Evaluation of the Sustainable Communities Tax Credit



Department of Legislative Services 2016

Evaluation of the Sustainable Communities Tax Credit

Department of Legislative Services
Office of Policy Analysis
Annapolis, Maryland

July 2016

Primary Staff for This Report

Robert Rehrmann
Matthew Bennett
Benjamin Blank
George Butler, Jr.
Mya Dempsey
Mindy McConville
Maureen Merzlak
Heather Ruby
Theresa Tuszynski

Other Staff Who Contributed to This Report

Ryan Bishop
John Rohrer

For further information concerning this document contact:

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF POLICY ANALYSIS
MARYLAND GENERAL ASSEMBLY

Warren G. Deschenaux
Executive Director

July 6, 2016

The Honorable Thomas V. Mike Miller, Jr., President of the Senate
The Honorable Michael E. Busch, Speaker of the House of Delegates
Members of the General Assembly

Ladies and Gentlemen:

As you know, the Tax Credit Evaluation Act of 2012 (Chapters 568 and 569) establishes a legislative process for evaluating certain tax credits. The legislative evaluation committee created by the Act is required to evaluate the sustainable communities tax credit by July 1, 2016.

To assist the committee in its work, the Department of Legislative Services (DLS) is required to evaluate the credit on a number of factors, including (1) the purpose for which the tax credit was established; (2) whether the original intent of the tax credit is still appropriate; (3) whether the tax credit is meeting its objectives; (4) whether the goals of the tax credit could be more effectively carried out by other means; and (5) the cost of the tax credit to the State and local governments.

DLS has conducted its evaluation of the sustainable communities tax credit and makes several findings and recommendations about the tax credit. The document is divided into 10 chapters.

Chapter 1 provides an overview of the Tax Credit Evaluation Act and the sustainable communities tax credit.

Chapter 2 provides an overview of federal and local historic preservation tax credits and credits in surrounding states.

Chapter 3 provides an overview of the intent and objectives of the tax credit.

Chapter 4 provides an overview of the residential rehabilitation tax credit.

Chapter 5 provides the legislative history and requirements of the commercial rehabilitation tax credit.

Chapters 6 and 7 provide an overview of commercial rehabilitation tax credit reforms and assess the impacts of those reforms.

Chapter 8 assesses the geographic concentration of tax credit projects and impacts on community revitalization.

Chapter 9 provides the State and local costs of the tax credit.

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Chapter 10 summarizes the findings of the report and discusses recommended changes to the tax credit program.

During the 2015 interim and 2016 session, the committee reviewed a draft of this report and also held a public hearing on the report. In the 2016 session, the General Assembly passed Senate Bill 759 (Chapter 578), at the request of the committee. Chapter 578 reestablishes the Sustainable Communities Tax Credit Program as the Heritage Structure Rehabilitation Tax Credit Program and extends the termination date of the program through fiscal 2022. Chapter 578 also alters certain program eligibility requirements and procedures, including the elimination of the requirement that the Maryland Historical Trust 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.

Additionally, in the 2016 session, the General Assembly passed legislation amending the Tax Credit Evaluation Act. Senate Bill 843 (Chapter 582) alters the tax credits to be evaluated and the process for evaluating those tax credits. Specifically, Chapter 582 adds the cybersecurity investment, Regional Institution Strategic Enterprise (RISE) zones, and job creation tax credits to the list of credits to be reviewed by the evaluation committee. Chapter 582 also (1) eliminates the requirement that, in lieu of a specified evaluation date, a credit must be evaluated in the year preceding the termination date of the credit and (2) alters the dates by which DLS must publish an evaluation of the credit (from October 31 to November 15) and the evaluation committee must hold a public hearing on the evaluation report (from December 14 to December 31). Finally, a tax credit designated for evaluation under the Tax Credit Evaluation Act is subject to reevaluation every seven years, instead of five years, after the initial evaluation.

We wish to acknowledge the cooperation and assistance provided by the Maryland Department of Planning in the development of this report. DLS trusts that this report will be useful to members of the General Assembly in future deliberations about the sustainable communities tax credit.

Sincerely,

Warren G. Deschenaux
Executive Director

WGD/mlm

cc: Richard S. Madaleno, Jr., Co-chair, Tax Credit Evaluation Committee
Jay Walker, Co-chair, Tax Credit Evaluation Committee

Contents

Executive Summary

Since the mid-1990s, the number of State business tax credits has grown exponentially, as have related concerns about the actual benefits and costs of many of these credits. Although tax credits comprise a small percentage of total income tax revenues, the number and amount of credits claimed have significantly increased over time.

In response to concerns about the fiscal impact of tax credits on State finances, Chapters 568 and 569 of 2012, the Tax Credit Evaluation Act, 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 the Speaker of the House of Delegates. The Act requires that the sustainable communities tax credit be evaluated by the committee by July 1, 2016. To assist the committee in its work, the Department of Legislative Services (DLS) is required to evaluate the credit on a number of factors, including (1) the purpose for which the tax credit was established; (2) whether the original intent of the tax credit is still appropriate; (3) whether the tax credit is meeting its objectives; (4) whether the goals of the tax credit could be more effectively carried out by other means; and (5) the cost of the tax credit to the State and local governments.

The Heritage Structure Rehabilitation Tax Credit Program was created in 1996 to allow taxpayers to claim a tax credit for expenditures incurred in rehabilitating residential and commercial historic structures. Now known as the sustainable communities tax credit, numerous statutory and regulatory reforms have been made to the credit since 2002. Adjusted for inflation, combined commercial and residential credit costs will total an estimated $475 million through the credit's current June 30, 2017 termination date.

Most studies have found that historic preservation programs are generally effective in achieving their goals. Historic preservation programs can stabilize neighborhoods by promoting the upkeep of properties and maintaining architectural conformity. Incentives can spur additional rehabilitation activity and raise property values, thereby increasing equity and the availability of credit. Legislative reforms have improved the implementation and administration of the sustainable communities tax credit. These reforms established a well-structured commercial tax credit program that provides fiscal certainty, prevents the buildup of unfunded State liabilities, and clarifies State liabilities in each fiscal year. The commercial program is also subject to a competitive process that generally maximizes the program's effectiveness.

This report provides an overview of the sustainable communities tax credit, including how commercial and residential credits are claimed, the amount of credits claimed, the impacts of legislative reforms to the commercial credit, and the geographic concentration of projects receiving the credit. An overview of federal and local historic preservation tax credits and credits in surrounding states is also provided.

DLS makes several findings and recommendations related to the sustainable communities tax credit as follows:

Credit Reforms Have Successfully Increased Fiscal Certainty and Served as a Model for Subsequent Tax Credit Programs

Between 2002 and 2004, the General Assembly made a number of legislative reforms to the then heritage structure rehabilitation tax credit that would decrease the growing fiscal costs of the program. The major components of these fiscal reforms include:

- shifting the commercial program from a traditional tax credit to a budgeted tax credit subject to an aggregate limit each year;
- limiting the maximum value of the commercial tax credit to $3 million, which was previously uncapped; and
- reducing the percentage value of the credit from 25% to 20%.

These changes prevented both unexpected revenue losses and a buildup of unfunded liabilities from unclaimed credits. Taking into account inflation, the fiscal impact of the commercial program peaked in the early 2000s, as commercial projects applying for Part 2 certification in calendar 2001 earned $78.7 million in credits. Since the commercial program was shifted to a budgeted program in fiscal 2006, annual fiscal costs have decreased to an estimated $8.9 million.

While the amounts of rehabilitation activity and credits have decreased significantly under the budgeted program, the budget process ensures that the commercial credit must compete with other State funding priorities. Budgeting the credit also provides flexibility for the State, as the appropriation is set on an annual basis and can be tailored to fit current funding priorities and the overall State budget.

The commercial tax credit program has become a template for subsequent tax credits established by the General Assembly. Almost every credit established since 2004 has a limit on either the maximum amount that can be claimed by a taxpayer and/or an aggregate limit on the total credits available. Additionally, many of the major State tax credit programs established since 2004 are subject to an annual appropriation including the biotechnology investment, film production activity, health enterprise zone, and cybersecurity investment tax credits.

Recommendation: DLS recommends that the General Assembly maintain the commercial tax credit as a budgeted tax credit subject to an aggregate limitation each year. DLS also recommends that the cap on the maximum value of the commercial tax credit of $3 million be maintained.

Using a Competitive Process to Award Commercial Project Credits Has Been Effective

The commercial tax credit is unique in that the Maryland Historical Trust (MHT) awards credits using a competitive process. Since fiscal 2006, commercial rehabilitation projects have been scored on a number of criteria outlined in statute and regulations including, but not limited to, the level of preservation, urgency of need for rehabilitation, economic benefit, and geographic distribution of projects. Thus, projects that deliver the most benefits in terms of key outcomes and goals identified by the General Assembly are more likely to be awarded credits. For example, two Baltimore City projects applied for a

$3 million credit in fiscal 2014, but due to the geographic limitation in effect at the time, both projects could not be funded. The competitive award process selected the project with estimated project costs of $40 million and a score of 95 over the project with $20 million in costs and a score of 82. In the absence of a competitive process, the economic benefit to the State may not have been maximized.

Although the competitive process does create a delay in awarding credits, a well implemented competitive program can result in a more effective program compared to a first-come, first-served approach or uncapped program. The first-come, first-served basis used previously for awarding credits resulted in several problems, including difficulty in accurately tracking the timing of application submissions. Projects were not selected based on merit, and some approved projects were less beneficial than others denied funding. The first-come, first-served process also increased the number of applications from projects that had not secured financial backing; some of these projects were not financially viable and did not proceed. With a competitive process, projects must meet program requirements and compete against each other. Subject to the program's geographic limitation criterion, higher ranking projects receive funding first and lower ranking projects are generally less likely to be funded.

Recommendation: DLS recommends that the General Assembly maintain the competitive process used to award commercial tax credits. DLS also recommends that the General Assembly consider implementing competitive processes for other State tax credits, such as the biotechnology investment incentive tax credit and the One Maryland tax credit.

Statutory Criteria Designed to Ensure Geographic Diversity of Projects May Not Achieve Desired Results and Can Impact the Overall Quality of Projects Receiving Credits

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 and also provides that MHT 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.

MHT determines whether jurisdictions have been underrepresented based on the total number of National Register of Historic Places properties in each jurisdiction. This measurement does not accurately reflect whether jurisdictions are underrepresented because it does not consider the commercial zoning of jurisdictions, nor does it consider the number of vacant properties in a jurisdiction. Additionally, the measure does not account for properties that are eligible for the credit but are not listed in the National Register of Historic Places.

The geographic limitation and preferential scoring for projects located in historically underrepresented counties have had limited impacts in promoting geographic diversity. Given the geographic limitation and a relatively low number of applications submitted by county projects, nearly every project outside of Baltimore City has been awarded a credit in the 10 years of the current program without regard to the project's score.

A total of 199 Baltimore City projects have been denied in contrast to 10 projects located outside Baltimore City. Providing preferential scoring only factors into the award selection process if county projects are susceptible to being denied, which has occurred in only 2 of the 10 years of the current program.

Recommendation: Based on the number of projects applying for and awarded credits in jurisdictions outside of Baltimore City in recent years, the limitation on the amount of the credits that may be awarded to projects in a single jurisdiction appears to have a limited impact in providing geographic diversity to the program. However, when this limitation has redirected project funding from Baltimore City projects to projects in other counties, MHT estimates that these projects resulted in less economic benefits and historic preservation than the amount that would have occurred if the Baltimore City projects had received funding. **DLS therefore recommends that the General Assembly consider increasing the current 60% geographic limitation to a higher percentage or completely eliminating the limitation.**

Recommendation: The formula for calculating whether a jurisdiction is underrepresented does not accurately reflect whether jurisdictions are fairly represented. Additionally, awarding points on geographic distribution is rarely the tipping point in determining whether a project is awarded a credit. **DLS therefore recommends that the General Assembly eliminate the criterion of scoring points on geographic underrepresentation. Alternatively, if the General Assembly prefers to keep this scoring criterion, MHT should develop a new scoring metric to better capture the inventory of eligible properties in historically underrepresented jurisdictions.**

Despite Efforts to Increase Geographic Diversity, Baltimore City Continues to Have a Large Majority of Commercial and Residential Credit Projects

While Baltimore City comprises about 11% of the State's total population and has about 18% of the State's properties listed in the National Register of Historic Places, approximately 6 in 10 of all residential credits and 7 out of every 10 budgeted commercial tax credits have been awarded to Baltimore City projects. If unbudgeted tax credits are included, Baltimore City projects have been awarded slightly more than $8 out of every $10 of program funding.

Compared to its share of the State's population, most of the additional Baltimore City credits result from a greater share of eligible historic buildings, including the impact of locally designated historic districts, and the impact of the commercial program's adjusted basis requirement that focuses credit activity to areas in which historic properties have lower property values and are more likely in need of rehabilitation. The larger scale of Baltimore City projects explains the remaining amount, as this difference is greater in the commercial program and explains the additional geographic concentration of commercial credits within the city.

Recommendation: Chapter 601 of 2014 required MHT to develop programs, including web-based tools, in order to increase residential and commercial tax credit participation in jurisdictions that have been historically underrepresented in the award of tax credits. **MHT should comment**

on its outreach efforts to increase credit participation in jurisdictions that have been historically underrepresented in the award of tax credits.

Commercial and Residential Credit Projects in Baltimore City Generally Occur in Different Parts of the City, with Residential Projects Skewed to Neighborhoods with Higher Incomes and Housing Values

Commercial and residential projects and funding in Baltimore City generally occur in different parts of the city and are not correlated with each other. Residential rehabilitation projects and credits in the city tend to occur in census tracts with higher household incomes and housing values. Compared to the enterprise zone, One Maryland, and commercial tax credits, residential credit activity is found mostly in neighborhoods that are less diverse and that have significantly higher incomes, home values, and rates of employment and education.

While commercial projects also occur in neighborhoods that are significantly more educated, have higher home values and higher rates of employment and that are less diverse, some commercial projects do occur within neighborhoods with a higher incidence of poverty and vacant housing units as well as lower household incomes.

Recommendation: DLS recommends that the General Assembly consider prohibiting residential tax credits if the assessed value of the property is greater than 150% of the county's median home price. This could better target credits to residential properties in neighborhoods in need of revitalization instead of simply rehabilitating properties in neighborhoods with high market values.

Commercial Credit Reporting Requirements Are More Detailed Than For Other Similar Tax Credit Programs

Tax credit reporting requirements, and the capability of State agencies to provide information, vary across programs. Certain tax credit programs require agencies to publish specified information about the credit on an annual basis. These reporting requirements are often inconsistent, and other tax credit programs lack any reporting requirements.

As part of the effort to quantify the State liabilities that occurred in the early years of the program, MHT was required to annually report specified information about commercial rehabilitation projects and later required to provide additional project-specific information and to increase the frequency of reporting. These reporting requirements have enhanced (1) the capability to respond to information requests and analyze the program's effectiveness; (2) program transparency and administration; and (3) interagency cooperation between MHT, DLS, and the Comptroller's Office.

The information that MHT must report on commercial rehabilitation projects is generally both more frequent and detailed than that of other tax credit programs. This information has also helped clarify the treatment of expired tax credits. Chapter 76 of 2004 specified that tax credits expire and may not be claimed if a commercial rehabilitation is not completed by specified deadlines. Chapter 76 also required MHT to notify the Comptroller's Office of these expired credits. As a result of communication between DLS and MHT, subsequent legislation clarified the expiration of initial tax credits awarded under the budgeted tax credit program as well as establishing the process for expiring credits for a project that had started the application process but had not received final certification during the prior tax credit program. This helped clarify State liabilities by removing these older projects that represented a potential liability to the State and provided the necessary information to the Comptroller's Office to prevent expired credits from being incorrectly claimed.

Recommendation: DLS recommends that the General Assembly maintain MHT's current reporting requirements for commercial tax credits. DLS also recommends that the General Assembly consider implementing comparable reporting requirements for other State tax credits.

Sustainable Community Revitalization Efforts Should Be Coordinated With Other Federal and State Infrastructure Investment Programs

The Partnership for Sustainable Communities is a federal partnership formed to ensure that federal policies, programs, and funding consider affordable housing, transportation, and environmental protection in concert. By coordinating federal investments in infrastructure, facilities, and services, the partnership seeks to achieve multiple economic, environmental, and community objectives with each dollar spent and thereby realize better results for communities and utilize taxpayer monies more efficiently.

In response to the establishment of the federal Partnership for Sustainable Communities, the Sustainable Communities Act of 2010 was enacted into law. Recognizing the State's need to "refine its focus on and develop a coordinated approach to creating, enhancing, supporting, and revitalizing sustainable communities in order to position itself to take advantage of federal opportunities" and encourage "more integrated thinking about how transportation, land use, and housing programs intersect with environmental, economic, and equity goals at the State level," the Act requires State programs, including the sustainable communities tax credit program, to coordinate and target investment in housing, historic preservation, economic growth, and transportation development in existing neighborhoods and town centers.

Recommendation: DLS recommends that the Maryland Department of Planning and MHT comment on how creating, enhancing, supporting, and revitalizing sustainable communities fit into existing and new strategies to take advantage of federal and State infrastructure investment opportunities.

Claims for Fraudulent Rehabilitation Expenditures May Occur Even With a Detailed Certification Process

Maryland has a three-stage project certification process similar to that used in Virginia. A recent case involving a Virginia developer who significantly overstated rehabilitation costs for multiple developments in Richmond exemplified how fraudulent activity can occur despite an extensive certification process. Virginia officials indicated that the majority of fraudulent expenditures consisted of items that would not be readily identifiable in the photographs submitted. In response, Virginia officials now calculate the cost per square foot for every project and may perform additional review if necessary.

Recommendation: MHT should comment on its process for reviewing rehabilitation activity and preventing fraudulent claims and whether its review process is sufficient to detect and deter potential fraud. MHT should also consider taking additional steps to detect fraud, such as calculating the cost per square foot for projects, and performing additional review if this calculation exceeds a certain threshold.

Federal Grants Qualify as Credit Expenditures and Can Limit Private Investment

The sustainable communities tax credit prohibits the following from counting as qualified expenditures:

- State or local grants;
- grants 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; or
- any other State or local tax credit.

Any other financial assistance from the State or a political subdivision of the State other than a loan must be repaid at an interest rate that is greater than the interest rate on general obligation bonds issued by the State at the most recent bond sale prior to the time the loan is made.

Although these types of State and local financial assistance may not be counted as qualified rehabilitation expenditures, the program does not prevent federal funding from being considered as qualified expenditures. Thus, if a project is fully funded by a federal grant, the taxpayer could potentially receive the State tax credit without providing any private investment of funds.

Recommendation: MHT stated that it measures the success of the credit by how projects maximize the leverage of private investment; however, a taxpayer could avoid using private funds by utilizing federal funds. **Therefore, DLS recommends that the General Assembly prohibit any federal funds from qualifying as expenditures for purposes of the State credit.**

Notification to Commercial Credit Recipients Is Often Unnecessarily Delayed

Applications for the commercial tax credit must be submitted by August 31 of each year. MHT makes decisions on which projects will be awarded credits fairly quickly, usually by the end of October. However, applicants are not typically notified of the award decisions until mid-December when an announcement is made by the Governor.

Notifying businesses at the end of the taxable year creates a hardship for applicants as they try to do year-end planning. This waiting period between the application deadline and the announcement of credit recipients leaves certain applicants with a difficult decision between completing necessary improvements and waiting to find out the status of their project application. If the notice of application approvals were made sooner, tax credit recipients could move forward with the projects and not be rushed with year-end planning.

Recommendation: Given that businesses must make planning decisions before the end of the tax year and that any renovations started before the award announcement do not count towards the credit, DLS recommends that MHT notify applicants of its award decisions no later than 60 days after the application deadline.

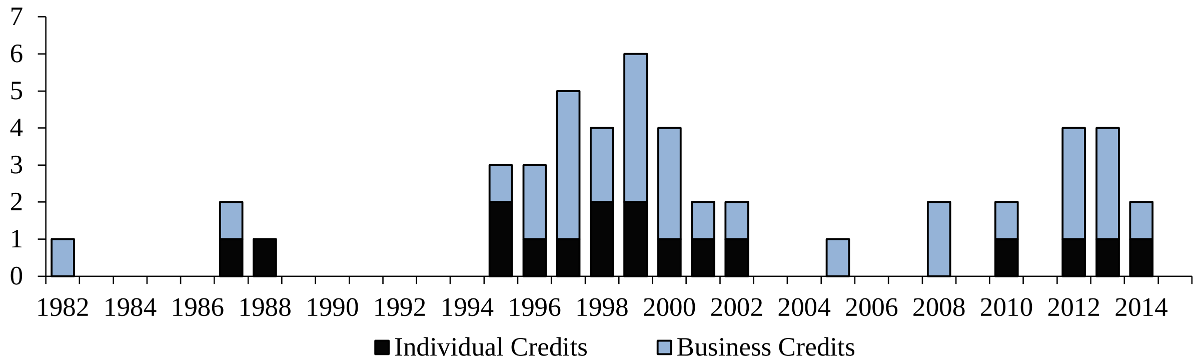
Chapter 1. Overview and Background

Overview

Since the mid-1990s, the number of State business tax credits has grown significantly, as have related concerns about the actual benefits and costs of many of these credits. Although the reduction in State revenues from tax credits is generally incorporated in the State budget, most tax credits are not subject to an annual appropriation as required for other State programs. However, a few credits are subject to a budget appropriation, including the sustainable communities tax credit, and State reimbursement for one-half of the local property tax credit costs under the Enterprise Zone Tax Credit Program. Reporting information for State tax credits varies. Under certain tax credit programs, agencies are required to publish specified information about the credit on an annual basis. The Department of Budget and Management (DBM) is required to prepare, every other year, a statement of the estimated amount by which exemptions from all types of State taxation reduces revenues.

Although tax credits comprise a small percentage of total income tax revenues (less than 3% in fiscal 2009), **Exhibit 1.1** shows that the number and amount of credits claimed has increased over time. Prior to 1995, there was one credit for individuals (earned income credit) and two primarily business tax credits (enterprise zone and Maryland-mined coal credits). Since 1995, 29 tax credits primarily for businesses and 15 tax credits primarily for individuals have been established. This includes temporary and expired tax credits. Twenty-nine of the credits were established between 1995 and 2002. More recently, 10 credits have been established since 2012, including 7 primarily for businesses. The total amount of credits has increased from a little less than $50 million in tax year 1994 to about $250 million in tax year 2008. Most of this increase has been due to an increase in tax credits for individuals, and in particular earned income credits, which have increased almost five-fold since 1994.

Exhibit 1.1
Number of Tax Credits Created Each Year
1982-2015



Source: Department of Legislative Services

Tax Credit Evaluation Act

Overview

In response to concerns about the impacts of certain tax credits, Chapters 568 and 569 of 2012 established the Tax Credit Evaluation Act, a legislative process for evaluating certain tax credits. The evaluation process is conducted by a legislative evaluation committee and must be done in consultation with the Comptroller's Office, DBM, the Department of Legislative Services (DLS), and the agency that administers each tax credit. The committee is appointed jointly by the President of the Senate and the Speaker of the House of Delegates and must include at least one member of the Senate Budget and Taxation Committee and one member of the House Ways and Means Committee.

Chapter 582 of 2016 altered the Tax Credit Evaluation Act so that the following credits are required to be reviewed by the date indicated:

- July 1, 2014: enterprise zone and One Maryland credits;
- July 1, 2015: earned income and film production activity credits;
- July 1, 2016: sustainable communities;
- July 1, 2017: businesses that create new jobs and job creation credits;
- July 1, 2018: research and development and biotechnology; and
- July 1, 2019: RISE and cybersecurity.

In lieu of the evaluation dates listed above, if a tax credit has a termination date provided for by law, an evaluation of that credit must be made on or before July 1 of the year preceding the calendar year of the termination date. The tax credits are subject to reevaluation seven years after the previous evaluation unless otherwise specified.

Department of Legislative Services' Evaluation

By June 30 of the year prior to a tax credit's evaluation date, the evaluation committee is required to meet with the Comptroller's Office, DBM, DLS, and the agency that administers the credit to prepare a plan for evaluation. By November 15 of the same year, DLS is required to publish a report evaluating the tax credit.

The report submitted by DLS must discuss:

- the purpose for which the tax credit was established;
- whether the original intent of the tax credit is still appropriate;
- whether the tax credit is meeting its objectives;
- whether the goals of the tax credit could be more effectively carried out by other means; and

- the cost of the tax credit to the State and local governments.

By December 14 of the same year, the evaluation committee must hold a public hearing on the evaluation report. By the twentieth day of the legislative session before the evaluation date of a tax credit, the committee is required to submit a report to the General Assembly that states whether or not the tax credit should be continued, with or without changes, or terminated.

Sustainable Communities Program

The Partnership for Sustainable Communities, a partnership between the U.S. Department of Housing and Urban Development, U.S. Department of Transportation, and the U.S. Environmental Protection Agency, was formed in June 2009 in order to ensure that the agencies' policies, programs, and funding consider affordable housing, transportation, and environmental protection in concert. By coordinating federal investments in infrastructure, facilities, and services, the partnership seeks to achieve multiple economic, environmental, and community objectives with each dollar spent and, thereby, realize better results for communities and utilize taxpayer monies more efficiently. The partnership is guided by six livability principles: (1) provide more transportation choices; (2) promote equitable, affordable housing; (3) enhance economic competitiveness; (4) support existing communities; (5) coordinate and leverage investment; and (6) value communities in neighborhoods.

Sustainable Communities Act of 2010

In response to the establishment of the federal Partnership for Sustainable Communities, the Sustainable Communities Act of 2010 was enacted into law (Chapter 487). Recognizing the State's need to "refine its focus on and develop a coordinated approach to creating, enhancing, supporting, and revitalizing sustainable communities in order to position itself to take advantage of federal opportunities" and encourage "more integrated thinking about how transportation, land use, and housing programs intersect with environmental, economic, and equity goals at the State level," the Act requires State programs, including the Sustainable Communities Tax Credit Program (formerly the Heritage Structure Rehabilitation Tax Credit Program), to coordinate and target investment in housing, historic preservation, economic growth, and transportation development in existing neighborhoods and town centers.

Chapter 487 of 2010 expressed the legislature's intent that the Community Legacy and Neighborhood Business Development programs create and support sustainable communities and be coordinated with other State programs in order to maximize the State's investment in those communities. To that end, the Act eliminated community legacy areas and community legacy plans, replacing them with sustainable communities and sustainable community plans. Under both the community legacy program and neighborhood business development program, designated neighborhoods were eliminated and replaced with sustainable community designations.

A sustainable community is (1) a part of a priority funding area that is designated by the Smart Growth Subcabinet on the recommendation of the Secretary of Housing and Community Development or (2) an area that has either been designated as a Base Realignment and Closure (BRAC) revitalization zone or a transit-oriented development district. A sustainable community plan consists of one or more community legacy projects or other revitalization projects to prevent or reverse the decline or disinvestment in a sustainable community through improvements in residential, commercial, or other public or private properties. To maintain a sustainable community designation, an updated plan and application must be sent every five years to the Department of Housing and Community Development.

Sustainable Communities Tax Credit Program

As noted above, 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 (increased to 25% if certain energy efficiency standards are met).

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 the Maryland Historical Trust (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 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.

For small commercial projects, (1) the amount of the credit is generally equal to 20% of rehabilitation expenditures, subject to a maximum of $50,000; (2) at least $5,000 must be spent to qualify; and (3) the project must meet program requirements related to historic structures and rehabilitations. 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.

Chapter 2. Federal and Local Historic Preservation Tax Credits and Credits in Surrounding States

Federal Historic Preservation Tax Credit Program

The origins of the federal Historic Preservation Tax Incentive Program begin with the Tax Reform Act of 1976 (P.L. 94-455) and Tax Recovery Act of 1978 (P.L. 95-600). As amended, this legislation established the federal program that allows qualified historic rehabilitations to claim an income tax credit generally equal to 20% of qualified rehabilitations (10% for nonhistoric, nonresidential buildings). The Tax Reform Act of 1986 resulted in tax law changes that indirectly impacted the historic preservation tax credit. In general, persons with federal adjusted gross incomes greater than $250,000 cannot utilize the tax credit until either income falls below a certain level or sufficient net passive income exists to offset the passive losses generated by the rehabilitation project.

The federal rehabilitation tax credit is only available to the person or entity holding title to the property. There can be no transfer of the credit without the requisite ownership, and the credit by itself cannot be bought or sold. U.S. Treasury regulations do allow the transfer of qualified rehabilitation expenditures to a new owner provided the previous owner did not place the property in service.

Maryland's sustainable communities tax credit has many of the same features as the federal credit. In addition, the federal tax credit program is administered by state historic preservation offices. Important distinctions, however, exist between the two programs. First, the federal tax credit is limited to income-producing, depreciable properties. Single-family, owner-occupied residences do not qualify unless the property is income producing (such as a bed and breakfast) and the credit is limited to the portions of the building that are exclusively devoted to the income-producing activity. Second, the federal tax credit is limited to the tax liability of the entity(s) claiming the credit and is not refundable. The unused amount of the credit can generally be carried back to 1 tax year and forward for 20 tax years. Other provisions can limit the applicability of the federal credit, including the alternative minimum tax, tentative minimum tax, and passive activity rules.

In federal fiscal 2014, a total of 21 rehabilitation projects located in the State received the federal historic tax credit. Of the 138 rehabilitation projects that have claimed either the federal or State credit between calendar 2009 and 2014, 63% claimed only the federal credit, 12% claimed only the State credit, and 25% claimed both credits. Projects that claimed only the federal credit accounted for two-thirds of all rehabilitation activity ($518.2 million).

Local Historic Property Tax Credits

Local jurisdictions in Maryland are authorized to provide property tax credits for the rehabilitation of both residential and income-producing historic buildings. These local programs provide property tax relief with an offset based on a percentage of the rehabilitation expenses and/or the increase in property taxes resulting from the rehabilitation.

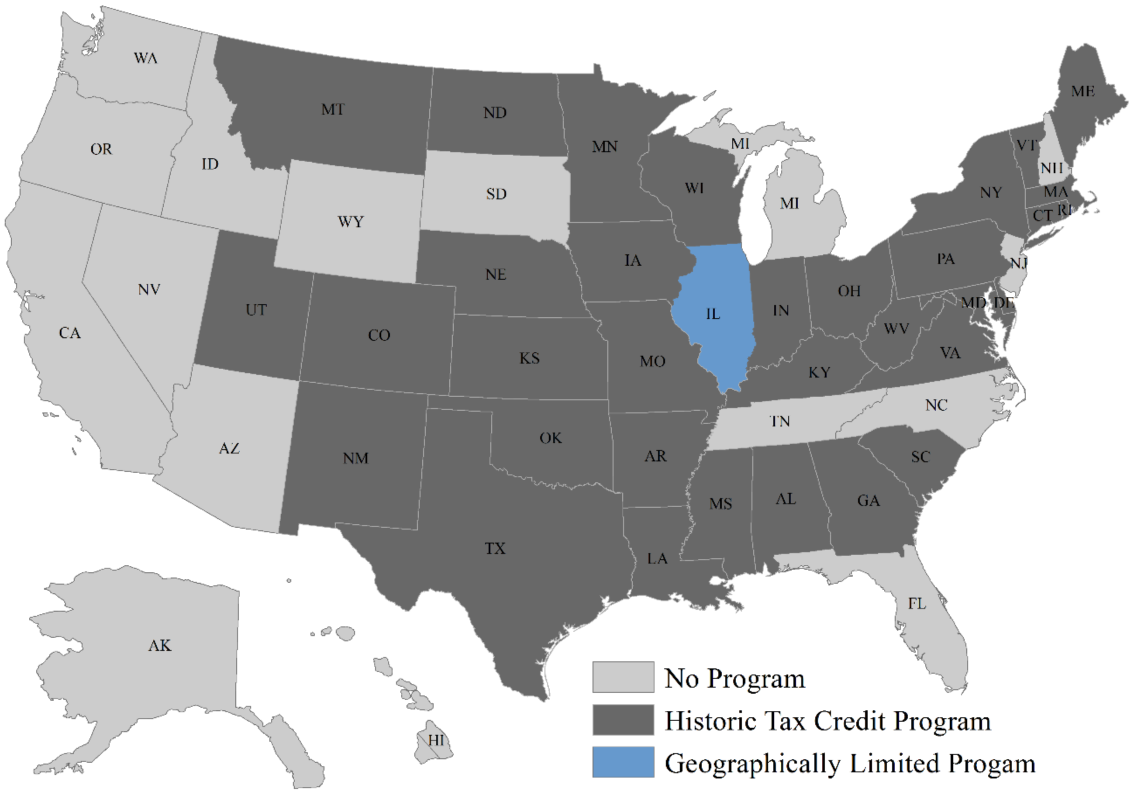
Chapter 189 of 2013 authorizes local governments to grant a property tax credit of up to 25% of the properly documented expenses incurred by a private-owner taxpayer for the restoration and preservation of a structure that the local government has determined to have historic or architectural value. Prior to Chapter 189 the authorized credit amount was limited to 10%. As of October 2015, 10 counties (Baltimore, Calvert, Cecil, Charles, Harford, Howard, Montgomery, Prince George's, St. Mary's, and Washington) provide a property tax credit. The value of the credit in a majority of these counties has remained at 10%; however, Baltimore County provides a 20% credit, and Calvert, Montgomery, and Prince George's counties provide a 25% credit.

Counties and municipalities may also establish, by law, a program that provides for a 10-year property tax credit not to exceed the difference between the property tax that, but for the tax credit, would be payable after the completion of eligible improvements and the property tax that would be payable if the eligible improvements were not made. This credit is available in Allegany and Frederick counties and Baltimore City. Baltimore County provides this credit for commercial properties and an expenditure-based tax credit for residential projects. Additionally, six municipalities have established property tax credits based on rehabilitation expenses and/or increased property assessments resulting from rehabilitations: Annapolis, Bel Air, Cumberland, Frederick, Laurel, and Westminster. **Appendix 1** provides further details on each local program.

Other State Programs

As shown in **Exhibit 2.1**, 34 states have established a state historic preservation tax credit program. Most state credits are equal to 20% or 25% of the qualified rehabilitation expenditures. In addition to Maryland, eight other states (Iowa, Kentucky, Louisiana, Maine, Minnesota, Mississippi, New York, and Ohio) have a refundable or partially refundable credit. Eight states have aggregate credit limits that exceed $10 million, with Missouri having the highest ($140 million), followed by Ohio ($60 million). In 2014, 19 states did not have an aggregate credit limit and 21 states did not limit the maximum value of the credit.

Exhibit 2.1
State Historic Preservation Tax Credit Programs Calendar 2015



Source: National Trust for Historic Preservation

Surrounding State Programs

Delaware

Established in 2001, Delaware's historic rehabilitation tax credit is a nonrefundable, transferable tax credit that can be claimed against the income or franchise tax. The qualified expenditures of income-producing properties must exceed the greater of the adjusted basis of the property or $5,000 and must exceed $5,000 for all other properties. The credit is equal to 20% of qualified rehabilitation expenditures, if the certified historic property is depreciable and eligible for the federal historic preservation tax credit. An additional 10% credit can be claimed if the property provides low-income housing.

The credit is equal to 30% for owner-occupied, certified historic properties and for properties owned by nonprofits or local governments. The maximum credit is limited to $20,000 for owner-occupied projects; however, applicants may re-apply every 24 months. The aggregate credit limit is currently $5 million. From 2001 to 2009, Delaware awarded a total of $34.3 million in historic preservation tax credits to projects with a total of $166.0 million in qualified expenditures.

District of Columbia

The District of Columbia does not have a historic preservation tax credit program.

Pennsylvania

Established in 2013, the Pennsylvania historic preservation tax credit provides a tax credit to qualified taxpayers who restore a qualified historic structure into an income-producing property. The tax credit equals 25% of qualified expenditures, not to exceed $500,000 in any fiscal year. The credit is transferable but not refundable, and it may be carried forward to eight tax years. A maximum of $3 million in credits can be awarded in each year, and credits are awarded equitably for projects in each of the commonwealth's five regions. In its first year, the credit program received 34 applications and awarded $3 million to 15 projects on a first-come, first-served basis.

Virginia

Established in 1997, the Virginia tax credit is equal to 25% of eligible rehabilitation expenses. The rehabilitation expenses must be (1) at least 25% of the assessed value of the building for owner-occupied structures or (2) at least 50% of the assessed value of the building for all other eligible structures. The credit is not transferable or refundable, but it may be carried forward for up to 10 tax years. There is no maximum credit or aggregate credit limit. From 1997 to 2013, Virginia awarded a total of $986.3 million in historic preservation tax credits to 2,375 projects with qualified rehabilitation expenditures of $3.97 billion.

West Virginia

Established in 1996, the West Virginia rehabilitation investment tax credit provides a transferable tax credit for the rehabilitation of historic, private residences and income-producing properties. The nonrefundable credit is equal to 20% of the expenditures necessary to carry out material rehabilitation of historic, private residences and 10% for qualified commercial property expenditures. The residential credit may be carried forward for up to 5 tax years and the commercial credit may be carried forward for up to 20 tax years. There is no maximum credit value or aggregate credit limit.

Historic Preservation Studies

Previous Maryland Studies

The Abell Foundation published a report in 2009 analyzing the economic and environmental benefits of the tax credit. Using the IMPLAN economic model, the report found that over a 12-year period commercial projects generated more than $1.74 billion of economic activity in Maryland and created 15,120 jobs totaling $673.1 million in wages, with construction labor consisting of over three-fifths of the total economic impact. Residential projects generated over $354.9 million of economic activity in Maryland and created 3,343 jobs with total wages of $88.5 million. Construction labor comprised about half of the total economic impact.

The report assumed that none of the historic preservation activity would have occurred in the absence of the State credit, thereby overestimating the credit's effectiveness. Additionally, to accurately reflect the full economic impact – which includes the State's requirement to maintain a balanced budget – a reduction in tax revenue from a historic preservation tax credit must be offset by decreased government spending and/or increasing revenue from other sources. The lack of detailed methodology in the Abell Foundation report makes it unclear whether these additional economic impacts were included.

Studies in Surrounding States

Studies analyzing programs in surrounding states have generally found positive program benefits. The Delaware Division of Historical and Cultural Affairs found that every $1 million invested in rehabilitating a historic building generated 14.6 jobs and $540,000 in household income.

Preservation Virginia reported that 54% of surveyed participants would not have rehabilitated their property without the state credit, and 31% of participants would have reduced rehabilitation expenditures. Preservation Virginia calculated that almost $1 billion in tax credits over 17 years generated an economic impact of $3.93 billion and supported over 31,000 jobs.

The Virginia Joint Legislative Audit and Review Committee also analyzed the Virginia program and concluded that the credit appears to effectively achieve its policy goal of encouraging historic rehabilitations. The analysis cited survey research estimating that 67% of credit recipients reported that the credit was "very important" in the decision to undertake the rehabilitation and 26% reporting it was "somewhat important." Research conducted by the staff and faculty at the Virginia Commonwealth University suggested that the state credit, or the combination of state and federal credits, promoted more commercial rehabilitation projects than the federal tax credit alone had done in previous years.

However, the study noted some concerns about how the credits are structured and whether they are being properly claimed. It stated that "importantly, the future effectiveness of the credit may be impacted by fraudulent claims." A recent case involving a Virginia developer who significantly overstated rehabilitation costs for multiple developments in Richmond exemplified how fraudulent activity can occur despite a three-stage certification process. Developers had submitted cost certifications prepared by independent certified public accountant (CPA) firms; however, the CPA firms did not detect the falsified invoices and are not required to assess the reasonableness of costs or perform independent confirmations of the invoiced amounts. Virginia officials indicated the majority of fraudulent expenditures consisted of items that would not be readily identifiable in the photographs submitted such as mechanical, electrical, and plumbing repairs or upgrades.

In response to these findings, Virginia established additional certification procedures. Additionally, Virginia officials now calculate the cost per square foot for every project and perform additional review if necessary, which may include additional review of invoices or confirmation of invoiced amounts directly with the contractor or vendor. The Virginia Department of Historic Resources conducts a physical inspection of the project.

The District of Columbia Office of Revenue Analysis found that states with historic tax credit programs leveraged federal resources by increasing total annual certified expenditures on average by $15 million to $35 million. Additionally, the study's findings suggested that a state program with a more generous subsidy paired with a reasonable budget cap encourages additional projects and leverages more federal preservation tax credits compared to an uncapped program with a more modest subsidy.

Chapter 3. Intent and Objectives of the Sustainable Communities Tax Credit

Intent of the Sustainable Communities Tax Credit Program

Historic preservation tax incentives encourage the preservation and rehabilitation of historic buildings in order to preserve the historic places associated with the identity and character of cities, towns, and rural areas. Maryland's sustainable communities tax credit, initially established as the heritage structure rehabilitation tax credit under Chapter 601 of 1996 and reestablished as the sustainable communities tax credit under Chapter 487 of 2010, includes these objectives. Specifically, § 5A-302 of the State Finance and Procurement Article enumerates the General Assembly's findings that:

- historic properties significant to the State's heritage are being lost or substantially altered, often inadvertently, with increasing frequency;
- historic properties are a vital part of our community life and development and cannot be replaced if lost or destroyed;
- it is in the public interest to preserve the State's heritage and enrich present and future generations with the cultural, educational, inspirational, social, and economic benefits of the past;
- increasing knowledge of our historic resources, establishing better means of identifying and administering them, and encouraging their preservation will assist the economic and cultural growth of the State; and
- the State's heritage has been enriched by accomplishments and contributions of the State's private preservation organizations, and their continuing activities are in the public interest.

Moreover, the preamble of Chapter 487 of 2010 provides, in part, that "[as] natural and financial resources dwindle, there is a need for tax incentives that will create jobs and spur entrepreneurship, to unlock sources of credit and capital which have been in short supply as a result of the financial crisis and that will do so in a way that promotes and furthers the State's goal of revitalizing communities."

Consistent with these findings, the Maryland Historical Trust advises that the purpose of the State and federal preservation tax incentives is to encourage private-sector investment in the rehabilitation and re-use of historic buildings and to promote investment in local economies.

Rationale for Government Intervention

The United States is a modern market economy as most goods and services are produced by the private market. Markets provide optimal benefits to society when economic activity and resources are efficiently allocated. This allocation depends on several conditions including free competition and a clear assignment of prices and benefits. Although most goods and services in the United States are supplied by the private market, governments intervene in many markets by either supplying the good or service or causing different outcomes than that produced by the private market alone.

Market failures occur when the private market does not produce the most efficient outcome for society. For example, the private market may not incorporate all of the activity's costs and benefits to society. If the activity has additional benefits to society, such as health care or education, markets may under-produce the good compared to the socially optimal quantity. A recent U.S. Federal Reserve analysis noted that in the midst of the recent financial crisis and resulting recession, few people are left unconvinced of the possibility of market failures. Governments can intervene in a variety of ways – through regulation, taxation, and/or subsidies. Subsidies are a form of government assistance provided by government to a subset of the public that lowers the cost of producing a good or the price that a consumer pays for a good. While tax credits are a form of subsidies provided through the tax code, subsidies can also be delivered via regulation and direct provision.

Most analysts believe that although markets can fail, there should be an expectation that government intervention can improve outcomes before any action is taken. Poorly designed policies can result in society being worse off. For example, most economists believe that although there were market failures within the U.S. housing industry, poorly designed policies including subsidies, contributed to the housing market implosion. Policy analysts typically identify two rationales for how subsidies can improve free-market outcomes:

- **efficiency:** subsidies can correct the failure of the market to produce the efficient amount of goods and services, thereby improving societal benefits; and

- **outcomes:** markets can operate efficiently but produce outcomes that are deemed inequitable – for example, private market activities can result in unacceptable levels of poverty and joblessness.

Outcome or Efficiency Goals of State Tax Credits

The Department of Legislative Services (DLS) reviewed the intent of numerous current and recently expired State business tax credits. For the vast majority of these credits, DLS could identify a valid efficiency or outcome goal specified in the legislation creating the tax credit that is supported by economic theory, or could be found in a similar federal program. For example, the research and development tax credit provides tax credits for a firm's qualified research expenses. Economists believe that firms may not produce the optimal amount of research as the benefits to society, through spillover effects, are greater than the private gain to the firm. In the absence of credits, firms will produce less than the efficient amount of research. The goal of four business tax credits – enterprise zone, community investment, employment opportunity, and One Maryland – is to change market outcomes, specifically those that the market produces in areas of poverty and economic distress. In addition, the goal of the State's largest tax credit, the earned income credit, is to alleviate poverty.

Exhibit 3.1 shows the underlying outcome and efficiency goals of several State business tax credits. In some cases, tax credits have both goals. Although the goals of these tax credits may be valid, DLS has questioned whether these programs efficiently achieve their goals, most recently in the evaluations of the enterprise zone, One Maryland, and film production activity tax credits.

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Exhibit 3.1
Goals and Outcomes for Various State Business Tax Credits

Tax Credit Program	**Program Goal**
Job Creation	Increase employment and economic growth – reduce negative impacts of unemployment
Biotechnology Investment	Provide capital to start ups with promising research as capital markets may not be efficient
Clean Energy/Electric Vehicle	Promote energy independence and clean technologies that may have fewer negative environmental impacts than conventional energy sources
Cybersecurity Investment	Promote investment in emerging industry and provide incentive to cluster in Maryland
Sustainable Communities	**Preserve historic structures and promote community revitalization**
	Promote efficient land use by encouraging development within areas with adequate infrastructure
Research and Development	Gains to economy and society from research are greater than private gain realized by company conducting research
Security Clearance – Employer Costs	Promote clustering in Maryland; promote employment by lowering industry employment costs
Community Investment	Promote community development in distressed areas
Enterprise Zone	Promote economic development within distressed areas and employment of community residents
	Reduce areas of concentrated poverty which impose additional costs on individuals
Employment Opportunity	Employment opportunities for low-income individuals may be limited – reduce State social safety net costs by increasing employment
One Maryland	Promote employment and capital investments within distressed areas
Long-term Employment of Ex-felons	Promote employment opportunities for ex-felons – reduce recidivism and future State costs
Maryland Disability Employment	Private market may provide limited opportunities for individuals with disabilities

Source: Department of Legislative Services

Sustainable Communities Tax Credit

The sustainable communities tax credit addresses several outcome and efficiency market failures. First, the benefits to society from rehabilitation activity are typically greater than the private gain realized by the developer. Accordingly, private developers will undertake less rehabilitation activity than the amount that provides maximum benefits to society. The private market may not adequately value historic structures by not considering the benefit of preserving the State's heritage when making rehabilitation decisions. Dilapidated buildings may negatively impact the surrounding neighborhood by posing a threat to public safety and decreasing property values. These dilapidated buildings can depress the development potential of the surrounding neighborhood while a rehabilitated building with amenities can become an anchor that positively impacts the surrounding neighborhood. Additionally, when considering whether a project is profitable, private developers generally do not incorporate the gains and costs from efficient land use and the environmental impacts of urban sprawl. The environmental benefits from discouraging sprawling development patterns include reducing vehicle miles traveled**,** preserving undeveloped lands, reducing stormwater runoff, contributing less waste to landfills than demolition, and utilizing existing infrastructure.

Moreover, performing rehabilitation instead of new construction is more labor intensive so historic preservation tax credits encourage job growth. DLS compared the economic impacts of $1 million of new construction versus $1 million of maintenance and repairs (a proxy for renovations) for both residential and commercial properties by using the REMI PI+ model. DLS estimates that $1 million of new residential construction creates about 6 jobs while $1 million of residential repairs and maintenance creates 70 jobs. Commercial projects have less of a difference in employment with $1 million of new commercial construction creating 29 jobs while $1 million of commercial maintenance and repairs creates 35 jobs.

A primary objective of the sustainable communities tax credit is the revitalization of communities. It does not designate particular communities but states there is a need for financial incentives to increase credit and capital which have been in short supply as a result of the financial crisis. As the economic recovery continues, the shortage of credit and capital has ameliorated but remains acute in economically distressed communities. Community revitalization is typically targeted towards economically distressed areas, places in which the private marketplace provides an insufficient amount of investment.

The sustainable communities tax credit is for entities that undertake qualifying rehabilitation activity, thereby increasing the after tax return on investment from commercial and residential rehabilitations. This provides an incentive for the economy to expand its output of rehabilitation activity and, if properly targeted, equal or become closer to the socially optimal output. However, the federal government provides a historic preservation tax credit that already addresses many of the market failures, raising questions as to whether there is a need for additional State intervention beyond that provided by the federal government.

The need for State intervention may be valid if the federal program is insufficient to produce optimal market outcomes, but if the federal program adequately addresses these market failures then there may be no need for further intervention. Offering a state historic preservation tax credit provides additional incentives to undertake historic rehabilitation activity. If the federal credit is insufficient, a state credit may be the tipping point that encourages the taxpayer to undertake certain projects. Additionally, the federal credit does not apply to residential homeowners and a state program may incorporate additional goals beyond those of the federal tax credit.

However, additional state incentives beyond the federal incentive may be inefficient. Some projects may have been undertaken in the absence of the state credit, and additional incentives may encourage overinvestment in housing and real estate in general. As mentioned earlier, many analysts believe that poorly designed housing subsidies and incentives contributed to the real estate market crisis.

Chapter 4. Residential Tax Credit Requirements and Activity

Unlike the federal historic preservation tax credit, which is limited to income-producing properties, the sustainable communities program provides a tax credit to homeowners for the qualified rehabilitation of a residential property. The residential credit program operates as a traditional tax credit program without an aggregate statutory or budgetary limitation on the maximum amount of credits that can be earned in each year. The Maryland Historical Trust (MHT) is also not required to award credits on a competitive basis.

Credit Amount and Guidelines

In order to qualify, the project and application must be reviewed and approved by MHT prior to the start of the rehabilitation work. Additionally, the proposed and completed work must meet the U.S. Secretary of the Interior's *Standards for Rehabilitation*. A project must have at least $5,000 in eligible expenses and the maximum credit is limited to $50,000.

MHT can award an unlimited amount of credits to those projects that meet program requirements. The value of the credit is equal to 20% of the qualified rehabilitation expenditures incurred in the rehabilitation of a single-family, owner-occupied residence. For mixed-use properties in which a portion of the residence includes income-producing property, qualifying expenses are prorated based on the square footage of the qualifying residential portion. If disqualifying work is undertaken on the property within five years of claiming the credit, a portion of the credit is recaptured.

Eligibility

To qualify for the residential credit, a building must be a single-family, owner-occupied residence and a certified historic structure.

A single-family, owner-occupied residence is defined as:

- a structure or a portion of a structure occupied by the owner and the owner's immediate family as their primary or secondary residence; or
- a residential unit in a cooperative owned by 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 under a proprietary lease.

Application and Approval Process

The application is a three-part process administered by MHT. Part 1 of the application process determines if the residence qualifies as a certified historic structure. Properties that are individually listed in the National Register of Historic Places automatically qualify. Otherwise, MHT determines if a structure contributes to the significance of a listed or designated historic district based on U.S. Secretary of the Interior criteria.

Part 2 of the application process requires the applicant to submit information about the proposed rehabilitation project. Applications must be approved by MHT prior to commencement of any of the proposed rehabilitation work. Proposed projects are evaluated for conformance with the *Standards for Rehabilitation*. The standards focus on the preservation of significant historic materials and features of structures, applying to both interior and exterior renovation work.

Applicants must estimate the total qualified rehabilitation expenditures, provide a detailed description of the rehabilitation work, and pay an application fee. Additionally, applicants must provide photographs of the interior and exterior of the entire property, including areas that are not being rehabilitated. Sketches and drawings also must be submitted to show all proposed alterations and new construction.

Part 3 of the application process is MHT certification of the rehabilitation upon project completion. Applicants submit an application form, which includes verification of the historic designation, the project timeline, an accounting of expenses, a review fee, and photographs. All qualifying expenditures must be incurred within 24 months of the project start date. Additionally, applicants must submit photographic evidence of the interior and exterior of the entire property verifying that the work was completed. Completed projects may be subject to MHT inspection. A homeowner can claim a refundable credit in the year in which Part 3 certification is received.

Scale of Residential Projects Receiving Credits

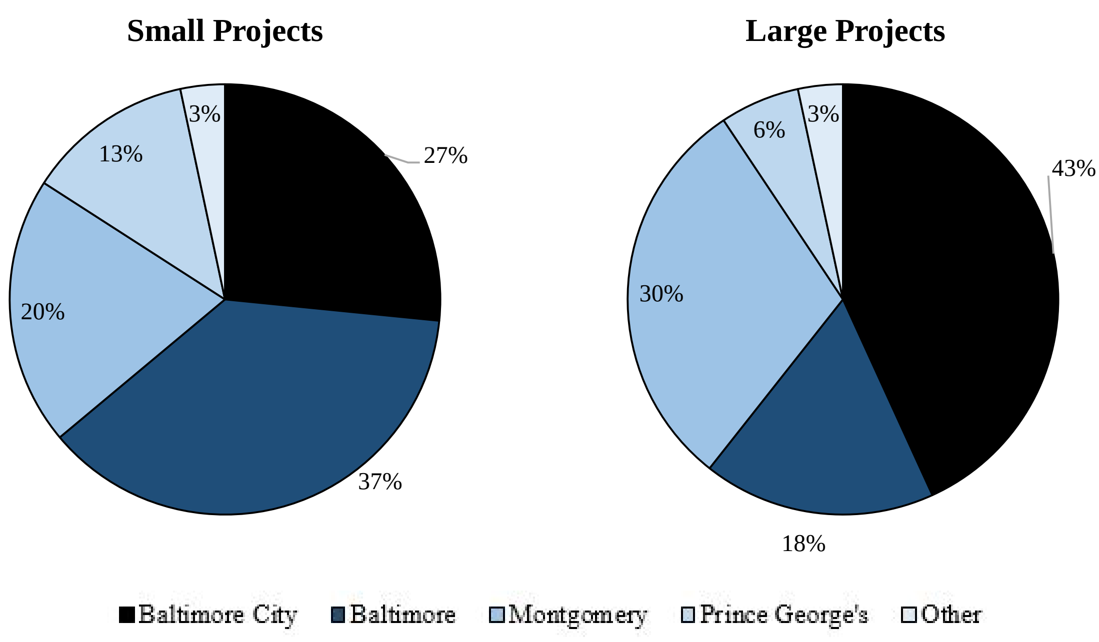
Residential rehabilitation projects receiving credits have ranged in scope from minor renovations to large-scale restorations. The typical project had about $34,500 in eligible expenditures, earning a credit of $6,900. About one-quarter of all projects incurred qualified rehabilitation expenditures of $15,000 or less (a maximum credit of $3,000) and about one-quarter of all projects were substantial rehabilitations with expenditures of $95,000 or more (minimum credit of $19,000). The scale of rehabilitation project expenditures increased over the first 10 years, reaching a median of $46,200 in fiscal 2007, and has decreased since, equaling $23,350 in fiscal 2014. The total credits claimed by the largest projects has decreased from about one-half through fiscal 2006 to a little more than one-third in fiscal 2012 through 2014.

Fiscal 2014 Rehabilitation Projects

In fiscal 2014, residential tax credits ranged from a project just over the minimum $5,000 qualified expenditure requirement, earning a $1,080 credit, to three Montgomery County projects claiming the maximum $50,000 credit. The typical small residential project (a project in the lowest quartile) had less than $13,500 in qualified rehabilitation expenditures, earning a tax credit of under $2,720. In fiscal 2014, smaller-scale projects most commonly occurred in Baltimore County, Baltimore City, and Prince George's County, as shown in **Exhibit 4.1.**

A typical large project (those in the top quartile) had qualified expenditures of over $48,000 and qualified for a tax credit of over $9,600. Baltimore City projects earned a little less than one-half of all credits earned by large-scale projects, followed by projects in Prince George's County and Baltimore County.

Exhibit 4.1
Distribution of Residential Tax Credits
Fiscal 2014



Note: Small projects are the residential projects with expenditures that are within the lowest 25% of all projects in the year. Large projects are the residential projects with expenditures that are within the highest 25% of all projects within the year.

Source: Maryland Department of Planning; Department of Legislative Services

Residential Credit Activity over Time

Since the program's inception, MHT has certified 3,062 residential projects that have earned a total of $49.1 million in credits, representing about 14% of the program's total fiscal cost. Although not in the same magnitude as the commercial program and due to different factors, residential credit activity has changed over time in a similar fashion to the commercial program.

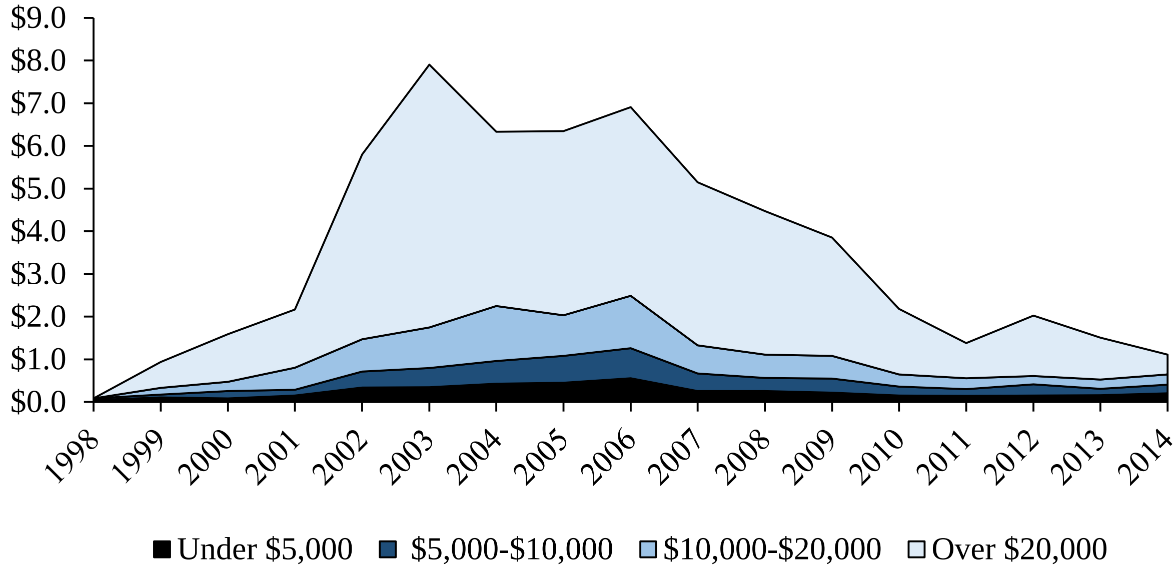
Costs rose quickly, as total credits increased by over eight-fold between fiscal 1999 and 2003, peaking at $7.9 million in fiscal 2003. Maryland's housing market was fueled by strong demand during this period – single-family home sales increased from 123,300 in calendar 2000 to a peak of 168,500 in calendar 2004. A majority of the credit's growth during this time was due to an increase in larger projects, with several projects earning a credit in excess of $500,000.

The amount of credits awarded in each year since fiscal 2003 has decreased on average by 11% annually. In the past five years, MHT certified an average of 125 projects with project costs averaging approximately $12,600. The median tax credit was $3,225 in fiscal 1998, peaked at $9,244 in fiscal 2007, and subsequently decreased to $4,668 in fiscal 2014. This decrease reflects both the decrease in housing demand and fiscal reforms enacted to the program.

Program reforms sharply curtailed commercial activity but had a more limited impact on the residential program. Chapter 76 of 2004 limited the maximum value of the residential credit to $50,000, thereby reducing the fiscal impact of large-scale rehabilitations. This limit reduced the total credits in each year by an average of $771,000, a reduction of about one-quarter.

Exhibit 4.2 shows, over time, the total residential credits by the amount of credit awarded. The impact of large-scale projects peaked between fiscal 2002 through 2006, as projects that received a credit of at least $20,000 earned an average of $4.7 million in credits. Small-scale projects receiving a credit of less than $5,000 have remained fairly consistent, typically comprising only 7% of all credits. The majority of all projects received a credit of less than $10,000, but from fiscal 1998 to 2013 the majority of the costs resulted from projects receiving a credit of at least $20,000. Fiscal 2014 was the first year in which a majority of credits were not earned by these projects. The number of projects with a credit of at least $50,000 grew substantially, from only two projects in 1999 to 30 projects in fiscal 2003. However, only 14% of fiscal 2014 credits were received by projects eligible for the maximum credit of $50,000.

Exhibit 4.2
Residential Tax Credits by Credit Amount
Fiscal 1998-2014
($ in Millions)



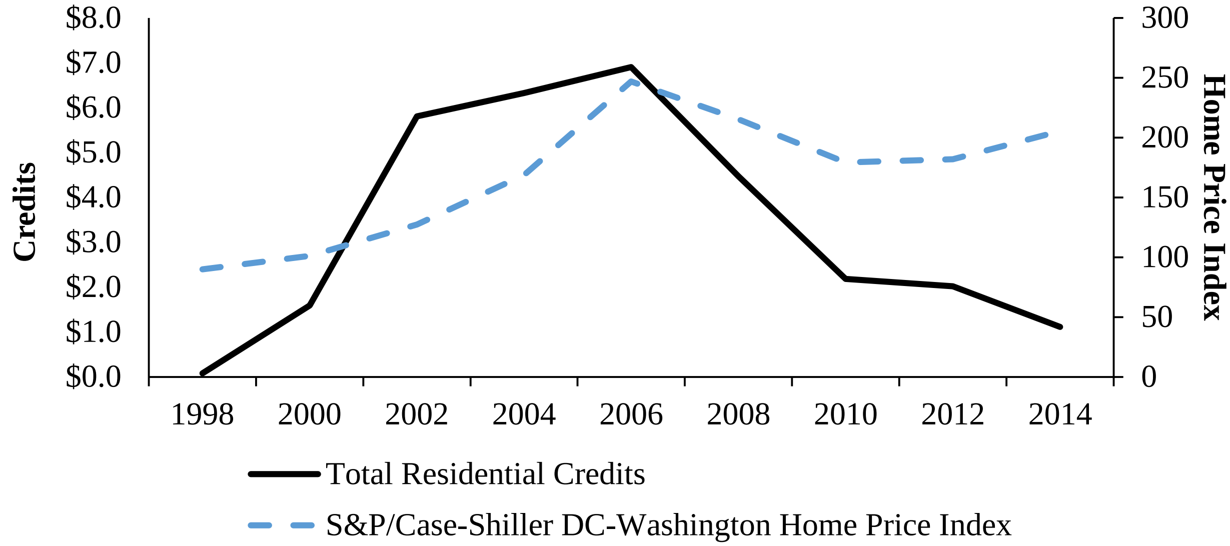
Note: Credits are adjusted for inflation and expressed in constant 2015 dollars.

Source: Maryland Department of Planning; Department of Legislative Services

The housing market crisis and recession decreased the demand for housing and real estate investment, including for residential rehabilitations. Prior to the housing crisis, individuals, including high-risk borrowers, could more easily finance the purchase or rehabilitation of a home and earn a significant return on investment when the house was sold. The number of single-family homes sold in Maryland decreased from 167,800 in calendar 2005 to 70,700 in calendar 2008. Sales rebounded modestly in 2013 and 2014, averaging just under 82,000 annually.

Residential projects increased through fiscal 2006, peaking at 415 projects. However, the collapse of the subprime mortgage lending industry decreased home prices and tightened lending standards, preventing many applicants from receiving a mortgage. The housing market did not stabilize until 2012. In fiscal 2007, residential projects decreased by almost 40% to 255, with smaller-scale projects (those receiving a credit of less than $5,000) decreasing by almost half to 82. Large-scale projects did not decrease as significantly (10%); this difference may reflect the difficulty lower-income taxpayers had in obtaining loans for lower-cost renovations compared to higher-income taxpayers with more access to capital. **Exhibit 4.3** shows the relationship between the residential program and the housing market, as measured by a price index for the price of homes in the District of Columbia.

Exhibit 4.3
Residential Tax Credits and Home Prices
Fiscal 1998-2014
($ in Millions)



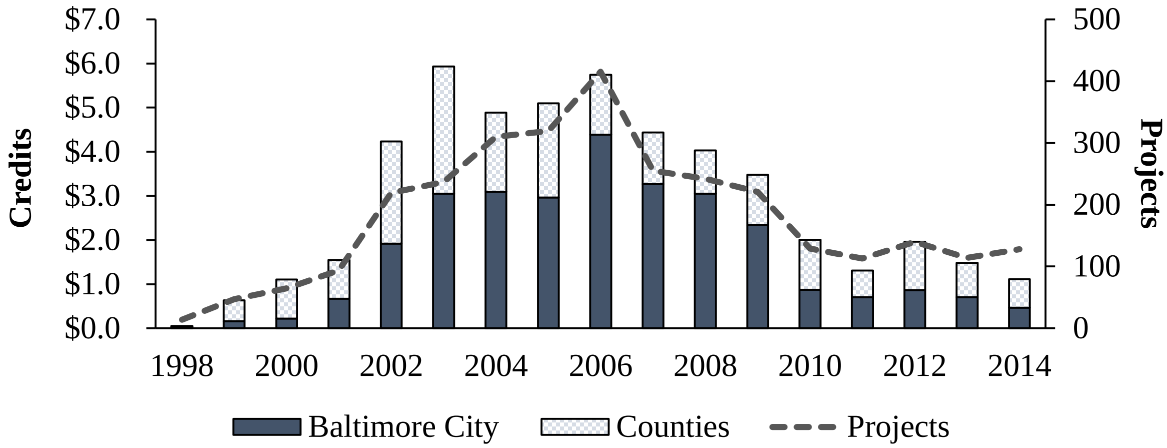
Note: Credits are adjusted for inflation and expressed in constant 2015 dollars.

Source: Maryland Department of Planning; S&P Dow Jones Indices; Department of Legislative Services

Geographic Distribution of Residential Tax Credits

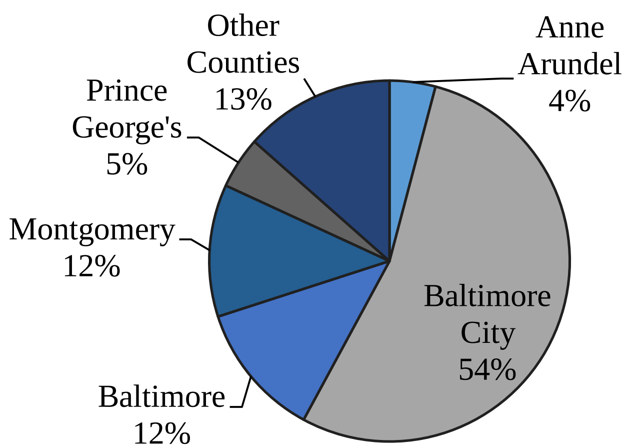
Residential credit activity is not distributed equally across the State, reflecting differences in the number of eligible properties, utilization, and project size. Since program inception, Baltimore City projects have comprised 54% of all projects and have received 59% of all credits. In fiscal 2006 through 2008, Baltimore City projects received about three-quarters of all residential credits, but this amount has decreased in the last three fiscal years to less than one-half, as shown in **Exhibit 4.4**. Projects from Baltimore and Montgomery counties claimed about one-quarter of all credits, as shown in **Exhibit 4.5**.

Exhibit 4.4
Residential Tax Credits and Projects
Fiscal 1998-2014
($ in Millions)



Source: Maryland Department of Planning; Department of Legislative Services

Exhibit 4.5
Percentage of Residential Credits by County
Fiscal 1998-2014



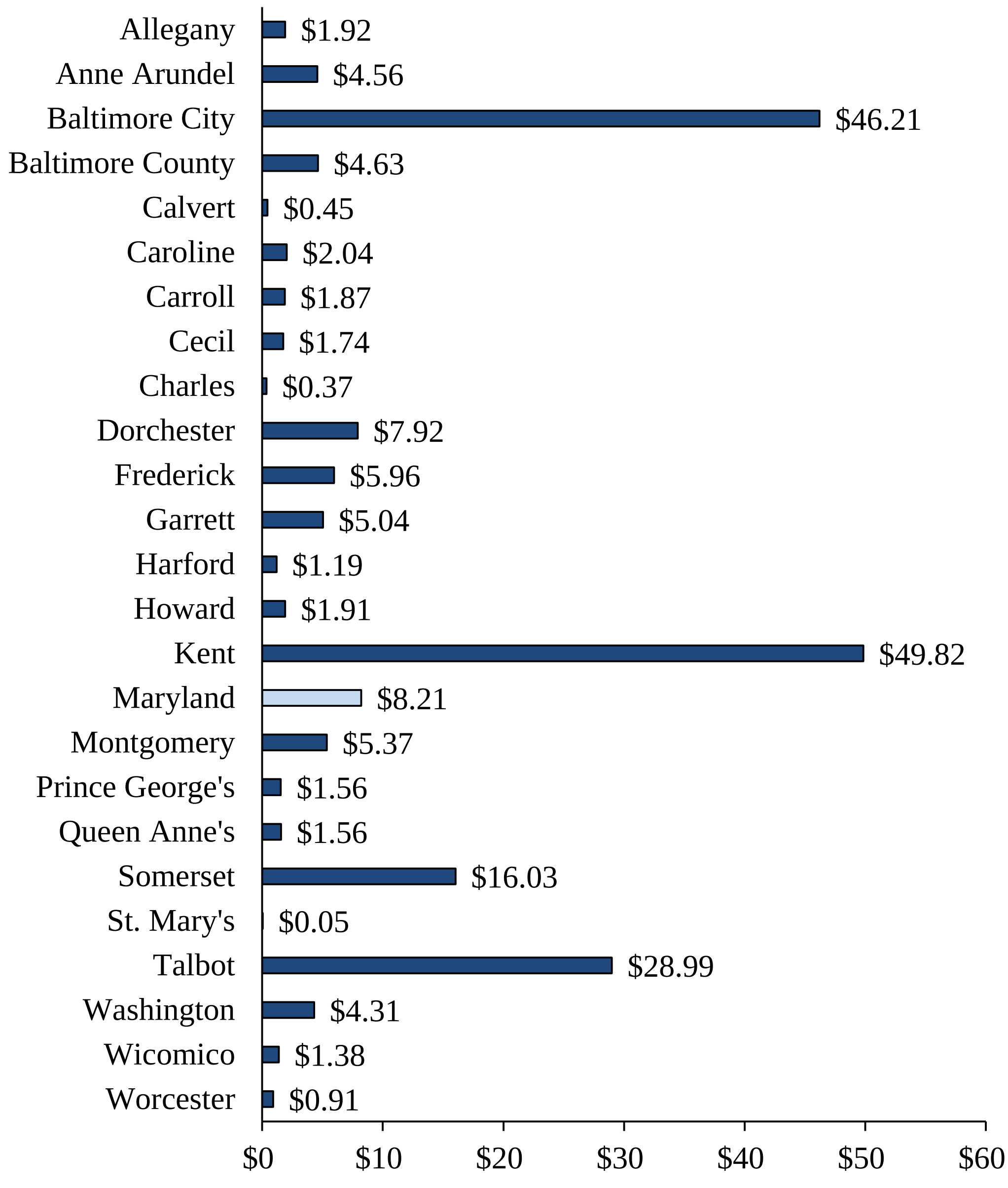
Source: Maryland Department of Planning; Department of Legislative Services

Determining the factors that explain the unequal geographic distribution of the program is challenging due to the lack of an accurate count of eligible historical residential properties by county. Examining residential tax credits on a per capita basis highlights distribution by population, but it does not take into account that some counties have significantly fewer eligible historical properties. In assessing program utilization by county, MHT uses the percentage of National Register of Historic Places properties, as required by statute. As discussed later in this report, using this approach has shortcomings because the National Register also includes commercial properties but does not include eligible residential properties in locally designated historic districts. With these caveats in mind, the following section examines the geographic distribution of residential credits on a per capita basis and compared to the National Register.

Kent County and Baltimore City have the highest per capita amount of credits, almost $50 per person since the program's inception, as shown in **Exhibit 4.6**. Somerset and Talbot counties are the only other counties that received a greater amount than the State average of $8 per capita, with credits of $16 and $29 per capita, respectively. One-half of all counties received less than $2 per capita in residential tax credits between fiscal 1998 and 2014.

The significant difference in credits claimed per capita is not surprising given the unequal distribution of historic properties. As shown in **Exhibit 4.7**, Baltimore City, Baltimore County, and Montgomery County claim a greater share of credits relative to the percentage of National Register Properties within these local jurisdictions. Other counties claim a lower share of credits relative to the percentage of properties listed in the National Register, ranging from 80% in Kent County to 1% in St. Mary's County.

Exhibit 4.6
Total Residential Tax Credits
Per Capita by County
Fiscal 1998-2014



Source: Maryland Department of Planning; Department of Legislative Services

Exhibit 4.7
Total Residential Credits as a Percentage of National Register Properties
Fiscal 1998-2014

County	Total Credits	% of Total Credits	National Register	% of National Register	Total Credit % /National Register %
Allegany	$139,866	0.3%	54	3.4%	8.3%
Anne Arundel	2,556,963	5.2%	104	6.6%	78.8%
Baltimore City	28,777,332	58.7%	290	18.4%	318.0%
Baltimore County	3,828,831	7.8%	90	5.7%	136.3%
Calvert	40,453	0.1%	20	1.3%	6.5%
Caroline	66,366	0.1%	21	1.3%	10.1%
Carroll	314,320	0.6%	61	3.9%	16.5%
Cecil	178,559	0.4%	51	3.2%	11.2%
Charles	56,611	0.1%	41	2.6%	4.4%
Dorchester	258,145	0.5%	26	1.7%	31.8%
Frederick	1,451,602	3.0%	94	6.0%	49.5%
Garrett	149,595	0.3%	22	1.4%	21.8%
Harford	298,087	0.6%	79	5.0%	12.1%
Howard	591,677	1.2%	41	2.6%	46.2%
Kent	987,525	2.0%	39	2.5%	81.2%
Montgomery	5,528,471	11.3%	76	4.8%	233.1%
Prince George’s	1,406,764	2.9%	102	6.5%	44.2%
Queen Anne’s	76,086	0.2%	38	2.4%	6.4%
St. Mary’s	5,545	0.0%	30	1.9%	0.6%
Somerset	414,411	0.8%	73	4.6%	18.2%
Talbot	1,091,118	2.2%	61	3.9%	57.3%
Washington	644,967	1.3%	105	6.7%	19.7%
Wicomico	140,334	0.3%	22	1.4%	20.4%
Worcester	46,982	0.1%	32	2.0%	4.7%
Maryland	**$49,050,609**	**100.0%**	**1,572**	**100.0%**	**100.0%**

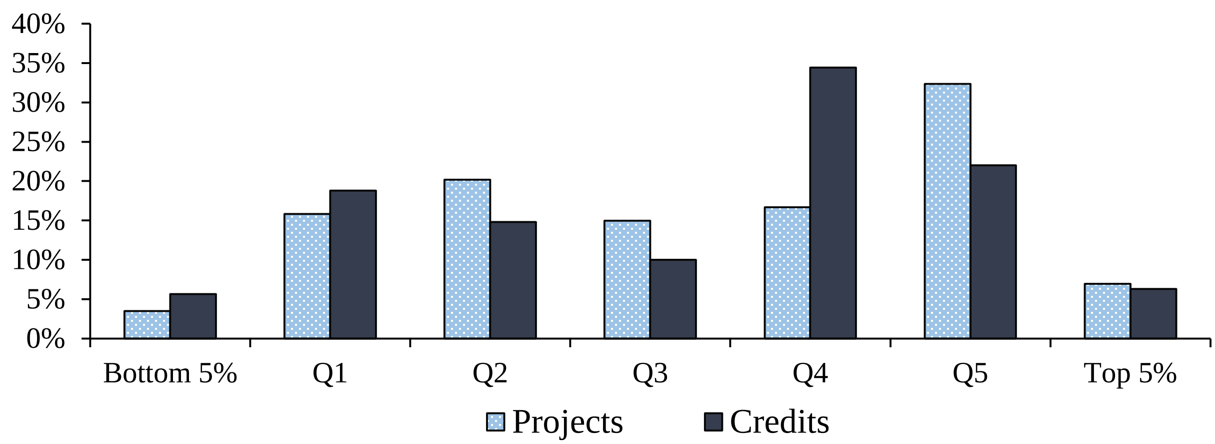
Source: Maryland Department of Planning; Department of Legislative Services

Residential Projects by Neighborhood Income and Home Values

Exhibit 4.8 shows by quintile the distribution of projects and credits certified in fiscal 2010 through 2014 based on the census tract median household income. For example, Quintile 1 reflects the percentage of credits and projects located in the bottom 20% of census tracts in the State with the lowest median household income. Projects and credits are skewed towards higher household incomes as about half of all projects and over half of all credits have been awarded to projects within the highest two quintiles. Within Quintile 4, credit activity is concentrated in census tracts with incomes between $111,900 and $122,700. A little more than one-quarter of all residential credits have been claimed by projects located in these census tracts even though these areas comprise only 5% of all census tracts. A majority of projects and credits occur in census tracts within the highest quintile of housing values (value of $480,300 or more), as shown by **Exhibit 4.9**. Although the program is skewed towards higher incomes and housing values, the top 5% of census tracts with the highest median household income and housing values only claimed about 6% of all credits.

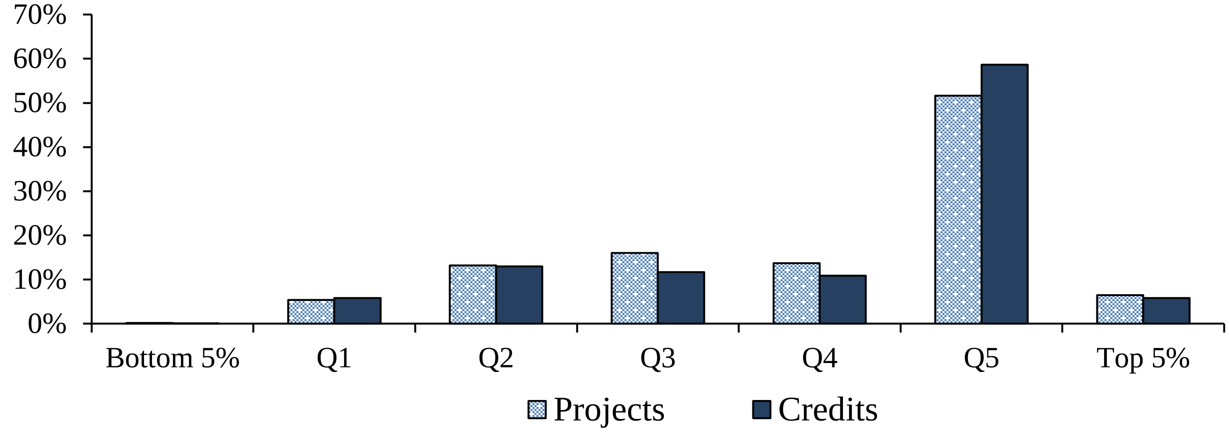
Residential projects in 11 counties are located in census tracts with lower median household incomes compared to the county's average census tract. Projects in Baltimore, Calvert, and Caroline counties and Baltimore City are typically located in census tracts with a median household income that was at least 20% higher than the local jurisdiction's average census tract. As **Exhibit 4.10** shows, projects in 11 counties were located in census tracts with housing values that were higher than the local jurisdiction's average census tract. Anne Arundel County had the greatest disparity – a median housing value of $744,200 for residential projects census tracts compared to a county average of $338,500.

Exhibit 4.8
Residential Projects and Credits
By Census Tract Household Income
Fiscal 2010-2014



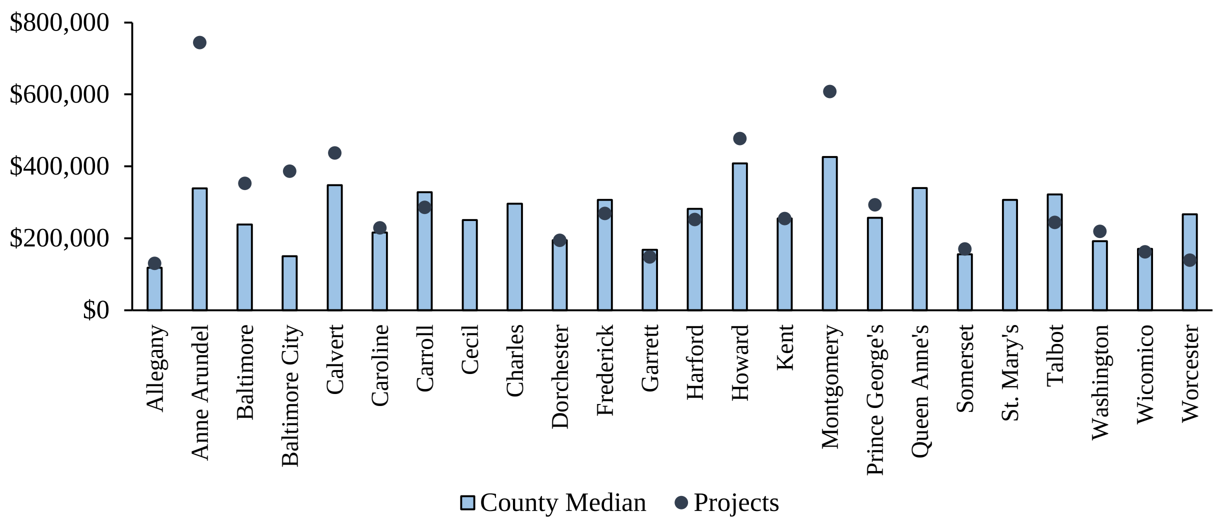
Source: Maryland Department of Planning; U.S. Census Bureau; Department of Legislative Services

Exhibit 4.9
Residential Projects and Credits By Census Tract Housing Value
Fiscal 2010-2014



Source: Maryland Department of Planning; U.S. Census Bureau; Department of Legislative Services

Exhibit 4.10
Median Housing Value of Residential Project Census Tracts
Fiscal 2010-2014



Source: Maryland Department of Planning; U.S. Census Bureau; Department of Legislative Services

Chapter 5. Commercial Program Legislative History and Requirements

Legislative History

Credit Establishment and Expansion

Chapter 601 of 1996 established the Heritage Structure Rehabilitation Tax Credit Program, replacing a subtraction modification that allowed taxpayers to deduct certain expenses incurred in the rehabilitation of nondepreciable historic structures. Unlike the subtraction modification, which was generally limited to residential properties, taxpayers could claim a credit for residential and commercial rehabilitation expenditures. The credit was equal to 10% of the taxpayer's qualified rehabilitation expenditures and nonrefundable, so any credit amounts claimed could not exceed the tax liability imposed in the tax year.

Legislation enacted over the next five years extended eligibility for the credit and enhanced the credit by increasing its percentage value and making it refundable. Chapter 731 of 1997 increased the percentage value of the credit to 15%, which was subsequently increased to 25% by Chapter 735 of 1998. Chapters 160 and 161 of 2001 made the credit refundable, so that any amount of the credit that exceeded the tax liability imposed in the year could be claimed as a refund. The Acts also extended eligibility of the credit to organizations that are exempt from taxation under Section 501 (c)(3) of the Internal Revenue Code.

Significant Revenue Losses Prompted Initial Program Reforms

In September 2001, the Department of Legislative Services (DLS) found that the fiscal costs resulting from the credit far exceeded the amounts previously reported by the Department of Housing and Community Development (the Maryland Department of Planning later assumed responsibility for administering the program). In response to these sudden and unexpected revenue losses, the General Assembly reduced the program's fiscal cost and uncertainty primarily by amending the commercial tax credit program. These legislative reforms evolved over time as additional information on the program's fiscal impact became available. Legislation enacted in 2002 reduced the credit's value, increased program reporting requirements, and placed a two-year sunset on the program. In 2003, legislation limited the aggregate amount of credits the Maryland Historical Trust (MHT) could award over specified periods. In 2004, the General Assembly restructured the commercial tax credit program primarily by converting the program to a budgeted tax credit, placing geographic limits on credits, and requiring MHT to award credits on a competitive basis.

Chapter 541 of 2002 reduced the percentage value of the credit to 20% and limited the maximum value of the credit to $3 million. The Act also limited qualified expenditures to the amount expended in compliance with a plan of proposed expenditures approved by the Director of MHT. The Act also increased legislative oversight over the program. Chapter 511 of 2002 stated that it was the intent of the General Assembly that commercial rehabilitation tax credits not exceed $50 million annually and required DLS to monitor the approval of commercial rehabilitations. If the proposed commercial rehabilitations approved in any calendar year would result in more than $50 million in credits, DLS was required to notify the General Assembly, make recommendations to limit the fiscal cost, and prepare legislation to implement a $50 million aggregate limit. Lastly, the Act provided a two-year sunset on the credit that allowed the General Assembly to evaluate the program and make a determination as to continuation of the tax credit program. Chapter 203 of 2003 established the first aggregate fiscal limit on the program by limiting the amount of commercial rehabilitation activity that could be approved by MHT over specified periods. MHT could award a maximum of $23 million in credits within a specified period in 2003 and $15 million in 2004.

A task force appointed by Governor Ehrlich met during the 2003 interim to evaluate the tax credit program and determine if the tax credit should be continued and in what form. The task force recommended extending the program with no aggregate limit as it concluded that the program had been a very successful economic and community revitalization tool that generated new State and local revenues.

Commercial Credit Program Restructuring

Chapter 76 of 2004 reestablished the tax credit but placed the commercial program under budgetary control, required MHT to award credits through a competitive process, and established a reserve fund to offset revenue losses caused by commercial tax credits. The amount of commercial credits approved in each fiscal year could not exceed the amount of money budgeted to the reserve fund in that fiscal year and required the Governor to appropriate $20 million to the fund in fiscal 2006 and $30 million in each of fiscal 2007 and 2008. The Act also increased the aggregate limit in calendar 2004 to $25 million and required MHT to award $10 million on a competitive basis.

Chapter 76 specified that the credit is equal to 20% of the qualified rehabilitation expenditures expended in the rehabilitation of a certified historic structure. The maximum credit for any project cannot exceed (1) $50,000 for noncommercial projects and (2) the lesser of $3 million or the maximum amount stated on an initial credit certificate for commercial projects. Chapter 76 also included the first provision to promote the program's geographic diversity by prohibiting MHT from awarding more than 50% of all initial credit certificates in a fiscal year for projects located in one county or Baltimore City.

Program Administration and Extension

Chapter 444 of 2005 required MHT to adopt regulations charging a fee of up to 1% to certify commercial rehabilitations. Chapters 566 and 567 of 2007 extended the program's termination date through fiscal 2010 and required the Governor to include in the annual budget bill an appropriation for the commercial program but did not require or suggest a specific amount. The Acts also increased to 75% the maximum amount of total initial credit certificates that MHT could issue in a fiscal year for commercial projects located in one county or Baltimore City. If the total amount of initial credit certificates is less than the total amount appropriated in a fiscal year due to the geographic limitation, the excess amount may be distributed without regard to the limitation.

Chapters 566 and 567 required MHT to award credits in a manner that favors projects located in jurisdictions that have been historically underrepresented in the awarding of tax credits, instead of the previous requirement that credits be awarded in a manner that reflects the geographic diversity of the State. The determination that a jurisdiction has been historically underrepresented is based on the number of structures located in each jurisdiction that are listed in the National Register of Historic Places. Finally, the Act extended certification fees to residential rehabilitations and repealed a requirement that at least 10% of all commercial credits must be awarded to nonprofit organizations.

Reestablishment of the Program

Chapter 487 of 2010 extended, altered, and reestablished the Heritage Structure Rehabilitation Tax Credit Program as the Sustainable Communities Tax Credit Program. The Act retained the commercial program as a budgeted tax credit. The Act also generally retained the values of the credit but established an enhanced credit of up to 25% for a commercial rehabilitation that meets specified energy efficiency standards. Credit eligibility was also extended to qualified nonhistoric commercial buildings located in a Main Street Maryland community or a sustainable community.

In addition to expanding eligibility of the commercial program to qualified nonhistoric commercial buildings, the Act altered the criteria by which MHT awards commercial credits. The Governor was required to provide an appropriation for the commercial credit in fiscal 2011 through 2014 but was not required to include a specific amount. The Act also altered eligibility of the residential credit by establishing the definition of a single-family, owner-occupied residence.

Additional Program Changes

Chapter 133 of 2011 allows an applicant that has proceeded with a substantial portion of a commercial rehabilitation to apply for the credit if the rehabilitation work has been approved under the federal historic preservation tax credit. Chapter 383 of 2011 increased the amount of certification fees MHT could levy and clarified that the enhanced credit for high-performance buildings and qualified rehabilitated structures is available only for the rehabilitation of commercial buildings. Chapter 668 of 2012 allows the credit to be allocated among the partners, members, or shareholders of an entity in any manner agreed to by those persons in writing.

Chapter 601 of 2014 extended the program through fiscal 2017. The Governor is required to include an appropriation to the commercial program in fiscal 2015 through 2017, and MHT may award residential tax credits through fiscal 2017. The Act repealed credit eligibility for nonhistoric commercial buildings and established eligibility for small commercial projects that meet certain requirements. MHT is authorized to award up to $4.0 million in credits to these small commercial projects. The legislation also clarified the authority of MHT to revoke certain expired tax credits, required MHT to establish an additional minimum fee for the second phase of the application process, and reduced to 60% the maximum amount of total initial credit certificates issued in a fiscal year that can be allocated for projects located in one county or Baltimore City.

Commercial Credit Requirements

Owners of income-producing properties may apply for the competitive commercial tax credit. A rehabilitation generally qualifies if it involves income-producing property that (1) is a certified historic structure and (2) has total qualified rehabilitation expenditures that exceed the greater of $25,000 or 50% of the adjusted basis of the property. Insurance reimbursement funds, State and local grants, loans, or other State income tax credits are not eligible and must be backed out when calculating qualified rehabilitation expenditures. To be certified for a credit, a project must complete a three-part application process administered by MHT.

Certified Historic Structure

In Part 1 of the application process MHT evaluates the significance of the historic structure. Properties that are individually listed in the National Register of Historic Places automatically qualify. For other properties, MHT must make one of the following determinations:

- certification that a structure contributes to the significance of a National Register listed historic district or of a locally designated historic district determined by the Director of MHT to be eligible for listing in the National Register;

- certification that a structure is individually designated under local law and is eligible for listing in the National Register;

- certification by the Maryland Heritage Areas Authority that a structure located in a certified heritage area contributes to the significance of the certified heritage area; or

- preliminary certification of an individual structure or historic district pending national or local designation (final designation must occur by the end of the calendar year in which the project is completed).

Generally, MHT determines if a structure contributes to the historic significance of a district by evaluating if the location, design, setting, materials, workmanship, feeling, and association adds to the district's sense of time and place and historical development. A structure does not contribute to the historic significance of a district if it is one where the location, design, setting, materials, workmanship, feeling, or association has been so altered or has so deteriorated that the overall integrity of the property has been irretrievably lost. A structure that has been built within the past 50 years typically may not be considered to contribute to the historic significance of a district.

Eligible Rehabilitations

In Part 2 of the application process, MHT evaluates the proposed rehabilitation for conformance with the U.S Secretary of the Interior's *Standards for Rehabilitations*. These standards guide the rehabilitation of all historic structures. MHT generally adheres to guidelines issued in National Park Service bulletins when interpreting the standards.

Generally, a qualifying rehabilitation is one that will return a structure to a state of utility through repair or alteration, making possible an efficient use while preserving portions and features. Applicants who undertake rehabilitations involving the following activities must submit additional information to MHT in order to verify the work will not negatively impact the historic character of the structure:

- new heating, ventilating, and air conditioning;
- new windows;
- interior partition alteration and interior plaster removal;
- exterior masonry repair; and
- new additions and new construction.

Certification of Completed Work

Upon completion of the rehabilitation project, the owner must submit Part 3 of the application. All work must be completed within 30 months of the Part 2 certification. Rehabilitation expenditures must have been approved in advance and incurred within a 24-month period ending with the taxable year the project was completed. Unless a project has received federal credit certification from the National Park Service, expenditures for rehabilitation work that commenced prior to certification of the Part 2 application are ineligible. The applicant must attach a report from an independent certified public accountant summarizing their examination of the Schedule of Rehabilitation Costs and Calculation of Qualified Rehabilitation Expenditures.

Competitive Commercial Scoring System

MHT is required to establish by regulation the criteria to competitively rank commercial credit applications. Projects can receive a maximum of 145 points based on the criteria as follows:

Rare Example of Structure (20 points): Evaluates the extent to which the certified historic structure is a rare example of an architectural style or a structure designed by a noted architect.

Level of Preservation (20 points): Evaluates the extent to which the rehabilitation sustains the existing form, integrity, and material of the certified historic structure and accurately recovers the form and details of the certified historic structure as it appeared at the period of time for which the structure is historically significant.

Protected by Easement or Memorandum of Understanding (10 points): Evaluates whether the certified historic structure is protected by a historic preservation easement held by MHT or is subject to preservation conditions or restrictions through a memorandum of understanding or programmatic agreement with MHT or some other instrument.

Urgency of Need for Rehabilitation (20 points): Evaluates if the rehabilitation need of the certified historic structure is of an urgent or emergency nature.

Consistency with State Growth/Development Policies and Programs (30 points): This criterion assigns points based on whether the certified historic structure is located in an area targeted by the State for additional revitalization and economic development opportunities due to the focusing of State resources and incentives, including whether the project is located within a priority funding area or sustainable community.

Areas with Regulatory Streamlining (5 points): Assesses whether the certified historic structure is located in an area in which the political subdivision has implemented regulatory streamlining or other development incentives that foster redevelopment and revitalization.

Affordable and Workforce Housing (5 points): Assesses whether the rehabilitation project will include affordable and workforce housing options.

Economic Benefit (20 points): Assigns points based on the percentage by which the qualified rehabilitation expenditures exceed the assessed value of the structure.

Statewide Geographic Distribution (15 points): Assigns points based on whether the certified historic structure is located in a local jurisdiction that has been historically underrepresented in the awarding of commercial tax credits based on the number of National Register listed structures in each jurisdiction.

The deadline for commercial credit applications is typically at the end of August. MHT reviews the applications, ranks the eligible projects, and makes a determination of which projects will receive credits by the end of October. Generally, the Governor will hold a press conference later in the year and announce the approved projects. In calendar 2014, this announcement was made on December 10. MHT will often communicate with applicants during the application process but does not communicate with applicants from the time of the application deadline to the announcement of approved projects. This lack of communication makes it more difficult for applicants to plan a project and may also delay the start of projects.

Chapter 6. Overview of Commercial Credit Program Reforms

Most studies have found that historic preservation programs are generally effective in achieving their goals. Historic preservation programs can stabilize neighborhoods by promoting the upkeep of properties and maintaining architectural conformity. Incentives can spur additional rehabilitation activity and raise property values, thereby increasing equity and the availability of credit. A common requirement of historic tax incentive programs, including the State commercial tax credit, is that a rehabilitation must generally exceed the adjusted basis of the structure. The adjusted basis is equal to the cost of the building adjusted for capital expenditures and depreciation. Rehabilitations of structures that are of high value and generally well maintained are less likely to qualify for the credit than the rehabilitation of a historic structure that is deteriorating due to a lack of maintenance and/or abandonment. The adjusted basis requirement focuses credit rehabilitation activity towards these at-risk historic resources – the Maryland Historical Trust (MHT) reports that most commercial structures are vacant prior to rehabilitation.

The objective and goals of the sustainable communities tax credit program are generally clear and the program has a valid intent. Research indicates that rehabilitating buildings is often more expensive than new construction. Although the benefits of historic preservation are difficult to quantify, encouraging the re-use of historic buildings provides additional economic and social benefits compared to new construction. Vacant properties and the blight that usually follows have emerged as a major challenge in efforts to revitalize communities. Preservation programs can also benefit State and local governments by reducing infrastructure demands that result from new construction.

As discussed in more detail in this chapter, legislative reforms have improved the program's implementation and administration. These reforms established a well-structured commercial tax credit program that provides fiscal certainty, prevents the buildup of unfunded State liabilities, and clarifies State liabilities in each fiscal year. The commercial program is also subject to a competitive process that generally maximizes the program's effectiveness compared to an uncapped program or first-come, first-served approach. In fiscal 2015, MHT competitively ranked 17 commercial tax credit applications and awarded a credit to nine applicants. The denied projects applied for a total of $10.6 million in credits and had proposed project rehabilitation expenditures totaling $55.6 million. The approved projects received a similar amount of credits ($10.7 million), but the rehabilitation expenditures of these approved projects totaled $76.7 million or $21.1 million more than the amount proposed by the denied projects. The legislative reforms also generally prohibited rehabilitation projects from receiving other State and local financial assistance, further increasing the effectiveness of the program. Compared to other tax credit programs, MHT is able to accurately and timely report basic program outputs including the number of projects and credits in each fiscal year and the economic development impacts of these projects. This capability facilitates legislative oversight of the program and program analysis.

This evaluation will analyze how these legislative reforms impacted the program's rehabilitation activity, geographic diversity, and effectiveness in achieving key outcomes and goals identified by the General Assembly. The evaluation will also contrast the program's implementation and administration to other State tax credit programs, which often do not provide fiscal certainty or maximize the State's return on investment.

Policy Implications of Program Reforms

As previously discussed, the General Assembly passed legislation enacting significant reforms to the tax credit program from 2002 to 2004. The primary goal of the General Assembly's legislative reforms was to decrease the fiscal cost of the program and its unpredictability. The major components of these fiscal reforms include:

- shifting the commercial program from a traditional tax credit to a budgeted tax credit subject to an aggregate limit each year;
- establishing a reserve fund to offset revenue losses resulting from commercial rehabilitations;
- limiting the maximum value of the commercial tax credit to $3 million, which was previously uncapped; and
- reducing the percentage value of the credit from 25% to 20%.

As originally implemented, the tax credit program was not subject to an aggregate limitation on the amount of credits that could be awarded in each year. Tax credits directly reduced State revenues as there was no money appropriated in the State budget for the program nor was there a reserve fund to offset tax credit claims.

Chapter 601 of 1996 established the tax credit program, replacing a subtraction modification that was available for qualified residential rehabilitation expenditures. Commercial rehabilitation activity under the program increased significantly beginning in calendar 1999 and peaked in 2001 – adjusting for inflation commercial projects applying for Part 2 certification in these three years earned a total of $165.8 million in credits, with over one-half of the total resulting from projects in 2001 alone. In addition to the increased rehabilitation activity, fiscal costs also increased as legislation enacted in 2001 made the credit refundable. Revenue losses would have been significantly higher, but some projects were not completed and the associated tax credits expired. In addition, legislation enacted in 2002 and 2003 reduced the fiscal impact of the program before the establishment of a budgeted tax credit in 2004.

Most commercial rehabilitations were completed within one year of the project's Part 2 application date. However, about 40 projects that earned a total of $66.2 million in credits were not completed until at least four years after the Part 2 application date. This resulted in a "pipeline" of unclaimed credits as projects were in process and would claim credits in the future. In addition, there was a lack of data on projects being undertaken, limiting the ability to estimate the program's fiscal impact. As projects were completed, this pipeline resulted in sudden and higher-than-expected State revenue losses.

Due to ongoing legislative concerns, Chapter 76 of 2004 shifted the commercial tax credit from a traditional tax credit to a tax credit that is subject to an annual appropriation in the State budget, with an aggregate limitation on annual credits based on the final budgetary appropriation. In contrast to an uncapped tax credit program, a budgeted tax credit prevents unexpected revenue losses which can impact the overall budget process. Any buildup of unclaimed credits or project pipeline will not impact State finances as the credits have already been provided for in the State budget, thereby preventing unfunded liabilities. The budget process also requires that the commercial credit must compete with other State funding priorities. Budgeting the credit also provides flexibility for the State, as the appropriation is set on an annual basis and can be tailored to fit the current funding priorities and the overall State budget.

The commercial tax credit program became a template for subsequent tax credits established by the General Assembly. Almost every credit established since 2004 has a limit on either the maximum amount that can be claimed by a taxpayer and/or an aggregate limit on the total credits available. Additionally, many of the major State tax credit programs established since 2004 are subject to an annual appropriation including the biotechnology investment, film production activity, health enterprise zone, and cybersecurity investment tax credits.

In previous tax credit evaluations, the Department of Legislative Services (DLS) has determined that other tax credit programs have uncertain, but potentially significant, fiscal costs. As of 2013, the Department of Commerce (Commerce) certified a total of $197.4 million in One Maryland tax credits, but only an estimated one-third of this amount has been claimed, thus creating a large pipeline of unclaimed credits. The Comptroller's Office advises it lacks a timely process to accurately assess the amount of credits claimed in each year, so the actual amount claimed could be higher or lower than estimated. Businesses generally have 15 years to claim the entire amount of the credit; therefore, existing projects will continue to decrease State revenues by up to $136 million through tax year 2025 (fiscal 2026). These revenue losses will reduce future State revenues and will not be offset by a reserve fund, creating a potential State unfunded liability. In addition, the timing of this fiscal impact cannot be accurately estimated.

Maximum Credit Limitations

Prior to Chapter 541 of 2002, there was no limit on the maximum value of the credit. In addition to limiting the maximum value of the commercial credit, Chapter 541 of 2002 reduced the credit percentage from 25% to 20%. The Act also treated as a single rehabilitation the phased rehabilitation of the same structure, the separate rehabilitation of different components of the same structure, or the rehabilitation of multiple structures that are functionally related to serve an overall purpose. These provisions applied to project applications submitted after February 1, 2002, and were the first steps in curtailing the program's fiscal impact.

Chapter 203 of 2003 limited the annual amount of credits MHT could award before Chapter 76 of 2004 converted the commercial program to a budgeted tax credit. As a result of this change, limiting the maximum credit value no longer acts to directly limit the program's fiscal impact. However, limiting the maximum value continues to have other benefits. Limiting the maximum value of the credit prevents additional revenue losses that would occur if the project's final cost exceeded the initial cost estimate. It also increases program effectiveness, as the State provides less funding for a given level of rehabilitation activity. In addition, limiting the maximum value of the credit increases the amount of funding that is available for other projects.

Lastly, limiting the credit can potentially provide a more equitable distribution of tax credits. A few taxpayers often claim the vast majority of certain tax credits. For example, DLS found that two productions claimed 98% of a total of $61.8 million in film production activity tax credits in fiscal 2012 through 2016. As a result, DLS recommended that the General Assembly consider whether limitations on the amount of tax credits that any single production may receive in a given fiscal year would be appropriate when allocating film production activity tax credits.

Competitive Process for Commercial Projects

The commercial tax credit is unique in that MHT awards credits using a competitive process. Commercial rehabilitation projects are scored on a number of criteria outlined in statute and regulations including but not limited to the level of preservation, urgency of need for rehabilitation, economic benefit, and geographic distribution of projects. Thus, projects that deliver the most benefits in terms of key outcomes and goals identified by the General Assembly are more likely to be awarded credits. For example, two Baltimore City projects applied for a $3 million credit in fiscal 2014, but due to the geographic limitation in effect at the time, both projects could not be funded. The competitive award process selected the project with estimated project costs of $40 million and a score of 95 over the project with $20 million in costs and a score of 82. In the absence of a competitive process, the economic benefit to the State may not have been maximized.

Although MHT notes that the competitive process creates a delay in awarding credits, a well-implemented competitive program can result in a more effective program compared to a first-come, first-served approach or uncapped program. Chapter 203 of 2003 established an aggregate annual limit on commercial credits as part of the evolving process of curtailing the program's fiscal impact. MHT reports that the first-come, first-served basis resulted in several problems, including difficulty in accurately tracking the timing of the application submissions. Projects were not selected based on merit and MHT reports that some approved projects were less beneficial compared to others denied funding. Additionally, MHT reports that the first-come, first-served process increased the number of applications from projects that had not secured financial backing; these applicants proceeded to "shop around" for investment once the project had been awarded a credit. As such, some of these projects were not financially viable and did not proceed.

Other State tax credits, including those subject to funding in the State budget or an aggregate limit specified in statute, are either awarded on a first-come, first-served basis or a pro-rated basis. For example, Commerce awards biotechnology investment tax credits on a first-come, first-served basis. Despite a significant excess of demand relative to the supply of credits in many years, Commerce reports that private investment is not significantly leveraged beyond the minimum amount required to claim the credit. In addition, an assessment of the highest economic benefit does not determine which companies receive tax credits. Other credits, including the research and development and the wineries and vineyard tax credits, are awarded on a pro-rated basis. A business does not receive verification of the credit's value until after the qualifying activity occurred, thus diminishing the credit's ability to influence business decisions and incent the targeted activities. The research and development tax credit is oversubscribed – companies qualify for significantly more credits than the amount available, so the amount each company receives is substantially less than that requested. As a result, the credit provides significantly less incentive to conduct research and development, leading to questions over its efficacy in promoting this activity.

State credits without a competitive process, such as the One Maryland tax credit, operate on a floor-based or hurdle approach – a business will receive a credit if it meets minimum program requirements. This is in contrast to the commercial program – projects must meet program requirements and compete against each other. Subject to the program's geographic limitation criterion, higher ranking projects received funding first and lower ranking projects are generally less likely to be funded.

As discussed in the evaluation of the One Maryland tax credit, there was significant variation in the number of jobs created and wages paid by projects that received a tax credit. The most effective projects reported paying $3.27 in wages for every $1.00 in credit received, compared to $0.23 for the least effective. These findings led DLS to recommend that DOC should propose statutory changes to the credit to provide targeted incentives that are commensurate with the expected economic impact of the project and that the General Assembly establish a limit on the maximum amount of credits that can be awarded.

Prohibition on Using Other State/Local Funding

Chapter 541 of 2002 specified that in order to qualify for the credit, an expenditure could not be funded, financed, or otherwise reimbursed by any:

- State or local grants;
- grants 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;
- any other State or local tax credit; or
- other financial assistance from the State or a political subdivision of the State other than a loan that must be repaid at an interest rate that is greater than the interest rate on general obligation bonds issued by the State at the most recent bond sale prior to the time the loan is made.

Prior to this change, several commercial projects receiving tax credits also received other types of State and local financial assistance, resulting in additional fiscal commitments beyond that provided by the tax credit. Disqualifying expenditures financed from State and local funds limits State and local financial liabilities from these projects and increases the total benefits relative to the costs as additional government funding is not provided. This change also prevents pyramiding – an applicant could receive a State grant and receive a credit on top of the grant amount.

Other tax credits offered by the State do not prevent businesses from claiming multiple tax credits or receiving other financial assistance. As a result, each program's actual economic benefit is less than reported by the program due to an overlap of economic activity across State programs. This decreases the cost effectiveness of the programs as less economic benefit is delivered relative to the commitment of State resources. In its evaluation of the One Maryland tax credit, DLS found that slightly over 90% of all Baltimore City economic development projects that received a One Maryland tax credit also received additional types of State and local financial assistance, including other tax credits. As such, the actual economic benefits to the State from the program are significantly lower after accounting for the additional State costs incurred by these other programs.

While projects may not receive certain forms of State and local financial assistance for purposes of the credit, projects can receive local property tax abatements through local historic property tax credit programs and under the Enterprise Zone Tax Credit Program. In addition, a project may receive a federal historic tax credit and federal housing grants. This may reduce the amount of private funding leveraged and allow applicants to pyramid federal funds. For example, a project that receives a $2 million federal housing grant will also receive a State tax credit of $400,000 in addition to the grant.

Recapture Provisions and Long-term Benefits

Ideally, tax credit programs should provide both short-term and long-term benefits. The sustainable communities tax credit provides an incentive to rehabilitate residential and commercial buildings, long-term assets that provide benefits beyond the short-term economic impact generated by construction activity during rehabilitation. In addition, Chapter 160 of 2001 provided for the recapture of the credit within four years after the credit was claimed if "disqualifying work" is performed after the credit was granted. Disqualifying work is any work that would have made the rehabilitation ineligible for certification. Chapter 487 of 2010 added a condition for recapture by stipulating a commercial tax credit could be recaptured if the certified rehabilitation was complete and had been disposed of in any of the succeeding four years.

The recapture provision and potential long-term benefits are in contrast to other State tax credit programs. For example, *VEEP* received $22.7 million in film production activity tax credits between fiscal 2012 and 2015, but production has subsequently moved to California. The production's economic benefit was temporary, despite the significant commitment of State resources. The film production activity tax credit lacks recapture provisions that would have allowed the State to recoup a portion of the significant financial assistance provided to the production.

Reporting Requirements and Credit Expiration

Tax credit reporting requirements, and the capability of State agencies to provide information, vary across programs. Certain tax credit programs require agencies to publish specified information about the credit on an annual basis. These reporting requirements are often not consistent, and other tax credit programs lack any reporting requirements. For example, DLS determined in previous tax credit evaluations that insufficient information was being reported about the enterprise zone and One Maryland tax credits, thereby hampering efforts to assess the effectiveness of these credits. In order to more accurately assess the effectiveness of the One Maryland credit, DLS recommended statutory changes requiring agencies to report annually to the General Assembly additional specified information. DLS also recommended uniform enterprise zone tax credit data collection procedures.

As part of the effort to quantify the State liabilities that occurred in the early years of the program, Chapter 160 of 2001 required MHT to annually report specified information about commercial rehabilitation projects. Chapter 541 of 2002 bolstered these reporting requirements by requiring additional project-specific information and increasing the frequency of reporting (quarterly). These reporting requirements have enhanced (1) the capability to respond to information requests from the General Assembly and analyze the program's effectiveness; (2) program transparency and administration; and (3) interagency cooperation between MHT, DLS, and the Comptroller's Office.

A common challenge in tax credit administration is the difficulty in coordinating information between the agency that awards tax credits and the Comptroller's Office, which administers tax credit claims. These information gaps can hinder an accurate assessment of tax credit liabilities, tax compliance, and program evaluation.

The information that MHT must report on commercial rehabilitation projects is generally both more frequent and detailed as compared to other tax credit programs. This information also helped clarify the treatment of expired tax credits. Chapter 76 of 2004 specified that tax credits expire and may not be claimed if a commercial rehabilitation is not completed by specified deadlines. Chapter 76 also required MHT to notify the Comptroller's Office of these expired credits. As a result of communication between DLS and MHT, subsequent legislation clarified the expiration of initial tax credits awarded under the budgeted tax credit program as well as establishing the process for expiring credits for a project that had started the application process but had not received final certification during the prior tax credit program. Most, if not all, of these projects would not have been completed. However, this process helped clarify State liabilities by removing these older projects that represented a potential liability to the State and provided the necessary information to the Comptroller's Office to prevent expired credits from being incorrectly claimed. As a result of this legislation, MHT terminated a total of $13.2 million in credits from 40 projects that had received Part 2 approval under the unbudgeted commercial program but had not been completed. It also clarified the process for terminating the credits for an additional 40 projects that were not completed within program requirements under the budgeted tax credit program.

This reporting, coordination of information, and established process for the expiration of tax credits is in contrast to other State tax credit programs. For example, DLS estimated that $75 million in One Maryland tax credits would expire within the next several years. There is no established process providing for the expiration of these credits, and the Comptroller's Office advises it does not have sufficient information to validate whether a business is claiming an unexpired credit.

Chapter 7. Impacts of Commercial Credit Program Reforms

The previous chapter discussed how legislative reforms restructured the commercial tax credit program, including a requirement that the Maryland Historical Trust (MHT) award credits on a competitive basis. This requirement increases the likelihood that the program achieves key objectives identified by the General Assembly vis-à-vis a traditional uncapped or a first-come, first-served tax credit program. The legislative reforms also contained two mechanisms designed to promote the program's geographic diversity. This chapter will discuss the efficacy of these reforms in achieving this goal and how these mechanisms impacted program activity and resulted in a trade-off relative to other key program goals and objectives.

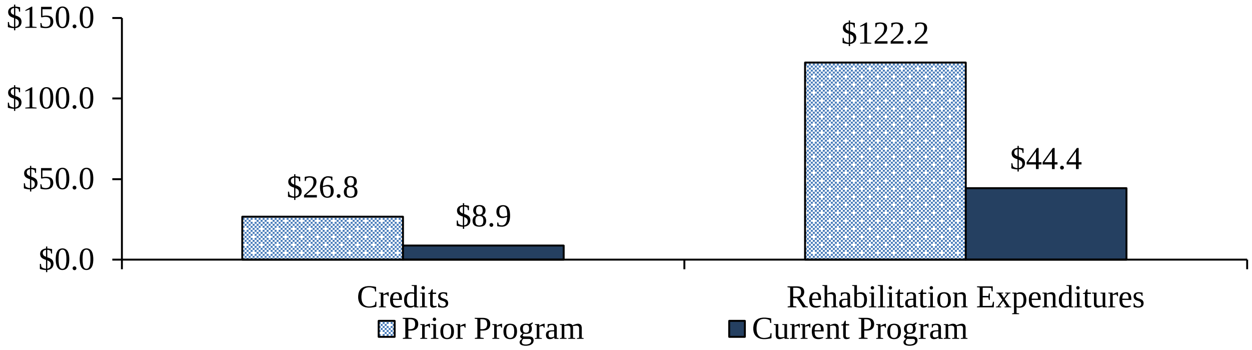
Impacts of Program Reforms

Funding Reductions Have Decreased Commercial Rehabilitation Activity and Projects

Rehabilitation activity associated with the commercial program decreased commensurate with the reduction in funding provided to the budgeted program relative to the amount previously claimed under the unbudgeted program. The number of annual projects certified for credits decreased from about 45 to 14, with reported rehabilitation expenditures decreasing by about two-thirds to $44.4 million annually. This may overstate the reduction, as MHT advises that projects earning the maximum $3.0 million credit may have expenditures above the amount that qualifies the project for the maximum credit. In addition, this only captures activity under the State credit and does not capture total rehabilitation activity, including projects that only claim the federal historic tax credit. **Exhibit 7.1** illustrates the estimated reduction in credits and associated rehabilitation activity since the establishment of the budgeted tax credit program.

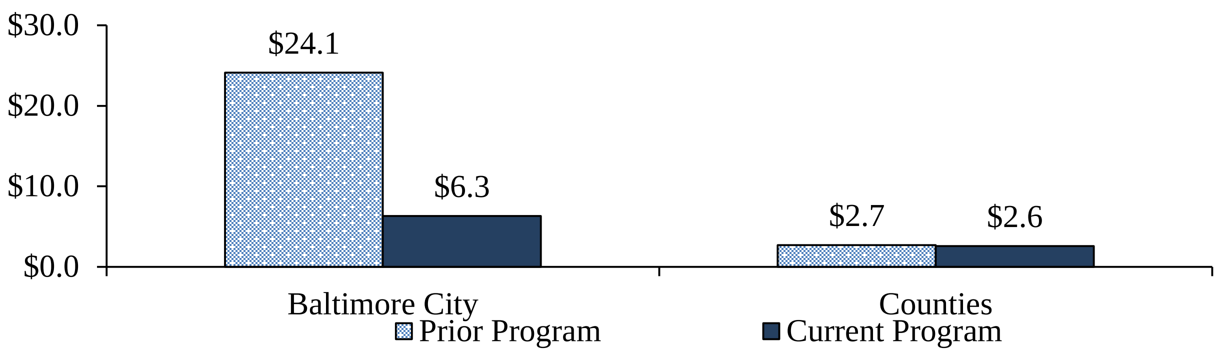
The average annual funding provided to the current program, $8.9 million, is significantly less than the annual average of $26.8 million earned in the prior program. The interaction of program funding and geographic limitations has resulted in a slight decrease in funding to county projects in contrast to a significant reduction in funding for Baltimore City. As shown in **Exhibit 7.2**, annual funding to Baltimore City projects has decreased by $17.8 million, a reduction of 74%.

Exhibit 7.1
Comparison of Average Annual Commercial Credits and Rehabilitation Activity
($ in Millions)



Source: Maryland Department of Planning; Department of Legislative Services

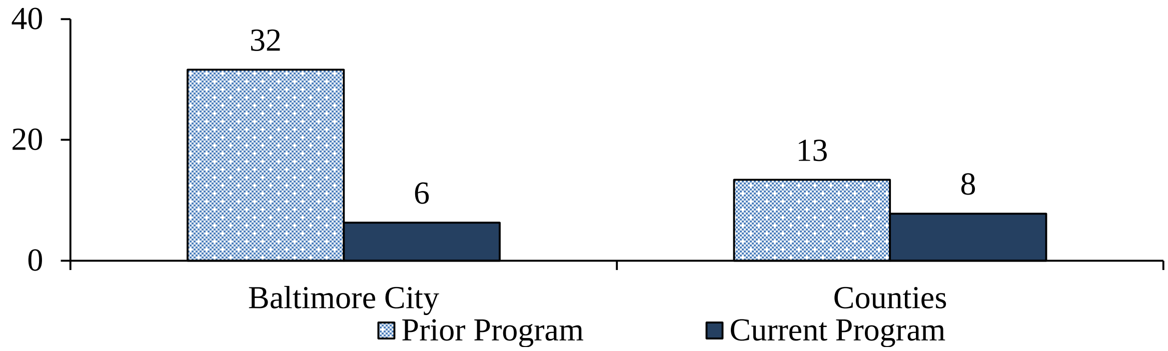
Exhibit 7.2
Annual Average Commercial Credits for Baltimore City and Counties
Fiscal 1997-2015
($ in Millions)



Source: Maryland Department of Planning; Department of Legislative Services

The frequency of projects receiving credits decreased in both Baltimore City and in the counties; however, the reduction was far greater in Baltimore City. As shown in **Exhibit 7.3**, the average number of county projects in each year decreased by about 38%, compared with a reduction of 81% in Baltimore City.

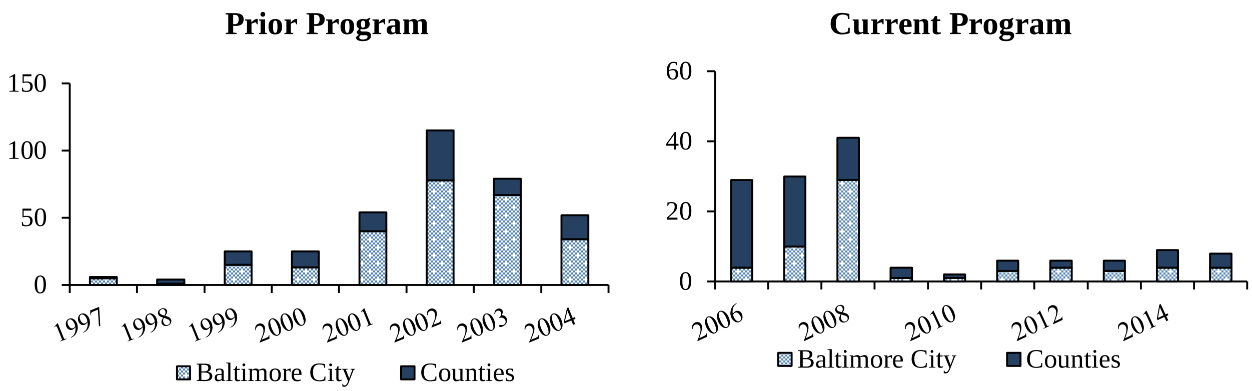
Exhibit 7.3
Annual Average Commercial Credit Projects
Fiscal 1997-2015



Source: Maryland Department of Planning; Department of Legislative Services

The share of projects located in Baltimore City decreased from 70% to 45% as 78 out of the 141 projects awarded credits under the current program were located outside of Baltimore City. **Exhibit 7.4** compares the geographic distribution of projects in each year under the prior and current program.

Exhibit 7.4
Commercial Projects in Baltimore City and Counties
Fiscal 1997-2015

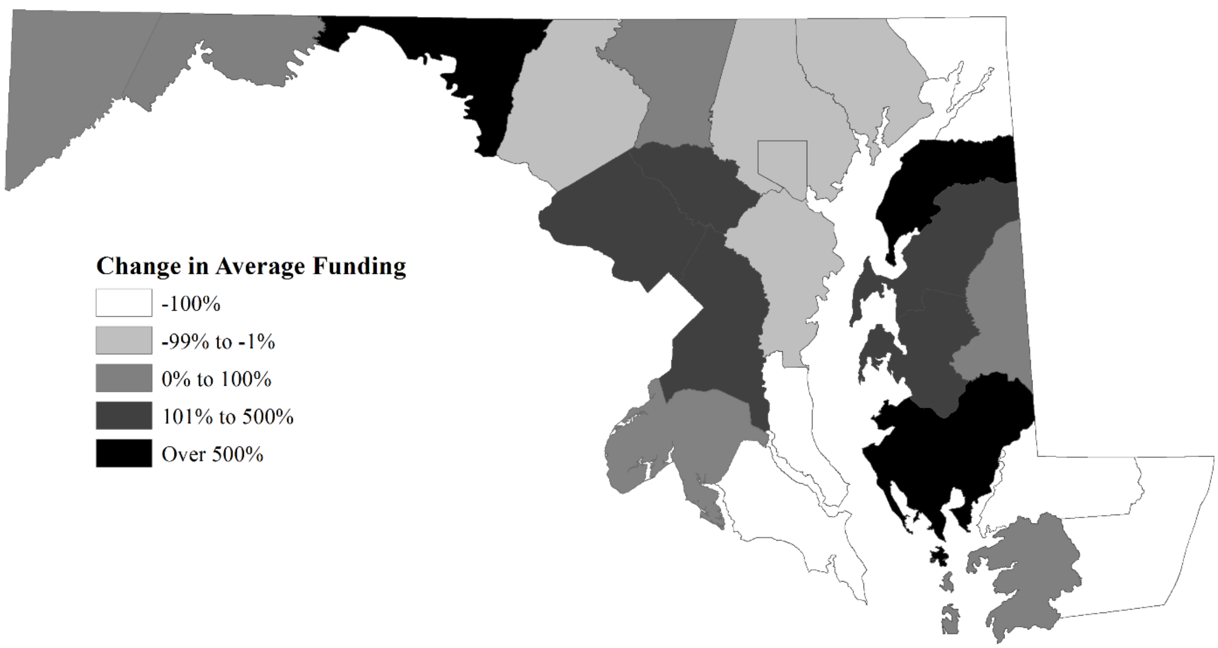


Note: No projects earned credits in 2005 as the program transitioned to a budgeted tax credit program. Prior program projects reflect the year in which the project applied for Part 2 certification.

Source: Maryland Department of Planning; Department of Legislative Services

Almost half of all counties had an increase in average annual funding under the current program, as shown in **Exhibit 7.5**. Average annual funding declined in 10 counties, and no projects in Charles and Garrett counties received credits under either program. Projects in Calvert, Cecil, St. Mary's, Wicomico, and Worcester counties received funding under the prior program but to date no projects have received any credits under the current program. There were no credit projects in Somerset County under the prior program, but projects in that county have subsequently received a total of $189,640 in credits. Projects in Dorchester County had the largest percentage increase in average annual credits, increasing from $8,455 to $139,032. **Appendix 2** shows the number of projects and credits in each county and Baltimore City.

Exhibit 7.5
Average Annual Change in Commercial Credits
Current Versus Prior Program



Note: Average annual change in commercial credits is the percentage change in the average annual amount of credits earned in each county during the current program compared to the prior program.

Source: Maryland Department of Planning; Department of Legislative Services

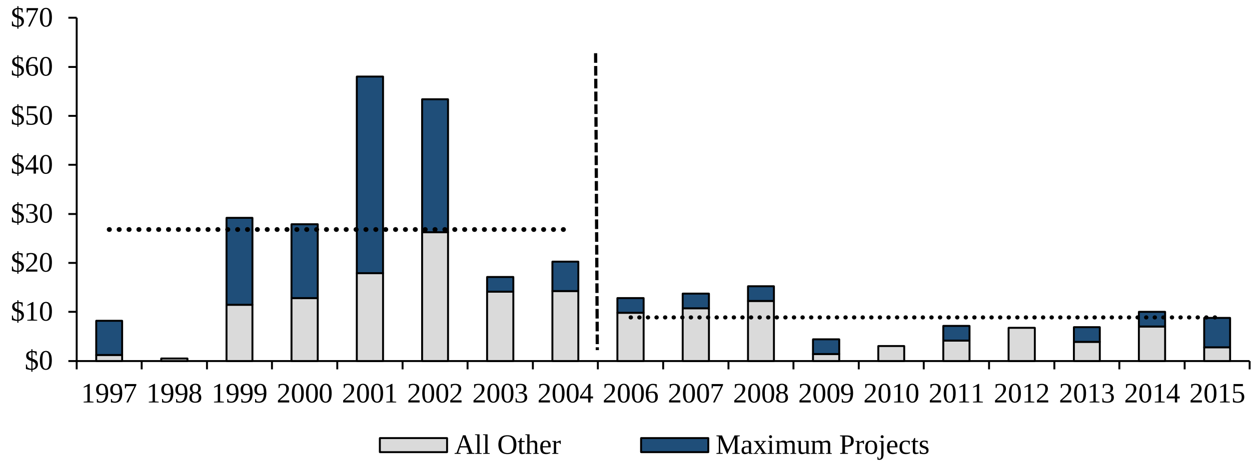
The total number of projects to date under the current program is 141, significantly less than the 360 projects that occurred under the prior program. The number of projects in seven counties (Caroline, Carroll, Dorchester, Kent, Prince George's, Somerset, and Talbot counties) increased despite this reduction. The number of projects decreased in Allegany, Howard, Montgomery, and Queen Anne's counties even though project credit amounts increased in those counties, representing a shift towards larger projects.

Commercial Credit Limits Have Decreased the Percentage of Funding for the Largest Projects

Projects applying for Part 2 certification in the first two years of the program (1997 and 1998) earned a total of $8.7 million in credits. Rehabilitation activity increased significantly in the next few years – 219 completed projects applied for Part 2 certification in 1999 through 2002, earning a total of $168.4 million in credits. Of these tax credits, a little over 60% or $103.9 million resulted from just 17 Baltimore City projects that earned an average credit of $6.1 million. The largest two projects earned credits of $17.7 million and $16.3 million.

Program reforms reduced the fiscal impact of these large-scale projects by reducing the percentage value of the credit and more significantly capping the maximum credit award at $3 million. Projects earning a credit of at least $3 million earned 54% of all credits in the unbudgeted program. Through fiscal 2015, MHT has awarded 30% of all credits under the budgeted program to projects earning the maximum $3 million credit. **Exhibit 7.6** compares the fiscal impact of the unbudgeted and budgeted tax credit programs and the fiscal impact of projects earning a credit of at least $3 million. Under the budgeted program, $2 out of $3 have been awarded to projects that did not earn the maximum $3 million credit, compared to less than $1 in $2 under the unbudgeted program. In addition, the average credit percentage for all projects decreased from 23.5% to 20.7%. The decrease is likely greater as projects earning the maximum $3 million credit may have additional rehabilitation expenditures beyond the amount reported by MHT.

Exhibit 7.6
Annual Commercial Credits Claimed
By Amount of Credit & Program
($ in Millions)



Note: Years 1997 to 2004 reflect the unbudgeted tax credit program and the calendar year in which the project applied for Part 2 certification. Years 2006 through 2015 reflect the fiscal year in which MHT awarded a project a tax credit under the budgeted program. No projects earned credits in 2005 as the program transitioned to a budgeted tax credit program.

Source: Maryland Department of Planning; Department of Legislative Services

The Typical Commercial Project Size and Credit Amount Has Increased Despite Credit Limitations

Despite the reduced fiscal impact of the largest commercial rehabilitations, projects have become, on average, larger since the program's shift to a competitive budgeted process. The median project has more than tripled since this change, from $315,900 to $1 million. The average number of all projects has decreased but has not been uniform, as smaller projects have decreased at a greater rate. The number of projects earning a credit of less than $25,000 decreased from 10.6 annually under the prior program to 1.5 under the budgeted program and now comprise 10.6% of all projects (compared to a little less than one-quarter previously). A total of 44% of all projects under the prior program received a credit of less than $50,000; this has now decreased to a little less than one-quarter.

Conversely, larger-scale projects now comprise a greater share of all projects and percentage of total credits allocated. The percentage of all projects earning a credit of at least $250,000 but less than the maximum $3 million doubled to 40% under the budgeted program – the increase has been greatest for projects earning a credit of between $500,000 and $1 million. Given the increase in project size, larger-scale projects continue to dominate the amount of credits allocated – $65.1 million, or about three-quarters of the total under the budgeted program, have been earned by projects claiming a credit of at least $1 million.

Exhibit 7.7 compares the number of projects and credits earned by the amount of credit under the unbudgeted program and budgeted program.

Exhibit 7.7
Projects and Credits Earned by Credit Amount
Prior Program and Current Budgeted Program
($ in Millions)

	Prior Program		Budgeted Program	
Credit Amount	**Number**	**Credits**	**Number**	**Credits**
$0-$25,000	85	$1.3	15	$0.2
$25,000-$50,000	73	2.5	19	0.7
$50,000-$250,000	104	11.5	43	5.4
$250,000-$500,000	25	9.4	16	5.5
$500,000-$1 million	20	13.9	17	11.9
$1 million-$3 million	32	59.9	22	38.1
$3 million or more	21	115.9	9	27.0
Total	**360**	**$214.5**	**141**	**$88.9**

Source: Maryland Department of Planning; Department of Legislative Services

Using National Register Properties to Measure Geographic Diversity for Commercial Projects Does Not Accurately Measure Representation

In addition to specifying that no more than 50% of the total initial credit certificates issued in a fiscal year could be allocated for projects located in a single county or Baltimore City, Chapter 76 of 2004 also required MHT to award credits in a manner that reflects the geographic diversity of the State. Chapters 566 and 567 of 2007 amended this provision by requiring the competitive process for initial credit certificates to favor projects that are located in jurisdictions that have been historically underrepresented in the awarding of commercial rehabilitation tax credits. This requires MHT to determine if a jurisdiction is historically underrepresented based on the number of properties listed in the National Register of Historic Places.

This determination is made by calculating the percentage of total commercial credits that have been awarded in each county divided by the percentage of total historic properties listed in the National Register in each county. MHT scores projects based on nine criteria, with a maximum score of 145 points. Statewide geographic distribution is currently given a maximum of 15 points, representing slightly more than 10% of the overall score. The equation used by MHT in scoring commercial projects for statewide geographic distribution is:

$$\frac{\text{Total Commercial Credits of County}}{\text{Total Commercial Credits in Maryland}} \div \frac{\text{National Register Properties in County}}{\text{National Register Properties in Maryland}} = \text{Score of Geographic Distribution}$$

This equation does not accurately measure the inventory of eligible certified historic structures in each local jurisdiction for several reasons, so it may not accurately assess whether a local jurisdiction is historically underrepresented.

Not every structure listed within the National Register of Historic Places is eligible for the commercial credit as it includes government-owned structures and properties. Conversely, the National Register does not include other eligible properties. A certified historic structure is a structure located in the State that is:

- listed in the National Register of Historic Places;
- designated as a historic property under local law and determined by MHT to be eligible for listing on the National Register of Historic Places;
- located in a historic district listed on the National Register of Historic Places or in a local historic district that MHT determines is eligible for listing on the National Register of Historic Places and is certified by MHT as contributing to the significance of the district; or
- located in a certified heritage area and certified by the Maryland Heritage Areas Authority as contributing to the significance of the certified heritage area.

The measure also does not consider the number of vacant properties or if the historic structures are well maintained. Commercial rehabilitation expenditures must exceed the greater of the adjusted basis of the structure or $25,000. This measure is a crucial component in the program's effectiveness – it results in credits being awarded to projects that rehabilitate at-risk properties that typically have a lower adjusted basis. It also limits the amount of credits that are provided to areas that may have many historic properties but where properties are well maintained and have higher real estate values. Providing credits to areas in which the properties are well maintained in the absence of the credit reduces the effectiveness of the credit.

MHT reports that most commercial properties that qualify for the credit are vacant prior to the rehabilitation as a result of the substantial rehabilitation requirement. Thus, a county with few vacant or at-risk commercial properties may not have a significant number of rehabilitation projects despite having a large stock of eligible historic properties.

Lastly, the National Register does not distinguish between residential and commercial properties. A more accurate measure would compare the share of total commercial credits awarded in each local jurisdiction to the jurisdiction's share of the total eligible commercial properties.

While the Overall Share of Commercial Credits Awarded to Projects Outside of Baltimore City Has Increased Over the Last 10 Years, Projects in Baltimore City Still Receive a Large Majority of Credits

The share of credits earned by projects located outside of Baltimore City has increased from 10% under the 8 years of the prior program to 29% of the credits awarded in the first 10 years of the current program, as shown by **Exhibit 7.8**. County projects have earned a total of $25.8 million in credits awarded by MHT in the current program. Baltimore City projects, however, continue to receive the majority of all credits, earning $63.1 million of the $88.9 million in total credits, over double the amount of credits earned by projects in other counties. Under the prior program, however, Baltimore City projects earned nine times the amount earned by county projects.

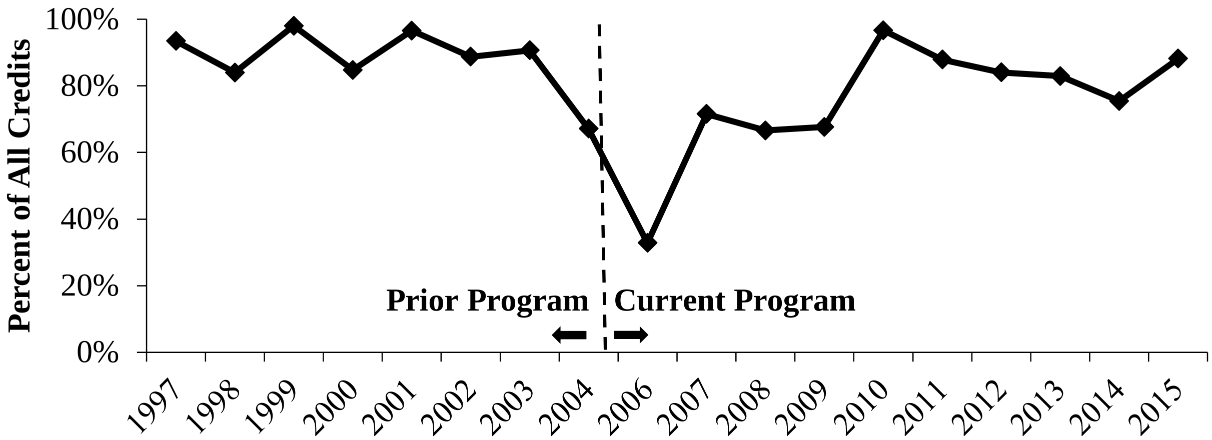
Exhibit 7.8
Total Credits Claimed by Jurisdiction
Current and Prior Commercial Program

	Total Credits ($ in Millions)			Percent of Total	
Program	**Baltimore City**	**Counties**	**Total**	**Baltimore City**	**Counties**
Prior	$192.9	$21.7	$214.5	90%	10%
Current	63.1	25.8	88.9	71%	29%
Total	**$256.0**	**$47.4**	**$303.4**	84%	16%

Source: Maryland Department of Planning; Department of Legislative Services

Exhibit 7.9 illustrates the change over time in the percentage of commercial credits awarded to Baltimore City under the prior program and current program. The 50% geographic limitation first applied to projects beginning in fiscal 2006, resulting in a significant decrease in the percentage of credits awarded to Baltimore City projects. This percentage was subsequently increased and the limit could be exceeded under certain circumstances. MHT did not award $10 million in credits in fiscal 2007 due to the geographic limitation – this amount was carried over into fiscal 2008 and could be allocated without regard to the geographic limitation. As a result, Baltimore City projects have received, in certain years, credits in excess of the statutory limit. Greater utilization of the program in counties would have reduced the amount of unallocated funds and lowered the percentage of credits awarded to Baltimore City projects. In fiscal 2010 the percentage of Baltimore City credits peaked at 96.7% of all credits. In fiscal 2015, MHT awarded credits to eight projects, four of which were located in Baltimore City. These projects were awarded $7.7 million or 88% of the total credits awarded.

Exhibit 7.9
Percentage of Commercial Credits Awarded to Baltimore City
Fiscal 1997-2015



Note: Years 1997 to 2004 reflect the unbudgeted tax credit program and the calendar year in which the project applied for Part 2 certification. Years 2006 through 2015 reflect the fiscal year in which MHT awarded a project a tax credit under the budgeted program. No projects earned credits in 2005 as the program transitioned to a budgeted tax credit program.

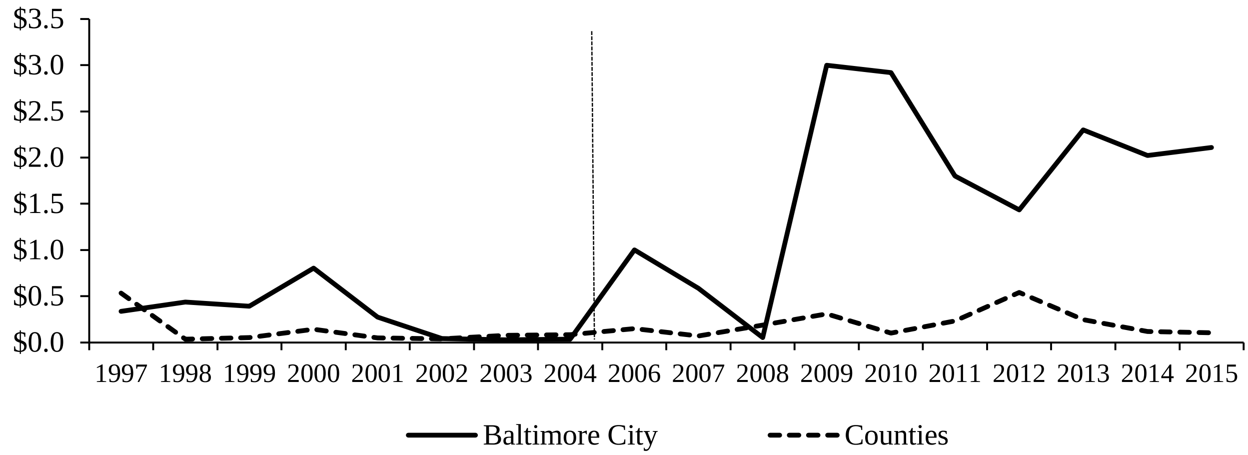
Source: Maryland Department of Planning; Department of Legislative Services

Commercial Credit Projects Have Become Larger in Baltimore City Relative to Projects in Other Counties

While fiscal reforms reduced the impact of large-scale projects, the typical project over time has become larger with the typical Baltimore City project increasing by a greater magnitude. Under the prior program, the median Baltimore City credit was $77,100, about one-half larger than the median county credit of $51,800. The median credit in Baltimore City has increased by about five-fold to $400,000 and is now 2.75 times larger than the $145,000 median county credit. This disparity reflects the lack of large-scale projects outside of Baltimore City – eight out of the nine projects earning the maximum $3.0 million credit under the budgeted program were located in Baltimore City with the remaining one project located in Montgomery County. Of the $142.9 million in credits awarded to all projects with a credit of $3 million or more, 96% of these credits were awarded to Baltimore City projects. The increase in the scale of Baltimore City projects also reflect the impact of a reduction in funding for city projects, which disproportionately resulted in greater reductions in smaller-scale projects.

The county limitation can also impact the scale of projects by diverting funding from large-scale Baltimore City projects to smaller-scale county projects. In the absence of a geographic limitation, the competitive scoring process would have resulted in MHT awarding a credit to two additional Baltimore City projects in fiscal 2014 and 2015. However, the limitation resulted in MHT instead awarding credits to four smaller-scale county projects. The geographic limitation also resulted in awarding projects to smaller-scale Dorchester and Anne Arundel county projects in fiscal 2012 and 2013. **Exhibit 7.10** shows the change over time in the median credit in Baltimore City and counties.

Exhibit 7.10
Median Commercial Credits in Baltimore City and Counties
Fiscal 1997-2015
($ in Millions)



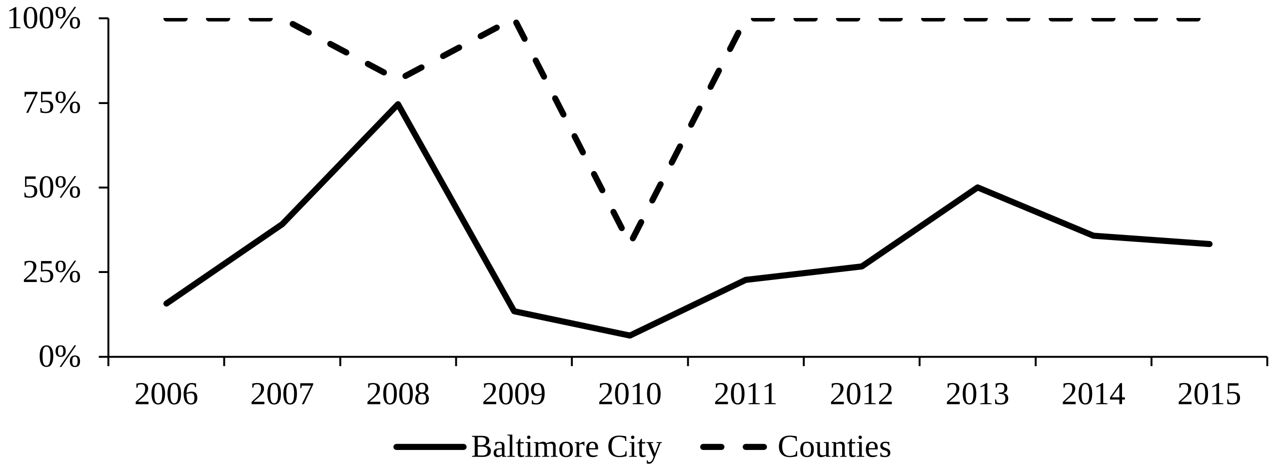
Note: No projects earned credits in 2005 as the program transitioned to a budgeted tax credit program.

Source: Maryland Department of Planning; Department of Legislative Services

Commercial Credit Project Approval Rates Are Significantly Lower in Baltimore City

As shown in **Exhibit 7.11** and **Exhibit 7.12**, Baltimore City's project approval rate of 36.0% is much lower than the approval rate of 91.2% for county projects. In 8 of the last 10 years, every eligible project outside of Baltimore City was approved. A similar number of county and Baltimore City projects have been approved; however, only 10 county projects have been denied in contrast to 199 Baltimore City projects. The approval rate of all projects has been just over 50% in the past two years, with a project approval rate in Baltimore City of approximately one-third of that of other jurisdictions.

Exhibit 7.11
Commercial Program Approval Rates
Fiscal 2006-2015



Source: Maryland Department of Planning; Department of Legislative Services

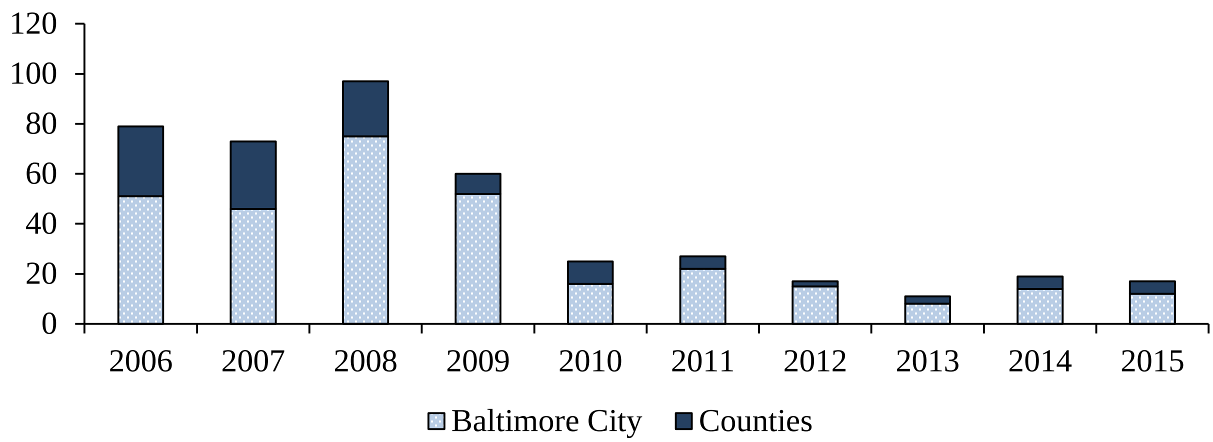
Exhibit 7.12
Commercial Program Approval Rates
Baltimore City and County Applications
Fiscal 2006-2015

	Baltimore City				Counties				Total			
Fiscal Year	**Approved Projects**	**Denied Projects**	**Total Applications**	**Approval Rate**	**Approved Projects**	**Denied Projects**	**Total Applications**	**Approval Rate**	**Approved Projects**	**Denied Projects**	**Total Applications**	**Approval Rate**
2006	8	43	51	15.7%	28	0	28	100.0%	36	43	79	45.6%
2007	18	28	46	39.1%	27	0	27	100.0%	45	28	73	61.6%
2008	56	19	75	74.7%	18	4	22	81.8%	74	23	97	76.3%
2009	7	45	52	13.5%	8	0	8	100.0%	15	45	60	25.0%
2010	1	15	16	6.3%	3	6	9	33.3%	4	21	25	16.0%
2011	5	17	22	22.7%	5	0	5	100.0%	10	17	27	37.0%
2012	4	11	15	26.7%	2	0	2	100.0%	6	11	17	35.3%
2013	4	4	8	50.0%	3	0	3	100.0%	7	4	11	63.6%
2014	5	9	14	35.7%	5	0	5	100.0%	10	9	19	52.6%
2015	4	8	12	33.3%	5	0	5	100.0%	9	8	17	52.9%
Total	**112**	**199**	**311**	**36.0%**	**104**	**10**	**114**	**91.2%**	**216**	**209**	**425**	**50.8%**

Source: Maryland Department of Planning; Department of Legislative Services

The low approval rates for Baltimore City projects may also deter additional applicants. Accordingly, MHT advises that examining the approval rates for projects may not capture the full impact on Baltimore City. Baltimore City applications have decreased from a maximum of 75 in fiscal 2008 to under 15 in recent years, as **Exhibit 7.13** illustrates. County applications have also decreased, albeit not as significantly.

Exhibit 7.13
Commercial Credit Applications
Fiscal 2006-2015



Source: Maryland Department of Planning; Department of Legislative Services

The Impact of Preferential Scoring for Projects in Historically Underrepresented Counties Has Been Limited

Providing preferential scoring to projects located in historically underrepresented counties has had a minimal impact in promoting geographic diversity. Given the geographic limitation and low volume of applications submitted by county projects, nearly every project outside of Baltimore City has been awarded a credit in the 10 years of the current program without regard to the project's score. Fiscal 2008 and 2010 were the only years in which eligible projects outside of Baltimore City were denied. Providing preferential scoring only factors into the award selection process if county projects are susceptible to being denied, which has occurred only in 2 of the 10 fiscal years.

The Geographic Limitation on Credits to a Single Jurisdiction Can Impact Project Timing

About 40 Baltimore City applicants that have been denied a credit due to the county limitation delayed their rehabilitation and typically reapplied in the following year. For instance, Centre Theatre was denied a $3 million tax credit in fiscal 2012, due to the geographic limitation, but was awarded a credit in the next year. Kensett House applied three times, in fiscal 2006, 2009, and 2010, before being granted a commercial credit in fiscal 2013. Projects can be delayed for many reasons as receipt of the tax credit may not be a deciding factor on an applicant's decision but may reflect other economic factors, such as the recent recession.

The Redirection of Funding to Projects in Jurisdictions Outside of Baltimore City Has Resulted in Less Economic Benefits and Historic Preservation

The maximum limitation on the credits that can be awarded to any one local jurisdiction in a fiscal year has redirected project funding from Baltimore City to the counties. Promoting geographic diversity has resulted in a trade-off as the county projects that received these redirected funds are estimated by MHT to have resulted in less economic benefits and historic preservation than the amount that would have occurred if the Baltimore City projects had received funding.

In fiscal 2014, six denied projects in Baltimore City had higher scores than a majority of the approved projects outside of the city. In fiscal 2015, eight denied projects in Baltimore City had higher scores than an approved project in Dorchester County.

Between fiscal 2006 and 2015, the average score of all commercial applications in Baltimore City did not vary greatly from the average score of commercial applications in the counties, as shown in **Exhibit 7.14**. Baltimore City applicants had an average score of 79.4 compared to an average score of 80.2 for county applicants. However, on average, approved projects in Baltimore City scored 8.3 points higher than approved projects in the counties, and denied projects in Baltimore City scored 11 points higher than denied county projects. In fiscal 2007 and 2015, denied Baltimore City applicants had a higher average score than the average score of approved county projects. In fiscal 2009, approved Baltimore City projects had an average score of 121.7, 25.6 points higher than the average score of approved projects in the counties at 96.1.

The disparity in scores between Baltimore City and counties is likely understated as projects located in jurisdictions that have been historically underrepresented may receive up to 15 additional points. Therefore, the difference in scores may not fully represent the difference in the ability of the projects to meet key program goals. For instance, a Howard County project in fiscal 2015 received a score of 84, including 10 points for being located in a historically underrepresented county. A comparable project in Baltimore City relative to economic benefits, historic preservation, and other goals would receive a score of 74.

Based on the competitive scoring process instituted by MHT, removing the geographic limitation would result in additional economic benefits and historic preservation. However, this would likely decrease funding to county projects and reduce the geographic diversity of the program, which has been identified by the General Assembly as an important goal of the program.

Exhibit 7.14
Average Baltimore City and County Project Scores
Commercial Tax Credit Applications
Fiscal 2006-2015

	Baltimore City			Counties			Total			Difference		
Fiscal Year	**Approved Projects**	**Denied Projects**	**All Projects**	**Approved Projects**	**Denied Projects**	**All Projects**	**Approved Projects**	**Denied Projects**	**All Projects**	**Approved Projects**	**Denied Projects**	**All Projects**
2006	79.5	68.9	70.5	69.4	N/A	69.4	71.6	68.9	70.1	10.1	N/A	1.2
2007	76.4	67.3	70.8	64.7	N/A	64.7	69.4	67.3	68.6	11.8	N/A	6.2
2008	76.2	65.8	73.5	83.3	53.0	77.8	77.9	63.6	74.5	-7.2	12.8	-4.3
2009	121.7	91.6	95.6	96.1	N/A	96.1	108.1	91.6	95.7	25.6	N/A	-0.5
2010	109.0	83.9	85.4	119.3	74.0	89.1	116.8	81.0	86.8	-10.3	9.9	-3.7
2011	88.4	63.5	69.2	87.8	N/A	87.8	88.1	63.5	72.6	0.6	N/A	-18.6
2012	92.3	76.9	81.0	84.0	N/A	84.0	89.5	76.9	81.4	8.3	N/A	-3.0
2013	90.0	74.3	82.1	80.7	N/A	80.7	86.0	74.3	81.7	9.3	N/A	1.5
2014	93.2	72.4	79.9	73.6	N/A	73.6	83.4	72.4	78.2	19.6	N/A	6.3
2015	94.3	80.9	85.3	79.2	N/A	79.2	85.9	80.9	83.5	15.1	N/A	6.1
Average	**92.1**	**74.5**	**79.4**	**83.8**	**63.5**	**80.2**	**87.7**	**74.0**	**79.3**	**8.3**	**11.0**	**-0.9**

Note: Difference reflects average score of Baltimore City projects minus average score of county projects.

Source: Maryland Department of Planning; Department of Legislative Services

Residential Credit Caps Have a Limited Fiscal Impact

Given the magnitude of reforms relative to the commercial program, the limitation on the amount of credit that a residential project can receive had a more limited overall fiscal impact. From 1999 to 2008, 91 residential projects received a credit in excess of $50,000. These projects earned a total of a little more than $11.0 million in credits for an average credit of $121,400. Had the limitation been in effect for these projects, the total residential credits earned during this period would have been $6.5 million less, a 17% reduction.

Based on MHT data, it appears that the limitation has applied to 108 projects from 2005 through 2014. These projects earned a total of $13.1 million in credits. If these credits would have claimed the average credit earned by the uncapped projects, the limitation reduced revenue losses by a total of $7.7 million through fiscal 2014. This equals an annual savings of $771,000 or a total reduction in credits of 25%. In recent years, residential activity has decreased and the limitation has reduced total credit claims annually by about $275,000.

The Maryland Historical Trust Has Conducted Outreach Efforts to Promote the Commercial and Small Commercial Credits

Chapter 601 of 2014 requires MHT to develop programs, including web-based tools, in order to (1) increase residential and commercial tax credit participation in jurisdictions that have been historically underrepresented in the award of tax credits and (2) educate eligible small businesses on the availability of tax credits. In addition, the Act required MHT to consult with local planning officials in jurisdictions that had been historically underrepresented prior to developing the program to increase tax credit participation in these jurisdictions.

In response to these legislative requirements, MHT undertook a targeted campaign to promote the availability of the newly enacted small commercial project tax credit. In accordance with Chapter 601, this campaign also targeted jurisdictions of the State that had historically been underrepresented in the submission of applications or receipt of tax credit awards.

Of the 25 outreach efforts conducted by MHT since April 2014, 20 events specifically targeted areas or audiences in historically underrepresented areas of the State. Through MHT's participation in community workshops, MHT worked with local sponsors to aid its outreach to local commercial property owners and encourage their participation in the program. In addition, MHT participated in or led meetings and made presentations to groups, particularly small businesses, regarding the availability and use of the small commercial project tax credit. Examples of this outreach includes MHT presentations to Main Street organizations and developer roundtable groups.

In addition to these outreach efforts, MHT also maintains and regularly updates information resources on its tax credit website. The website allows credit applicants and local officials to easily access newly developed fact sheets for each tax credit program, along with frequently asked questions and instructions on how to apply for credits under the programs.

MHT notes that staff vacancies have hindered recent outreach efforts. MHT indicates that it plans to continue its outreach and promotional efforts through presentations and intergovernmental coordination as well as by developing additional online resources, including case studies, tutorials, and blog entries promoting the program.

Chapter 8. Geographic Concentration of Projects and Community Revitalization

Geographic Concentration of Projects

Commercial Credit is More Geographically Concentrated

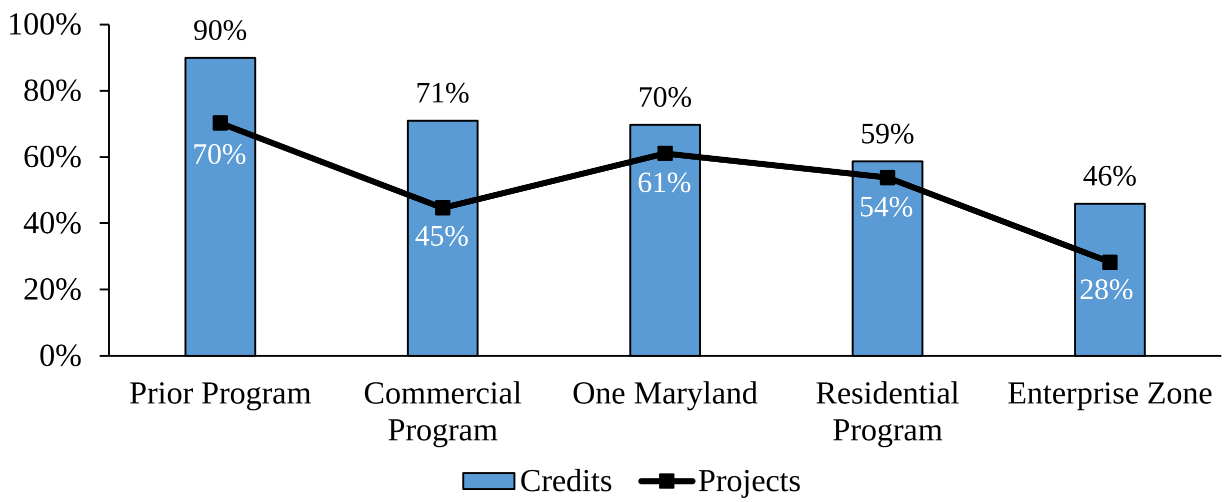
Previous sections of this report discussed the geographic concentration of the historic rehabilitation tax credit program and how legislative reforms have promoted the commercial program's geographic diversity. Despite these returns, approximately 6 in 10 of all residential credits and 7 out of every 10 budgeted commercial tax credits have been awarded to Baltimore City projects. If unbudgeted tax credits are included, Baltimore City projects have been awarded slightly more than $8 out of every $10 of program funding.

Baltimore City comprises about 11% of the State's total population and has about 18% of the State's properties listed in the National Register of Historic Places. Compared to its share of the State's population, most of the additional credits result from a greater share of eligible historic buildings, including the impact of locally designated historic districts, and higher program utilization, including the impact of the commercial program's adjusted basis requirement. The adjusted-basis requirement focuses credit activity to areas in which historic properties have lower property values and are more likely to need rehabilitation. The larger scale of Baltimore City projects explains the remaining amount, as this difference is greater in the commercial program, and explains the additional geographic concentration of commercial credits within Baltimore City. The average commercial credit in Baltimore City is 176% larger than the average commercial credit earned in other local jurisdictions and explains about one-quarter of the commercial credit's concentration within the city. The average residential credit earned by Baltimore City projects is about two-thirds larger but only explains about 5% of the additional concentration of residential credits within the city.

Other Tax Credit Programs Have Similar Levels of Geographic Concentration

Sustainable communities tax credit activity depends on the distribution of eligible properties and program utilization, subject to the commercial program's geographic limitation. While the enterprise zone and One Maryland tax credit programs do not have a similar geographic limitation, a business must be located in a specific area of the State to qualify for those credits. In calendar 2001 through 2014, the Department of Commerce awarded a total of $197.4 million in One Maryland credits to 54 projects. A total of 33 Baltimore City projects earned $137.6 million in credits or 70% of the total amount awarded. Over a similar period, a total of 2,661 Baltimore City projects earned 46% of all enterprise zone credits or a total of $60.3 million. As shown by **Exhibit 8.1**, the percentage of residential and commercial credits earned by Baltimore City projects is similar to the percentage of total credits awarded under the One Maryland program. In contrast to the residential and commercial programs, the geographic concentration of the enterprise zone program, although lower in this period, has increased in recent years – Baltimore City projects comprised 60% of all fiscal 2014 credits. Given the recent project activity within Baltimore City, the geographic concentration of the enterprise zone program will soon likely equal or exceed that of the commercial credit.

Exhibit 8.1
Percentage of Baltimore City Projects and Credits by Program



Note: Prior program includes commercial credits earned during the unbudgeted, uncapped commercial program. Commercial program includes only credits awarded under the budgeted tax credit program.

Source: Department of Commerce; State Department of Assessments and Taxation; Maryland Department of Planning; Department of Legislative Services

Community Revitalization and Program Objectives

The sustainable communities tax credit, with its emphasis on historic preservation, would appear to have little in common with either the One Maryland or enterprise zone programs. The objective of the enterprise zone program is to focus local and State resources on creating economic growth in economically distressed areas and increasing employment of the chronically unemployed in the State, while the One Maryland program encourages capital investment and job creation in economically distressed counties. However, MHT is required by statute to award commercial tax credits in a manner that reflects other objectives besides historic preservation, including that tax credits be awarded to projects that are (1) consistent with and promote current growth and development policies and (2) located in areas targeted by the State for additional revitalization and economic development opportunities due to the focusing of State resources and incentives. Consistency with these growth and development programs and policies is one of the nine criteria used to rank commercial projects (maximum of 30 points out of the total project maximum score of 145). In fiscal 2015, MHT evaluated whether a project is consistent with these goals based on six determinations (maximum 5 points in each determination).

One of these six determinations is whether a commercial project is located within a priority funding area (PFA). Almost all of the commercial projects that applied for funding in fiscal 2015 were located within a PFA. PFAs are existing communities and places where future growth and development are targeted. Growth-related projects include most State programs that encourage infrastructure growth and development such as highways, sewer and water construction, economic development assistance, and State leases or construction of new office facilities. Enterprise zones and One Maryland economic development projects must also be located within a PFA. A significant percentage of credits from the historic rehabilitation tax credit, One Maryland, and enterprise zone programs have been awarded to projects located within Baltimore City, which is a PFA.

An additional objective of the sustainable communities program is to encourage investment in local communities. This goal is also commonly described as community revitalization – the U.S. Department of Interior states that the federal historic preservation tax incentive program is one of the nation's most successful and cost-effective community revitalization programs. Several current and proposed federal community revitalization programs describe the focus of the programs as assisting neighborhoods with the interconnected challenges of high poverty, extremely low incomes, severely distressed housing, inadequate early care and education, little access to capital, high unemployment, persistent crime, and other social ills.

There Is Significant Variation Within Counties That Are Economically Distressed

Several counties located in Western Maryland and the lower Eastern Shore, as well as Baltimore City, have lower demographic and socio-economic indicators as described in the previous paragraph. However, there is considerable variation within these local jurisdictions and significant areas of these jurisdictions may be affluent and have less revitalization needs. Baltimore City educational attainment rates are significantly lower than the State average – 27% of all individuals age 25 years or more have a bachelor's degree or higher, compared to a State average of 37%. Baltimore City also has the highest incidence of poverty, 23.8%, which is slightly above Somerset County (23.4%). These average values mask significant differences in the characteristics of neighborhoods within Baltimore City – a number of affluent areas have high levels of educational attainment as well as a low incidence of poverty and joblessness. Housing values also vary significantly across the city – the median home value exceeds $550,000 in 2 census tracts, compared to a median home value of about $50,000 or less in 7 census tracts. Poverty is widespread – a little less than two-thirds of all Baltimore City census tracts have a poverty rate of at least 20%, designated by the U.S. Census bureau as poverty areas. However, there are 13 census tracts that have a poverty rate of less than 6%, well below the State average of 9.8% during the same period.

In order to assess the effectiveness of the sustainable communities tax credit in encouraging investment in local communities and community revitalization, the next section will examine the location of projects within Baltimore City given the variation in neighborhood characteristics. This analysis will compare the geographic distribution of the programs within the city. This will also examine whether the sustainable communities, One Maryland, and enterprise zone programs complement each other by focusing within the same areas or are supplemental and occur within different areas of the city.

Geographic Distribution of Credits within Baltimore City

Exhibit 8.2 compares, by census tract, the geographic distribution of Baltimore City residential and budgeted commercial tax credits to the distribution of Baltimore City enterprise zone and One Maryland tax credits.

An analysis of this data and the demographic characteristics of the neighborhoods in which projects occur shows that:

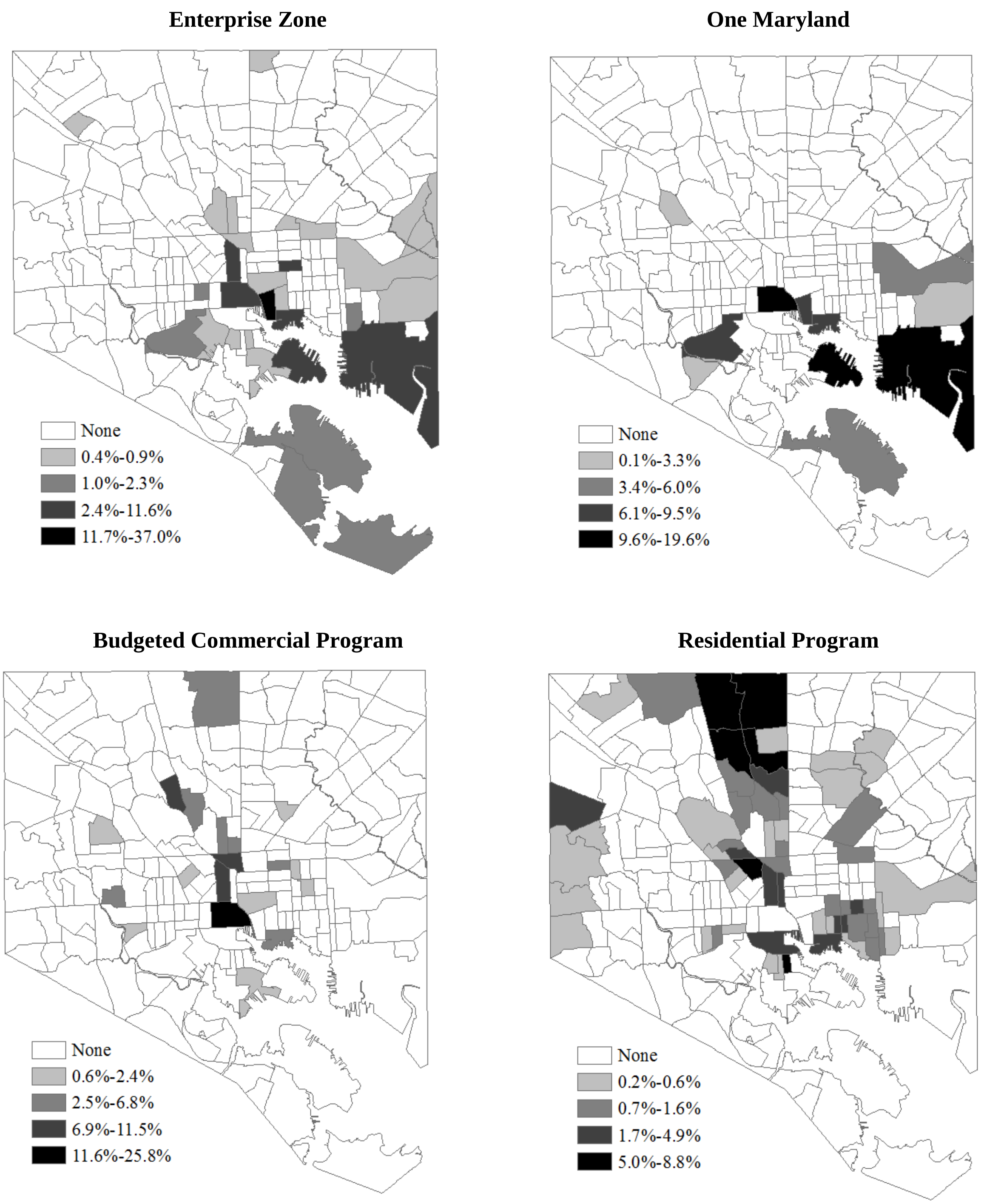
- Residential credit activity is more widely dispersed and compared to the typical Baltimore City neighborhood is utilized mostly in neighborhoods that are significantly less diverse and have significantly higher incomes, home values, rates of employment, and education.

- Commercial projects also occur in neighborhoods that are significantly more educated, have higher home values and higher rates of employment, and are also less diverse. However, some projects do occur within neighborhoods with a higher incidence of poverty and vacant housing units as well as lower household incomes.

- Most residential credit activity occurs in different parts of the city, and both activity and funding are uncorrelated with the other three programs. Commercial projects are much more likely than residential projects to occur in neighborhoods in need of community revitalization.

- Commercial credit activity is moderately correlated with the One Maryland program and only weakly correlated with the enterprise zone program.

Exhibit 8.2
Distribution of Program Credits by Census Tract



Source: Maryland Department of Planning; Department of Commerce; State Department of Assessments and Taxation; Department of Legislative Services

Distribution and Concentration of Each Program

The residential credit is the most widely dispersed program, as 71 of the 200 Baltimore City census tracts had at least one residential project. The residential credit has the least geographic concentration of the four programs, as 40% of all credits have been awarded to projects located within five census tracts. The residential program has the highest utilization in parts of Midtown, Roland Park, Federal Hill, and Guilford. Enterprise zone projects were in a similar number of census tracts (69) as the residential program even though there were about 60% more enterprise zone projects in total (2,661). A little less than 70% of all enterprise zone credits were in the five census tracts located within Harbor East, Locust Point, Midtown, Fells Point, and the Downtown District.

A total of 29 census tracts had at least one project awarded a credit under the budgeted commercial tax credit program. About 60% of all credits were in the 5 census tracts located within Charles Village, Hampden, Midtown, and the Downtown District. The One Maryland credit is a high-value, low-utilization credit. Accordingly, it has the fewest projects in the city, 33 projects or about one-half the number of budgeted commercial tax credit projects, and projects were located in only 11 census tracts. A little less than three-quarters of all One Maryland credit activity is concentrated within the 5 census tracts located within the Downtown District, South Baltimore, Southeastern/Locust Point, Fells Point, and Harbor East.

Appendix 3 lists the top five census tracts and compares the geographic distribution of the programs. **Appendices 4** and **5** illustrate by program the five census tracts with the most credits.

Program Correlation

Commercial and residential projects and funding generally occur in different parts of the city and are not correlated with each other. Commercial program activity and funding is moderately correlated with the One Maryland program and weakly correlated with the enterprise zone program. One Maryland and enterprise zone projects are concentrated in similar areas of the city and are highly correlated, and project funding between these two programs is moderately correlated. Since most of the residential credit activity occurs in primarily residentially zoned areas, residential credit activity and funding is not correlated with any of the other three programs.

Demographic Characteristics

Exhibit 8.3 shows in more detail socio-economic, housing, and employment indicators for the average Baltimore City census tract compared to the average value of these indicators for each program.

Exhibit 8.3

Average Census Tract Characteristics by Program

	Sustainable Communities				
Demographic Indicators	**Residential**	**Commercial**	**Enterprise Zone**	**One Maryland**	**City Average**
Socio-economic					
% Non-White	37.9%	60.0%	53.0%	38.0%	72.1%
% with at least Bachelor's	62.8%	40.9%	34.4%	48.3%	25.6%
Poverty Rate	16.5%	28.4%	22.5%	19.8%	24.6%
Household Income	$80,100	$35,500	$44,800	$48,400	$38,800
Housing					
Home Value	$364,500	$200,400	$193,500	$217,500	$163,300
% Vacant Housing Units	11.1%	22.1%	15.9%	16.1%	19.5%
Employment					
Employment/Population Ratio	70.0%	64.2%	67.4%	71.9%	62.6%
Unemployment Rate	7.0%	12.7%	10.6%	7.7%	14.7%

Note: Home value is for owner-occupied units.

Source: U.S. Census Bureau; Department of Legislative Services

Compared to the typical Baltimore City neighborhood, commercial projects are located in neighborhoods that have mixed socio-economic (higher poverty rates and lower incomes but significantly more educated) and housing indicators (higher incidence of vacancies but higher home values). When comparing the four programs, commercial projects are located in areas with the lowest socio-economic, housing, and employment indicators, even though the objectives of the One Maryland and enterprise zone programs explicitly promote development within economically distressed areas. The average enterprise zone neighborhood has the next lowest indicators, followed by the One Maryland credit and residential program.

Commercial credits are also most likely of the four programs to occur in neighborhoods in the most distress, as measured by the census tracts within the lowest quartile of socio-economic, housing, and employment indicators. One-third of all credits occur in the census tracts with the highest poverty rate (average poverty rate of 41.5%) compared to 16.7% of all residential credits. Both of these amounts are higher than for both the One Maryland and enterprise zone programs, even though the enterprise zone meets the qualifications of that program based on an acute poverty rate. One-fifth of all commercial credits occur in the lowest (25% quartile) census tracts by income and vacant housing units, while 2% of all residential credits occur in census tracts with the lowest quartile housing value. By comparison, 13% of all credits occur in census tracts with a median home value in excess of $500,000.

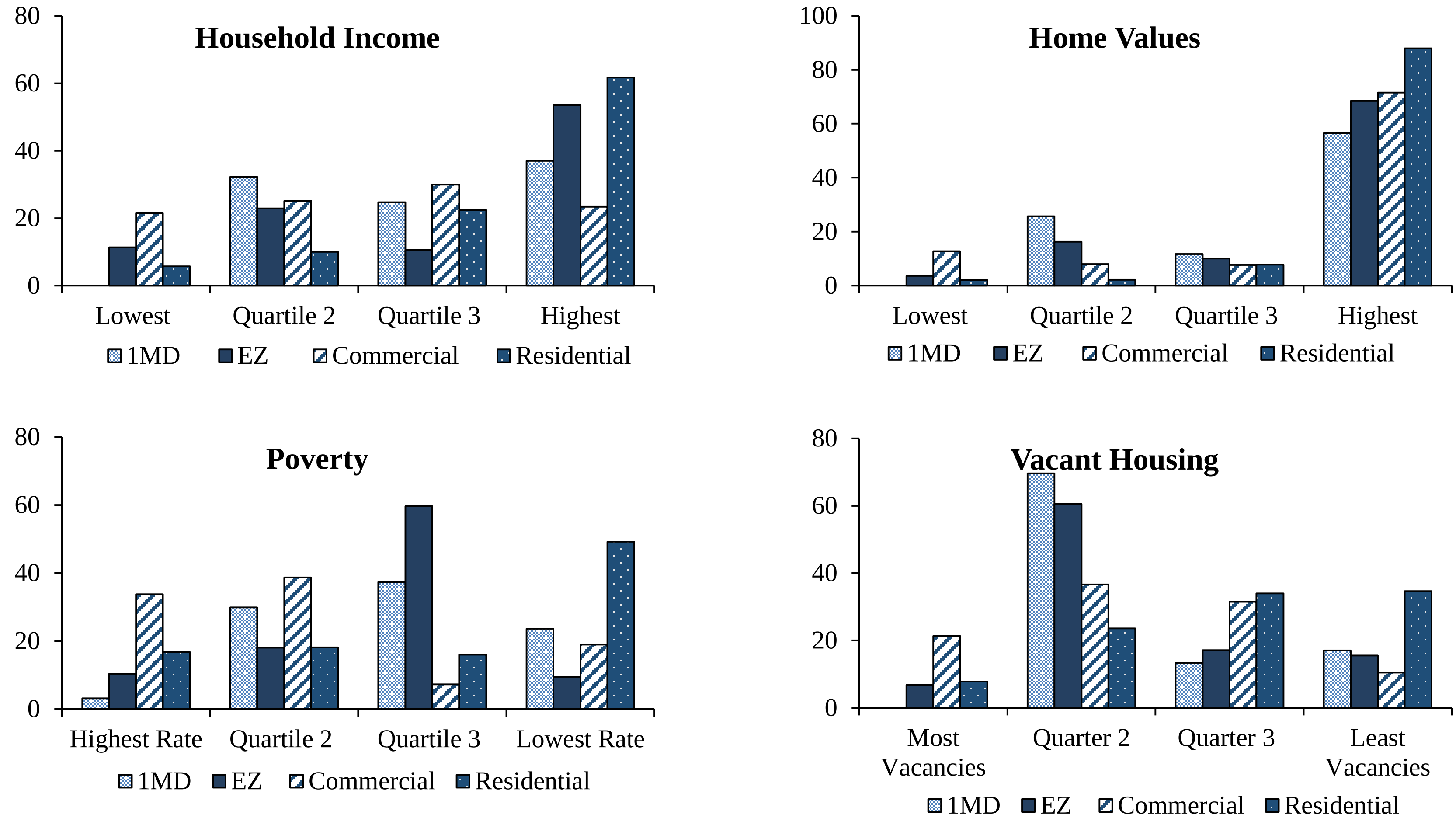
Enterprise zone and residential credits have a similar percentage of all credits located within the most distressed areas, and One Maryland credits have the lowest percentage of all credits in the most distressed areas. **Exhibit 8.4** shows the distribution of program credits by the lowest to highest quartile of home values, vacant housing, income, and poverty. **Exhibit 8.5** compares the total amount of residential and commercial credits awarded to projects within the lowest quartile census tracts.

Analyzing by different specifications (by lowest half, for example), generally leads to similar conclusions. Commercial credits are also most likely to occur in census tracts in the lower half of socio-economic, housing, and employment indicators; however, residential credits are the least likely to occur in these census tracts. Further, a little more than three-quarters of all commercial tax credits have been awarded to projects located within a poverty area, which are those areas that have a poverty rate of at least 20%. This percentage is greater than the other three programs including the enterprise zone (70% of all credits) and One Maryland (48% of all credits). About 40% of all residential credits have been awarded to projects located within poverty areas.

Exhibit 8.4

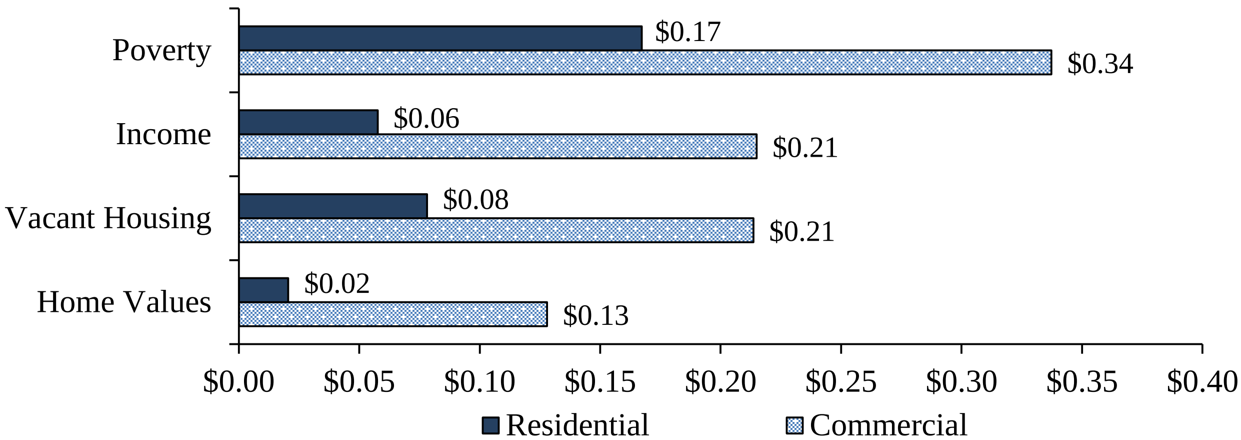
Program Credit Distribution by Census Tract Quartile

Household Income, Home Values, Poverty, and Vacant Housing



Source: Department of Commerce; State Department of Assessments and Taxation; Maryland Department of Planning; Department of Legislative Services

Exhibit 8.5
Residential and Commercial Credits in Lowest Quartile Census Tracts
Amount per Dollar



Source: Maryland Department of Planning; U.S. Census Bureau; Department of Legislative Services

Chapter 9. State and Local Costs

State Costs

The sustainable communities tax credit program is 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 continues to comprise the majority of the program's fiscal costs, about 86%, with the remaining 14% from the residential program.

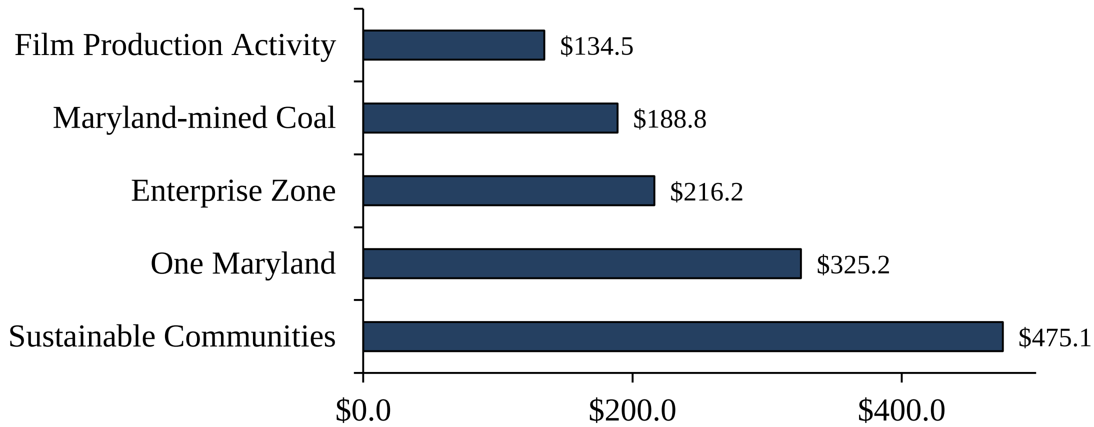
As previously discussed, legislative reforms curtailed the program's fiscal impact beginning in 2002. These reforms also shifted the commercial tax credit to a budgeted tax credit. Through fiscal 2016, the Maryland Historical Trust (MHT) will have awarded $98.1 million in commercial credits under the current budgeted program and $214.5 million under the prior uncapped, unbudgeted program for a total of $312.6 million in commercial credits. In addition, MHT has awarded a total of $49.1 million in residential credits through fiscal 2014, the last year of available data. MHT is also authorized to award a total of $4.0 million in small commercial credits through June 30, 2017.

Taking into account inflation, the fiscal impact of the commercial program peaked in the early 2000s, with commercial projects applying for Part 2 certification in calendar 2001, earning a total of $78.7 million in credits. Since the commercial program's shift to a budgeted program in fiscal 2006, annual fiscal costs have decreased to an estimated $8.9 million. Although residential rehabilitation activity has also subsequently decreased from its peak of $7.9 million in fiscal 2003, residential activity did not decrease significantly until fiscal 2007, several years after the curtailment of the commercial program. While the majority of the program reforms impacted the commercial program, residential activity over time is more reflective of economic trends including the recent recession and housing crisis. In fiscal 2011, residential credits decreased to $1.4 million annually, but that amount has since stabilized at about $1.6 million annually or 80% less than the fiscal 2003 peak.

Sustainable Communities is the Largest State Business Income Tax Credit in Cumulative Terms

Based on available data, the amount of credits awarded by the program through 2017 is greater than the costs associated with any other State business tax credit program. The second-largest program, the One Maryland tax credit, will award an estimated $325.2 million in total credits over this period. The difference between the amounts of credits awarded understates the larger impact of the sustainable communities tax credit for several reasons. The entire amount of the sustainable communities tax credit can typically be claimed upon project completion and the tax credit is fully refundable. The One Maryland credit is typically only partially refundable businesses claim the credit over a number of years, and the Comptroller's Office estimates that a significant portion of tax credits are not claimed by businesses. The enterprise zone, Maryland-mined coal, and film production activity credit programs have the next largest State fiscal impact over this period. **Exhibit 9.1** compares the estimated amount of credits associated with each of these programs in fiscal 1998 through 2017.

Exhibit 9.1
Costs of Various State Tax Credit Programs
Fiscal 1998-2017
($ in Millions)



Note: Amounts are adjusted for inflation and expressed in constant 2015 dollars.

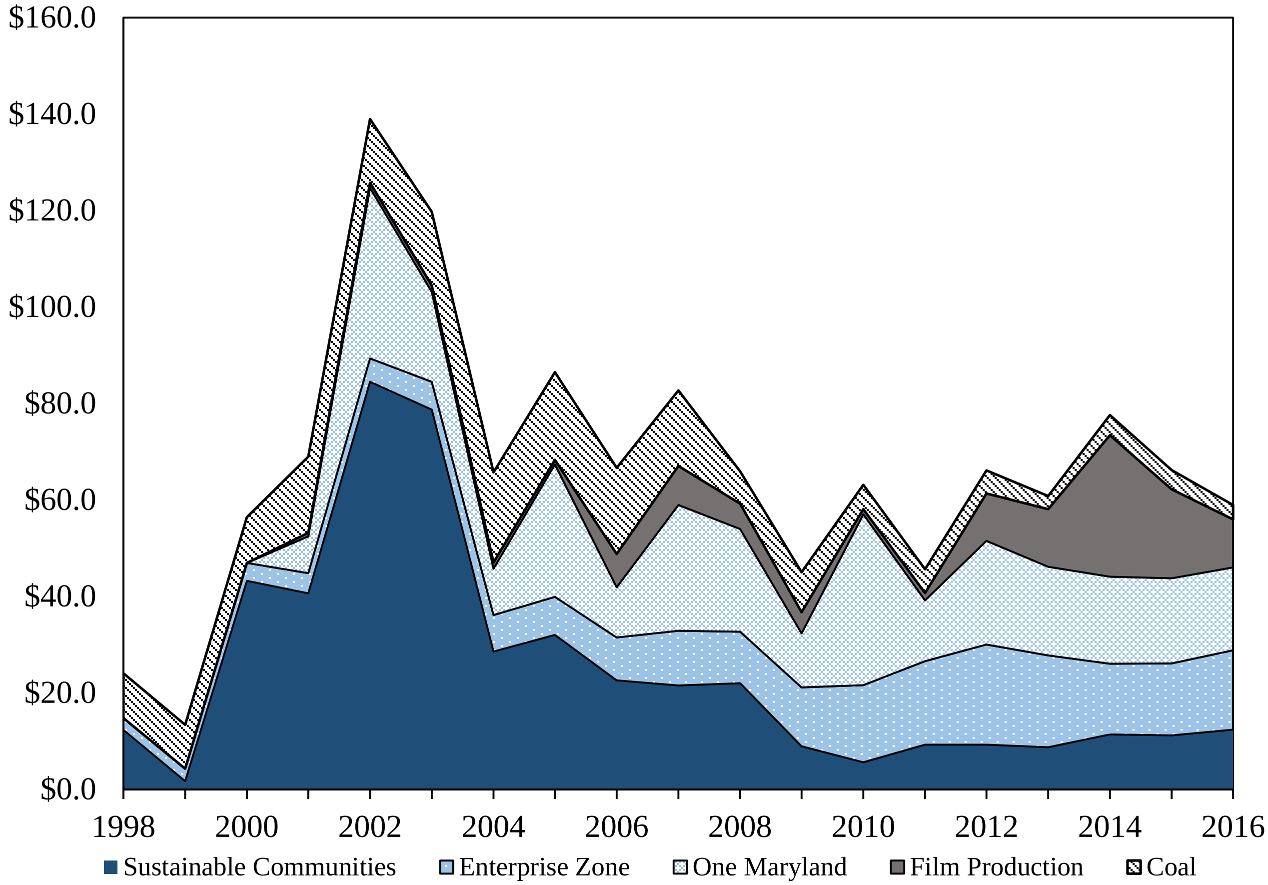
Source: Maryland Department of Planning; Department of Commerce; Comptroller's Office; State Department of Assessments and Taxation; Department of Legislative Services

Annual Amounts for Other State Tax Credits Have Recently Surpassed the Sustainable Communities Tax Credit

Although the Sustainable Communities Tax Credit Program has awarded the most credits, other State business tax credit programs have recently surpassed the program in magnitude. This reflects both a funding decrease to the commercial tax credit program since its shift to a budgeted program and an increase in funding provided to several other business tax credits.

In fiscal 2000 through 2004, the average amount of commercial and residential credits, $55.1 million, was almost six times more than the average amount of credits awarded by the other four programs, which ranged from a minimum of $0.9 million in film production activity tax credits to a maximum of $17.8 million in One Maryland tax credits. Except for the Maryland-mined coal tax credit, which is a capped credit, the fiscal costs of these other business tax credits have increased over time. From fiscal 2010 to 2014, the total annual fiscal cost of the sustainable communities tax credit averaged $8.9 million, less than film production ($10.7 million), enterprise zone ($17.6 million), and One Maryland ($21.2 million), but greater than the coal tax credit ($4.3 million). **Exhibit 9.2** illustrates over time the estimated annual fiscal cost of these programs from fiscal 1998 through 2016.

Exhibit 9.2
Annual Economic Development Tax Credit Program Fiscal Costs
Fiscal 1998-2016
($ in Millions)



Note: Amounts are adjusted for inflation and expressed in constant 2015 dollars.

Source: Maryland Department of Planning; Department of Commerce; Comptroller's Office; State Department of Assessments and Taxation; Department of Legislative Services

Budgeted Commercial Tax Credit Program

The commercial program has operated as a budgeted tax credit program subject to an overall limit since fiscal 2006. This change predates the extension and re-establishment of the program in 2010 as the sustainable communities tax credit. Under the budgeted tax credit program, the cost to the State begins with the amount appropriated in the State budget to the commercial tax credit reserve fund. This generally sets a maximum limit on the program's cost in each fiscal year.

MHT awards initial tax credit certificates based on the reserve fund balance, and tax credits are claimed once projects are completed and certified. MHT is required to notify the Comptroller's Office quarterly of completed projects, and upon this notification the Comptroller's Office then transfers back to the general fund the amount of credits awarded to the completed projects. This transfer generally offsets any tax credit claimed by the completed project. Unless the transfer is due to the expiration of a project or the credit claimed is less than initially estimated, transfers from the reserve fund to the general fund do not materially affect State finances.

Rehabilitation projects typically have a lag between the years in which a business starts the application process, undertakes and completes the qualifying activity, and receives tax credit certification. Unlike the prior unbudgeted commercial tax credit program and other existing State tax credit programs, this lag of unclaimed credits does not lead to the buildup of a State unfunded liability as these projects have been in essence paid for by the State when the amount is appropriated to the reserve fund.

The sum of the budgeted commercial tax credit program's cost is equal to the net amount appropriated to the program less any credits that are expired and are not subsequently reallocated by MHT. From fiscal 2006 through 2016, the General Assembly appropriated a total of $139.7 million for the commercial tax credit program. As part of overall cost containment actions, the Board of Public Works (BPW) reduced the amount appropriated to the reserve fund in fiscal 2008 through 2010 and reduced the reserve fund balance by a total of $8.0 million, leaving a total net appropriation of $131.7 million. The actual net cost of the program is less for several reasons, including expired credits and completed projects that upon certification are awarded a credit that is less than the amount estimated on the credit application. In addition, the amount MHT allocates in each year may differ from the net or final program appropriation due to carry-over credits that were appropriated but not allocated in the previous fiscal year. For example, about $10.0 million in credits were not allocated in fiscal 2007 due to the geographic limitation on credits and were instead available for allocation in fiscal 2008.

MHT allocated a total of $121.6 million through fiscal 2015. Of these credits, $28.1 million expired because the applicant failed to complete the project within program deadlines and requirements. Of the net allocation of $93.5 million, MHT has certified 114 completed projects that received $57.6 million. The final amount claimed by these projects was $4.6 million less than the initial credit certificate amounts awarded, so those credits also expired. An additional 27 projects are in process and will earn an estimated $31.3 million upon completion, leaving a net estimated program cost of $88.8 million through fiscal 2015. The State budget provides an additional $9.0 million to the reserve fund in fiscal 2016, and MHT will award these credits in late calendar 2015. If MHT allocates the entire amount and ongoing and future projects are completed within program requirements and claim the maximum credit to which they are entitled, the total net cost of the program from fiscal 2006 through 2016 is $98.1 million, as shown in **Exhibit 9.3**.

Exhibit 9.3
Commercial Tax Credit Program Appropriation and Net Cost
Fiscal 2006-2016

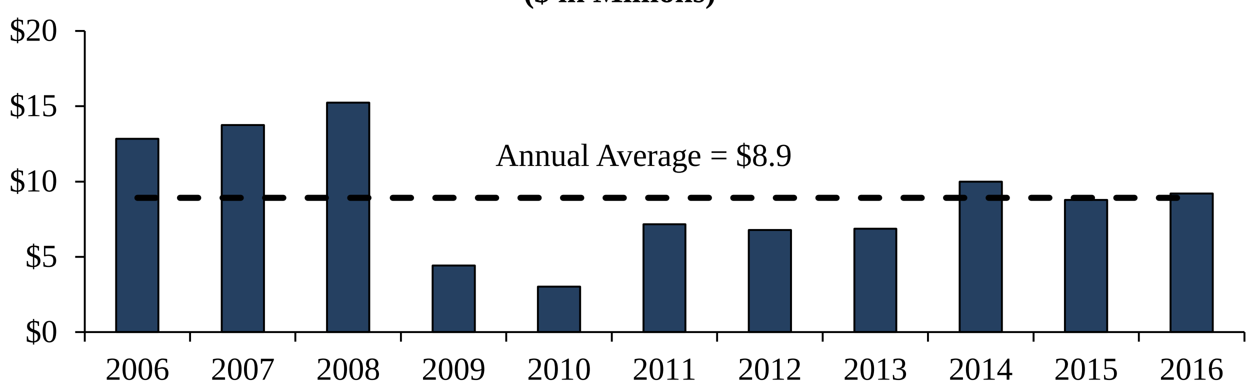
Program Impact	Total Cost ($ in Millions)
Legislative Appropriation	**$139.7**
BPW Actions	(8.0)
Net Appropriation	**$131.7**
MHT Allocation[1]	**$130.9**
Expired Projects[2]	(32.8)
Net Program Cost	**$98.1**

[1]Includes $9.0 million in fiscal 2016 funds that MHT will award in late calendar 2015.
[2]Includes $4.7 million in credits from completed projects or the final credit was less than initial credit certificate.

Source: Maryland Department of Planning; Department of Legislative Services

The program's fiscal impact has decreased over time, reflecting a decrease in the amount appropriated to the program and an increase in expired credits, particularly during the recent recession. In fiscal 2006 and 2007, the State budget provided an average of $25.0 million to the commercial program, compared to $9.0 million annually in fiscal 2015 and 2016. **Exhibit 9.4** shows the net annual fiscal cost in fiscal 2006 through 2016, which has averaged $8.9 million. The fiscal cost of the program in the last several years may actually be less than shown as more of these costs are associated with projects that have not received final credit certification. Some of these projects may not be completed or earn credits less than initially estimated, thereby decreasing the fiscal cost.

Exhibit 9.4
Net Cost of Commercial Tax Credits
Fiscal 2006-2016
($ in Millions)



Source: Department of Legislative Services

Residential Credits

MHT also certifies residential projects that have met the qualifications of the program and the amount of credit that the eligible taxpayer can claim. Since the program's inception, MHT has certified 3,062 projects that have been awarded a total of $49.1 million in credits. **Exhibit 9.5** shows the number of qualifying projects and the total amount of credits certified each year.

Exhibit 9.5
Total Residential Tax Credits Certified
Fiscal 1998-2014

Certification Date	Projects	Total	Average
1998	14	$54,400	$3,890
1999	47	634,500	13,500
2000	65	1,106,800	17,030
2001	94	1,546,500	16,450
2002	219	4,234,400	19,340
2003	237	5,932,200	25,030
2004	310	4,883,200	15,750
2005	319	5,094,700	15,970
2006	415	5,743,600	13,840
2007	255	4,437,800	17,400
2008	242	4,027,400	16,640
2009	221	3,478,700	15,740
2010	129	2,007,000	15,560
2011	113	1,311,600	11,610
2012	140	1,961,100	14,010
2013	114	1,486,800	13,040
2014	128	1,109,800	8,670
Total	**3,062**	**$49,050,600**	**$16,020**

Source: Maryland Department of Planning; Department of Legislative Services

While the residential credit is a lesser component of total program costs (about 14%), MHT has certified since 2000 an average of $3.2 million in residential credits. The residential credit over this time is greater in magnitude than all but a handful of other State economic development tax credits. In recent years, the residential credit's fiscal impact has also decreased, averaging $1.5 million annually, but it is still larger than all but the major State economic development tax credits.

Small Commercial Program

Chapter 601 of 2014 established a credit for small commercial projects that meet certain requirements. Applicants must apply to MHT and receive an initial credit certificate. MHT may award a maximum of $4.0 million in credits beginning on January 1, 2015, through June 30, 2017. Through the first six months, 16 projects applied for an estimated $572,600 in credits.

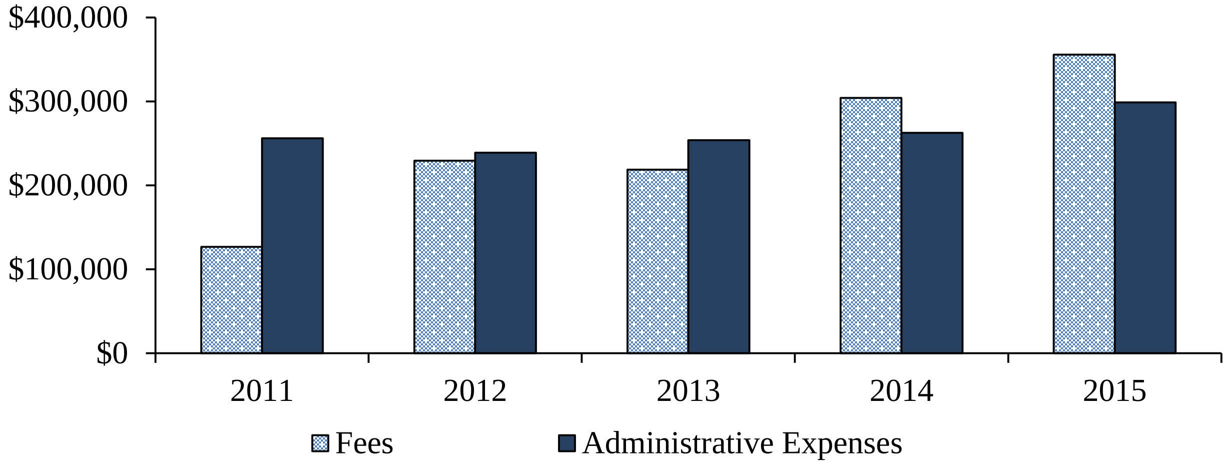
Program Administrative Costs

MHT administrative costs have grown over time in part due to additional staffing costs. In fiscal 2014, the program's three staff and one contractual employee processed about 260 new residential and commercial project applications (federal and State) and certified projects from previous years. In fiscal 2015, the contractual position became a permanent position.

Legislation enacted in 2005 required MHT to adopt regulations charging a fee to certify commercial rehabilitations. The General Assembly subsequently passed legislation increasing fee amounts and extending fees to residential rehabilitations. The goal of the legislation was to increase these fees in a sufficient manner to cover the program's administrative costs. Commercial tax credit reserve funds may also be used for the payment of administrative costs if the fees are insufficient. Fees generally equal 3% of the tax credit received by a project.

Pursuant to the increased authority and requirements to levy fees, administrative fees grew significantly from $126,900 in fiscal 2011 to $355,910 in fiscal 2015, as shown in **Exhibit 9.6**. However, administrative fees were insufficient to cover administrative expenses in fiscal 2011 through 2013. In fiscal 2011, MHT received a little less than $130,000 in general funds to cover the deficiency, and in fiscal 2012 and 2013, shortfalls of approximately $10,000 and $35,000, respectively, were offset by tax credit reserve funds. This trend reversed in fiscal 2014 and 2015 as the fees generated a surplus of $41,620 and $57,026, respectively. These surpluses were reduced by BPW in July 2014, and only $40,646 of the surplus was rolled into fiscal 2016 awards.

Exhibit 9.6
Program Fees and Administrative Expenses
Fiscal 2011-2015



Source: Maryland Department of Planning; Department of Legislative Services

Local Impact

Local governments receive a portion of income tax revenues to support the construction and maintenance of local roads and other transportation facilities. Commercial rehabilitation credits claimed against the corporate income tax will decrease local highway user revenues. An estimated one-third of all commercial credits have been claimed against the corporate income tax.

Chapter 10. Findings and Recommendations

Based on the information and analysis provided in this report, the Department of Legislative Services (DLS) makes a number of findings and recommendations about the sustainable communities tax credit, as discussed below.

Credit Reforms Have Successfully Increased Fiscal Certainty and Served as a Model for Subsequent Tax Credit Programs

Between 2002 and 2004, the General Assembly made a number of legislative reforms to the then heritage structure rehabilitation tax credit that would decrease the growing fiscal costs of the program. The major components of these fiscal reforms include:

- shifting the commercial program from a traditional tax credit to a budgeted tax credit subject to an aggregate limit each year;
- limiting the maximum value of the commercial tax credit to $3 million, which was previously uncapped; and
- reducing the percentage value of the credit from 25% to 20%.

These changes prevented both unexpected revenue losses and a buildup of unfunded liabilities from unclaimed credits. Taking into account inflation, the fiscal impact of the commercial program peaked in the early 2000s, as commercial projects applying for Part 2 certification in calendar 2001 earned $78.7 million in credits. Since the commercial program was shifted to a budgeted program in fiscal 2006, annual fiscal costs have decreased to an estimated $8.9 million.

While the amounts of rehabilitation activity and credits have decreased significantly under the budgeted program, the budget process ensures that the commercial credit must compete with other State funding priorities. Budgeting the credit also provides flexibility for the State, as the appropriation is set on an annual basis and can be tailored to fit current funding priorities and the overall State budget.

The commercial tax credit program has become a template for subsequent tax credits established by the General Assembly. Almost every credit established since 2004 has a limit on either the maximum amount that can be claimed by a taxpayer and/or an aggregate limit on the total credits available. Additionally, many of the major State tax credit programs established since 2004 are subject to an annual appropriation including the biotechnology investment, film production activity, health enterprise zone, and cybersecurity investment tax credits.

Recommendation: DLS recommends that the General Assembly maintain the commercial tax credit as a budgeted tax credit subject to an aggregate limitation each year. DLS also recommends that the cap on the maximum value of the commercial tax credit of $3 million be maintained.

Using a Competitive Process to Award Commercial Project Credits Has Been Effective

The commercial tax credit is unique in that the Maryland Historical Trust (MHT) awards credits using a competitive process. Since fiscal 2006, commercial rehabilitation projects have been scored on a number of criteria outlined in statute and regulations including, but not limited to, the level of preservation, urgency of need for rehabilitation, economic benefit, and geographic distribution of projects. Thus, projects that deliver the most benefits in terms of key outcomes and goals identified by the General Assembly are more likely to be awarded credits. For example, two Baltimore City projects applied for a $3 million credit in fiscal 2014, but due to the geographic limitation in effect at the time, both projects could not be funded. The competitive award process selected the project with estimated project costs of $40 million and a score of 95 over the project with $20 million in costs and a score of 82. In the absence of a competitive process, the economic benefit to the State may not have been maximized.

Although the competitive process does create a delay in awarding credits, a well implemented competitive program can result in a more effective program compared to a first-come, first-served approach or uncapped program. The first-come, first-served basis used previously for awarding credits resulted in several problems, including difficulty in accurately tracking the timing of application submissions. Projects were not selected based on merit, and some approved projects were less beneficial than others denied funding. The first-come, first-served process also increased the number of applications from projects that had not secured financial backing; some of these projects were not financially viable and did not proceed. With a competitive process, projects must meet program requirements and compete against each other. Subject to the program's geographic limitation criterion, higher ranking projects receive funding first and lower ranking projects are generally less likely to be funded.

Recommendation: DLS recommends that the General Assembly maintain the competitive process used to award commercial tax credits. DLS also recommends that the General Assembly consider implementing competitive processes for other State tax credits, such as the biotechnology investment incentive tax credit and the One Maryland tax credit.

Statutory Criteria Designed to Ensure Geographic Diversity of Projects May Not Achieve Desired Results and Can Impact the Overall Quality of Projects Receiving Credits

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 and also provides that MHT 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.

MHT determines whether jurisdictions have been underrepresented based on the total number of National Register of Historic Places properties in each jurisdiction. This measurement does not accurately reflect whether jurisdictions are underrepresented because it does not consider the commercial zoning of jurisdictions, nor does it consider the number of vacant properties in a jurisdiction. Additionally, the measure does not account for properties that are eligible for the credit but are not listed in the National Register of Historic Places.

The geographic limitation and preferential scoring for projects located in historically underrepresented counties have had limited impacts in promoting geographic diversity. Given the geographic limitation and a relatively low number of applications submitted by county projects, nearly every project outside of Baltimore City has been awarded a credit in the 10 years of the current program without regard to the project's score. A total of 199 Baltimore City projects have been denied in contrast to 10 projects located outside Baltimore City. Providing preferential scoring only factors into the award selection process if county projects are susceptible to being denied, which has occurred in only 2 of the 10 years of the current program.

Recommendation: Based on the number of projects applying for and awarded credits in jurisdictions outside of Baltimore City in recent years, the limitation on the amount of the credits that may be awarded to projects in a single jurisdiction appears to have a limited impact in providing geographic diversity to the program. However, when this limitation has redirected project funding from Baltimore City projects to projects in other counties, MHT estimates that these projects resulted in less economic benefits and historic preservation than the amount that would have occurred if the Baltimore City projects had received funding. **DLS therefore recommends that the General Assembly consider increasing the current 60% geographic limitation to a higher percentage or completely eliminating the limitation.**

Recommendation: The formula for calculating whether a jurisdiction is underrepresented does not accurately reflect whether jurisdictions are fairly represented. Additionally, awarding points on geographic distribution is rarely the tipping point in determining whether a project is awarded a credit. **DLS therefore recommends that the General Assembly eliminate the criterion of scoring points on geographic underrepresentation. Alternatively, if the General Assembly prefers to keep this scoring criterion, MHT should develop a new scoring metric to better capture the inventory of eligible properties in historically underrepresented jurisdictions.**

Despite Efforts to Increase Geographic Diversity, Baltimore City Continues to Have a Large Majority of Commercial and Residential Credit Projects

While Baltimore City comprises about 11% of the State's total population and has about 18% of the State's properties listed in the National Register of Historic Places, approximately 6 in 10 of all residential credits and 7 out of every 10 budgeted commercial tax credits have been awarded to Baltimore City projects. If unbudgeted tax credits are included, Baltimore City projects have been awarded slightly more than $8 out of every $10 of program funding.

Compared to its share of the State's population, most of the additional Baltimore City credits result from a greater share of eligible historic buildings, including the impact of locally designated historic districts, and the impact of the commercial program's adjusted basis requirement that focuses credit activity to areas in which historic properties have lower property values and are more likely in need of rehabilitation. The larger scale of Baltimore City projects explains the remaining amount, as this difference is greater in the commercial program and explains the additional geographic concentration of commercial credits within the city.

Recommendation: Chapter 601 of 2014 required MHT to develop programs, including web-based tools, in order to increase residential and commercial tax credit participation in jurisdictions that have been historically underrepresented in the award of tax credits. **MHT should comment on its outreach efforts to increase credit participation in jurisdictions that have been historically underrepresented in the award of tax credits.**

Commercial and Residential Credit Projects in Baltimore City Generally Occur in Different Parts of the City, with Residential Projects Skewed to Neighborhoods with Higher Incomes and Housing Values

Commercial and residential projects and funding in Baltimore City generally occur in different parts of the city and are not correlated with each other. Residential rehabilitation projects and credits in the city tend to occur in census tracts with higher household incomes and housing values. Compared to the enterprise zone, One Maryland, and commercial tax credits, residential credit activity is found mostly in neighborhoods that are less diverse and that have significantly higher incomes, home values, and rates of employment and education.

While commercial projects also occur in neighborhoods that are significantly more educated, have higher home values and higher rates of employment, and that are less diverse, some commercial projects do occur within neighborhoods with a higher incidence of poverty and vacant housing units as well as lower household incomes.

Recommendation: DLS recommends that the General Assembly consider prohibiting residential tax credits if the assessed value of the property is greater than 150% of the county's median home price. This could better target credits to residential properties in neighborhoods in need of revitalization instead of simply rehabilitating properties in neighborhoods with high-market values.

Commercial Credit Reporting Requirements Are More Detailed Than For Other Similar Tax Credit Programs

Tax credit reporting requirements, and the capability of State agencies to provide information, vary across programs. Certain tax credit programs require agencies to publish specified information about the credit on an annual basis. These reporting requirements are often inconsistent, and other tax credit programs lack any reporting requirements.

As part of the effort to quantify the State liabilities that occurred in the early years of the program, MHT was required to annually report specified information about commercial rehabilitation projects and later required to provide additional project-specific information and increase the frequency of reporting. These reporting requirements have enhanced (1) the capability to respond to information requests and analyze the program's effectiveness; (2) program transparency and administration; and (3) interagency cooperation between MHT, DLS, and the Comptroller's Office.

The information that MHT must report on commercial rehabilitation projects is generally both more frequent and detailed than that of other tax credit programs. This information has also helped clarify the treatment of expired tax credits. Chapter 76 of 2004 specified that tax credits expire and may not be claimed if a commercial rehabilitation is not completed by specified deadlines. Chapter 76 also required MHT to notify the Comptroller's Office of these expired credits. As a result of communication between DLS and MHT, subsequent legislation clarified the expiration of initial tax credits awarded under the budgeted tax credit program as well as establishing the process for expiring credits for a project that had started the application process but had not received final certification during the prior tax credit program. This helped clarify State liabilities by removing these older projects that represented a potential liability to the State and provided the necessary information to the Comptroller's Office to prevent expired credits from being incorrectly claimed.

Recommendation: DLS recommends that the General Assembly maintain MHT's current reporting requirements for commercial tax credits. DLS also recommends that the General Assembly consider implementing comparable reporting requirements for other State tax credits.

Sustainable Community Revitalization Efforts Should Be Coordinated With Other Federal and State Infrastructure Investment Programs

The Partnership for Sustainable Communities is a federal partnership formed to ensure that federal policies, programs, and funding consider affordable housing, transportation, and environmental protection in concert. By coordinating federal investments in infrastructure, facilities, and services, the partnership seeks to achieve multiple economic, environmental, and community objectives with each dollar spent and, thereby, realize better results for communities and utilize taxpayer monies more efficiently.

In response to the establishment of the federal Partnership for Sustainable Communities, the Sustainable Communities Act of 2010 was enacted into law. Recognizing the State's need to "refine its focus on and develop a coordinated approach to creating, enhancing, supporting, and revitalizing sustainable communities in order to position itself to take advantage of federal opportunities" and encourage "more integrated thinking about how transportation, land use, and housing programs intersect with environmental, economic, and equity goals at the State level," the Act requires State programs, including the sustainable communities tax credit program, to coordinate and target investment in housing, historic preservation, economic growth, and transportation development in existing neighborhoods and town centers.

Recommendation: DLS recommends that the Maryland Department of Planning and MHT comment on how creating, enhancing, supporting, and revitalizing sustainable communities fit into existing and new strategies to take advantage of federal and State infrastructure investment opportunities.

Claims for Fraudulent Rehabilitation Expenditures May Occur Even With a Detailed Certification Process

Maryland has a three-stage project certification process similar to that used in Virginia. A recent case involving a Virginia developer who significantly overstated rehabilitation costs for multiple developments in Richmond exemplified how fraudulent activity can occur despite an extensive certification process. Virginia officials indicated that the majority of fraudulent expenditures consisted of items that would not be readily identifiable in the photographs submitted. In response, Virginia officials now calculate the cost per square foot for every project and will perform additional review if necessary.

Recommendation: MHT should comment on its process for reviewing rehabilitation activity and preventing fraudulent claims and whether its review process is sufficient to detect and deter potential fraud. MHT should also consider taking additional steps to detect fraud, such as calculating the cost per square foot for projects, and performing additional review if this calculation exceeds a certain threshold.

Federal Grants Qualify as Credit Expenditures and Can Limit Private Investment

The sustainable communities tax credit prohibits the following from counting as qualified expenditures:

- State or local grants;
- grants 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; or
- any other State or local tax credit.

Any other financial assistance from the State or a political subdivision of the State other than a loan must be repaid at an interest rate that is greater than the interest rate on general obligation bonds issued by the State at the most recent bond sale prior to the time the loan is made.

Although these types of State and local financial assistance may not be counted as qualified rehabilitation expenditures, the program does not prevent federal funding from being considered as qualified expenditures. Thus, if a project is fully funded by a federal grant, the taxpayer could potentially receive the State tax credit without providing any private investment of funds.

Recommendation: MHT stated that it measures the success of the credit by how projects maximize the leverage of private investment; however, a taxpayer could avoid using private funds by utilizing federal funds. **Therefore, DLS recommends that the General Assembly prohibit any federal funds from qualifying as expenditures for purposes of the State credit.**

Notification to Commercial Credit Recipients Is Often Unnecessarily Delayed

Applications for the commercial tax credit must be submitted by August 31 of each year. MHT makes decisions on which projects will be awarded credits fairly quickly, usually by the end of October. However, applicants are not typically notified of the award decisions until mid-December when an announcement is made by the Governor.

Notifying businesses at the end of the taxable year creates a hardship for applicants as they try to do year-end planning. This waiting period between the application deadline and the announcement of credit recipients leaves certain applicants with a difficult decision between completing necessary improvements and waiting to find out the status of their project application. If the notice of application approvals were made sooner, tax credit recipients could move forward with the projects and not be rushed with year-end planning.

Recommendation: Given that businesses must make planning decisions before the end of the tax year and that any renovations started before the award announcement do not count towards the credit, DLS recommends that MHT notify applicants of its award decisions no later than 60 days after the application deadline.

Appendix 1. Local Historic Property Tax Credits

County	Jurisdiction	Program
Allegany		• County property tax assessment freeze is available for 10 years • Minimum expenditure of $5,000
Allegany	Cumberland	• 10% property tax credit • Minimum expenditure of $5,000 • Credit can be carried forward 5 years • Additional city property tax assessment freeze is available for 10 years
Anne Arundel	Annapolis	• 10% property tax credit • 25% property tax credit for income-producing property, residential properties with qualified interior improvements required for life/safety or hazard mitigation, and exterior restoration work when there is replacement of a nonhistoric feature/material with historically appropriate feature/material
Baltimore City		• 10-year tax credit computed once at beginning of project • 100% credit for projects with construction costs less than $3.5 million • 80% credit for projects with construction costs greater than $3.5 million, declining by 10% each year
Baltimore County		• 20% property tax credit for residential projects with at least $1,000 in expenses • Credit may be carried forward 10 years and is transferable • For commercial historic properties, the credit amounts to the difference between the assessed value before the rehabilitation work began and the increase in assessment attributable to the rehabilitation work • Generally, commercial rehabilitation must exceed $50,000 to generate a reassessment • For commercial properties, the credit amount is the same each year for a total of 10 subsequent tax years and is transferable
Calvert		• 25% property tax credit • Credit may be carried forward 4 tax years
Carroll	Westminster	• 10% city property tax credit for restoration and preservation work • 5% city property tax credit for expenses related to construction of an architecturally compatible new structure on an eligible historic property • Credit is granted for period of 10 years and may be carried forward for 5 tax years • Expenses must exceed $5,000 to be eligible for credit

County	Jurisdiction	Program
Cecil		• 10% property tax credit • No carry forward authorized
Charles		• 10% property tax credit • $500 minimum expenditure • Credit may be carried forward for 4 years
Frederick	Frederick City	• 25% city property tax credit • Minimum expenditure of $500 • Maximum credit amount capped at $7,500 annually • Credit may be carried forward for 5 years
Frederick		• Property tax credit of 100% of the increase in assessment attributable to the rehabilitation work in the first and second year, 80% of the increase in the third year, 60% in the fourth year, and 40% in the fifth year
Harford	Bel Air	• 10% property tax credit • Credit may be carried forward for 5 years • 5% property tax credit for compatible new construction
Harford		• 10% property tax credit • May be carried forward for 5 years • Maximum credit amount capped at $7,500 annually
Howard		• 10% property tax credit • Minimum expenditure of $500 • For projects exceeding $5,000, an additional credit is available that abates the increase in property tax that would result from increased assessed value due to the restoration work done • Available for 10 years upon completion of the project
Montgomery		• 25% property tax credit (increased from 10% in 2013) • Minimum expenditure of $1,000 • Credit may be carried forward for 5 years
Prince George's	Laurel	• 10% city property tax credit
Prince George's		• 25% property tax credit (increased from 10% in 2013) for preservation and restoration projects • 10% property tax credit for expenses related to new construction adjacent to and architecturally compatible with structures having historic architectural or cultural value • Credit may be carried forward for 4 years and is refundable after that time period
St. Mary's		• 10% property tax credit for preservation and restoration projects • 5% property tax credits for expenses related to new construction that is architecturally compatible within historic district architectural or cultural value • Credit may be carried forward for 5 years

County	Jurisdiction	Program
Washington		• 10% property tax credit for preservation and restoration projects • 5% property tax credits for expenses related to new construction that is attached to an existing historic structure • Credit may be carried forward for 5 years

Appendix 2. Commercial Projects and Credits by County: Current and Prior Program

	Prior Program			Current Program		
County	**#**	**Total**	**% Total**	**#**	**Total**	**% Total**
Allegany	14	$2,097,100	1.0%	7	$4,154,200	4.7%
Anne Arundel	16	4,765,300	2.2%	5	333,600	0.4%
Baltimore City	253	192,853,000	89.9%	63	63,101,400	71.0%
Baltimore County	12	4,072,100	1.9%	7	1,483,300	1.7%
Calvert	1	63,900	0.03%	0	0	0.0%
Caroline	1	43,800	0.02%	3	97,600	0.1%
Carroll	7	1,800,100	0.8%	9	2,690,700	3.0%
Cecil	2	90,100	0.04%	0	0	0.0%
Dorchester	2	67,600	0.03%	8	1,390,300	1.6%
Frederick	14	4,662,000	2.2%	6	673,300	0.8%
Harford	1	100,000	0.04%	1	100,000	0.1%
Howard	6	374,800	0.2%	4	1,060,500	1.2%
Kent	3	189,800	0.1%	6	1,497,000	1.7%
Montgomery	7	905,100	0.4%	4	4,046,700	4.6%
Prince George’s	2	553,700	0.3%	3	1,545,800	1.7%
Queen Anne’s	3	148,000	0.1%	1	781,700	0.9%
St. Mary’s	2	172,600	0.1%	0	0	0.0%
Somerset	0	0	0.0%	2	189,600	0.2%
Talbot	8	1,260,800	0.6%	9	3,850,500	4.3%
Washington	3	143,600	0.1%	3	1,868,700	2.1%
Wicomico	2	109,500	0.1%	0	0	0.0%
Worcester	1	35,900	0.02%	0	0	0.0%
Total	**360**	**$214,508,700**		**141**	**$88,864,800**	

Appendix 3. Program Distribution and Concentration by Census Tract – Baltimore City Projects

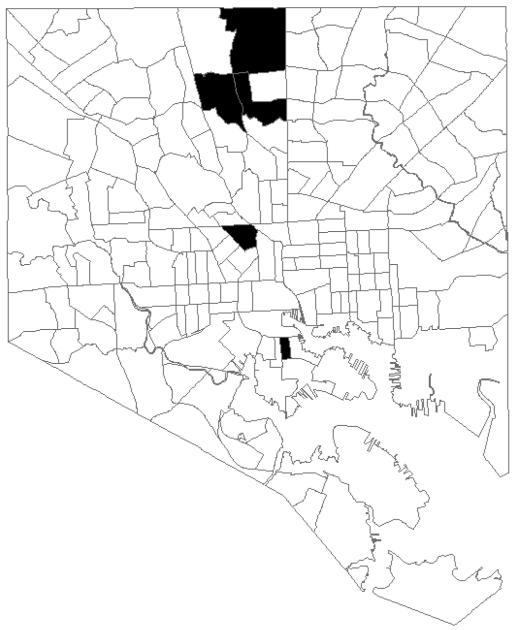
Program	Census Tracts with At Least One Project	Top Five Census Tracts % All Credits	Top Five Census Tracts Location
Commercial Program	29	60.8%	Charles Village
			Hampden
			Midtown
			Midtown
			Downtown/Seton Hill
Residential Program	71	40.1%	Midtown
			Roland Park
			Federal Hill
			Guilford
			Guilford
Enterprise Zone	69	69.0%	Harbor East
			Locust Point/Southeastern
			Midtown
			Fells Point
			Downtown/Seton Hill
One Maryland	11	72.6%	Downtown/Seton Hill
			South Baltimore
			Southeastern/Locust Point
			Fells Point
			Harbor East

Note: Commercial Program includes only credits awarded under current budgeted program.

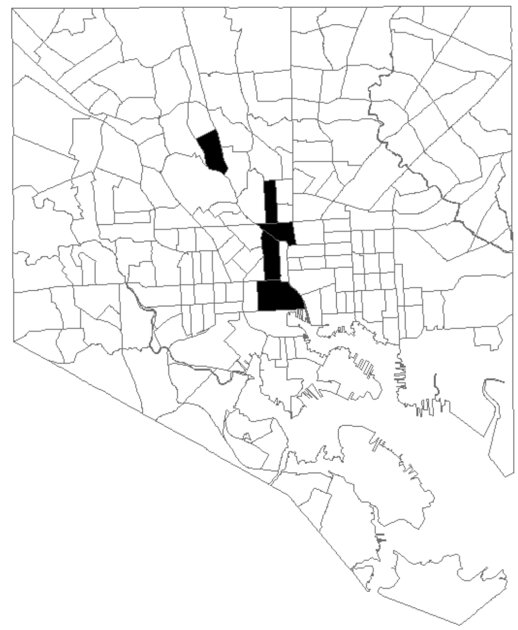
Source: Maryland Department of Planning; Department of Commerce; U.S. Census Bureau; State Department of Assessments and Taxation; Department of Legislative Services

Appendix 4. Top Five Census Tracts by Program

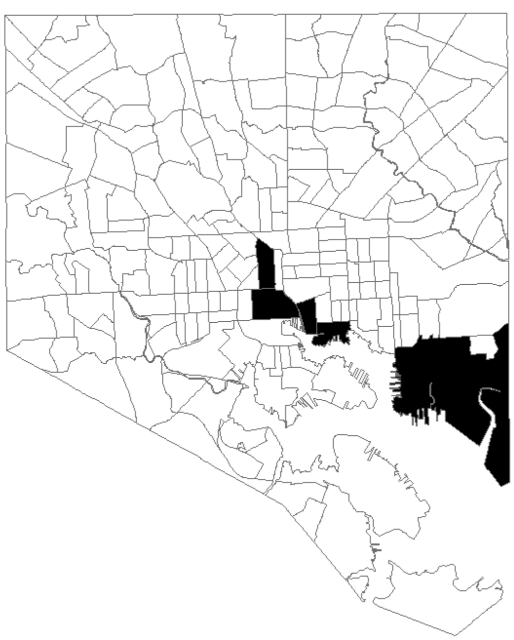
Residential Program



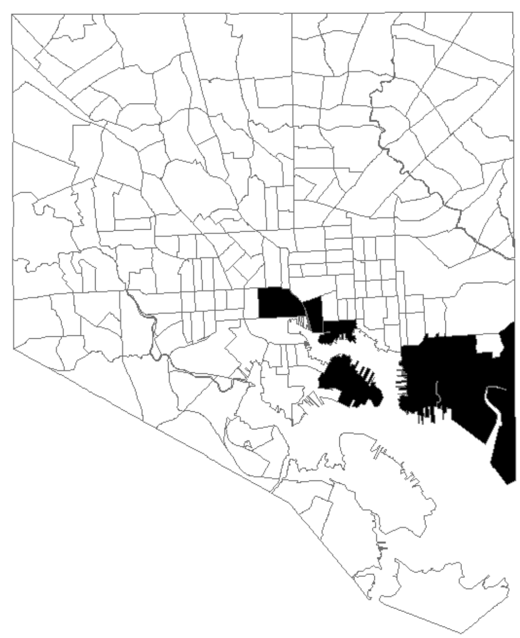
Budgeted Commercial Program



Enterprise Zone

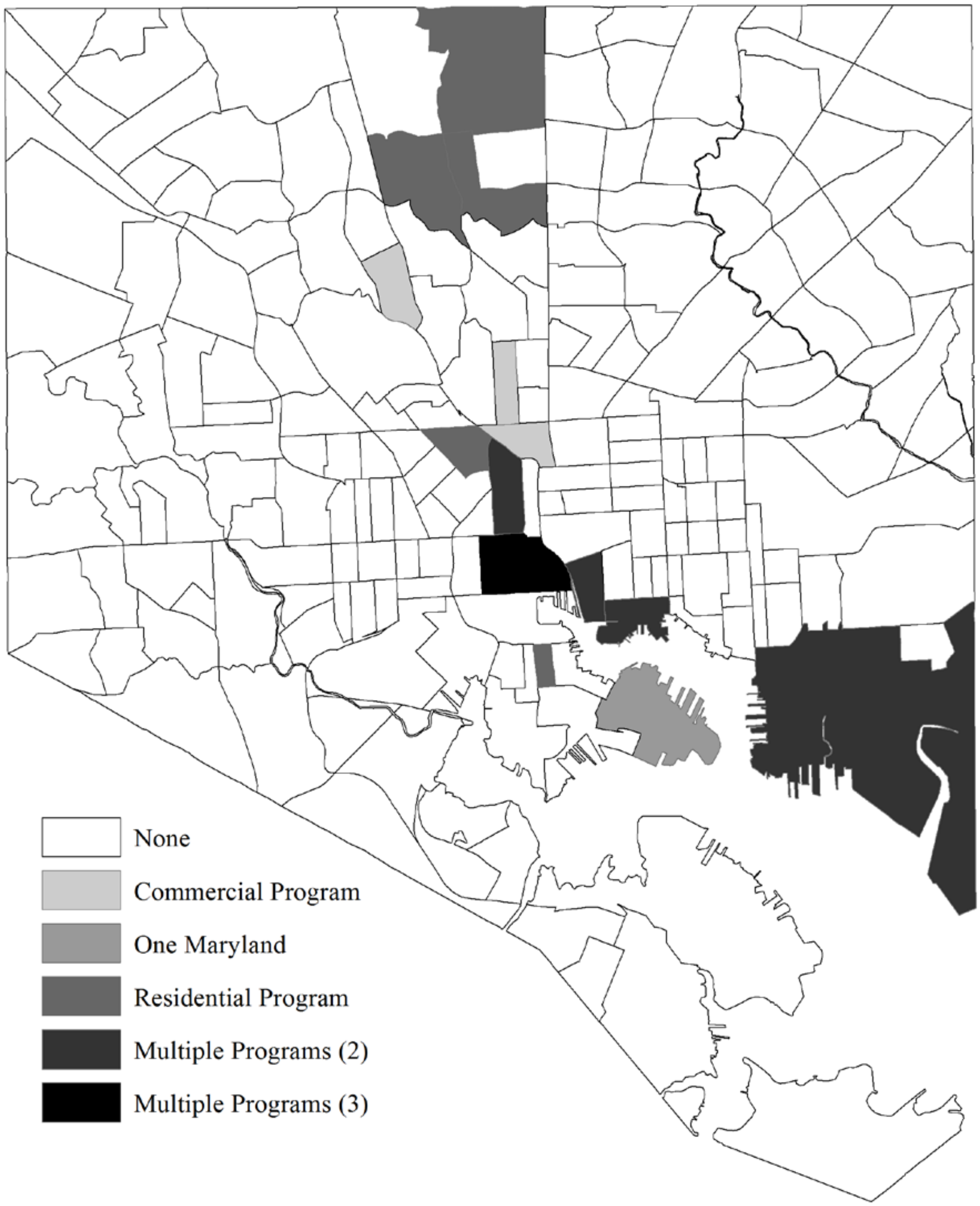


One Maryland



Source: Department of Commerce; State Department of Assessments and Taxation; Department of Planning; U.S. Census Bureau; Department of Legislative Services

Appendix 5. Top Five Census Tracts – All Programs



Source: Maryland Department of Planning; Department of Commerce; State Department of Assessments and Taxation; U.S. Census Bureau; Department of Legislative Services