SB 759

Department of Legislative Services

Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

Senate Bill 759 (Senator Madaleno)(By Request - Tax Credit Evaluation Committee) and Senator Peters

Budget and Taxation Ways and Means

Heritage Structure Rehabilitation Tax Credit - Alteration and Extension

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This bill reestablishes the Sustainable Communities Tax Credit Program as the Heritage Structure Rehabilitation Tax Credit Program, extends the termination date of the program through fiscal 2022, requires the Governor to include an appropriation for the commercial credit program in fiscal 2018 through 2022, and alters certain program eligibility requirements and procedures.

The bill takes effect June 1, 2016.

Fiscal Summary

State Effect: General fund revenues decrease by $0.9 million in FY 2018, by $2.1 million in FY 2019 and 2020, and by $2.2 million in FY 2021 and 2022 due to residential credits claimed against the income tax. General fund expenditures increase by $9.0 million annually in FY 2018 through 2022 due to commercial credit appropriations. Special fund revenues and expenditures increase by $0.3 million annually in FY 2018 through 2022 reflecting administrative fees and expenditures at MHT.

($ in millions)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
GF Revenue	$0	($0.9)	($2.1)	($2.1)	($2.2)
SF Revenue	$0	$0.3	$0.3	$0.3	$0.3
GF Expenditure	$0	$9.0	$9.0	$9.0	$9.0
SF Expenditure	$0	$0.3	$0.3	$0.3	$0.3
Net Effect	$0.0	($9.9)	($11.1)	($11.1)	($11.2)

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: Meaningful. Any small business that benefits from the tax credit will be positively impacted by the program's extension.

Analysis

Bill Summary:

- ***Extends Program Termination Date and Funding:*** The program's termination date is extended through fiscal 2022 for commercial, small commercial, and owner-occupied residential property rehabilitations. The Governor is required to provide an appropriation to the reserve fund for commercial projects in fiscal 2018 through 2022. The Maryland Historical Trust (MHT) can award credits through June 30, 2022.

- ***Renames Program as Heritage Structure Rehabilitation:*** In addition to renaming the program, the bill eliminates the requirement that a small commercial project must be located within a sustainable community.

- ***Eliminates MHT Scoring Requirement:*** The bill eliminates the requirement that MHT must evaluate as part of its commercial project scoring system whether proposed projects are located in jurisdictions that have been historically underrepresented in the award of commercial rehabilitation tax credits.

- ***Commercial Credit Administration:*** MHT must adopt procedures to announce to the public which commercial projects have been awarded credits within 60 days after the selection is made. The bill also clarifies several provisions related to fees that are charged to certify rehabilitations and procedures that apply when an applicant does not pay the required fee.

Current Law: Chapter 487 of 2010 reestablished the Heritage Structure Rehabilitation Tax Credit Program as the Sustainable Communities Tax Credit Program. Chapter 601 of 2014 subsequently extended the termination date of the program and altered specified eligibility requirements.

The value of the refundable credit is based on the type of rehabilitation undertaken and up to a percentage of qualified rehabilitation expenditures, as follows:

- 20% for the rehabilitation of a single-family, owner-occupied residence or a small commercial project; and
- 20% for the commercial rehabilitation of a certified historic structure, or 25% if certain energy efficiency standards are met.

A qualified expenditure is an amount that is expended by the end of the calendar year in which the rehabilitation is certified as being completed and in compliance with a plan of proposed expenditures that has been approved by the director of MHT and is not funded, financed, or otherwise reimbursed by any (1) State or local grant; (2) grant made from proceeds of tax-exempt bonds issued by the State, a political subdivision of the State, or an instrumentality of the State or of a political subdivision of the State; (3) State or local tax credit other than the sustainable communities credit; or (4) other financial assistance from the State or a political subdivision except for a loan that must be repaid at an interest rate that is greater than the interest rate on bonds issued by the State at the most recent bond sale.

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 or small commercial project), $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 or a small commercial project or (2) the greater of the adjusted basis of the property or $25,000 for all other properties. Applying for the credit is a three-part process that is administered by MHT within the Maryland Department of Planning.

Commercial Program

The commercial program includes the rehabilitation of certified historic structures and is the largest component of the program. The commercial credit is a budgeted tax credit and the Governor must appropriate funds to the program annually through fiscal 2017. MHT awards credits through a competitive process, with the amount awarded each year generally limited to the amount appropriated to the program.

Small Commercial Project Program

Chapter 601 of 2014 established credit eligibility for certain small commercial projects. 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 between January 1, 2015, and June 30, 2017. 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.

There is no reserve fund to offset the cost of small commercial credits.

Residential Program

MHT can award an unlimited amount of residential credits for applications received through June 30, 2017. 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 also 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.

Background:

Sustainable Communities Tax Credit Program

The Sustainable Communities Tax Credit Program encourages the preservation and rehabilitation of residential and commercial historic buildings in order to preserve the historic places associated with the identity and character of cities, towns, and rural areas. The program is also one of the State's largest economic development programs. Through its current June 30, 2017 termination date, program costs will total an estimated $378.5 million ($475.1 million in current dollars). The commercial program comprises the vast majority of the program's fiscal costs, about 86%, with the remaining 14% from the residential program.

Between 2002 and 2004, the General Assembly made a number of legislative reforms to the tax credit that decreased the fiscal cost of the program and its unpredictability. Commercial program reforms included capping the maximum value of the credit and converting the commercial program into a budgeted tax credit. The commercial credit program was restructured so that credits are awarded through a competitive process, and additional reporting on commercial credit recipients was also required.

Tax Credit Evaluation Committee and the Department of Legislative Services Evaluation

The Tax Credit Evaluation Act of 2012 (Chapters 568 and 569) established a legislative process for evaluating certain tax credits. The evaluation process is conducted by a legislative evaluation committee that is appointed jointly by the President of the Senate and Speaker of the House. The Act specifies the year in which a tax credit must be evaluated. The committee is required to evaluate the sustainable communities tax credit by July 1, 2016. By October 31 of the year prior to a tax credit's evaluation date, the Department of Legislative Services (DLS) is required to publish a report evaluating the tax credit.

In its November 2015 draft evaluation report on the sustainable communities tax credit, DLS found that the legislative reforms described previously have made the commercial tax credit program a template for subsequent tax credits established by the General Assembly. DLS recommended that the General Assembly maintain the commercial tax credit as a budgeted tax credit subject to an aggregate limitation each year and that the cap on the maximum value of the commercial tax credit of $3 million be maintained. Additionally, DLS recommended that the General Assembly consider implementing similar competitive processes and reporting requirements for other State tax credits.

While DLS found that the credit is generally effective in encouraging the preservation and rehabilitation of historic buildings, the evaluation includes several other recommendations to improve the effectiveness of the credit.

Current law generally requires that no more than 60% of credits in a fiscal year can go to projects in a single county or Baltimore City. In addition, MHT must evaluate, as part of its project scoring system, whether projects are located in jurisdictions that have been historically underrepresented in the award of commercial rehabilitation tax credits. DLS found that the measure used by MHT does not accurately reflect whether jurisdictions are underrepresented and that the two criteria designed to ensure geographic diversity of projects may not achieve the desired results and can impact the overall quality of projects receiving the credit. Therefore, DLS recommended that the General Assembly (1) consider increasing the current 60% geographic limitation to a higher percentage or completely eliminating the limitation and (2) eliminate the criterion of scoring points on geographic underrepresentation.

According to MHT, it measures the success of the program by how projects maximize the leverage of private investment; however, a taxpayer could avoid using private funds by utilizing federal funds. DLS recommended that the General Assembly prohibit any federal funds from qualifying as expenditures for purposes of the State credit. DLS also recommended a number of additional administrative changes to the program, including more timely notification of commercial credit awards.

The DLS draft evaluation report for the Sustainable Communities Tax Credit Program can be found here.

Pursuant to the DLS evaluation, this bill includes several of the tax credit evaluation committee's recommended changes to the sustainable communities tax credit, including a proposed extension of the program through fiscal 2022.

State Fiscal Effect: The bill extends the termination date of the program to June 30, 2022, and requires that the Governor provide an appropriation to the reserve fund for commercial projects in fiscal 2018 through 2022. As a result, the net effect on State finances will be a decrease of $9.9 million in fiscal 2018. **Appendix 1** details the fiscal impact of the bill in fiscal 2018 through 2021.

Commercial 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 2017 budget includes $9.0 million in funding for commercial credits. Based on the fiscal 2017 appropriation and the average amount of funding provided under the existing program, it is estimated that the program will receive $9.0 million annually through fiscal 2022.

Small Commercial Projects

The bill extends the authority for MHT to issue small commercial project credits but does not alter the total amount of credits that MHT can award. Accordingly, there will be no fiscal impact beyond that provided under current law.

Residential Credits

The bill extends the residential tax credit program beginning with the second half of calendar 2017. 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 $865,400 in residential credits will be claimed in fiscal 2018 as shown in Appendix 1. Future year estimates reflect annualization and the projected amount of claims.

Administrative Fees

The bill extends and clarifies MHT's authority to assess fees to pay the cost of administering the State and federal historic tax credits. Appendix 1 shows MHT's projected fees and administrative expenses in each fiscal year.

Additional Information

Prior Introductions: None.

Cross File: HB 939 (Delegate Walker) (By Request - Tax Credit Evaluation Committee) - Ways and Means.

Information Source(s): Comptroller's Office, Department of Planning, Department of Legislative Services

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Analysis by: Robert J. Rehrmann

Direct Inquiries to:
(410) 946-5510
(301) 970-5510

Appendix 1 – Fiscal Impact of Legislation
Fiscal 2017-2021

Expenditures	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
General Fund Expenditures					
Reserve Fund Appropriation	$0	$9,000,000	$9,000,000	$9,000,000	$9,000,000
Special Fund Expenditures					
MHT Administrative Expenses	$0	$310,000	$313,100	$316,200	$322,600
Total Expenditures	**$0**	**$9,310,000**	**$9,313,100**	**$9,316,200**	**$9,322,600**
Revenues					
General Fund Revenues					
Residential Credit Claims	$0	($865,400)	($2,060,200)	($2,134,600)	($2,183,600)
Special Fund Revenues					
MHT Certification Fees	$0	$310,000	$313,100	$316,200	$322,600
Total Revenues	**$0**	**($555,400)**	**($1,747,100)**	**($1,818,400)**	**($1,681,000)**
Net Effect	**$0**	**($9,865,400)**	**($11,060,200)**	**($11,134,600)**	**($11,183,600)**