

Department of Legislative Services
Maryland General Assembly
2025 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 774

(Senators Hershey and Zucker)

Budget and Taxation

Property Tax - Valuation of Operating Property of Rural Broadband Service Providers

This bill alters the assessment process used by the State Department of Assessments and Taxation (SDAT) when valuing the operating property of a rural broadband service provider by specifying procedures that must be used. **The bill takes effect June 1, 2025, and applies to taxable years beginning after June 30, 2025.**

Fiscal Summary

State Effect: Annuity Bond Fund (ABF) revenues decrease by approximately \$344,000 annually beginning in FY 2026. The revenue decrease may require either (1) an increase in the State property tax rate or (2) a general fund appropriation to cover debt service on the State's general obligation (GO) bonds.

Local Effect: Local property tax revenues decrease by approximately \$35 million annually beginning in FY 2026. Local expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Bill Summary: The bill requires SDAT, when determining the value of operating property of a provider of rural broadband service, to only consider actual operating income when using an income approach. When the department uses a replacement cost approach, SDAT must offset the valuation of property to the extent of any contributions, tax credits, or other subsidies and benefits provided by a governmental unit or program. However, SDAT may

only use the replacement cost approach if the value determined is less than the value determined using the income approach.

Current Law: SDAT advises that when the income approach is used, the department uses the direct capitalization method by determining a company's value by using a projected net operating income and a cost of capital or capitalization rate for the upcoming year. This method assumes a company's present value can be approximated by its future earnings in the coming year once it has been divided by a capitalization rate. Other income approach models, like yield capitalization and discount cash flow also operate under the idea that a company's future or projected earnings is elemental in determining the value of a company's property. SDAT estimates a company's future net operating income under the assumption that their historical (previous five years) revenues and expenses are indicative of what the company will earn in the future.

Only revenues and expenses that are recurring year to year are included in the net operating income calculation. SDAT then adjusts this projection up or down based on additional information it may know, such as if a company sells a portion of its business or the Maryland Public Service Commission issuing a new utility rate.

SDAT reports that the net operating income used is different from operating income. Net operating income includes a deduction for any federal and State taxes a company pays, but operating income does not. Rural broadband providers are currently not expected to earn positive operating income until they build out their network and recruit customers, which could take several years.

State Fiscal Effect: SDAT reports that Maryland has received \$239 million in grants from the federal government in the past several years for rural broadband expansion. In addition, several counties have also provided grants to help expand rural broadband. Generally, these grants were provided to help a provider to cover capital costs needed to expand in areas where it might not otherwise have been economically feasible to do so due to cost. Grants that were provided were to be used only to cover capital costs but not operating costs. It was assumed that a provider was going to be profitable once the network has been built out.

SDAT reports that the bill specifies that the department can only use the income approach for rural broadband providers, when for all other utilities SDAT calculates the earning capacity of the unit (the unit approach) by comparing the income, cost, and sales approaches to select a final (unit) value. The bill also requires that SDAT only use actual operating income and replacement cost approach; however, the department advises that (1) only net operating income is used currently and (2) the department uses original cost rather than a replacement cost approach because federal and State regulators use original cost in their rate setting calculations.

The bill also requires the department to offset the value of property by the amount of any contributions, tax credits, or other subsidies and benefits that are provided by a government or program, which will exempt certain income from valuation, thereby reducing the value of property subject to property tax.

As a result, SDAT estimates that the changes proposed by the bill will reduce State property tax revenues by approximately \$344,000 annually beginning in fiscal 2026.

Debt service payments on the State's GO bonds are paid from the ABF. Revenue sources for the fund include State property taxes, premium from bond sales, and repayments from certain State agencies, subdivisions, and private organizations. General funds may be appropriated directly to the ABF to make up any differences between the debt service payments and funds available from property taxes and other sources. The fiscal 2026 State budget includes \$1.4 billion for GO debt service costs, including \$181.7 million in general funds, \$1.2 billion in special funds from the ABF, \$1.7 million in transfer tax revenues, and \$2.6 million in federal funds.

To offset the reduction in State property tax revenues, general fund expenditures could increase in an amount equal to the decrease in the ABF revenues, or the State property tax rate would have to be increased to meet debt service payments.

Local Fiscal Effect: Local property tax revenues decrease to the extent property values for rural broadband providers are decreased through specified offsets. Based on the estimated State property tax revenue decrease, SDAT estimates that local property tax revenues may decrease by approximately \$35 million annually beginning in fiscal 2026. The department advises that most of this revenue decrease will likely occur in Charles, Frederick, Harford, Kent, and Queen Anne's counties where broadband networks are being constructed.

Additional Comments: SDAT notes that the bill does not define a rural broadband service provider which may affect which service providers are eligible for the new assessment method proposed by the bill. The department also notes that actual operating income is not a defined term in the Tax-Property Article and is not a financial or accounting term used in utility property assessments. There are no known income approach models that use actual operating income as an input. Without underlying theoretical models, the department advises that it would not be able to ascertain or defend a property valuation on appeal. As a result, any rural broadband provider reporting no positive operating income would be considered to have an assessable property base of zero.

Additional Information

Recent Prior Introductions: Similar legislation has not been introduced within the last three years.

Designated Cross File: HB 969 (Delegate A. Johnson) - Ways and Means.

Information Source(s): Maryland Municipal League; State Department of Assessments and Taxation; Department of Legislative Services

Fiscal Note History: First Reader - February 17, 2025
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