 10).

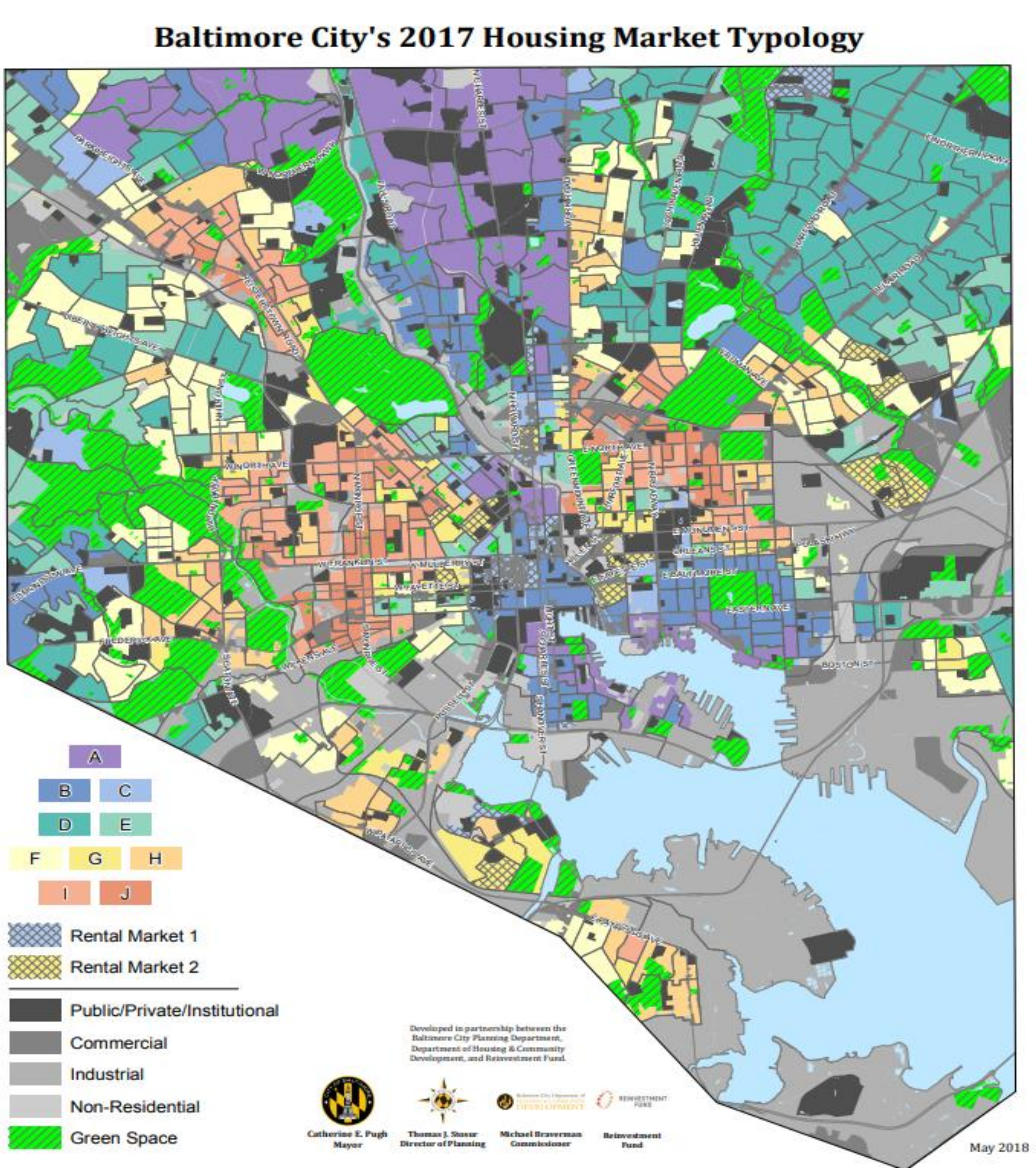
CHAP Cost *(in $ millions)*	**FY 24**	**FY 25**	**FY 26**	**FY 27**	**FY 28**	**Total**
100% for 10 Years	$14.9	16.2	16.1	16.1	16.8	$80.0
80% for Years 1-5 Declining to 30% in Year 10	14.5	15.4	15.0	14.6	14.8	74.3
Difference / Savings:	0.4	0.8	1.1	1.5	1.9	5.7

Modifying the terms of the credit would save the City $5.7 million over the new five-year term, assuming that the volume of projects and credits remains similar to recent trends. Savings would grow even more dramatically over an additional five years, growing to $30.3 million over ten years.

Other Considerations

We believe that, in order to better target the CHAP tax credit to City neighborhoods in need of subsidies for small-scale residential redevelopment, the CHAP Tax Credit should be de-coupled from the local and Federal historic designations. There could still be a role for CHAP to play in overseeing applications and in ensuring that renovations are done in a quality manner that is consistent with the neighborhood's character and aesthetic.

One idea for a new methodology to replace the historic designation is to use Housing's market typology map. This map divides City blocks into typologies ranging from A to J based on housing market indicators such as median sales price, foreclosures, and permits, among other factors. The City could use the map to set up different subsidy levels for different typologies. Presumably, the stronger tracts would require smaller subsidies to incent development while the weaker tracts would require more aggressive subsidies. Pictured below is the Market Typology map from 2017:



Unfortunately, using a different methodology for the CHAP Tax Credit would not be allowable under current State law, and would require a re-examination of the State enabling legislation for this tax credit. The Administration has asked Finance and Planning to review the State law in advance of making a proposal to change the enabling legislation for this credit.

Conclusion

The CHAP Tax Credit has been an effective tool to encourage small-scale residential redevelopment in many Baltimore neighborhoods. However, linking the eligibility with Federal and local historic designations has distorted its use and led to subsidies that do not align with the City's overall development strategy. In addition, the unusually generous terms of this credit have led us to conclude that the City is over-subsidizing many of the residential renovation projects in neighborhoods that already have strong market indicators.

For the reasons stated above, the Department of Finance opposes City Council Bill 22-0299.

We propose a shorter extension (18 months) to provide time for the City to seek State-enabling legislation to modify the terms of the CHAP Tax Credit as outlined above.

cc: Yoanna Moisides
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