



Bill 34-19, Taxation – Development Impact Taxes – Affordable Housing – Housing Impact Fairness Act



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Completed: 11/26/19

Description

As introduced on October 15, 2019, Bill 34-19 would:

- Alter the applicability of the development impact tax for public school improvements;
- Establish an excise tax on certain demolitions and renovations of single family homes; and
- Specify the use of certain tax revenues for affordable housing initiatives

Summary of Staff Recommendations

Staff recommends no action be taken on Bill 34-19 at this time. The concepts promoted in the bill should be evaluated more thoroughly as part of a comprehensive review of school impact taxes with the 2020 update to the Subdivision Staging Policy (SSP).

Should the County Council choose to move forward with the bill, staff recommends that answers to the questions and concerns presented in the Staff Recommendations section of this report be addressed through committee and Council work sessions.

Background

Bill 34-19 was introduced on October 15, 2019 by lead sponsor Councilmember Evan Glass and co-sponsor Councilmember Will Jawando. The bill would apply the school impact tax on certain replacement homes and create an excise tax for replacement homes that exceed the square footage of the original home. The bill does not alter the applicability of the transportation impact tax. The purpose of the bill is to increase revenue for affordable housing initiatives and public school capital projects.

Key Terms and Processes

Staff offers the following definitions to key terminology used throughout this report:

- *School Impact Tax* – a tax imposed to defray a portion of the costs associated with public school improvements that are necessary to accommodate the enrollment generated by the development. (County Code Section 52-52)
- *Transportation Impact Tax* – a pro rata per unit or per square foot of gross floor area tax intended to defray a portion of the costs associated with transportation improvements that are necessary to accommodate traffic generated by a development. (County Code Section 52-39)
- *Partial Demolition* – the teardown, destruction, or removal of at least 50% of a single family home. (Bill 34-19)
- *Replacement Single Family Home* – a single family home that replaces a demolished or partially demolished single family home. (Bill 34-19)

When a property owner decides to demolish or partially demolish an existing home, they must apply for a demolition permit from the Department of Permitting Services (DPS). If the property owner desires to construct a replacement home on the property, they must also apply for a building permit. Before any building permit can be issued, the applicant is required to pay any applicable school and transportation impact taxes.

Proposed Change to the Applicability of the School Impact Tax

The laws pertaining to impact taxes can be found in County Code Chapter 52. School impact taxes were introduced as a result of the 2003 update to the Annual Growth Policy (the precursor to the Subdivision Staging Policy) and took effect on March 1, 2004.

County code Section 52-54(d) currently indicates that development impact taxes do not apply to “any reconstruction or alteration of an existing building or part of a building that does not increase the number of dwelling units of the building.” It further states that the impact taxes do not apply to:

any building that replaces an existing building on the same site or in the same project...to the extent of the number of dwelling units of the previous building, if:

(A) construction begins within one year after demolition or destruction of the previous building was substantially completed; or

(B) the previous building is demolished or destroyed, after the replacement building is built, by a date specified in a phasing plan approved by the Planning Board or equivalent body.

However, if in either case the tax that would be due on the new, reconstructed, or altered building is greater than the tax that would have been due on the previous building if it were taxed at the same time, the applicant must pay the difference between those amounts.

Bill 34-19 would specifically modify the above exceptions to the school impact tax and require that the impact tax be applied to “a new, reconstructed, or altered attached or detached single-family home that replaces a home built before March 1, 2004.” The intent is to require impact tax payments for the replacement of homes for which they had not been paid previously.

Proposed Affordable Housing Teardown Excise Tax

Adoption of Bill 34-19 would add a new article to Chapter 52 that would require property owners seeking to demolish or partially demolish an existing single family home and build a larger replacement home to pay an excise tax that will help fund the Montgomery Housing Initiative.¹ As proposed, the excise tax would be paid upon issuance of a demolition permit or building permit and be calculated at \$9 for each square foot that the replacement home’s gross floor area exceeds that of the original home. The bill provides one exception to the excise tax, for homes that are deemed unsafe or condemned by the Department of Housing and Community Affairs (including homes damaged by fire or natural disaster).

Analysis

¹ Per County Code Section 25B-9, funds allocated to the initiative may be used to:

- 1) construct or acquire affordable housing units;
- 2) buy and rehabilitate existing rental units that would otherwise be removed from the supply of affordable housing; and
- 3) participate in housing or mixed-use developments that will include affordable housing.

At the request of Council staff, Planning staff performed numerous analyses of data related to demolition and replacement homes. This report provides an overview of these analyses and clarification of our findings. In general, the data do not suggest that the student impacts of replacement homes are any greater than existing homes.

Trends in Demolition and Replacement

Over the last ten years, there has been an average of 219 single family detached home demolition permits issued per year by the Department of Permitting Services. Approximately 87 percent of the demolition permits occurred in Council District 1, which includes the areas of Bethesda, Potomac, and Chevy Chase.

Using deeds records from CoreLogic, Planning Staff was able to find 734 records where transactions occurred both pre and post demolition permit between the years of 2014 and 2017. The average sales price for these homes increased by over \$1 million following construction of the replacement home. The increase in price and the percent increase in price varied by part of the county, as shown in the table below:

Town/City	Average 1 st Sale	Average 2 nd Sale	% Increase	Price Increase
Potomac	\$854,583	\$1,901,000	122%	\$1,046,417
Bethesda	\$742,830	\$1,736,534	134%	\$993,704
Chevy Chase	\$924,328	\$2,272,003	146%	\$1,347,675
Cabin John	\$567,500	\$1,417,500	150%	\$850,000
Kensington	\$514,746	\$1,337,897	160%	\$823,151
Silver Spring	\$297,866	\$782,725	163%	\$484,860
Rockville	\$781,042	\$2,059,242	164%	\$1,278,200
MONTGOMERY COUNTY	\$735,083	\$1,748,385	138%	\$1,013,301

For homes demolished and replaced since 2012, the gross floor area increased 152%, or 2,554 square feet on average. As such, the typical replacement home would have required an affordable housing teardown excise tax payment of \$22,986.

The current school impact tax for single family homes is \$26,207, meaning that this bill would require an applicant to pay a total of \$49,193 in new taxes on the typical replacement home (regardless of location in the county).

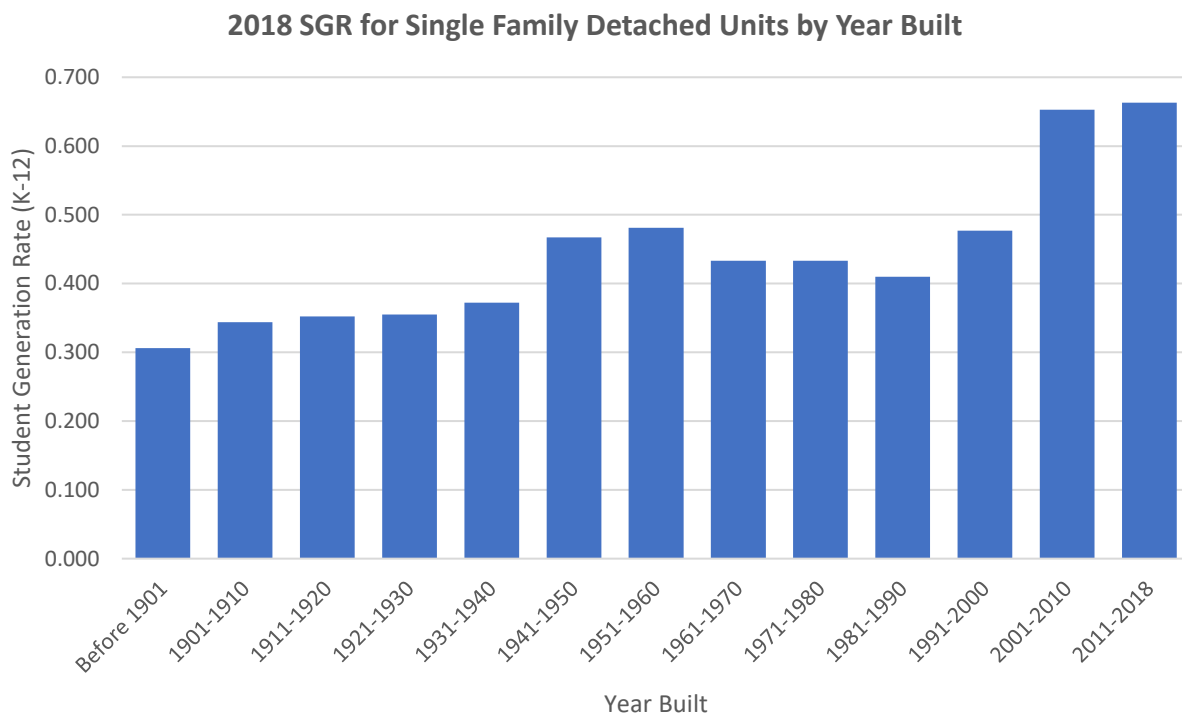
Impact on Student Generation

Planning staff calculates student generation rates every two years using enrollment data provided by Montgomery County Public Schools (MCPS) and housing data provided by the State Department of Assessments and Taxation (SDAT). The student generation rates currently in use² were calculated using enrollment data from the start of the 2018-19 school year. Staff was able to match 99.4% of the nearly

² Countywide student generation rates are used to compute school impact tax rates by dwelling type. Regional student generation rates, by dwelling type, are used to estimate the enrollment impacts of a sector plan and development applications.

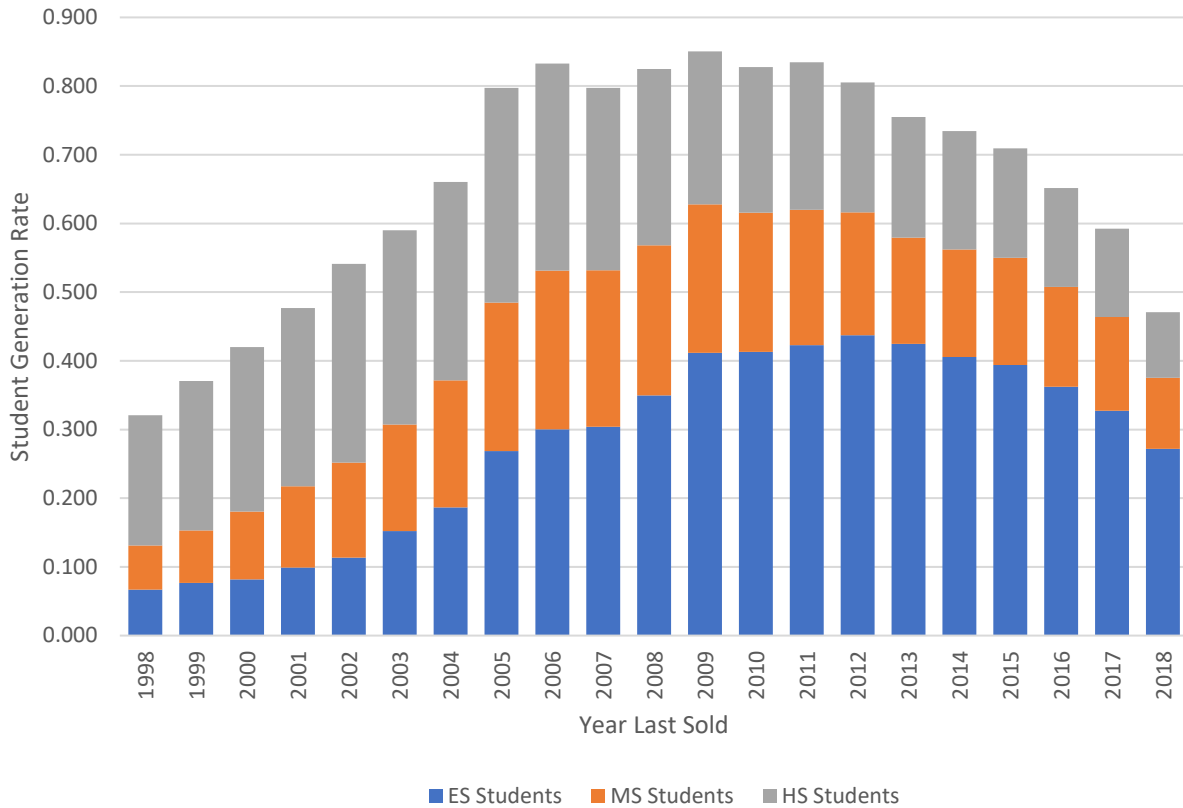
163,000 public school students to a housing type.³ Countywide, a single family detached home (regardless of year built) currently generates 0.462 students on average.

Using the same data set, Planning staff calculated the student generation rate for the 848 replacement homes built between 2014 and 2018. On average, these homes were generating 0.557 students per home, or 20.6% more students per home than the average single family detached home across the county (regardless of year built). Staff, however, does not believe that this is a relevant comparison since the replacement homes are ones that were recently built and most likely recently sold. Our review of student enrollment data reveals relatively high rates of student generation associated with single family homes that were recently built and, more broadly, single family homes that have recently been sold.



³ Each of these students was matched to one of over 382,000 dwelling units in the county, identified as either single family detached, single family attached (townhouse), multifamily low-rise (4 stories or less), or multifamily high-rise (5 stories or more).

2018 SGR for Single Family Detached Units by Year Last Sold



In fact, all new single family detached homes built between 2014 and 2018 (not just the ones that were replacement homes) were generating 0.598 students per home on average in 2018. That is 7.4% more than the replacement homes.

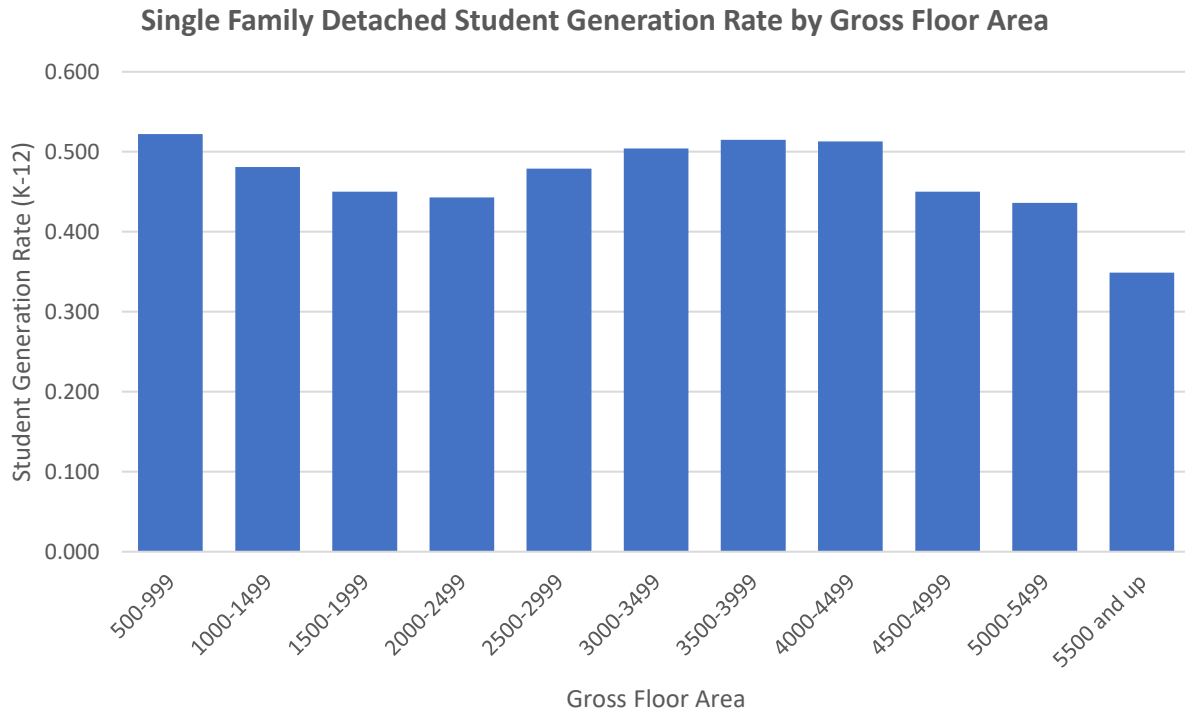
A review of single family detached homes sold between 2014 and 2018 revealed that they were generating 0.622 student per home on average in 2018, or 11.7% more than replacement homes.

Ultimately, these student generation rates reveal that replacement homes on average are generating *fewer* students in the short term than other new homes or other homes that were recently sold. There is also no reason to suspect that these replacement homes, over the course of their entire life, will not fall to the average student generation rate like all other homes in the county.

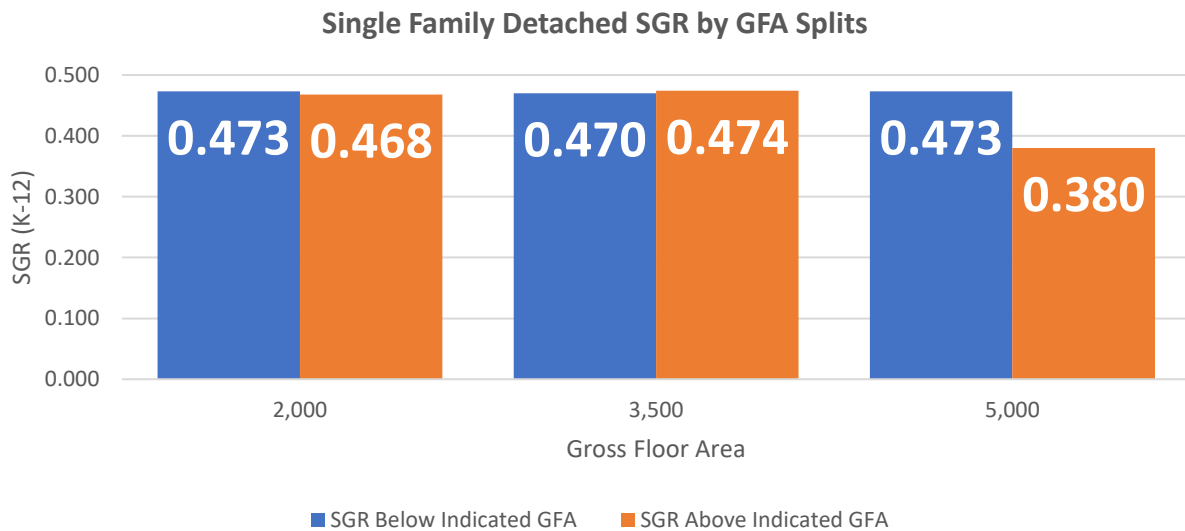
Impact of Larger Homes on Enrollment

Some may argue that the replacement homes are materially different than the existing housing stock simply because they tend to be larger, and therefore are less likely to fall to the average lifetime student generation rate (0.462 students per home) than existing homes that were recently sold. In other words, these homes, even if they are producing fewer students in the short term, will produce more students over their entire life than the typical existing single family home.

Our review of student enrollment, however, reveals no obvious correlation between the gross floor area (GFA) of a home and student generation, as can be seen in the graph below.



More generally, we reviewed several GFA splits, which continued to counter the popular belief that larger homes generate more students than smaller homes:



Revenue Generation

In promoting the bill, the sponsors have indicated that the bill is anticipated to generate approximately \$57 million in new funding for school construction and \$47 million in new funding for affordable housing initiatives over a ten-year period. Further, they have also indicated that the Planning Department developed those estimates. For clarification, Planning staff had previously only run a simple calculation to generate a rough estimate of the potential new school impact tax revenue. Assuming a continuation of the 10-year countywide average of 219 replacement homes per year, if you apply the current school impact tax for single family detached homes of \$26,207 per home, applying the impact tax to replacement homes would approximately generate \$5.7 million per year to support school construction efforts.

Staff did not previously estimate the potential revenue from the proposed affordable housing excise tax. However, if you again assume a continuation of the 10-year countywide average of 219 replacement homes per year and further assume that those replacement homes will be, on average, 2,554 square feet larger than the original homes (the average countywide increase since 2012), the \$9 per square foot excise tax would generate approximately \$5.0 million per year to support affordable housing initiatives.

It is important to note that it is unclear what impact these new taxes would have on the number of demolitions and replacement homes built each year. As such, Planning staff leaves a more thorough fiscal impact statement to the county's Office of Management and Budget.

Staff Recommendations

Staff understands well the need to preserve and grow the county's affordable housing and to fund the capacity demands of growing public school enrollment. Nevertheless, staff recommends no action be taken on Bill 34-19 at this time. The concepts promoted in the bill should be evaluated more thoroughly as part of a comprehensive review of school impact taxes with the 2020 update to the Subdivision Staging Policy (SSP). The SSP update effort currently includes an investigation of alternative student generation rates that may have implications on how school impact taxes are calculated or applied in the future.

Should the County Council choose to move forward with the bill, staff recommends that answers to the following questions and concerns be addressed through committee and Council work sessions:

- In the case of the proposed affordable housing impact excise tax, what is the basis for the \$9 per square foot charge? How was this rate determined?
- Under the current law, if a replacement home is not built within a year of demolition of the original home, the property owner is already required to pay both school and transportation impact taxes on the new home because it is no longer viewed as a replacement home. Under the proposed bill, would these property owners still be required to pay the affordable housing excise tax?
- Assuming the average increase of 2,554 square feet, Bill 34-19 would require the property owner to pay \$49,193 in new taxes. This is quite a significant tax bill that presents several concerns:
 - In 2016, the Council decided to calculate impact taxes using the average student enrollment impact of single family detached homes over their entire lifespan. In this regard, replacement homes have not been shown to generate any more students over their lifespan than the existing stock of single family homes.
 - Over the short term, we have found the exact opposite. Other newly built homes generate 7.4% more students than replacement homes. Existing homes recently sold (regardless of

the age of the home) generate 11.7% more students than replacement homes built over the same timeframe. In other words, the typical existing home sale will generate more students in the short term than the typical home replacing one that was demolished. Why should the developer or owner of a replacement home incur this cost, but not the purchasers of an existing home?

- Most of the demolition and replacement projects are handled by boutique developers that specialize in building individual homes. The development industry has expressed some concerns that these developers are already adversely impacted by fees and development costs that don't scale down and hurt the viability of their business. The proposed new fees seem to unfairly target these developers, while developers of larger residential projects are building more than 10 times as many single family homes per year without having to pay the proposed excise tax. While larger projects require developers to build MPDUs or pay into the County's Housing Initiative Fund, projects with ten or fewer homes are exempt in recognition of the burden such a fee would present.
- Impact taxes in Montgomery County are already by far the highest in the region, other than Loudoun County, which is still mostly experiencing greenfield development that requires the construction of new infrastructure facilities. At a certain point, we need to consider whether adding more taxes – in this case nearly \$50,000 in additional taxes on average – would have unintended consequences on market behavior. (Developers may choose to take their business elsewhere, or more property owners may opt to build large additions rather than demolishing and replacing existing homes.)
- Another concern relates to the burden this bill would place on homeowners that have outgrown their existing home and would like to continue living at their current address but in a larger home. Unlike a developer flipping a property for profit, these homeowners do not have an opportunity to recuperate the tax payments.⁴ For many homeowners, they may be forced to forego the project and instead find an appropriately size home elsewhere.
- The stated purpose of the proposed excise tax is to raise revenue for affordable housing initiatives. If the Council desires to implement another tax on residential development to help preserve and grow the county's affordable housing stock, it might be better to base the tax on the sales price of the replacement home, rather than its increased gross floor area. The sales price basis has a more direct nexus to affordability. For instance, why should the owner of a replacement home in Silver Spring that is 2,500 square feet larger than the property's original home be required to pay the same amount as the owner of a corresponding replacement home in Bethesda if the home in Silver Spring sells for \$1 million less?
 - Staff hesitates to recommend such broad application of an affordable housing excise tax without a thorough review of the economic implications within the context of a competitive regional housing market.
- In 2016, the County Council increased the recordation tax paid on home sales, in part to increase revenue for affordable housing initiatives. The impacts of that change should be evaluated before a new affordable housing excise tax is introduced. The recordation tax more fairly applies to all home sales and is progressive in nature since it is based on the sales price.

⁴ It is also an open question whether the typical developer of a replacement home would be able to recuperate the new taxes through the sale of the property without cutting too deeply into profits. This is the crux of the previous point that these taxes might alter the market and cause some developers to take their business and the jobs they create elsewhere.

- Although it is not a stated purpose of the bill, some advocates for it have contended that it might discourage the mansionization of homes in older, established single family neighborhoods. If this is a desired outcome, then the Council should alternatively consider applying context-sensitive size restrictions on replacement homes.

Attachments

1. Bill 34-19 as introduced



Committee: GO
Committee Review: At a future date
Staff: Christine M.H. Wellons, Legislative Attorney
Purpose: To introduce agenda item – no vote expected
Keywords: #HousingImpactFairness

AGENDA ITEM #4B
October 15, 2019
Introduction

SUBJECT

Bill 34-19, Taxation – Development Impact Taxes – Affordable Housing – Housing Impact Fairness Act
Lead Sponsor: Councilmember Glass; Co-Sponsor: Councilmember Jawando

EXPECTED ATTENDEES

None

COUNCIL DECISION POINTS & COMMITTEE RECOMMENDATION

- N/A; Bill introduction

DESCRIPTION/ISSUE

Bill 34-19, Taxation – Development Impact Taxes – Affordable Housing – Housing Impact Fairness Act would:

- alter the applicability of the development impact tax for public school improvements;
- establish an excise tax on certain demolitions and renovations of single-family homes; and
- specify the use of certain tax revenues for affordable housing initiatives.

SUMMARY OF KEY DISCUSSION POINTS

- N/A

This report contains:

Staff Report

Bill 34-19

Legislative Request Report

Pages 1-2

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©6

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MEMORANDUM

October 10, 2019

TO: County Council

FROM: Christine M.H. Wellons, Legislative Attorney
Wellons

SUBJECT: Bill 34-19, Taxation – Development Impact Taxes – Affordable Housing – Housing Impact Fairness Act

PURPOSE: Introduction – no Council votes required

Bill 34-19, Taxation – Development Impact Taxes – Affordable Housing – Housing Impact Fairness Act, sponsored by Lead Sponsor Councilmember Glass and Co-Sponsor Councilmember Jawando, is scheduled to be introduced on October 15, 2019. A public hearing is tentatively scheduled for December 3, 2019 at 7:30 p.m.¹

Bill 34-19 would:

- alter the applicability of the development impact tax for public school improvements;
- establish an excise tax on certain demolitions and renovations of single-family homes; and
- specify the use of certain tax revenues for affordable housing initiatives.

Background and Purpose

The purpose of Bill 34-19, Taxation – Development Impact Taxes – Affordable Housing – Housing Impact Fairness Act is to raise revenue for: (1) affordable housing initiatives; and (2) public school improvements. As described more specifically below, the bill would achieve this purpose by: (1) creating an excise tax on the demolition or partial demolition (i.e., “teardown”) of single-family homes; and (2) expanding the applicability of the development impact tax for public school improvements.

Currently, teardowns of older existing single-family homes – which often result in the creation of substantially larger and less affordable homes – are not subject to impact taxes in the County. Comparable newer developments, however, are subject to transportation and school impact taxes under existing law. Under the bill, teardowns of certain older single-family homes would be made subject to the impact tax for school improvements. Furthermore, teardowns resulting in larger single-family homes would be subject to a separate excise tax, the revenues of which would be dedicated solely to affordable housing initiatives in the County (as opposed to transportation projects or other County programs). The transportation impact tax, as well as the formula for the school impact tax, would remain unchanged.

¹ #HousingImpactFairness

Specific Provisions of Bill 34-19:

A new Affordable Housing Teardown Excise Tax would apply to certain total demolitions and partial demolitions of attached or detached single-family homes when the replacement home has a greater square footage than the original home. The tax rate would be \$9, or a higher rate adopted by resolution of the County Council, for each square foot that the floor area of the replacement home exceeds the floor area of the original home.

The Department of Permitting Services (DPS) would calculate the amount of the tax. The tax would be collected as a precondition to a demolition permit in the case of a total demolition, or as a precondition to a building permit in the case of a partial demolition. A “partial demolition” would include the destruction of 50% or more of the original home.

Revenues from the new excise tax would be dedicated to the Montgomery Housing Initiative for affordable housing.

The bill also would expand the applicability of the development impact tax for public school improvements. Currently, the impact tax does not apply to:

- (1) “any reconstruction or alteration of an existing building or part of a building that does not increase the number of dwelling units of the building...” or
- (2) “any building that replaces an existing building on the same site or in the same project (as approved by the Planning Board or the equivalent body in Rockville or Gaithersburg) to the extent of the number of dwelling units of the previous building, if:
 - (A) construction begins within one year after demolition or destruction of the previous building was substantially completed; or
 - (B) the previous building is demolished or destroyed, after the replacement building is built, by a date specified in a phasing plan approved by the Planning Board or equivalent body....”

(County Code Section 52-54).

The bill would alter these two exceptions under Section 52-54 so that the public school impact tax *would apply* to a new, reconstructed, or altered attached or detached single-family home that replaces a home built before the effective date of the school impact tax law, which was March 1, 2004. Homes built before March 1, 2004 have never been subject to the impact tax for public school improvements under Section 52-54. Under the bill, the effect of these older single-family homes on public schools would be captured at the time the home is reconstructed or replaced.

This packet contains:

Bill 34-19

Legislative Request Report

Circle #

1

6

Bill No. 34-19
Concerning: Taxation – Development
Impact Taxes – Affordable Housing –
Housing Impact Fairness Act
Revised: 10/07/2019 Draft No. 10
Introduced: October 15, 2019
Expires: April 15, 2021
Enacted: _____
Executive: _____
Effective: _____
Sunset Date: None
Ch. _____, Laws of Mont. Co. _____

COUNTY COUNCIL FOR MONTGOMERY COUNTY, MARYLAND

Lead Sponsor: Councilmember Glass
Co-Sponsor: Councilmember Jawando

AN ACT to:

- (1) alter the applicability of the development impact tax for public school improvements;
- (2) establish an excise tax on certain demolitions and renovations of single-family homes;
- (3) specify the use of certain tax revenues for affordable housing initiatives; and
- (4) generally amend the law concerning taxation.

By amending

Montgomery County Code
Chapter 52, Taxation
Section 52-54

By adding

Article XI, Affordable Housing Teardown Excise Tax
Sections 52-112, 52-113, 52-114, and 52-115

Boldface	<i>Heading or defined term.</i>
<u>Underlining</u>	<i>Added to existing law by original bill.</i>
[Single boldface brackets]	<i>Deleted from existing law by original bill.</i>
<u>Double underlining</u>	<i>Added by amendment.</i>
[[Double boldface brackets]]	<i>Deleted from existing law or the bill by amendment.</i>
* * *	<i>Existing law unaffected by bill.</i>

The County Council for Montgomery County, Maryland approves the following Act:

reconstructed, or altered building is greater than the tax that would have been due on the previous building if it were taxed at the same time, the applicant must pay the difference between those amounts.

(4) Replacement of an Older Single-family Home. Unless an exemption under subsection (c) applies, the development impact tax under this Section must apply to a new, reconstructed, or altered attached or detached single-family home that replaces a home built before March 1, 2004.

* * *

Article XI. Affordable Housing Teardown Excise Tax

52-112. Definitions.

In this Article, the following terms have the meanings indicated:

Applicant means a property owner, or duly designated agent of the property owner, of land on which:

- (1) a demolition permit has been requested to demolish a single-family home; or
- (2) a building permit has been requested in connection with a partial demolition of a single-family home.

Demolition means the teardown, destruction, or removal of a single-family home under Section 8-27.

Department means the Department of Permitting Services.

Partial demolition means the teardown, destruction, or removal of at least 50% of a single-family home.

Replacement single-family home means a single-family home that replaces a demolished or partially demolished single-family home.

53 Single-family home means a single-family detached or attached
 54 residential building.

55 **52-113. Imposition and applicability of excise tax.**

56 (a) Except as provided in subsection (b), an applicant must pay a
 57 demolition tax in the manner and amount prescribed by this Article.

58 (b) An applicant must not pay a tax under this Article to demolish or
 59 partially demolish a building or structure deemed unsafe under Sections
 60 8-10 or 26-13.

61 **52-114. Tax amount.**

62 (a) Unless a higher tax rate is established under subsection (b), the tax rate
 63 under this Article must be \$9 for each square foot of gross floor area of
 64 the replacement single-family home that exceeds the gross floor area of
 65 the demolished or partially demolished single-family home.

66 (b) The Council may establish a rate for the tax that is higher than the rate
 67 under subsection (a) by resolution after a public hearing under Section
 68 52-17.

69 **52-115. Determination of amount; use of funds.**

70 (a) The Department must not issue a demolition permit or a building permit
 71 to an applicant unless:

72 (1) the applicant has paid the tax due under this Article; or

73 (2) the applicant is exempt from the tax under Section 52-113.

74 (b) The Department must calculate the amount of the demolition tax under
 75 Section 52-114.

76 (c) The applicant must submit to the Department any information,
 77 certification, and documentation required by the Department to
 78 calculate the amount of the tax.

79 (d) Tax revenues under this Section must be used solely to fund the
80 Montgomery Housing Initiative under Section 25B-9.

81 **Sec. 2. Transition.** The amendments to the impact tax for public school
82 improvements, and the affordable housing excise tax, under Section 1 of this Act
83 must apply to an application for a building or demolition permit filed on or after the
84 effective date of the Act.

LEGISLATIVE REQUEST REPORT

Bill 34-19

Taxation – Development Impact Taxes – Affordable Housing – Housing Impact Fairness Act

DESCRIPTION: Bill 34-19, Taxation – Development Impact Taxes – Affordable Housing – Housing Impact Fairness Act would:

- alter the applicability of the development impact tax for public school improvements;
- establish an excise tax on certain demolitions and renovations of single-family homes; and
- specify the use of certain tax revenues for affordable housing initiatives.

PROBLEM: More affordable housing is needed in the County. School improvements are needed in the County.

GOALS AND OBJECTIVES: Raise revenue for affordable housing initiatives and for public school improvements.

COORDINATION: Finance; Department of Permitting Services

FISCAL IMPACT: OMB

ECONOMIC IMPACT: Finance

EVALUATION: To be done.

EXPERIENCE ELSEWHERE: To be researched.

SOURCE OF INFORMATION: Christine M.H. Wellons, Legislative Attorney

APPLICATION WITHIN MUNICIPALITIES: N/A

PENALTIES: N/A