FROM

NAME & TITLE: Robert Cenname, Deputy Finance Director

AGENCY NAME & ADDRESS: Bureau of the Budget and Management Research
Room 432, City Hall

SUBJECT: City Council Bill 23-0369 – High Performance Inclusionary Tax Credit

CITY of BALTIMORE

MEMO

TO

DATE:

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

May 9, 2023

Position: Oppose

The Department of Finance is herein reporting on City Council Bill 23-0369, High-Performance Inclusionary Tax Credit, for the purpose of establishing a High-Performance Inclusionary Housing Tax Credit, and providing for the eligibility criteria and amount of the credit and defining certain terms.

Background

CCB 23-0369 (High-Performance Inclusionary Tax Credit) is intended to provide a subsidy for development projects that qualify under companion bill CCB 22-0195 (Inclusionary Housing for Baltimore City). CCB-0195, as currently amended, would require developers to create affordable units as part of any new residential project that is newly-constructed, wholly renovated, or converted, with at least 20 units and a cost of at least $60,000 per unit. The "affordable" requirement would equal 10% of total units for households at 60% of the Area Median Income (AMI), and the inclusionary requirements would apply to any project City-wide. CCB 23-0369 would create a 15-year 15% tax credit to compensate developers for the lost rental revenue from the affordability requirements.

Prior to the introduction of CCB 22-0195 and CCB 23-0369, the City Department of Housing and Community Development (DHCD) issued an RFP to seek a consultant to make recommendations on an inclusionary housing ordinance for Baltimore City. Enterprise Community Partners, a leading expert in the field, was chosen as the consultant and completed a draft report in August 2021 and final report in November 2022. Enterprise concluded that the City could only support inclusionary requirements in "Core" sub-markets, defined as areas of the City with the highest rents and strongest market demand. Further, even in these markets, Enterprise estimated that a 10-year 15% tax credit would be required to make the projects financially feasible for developers. Enterprise did not recommend inclusionary requirements outside of the "Core" sub-market.

In summary, the companion bills, CCB 22-0195 and CCB 23-0369, would include requirements that stretch well beyond the recommendation of the subject-matter expert, Enterprise, in three ways:

	Enterprise Recommendation	City Council companion bills
Geography	"Core" sub-market only, roughly analogous to Typology A	City-wide
Tax Credit	10-year, 15%	15-year, 15%
Affordability Requirements	5% of units at 60% AMI, 5% of units at 80% AMI	10% of units at 60% AMI

Fiscal Impact
The wide disparity between the recommendations of the subject-matter expert and the companion bills currently under consideration raises three concerns for the Department of Finance:

Lost Tax Revenue: Inclusionary requirements that go beyond what the City housing market can bear threaten the City's property tax and other related revenues. To measure this impact, we looked back at multi-family projects that qualified for the High-Performance Market Rate Tax Credit over the past five years. Over this time, an average of four multi-family projects have been built each year in the "Strong" or "Transitional" sub-markets, with an average post-assessed property value of $16.9 million per property. Based on Enterprise's assessment of the City's housing market these projects would not be feasible financially under an inclusionary requirement and would not be built. This would cost the City valuable tax revenue over time:

Lost Property Tax Revenue
($ in millions)

	Y1	Y2	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10	Y11	Y12	Y13	Y14	Y15	Total
Lost Revenue	0.3	0.6	0.9	1.3	1.6	2.1	2.8	3.6	4.4	5.9	6.0	6.2	6.4	6.6	6.8	**55.8**

Further, there is no guarantee that an inclusionary requirement would not further threaten development in Core sub-markets. Projects that are currently feasible can change quickly as housing demand, interest rates, and other market conditions change. With an inclusionary requirement locked into statute, the City would be poorly positioned to react if there are negative impacts on the housing market.

Subsidy Cost: Even in a more optimistic scenario where development continues to occur under an inclusionary requirement, the City would bear all of the incremental cost for subsidizing the new inclusionary units. To measure this impact, we looked at the current volume of new multi-family housing construction that qualifies for the High-Performance Market Rate Tax Credit. Between Fiscal 2019 and 2022 the City is averaging six new qualifying projects per year:

	Core Sub-Market	Other Sub-Markets	Total
Projects	2	4	6
Average Assessment	$61,705,700	$16,936,985	$78,642,685
Total Assessment	$123,411,400	$67,747,942	$191,159,342
Gross Tax Revenue	$2,774,288	$1,522,974	$4,297,262
New 15% Credit Cost	$416,143	$228,446	$644,589

If we assume that, going forward, six qualifying multi-family projects will get built each year, the City would incur a cost of $644,589 in the first year and then grow over the next fifteen years, for a total cost of $102.5 million. The cost would then level off at approximately $15.0 annually, as the expiration of earlier tax credits offsets the cost of additional subsidies:

Incremental Tax Credit Costs
($ in millions)

	Y1	Y2	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10	Y11	Y12	Y13	Y14	Y15	Total
Cost	0.6	1.3	2.1	2.8	3.6	4.5	5.4	6.3	7.3	8.4	9.5	10.7	11.9	13.3	14.6	**102.5**

***Budget Context*:** Since the introduction of CCB 22-0195 in 2022, the City's financial outlook has changed dramatically. In Fiscal 2024 the City will face an unanticipated $79 million increase in State-mandated contributions for City Schools. In total the City's contribution for Schools will increase by $129 million, or 49%, over just a two-year span. Due to this dramatic increase in costs, the Fiscal 2024 budget relies on one-time resources of $30 million just to stay in balance.

The additional State-mandated Kirwan costs are already crowding out other much-needed investments in basic City needs: employee pay, core service delivery, and infrastructure investment, among many others. Adding an additional new unbudgeted program, with the guarantee of either new General Fund costs or lost revenue, adds too much risk to the City's already precarious financial position.

Other Considerations

The current bill language for CCB 23-0369 includes a number of problems, including the definitions of certain terms, the rules for calculating the credit, and the positioning of the High-Performance Inclusionary Housing Tax Credit vis-à-vis other City tax credits. We believe these issues were caused by using language from the 15-year High-Performance Market Rate "Targeted" Tax Credit which has since expired. Additionally, we estimate that it will take nine months from time of enaction to create and test a new online application. BCIT estimates 6-7 months to develop the online application, and Finance requires two months to test the application. Therefore, we recommend that the ordinance becomes effective nine months after the date of enaction.

A better approach would be to start with the currently active High-Performance Market Rate Tax Credit and to make the additional 15% for the Inclusionary Housing Tax Credit part of an enhanced subsidy under the existing active tax credit, rather than creating an entirely new tax credit. This would simplify the application process, make the calculations consistent, and cut down on the time for programming the tax credit system. The Department of Finance would like to work with the Department of Legislative Reference on a clean draft of the bill which would meet these terms.

Conclusion

The Department of Finance does not believe that the City can support a broad-based inclusionary housing requirement as envisioned by companion bills 22-0195 and 23-0369 without incurring significant costs. The Enterprise report, which was commissioned to study this issue, concludes that the vast majority of the City's housing market is too weak to bear these additional requirements.

In effect, the City faces a "lose-lose" financial proposition under these companion bills. In a weak housing market in which new inclusionary requirements scare away potential new development, the City suffers from the loss of valuable property tax revenue. In a strong housing market where development occurs even with inclusionary requirements, the City bears the full cost of the additional subsidy through the new tax credit.

In order to mitigate the City's risk from this bill, two changes will be necessary. One, the bill will need to align more closely with the terms laid out in the Enterprise report on geography and income restrictions. And, two, an annual cost cap will be needed on the new tax credit to limit the City's financial exposure.

For the reasons stated above, the Department of Finance opposes City Council Bill 23-0369 in its current form.

cc: Michael Moiseyev
Nina Themelis