University of Baltimore Journal of Land and Development

Volume 4
Issue 1 *Fall 2014*

Article 6

2014

Comments: An Unnecessary "Solution": High-Performance Market-Rate Rental Housing

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AN UNNECESSARY "SOLUTION": HIGH-PERFORMANCE MARKET-RATE RENTAL HOUSING

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I. Introduction

On April 11, 2013, new rules and regulations regarding Baltimore City's property tax credits became effective.[1] Similar to the payments in lieu of taxes program (PILOT), Baltimore City has enacted rules and regulations that afford property owners a major tax credit for developing and, or converting current buildings into high-performance market-rate rental housing.[2] Baltimore City Mayor, Stephanie Rawlings-Blake, is optimistic about the tax credit, believing the credit will spur development within Baltimore City.[3] The city believes that development projects will attract new residents to Baltimore City, as well as deter current residents from leaving the city for areas that have a lower property tax rate.[4] Critics of the tax credit have questioned the program's ability to successfully encourage developers to initiate development projects in Baltimore that weren't already interested in doing so in the first place.[5]

Arguably, the fastest way to encourage economic development and to cause an increase in residents in Baltimore City would be to lower the property taxes across Baltimore City.[6] The fact that Baltimore City chose to forego lowering the property tax rate, and instead implemented a property tax credit, has received its' fair share of criticism.[7] Normally, municipalities do not offer a tax credit for high-performance market-rate rental housing because market-rate housing normally houses professionals, and professionals are generally better able to afford housing than low-income residents.[8] Baltimore City has jus-

1. *See* Baltimore, Md., Code art. 28 § 10-17 (2013), *available at* https://law.resource.org/pub/us/code/md/baltimore.code.article.28.pdf.
2. *See* Mark Reutter, *Major tax break for downtown developers set for approval today*, Balt. Brew (Apr. 8, 2013, 10:51 AM), https://www.baltimorebrew.com/2013/04/08/major-tax-break-for-downtown-developers-set-for-approval-today/.
3. *See* Yvonne Wenger, *City Council approvals tax breaks to spur Baltimore development*, Balt. Sun (June 23, 2014), http://articles.baltimoresun.com/2014-06-23/news/bs-md-ci-tax-credits-development-20140623_1_tax-bills-tax-breaks-property-tax.
4. *See id.*
5. *See id.*
6. *See id.*
7. *See id.*
8. *See* Reutter, *supra* note 2.

tified the tax credit for market-rate rental housing in many ways, one of which is by requiring the new or converted buildings to be LEED (Leadership in Energy and Environmental Design) certified, in an effort to become more environmentally friendly.[9] Additionally, developers must also submit information that proves the development project achieves a public purpose, as well as information that allude to the economic benefits of the project.[10]

II. Background

a. *The Bill in A Nutshell*

The term "High-Performance Market-Rate Rental Housing" can be broken down into three separate, definable terms.[11] The relevant terms are: "high-performance," "market-rate," and "rental housing."[12] The easiest of the terms to comprehend is the term "rental housing," which, depending on the bill passed by the city, must contain either twenty or fifty different housing units.[13]

The next important term is "market-rate."[14] "Market-rate" simply refers to the fair market value of a property.[15] Due to economic stability generally enjoyed by those living in market-rate rental housing, policy makers shy away from issuing a market-rate rental housing tax credit. Instead, they opt to create tax credits for inclusionary housing, such as for low-income families, veterans, individuals with disabilities, and the elderly.[16] Baltimore City officials contend "recent analyses have shown that there is a propensity for young professionals to prefer an urban environment close to where they work," and it is the city's intention to "capitalize on these recent trends by causing existing, underutilized commercial structures in the Downtown Management Area to be converted to mixed residential-commercial use through the use of this credit," which they will do through creation of a high-performance market-rate rental housing tax credit.[17]

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9. *See id.*
10. *See PILOTS & TIFS*, BALT. DEV. CORP., http://baltimoredevelopment.com/for-businesses/assistance-programs—tax-credits/pilots—tifs/ (last visited Mar. 24, 2015).
11. *See* BALTIMORE, MD., CODE art. 28 § 10-17 (2013), *available at* https://law.resource.org/pub/us/code/md/baltimore.code.article.28.pdf.
12. *See id.*
13. *See id.*
14. *See id.*
15. *See Housing Type Definitions*, HOMEBASE FOR HOUSING, http://homebaseforhousing.org/Education/Definitions.cshtml (last visited Oct. 11, 2014).
16. *See* Chickie Grayson, *Affordable housing at risk*, BALT. SUN (Apr. 24, 2013), http://articles.baltimoresun.com/2013-04-24/news/bs-ed-housing-credit-20130424_1_housing-credit-housing-authority-affordable-housing-crisis.
17. *See* Memorandum from Andrew W. Kleine on High-Performance Market-Rate Rental Housing Tax Credits to Honorable President and Members of the City Council (Mar. 12, 2013) (on file with author) [hereinafter Kleine Memorandum].

The final definable term of the bill is "high-performance,"[18] which refers to any building that achieves at least a silver rating according to the U.S. Green Building Council's LEED green building rating system, or to any building that receives a comparable rating system.[19] Likewise, the Maryland State Tax-Property Article § 9-242 permits a county or municipality to create tax credits for any buildings that can achieve such a rate.[20] Baltimore City officials have stressed that the implementation of the high-performance market-rate rental housing tax credit is designed in a way to increase the population in downtown Baltimore,[21] likely in response to Baltimore City's precipitous decrease in population over several decades.[22]

b. The Great Exodus

From 1790 through 1950, Baltimore City's population steadily rose.[23] However, after peaking in 1950 at about 949,000 people, Baltimore City's population has significantly decreased, now estimated to be at 621,342 people as of 2013.[24] Residents fled Baltimore City at an alarming rate.[25] Along with the decrease in population, the median annual household income for Baltimore City dropped significantly.[26] In 1950, the median annual household income in Baltimore City was seven percent above the median household income in the United States.[27] However, by 2000 the median household income in Baltimore City had fallen to 28 percent below the median household income in the United States.[28]

c. Carrot or the Stick? High Property Taxes Create an Incentive For Residents To Move Out of Baltimore City

Baltimore implemented a high property tax rate during the post-World War II era in an effort to fund social welfare programs. These programs were aimed at aiding low-income members of the population, providing them with affordable housing in their respective cit-

18. *See* BALTIMORE, MD., CODE art. 28 § 10-17 (2013), *available at* https://law.resource.org/pub/us/code/md/baltimore.code.article.28.pdf.
19. *See* MD. CODE ANN., TAX – PROP. § 9-242 (West 2012).
20. *See id.*
21. *See* Kleine Memorandum, *supra* note 17.
22. *See Population history of Baltimore from 1790 – 1990,* BOS. UNIV., http://physics.bu.edu/~redner/projects/population/cities/baltimore.html (last visited Sept. 7, 2014).
23. *See id.*
24. *See Baltimore Population 2013,* WORLD POPULATION STATISTICS (Sept. 2, 2013), http://www.worldpopulationstatistics.com/baltimore-population-2013/.
25. *See id.*
26. *See* Stephen J.K. Walters & Louis Miserendino, *How to Make Baltimore a Superstar City,* 2011 THE MD. J. 35, 35 (2011).
27. *See id.*
28. *See id.*

ies.[29] Baltimore's property tax rate was set at 2.3 percent, at least double the rate of all of the counties immediately surrounding the city.[30]

Baltimore City has not yet enjoyed a tax revolution due to Maryland's own tax policy,[31] which failed to introduce a major property tax cut.[32] Coupled with the fact that the surrounding county's property taxes are less than half of Baltimore City's property tax rate[33] (for example, Baltimore County's property tax rate is currently 1.1 percent of the market value of the home), it is easy to see why Baltimore City is currently dealing with a decreasing population (tax base), while the surrounding counties are currently enjoying an influx of new residents.[34]

d. The Current State of Baltimore City's Tax Policy and the People Affected

Baltimore City's politicians have constantly failed to accomplish their long-term goal of reducing the City's high property tax rate.[35] In fact, Baltimore City's current property tax rate of 2.288 percent is currently more than double that of neighboring Baltimore County's property tax rate, which is in turn higher than other surrounding counties such as Anne Arundel, Carroll, Harford, and Howard County.[36] For Baltimore City to have reached the goal set by itself in the early 1990s to "no more" than 150 percent of Baltimore County's property tax rate, the city would have to reduce the current tax rate of 2.288 percent by 30 percent, or more than 60 cents.[37]

e. The Competition: Implementation of High-Performance Market-Rate Rental Housing versus a Property Tax Rate cut

Instead of reducing Baltimore City's high property tax rate, the city's politicians decided to implement high-performance market-rate rental housing tax credits.[38] Mayor Rawlings-Blake contends that the high-performance market-rate rental housing tax credit, paired with a small reduction in the property tax (the property tax bill for the average home will be reduced by $174) will bring an influx of develop-

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29. *See id.* at 36.
30. *See id.* at 36-37.
31. *See id.* at 37.
32. *See id.*; *see also* Eric Siegel, *Political debate looms over the city's property tax rate*, BALT. SUN (Feb. 22, 2007), http://articles.baltimoresun.com/2007-02-22/news/0702220072_1_property-tax-rate-baltimore-county-commuter-tax.
33. *See 2014-2015 County Tax Rates*, DEP'T OF ASSESSMENTS & TAX'N, http://www.dat.state.md.us/sdatweb/taxrate.html (last visited Oct. 11, 2014).
34. *See* Donald C. Fry, *Addressing Baltimore City's High Property Tax Rate*, CENTER MD. (Mar.13, 2014), http://www.centermaryland.org/index.php?option=com_easyblog&view=entry&id=900.
35. *See* Siegel, *supra* note 32.
36. *See id.*
37. *See id.*
38. *See* Wenger, *supra* note 3.

ment and residents, which will in turn increase Baltimore City's coffers.[39]

However, there is reason to believe the menial property tax cut will essentially be cancelled out by Baltimore City's decision to raise the water and sewer rates.[40] For example, while the property taxes for the average home will be reduced by $174, water bills have concurrently increased by 42 percent, which constitutes a $100 increase.[41] Essentially, Baltimore City implemented both the high-performance market-rate rental housing tax credit and a minor property tax cut, claiming that it will attract new residents and keep old residents in the city limits.[42] Yet, the city nearly neutralized the marginal property tax cut after increasing the water and sewage rates, and has yet to make a decision regarding a long-term property tax cut.[43]

Baltimore City's inability to implement a long-term tax-relief plan comes at a most inopportune time.[44] Baltimore City currently has a median annual household income of $40,803.[45] Maryland, on the other hand, has a median annual household income of $72,999.[46] Thus, Baltimore City's median annual household income is roughly 55 percent of that of the state's median annual household income.[47]

Lenders generally advise individuals to spend no more than 28 percent of their monthly income on a mortgage or rent.[48] According to the Department of Housing and Urban Development, the fair market monthly rental value of a two-bedroom home in Baltimore City is $1,252.[49] This amount far exceeds the suggested 28 percent allotment lenders suggest for people to spend on housing per month[50] considering the median annual household income in Baltimore City is $40,803.[51] What would compel the city implement a high-perform-

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39. *See id.*
40. *See id.*
41. *See id.*
42. *See id.*
43. *See id.*
44. *See* Grayson, *supra* note 16.
45. *See* U.S. Census Bureau, Income in the Past 12 Months for Baltimore City (2008-2012), *available at* http://factfinder2.census.gov/bkmk/table/1.0/en/ACS/12_5YR/S1901/0500000US24510.
46. *See* U.S. Census Bureau, Income in the Past 12 Months for Maryland (2008-2012), *available at* http://factfinder2.census.gov/bkmk/table/1.0/en/ACS/12_5YR/S1901/0400000US24.
47. *See id.*
48. *See How Much You Should Spend on a Home*, Wall St. J., http://guides.wsj.com/personal-finance/buying-a-home/how-much-you-should-spend-on-a-home/ (last visited Sept. 7, 2014).
49. *See A Plan for Affordable Housing in Baltimore*, Housing Policy Watch (Apr. 6, 2014), http://housingpolicywatch.com/2014/04/06/a-plan-for-affordable-housing-in-baltimore/.
50. *See* Wall St. J., *supra* note 48.
51. *See* U.S. Census Bureau, Income in the Past 12 Months for Baltimore City (2008-2012), *available at* http://factfinder2.census.gov/bkmk/table/1.0/en/ACS/12_5YR/S1901/0500000US24510.

ance market-rate rental housing tax credit that does not contain a provision for inclusionary housing (otherwise known as affordable housing, encompassing below-market rents for low-income people, persons with disabilities, and seniors)[52] when Baltimore City residents are already paying the highest property taxes in the state while earning a median annual household income roughly 55 percent below that of the state's median annual household income?

III. Analysis

a. *A Tax Incentive for the Wealthy*

Generally governments do not create tax incentives for market-rate rental housing, instead opting to create tax credits for inclusionary housing.[53] Affordable housing is imperative to the economy, and in Maryland affordable housing tax credits have been notably beneficial, encouraging developers to create over 53,000 new homes, and creating over 62,000 jobs in the process.[54] The economic benefits far outweigh the possible negative effects of the housing tax credit: private investors and developers create the housing and provide the start-up money necessary for the project, and thus bear all the financial risks associated with the investment.[55] Maryland estimates that since the affordable housing tax credit was implemented the state has granted $2 billion in tax credits, which have returned $5 billion worth of local income.[56] While affordable housing tax credits are economically beneficial to the state, they more importantly provide relief and housing to those that would otherwise be unable to afford to house them due to Baltimore City's high property tax rate.[57]

On the other hand, market-rate rental housing tax credits are fairly new.[58] For example, as recently as 2010 Massachusetts implemented a market-rate rental housing credit.[59] However, this tax credit is strictly limited to rehabilitating properties, and the credit only covered 10 percent of qualified substantial rehabilitation expenditures.[60] Governments generally favor inclusionary housing tax credits over market-rate housing tax credits because they place higher priority on helping those in need of help, such as low-income families, people with special needs, seniors, and veterans.[61] Nevertheless, the Baltimore City Council approved the high-performance market-rate rental housing tax

52. *See Housing Type Definitions*, *supra* note 15.
53. *See* Reutter, *supra* note 2.
54. *See* Grayson, *supra* note 16.
55. *See id.*
56. *Id.* (citing statistics based on the National Association of Home Builders economic impact multipliers).
57. *See id.*
58. *See* MASS. GEN. LAWS ANN. ch. 59, § 5M (West 2010).
59. *See id.*
60. *See id.*
61. *See* Grayson, *supra* note 16.

credit, hoping the tax credit will spur economic development in the city and increase Baltimore City's tax base by attracting new residents to the city.[62]

b. Achieving Goals: Going Green

The carrot and the stick idiom is often used to describe a government's decision to employ taxes and tax credits in order to achieve goals consistent with public policy.[63] Effectually, Article 28 § 10-17 of the Baltimore City Code creates a "carrot" for developers to erect environmentally friendly housing real estate, a policy that has largely worked,[64] as Maryland is a nationwide leader in green buildings.[65] Maryland's green building laws also saw Maryland rank second in environmentally friendly building activity, behind only Illinois in 2013.[66]

Admittedly, requiring new buildings to achieve a certification deeming them to be environmentally friendly is noble, and is congruent with Maryland's public policy relating to environmental protection, such as statewide initiatives geared towards protecting the Chesapeake Bay.[67] However, the implementation of high-performance market-rate rental housing tax credit will act as the stick, having a detrimental effect on many current Baltimore City residents, further gentrifying areas of Baltimore City and displacing residents who cannot afford market-rate rental housing.[68]

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62. *See* Wenger, *supra* note 3. *See also* Reutter, *supra* note 2.
63. *See* Brian Galle, *Carrots, Sticks, and Salience*, 67 TAX L. REV. 53, 54 (2013).
64. *See* James B. Witkin & Kathleen J. Trinward, *Maryland's Green Building Laws*, 43 MD. B.J. 22, 28-29 (Sept./Oct. 2010).
65. *See* Steve Kilar, *Maryland ranks well for green building*, BALT. SUN (Jan. 25, 2013), http://articles.baltimoresun.com/2013-01-25/business/bs-re-maryland-ranks-well-for-green-building-20130125_1_leed-certification-energy-and-environmental-design-maryland-ranks. *See also* Jacob Kriss, *Top 10 States For LEED In 2012*, U.S. GREEN BUILDING COUNCIL (Jan. 23, 2012), http://www.usgbc.org/articles/usgbc-releases-2012-list-top-10-states-leed.
66. *See* Natalie Sherman, *Maryland ranked second in green building activity*, BALT. SUN (Feb. 18, 2014), http://articles.baltimoresun.com/2014-02-18/business/bal-maryland-jumps-to-second-place-in-green-building-activity-20140218_1_leed-maryland-top-10-list.
67. *See* Erin Fitzsimmons, *Resources Protecting Resources*, 41 MD. B.J. 18, 19-20 (May/June 2008) (discussing Maryland's need to focus on advancing the cleanup of the Chesapeake Bay).
68. *See* Andrew Zaleski, *Can a Baltimore Neighborhood Avoid the Pitfalls of Gentrification?*, NEXT CITY (Aug. 4, 2014), http://nextcity.org/daily/entry/gentrification-baltimore-station-north-arts-greenmount-west.

c. Gentrification Effect Felt by High-Performance Market-Rate Rental Housing

In the past, members of Baltimore City neighborhoods undergoing a gentrification process had "conceded some gentrification was a necessary trade-off to ensure sustainable inner-city redevelopment."[69]

As high-performance market-rate rental housing springs up in Baltimore City, neighborhoods will undoubtedly begin to feel the effects of gentrification taking place, both positive and negative.[70] To some, the gentrification process is viewed as a necessary evil: development will revitalize the neighborhood both aesthetically and economically, but will also increase property values, in turn increasing the amount of money residents spend on their property taxes.[71] An increase in a household's property tax bill could force residents to flee the areas they grew up in,[72] considering Baltimore City's median household income is $40,803,[73] 55 percent of Maryland's median household income of $72,999.[74] Luckily for Baltimore City residents, Maryland has codified a Homestead Property Tax Credit limiting the percentage a homeowner's property tax can increase on a yearly basis.[75] While the Homestead Property Tax Credit limits the percentage a homeowner's property tax can increase on a yearly basis, all it will do for residents in the long-term is postpone the inevitable increase in property tax rates.[76] Additionally, the cost of rising property tax rates will be felt by renters, after the cost of the rise in property taxes is passed on to them from landlords.[77]

d. A Viable Alternative

A reasonable alternative to Baltimore City's newly implemented high-performance market-rate rental housing is a uniform property tax cut to one percent; lower than that of Baltimore County.[78] Cur-

69. *See* John S. Reshwan, *Crossing the Threshold of Urban Mobility and Redevelopment: Using Tax Allocation Districts to Develop the Atlanta Beltline*, 23 GA. ST. U. L. Rev. 681, 705 (2007).
70. *See* Zaleski, *supra* note 68.
71. *See id.*
72. *See id.*
73. *See* U.S. CENSUS BUREAU, INCOME IN THE PAST 12 MONTHS FOR BALTIMORE CITY (2008-2012), *available at* http://factfinder2.census.gov/bkmk/table/1.0/en/ACS/12_5YR/S1901/0500000US24510.
74. *See* U.S. CENSUS BUREAU, INCOME IN THE PAST 12 MONTHS FOR MARYLAND (2008-2012), *available at* http://factfinder2.census.gov/bkmk/table/1.0/en/ACS/12_5YR/S1901/0400000US24.
75. *See* Zaleski, *supra* note 68. *See also* MD. CODE ANN., TAX-PROP. § 9-105 (West 2014).
76. *See* Zaleski, *supra* note 68. *See also* MD. CODE ANN., TAX-PROP. § 9-105 (West 2014).
77. *See* Zaleski, *supra* note 68.
78. *See* Walters & Miserendino, *supra* note 26, at 44.

rently there are over 30,000 structures vacant in Baltimore City.[79] By slashing the property tax rate to one percent, these seemingly worthless structures would gain value and attract investors and residents alike back to Baltimore City.[80] While the initial dollar amount collected per household would drop considerably, Baltimore would increase its tax base significantly, creating revenue from the influx of residents[81] without having to disenfranchise the majority of the city's population who are barely able to afford living in the city with its current property tax rate.[82]

Historically, cities such as Boston and San Francisco were similarly situated heading into the mid-1970s.[83] Yet, after employing dramatic property tax reductions, both Boston and San Francisco saw their populations steadily increase as the property tax reductions made the municipalities a desirable location for new residents and developers, who poured resources into developing the respective cities, promoting economic stability.[84]

IV. Conclusion

High-performance market-rate rental housing was implemented by Baltimore City in an effort to increase Baltimore City's tax base by creating an incentive for current residents to stay in the city in addition to attracting new residents and developers to Baltimore.[85] While the tax credit was implemented in an effort to increase Baltimore City's tax base, the savings provided by the bill are nearsighted, as the tax credit only applies for 15 years.[86] Instead, Baltimore City should consider slashing the property tax rate to one percent (below that of neighboring Baltimore County), which would allow Baltimore City to increase its tax base by attracting residents from all economic backgrounds, and in turn economically stabilize the city.[87]

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79. *See City to Offer Tax Credit for Market-Rate Housing*, HOUSING POLICY WATCH (Apr. 21, 2014), http://housingpolicywatch.com/2014/04/21/city-to-offer-tax-credit-for-market-rate-housing/.
80. *See id.*
81. *See id.*
82. *See* Grayson, *supra* note 16.
83. *See* Walters & Miserendino, *supra* note 26, at 36 (referring to statistics such as property tax, crime rates and job rates, and population decreases).
84. *See id.*
85. *See* Wenger, *supra* note 3.
86. *See* BALTIMORE, MD., CODE art. 28 § 10-17 (2013), *available at* https://law.resource.org/pub/us/code/md/baltimore.code.article.28.pdf.
87. *See* Walters & Miserendino, *supra* note 26, at 44.