FROM

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AGENCY NAME & ADDRESS	Bureau of the Budget and Management Research Room 432, City Hall (410) 396-4774
SUBJECT	City Council Bill 19-0389 – High-Performance Market-Rate Rental Housing (Citywide)—Eligibility for Tax Credit

CITY of BALTIMORE

MEMO

CITY OF BALTIMORE 1797

TO

DATE:

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

October 2, 2019

Position: Oppose

The Department of Finance is herein reporting on City Council Bill 19-0389, High-Performance Market-Rate Rental Housing (Citywide)—Eligibility for Tax Credit, the purpose of which is to modify the number of rental units required to qualify a multi-family dwelling for a High-Performance Market Rate Rental Housing Tax Credit, on a citywide basis. This bill would reduce the requirement to qualify from a rehabilitation or new construction project containing 20 or more rental units to one containing 10 or more rental units.

Background

Targeted HPMRRH Tax Credit

The Targeted High-Performance Market-Rate Rental Housing Tax Credit, adopted in Fiscal 2013 with the passage of City Council Bill 13-0176, was designed to encourage construction and rehabilitation of apartment structures in the City's downtown neighborhoods. The target area, defined in Article 28, § 10-17 (e), includes selected Census Tracts for the Downtown, Reservoir Hill, Jonestown, West Cold Spring Lane, Poppleton, York Road, Bel Air Road and Station North areas. Eligible projects must meet green building standards, have 50 or more rental units, and the total project cost must exceed $60,000 per unit. The credit's value is based on a percentage of the increase in tax liability on the first assessment after an occupancy permit is issued. The credit length is 15 years and phases out over time, from 100% in years 1 and 2 to 20% in years 13 to 15.

With the intent of limiting over-supply of credits, the original legislation required that no new credits could be granted after Fiscal 2019. However, existing credits will phase out over 15 years leaving the City with costs through Fiscal 2033. In Fiscal 2019, there were 12 projects receiving this credit for a total City cost of $4.9 million. There are three projects for which a credit application has been submitted, but not yet approved. From its inception through Fiscal 2020, the cumulative cost to the City is $12.94 million. The table below shows the 13 properties currently receiving the credit in Fiscal 2020 at a total cost of $5.6 million.

Address	Neighborhood	FY 2020 Assessment	Dwelling Units	Year Built	FY 2020 HPMRRH Tax Credit
10 Light St	Downtown	$89,915,767	420	2017	$1,149,264
12 N Calvert St	Downtown	$23,858,367	188	2016	$326,736
20 E Lanvale St	Station North	$10,365,100	103	2018	$177,148
26 S Calvert St	Downtown	$13,693,600	85	2017	$232,887
30 S Calvert St	Downtown	$13,095,700	85	2017	$232,683
103 S Gay St	Downtown	$23,019,500	136	2018	$217,130
111 W Baltimore St	Downtown	$46,283,833	183	2018	$798,330
207 N Calvert St	Downtown	$52,849,667	346	2019	$977,218

300 Saint Paul Pl	Downtown	$41,914,533	173	2019	$498,568
301 N Charles St	Downtown	$12,902,533	92	2015	$141,725
500 Park Ave	Downtown	$23,339,800	153	2019	$482,212
520 Park Ave	Downtown	$19,160,100	171	2016	$293,744
521 Saint Paul St	Downtown	$7,652,000	69	2014	$85,465
Total					**$5,613,110**

Citywide HPMRRH Tax Credit

The High-Performance Market-Rate Rental Housing Tax Credit, adopted in Fiscal 2014 with the passage of City Council Bill 14-0359, was not restricted to any geographic area. The credit was designed to encourage construction and rehabilitation of apartment structures throughout the City. Eligible projects are required to have 20 or more rental units and total project cost must exceed $60,000 per unit. The credit's value is based on a percentage of the increase in tax liability on the first assessment after an occupancy permit is issued. The credit length is 10 years and phases out over time, from 80% in years 1 to 5, to 30% in year 10.

The initial deadline to apply for the credit was December 31, 2017, but this credit was extended in Fiscal 2017 with the passage of City Council Bill 17-0030. This bill extended the application period by five years to December 31, 2022 and extended the permitting deadline for completed projects by five years, to June 30, 2024, from June 30, 2019.

In Fiscal 2019, there were 10 projects receiving this credit for a total credit amount of $4.70 million. There are 18 projects for which a credit application has been submitted, but not yet approved. From its inception through Fiscal 2020, the total cumulative cost to the City is $8.46 million. City costs are expected to grow through the application deadline in 2022, and then phase out over the next ten years through 2032. The table below shows the 10 properties currently receiving the credit in Fiscal 2020 at a total cost of $6.2 million.

Address	Neighborhood	FY 2020 Assessment	Dwelling Units	Year Built	FY 2020 HPMRRH Tax Credit
1212 S East Ave	Canton	$10,654,933	57	2015	$170,967
2700 Remington Ave	Remington	$20,063,300	86	2017	$216,739
3232 Eastern Ave	Highlandtown	$11,255,600	65	2017	$190,117
3610 Dillon St	Brewers Hill	$15,000,000	60	2016	$266,611
414 Light St	Otterbein	$141,934,300	394	2018	$3,159,184
501 W Franklin St	University of MD	$13,396,700	139	1962	$167,780
611 S Charles St	Otterbein	$82,184,833	349	2017	$1,237,769
711 W 40th St	Hampden	$91,908,600	379	2016	$729,858
815 Park Ave	Mount Vernon	$2,319,300	25	2018	$27,210
824 N Calvert St	Mount Vernon	$5,340,000	49	2017	$71,343
Total					**$6,237,577**

Fiscal Impact

City Council Bill 19-0389 would modify the number of rental units required to qualify a multi-family dwelling the citywide version of the High-Performance Market-Rate Rental Housing Credit by reducing the rental unit threshold from 20 or more units to 10 or more.

To calculate the cost impact, we compared the universe of eligible projects under current law (20 units or more) with those that would become eligible under this bill (10 units or more). We then used the current law to predict the average assessed value for an eligible project and the average cost of the credit under the proposed law. The following table summarizes these findings.

	20 Units or More Requirement	10 Units or More Requirement
Universe of potentially eligible properties in 2019	51	1,098
Number of properties granted / potentially-granted tax credit	10	215
Total value of HPMRRH - Citywide Tax Credit	$4,700,998	$15,758,904
Average value of HPMRRH - Citywide Tax Credit	$470,100	$73,197
Average assessed value - properties w/HPMRRH - Citywide Tax Credit	$25,516,707	$4,003,738

Note: $15.8 million = Average amount of tax credit per square foot under current regulation * average property sf. area under the new regulation * total number of potentially eligible x 20% (assuming 20% of the properties will receive tax credits under the new regulation) = $1.8 x 40,101sf. x 1,098 x 20%.

By relaxing the requirement for the number of units required to qualify for the credit, this bill would significantly expand the universe of projects eligible for the credit, at an estimated cost of $11 million annually, and $113.1 million over ten years.

Other Considerations

Finance's viewpoint is that tax credits should be treated like any other expenditure and should be vigorously evaluated periodically to ensure the best result for the City. To that end, as part of the City's 10-Year Financial Plan refresh, we have worked with our vendor, Ernst & Young, to evaluate each of the City's tax credits.

We do not find the reasons for expanding this credit compelling based on our fiscal analysis and examination of the following factors.

Green Construction

One of the justifications for the original High-Performance Market-Rate Rental Housing Tax Credit was to encourage green construction and development. However, construction and/or renovation of high-performance buildings is now required by the City's Building Code. Part XI, Section 101.3 of the Baltimore City Building Fire and Related Codes mandates specific green construction requirements for multiple-family dwellings that are four stories or higher with more than five dwelling units. Buildings must be built according to the Code – modeled after the International Green Construction Code – or one of several codified alternatives, including LEED Silver. All newly constructed or converted residential buildings must comply with these requirements.

Even if developers had the option to choose between green building standards versus traditional construction, there are substantial financial incentives for investing in green building projects without the need for public subsidies. For example, the US Green Building Council reports that LEED-certified buildings have 20 percent lower maintenance costs, consume 25 percent less energy and 11 percent less water. Further research shows that tenants are willing to pay a premium to occupy LEED certified space. A University of San Diego study showed that green buildings have 3.5 percent lower vacancy rates and 13 percent higher rental rates than their traditional counterparts.

Multi-Family Building Activity

The market for multi-family buildings has begun to show signs of fatigue. According to data from the Federal Department of Housing and Urban Development (HUD), in its Comprehensive Housing Market Analysis for the Baltimore-Columbia-Towson area published in 2018, construction in this market peaked during 2016 and 2017, with an average of 2,750 units permitted annually. Through May 2018, only 380 new units had been permitted, down 55% year-over-year.

In turn, Baltimore's rental vacancy rate has grown from 6.2% to 6.8% in 2018. Baltimore's rental vacancy rate is already consistently higher than regional and national averages, and this rate has been exacerbated by the rapid pace of apartment construction in 2016 and 2017. These factors suggest that the City is not able to support additional rental market inventory for the short-to-medium term and should not approve additional subsidies for rental housing.

Economic Development

One way to determine the impact of a tax credit is to look at key neighborhood housing variables both before and after the implementation of the tax credit. When looking at the neighborhoods with properties granted this tax credit, we found that these neighborhoods were already experiencing significant per capita income growth and reductions in vacancy rates. The preexistence of increased housing demand in these neighborhoods indicates that they were low risk to developers and in little need of subsidy.

Neighborhoods with HPMRRH-Citywide Tax Credit in 2019					
	2010	2015	2019	2010-2015 Change	2015-2019 Change
Per Capita Income	$36,422	$41,608	$49,141	14.2%	18.1%
Total Properties	15,336	15,447	15,500	0.7%	0.3%
Average Assessment value	$229,064	$213,089	$265,038	-7.0%	24.4%
Total Housing Units	15,286	16,743	17,386	9.5%	3.8%
Vacancy Rate	18%	13%	12%	-4.7%	-0.8%

We also examined comparable neighborhoods to those that received the tax credit. Here we found that these neighborhoods experienced similar income and assessment growth without the benefit of this credit.

Comparable Neighborhoods without HPMRRH-Citywide Tax Credit (at least 20 units)					
	2010	2015	2019	2010-2015 Change	2015-2019 Change
Per Capita Income	$24,952	$26,621	$30,803	6.7%	15.7%
Total Properties	15,880	16,128	16,451	1.6%	2.0%
Average Assessment value	$282,316	$272,248	$348,870	-3.6%	28.1%
Total Housing Units	23,328	23,629	23,878	1.3%	1.1%
Vacancy Rate	18%	14%	14%	-3.2%	-0.3%

These findings suggest that this tax credit was subsidizing the construction of more expensive apartments in neighborhoods that were already seeing a pattern of growth.

Equity Considerations

When the High-Performance Market-Rate Tax Credit was expanded from a targeted area to a City-wide credit, one of the stated objectives was to spur development of market-rate apartments to more neighborhoods throughout the City. However, the evidence to date suggests that properties in only eight neighborhoods have received the credit, which represents only 2.8% of the City's 278 defined neighborhoods. The chart below lists the number of credits granted by neighborhood.

Total Number of HPMRRH –Tax Credit by Neighborhood				
	2016	**2017**	**2018**	**2019**
Otterbein			1	2
Hampden		1	1	1
Brewers Hill			1	1
Remington			1	1
Highland Town			1	1
Canton	1	1	1	1
University of Maryland		1	1	1
Mount Vernon			1	2
Baltimore City	**1**	**3**	**8**	**10**

Conclusion
The High-Performance Market-Rate Tax Credit will cost the City $13.2 million in Fiscal 2020 and grow to $22.4 million by Fiscal 2022 due to 12 properties that are in the pipeline. This legislation, by relaxing the number of units required (from 20 to 10) to qualify for the credit, would further expand the universe of eligible properties with the potential for an **additional $11 million of cost**.

In addition to the significant cost, from a policy perspective, the reasons to incent this type of building over others is limited. Construction for apartments has slowed and rental vacancy rates have grown, suggesting over-supply in the market. The green construction requirements that were required for tax credit eligibility are now part of the building code anyway. Additionally, our evaluation shows a clear pattern where credits were granted for projects in neighborhoods that were already experiencing significant growth, which has likely increased financial returns to developers rather than spread this type of housing to more City neighborhoods.

For the reasons stated above, the Department of Finance opposes City Council Bill 19-0389 and would propose an amendment to accelerate the sunset provision from December 31, 2022 to December 31, 2019.

cc: Henry Raymond
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