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FROM	NAME & TITLE	Robert Cename, Budget Director	CITY of BALTIMORE MEMO	
	AGENCY NAME & ADDRESS	Bureau of the Budget and Management Research Room 432, City Hall		
	SUBJECT	City Council Bill 21-0062 – High-Performance Newly Constructed Dwellings – Clarifications		

DATE:

TO

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

April 26, 2021

Position: Support with amendments

The Department of Finance is herein reporting on City Council Bill 21-0062 – High-Performance Newly Constructed Dwellings – Clarifications, the purpose of which is to extend and change the deadline for applications from June 30, 2021 to within 90 days of closing for properties that have closed prior to July 1, 2022. In addition, the legislation revises the definition of a newly constructed property and makes administrative clarifications allowing for the program to continue.

Background

The High-Performance Newly Constructed Tax Credit was enacted on August 29, 2019, via Ordinance 19-0290, and created a five-year real property tax credit for dwellings fitting the definitions of “Newly Constructed” and “High-Performance”. A “newly constructed” dwelling refers to a residential property that has not been occupied since its construction and for which a building permit has been issued on or after October 1, 1994. This definition includes vacant dwellings that have been rehabilitated and unoccupied since rehabilitation. A “high-performance” dwelling is one that meets certain building standards as established by the U.S. Green Building Council’s Leadership in Energy and Environmental Design, the International Code Council’s 700 National Green Building Standards, or other comparable rating systems, as well as meeting the green building guidelines established by the State.

The original legislation was enacted in response to the sunset of the Newly Constructed Tax Credit on June 30, 2019. Both credits have the exact same term, five-years, and structure, in which a property receives a 50% real property tax credit in the first year and the credit declines by 10% each year after.

Updates to the State legislation in June of 2020 caused a blackout period for High-Performance Newly Constructed Dwellings that received building permits between June 30, 2019, and July 1, 2020, which we think was an unintended result. The portion of the legislation that amends Section 10-18.1 to include an actual definition of a “Newly Constructed Dwelling” rather than relying on the definition in Section 9-304 of the Tax Property Article of the State Code fixes this unintended issue. The City currently has 44 applicants that would be denied the credit due to this change.

Fiscal Impact

The Department of Finance anticipates that this legislation will lead to an increase in tax credit expenditures of up to \$1.3 million, as a result of foregone real property tax revenue.

Tax Credit Scenario	FY22	FY23	FY24	FY25	FY26	FY27	Total
Current - High Perf. Newly Constructed	\$487,471	\$379,480	\$269,231	\$156,318	\$55,054	\$0	\$1,347,553
Proposed - Definition Change	\$175,569	\$145,005	\$112,789	\$78,002	\$40,386	\$0	\$551,751
Proposed - Extension	\$487,471	\$626,648	\$474,294	\$315,847	\$165,161	\$57,009	\$2,126,429
					Proposed Total		\$2,678,180
					Impact		\$1,330,627

Finance currently projects the High-Performance Newly Constructed Tax Credit to continue issuing credits from Fiscal Year 2022 through Fiscal Year 2026, based on the approved applications at this time, at a total cost of \$1.3 million. The proposed legislation extends the application deadline, which we estimate will lead to an additional 50 approved applicants, extending these expenditures to Fiscal 2027 and increasing the total to \$2.1 million. The proposed legislation also changes the definition of Newly Constructed Dwellings, allowing for at least an additional 44 current applicants to receive this credit, this brings the total expenditures up to \$2.7 million.

Based on the expired and expiring tax credits, it is unclear if this credit would lead to new construction that would not have happened in the absence of the credit. If we assume that all 50 dwellings would not have been constructed otherwise, this extension leads to an increase in real property tax revenues of \$2.1 million through Fiscal Year 2027. Due to the current condition of the residential market, Finance does not believe this credit is needed to incentivize new construction.

Other Considerations

The Department of Finance agrees with correcting the definition of newly constructed to remove the gap that is part of the State definition. However, Finance opposes the extension of the sunset date and additional language in Section 3. As such, Finance is proposing an amendment that would maintain the definition change, but eliminate the sunset extension to June 30, 2022 and Section 3 of the legislation. Implementation of this amendment would cost the City approximately \$551,751. This is based on the estimated cost of the 44 applicants that would otherwise be denied the credit due to the change in the State law.

Finance believes that all tax credits should be subject to yearly evaluation. Tax credits should be coupled with performance measures to ensure that credits are sustainable, efficient, and accomplish their intended objectives. As such, finance is working on a framework for a more comprehensive review of tax credits and recommends pausing any new costs until that is complete.

Currently, this tax credit requires an annual report regarding any results and findings of any analysis of the tax credit, including the steps taken and proposed to be taken to promote and otherwise further the use of the tax credit program. The Fiscal Year 2021 Board of Estimates Recommendations budget publication contained an analysis on this credit and the Newly Constructed Tax Credit. The findings of the analysis, based on the application survey, were that both credits were highly concentrated in only a handful of neighborhoods and were received mainly by residents with incomes higher than the City and State average household income. Although many of the recipients were first time homebuyers, a large portion were already City residents and were only looking for homes within the City. Finance is able to provide more details on this report, which is publicly available, and hopes these factors will be taken into consideration when discussing this and other tax credits.

As stated above, the current residential market is the strongest it has been in years. In the current fiscal year, monthly sales volume and average price in the City has routinely ranked within the top 10 of all months recorded dating back to Fiscal 2015. Average prices over the past year are the highest on record with a calendar year 2020 average price of \$208,5712 and calendar year 2021 average price of \$215,608. In addition, the number of recipients of this tax credit has had a minimal impact on the total number of residential transactions. In Fiscal 2021, there have been 78 recipients, which represents only 1% of the average monthly units sold, 783, for calendar year 2020. Based on Finance's analysis, subsidizing the residential market during this time does not appear to be necessary. In contrast, changes in the market spurred by COVID-19 have led to higher office space vacancies and lower incomes, which indicates the City should focus more on commercial property.

The Newly Constructed and High Performance Newly Constructed Tax Credits oftentimes work as a developer credit. The existence of the credit allows for the developer to raise the sale price, as the buyer will have lower taxes in the first five years and resulting lower monthly payments in their mortgage. As the credit declines, buyers are then subject to a higher cost of housing. For some recipients this increase is unexpected. The sale price can be increased enough by developers to completely negate the benefit received by homeowners.

Conclusion

This legislation will result in increased costs of approximately \$1.3 million for the City. In addition, it will extend a tax credit that is not necessary to incentivize new construction in the current market and does not appear to expand the City's tax base or benefit all residents equitably. Finance does not oppose the change in definition to allow for recipients of building permits between June 30, 2019, and July 1, 2020 to receive the credit, but recommends striking the extension of the credit and Section 3 of the legislation.

For the reasons stated above, the Department of Finance supports City Council Bill 21-0062 with amendments.

cc: Henry Raymond
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