NAIOP
MARYLAND CHAPTERS
THE ASSOCIATION FOR COMMERCIAL REAL ESTATE

March 10, 2025

The Honorable Vanessa Atterbeary, Chair
House Ways and Means Committee
House Office Building, Room 121
6 Bladen St., Annapolis, MD 21401

Unfavorable: HB 1554 – Sales Tax on Services

Dear Chair, Atterbeary and Committee Members:

The NAIOP Maryland Chapters represent more than seven hundred companies involved in all aspects of commercial, mixed-use, and light industrial real estate. On behalf of our member companies, I am writing to recommend your unfavorable report on HB 1554 which would impose a 2.5% sales tax on business-to-business services including many listed in the shadow box to the right that affect commercial real estate.

NAIOP strongly opposes HB 1554 because expanding the sales tax to services purchased and provided by commercial real estate will:

- **Further weaken Maryland's position when competing with lower tax, higher growth states for capital investment and national tenants**

Rasing an additional $1 billion annually in sales tax revenues would require taxing $40 billion in business services transactions. The result would increase sales tax revenues by 16.9% compared to 2024.

NAIOP's member companies compete for tenants and investment capital on a regional and national basis. Maryland's slow growth, unfavorable tax structure and building energy performance standards are already negatively influencing decisions about leasing and allocation of capital to the state. HB 1554 imposes taxes that increase operating and production costs undermining the value proposition for companies to locate and remain in Maryland office, retail, and warehouse space.

Almost any office, warehouse distribution or professional service function in Maryland can be provided from a neighboring state. While the final sale may be subject to Maryland tax the intermediate taxes can easily be avoided by leasing office, retail, and warehouse space in an adjacent state. The local effects will be felt hardest in business centers adjacent to Virginia. It is only 11 miles from Bethesda to Tysons Corner.

- **Increase consumer costs by embedding the sales tax in the operating expenses and overhead of thousands of businesses.**

The tax on facility operations, maintenance and repair of heating and air conditioning and hydraulic equipment, forklifts, and materials handling equipment, as well as general business services increases the overhead of companies producing and distributing goods and services to the public. By

Taxable Commercial Real Estate Related Services

- Commercial facilities operational support services
- HVAC repair and maintenance
- Pest control
- Landscaping
- Hydraulic equipment repair and maintenance
- Locksmiths, security system maintenance and repair
- Cleaning of building exteriors, chimney, ventilation, duct, drains and gutters.
- Traffic engineering
- Environmental consulting (Geotech, forest, land, air, and water, building remediation)
- Heavy truck maintenance
- Construction equipment, material handling equipment, forklifts, and conveyors maintenance
- Maintenance of restaurant cooking and commercial refrigeration equipment

Taxable General Business Services

- Accounting, payroll, and bookkeeping
- IT, data processing and web hosting
- Office administrative support and management
- Employee and contractor placement
- Consulting
- Public Relations
- Photography, design, and printing
- Marketing and Market research
- Financial planning and tax preparation

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taxing the intermediate services purchased by these businesses the bill would function as a tax on in-state production and distribution, increasing final sales prices to the public at rates higher than the 2.5% rate in the bill.

- **Pyramid the tax by applying it to land development services inflating costs of finished lots and buildings.**

The sales tax would apply to many services related to land development projects such as environmental consultants and traffic engineers. Applying the sales tax at this stage would embed sales taxes into contractor and subcontractor invoices at the earliest stages of real estate projects incrementally increasing transfer, recordation, and real estate taxes applied to the finished lots and associated buildings.

- **Exacerbate the disproportionate share of government services financed by commercial real estate.**

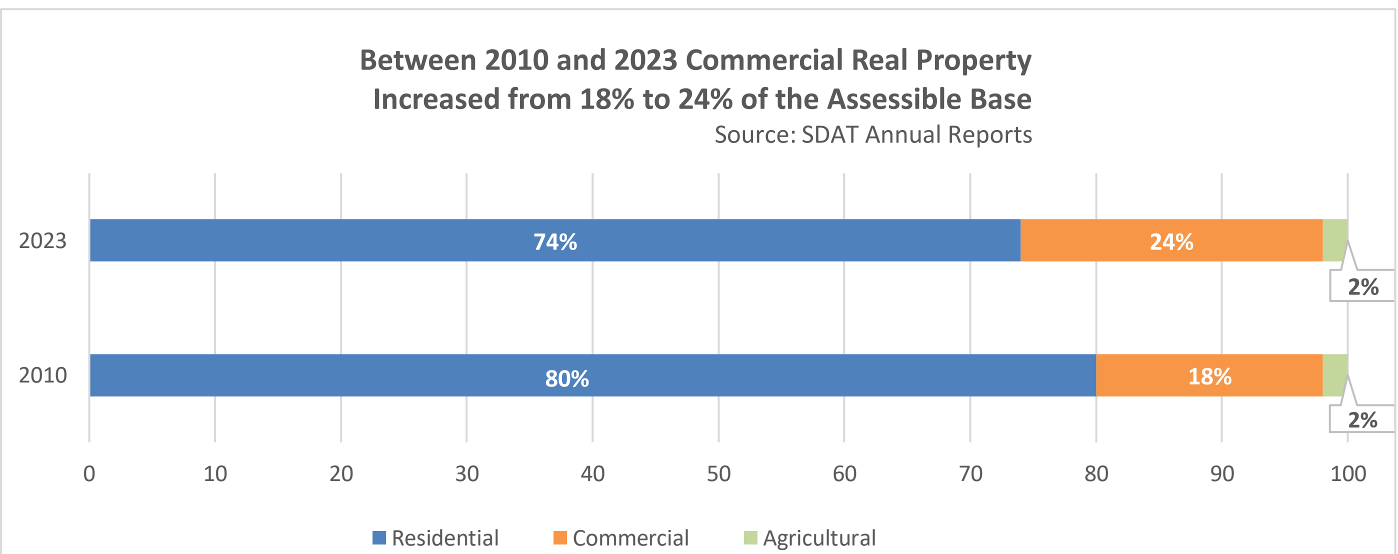
Commercial real estate generates more net tax revenue than any other class of property. The business-to-business sales tax would stack on top of transfer and recordation taxes, impact fees and real property taxes further exacerbating the disproportionate share of government services funded by commercial real estate.

Between 2010 and 2023 the commercial real estate tax base grew by 60% ($81 billion). Over that same time period the residential tax base grew only 11% ($68 billion) as it struggled to recover from the great recession.

2010-2023 The Commercial Real Property Tax Base Increased 60% ($81 billion)
Offsetting 11% ($61 billion) Increase in the Residential Tax Base

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	'10-'23	Pct
Residential	598.7	577.4	530.0	501.0	489.6	502.2	531.1	536.7	554.2	571.1	588.7	608.4	632.3	666.8	68.1	11%
Commercial	135.4	140.0	145.9	143.5	160.9	169.0	169.0	177.1	185.2	190.8	198.5	203.0	208.1	216.7	81.3	60%
Agricultural	13.6	13.5	12.7	12.1	11.8	11.9	12.0	12.2	12.3	12.4	12.6	13.0	13.4	14.1	0.5	4%

Values in Billions of Dollars, Source: SDAT Annual Reports



Growth in the real estate tax base during that time resulted in commercial property owners paying a larger percentage of the cost of government services. In 2010 commercial property comprised 18% of the total assessable base. By 2023 commercial estate had grown to 24% of the real property tax base.

- **We do not see how our member companies and vendors can comply with the effective date of July 1, 2025**

Making this tax operational by the effective date in the bill poses significant challenges. Commercial real estate companies will need significantly more time to make this operational with thousands of tenants and vendors. There are terms like business entity that are undefined and need to be clarified. The gray area between overlapping NAICS codes need clarification. Service contracts and leases may have to be amended to implement the sales tax.

- **The sales tax increases in HB 1554, combined with the BEPS energy use fines in HB 49 and the higher commercial property tax rates in HB 23, set the stage for a commercial real estate financial crisis in Maryland.**

In the decade between 2010 and 2020 expansion of the commercial real estate tax base backfilled sluggish growth in the residential tax base. But that was a time of strong job growth, lower interest rates, lower inflation, lower energy costs and higher office occupancy rates. Today, valuations of commercial property and new commercial construction are not supported by those positive economic influences. Raising taxes under these circumstances is a major concern.

The tax increases in HB 1554 equate to a 16.9% increase in overall sales tax revenues compared to 2024. For commercial real estate, the tax will increase operating expenses and decrease operating income which immediately puts downward pressure on commercial real estate valuations and the real estate tax base.

Beyond that, NAIOP urges the General Assembly to carefully consider how much financial pressure will be put on commercial building owners and occupants by the combined policy impacts of HB 1554, HB 49 / SB 256 – Building Energy Performance Standards – Compliance and HB 23 Property Tax – Special Rates for Commercial and Industrial Property.

HB 49 / SB 256 authorizes the Maryland Department of Environment to allocate electricity use by building type and assess a non-compliance fee equivalent to $0.17 per kwh for energy use above established limits. Based on MDE's previously published energy use limits, commercial and multifamily buildings will face extraordinarily high fees under the authority granted in HB 49.

HB 23 authorizes counties and Baltimore City to set higher property tax rates for commercial and industrial property. The bill caps the so-called special rates at $0.125 per $100 of assessed value. Based on current local rates, this would allow counties to increase commercial and industrial property taxes by 12%.

These policy decisions will put significant financial pressure on commercial and multifamily real estate when properties in certain markets are struggling with vacancies, inflation, and high interest rates.

In the fourth quarter of 2024, the Rockville – Bethesda office market, containing more than 52 million square feet had a vacancy rate of 20.5%. Baltimore City Center, an office market containing more than 12 million square feet had a vacancy rate of 28.2%. The buildings in these markets are financed based on and average vacancy rate of 10%.

One NAIOP member owns three Class A office buildings in Baltimore. The three buildings are worth 40% of their pre COVID purchase prices despite the ownership group making improvements valued at more than $200 million.

These markets do not have the ability to absorb sharp increases in operating costs.

<u>For these reasons, NAIOP respectfully recommends your unfavorable report on HB 1554</u>.

Sincerely,

T.M. Ballt

Tom Ballentine, Vice President for Policy
NAIOP – Maryland Chapters, *The Association for Commercial Real Estate*

cc: House Ways and Means Committee Members
Nick Manis – Manis, Canning Assoc.