



City of Baltimore

BBMR Management Research Report

A Comprehensive Review of the City's Current Tax Credit Programs

August 2022



Management Research Report:

A Comprehensive Review of the City's Current Tax Credit Programs

What BBMR Found

Tax Credit Issues

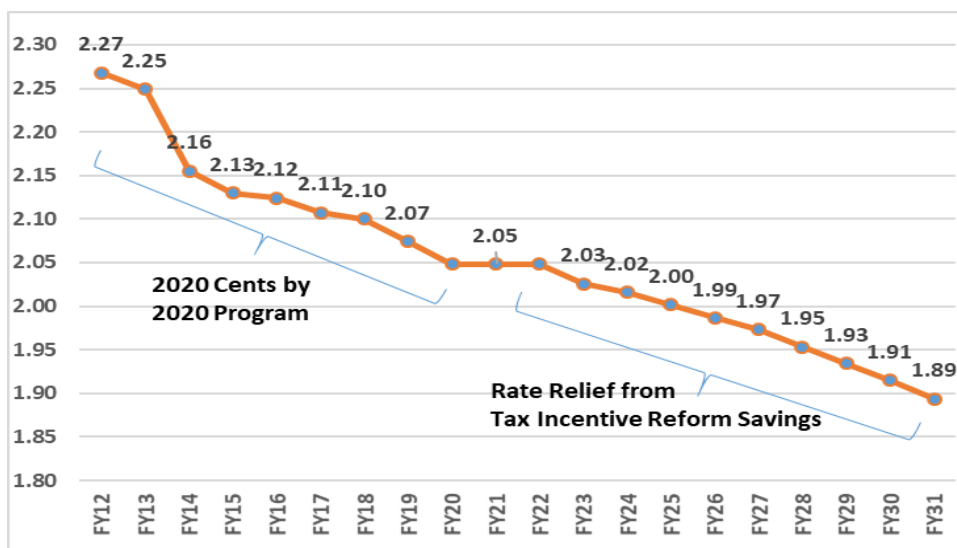
- 1. Equity:** The City's existing tax credit system is highly inequitable and collectively favors the stronger and more-established neighborhoods.
- 2. Developer Benefit:** The cost of some tax credits, such as the Newly Constructed and the Historic Preservation Tax Credit, likely gets capitalized into the resale price of the home when the development work is complete. This means that the developer, not the homeowner, ultimately benefits from these subsidies.
- 3. "By Right" System:** The City's current tax credit system is a "by right" system which means any project that meets minimum eligibility is granted a credit. However, this limits the City's ability to control costs and ensures that some development is over-subsidized.
- 4. Terms and Sunset Dates:** There is significant inconsistency in tax credit terms and sunset. This makes it harder for the City to evaluate the benefits of the programs collectively.

Budget Impact

Even modest reforms to the City's tax credits could generate significant savings over time that could be redirected to general property tax relief for residential homeowners. This would continue the City's progress from the "20 Cents by 2020" Program and reduce the effective rate an additional 8%, from \$2.048 to \$1.890.

Redirecting Tax Incentive Reform Savings to Property Tax Relief

Effective Tax Rate for Residential Owner-Occupied (per \$100 of Assessed Value)



Why BBMR Did This Study

One of the recommendations from the City's 10-Year Financial Plan was to do a comprehensive review of the City's tax credit portfolio to find areas of efficiency. The City has a large portfolio of tax credits that collectively cost \$126.7 million in the Fiscal 2022 budget, which equates to nearly 14% of the City's real property tax revenue.

What BBMR Recommends

To get better value from the City's tax credit system, BBMR recommends the following actions:

1. The City should set a budget for development incentives at 6% of the City's property tax revenue, to be achieved over a ten-year period.
2. The City should convene a stakeholder team to develop a tax credit package that better targets these incentives within the budgeted parameters.
3. The City should better align its tax credits to existing development strategies, such as DHCD's Impact Investment Areas. Investments in these areas are most likely to sustainably grow the City's tax base.
4. Two specific targets for reform should be the Historic Preservation (CHAP) and Brownfields Tax Credit. The unusual structure of these programs ensures that the City receives no new tax revenue from these projects for five years (and up to ten years in many cases).

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INTRODUCTION

Background

Tax abatements and credits can be a useful tool for City policy-makers. If used judiciously, tax credits have the potential to spark private investment and generate new taxable growth. Tax incentives also can be used to promote other City policy goals, such as protecting certain classes of homeowners or incenting certain groups to reside in the City. However, if left unchecked, these credits can result in the City over-subsidizing development. In turn, the City risks diverting precious General Fund resources away from other City priorities, such as general tax reduction, capital investment, and education spending, to name just a few.

In 2013 the City developed a 10-Year Financial Plan, and one of the recommendations from that report was to reevaluate the mix of tax incentives to ensure alignment with the City's vision for growth. The report noted that Baltimore's mix of "tax expenditures" had developed through accretion over many years. By taking a fresh, comprehensive, and balanced look at the overall mix, the City believed it could better target these incentives to meet contemporary goals and ensure a positive return on investment.

In pursuit of this goal, in 2018 the Bureau of Budget & Management Research (BBMR) contracted with Ernst & Young (E&Y) to assist the City in evaluating the existing tax credit portfolio. E&Y was chosen due to their extensive resources, their demonstrated success with other similar clients, and their focus on rigorous economic analysis of these tax credits. BBMR provided E&Y with raw data on all City tax credits granted extending back to 2007. BBMR also provided its insight on the history of the tax credits, their purpose, and any other internal analyses that were performed.

This BBMR Management Research Report, "**A Comprehensive Review of the City's Current Tax Credit Programs,**" is a summary of our findings.

The report is available at BBMR's website at: <http://bbmr.baltimorecity.gov/management-research>

Methodology

We approached this research in three steps. First, we looked at the tax credits and their cost in the context of the City's General Fund budget. Second, E&Y analyzed each tax credit individually for basic facts such as cost, historical trend, and geographic distribution. Third, we looked for patterns and issues across the entire portfolio. The "**Findings**" and "**Conclusions**" section of this report summarizes the answers to the following research questions:

Tax Credit Budget Impact

1. What is the historical trend in the cost of City tax credits?
2. How does the cost of City tax credits compare to the City's overall real property tax revenue? What percentage of revenue is foregone through these tax credits?

Individual Tax Credit Review

1. What is the stated purpose of the tax credit and what behavior or goal is it trying to incent?
2. What are the eligibility criteria for the credit?

3. Is there a sunset date for the credit or a review process to evaluate results?
4. Are there any legal restrictions? What flexibility does the City have in modifying the credit?
5. What is the historical trend for how many credits are granted and the total cost of those credits?
6. What is the geographic distribution of properties that receive the credit?
7. Which neighborhoods benefit most from the credit, and why?
8. Is the tax credit efficient in economic terms? Is the credit optimally allocating resources based on the stated intent, and does it distort economic behavior?
9. Is the tax credit equitable in economic terms? Are resources fairly distributed vertically, i.e. up and down the income and wealth spectrum? Are resources fairly distributed horizontally, i.e. are similar people or properties treated the same?

General Tax Credit Analysis

1. Are there any patterns that emerged consistently across the entire spectrum of tax credits?
2. Are there any other issues that are specific to one tax credit or one class of tax credits?

Scope

The scope of this report includes most but not all the City's tax credits. City tax credits can be classified into one of three categories based on the intent of the credit:

- 1) Homeowner Protection – to protect or reduce the tax burden on residential homeowners
- 2) Development Incentive – to incent either residential and/or commercial development
- 3) City Workforce Incentive – to incent certain populations of City workers to reside in the City

We chose to narrow the focus to the credits highlighted below in red. The credits excluded from the analysis make up less than 1% of the cost of the entire tax credit portfolio:

List of Real Property Tax Credit Programs

By Intended Benefit

Homeowner Protection	Development Incentive	City Workforce Incentive
Homestead Targeted Homeowners Supplemental Homeowners	Newly Constructed/High Performance Historic Restoration High Performance Market Rate Rental Brownfields Enterprise Zone Home Improvement Vacant Structure Cemetery	Public Safety Officers Low Income City Workers

The following table summarizes the tax credits that are included in this report, with a short description of the length and terms of the credit, any other eligibility criteria, and the cost in the Fiscal 2022 budget:

Summary of City Real Property Tax Credit Programs
(in \$ millions)

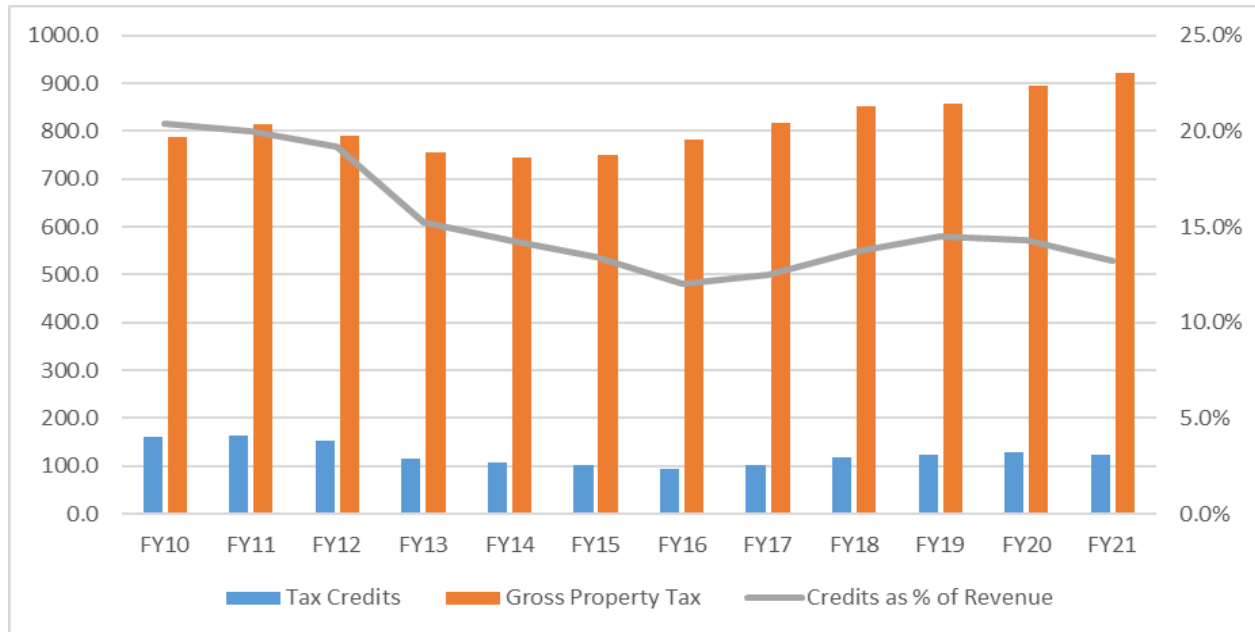
Tax Credit	Description	FY 22 Budget
Homestead	A 4% taxable assessment increase cap on residential owner-occupied properties. Property owners must have an approved Homestead application.	\$22.6M
Targeted Homeowners (THTC / 20 Cents by 2020)	An annual credit granted to residential owner-occupied properties only, which effectively grants a \$0.20 reduction to the base tax rate of \$2.248. Property owners must have an approved Homestead application.	\$31.3M
Newly Constructed (NCTC)	A five-year tax credit on newly constructed or city owned, vacant rehabbed dwellings. The credit is 50% in the first year and declines by 10% each year thereafter.	\$1.8M
Historic Restoration and Rehabilitation (CHAP)	A 10-year tax credit for improvement projects on properties within a designated historic district. For projects with costs below \$5.0M, the credit is 100% for all ten years. For projects with costs above \$5.0M, the credit is 80% in the first five taxable years and declining by 10% each year thereafter.	\$12.1M
High-Performance Market-Rate Rental Housing (HPMRRH)	A 10-year credit on the increased value on construction of high-performance market rate rental housing. The credit is 80% in the first five years and then declines by 10% each year thereafter.	\$20.1M
Brownfields	A five-year credit on the increased value of brownfield sites after eligible improvements are made. The credit is 50% for all five years. For projects that exceed \$250,000 and are in an Enterprise Zone, the credit is extended to ten years at 70% for each year. The City must also pay 30% of the value of the credit into the State Brownfield Fund for the first five years of the credit.	\$18.0M
Enterprise Zone (EZTC)	A 10-year credit in designated State Enterprise Zones on the increased value of a commercial property after improvements. The credit is 80% in the first five taxable years and declines by 10% each year thereafter. For properties located in a Focus Area, the credit is 80% for ten years. The State reimburses the City for 50% of the cost.	\$20.8M
Total		\$126.7M

FINDINGS: Tax Credit Overview & Budget Impact

In each year's annual budget, BBMR presents both the gross real property tax revenue and the cost of each tax credits. This allows the City to see trends in gross property tax revenue, as well as how much property tax revenue is foregone due to tax credits. The following chart shows this trend for Fiscal 2010 to Fiscal 2021:

Real Property Tax Credits as a % of Gross Property Tax Revenue

*All City Tax Credits
(in \$ millions)*



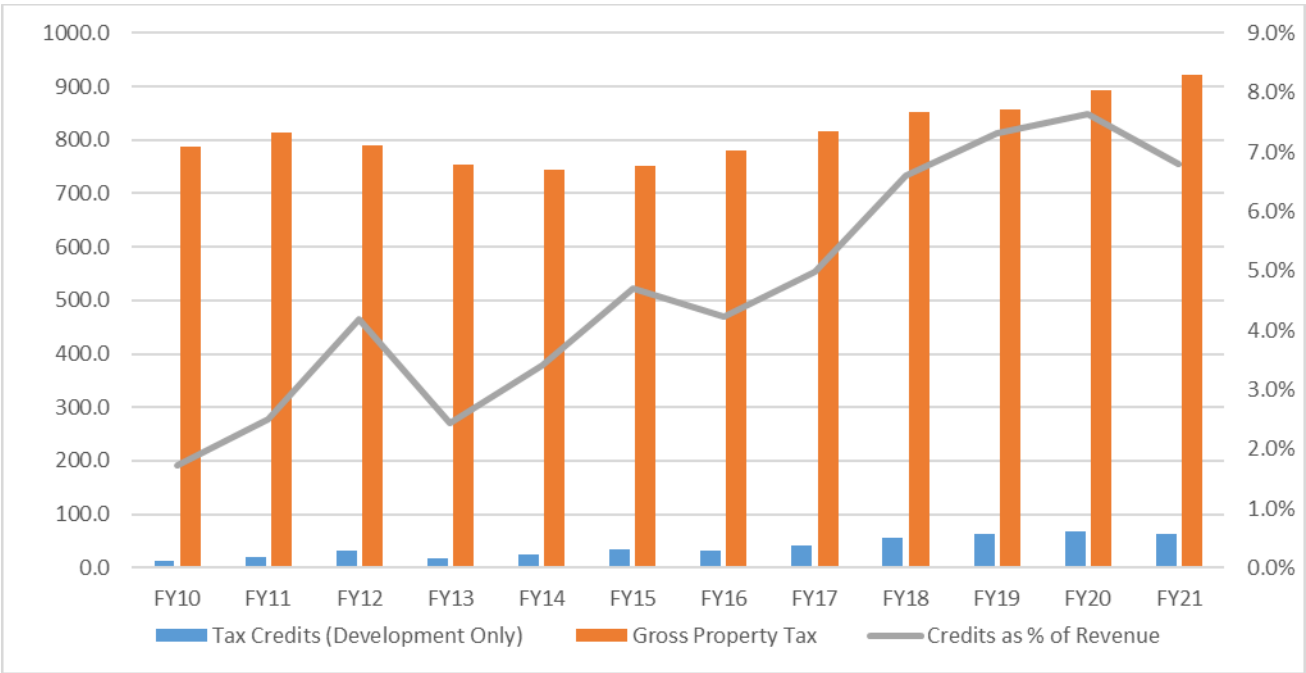
Property tax revenue declined each year from Fiscal 2011 to Fiscal 2014, as the loss in real property values from the Great Recession was phased in as part of the regular reassessment cycle. Concurrently, the City's tax credit costs as a percentage of property tax revenue declined from Fiscal 2011 to Fiscal 2016.

The decline in tax credit costs was largely driven by a reduction in Homestead Tax Credit costs. These costs peaked at \$147.2 million in Fiscal 2010 and declined to only \$23.5 million in Fiscal 2021. Prior to the real estate crash during the Great Recession, the City had experienced a rapid run-up in real estate prices and assessed values. The Homestead Tax Credit, which caps a homeowners' property tax growth at 4%, led to a large increase in the value of these credits granted. After the real estate market crash, the value of the Homestead Tax Credit slowly declined as real estate value prices and growth returned to more regular patterns.

From Fiscal 2016 to Fiscal 2021, the City's tax credit costs crept upward. One reason for this growth was the implementation of Mayor Stephanie Rawlings-Blake's "20 Cents by 2020" program. This program, which aimed to reduce the tax burden on residential owner-occupied programs, was rolled out gradually from Fiscal 2013 to Fiscal 2020 in the form of the Targeted Homeowners Tax Credit. The cost of this credit grew from \$3.5 million in Fiscal 2013 to \$34.2 million in Fiscal 2021, when the City met the goal of effectively reducing the effective rate for owner-occupied residential properties from \$2.248 to \$2.048.

Probing more deeply, there was another trend that accelerated over the last decade. If we exclude the cost of the Homestead Tax Credit and the Targeted Homeowners Tax Credit, which are both designed for homeowner protection, we can see the accelerating growth in the cost of development tax credits only:

Development Real Property Tax Credits as a % of Gross Property Tax Revenue
excludes Targeted Homeowners Tax Credit and Homestead Tax Credit
(in \$ millions)



From Fiscal 2010 to Fiscal 2021, the cost of the City’s development tax credit programs grew rapidly from \$13.6 million to \$62.6 million. On a percentage basis, the tax credits grew from only 1.7% of gross property tax revenue to 6.8%. The key driver was the growing cost of the Brownfield, High Performance, and Enterprise Zone Tax Credits. In Fiscal 2013 these credits collectively cost \$8.3 million; by Fiscal 2020 these credits had grown to a cost of \$62.1 million. The City’s net property revenue grew from the properties receiving this credit collectively; however, the rapid growth in the cost of these credits raised questions about whether the City over-subsidized some of this development.

In the next section, we will examine in more depth the historical trends and of each individual City tax credit.

FINDINGS: Individual Tax Credit Synopses

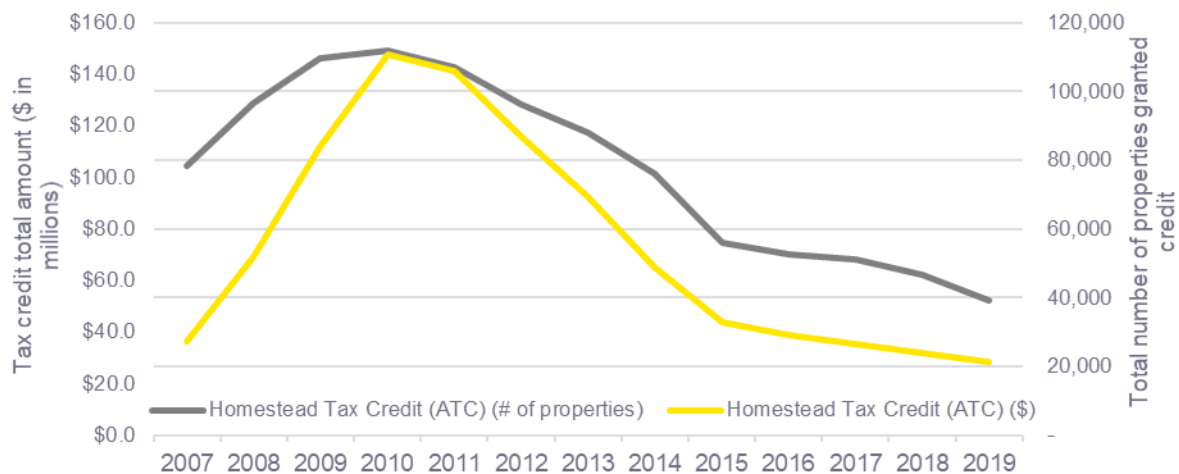
Homestead Tax Credit (ATC)

Background	Type	Residential Protection
	Sub-Market	Owner-Occupied
Credit Mechanics	Eligibility	Homeowners must file a one-time application certifying that the property is their primary residence.
	Credit	Limits the annual increase in property tax liability. Baltimore City's cap is 4%. Allowable range is 0% to 10%.
Financials Legal	FY22 Cost	\$22.6 million
	Sunset Date	No Sunset
	Legal	Statewide Mandatory

Background: The Homestead Tax Credit (ATC) is a Statewide credit created in the late 1970's. The intent of the credit is to protect residential owner-occupied properties from higher tax bills during times of growing real estate assessments. Local jurisdictions can cap tax increases anywhere from 0% to 10% annually. Baltimore City's cap is set at 4%.

The ATC was heavily abused in the past; homeowners would falsely claim a second home or rental property as their primary residence. Due to these concerns, in 2007 the General Assembly enacted legislation requiring a one-time application process for homeowners to certify that the property is the primary residence. Locally, the City's Billing Integrity Unit regularly checks Homestead-eligible properties versus the Department Housing and Community Development (DHCD) rental registration system. Any anomalies are reported to SDAT for further review.

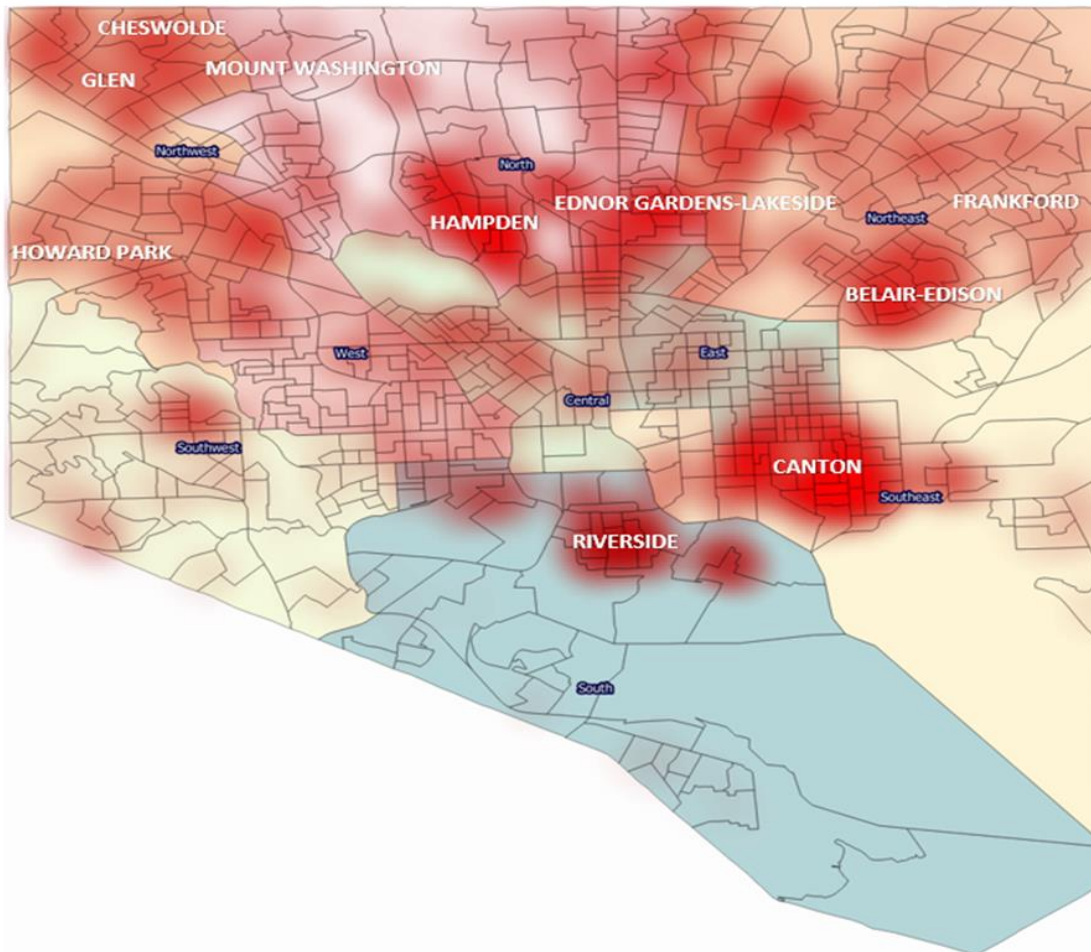
Historical Trend: The ATC peaked in 2010; 111,960 properties claiming the credit for a total cost to the City of \$147.8 million. The rapid growth in real estate prices in the prior decade had often exceeded the 4% cap, which led to many newly eligible properties. Property values declined between Fiscal 2011 and Fiscal 2014. Then, from Fiscal 2015 forward growth has returned to more modest levels that rarely exceeded the 4% cap, averaging 2.4% annually. Subsequently, the number of properties eligible for the credit and the cost of the credit have slowly declined since then.



Geographical Distribution: The following is a heat map showing the neighborhoods with the highest number of parcels granted the Homestead Tax Credit in 2019, and the top five neighborhoods by tax credit granted:

Distribution of the Homestead Tax Credit

Fiscal 2019



Top Five Neighborhoods by Tax Credit Amount Granted

Fiscal 2019

Neighborhood	Credit Cost	# of Properties	Avg. Credit
Canton	\$2.1M	1,653	\$1,281
Riverside	\$1.3M	813	\$1,609
Hampden	\$1.2M	1,371	\$874
Reservoir Hill	\$0.9M	424	\$2,229
Cheswolde	\$0.8M	737	\$1,095
Baltimore City-Wide	\$28.6M	39,259	\$725

The distribution of the ATC tracks closely with neighborhoods that have experienced both high rates of residential ownership and rapidly appreciating assessment values. This includes traditionally strong neighborhoods, such as Canton and Riverside, as well as neighborhoods that have seen rapid growth in recent years, such as Hampden and Reservoir Hill. Although Homestead Tax Credits are widely distributed among many neighborhoods, 22% of the value of ATC's were granted to the five neighborhoods listed above in 2019. The

value of Homestead Tax Credits in these neighborhoods far exceeds the City-wide average. For example, the average credit granted in Reservoir Hill is approximately three times that of the City-wide average.

Efficiency Considerations: The ATC creates friction in the local housing market. For properties that have grown in value beyond the 4% annual cap, the homeowner has a strong incentive to either stay in the property to retain the benefit or move to a lower-tax jurisdiction. This limits housing turnover and creates a shortage of housing for new family formation for younger households. Portability of the ATC is often suggested as a solution to this problem, and in 2014 the Resident Retention Tax Credit was created for this exact purpose. However, the eligibility requirements for that credit have a high threshold and the take-up has been limited. In 2021, the City only issued the credit to 17 properties. The Resident Retention Tax Credit expired on July 1, 2020.

Equity Considerations: The ATC is vertically regressive within the owner-occupied category of residential homeowners. Higher-valued properties generally experience proportionally greater value growth and reap most of the benefit from this program. Also, the ATC is horizontally inequitable as homeowners with shorter terms of residency face a higher effective tax burden.

Per State law, local jurisdictions can choose a Homestead cap between 0% and 10%. Higher caps yield more property tax revenue for the local jurisdiction. The City set its cap at 4% in 1990 and it has not been changed since. The chart below shows the City's cap versus other neighboring jurisdictions and large Maryland counties:

Homestead Tax Cap
Neighboring Counties and Large Maryland Counties

Baltimore City	4%
Harford	5%
Howard	5%
Frederick	5%
Carroll	5%
Baltimore	4%
Prince Georges	2%
Montgomery	10%

The City's relatively low 4% cap magnifies the equity issues discussed above, as a larger percentage of assessed value in Baltimore City is shielded from taxation. In the example below, we show that more revenue would have been generated from Fiscal 2017 to Fiscal 2019 if the City had a higher cap:

Homestead Tax Credit Cost Under Different Cap Scenarios
Dollars in Millions

Total Homestead Tax	Fiscal 2017	Fiscal 2018	Fiscal 2019	Total
With 4% Cap (current)	\$35.2	\$32.0	\$28.5	95.7
With 6% Cap	29.5	22.7	17.7	69.9
With 8% Cap	24.6	15.8	10.8	51.2
Additional Tax Revenue	Fiscal 2017	Fiscal 2018	Fiscal 2019	Total
With 6% Cap	\$5.7	\$9.4	\$10.7	\$25.8
With 8% Cap	10.6	16.3	17.7	44.6

One option for reducing the inequity inherent in a percentage-based ATC is to introduce fixed-dollar Homestead exemptions. Fixed-dollar exemptions provide a set dollar increase exemption on rising property values and are generally more equitable as they provide a similar value for lower-valued property and higher-valued properties. The City could create such a structure by raising the cap to the maximum 10% level, and then creating a fixed-dollar exemption for any costs above the 4% level.

Other Considerations: It is important to note that the Homestead Tax Credit helped to create a natural budget stabilizer for local jurisdictions, including Baltimore City, in the aftermath of the Great Recession. Many homeowners, who were shielded from higher taxes during the run-up in housing prices, faced higher annual tax bills between Fiscal 2011 and Fiscal 2014 even as their property assessments declined. Likewise, the City's property tax revenues increased from Fiscal 2011 to Fiscal 2014 during a time of declining assessments. The City only experienced declining property tax revenues in Fiscal 2015, after the full impact of three assessment declines over all three assessment groups had been phased in. This effect helped stabilize the City's budget during a time of extreme stress. In effect, it provided modest property tax increases in years that many other City revenue sources were declining, such as income tax, transfer and recordation taxes, and State aid.

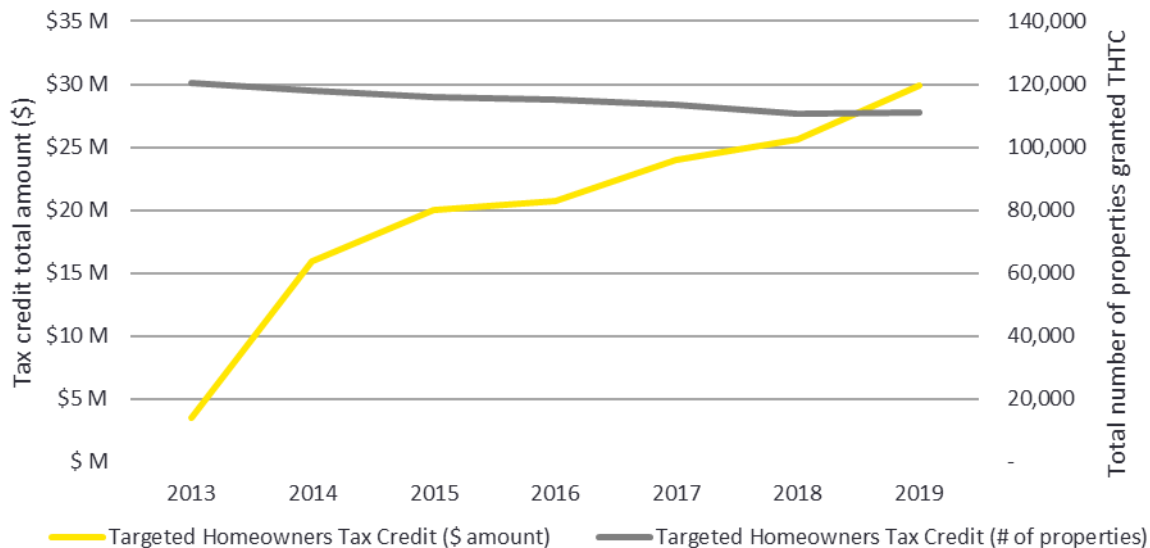
Looking ahead, the City is likely to experience some growth in the cost of the ATC again (and thus lost property tax revenue) as an effect of COVID-19. Residential housing prices have grown rapidly after COVID-19 as many buyers are seeking new homes or larger properties. In Fiscal 2023, Group I residential properties experienced triennial growth of 8.7%.

Targeted Homeowners Tax Credit (THTC)

Background	Type	Residential Protection
	Sub-Market	Owner-Occupied
Credit Mechanics	Eligibility	All owner-occupied properties that have qualified for the Homestead Tax Credit.
	Credit	Reduces the property tax by an amount equal to 20 cents, from the base rate of \$2.248 per \$100 of assessed value, to an effective rate of \$2.048.
Financials Legal	FY22 Cost	\$31.3 million
	Sunset Date	No Sunset
	Legal	Statewide Optional

Background: The Targeted Homeowners Tax Credit (THTC) is a local tax credit that was created in 2013. This program was initiated by Mayor Stephanie Rawlings-Blake and was continued by subsequent Administrations. It is commonly referred to as the “20 Cents by 2020” program. The goal was to reduce the effective property tax rate for residential owner-occupied properties by 20 cents, reducing the rate from \$2.248 per \$100 of assessed value to \$2.048. At the program’s inception, the THTC was expected to be fully funded by Horseshoe Casino revenues. The City’s agreement with the casino operator requires the operator to pay the City either a minimum payment or 2.99% of gross profits. However, the casino’s performance has underperformed versus expectations, and annual payments have never exceeded the minimum payment. This means that the cost of the THTC tax reduction program has been partially borne by the General Fund. In Fiscal 2021, the cost of the THTC totaled \$34.2 million, with only \$14.0 million coming from Casino revenues, and the remaining \$20.2 million from the General Fund.

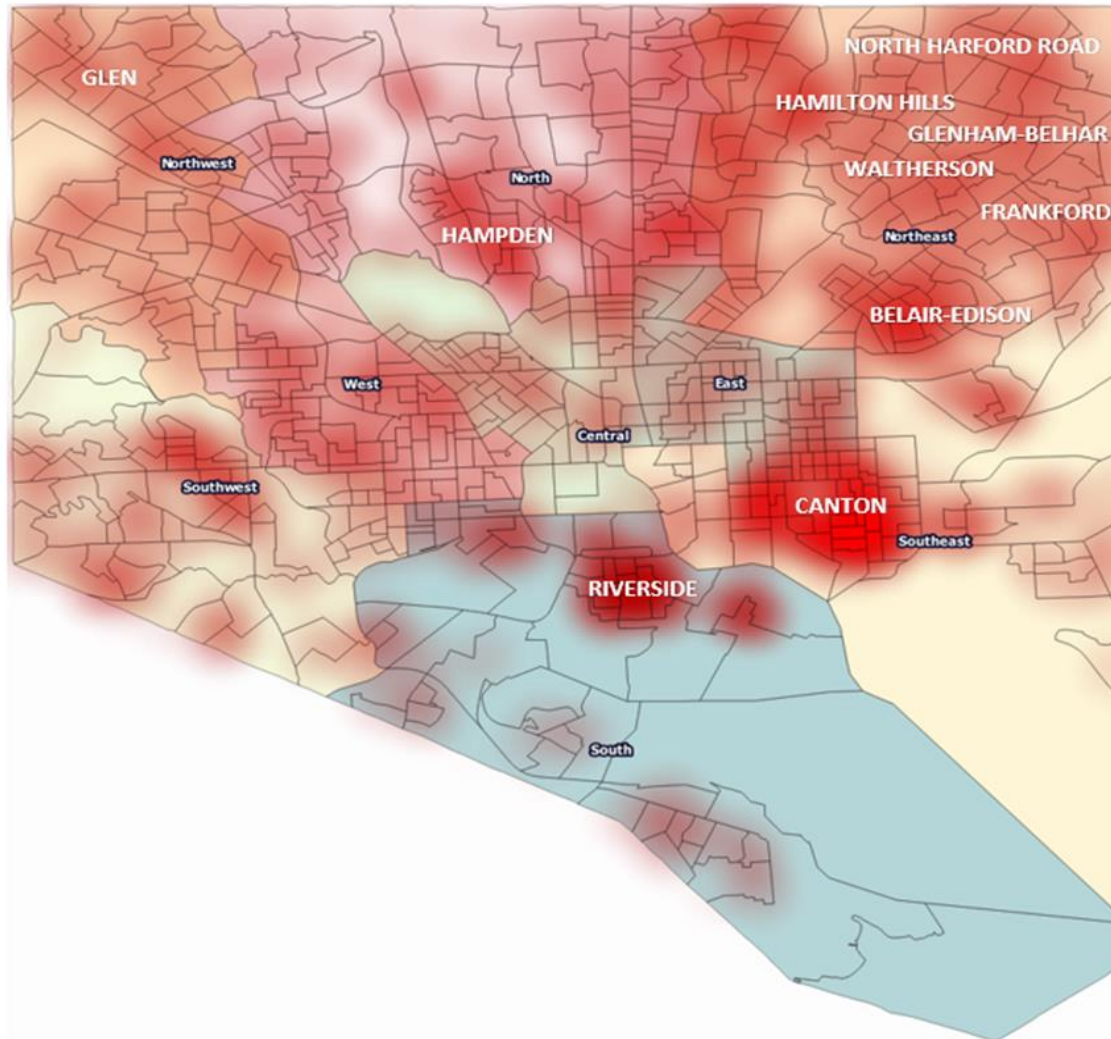
Historical Trend: In Fiscal 2013, 120,271 properties were granted the THTC. This number declined slightly to 110,914 properties in Fiscal 2021, as the City aligned its eligibility with the Homestead Tax Credit, which requires an application. The cost of the credit has grown each year as planned, per the intention to phase in the program between Fiscal 2013 and Fiscal 2020. The program achieved its goal of a 20-cent reduction in Fiscal 2020 and has remained at that effective level in Fiscal 2021 and Fiscal 2022.



Geographical Distribution: The following heat map shows the neighborhoods with the highest number of parcels granted the THTC in Fiscal 2019, and the top five neighborhoods by credit amount granted:

Distribution of the Targeted Homeowners Tax Credit

Fiscal 2019



Top Five Neighborhoods by Tax Credit Amount Granted

Fiscal 2019

Neighborhood	Credit Cost	# of Properties	Avg. Credit
Canton	\$1.9M	4,152	\$478
Riverside	\$1.0M	2,064	\$526
Roland Park	\$0.8M	1,117	\$724
Guilford	\$0.7M	693	\$961
Mount Washington	\$0.6M	1,279	\$475
Baltimore City-Wide	\$29.8M	110,914	\$269

The distribution of the THTC tracks directly to neighborhoods with both high property values and high rates of owner-occupied properties. The top five neighborhoods listed above account for nearly 17% of the total amount of THTC granted.

Efficiency Considerations: The THTC is efficient in that it delivers a lower effective tax rate for all owner-occupied residential properties. This makes those properties more competitive versus neighboring counties with lower property tax rates. However, the base tax rate of \$2.248 is still levied on commercial, industrial, and non-owner occupied housing, which increases the distortionary effect on those properties.

Equity Considerations: The THTC is vertically regressive. Tax relief that is granted in proportion to the improvement value of a home is naturally regressive in the distribution of its benefits. The average tax credit granted City-wide is \$269. For homeowners in Guilford and Roland Park the average credit granted is \$961 and \$724, respectively, both more than double the average City-wide credit amount.

Other Considerations: The THTC was conceived as part of the City's 10-Year Financial Plan and was considered a crucial first step in reducing the City's tax burden for residential owner-occupied properties. The City's property tax rate is nearly double the rate of neighboring jurisdictions and is perceived as a significant competitive disadvantage to attracting new residents or retaining existing ones. In addition, due to the nature of income taxation in Maryland, with residents being taxed based on where they live rather than where they work, the tax burden on Baltimore City taxpayers is especially high.

There have been some internal discussions about extending tax relief beyond the 20 Cents by 2020 goal which was achieved in Fiscal 2020. But, further rate reductions were paused due to the negative economic consequences of COVID-19, plus the expectation for new State-mandated education costs that begin in Fiscal 2023.

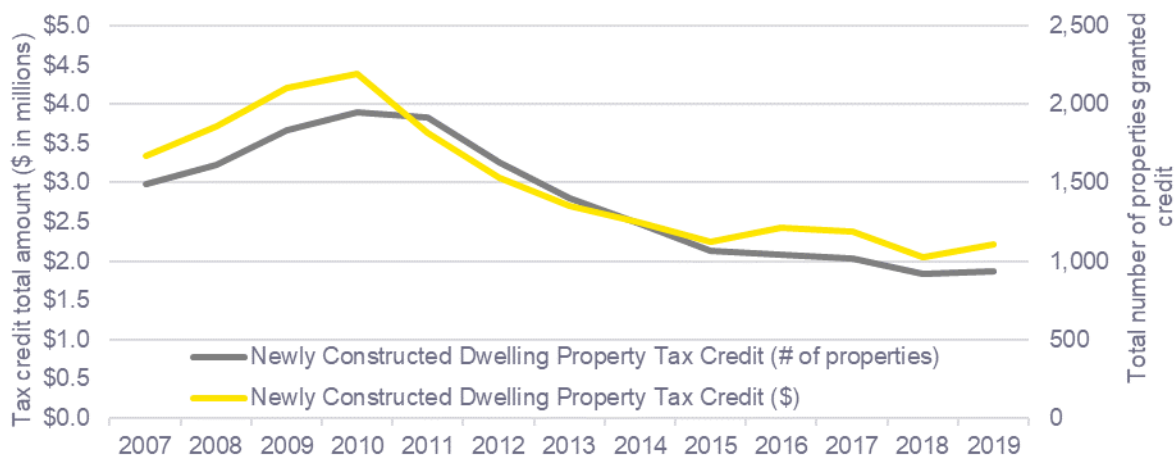
Newly Constructed Tax Credit (NCTC)

Background	Type	Development
	Sub-Market	New Construction, Vacants that are Substantially Rehabbed
Credit Mechanics	Eligibility	Must be newly constructed or substantial rehab and meet “high performance” building criteria.
	Credit	Five-year credit, 50% credit in year one, phasing out by 10% per year to 10% in year five.
Financials Legal	FY22 Cost	\$1.8 million
	Sunset Date	NCTC lapsed on June 30, 2019. High Performance NCTC sunset is June 30, 2027.
	Legal	Statewide Optional

Background: The Newly Constructed Tax Credit (NCTC) is a Statewide optional credit; the City began its program in 1996. The intent of the program is to encourage development of brand-new residential units or “substantial” rehabs, which are defined as properties that were declared vacant by DHCD for more than one year or had been owned by the Mayor and City Council for one year and needed substantial repair to comply with applicable City codes. The credit is a 5-year credit, starting at 50% in Year One and then declining by 10% per year to 10% in Year Five.

The Statewide NCTC expired at the end of Fiscal 2019, which meant that the City’s program lapsed and no new applications were accepted. As a stop-gap measure, the City Council created a new credit under the auspices of the High-Performance law. This credit, the High-Performance Newly Constructed Tax Credit, is intended to serve as a replacement for the NCTC, while re-authorization of the original NCTC is considered by the General Assembly. The structure of the new credit is identical to the NCTC but includes some additional green-building standards as part of the “high performance” requirements. All of the numbers listed here are for the NCTC and High-Performance NCTC combined.

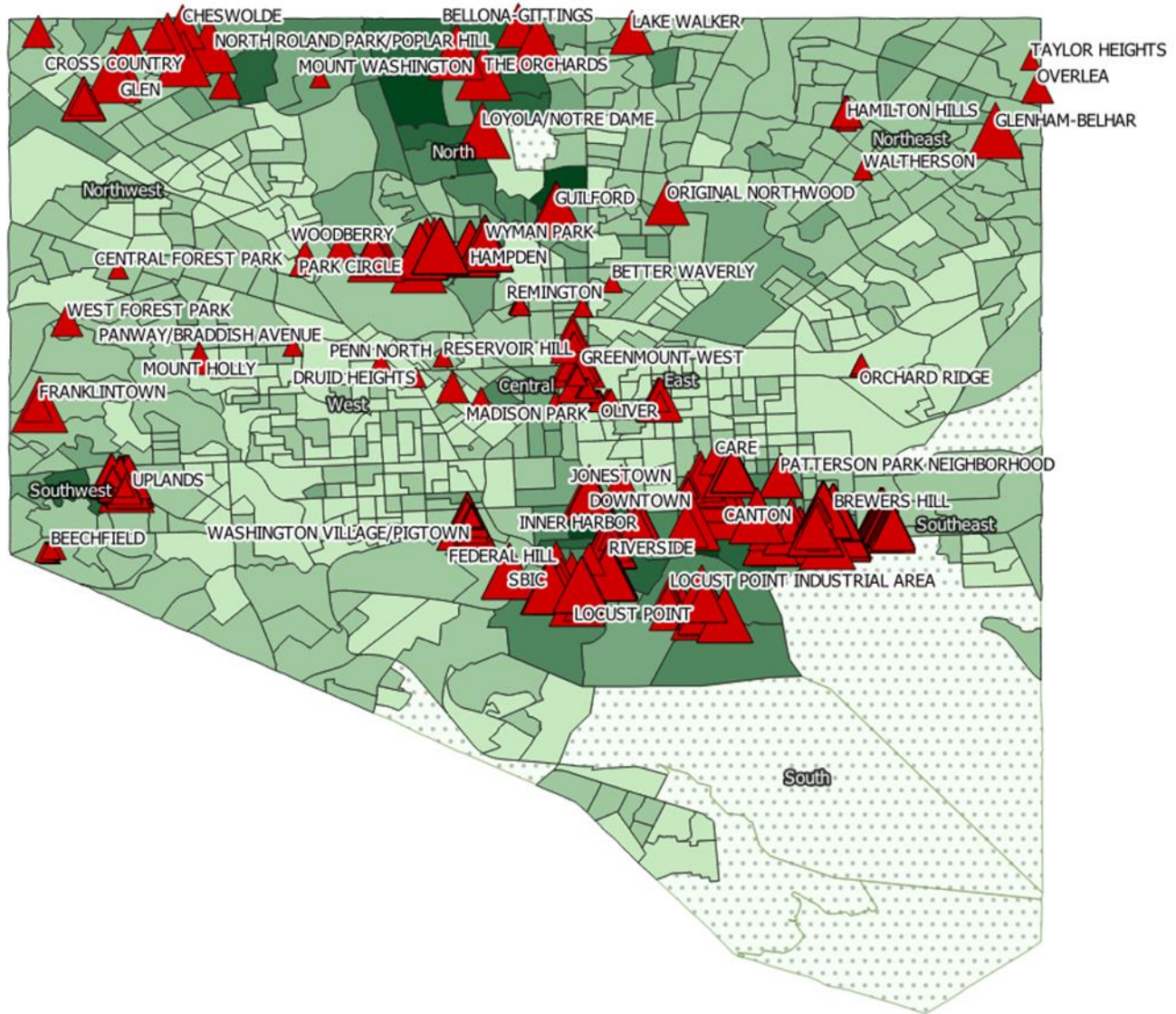
Historical Trend: The NCTC reached its peak in Fiscal 2010, due to a building surge during the run-up of housing prices in the years before the Great Recession. In Fiscal 2010, 1,947 properties received the NCTC, which declined to 932 properties in Fiscal 2019.



Geographical Distribution: The following map shows the block groups that are granted the Newly Constructed Tax Credit, and the top five neighborhoods by credit amount granted:

Distribution of the Newly Constructed Tax Credit

Fiscal 2019



Top Five Neighborhoods by Tax Credit Amount Granted

Fiscal 2019

Neighborhood	Credit Cost	# of Properties	Avg. Credit
Greektown	\$2.6M	218	\$1,756
Uplands	\$0.6M	121	\$1,750
Inner Harbor	\$5.9M	39	\$4,498
Canton	\$4.5M	47	\$3,437
Brewers Hill	\$0.4M	33	\$4,730
Baltimore City-Wide	\$2.2M	932	\$2,378

The NCTC tracks directly with neighborhoods that have seen a significant pace of new construction activity. This includes some traditionally stable neighborhoods, such as Canton and the Inner Harbor, but also has extended to other neighborhoods, such as Uplands, Greektown, Hampden, and Greenmount West. 49% of the value of all NCTCs authorized for 2019 alone were granted in the top five neighborhoods listed above.

Efficiency Considerations: The NCTC intends to incent the market towards new construction of owner-occupied properties. However, the simultaneous existence of this credit with the High-Performance (rental units) and the Historic Tax Credits (rehab) suggests that the effects of all credits might be diminished. The ultimate benefit of this credit is likely to be at least partially with the developer, as the effect of the credit can be capitalized into the price of the home.

Equity Considerations: The NCTC is likely to be vertically regressive, as developers and purchasers of newly-built homes are likely to be of higher income compared to the average resident.

Other Considerations: The NCTC legislation requires the Director of Finance to report on the public costs and benefits of the tax credit each year. The results are published annually in BBMR's Executive Summary budget publication. One of the tools for this analysis is a survey of NCTC recipients that is completed during the application process. Two of the results from the Fiscal 2015 to 2019 survey raise some questions about the efficacy of the NCTC.

First, tax credits are most effective if they incent new residents to the City, which adds to the City's tax base. But, in the survey, 57.3% of recipients already lived in Baltimore prior to the purchasing the new home, and 73.6% reported that they were only looking in the City for a new home. This suggests that the credit might simply be assisting City residents in moving from one location to another, rather than incenting brand-new City residents.

Second, tax credits are most effective if they influence the decision of the buyer as they are considering the purchase of a home. However, only 66.4% of recipients reported that they knew about the NCTC prior to purchasing the home. This means that an estimated 33.6% of buyers did not know about the credit, and so the tax credit did not influence their decision to buy the home.

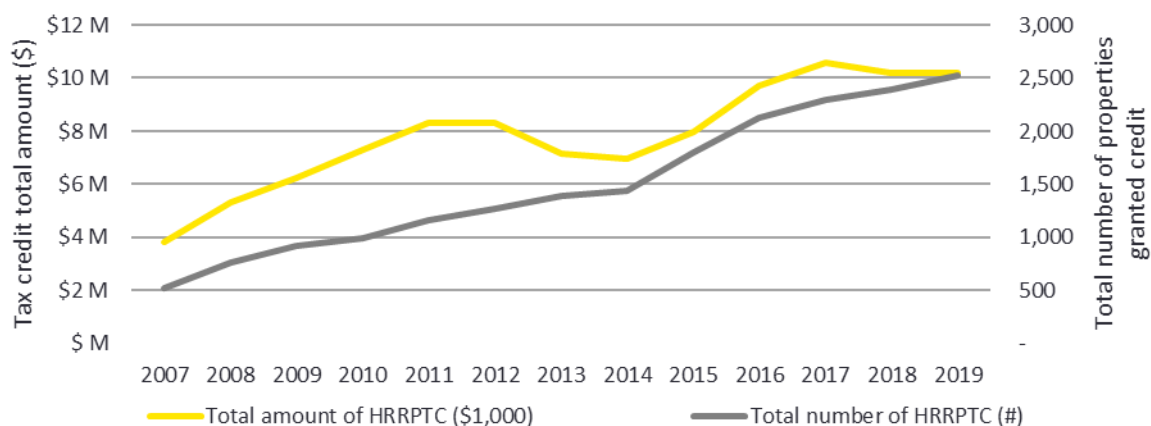
Historic Restoration and Rehabilitation Tax Credit (CHAP)

Background	Type	Development
	Sub-Market	Renovation of Existing Real Property
Credit Mechanics	Eligibility	Must be located in a historic district, and must be CHAP certified.
	Credit	For properties < \$5 million: 10-year credit, 100% of improved value for all years. For properties > \$5 million: 10-year credit, 80% of improved value in Years 1-5 phasing out to 30% in year 10.
Financials Legal	FY22 Cost	\$12.1 million
	Sunset Date	February 28, 2023
	Legal	Statewide Optional

Background: The Historic Restoration and Rehabilitation Tax Credit (CHAP) is a Statewide optional credit that was first established in Baltimore City in 1996. The intent of the credit was to incent the restoration of historic properties. For properties with construction costs under or equal to \$5 million, it is a 10-year credit on 100% of the improved value. For properties with construction costs over \$5 million, the credit is 10-years, declining from 80% in Years One to Five and declining to 30% in Year Ten.

For a property to be eligible, it must be within either a City Historic District or a National Register Historic District. All projects must be pre-approved by CHAP and meet design specifications. Additionally, the project cost must equal or exceed at least 25% of the property's full cash value before commencement of improvements. As part of the review process, the property undergoes a pre-rehab and post-rehab appraisal to determine the full value of the property. The difference in the pre-rehab and post-rehab appraisal is the "improved value", which is used to calculate the tax credit.

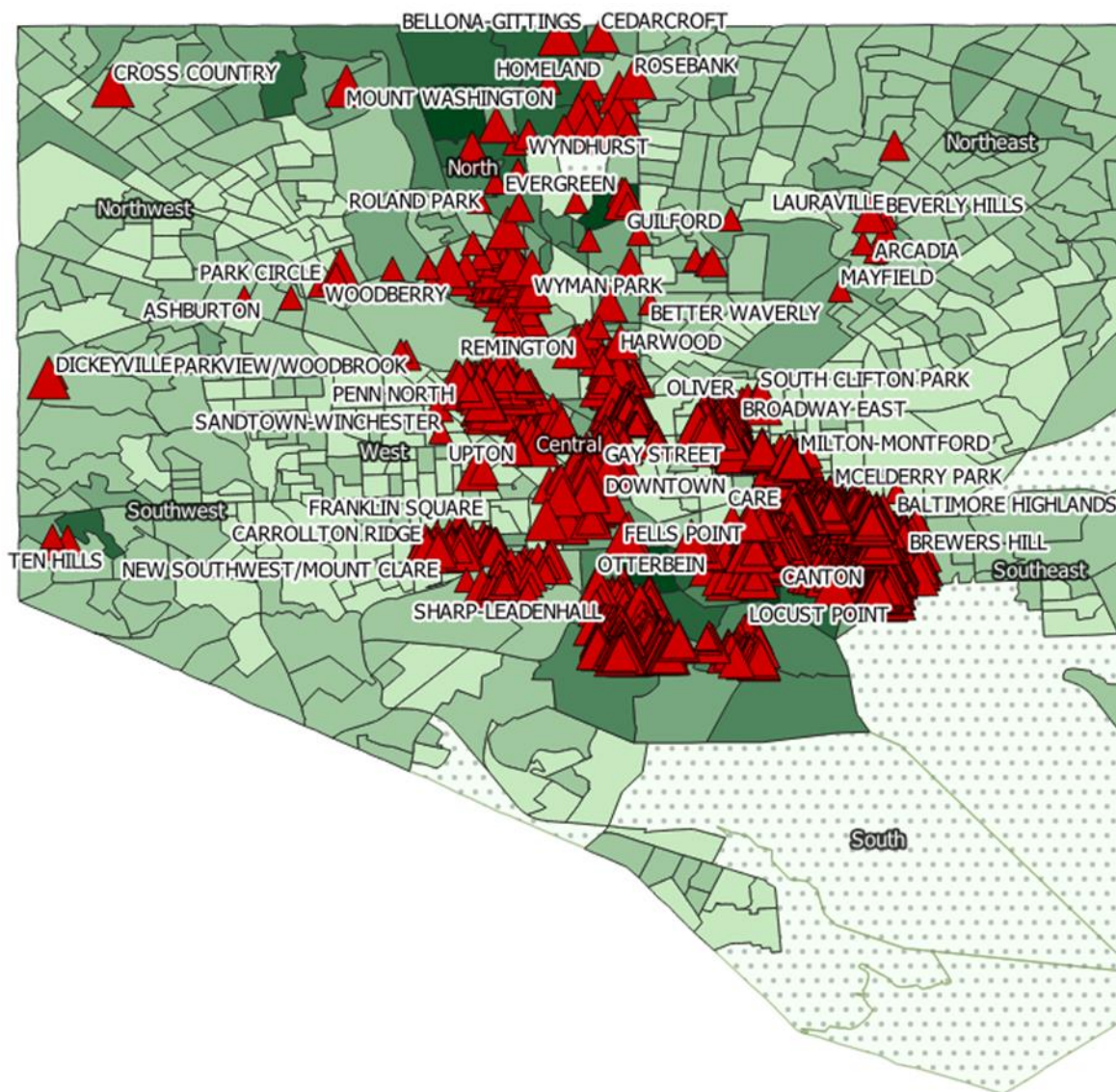
Historical Trend: There has been steady growth in this credit over the last twelve years. The reason for the growth is the continual addition of new historic designations, which broadens the number of neighborhoods and parcels that are eligible for the credit. The modest decline in cost beginning 2017 is due to tighter compliance with the program's rules and regulations.



Geographical Distribution: The following map shows the block groups that are granted the CHAP Tax Credit, and the top five neighborhoods by credit amount granted:

Distribution of the Historic Restoration and Rehabilitation (CHAP) Tax Credit

Fiscal 2019



Top Five Neighborhoods by Tax Credit Amount Granted

Fiscal 2019

Neighborhood	Credit Cost	# of Properties	Avg. Credit
Canton	\$2.2M	578	\$3,904
Patterson Park	\$0.9M	228	\$3,724
South Baltimore	\$0.6M	100	\$5,557
Riverside	\$0.5M	134	\$4,028
Upper Fells Point	\$0.5M	136	\$3,666
Baltimore City-Wide	\$10.9M	2,520	\$4,047

The distribution of this credit tracks directly to neighborhoods that have either a local or Federal historic designation. There are currently 87 historic districts in Baltimore that include approximately one-third of the properties in the City. Although the credit has been granted in 81 different neighborhoods in Baltimore since its inception, it does not reach all neighborhoods equally. The neighborhoods with the greatest count and dollar value of tax credit granted are among the highest per capita income areas of the City.

Efficiency Considerations: From a housing and redevelopment perspective, it is not clear that historic designation is synonymous with areas in need of greatest development. The CHAP credit permits non-historic buildings to receive credits simply because they fall within a historic district. CHAP does require projects to maintain certain small historic details in homes such as windows, doors, and staircases; but, in practice very few applications are rejected. Since the historic districts generally correspond to the wealthier areas of the City, the program has served as a tool for renovation projects in homes in these healthier neighborhoods.

In addition, the cost of the credit is likely to be at least partially capitalized into the price of the rehabilitated property, which delivers some benefit to the rehab developer rather than the new homeowner.

Equity Considerations: In practice the CHAP credit has been vertically regressive. The program reduces taxes on properties in historic districts only, which tend to be in neighborhoods with higher average per-capita incomes and a higher capacity to pay. Although the credit is available in a wide range of neighborhoods with a historic designation, most of the development occurs in already-established neighborhoods where the potential for market returns is the highest.

Other Considerations: The CHAP tax credit is the only City tax credit program that offsets up to 100% of the increase in tax liability that occurs following a substantial renovation. For projects that are less than \$5.0 million, the City grants a 10-year 100% credit on the improved value. ***This means that for a vast priority of CHAP applications granted, the City generates \$0 of net new tax revenue on these properties for ten years.***

High Performance Market Rate Rental Housing Tax Credit (HPMRRH)

Background	Type	Development
	Sub-Market	New Apartment Buildings or Conversions
Credit Mechanics	Eligibility	Must construct or convert 10+ or more units to a “high performance” construction standard. The construction cost must be greater than \$60,000 per unit.
	Credit	10-year credit. 80% in years one through five, phasing out to 30% in year ten.
Financials Legal	FY22 Cost	\$20.1 million
	Sunset Date	December 31, 2027
	Legal	Statewide Optional

Background: The High Performance Market Rate Rental House Tax Credit (HPMRRTC) is a Statewide optional credit created in 2013. The intent was to incent the conversion of real estate into market-rate rental apartment buildings. At the time of its inception, the City believed that it had an opportunity to grow Baltimore’s residential population by encouraging the construction of these types of developments in an environmentally sensitive manner. The credit discussed here is a summary of two components: the “Targeted” HPMRRTC, and the “Citywide” HPMRRTC.

The **Targeted** HPMRRTC, adopted in Fiscal 2013 with the enactment of Ordinance 13-112, was designed to encourage construction and rehabilitation of apartment structures in the City’s downtown neighborhoods. The target area, defined in Article 28, § 10-17 (e), includes selected Census Tracts for the Downtown, Reservoir Hill, Jonestown, West Cold Spring Lane, Poppleton, York Road, Bel Air Road, and Station North areas. Eligible projects must meet green building standards, have 50 or more rental units, and have a total project cost that exceeds \$60,000 per unit. The credit’s value is based on a percentage of the increase in tax liability on the first assessment after an occupancy permit is issued. The credit length is 15 years and phases out over time, from 100% in Year One and Year Two to 20% in Year 13 through Year 15. With the intent of limiting over-supply of credits, the original legislation required that no new applications be accepted after December 31, 2017. This credit expired in 2017.

The **Citywide** HPMRRTC, adopted in Fiscal 2014 with the enactment of Ordinance 14-278, was not restricted to any geographic area. The credit was designed to encourage construction and rehabilitation of apartment structures throughout the City. Eligible projects were required to have 20 or more rental units and total project cost must exceed \$60,000 per unit; this requirement was lowered to 10 or more rental units in December 2019. The credit’s value is based on a percentage of the increase in tax liability on the first assessment after an occupancy permit is issued. The credit length is 10 years and phases out over time, from 80% in Year One to Year Five, to 30% in Year 10. This credit is still active; the original deadline of December 31, 2017 was extended to December 31, 2022 and then further extended to December 31, 2027.

Historical Trend: As of Fiscal 2020, there were thirteen properties built that utilized the Targeted HPMRRTC and ten properties built that utilized the Citywide HPMRRTC, listed below:

Targeted HPMRRTC Properties

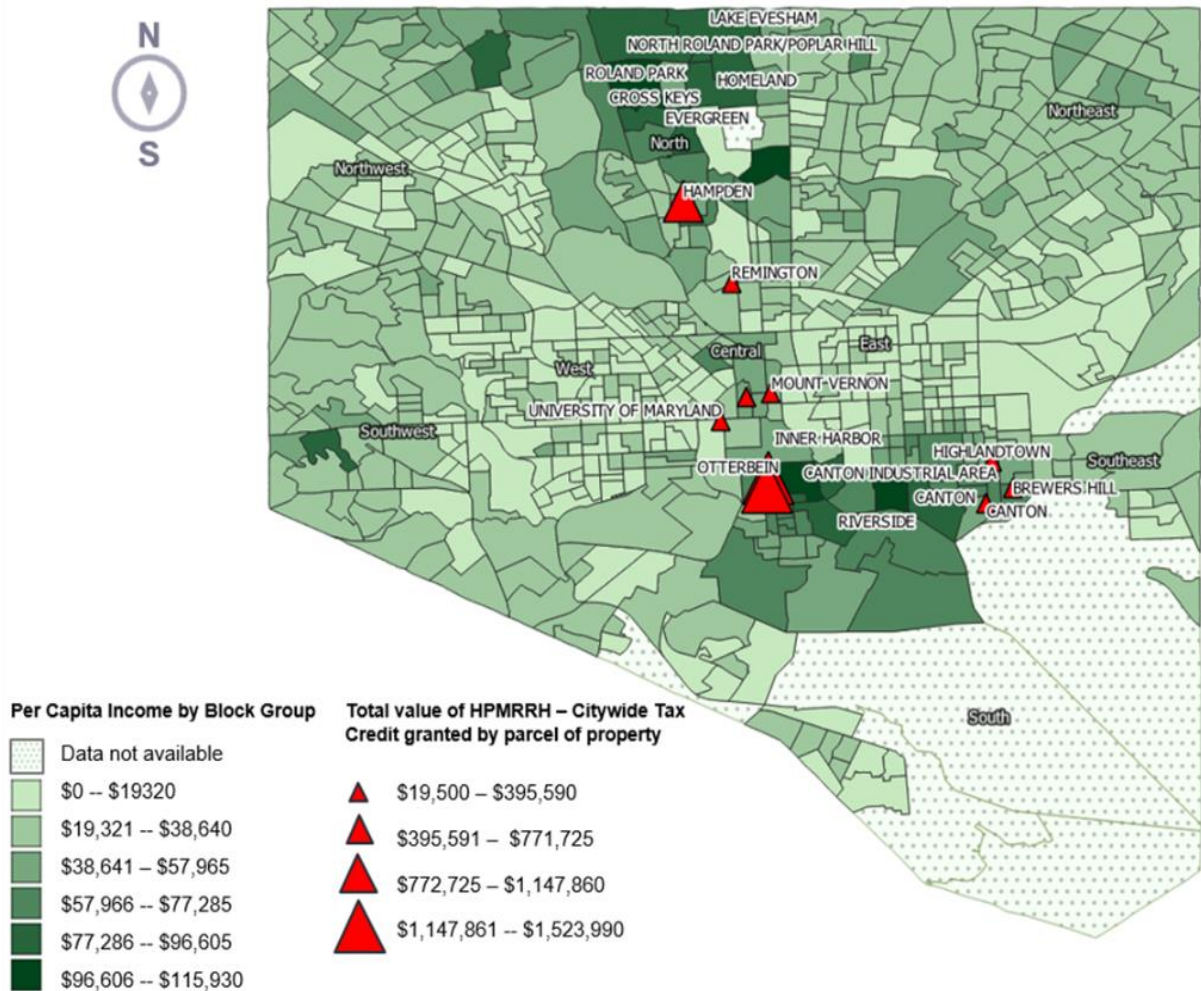
Address	Neighborhood	FY 2020 Assessment	Dwelling Units	Year Built	FY 2020 HPMRRH Tax Credit
10 Light St	Downtown	\$89,915,767	420	2017	\$1,149,264
12 N Calvert St	Downtown	\$23,858,367	188	2016	\$326,736
20 E Lanvale St	Station North	\$10,365,100	103	2018	\$177,148
26 S Calvert St	Downtown	\$13,693,600	85	2017	\$232,887
30 S Calvert St	Downtown	\$13,095,700	85	2017	\$232,683
103 S Gay St	Downtown	\$23,019,500	136	2018	\$217,130
111 W Baltimore St	Downtown	\$46,283,833	183	2018	\$798,330
207 N Calvert St	Downtown	\$52,849,667	346	2019	\$977,218
300 Saint Paul Pl	Downtown	\$41,914,533.00	173	2019	\$498,568
301 N Charles St	Downtown	\$12,902,533	92	2015	\$141,725
500 Park Ave	Downtown	\$23,339,800	153	2019	\$482,212
520 Park Ave	Downtown	\$19,160,100	171	2016	\$293,744
521 Saint Paul St	Downtown	\$7,652,000	69	2014	\$85,465

Citywide HPMRRTC Properties

Address	Neighborhood	FY 2020 Assessment	Dwelling Units	Year Built	FY 2020 HPMRRH Tax Credit
1212 S East Ave	Canton	\$10,654,933	57	2015	\$170,967
2700 Remington Ave	Remington	\$20,063,300	86	2017	\$216,739
3232 Eastern Ave	Highlandtown	\$11,255,600	65	2017	\$190,117
3610 Dillon St	Brewers Hill	\$15,000,000	60	2016	\$266,611
414 Light St	Otterbein	\$141,934,300	394	2018	\$3,159,184
501 W Franklin St	University of MD	\$13,396,700	139	1962	\$167,780
611 S Charles St	Otterbein	\$82,184,833	349	2017	\$1,237,769
711 W 40th St	Hampden	\$91,908,600	379	2016	\$729,858
815 Park Ave	Mount Vernon	\$2,319,300.00	25	2018	\$27,210
824 N Calvert St	Mount Vernon	\$5,340,000	49	2017	\$71,343

Geographical Distribution: The “Targeted” HPMRRTC was intended to be restrictive in geographic scope. Eleven of the twelve properties that received the credit are in the Downtown neighborhood, with the other built in Station North. The “Citywide” HPMRRTC was intended to be broad in geographic scope, but in practice only eight neighborhoods have a property receiving this credit: Otterbein (two properties), Mount Vernon (two properties), and one each for Hampden, Brewers Hill, Remington, Highlandtown, Canton, and University of Maryland. The credit tracks directly with stronger neighborhoods where there is a high demand for housing.

The following map shows the limited scope of the “Citywide” HPMRRTC:



Note: The heat map is generated using the block group level “per capita income in the past 12 months (in 2017 inflation-adjusted dollars)” from the American Community Survey 2017. The labeled neighborhoods represent some of the affluent neighborhoods with the highest per capita income and the neighborhoods where most of the properties with the credit are located. The neighborhood per capita income is derived by taking the weighted average of block group level per capita income (weighted by population).

Efficiency Considerations: In a market with no new renters, the rental housing most likely to be developed is upper-scale market-rate and above housing, which is the stated target of the HPMRRTC. New supply at the upper end of the market depresses rents in other properties with similar amenity levels. The result is a filtering downward with the lowest-valued rental properties being forced from the market.

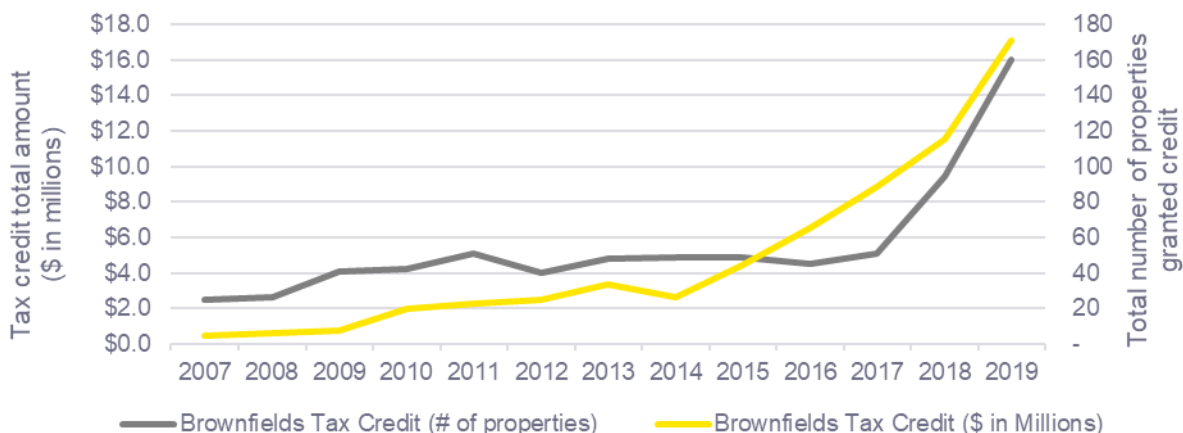
In a market where an inflow of new and wealthy renters was expected, as was the case when the HPMRRTC was conceived, there would be an especially strong market incentive for developers to build upper-scale market-rate housing to meet this demand. Without market demand a tax credit alone would not be expected to support this type of housing. Therefore, it is likely that the market would have responded to this demand with a more limited subsidy.

Brownfields Tax Credit

Background	Type	Development
	Sub-Market	Environmentally-Contaminated Parcels
Credit Mechanics	Eligibility	Applicant must provide evidence of a voluntary cleanup or corrective action plan approved by the Maryland Department of the Environment (MDE).
	Credit	Cost < \$250,000 – 5-year credit at 50% each year. Cost > \$250,000 – 5-year credit at 70% each year. Projects within Enterprise Zones – 10-year credit. Plus, the City must contribute into the State Brownfield Fund at 30% of the cost of the credit for the first five years.
Financials Legal	FY22 Cost	\$18.0 million
	Sunset Date	Voluntary
	Legal	Statewide Optional

Background: The Brownfield Tax Credit is a Statewide optional tax credit that was established by State law in 1997 as part of Maryland’s Smart Growth policy. The program’s stated intent was to promote economic development in distressed urban areas by incenting the re-development of contaminated abandoned sites and/or under-utilized commercial or industrial sites. The City opted into the program in 1998 via Ordinance 98-248, allowing for a 5-year 50% credit on the increased taxable value after cleanup. Baltimore also chose to add two additional sub-provisions to encourage development within Enterprise Zones. Properties within Enterprise Zones receive an extended credit, to 10-years, and projects with costs greater than \$250,000 receive an extended benefit, to 70%. Due to the wide map for Enterprise Zones and the low-cost threshold, 97% of Brownfields projects qualify for both additional sub-provisions.

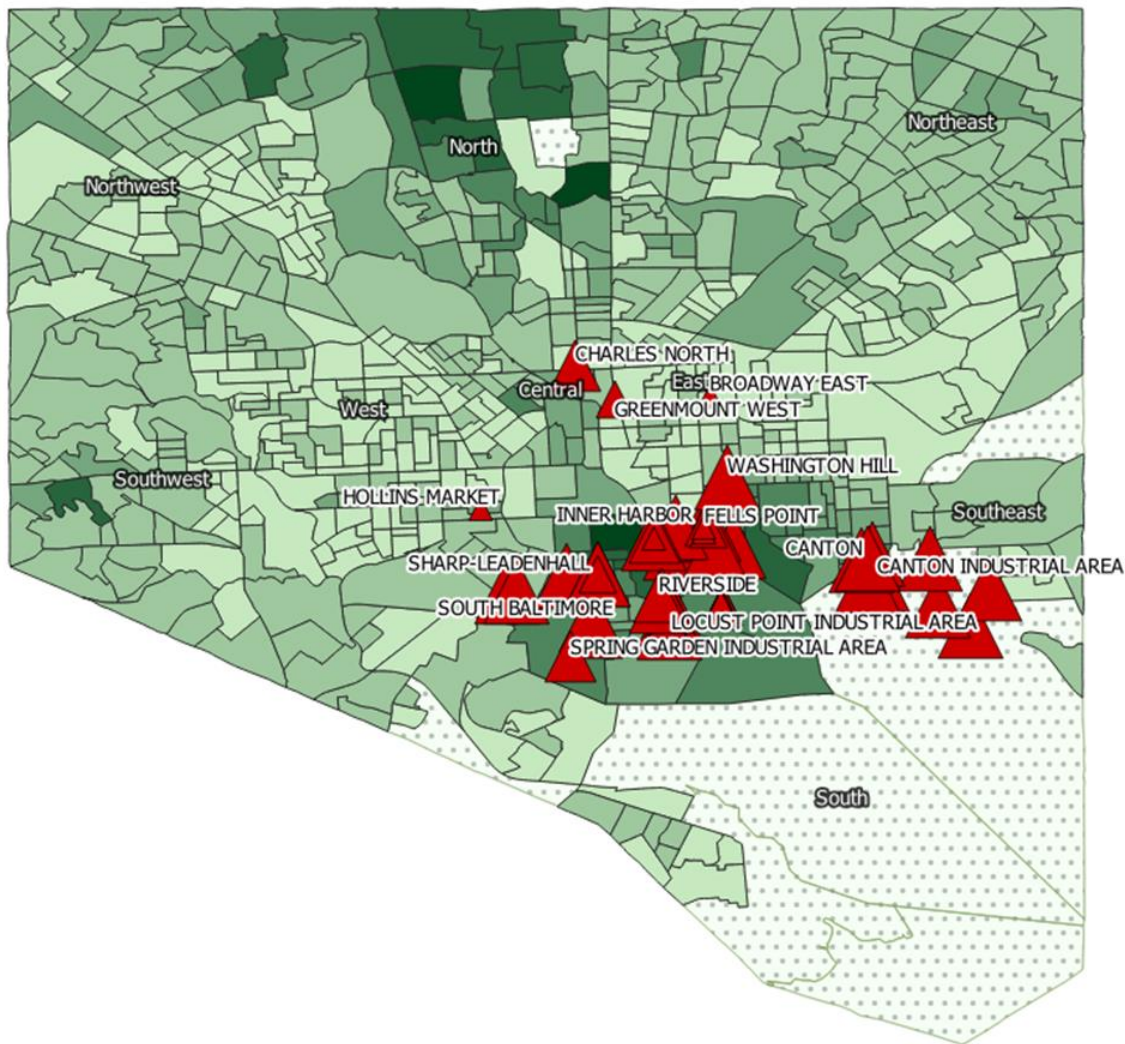
Historical Trend: The use of this credit has exploded in recent years. Over the ten-year period between Fiscal 2008 and Fiscal 2017, a total of only 97 unique properties were granted this credit. Over the three-year period between 2017 and 2019, an additional 120 properties were granted the credit. Much of the growth in the program is due to its growing use as a residential development incentive. Although the stated goal of the program is for commercial development, new residential developments that fall within City Enterprise Zones have qualified, including new townhome developments in Locust Point and the Four Seasons condominiums in Harbor East.



Geographical Distribution: The following map shows the block groups that have been granted the Brownfield Tax Credit, and the top five neighborhoods by credit amount granted:

Distribution of the Brownfield Tax Credit

Fiscal 2019



Top Five Neighborhoods by Tax Credit Amount Granted

Fiscal 2019

Neighborhood	Credit Cost	# of Properties	Avg. Credit
Fells Point	\$3.7M	11	\$337,121
Canton IA	\$3.3M	8	\$413,682
Inner Harbor	\$2.5M	63	\$40,551
Riverside	\$1.7M	3	\$568,090
Carroll Camden IA	\$1.3M	2	\$657,294
Baltimore City-Wide	\$17.1M	160	\$107,029

The distribution of this credit tracks closely with the City's Enterprise Zones, due to the extended benefit granted for properties located in these zones. The top five neighborhoods listed above account for 73% of the tax credit cost in 2019.

Efficiency Considerations: The intent of this credit is to provide an incentive to redevelop certain classes of "brownfield" properties that have presumably been removed from the market due to contamination. However, most of the City can technically qualify as a brownfield due to small traces of toxic material that can be found in soils from prior industrial uses, even if the industrial use wasn't on the site itself. Naturally, developers choose to develop parcels based on the greatest expected market return net of the mitigation costs. Due to the generous size of the credit, builders are incented to develop parcels in neighborhoods with strong market value that have minimal cleanup costs. Additionally, the Brownfields Credit can be combined with the Newly Constructed Tax Credit for eligible properties.

Other Considerations: Due to the wide map for Enterprise Zones and the low-cost threshold of only \$250,000 to qualify for the Brownfield extended benefit, 97% of the Brownfields tax credits granted by the City qualify for the more generous sub-provisions. ***In practice this means that for the clear majority of Brownfield projects, the City provides both a 70% tax credit and then makes a required 30% contribution to the State Brownfield Fund, resulting in \$0 of net new City tax revenues for the first five years.***

Additionally, the Brownfield Tax Credit is now being used in place of other tax credits that provide a better net return to the City while also providing a reasonable incentive for the developer. This is true on both the residential and commercial development side.

On the residential side, Fiscal 2020 data reveals that 67.1% of Brownfield Tax Credit recipients are being used for residential development. Residential Brownfield Tax Credit projects would have otherwise qualified for the Newly Constructed Tax Credit. The result is that the City bears an additional 50% cost in Year One (100% Brownfield vs. 50% NCTC), and an additional 90% cost in Year Five as the NCTC phases out (100% Brownfield vs. 10% NCTC).

On the commercial side, the City has one tax credit, the Enterprise Zone (EZ) tax credit, which covers most of the City's commercial development needs. The EZ Tax Credit is a 10-year credit that begins at 80% in the first year. For projects in EZ Focus Areas, the credit remains at 80% for the entire 10-year period. ***From a cost-effectiveness standpoint, the EZ Tax Credit is the preferred incentive of choice because the State reimburses the City for 50% of the cost.*** In contrast, Brownfield Tax Credits, even if used in tandem with the EZ credit, require a 30% City payment into the State BRIF. In addition, the City and Baltimore Development Corporation play a role in drawing the boundaries for Enterprise Zones, which provides some assurance that incentives are targeted to the districts most in need of assistance.

In Fiscal 2021, as a savings option in response to COVID-19, the Young Administration submitted a bill to the City Council to opt the City out of the State Brownfield Tax Credit program. Support for the bill was eventually dropped and the bill never received a hearing. The City budgeted \$2.1 million of savings in the Fiscal 2021 budget, which was not realized.

Going forward, reform to the Brownfield Tax Credit is a crucial component of any overall tax incentive reform. The Brownfield Tax Credit is duplicative of other residential tax credits, is not urgently needed for commercial development, and requires an additional State-mandated contribution, which is not cost-effective for the City.

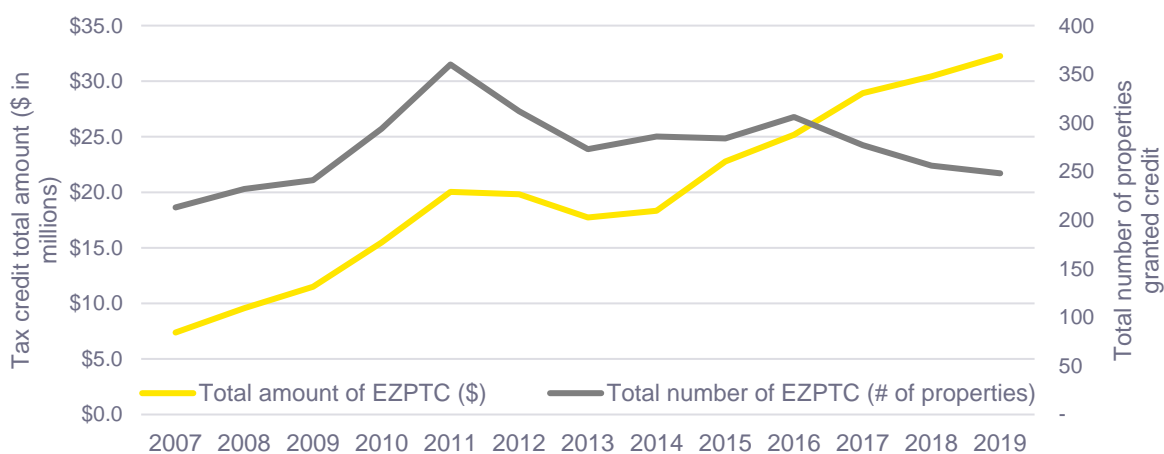
Enterprise Zone Tax Credit (EZTC)

Background	Type	Commercial Development
	Sub-Market	Economically Distressed Areas
Credit Mechanics	Eligibility	Property must be located within an Enterprise Zone. Property must not be used for residential purposes.
	Credit	10-year credit. 80% in years one through five, phasing out to 30% in year ten. For Focus Areas, the credit is 80% for all 10 years. State reimburses City for 50% of the credit cost.
Financials Legal	FY22 Cost	\$20.8 million
	Sunset Date	June 14, 2022
	Legal	Statewide Mandatory

Background: The Enterprise Zone Tax Credit (EZTC) is a Statewide mandatory credit that was established in 1982. The stated intent of the program is to encourage targeted investment in economically distressed areas as measured by unemployment, poverty status, population decline, or property abandonment. Qualified properties must not be used for residential purposes, and must be in an Enterprise Zone, the boundaries of which are re-drawn periodically by the State with local jurisdiction input. The current boundaries for Baltimore are broad and include many industrial areas of the City, as well as traditional commercial districts along Harford Road, Belair Road, York Road, North Avenue, and Liberty Heights Avenue, among others.

The EZ Tax Credit is a 10-year credit at 80% in Year One through Year Five, phasing out by 10% annually to 30% in Year Ten. Focus Areas receive an 80% credit for all ten years. Baltimore has three focus areas: Carroll-Camden, Jones Falls, and Oldtown; Holabird Orangeville Industrial Area; and the Central West Baltimore area. The credit is due for sunset or renewal by June 14, 2022.

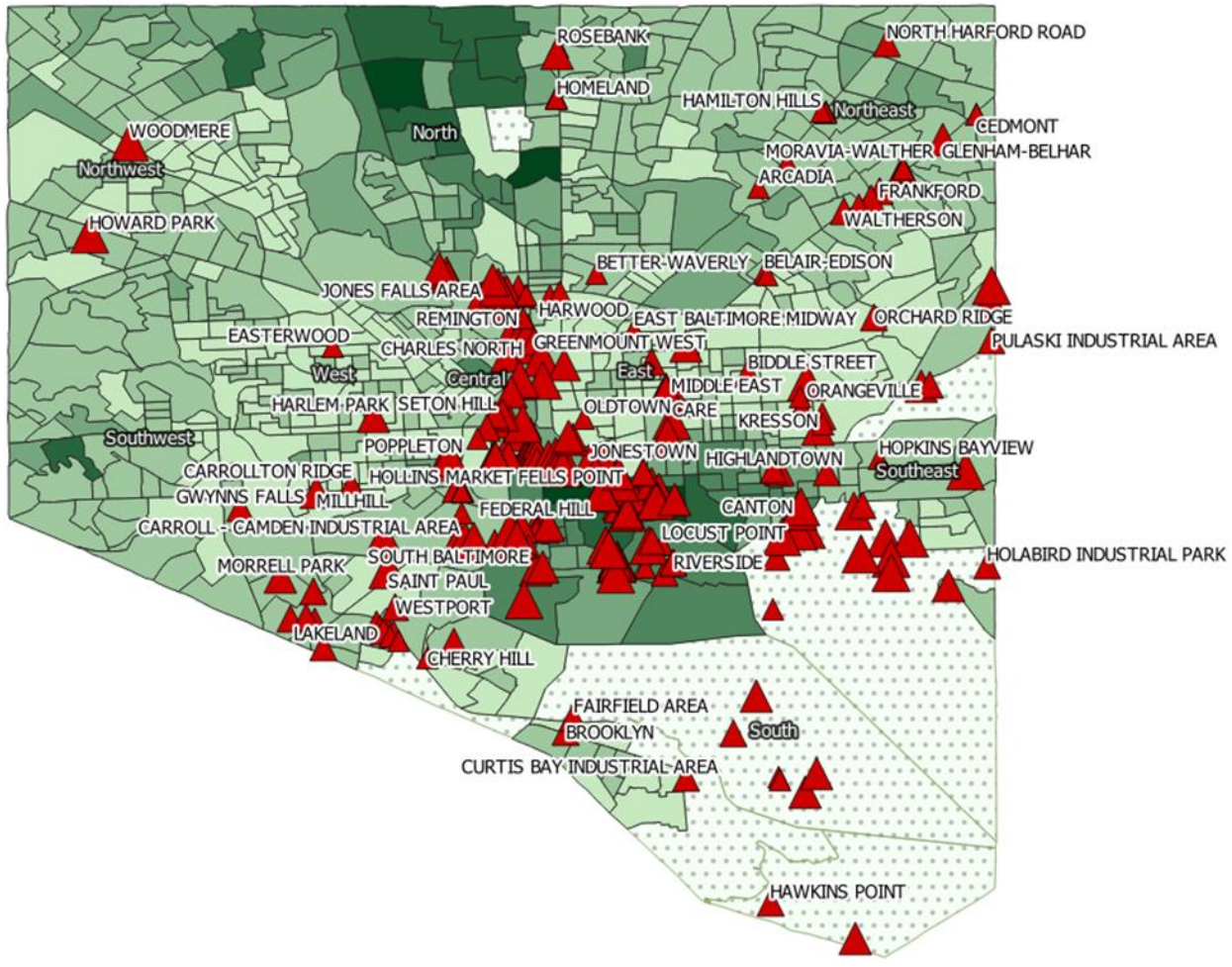
Historical Trend: The number of properties receiving the EZTC has remained steady from Fiscal 2007 to Fiscal 2019. However, the cost of the program grew from \$7.3 million in Fiscal 2007 to \$32.3 million in Fiscal 2019. Note that these costs are net of the 50% reimbursement that the City receives from the State:



Geographical Distribution: The following map shows the block groups that have been granted the EZTC, and the top five neighborhoods by credit amount granted:

Distribution of the Enterprise Zone (EZ) Tax Credit

Fiscal 2019



Top Five Neighborhoods by Tax Credit Amount Granted

Fiscal 2019

Neighborhood	Credit Cost	# of Properties	Avg. Credit
Carroll Camden IA	\$6.6M	6	\$1,010,818
Canton IA	\$6.0M	16	\$375,115
Fells Point	\$5.4M	19	\$289,933
Inner Harbor	\$3.1M	7	\$440,307
Middle East	\$2.3M	5	\$476,989
Baltimore City-Wide	\$32.3M	248	\$130,070

71% of the total cost of the EZTC accrues to properties in the top five neighborhoods listed above. Three of those areas are in more prosperous areas of the City – Inner Harbor, Fells Point, and Canton Industrial Area. The Carroll-Camden Industrial Area and Middle East are more economically distressed areas of the City. Carroll-Camden ranks first in total credit cost since it is located within a Focus Area and receives an 80% credit for all ten years.

The average credit amount in Carroll-Camden is nearly eight times higher than the average credit amount City-wide.

Efficiency Considerations: Enterprise Zones do not create “new” economic activity; rather, they have the potential to transfer economic activity from other areas to the Enterprise Zone. This can produce benefits for the City if the economic activity is moved from an area outside of Baltimore City. However, the benefits of an Enterprise Zone are often limited for two key reasons. First, the assumed employment benefits often leak to employees that live outside of Enterprise Zones or outside of the City entirely. For example, if a new business locates in a Baltimore City Enterprise Zone, but the employees live in Baltimore County, the benefits of that employment (including the income tax revenue) flow back to Baltimore County. Second, an Enterprise Zone often increases the value of the land and therefore benefits existing property owners.

Other Considerations: The EZTC is the only City tax credit that receives partial reimbursement from the State. By law, the State must reimburse the City for 50% of the cost. Therefore, there is an incentive for the City to maximize its use even if there are inefficiencies in its distribution.

CONCLUSIONS: General Tax Credit Issues

When looking at all the City's tax credits collectively, there were six general issues that emerged across the entire portfolio. This section describes those issues, as well as potential solutions.

Issue #1: Equity

The City's existing tax credit programs clearly favor the wealthier and more-established neighborhoods. In the Findings Section we mapped the geographic distribution of each credit and listed the top five neighborhoods by credit amount granted. In reviewing this data, a clear pattern emerged where the same neighborhoods were the top beneficiaries of multiple credits. For example, either the Canton or Canton Industrial Area neighborhood ranks in the top five for credit amount granted in five of the seven tax credits reviewed: Homestead, THTC, NCTC, Brownfield, and EZTC. Additionally, Riverside ranks in the top five for four of the seven tax credits reviewed.

The effect of this structure is that homeowners in the wealthier neighborhoods are collectively paying a lower effective tax rate (net of credits) than homeowners in poorer neighborhoods. The City's base property tax rate is \$2.248 per \$100 of assessed value. In percentage terms, this equates to a 2.248% rate on the property's assessed value. The following chart shows the effective tax rate for residential property in selected neighborhoods based on total property taxes paid versus the total assessed value. This list is not inclusive of all neighborhoods, but gives an idea of the inherent inequity of the current system:

Effective Property Tax Rate net of Credits on Residential Property

Selected Neighborhoods

Neighborhood	# of Properties	Effective Tax Rate
Carrollton Ridge	2,017	2.18%
Brooklyn	2,762	2.13%
Belair-Edison	6,160	2.12%
Ellwood Park	1,297	2.11%
Morrell Park	1,700	2.10%
Charles Village	1,313	2.05%
Federal Hill	1,143	2.04%
Riverside	2,997	1.89%
Canton	6,142	1.85%
Hampden	3,095	1.80%
Brewers Hill	762	1.72%

One option for making the system more equitable is to phase out the eligibility for certain tax credits by neighborhood. Neighborhoods that are more stable and desirable should have less need for ongoing development subsidies. DHCD has developed a tool, the housing market typology map, that could assist in this analysis. The housing market typology map categorizes neighborhoods from an "A" through "J" designation, with "A" neighborhoods being the strongest and "J" being the weakest. The typology is based on several market indicators such as sales prices, vacancy rates, foreclosures, owner-occupied rates, and active construction permits, among many others. The typology map could be used as one factor to determine either the eligibility or the amount of certain credits. For example, tax credits could be eliminated completely for neighborhoods in

the “A” or “B” designations. Or, credit amounts could be tiered based on the typology, with “C” neighborhoods receiving a 10% credit, “D” neighborhoods a 20% credit, and so forth.

Issue #2: Developer Benefit

Many of the City’s tax credits tend to favor the developer directly rather than the homeowner, with the benefit of the credit being capitalized into the price of the property. This is especially true for development incentives, such as the CHAP and NCTC, that involve a developer either constructing or improving a property and then selling it at the highest possible price. The developers’ profit on a project is directly tied to the final sale price, whereas the buyer is more influenced by the net monthly payment (mortgage plus taxes). With a tax credit, a developer can pitch a lower net monthly payment to the buyer, while also increasing the sale price. In this way the benefit gets capitalized into the sale price to the benefit of the developer. The scenario below shows the effect on a home assessed at \$300,000 using the NCTC as an example versus the same property with no credit:

Homeowner Net Monthly Payment
Newly Constructed Tax Credit (NCTC) example

	No Tax Credit	With NCTC Year One	With NCTC Year Five
Purchase Price	\$300,000	\$305,000	\$305,000
Down Payment	\$75,000	\$75,000	\$75,000
Mortgage (30 year fixed at 4%)	\$1,074	\$1,098	\$1,098
City Tax (@ 2.248%)	\$562	\$571	\$571
Tax Credit	\$0	(\$286)	(\$57)
Net Monthly Payment	\$1,636	\$1,384	\$1,612

In this example, with a property that qualifies for a tax credit, the developer can increase the sales price by \$5,000 while the homeowner still gets a much lower net monthly payment in Year One. Even by Year Five, when the credit has declined from 50% to 10%, the homeowner is still paying a lower monthly payment versus a home with a lower sales price and no tax credit. In effect, development tax credits get translated into higher sales prices which leads to higher profit margins on development projects. This also helps explain why many NCTC recipients, when surveyed, said that they were unaware of the credit before purchasing the home.

Issue #3: “By Right” System

The City’s current tax credit system is a “by right” program. Developers are not required to prove that a project requires a subsidy. Rather, any project that meets all eligibility criteria and submits a timely and accurate application will receive the appropriate tax credit.

This system has some clear benefits. For developers, it provides a clear set of parameters that must be met to qualify for any tax credit. It provides some consistency and reliability for developers that are planning longer-term projects. It also makes the process fairer and cleaner—instead of lobbying City officials directly for subsidies, a developer can be assured of the “rules of the game” when planning a project.

However, this “by right” program limits the ability of the City to control tax expenditure costs. Tax credits are costs in the City budget, and they consume City revenues just like normal operating appropriations for City

agencies, such as the Police Department or Department of Transportation. In a “by right” program, tax credit costs have the potential to crowd out other important budgetary priorities in any given year.

In addition, the City has no guarantee that only the minimal subsidy needed to spur the development was provided. This is especially problematic during disruptive moments in the real estate market. Currently, for example, in response to the COVID-19 pandemic the City is experiencing rapid growth in residential real estate prices. In turn, the City might not need to incent residential properties via the Newly Constructed or CHAP Tax Credits. Or, the City might want to shift incentives to a different segment or sub-segment of the market. This likely leads to wasted incentives and lost revenue.

One option to address this problem is to set annual caps on either the number of credits granted or the amount granted. Once the expenditure cap is met for the year, applicants would be placed on a waiting list for the following year. This process would recognize that tax incentives use City revenue just like appropriations and will ensure that tax credit expenditures do not crowd out other important budgetary priorities.

Another idea is to require a “but for” analysis for new project applications. Of course, it would be impractical to require a “but for” analysis for every qualifying tax credit; the City receives 420 applications annually for development tax credits alone. But, one option would be to require projects that exceed a certain cost threshold to request a Payment-in-lieu-of-Taxes (PILOT) agreement from the City. This approach would allow most projects to proceed, but would also give the City the opportunity to negotiate the terms on high-dollar projects and ensure that only the minimal subsidy required for the development is granted.

Issue #4: Tax Credit Terms

The City’s tax credits each have varying lengths and terms. The NCTC and the Brownfield Tax Credit are five-year credits; all the rest are ten-year credits. Some credit amounts decline over the life of the credit, while others stay at the same amount over the full length of the credit. The following table shows the tax credit percentage in each year for all the City’s development tax credits:

Tax Credit Percentage by Year
for All City Development Tax Credits

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
NCTC / HPNCTC	50%	40%	30%	20%	10%	NA	NA	NA	NA	NA
CHAP <\$5.0M	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
CHAP >\$5.0M	80%	80%	80%	80%	80%	70%	60%	50%	40%	30%
HPMRRTC	80%	80%	80%	80%	80%	70%	60%	50%	40%	30%
Brownfield	50%	50%	50%	50%	50%	NA	NA	NA	NA	NA
Brownfield in EZ and > \$250k cost	70%	70%	70%	70%	70%	70%	70%	70%	70%	70%
EZTC	80%	80%	80%	80%	80%	70%	60%	50%	40%	30%
EZTC Focus Area	80%	80%	80%	80%	80%	80%	80%	80%	80%	80%

We do not believe that each credit needs to have identical lengths and terms. But, given the wide variety of terms, each credit should be re-evaluated periodically to ensure that the length and terms match the specific development needs of those types of projects.

Issue #5: Periodic Reviews and Sunset Dates

Currently, the City's tax credits do not have consistent sunset dates. In addition, some credits do not have fixed expiration dates and exist in perpetuity without City action. The following table shows the sunset dates by credit:

Tax Credit Sunset Dates

for All City Tax Credits

Tax Credit	Sunset Date	Notes
Homestead	None	City has authority to set rate anywhere from 0% to 10%. The current rate for Baltimore City is 4%.
Targeted Homeowners	None	City Board of Estimates must approve rate each year.
Newly Constructed	June 30, 2027	Current credit exists as the High Performance Newly Constructed Tax Credit.
Historic Preservation	February 28, 2023	
High Performance	December 31, 2027	
Brownfield	None	City opted into State program. City must pass local legislation to either opt out or modify program.
Enterprise Zone	June 14, 2022	City's application to re-designate Enterprise Zones is pending approval from the State. If approved, Enterprise Zone sunset date would be extended ten years.

When a local tax credit is due to sunset, a City Council member can sponsor its reauthorization. That process requires a bill response from all affected City agencies. Generally, on tax credit bills, the Council will ask for testimony from the Department of Finance and BBMR, as well as other development agencies such as the Baltimore Development Corporation (BDC), DHCD, Department of Planning, and Live Baltimore, among others. This gives all affected stakeholders an opportunity to review the credit and make recommendations to the City Council on proposed modifications.

Although there is a built-in review mechanism for these local credits, the varying sunset dates means that each tax credit gets reviewed separately, with no opportunity to look holistically at how the tax credit programs are working collectively. One alternative option would be to synchronize each credit's sunset date, to ensure that all credits are due to expire at the same time, and then keep each credit on the same cycle. The City could also require that a lead agency, such as BBMR, perform a periodic review (like this report) before all credits are due for reauthorization.

For the credits with no sunset date, the City could also synchronize these to be consistent with a systemic review. For example, legislation could be created to effectively add a sunset date to the Brownfield Tax Credit by requiring that the City opt out of the program by a certain date that is consistent with the other credits. This would reinforce the notion of a required City-wide review and take these credits off the current "auto-pilot" mode. The Brownfield program, for example, began in 1997 and has not had any action or review since then, a period of 25 years.

RECOMMENDATIONS

Based on our findings, we believe the following three recommendations would improve the cost-effectiveness of the City's Tax Credit program:

Recommendation #1: Set a Tax Incentive Budget

We recommend that the City set a tax incentive budget for development credits at 6% of the City's gross property tax revenue, to be achieved over a 10-year period. This target was determined based on examining the following factors:

Development vs. Homeowners Protection Tax Credits

For target-setting purposes, we chose to include only the cost of development tax credits and excluded the two primary homeowner protection tax credits, the Homestead and Targeted Homeowners Tax Credits. Although the City can change the capped percentage (currently 4%) on the Homestead Tax Credit, the City cannot control the cost in any given year because the cost is determined by the pace of growth in the residential real estate market. Likewise, the Targeted Homeowners Tax Credit, which was an intentional effort by a previous Administration to reduce the City's effective tax rate for owner-occupied properties, is a central policy tool and should be preserved.

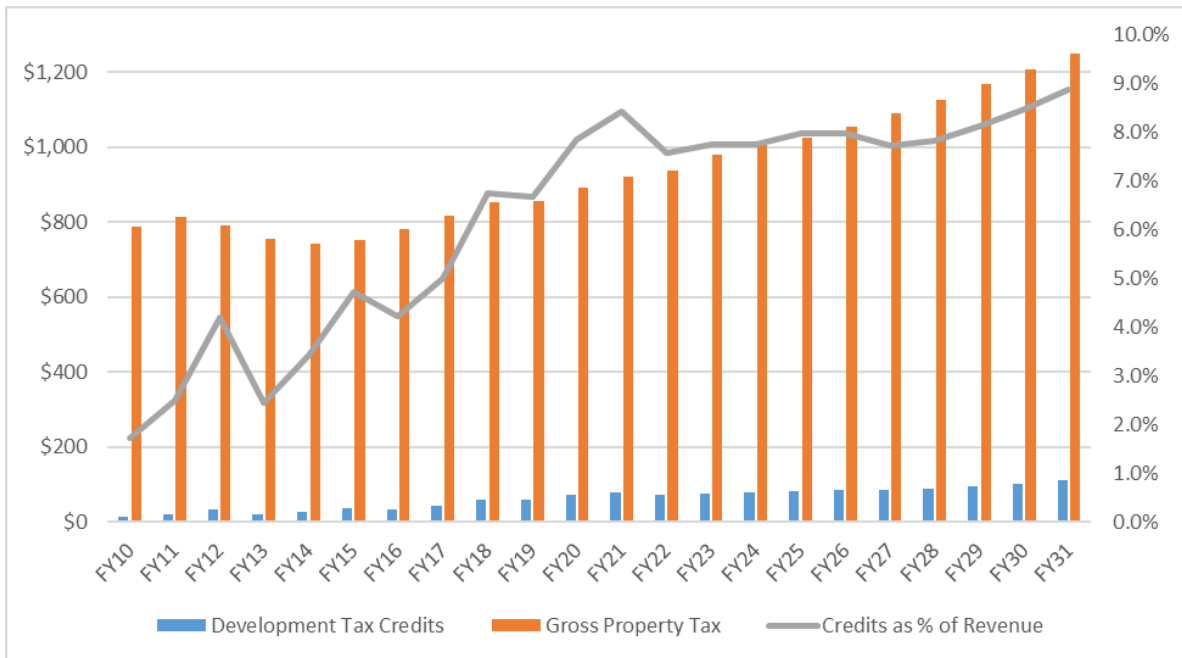
Baseline Forecast

BBMR developed a baseline forecast for the City's property tax revenue and development tax credit costs over the next ten years.

This analysis used annual property tax growth ranging from 1.7% to 4.6%, based on the assumptions in the most current 10-Year projection which is refreshed annually. For tax credit costs, we assumed that new credits would be approved at the same rate as an average of the past five years. We also included the "run-out" costs for credits already approved in prior years. Even if the City ended all development tax credits, there would still be costs for already-granted projects that would last until Fiscal 2031.

Based on these assumptions, the cost of the City's tax credit program will continue to grow over the next decade and consume nearly 9.0% of gross property tax revenue by Fiscal 2031:

Development Tax Credits as a % of Gross Property Tax Revenue
Fiscal 2010 to 2021 (Actuals) and Fiscal 2022 to 2031 (Projected)
(in \$ millions)



City Tax Rate Competitiveness

The City's high tax rate is often cited as a strong disincentive for attracting new development and new City residents. Generally, higher tax rates lead to higher costs over the term of development projects and provide justification for some sort of subsidy to help offset the additional cost.

There are two taxes that are crucial to any real estate transaction: the property tax rate, which is an annual tax on the assessed value of the property; and the transfer and recordation tax rates, which are one-time taxes levied on the value of the transaction. The table below shows how the City compares to other large counties in Maryland. Note that property tax rates are assessed based on each \$100 of assessed value, and recordation taxes are assessed on each \$500 of transaction value.

Property-Related Tax Rates

Baltimore City vs. Other Large Maryland Counties

Jurisdiction	Property Tax	Transfer Tax	Recordation Tax
Baltimore City	\$2.248	1.50%	\$5.00
Baltimore County	\$1.110	1.50%	\$2.50
Anne Arundel	\$0.933	1.00%	\$3.50
Harford	\$1.028	1.00%	\$3.30
Howard	\$1.014	1.25%	\$2.50
Montgomery	\$0.718	1.00%	\$4.45
Prince Georges	\$1.000	1.40%	\$2.75

Baltimore's tax rates are either the highest (property and recordation) or tied for the highest rate (transfer) among these other large Maryland jurisdictions. In addition, the City levies the equivalent of an additional 0.75% combined transfer and recordation tax rate on real estate transactions that exceed \$1.0 million.

However, there are two factors that make the City's property tax rate misleading when compared to other competitors. First, Baltimore City is the only large jurisdiction that funds Solid Waste collection costs in its General Fund; other counties charge a separate Solid Waste collection fee to property owners. In the Fiscal 2021 budget, the City spent \$78.0 million on these costs, which includes trash collection, recycling, alley cleaning, and landfill costs. Given that each penny of the City's tax rate generates \$4.5 million of General Fund revenue, the City's tax rate is overstated by the equivalent of \$0.173 when compared to other large Maryland counties, which are charging separate fees for those services.

Second, the City is providing all residential owner-occupied properties that have been approved for the Homestead Tax Credit with the Targeted Homeowners Tax Credit, which effectively reduces the rate for those property owners by an additional \$0.20. There is no equivalent program in other comparison counties.

In effect, these two factors reduce the true burden of property taxes when comparing versus other jurisdictions, as shown below:

Comparable Baltimore City Property Tax Rates

Accounting for Solid Waste Costs and the Targeted Homeowners Tax Credit

	Rate
Base Baltimore City Property Tax Rate	\$2.248
Less: equivalent Solid Waste Enterprise costs	(\$0.173)
Equals: Comparable Tax Rate for Commercial and Residential Non-Owner Occupied Property	\$2.078
Less: Targeted Homeowners Tax Credit	(\$0.200)
Equals: Comparable Tax Rate for Residential Owner-Occupied Property	\$1.878

In addition, many Maryland municipalities charge an additional tax rate in combination with the county tax rate that increases the total rate. For example, taxpayers in the City of Annapolis pay a combined tax rate of \$1.409 when combining the county, State, and municipal tax rates together. When looked at through this angle, the City is still at a competitive disadvantage due to the higher tax rates. But the disadvantage is not nearly as bad as the "double the tax rate" headline that is often used to describe the City's tax rates.

Benchmarking vs. Other Jurisdictions

In addition to looking at tax rates, we also evaluated the tax incentive programs that other counties are offering to incent development. If other counties are offering larger or more lucrative tax credits, then the City would need to match these programs to remain competitive. However, our analysis shows that the City spends far more on total tax credits and development tax credits compared to other large Maryland counties:

Tax Credits as a % of Real Property Revenue

Selected Maryland Jurisdictions

Jurisdiction	Total Tax Credits	Development Tax Credits
Baltimore City	13.8%	6.8%
Montgomery County	11.5%	0.7%
Anne Arundel County	10.8%	0.1%
Prince George's County	9.1%	0.7%
Baltimore County	4.0%	1.3%
Howard County	1.5%	0.8%

Below is a brief synopsis of the findings from these other counties. Information was gathered from the most recently available budget publications:

Montgomery County

In 2019, Montgomery County collected \$1.85 billion in real property tax revenue and provided \$213.9 million in tax credits. Tax credits as a percentage of real property revenue were 11.5%. Most of these tax credit expenditures come from one program, 79%, the Local Income Tax Offset. This credit gives owner-occupied properties a real property tax credit to serve as an offset to the local income tax rate of 3.2%. The development tax credits cost \$13.3, which accounts for only 0.7% of the real property tax revenue. The largest development tax credit is \$5.6 million for the Brownfields Tax Credit.

Anne Arundel County

For the Fiscal 2022 budget, Anne Arundel County is projecting approximately \$751.1 million in real property revenue and \$91.1 million in tax credits. Tax credits as a percentage of real property revenue are projected at 10.8%. 91% of the cost of tax credits comes from the Homestead Tax Credit, due to the low 2% cap. Development tax credits cost \$1.0 million, which accounts for only 0.1% of the real property revenue.

Prince George's County

In 2020, Prince George's County collected \$929.6 billion in real property revenue and issued \$84.4 million in tax credits. Tax credits as a percentage of real property revenue was 9.1%. The low Homestead cap of 2% causes almost all the tax credit expenditures to come from the Homestead Tax Credit, 83% or \$70.0 million. The total of the development tax credits was \$6.3 million or 0.7% of the real property revenue. The largest development credit is \$3.0 million for Commercial Revitalization.

Baltimore County

For the Fiscal 2022 budget, Baltimore County is projecting \$1.02 billion in real property revenue and \$40.4 million in tax credits. Tax credits as a percentage of real property revenue will be 4%. The total of the development tax credits is roughly \$13.2 million or 1.3% of the real property revenue. The largest development credit is \$5.5 million for Commercial Revitalization.

Howard County

For the Fiscal 2022 budget, Howard County is projecting \$543.4 million in real property revenue and \$7.9 million in tax credits. Tax credits as a percentage of real property revenue will be 1.5%. The total of the development

tax credits is roughly \$4.3 million or 0.8% of the real property revenue. The largest development credit is \$1.9 million for Community Organizations.

Based on all these factors, we believe that the stated goal of keeping development tax credits to within 6% of overall property tax revenue, to be achieved over a 10-year period, provides enough resources for the City to provide significant incentives that compensate for the City's competitive disadvantage on tax rates.

Recommendation #2: Develop a Package of Tax Incentives within the Budget

In October 2021, Mayor Scott announced the creation of a Tax Credit Workgroup to analyze the City's current mix of tax credits and make recommendations for improvement. ***We recommend that this workgroup develop a package of tax incentives for the next ten years, which would stay within the 6% budgeted parameter.*** The stakeholder workgroup will include both internal City representatives from key development agencies such as BDC, DHCD, Planning, and Live Baltimore; and external stakeholders from different sectors of the development market. Stakeholder input to the process is crucial; it guarantees insight into the development landscape and it improves the chances of the recommended package ultimately being enacted into law.

The workgroup should be given creative license in how it develops a future tax incentive program. We should not assume that current credits must continue in their current form if they do not meet the City's development needs. And, we should consider brand-new incentives if they fit within the overall targeted budget. **We believe that a more-efficient tax credit system can both generate savings for the City budget and be better targeted to the City's current development landscape.**

To show what is possible for illustrative purposes, BBMR ran a scenario of four reforms based on some of the most important findings from the tax credit analysis:

- 1) Eliminate Brownfields Tax Credit:** The City could opt out of the program completely because the Brownfield tax credit is duplicative of other residential tax credits, is not urgently needed for commercial development, and requires an additional State-mandated City contribution that is not cost-effective for the City. We assumed that these projects would instead receive the Newly Constructed Tax Credit.
- 2) Refine CHAP Tax Credit:** The City could refine the credit from a 10-year, 100% credit, to a 7-year declining balance credit, with a 70% break in Year One declining to a 10% break in Year Seven. The current credit is too generous and generates no new net tax revenue for the City over the full ten-year period. There is value in keeping this credit given its impact on encouraging renovations of existing City buildings.
- 3) "But For" Test on Projects Greater Than \$5.0 million:** The City could require projects exceeding this threshold to go through a more formal PILOT Committee review. This would allow the City to better negotiate terms and ensure that only the minimum subsidy is provided for the project to move forward. We assumed 10 projects would go through this process per year, which would yield 10% savings versus the baseline scenario, and require 2 additional full time employees to staff the Committee.

- 4) **Add New Impact Investment Area Tax Credit:** The City could propose a brand-new tax credit, at an 80% subsidy for 10 years, for investments within DHCD's four Impact Investment Areas. These areas fit within the City's development strategy and are the most likely to generate sustainable property tax growth in future years. We assumed 50 applicants annually with an annual project value of \$500,000.

Even a modest reform package such as this could generate significant savings to the City budget. This reform package would generate \$190.8 million of savings to the City over a 10-year period versus the baseline and would reduce development tax credits to 5.5% of gross property tax revenues, well within the 6% target benchmark. Note that the savings would grow in later years as the cost of already-granted tax credits come off the City's books:

Development Tax Credit Costs

Baseline vs. Reform Proposal

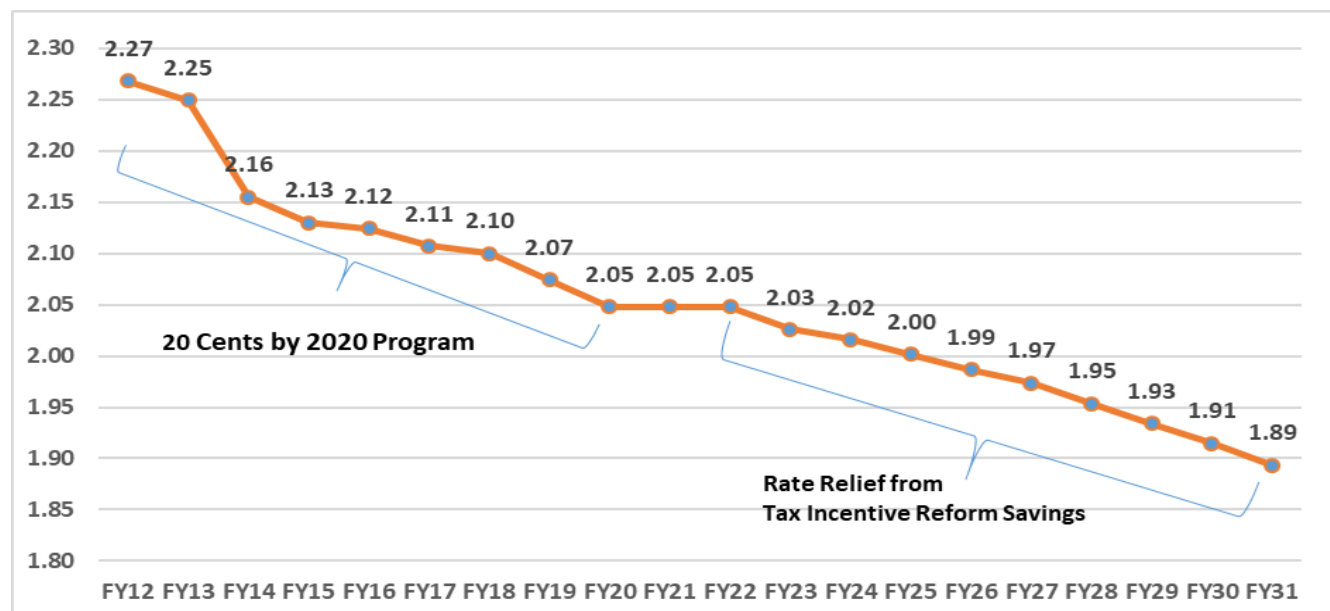
(in \$ millions)

	FY 22	FY 23	FY 24	FY 25	FY 26	FY 27	FY 28	FY 29	FY 30	FY 31	Total
Baseline Costs	\$73.3	73.2	74.3	78.0	80.4	79.4	84.3	91.6	99.5	108.9	843.0
Reform Proposal	73.3	70.3	70.1	72.0	72.4	69.7	72.0	76.8	82.2	88.8	747.7
Savings vs. Baseline	\$0.0	(2.9)	(4.2)	(6.0)	(8.0)	(9.7)	(12.3)	(14.8)	(17.3)	(20.1)	(95.3)

One potential outcome of tax incentive reform is to redirect some savings towards general property tax relief. In fact, the slow increase in savings over time creates a perfect opportunity to phase-in property tax relief. Between Fiscal 2012 and Fiscal 2020, the City phased in property tax relief to residential owner-occupied properties via the Targeted Homeowners Tax Credit. Similarly, even if only 50% of the savings from the modest reform package discussed above were directed into property tax relief (with the rest being held for budget balancing or other initiatives), the effective rate for residential owner-occupied properties could be further reduced from \$2.048 in Fiscal 2022 to \$1.890 by Fiscal 2031, a nearly 8% rate reduction:

Redirecting Tax Incentive Reform Savings to Property Tax Relief

Effective Tax Rate for Residential Owner-Occupied (per \$100 of Assessed Value)



Recommendation #3: Five-Year Periodic Review

Even after an initial review, it is still important to build in a periodic review of all tax incentives to ensure that they are being used in a manner that ensures the greatest return on investment to the City. ***We recommend that the City perform a periodic review by building in sunset dates for all tax credits at five years from the date of most recent reauthorization.*** This would ensure that all incentives get reviewed holistically, rather than a piece-meal approach to approving or reauthorizing each credit one at a time. We recommend a calendar year end date (December 31st) rather than a fiscal year end date (June 30th) so as not to conflict with the City budget passage and year-end closing schedules. A calendar year end date would also ensure that any modifications to tax credit programs could be forecast in the City's next fiscal year budget.

APPENDIX I: CONTACT INFORMATION

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