HB 510

Department of Legislative Services

Maryland General Assembly
2014 Session

FISCAL AND POLICY NOTE
Revised

House Bill 510 (Chair, Ways and Means Committee)(By Request - Departmental - Planning)

Ways and Means Budget and Taxation

Sustainable Communities Tax Credit Program - Extension and Alteration

This departmental bill extends the termination date of the Sustainable Communities Tax Credit Program through fiscal 2017, requires the Governor to include an appropriation to the commercial program in fiscal 2015 through 2017, authorizes the Maryland Historical Trust (MHT) to award a maximum $4.0 million in credits to small commercial projects, clarifies the authority of MHT to revoke certain expired tax credits, and alters other program eligibility requirements and procedures.

The bill takes effect June 1, 2014.

Fiscal Summary

State Effect: General fund revenues decrease by $0.9 million in FY 2015 due to residential credits claimed against the income tax. General fund expenditures increase by $10.0 million beginning in FY 2015 due to commercial project appropriations. The Governor's proposed FY 2015 budget includes $10.0 million in program funding and assumes $19.1 million in revenues related to expired tax credits. Special fund revenues and expenditures increase by $0.3 million beginning in FY 2015 reflecting administrative fees and expenditures at MHT. **This bill establishes a mandated appropriation beginning with FY 2015.**

($ in millions)	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
GF Revenue	($0.9)	($2.3)	($4.6)	($1.7)	($0.3)
SF Revenue	$0.3	$0.3	$0.3	$0	$0
GF Expenditure	$10.0	$10.0	$10.0	$0	$0
SF Expenditure	$0.3	$0.3	$0.3	$0	$0
Net Effect	($10.9)	($12.3)	($14.6)	($1.7)	($0.3)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local highway user revenues decrease as a result of any credits claimed against the corporate income tax. Local expenditures are not affected.

Small Business Effect: The Maryland Department of Planning has determined that this bill has a meaningful impact on small business (attached). Legislative Services concurs with this assessment. (The attached assessment does not reflect amendments to the bill.)

Analysis

Bill Summary: The bill extends the termination date of the Sustainable Communities Tax Credit Program through fiscal 2017 and alters the program as discussed below.

Extends Termination Date and Funding

The bill extends the program's termination date through fiscal 2017 for both commercial and owner-occupied residential property rehabilitations. The Governor is required to provide an appropriation to the reserve fund for commercial projects in fiscal 2015 through 2017. MHT can award residential credits through June 30, 2017.

Removes Eligibility for Qualified Rehabilitated Structures

Under current law, certain nonhistoric properties can qualify for a 10% tax credit under the commercial program. The bill repeals eligibility for these qualified rehabilitated structures to receive the tax credit.

Small Commercial Project Eligibility

The bill establishes credit eligibility for small commercial projects that meet certain requirements. Applicants must apply to MHT in order to qualify and receive an initial credit certificate. MHT may award a maximum of $4.0 million in credits beginning on January 1, 2015. A small commercial project is the rehabilitation of a structure primarily used for commercial, income-producing purposes if (1) the qualified rehabilitation expenditures do not exceed $500,000 and (2) the structure is located within a sustainable community. Small commercial projects include mixed use commercial/residential buildings, but structures that are used solely for residential purposes do not qualify. MHT, in consultation with the Smart Growth Subcabinet, must adopt regulations (1) establishing the percentage of the structure that may be used for residential purposes if the structure is a mixed-use purpose building and (2) specifying criteria and procedures for the issuance of initial credit certificates.

Program criteria related to commercial projects would not apply to small commercial projects, as the bill alters the definition of a single-family, owner-occupied residence to include a small commercial project. For these small commercial projects, (1) there is no reserve fund to offset the cost of credits; (2) the amount of the credit is generally equal to 20%, subject to a maximum of $50,000; (3) at least $5,000 must be spent to qualify (compared with the greater of $25,000 or the adjusted basis of the property for other commercial projects); (4) the project must meet program requirements related to historic structures and rehabilitations; and (5) the credit is subject to specified recapture provisions.

Expired Projects and Fund Transfers since Fiscal 2006

Under current law, initial credit certificates expire and credits may not be claimed if the applicant:

- has not notified MHT in writing within 18 months of credit certificate issuance that the commercial rehabilitation has begun;
- does not complete the rehabilitation within 30 months after credit certificate issuance; or
- fails to pay within 120 days the required fee charged to certify the rehabilitation.

For reasonable cause, MHT may postpone the 18-month and 30-month expiration provisions. Expired initial credit certificate amounts are transferred to the general fund.

The bill alters these provisions by (1) accelerating to 90 days the time in which an applicant must pay the required fee charged to certify a rehabilitation and (2) specifying that initial credit certificates expire if the applicant does not submit to MHT a request for final certification within 12 months after the 30-month expiration provision described above or the date to which MHT postponed the expiration date of the initial credit certificate. For reasonable cause, MHT may postpone this deadline if the commercial rehabilitation was completed prior to the expiration of the initial credit certificate. MHT may not accept an application from a commercial applicant whose credit certificate expired due to nonpayment of the required fee in the three fiscal years following the fiscal year after the certificate expiration.

The bill requires MHT to provide additional notices and deadlines for any commercial rehabilitation that (1) was approved from July 1, 2006, through June 30, 2014; and (2) the applicant does not submit to MHT within 12 months of the expiration date of the initial credit certificate a request for final certification. MHT is required to notify the applicant in writing that the credit certificate will be revoked within six months of the written notice unless the applicant provides to MHT (1) documentation that the rehabilitation was completed prior to the expiration and (2) written notification that the applicant intends to submit a request for final certification within 12 months of the written notice. The bill provides that an initial credit certificate is revoked and the credit may not be claimed if the applicant does not respond as required by the written notice or does not submit to MHT a request for final certification within 12 months of the written notice. MHT is required to report to the Comptroller the number and amount of credit certificates that have been revoked.

Commercial Credits Issued Before Fiscal 2005

The Budget Reconciliation and Financing Act (BRFA) of 2013 (Chapter 425) established procedures for the expiration of commercial rehabilitation credits approved prior to fiscal 2005. Specifically, BRFA provided that any commercial credit approved before fiscal 2005 expires on July 1, 2014, unless the applicant demonstrates to MHT that the project has a valid and unexpired building permit.

The bill alters these provisions by (1) delaying to January 1, 2015, the date by which credits will expire unless the applicant provides the documentation described above and (2) requiring that an applicant provide documentation that construction of the project began within three months of the building permit issuance. The bill also delays certain MHT-related reporting requirements related to these credits by six months.

Fees and Administrative Aspects

The bill also:

- reduces, from 75% to 60%, the maximum amount of total initial credit certificates issued in a fiscal year that can be allocated for projects located in one county or Baltimore City;

- requires MHT to develop programs, including web-based tools, in order to (1) increase residential and commercial tax credit participation in jurisdictions that have been historically underrepresented in the award of tax credits; and (2) educate eligible small businesses on the availability of tax credits. MHT must consult with local planning officials in jurisdictions that have been historically underrepresented prior to developing a program to increase tax credit participation in these jurisdictions;

- requires MHT to establish an additional minimum fee for the second phase of the application process;

- eliminates the requirement that MHT, in consultation with the Smart Growth Subcabinet, adopt regulations that favor the award of tax credits for commercial projects located in sustainable communities; and

- requires MHT, in consultation with the Smart Growth Subcabinet, to adopt regulations for commercial rehabilitations (1) requiring documentation that the applicant has ownership or site control of the structure and (2) providing a time limit for approval of the additional tax credit available if certain energy efficiency standards are met.

Current Law: The Sustainable Communities tax credit program terminates June 30, 2014. The value of the credit is dependent on the type of rehabilitation undertaken and is equal to (as a percentage of qualified rehabilitation expenditures):

- 20% for the rehabilitation of a single-family, owner-occupied residence;
- 20% for the rehabilitation of a certified historic structure (25% if certain energy efficiency standards are met); and
- 10% for the rehabilitation of a qualified rehabilitated structure.

The value of the tax credit may not exceed (1) for a commercial rehabilitation (any building that is not a single-family, owner-occupied residence), $3 million or the maximum amount specified under the initial credit certificate or (2) for all other rehabilitations, $50,000. In order to qualify, a rehabilitation must be substantial. A substantial rehabilitation is the rehabilitation of a structure for which the qualified rehabilitation expenditures over a 24-month period exceed (1) $5,000 for a single-family, owner-occupied residence; (2) the greater of 50% of the adjusted basis of the property, or $25,000 for a qualified rehabilitated structure located in a Main Street Maryland Community; or (3) the greater of the adjusted basis of the property or $25,000 for all other properties.

A qualified rehabilitated structure is a building other than a single-family, owner-occupied residence that is located in (1) a commercial area designated by January 1, 2010, either by the Secretary of Housing and Community Development as a Main Street Maryland Community or by the Mayor of Baltimore City as a Main Street or (2) beginning in fiscal 2012, a sustainable community. The rehabilitation must retain specified minimum percentages of internal and external walls and internal framework during the rehabilitation.

Residential Program

MHT can award an unlimited amount of residential credits for applications received through June 30, 2014. A single-family, owner-occupied residence is a structure or a portion of a structure occupied by the owner and the owner's immediate family as their primary or secondary residence. A single-family, owner-occupied residence includes a residential unit in a cooperative project owned or leased to a cooperative housing corporation and leased for exclusive occupancy to, and occupied by, a member of the corporation and the member's immediate family.

Commercial Program

The commercial program includes the rehabilitation of certified historic structures and qualified rehabilitated (nonhistoric) structures. The Governor must appropriate funds to the program in fiscal 2011 through 2014. A maximum of 10% of initial credit certificates can be awarded to qualified rehabilitated structures in each fiscal year.

MHT must, for commercial rehabilitations, adopt regulations in consultation with the Smart Growth Subcabinet that establish a competitive process for awarding commercial rehabilitation credits that favors the award of credits for projects that meet specified criteria.

Initial credit certificates expire if (1) within 18 months after the certificate was issued, the applicant has not notified MHT that the rehabilitation has begun or (2) within 30 months after the certificate was issued, the commercial rehabilitation is not completed. However, MHT may postpone the deadline for the completion of a project. On notification that the initial credit certificate for a project has expired due to the provisions above, the Comptroller is required to transfer an amount equal to the maximum credit amount stated in the initial credit certificate for the project from the reserve fund to the general fund.

In addition, the residential and commercial credits are recaptured if within four years specified disqualifying work is performed or the commercial property for which the credit is claimed is sold or otherwise transferred.

Background:

Program Evolution

The Sustainable Communities tax credit program, established in 2010, evolved from and replaced the former Heritage Structure Rehabilitation tax credit program. The Heritage tax credit program was established in 1996 as part of a larger piece of legislation that targeted heritage preservation and tourism. The Maryland Historical Trust (MHT) was designated as the State entity responsible for administering the tax credit, which operated as a traditional tax credit that was not subject to an aggregate limitation.

Legislation enacted in 2002 and 2004 enacted several significant legislative changes to the tax credit, primarily due to increasing concerns about the cost of the credit. The commercial tax credit portion was shifted from a traditional tax credit program to a tax credit program that is subject to an annual appropriation in the State budget, with an aggregate limitation based on the final appropriation and a limitation on the amount of credits that could be awarded to projects in a single jurisdiction. The maximum amount of credits earned for an individual rehabilitation project was set at a maximum of $50,000 for residential projects, and the lesser of $3 million or the maximum amount stated on an initial credit certificate for commercial projects. MHT must award an initial credit certificate to each approved commercial rehabilitation project based on the amount of estimated rehabilitation expenditures.

Commercial projects are awarded credits through a competitive process and a reserve fund was established to offset future credits claimed for the rehabilitation of commercial properties. The General Assembly also specified that the total amount of initial credit certificates issued by MHT in each fiscal year cannot exceed the amount appropriated to the reserve fund. There was no aggregate cap or reserve fund requirement, however, for residential tax credits.

Chapter 487 of 2010 reestablished the Heritage tax credit as the Sustainable Communities tax credit, altered the credit to allow certain nonhistoric properties to qualify, and extended the program’s termination date through fiscal 2014.

Commercial Tax Credit

The tax credit for commercial properties evolved into one of the State’s largest economic development programs and has been one of the largest business-related income tax credits. Since 1997, completed commercial rehabilitations have earned credits totaling $258.4 million. In addition, projects that are not yet completed may earn up to an additional $70.7 million in credits, bringing the potential total tax credits to $329.1 million through fiscal 2014. This amount includes credits awarded to projects that have not been completed and under current law have expired.

Since fiscal 2006, the commercial tax credit has existed as a budgeted tax credit with an aggregate limit. **Exhibit 1** lists the amount appropriated to the reserve fund in fiscal 2006 through 2014 and the actual amount of credits allocated in each year. The amount actually allocated may be different than the amount appropriated for several reasons, including Board of Public Works (BPW) funding reductions, expired credits, and carry-over credits that were appropriated but not allocated in the previous fiscal year. For example, as part of overall cost containment actions, BPW reduced the amount appropriated to the reserve fund in fiscal 2008 through 2010 as well as reducing the reserve fund balance by $671,000 in each of fiscal 2008 and 2009. Slightly less than $10 million was not allocated in fiscal 2007 due to the geographic limitation in effect at the time and was instead allocated in fiscal 2008. In addition, certain expired credits reverted to the general fund and were not reallocated. An estimated $6.9 million in credits were awarded but have subsequently expired because the projects did not meet specified deadlines; these credit amounts are transferred to the general fund.

Exhibit 1
Tax Credit Reserve Fund
Commercial Projects
Fiscal 2006-2014

Fiscal Year	Appropriated	Net Allocated
2006	$20,000,000	$18,595,256
2007	30,000,000	17,991,059
2008	15,000,000	21,901,343
2009	14,700,000	9,555,112
2010	7,000,000	3,820,000
2011	10,000,000	10,257,200
2012	7,000,000	6,958,000
2013	7,000,000	6,871,619
2014	10,000,000	10,001,035
Total	**$120,700,000**	**$105,950,624**

Source: Maryland Historical Trust; Department of Legislative Services

Geographic Distribution

Exhibit 2 lists by county the number of projects and total amount of commercial credits under the Heritage tax credit when it was not subject to an annual appropriation and since fiscal 2006, when both the Heritage and Sustainable Communities tax credits were subject to an annual appropriation and limitation on the amount of credits a single jurisdiction could receive.

Exhibit 2
Commercial Tax Credit Projects by County
Current and Prior Programs
1997-2014

	Prior to Chapter 76 of 2004*			Fiscal 2006 – 2014**		
County	**#**	**Total**	**% Total**	**#**	**Total**	**% Total**
Allegany	14	$2,097,054	1.0%	8	$4,234,165	4.2%
Anne Arundel	16	4,765,292	2.3%	5	333,557	0.3%
Baltimore	12	3,639,098	1.7%	7	1,530,911	1.5%
Baltimore City	249	189,067,426	89.9%	90	73,787,399	72.8%
Calvert	1	63,852	0.03%	0	0	0.0%
Caroline	0	0	0.0%	3	97,600	0.1%
Carroll	8	1,843,804	0.9%	8	2,688,444	2.7%
Cecil	2	90,135	0.04%	0	0	0.0%
Charles	0	0	0.0%	0	0	0.0%
Dorchester	2	67,637	0.0%	7	1,345,323	1.3%
Frederick	14	4,661,966	2.2%	7	743,280	0.7%
Garrett	0	0	0.0%	0	0	0.0%
Harford	1	100,000	0.05%	1	100,000	0.1%
Howard	6	374,841	0.2%	1	70,000	0.1%
Kent	3	189,814	0.1%	6	1,496,967	1.5%
Montgomery	7	905,145	0.4%	5	4,846,701	4.8%
Prince George’s	2	553,724	0.3%	4	1,875,836	1.8%
Queen Anne’s	3	148,032	0.1%	1	824,570	0.8%
St. Mary’s	2	172,613	0.1%	0	0	0.0%
Somerset	0	0	0.0%	2	189,640	0.2%
Talbot	7	1,257,590	0.6%	10	3,945,483	3.9%
Washington	3	143,578	0.1%	7	3,308,295	3.3%
Wicomico	2	109,498	0.1%	0	0	0.0%
Worcester	1	35,879	0.02%	0	0	0.0%
Total	**355**	**$210,286,978**		**172**	**$101,418,170**	

*Includes only completed projects and does not include credits awarded to projects that have not yet received final certification.
**Amounts include both completed projects and active incomplete projects.

Source: Maryland Historical Trust; Department of Legislative Services

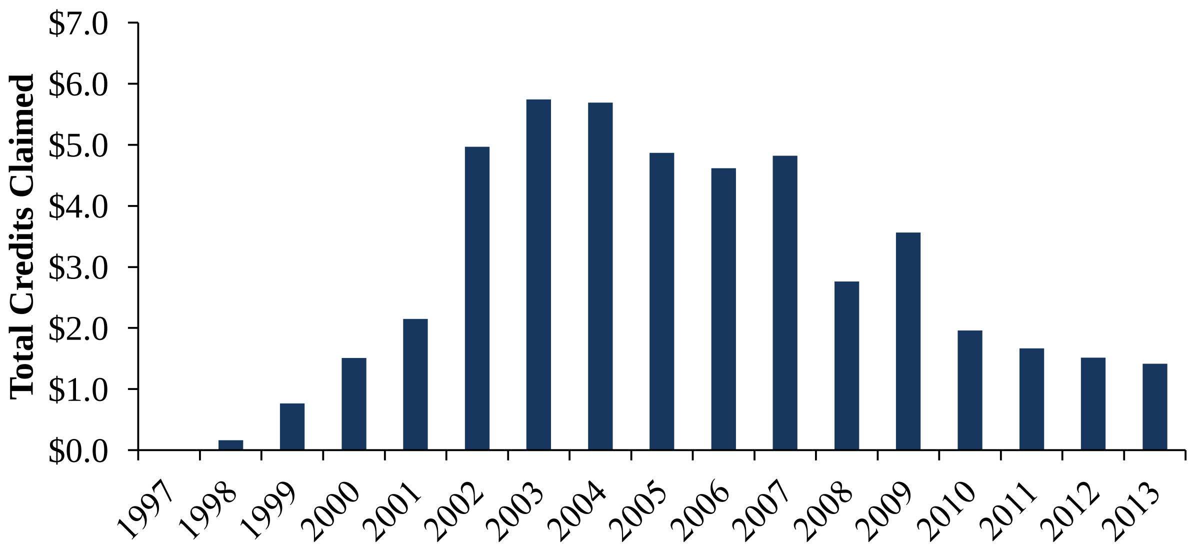
Baltimore City projects earned about 90% of all credits prior to Chapter 76, compared with just under three-fourths of credits under the budgeted tax credit.

Residential Credit

Although substantially smaller in scope than commercial projects, about 3,100 residential projects have earned a total of $48.2 million in credits since the program's inception. A total of $235.0 million in residential rehabilitation expenditures have qualified under the program. Although the current maximum value of the credit is limited to $50,000, the average credit earned since the program's inception is $15,600.

Exhibit 3 shows the amount of residential credits earned since calendar 1997. After initial sluggish growth, the residential program experienced exponential growth through 2002 and remained relatively static through 2007 before the economic and housing market downturns stunted rehabilitations in 2008. After rebounding in 2009, less than $2 million in credits has been earned in each of the last four calendar years.

Exhibit 3
Total Residential Credits
1997-2013
($ in Millions)



Source: Maryland Historical Trust; Department of Legislative Services

State Fiscal Effect: The bill extends the termination date of the program to June 30, 2017, and requires that the Governor provide an appropriation to the reserve fund for commercial projects in fiscal 2015 through 2017. As a result, the net effect on

State finances will be a decrease of $10.9 million in fiscal 2015. **Appendix 1** details the fiscal impact of the bill in fiscal 2015 through 2019.

Credit Reserve Fund

The bill does not require or suggest an amount that should be appropriated to the reserve fund. The Governor's proposed fiscal 2015 budget includes $10.0 million in commercial program funding. Based on the average amount of funding provided under the existing program, it is estimated that the program will receive $10.0 million annually through fiscal 2017.

The money transferred to the reserve fund is to be transferred back to the general fund on a quarterly basis based on the projects that are certified as being completed in that calendar quarter and would act to offset general fund revenue losses resulting from credit being claimed for these completed projects. Thus, general fund transfers for a project with an offsetting tax credit claim generally do not impact State finances.

Small Commercial Projects

The bill establishes credit eligibility and criteria for small commercial rehabilitation projects. MHT may award a maximum aggregate amount of $4.0 million in credits to these projects beginning on January 1, 2015.

As a result, general fund revenues may decrease by $115,000 in fiscal 2016, $1.8 million in fiscal 2017, $1.7 million in fiscal 2018, and $338,000 in fiscal 2019.

This estimate is based on the following facts and assumptions:

- According to MHT, there are an estimated 4,716 properties that are located within a sustainable community and that meet program requirements.
- MHT indicates that there are a total of 103,186 properties eligible for the residential credit, of which 0.14% claimed the credit in each of the last several years.
- The Jacob Francis Institute estimates that in Baltimore City the percentage of properties with rehabilitation permits in excess of $5,000 was equal to 13.6% for commercial rehabilitations and 2.5% for residential properties in 2011.
- A total of 218 completed commercial rehabilitations had expenditures of less than $500,000 during the years in which the Heritage tax credit program was not subject to a budgetary limitation.

- In order to qualify, small commercial properties must expend at least $5,000, whereas commercial properties must expend the greater of $25,000 or the adjusted basis of the property.
- Credit utilization relative to permitting activity is assumed to be 25% higher for commercial properties than for residential properties.
- Five percent of projects are completed in the same year, 75% in the next year, and 20% two years after.

Residential Rehabilitation Credits

The bill extends the residential tax credit program beginning with the second half of tax year 2014. There is no limitation on the aggregate amount of credits that can be earned in a year by residential projects. Based on the correlation of residential credits claimed, State home sales, total residential improvement expenditures, and the forecasts for these variables, it is estimated that $906,000 in residential credits will be claimed in fiscal 2015 as shown in Appendix 1. Future year estimates reflect annualization and the projected amount of claims.

MHT Administrative Fees

The bill (1) extends MHT's authority to charge a fee that is sufficient to pay the cost of administering the State and federal historic tax credit and (2) requires MHT to impose an additional minimum fee for the second application phase. Appendix 1 shows MHT's projected fees and administrative expenses in each fiscal year.

Fiscal 2015 Revenue Transfers

The Governor's proposed fiscal 2015 budget includes $19.1 million in transfers from the reserve fund to the general fund, reflecting the expiration of projects issued initial credit certificates in fiscal 2006 through 2010. DLS notes that the proposed budget already assumes that $1.9 million of these transfers will occur in fiscal 2014 and $4.8 million in fiscal 2015.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Maryland Department of Planning, Maryland Historical Trust, Department of Legislative Services

Fiscal Note History: First Reader - February 14, 2014
ncs/jrb Revised - House Third Reader - March 28, 2014

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Appendix 1
Fiscal Impact of Legislation
Fiscal 2015-2019

Expenditures	**FY 2015**	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019**
General Fund Expenditures					
Reserve Fund Appropriation	$10,000,000	$10,000,000	$10,000,000	$0	$0
Special Fund Expenditures					
MHT Administrative Expenses	$303,400	$305,100	$311,500	0	0
Total Expenditures	**$10,303,400**	**$10,305,100**	**$10,311,500**	**$0**	**$0**
Revenues					
General Fund Revenues					
Residential Credit Claims	($906,000)	($2,156,000)	($2,818,000)	$0	$0
Small Commercial Credit Claims	0	(115,000)	(1,815,000)	($1,731,000)	($338,000)
Total General Fund	($906,000)	($2,271,000)	($4,633,000)	($1,731,000)	($338,000)
Special Fund Revenues					
MHT Certification Fees	303,400	305,100	311,500	0	0
Total Revenues	**($602,600)**	**($1,965,900)**	**($4,321,500)**	**($1,731,000)**	**($338,000)**
Net Effect	**($10,906,000)**	**($12,271,000)**	**($14,633,000)**	**($1,731,000)**	**($338,000)**

ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: Maryland Sustainable Community Tax Credit - Extension

BILL NUMBER: HB 510

PREPARED BY: Amanda Conn

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

__ WILL HAVE MINIMAL OR NO ECONOMIC IMPACT ON MARYLAND SMALL BUSINESS

OR

X WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS

A new provision in this proposal would allow small commercial properties that have an historic structure and are located within a Sustainable Community to receive a tax credit for the rehabilitation of the structure. That tax credit would be capped at $50,000 and at least $500,000 must be spent in qualified rehabilitation expenditures to receive the credit. This would apply to properties used for commercial purposes or for mixed use properties that contain commercial uses and residential uses. Currently, small commercial properties are not eligible for the single-family, owner-occupied tax credit and these type of properties are not competitive for the commercial tax credit which has historically gone to large commercial developments. Thus, there are few programs to assist small business owners with rehabilitation costs for historic properties.