Economic Impact Statement

Montgomery County, Maryland

Expedited Bill 25-23 — Taxation – Development Impact Taxes for Transportation and Public School Improvements – Amendments

SUMMARY

The Office of Legislative Oversight (OLO) anticipates Expedited Bill 25-23 would have an overall positive impact on economic conditions in the County in terms of the Council's priority economic indicators. If the changes to the biennial tax rate adjustments reduce total development impact tax, then the Bill would reduce operating expenses for certain commercial and residential developers (holding all else equal). However, certain developers likely would pay higher development taxes due to the provision in the Bill that biennial tax rate adjustments exceeding 20% be carried over and added to the next biennial adjustment.

BACKGROUND AND PURPOSE OF EXPEDITED BILL 25-23

"Development Impact Taxes" are a means by which local governments "collect revenue from builders for public facilities necessitated by new residential or commercial development," thereby "shift[ing] the costs of financing new public facilities from existing taxpayers to individuals responsible for the development."[1]

The County has development impact taxes for transportation and schools. The Transportation Development Impact Tax is assessed on both residential and commercial projects and is used to fund improvements to enhance local transportation capacity. The School Development Impact Tax is assessed on residential projects only and is used to fund improvements to enhance the capacity of the public school system.[2]

If enacted, Expedited Bill 25-23 would make the following changes to the Transportation and School Development Impact Taxes:

- Use a cumulative approach over the prior two years rather than an annual average in calculating tax rate adjustments for development impact taxes;
- Establish a 20% inflation cap on the biennial tax rate adjustments; and
- Require that biennial tax rate adjustments exceeding 20% be carried over and added to the next biennial adjustment.[3]

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[1] County Development Impact Fees.
[2] See Montgomery County Code, Article IV and Article V.
[3] Introduction Staff Report for Expedited Bill 25-23.

According to the Introductory Staff Report for the Bill, the net result of making these changes would be "a net revenue loss of about $24.5 million in FYs24-28."[4]

The County Council introduced Expedited Bill 25-23, Taxation – Development Impact Taxes for Transportation and Public School Improvements – Amendments, on May 18, 2023.

INFORMATION SOURCES, METHODOLOGIES, AND ASSUMPTIONS

Per Section 2-81B of the Montgomery County Code, the purpose of this Economic Impact Statement is to assess, both, the impacts of Expedited Bill 25-23 on residents and private organizations in terms of the Council's priority economic indicators and whether the Bill would have a net positive or negative impact on overall economic conditions in the County.[5]

To assess the Bill's impacts on the Council's priority indicators, OLO draws on the following sources of information:

- Data from the Engineering-News Record's Baltimore Construction Cost Index that Department of Finance personnel provided to OLO; and
- Consultations with Council and Department of Finance staff.

Because OLO does not know how any potential forgone County revenues would otherwise be used in the absence of enacting the Bill, this analysis does not account for the Bill's potential economic opportunity cost.

VARIABLES

The primary variables that would affect the economic impacts of Expedited Bill 25-23 are the following:

- Inflation in construction costs; and
- Magnitude of development impact taxes.

IMPACTS

WORKFORCE ▪ TAXATION POLICY ▪ PROPERTY VALUES ▪ INCOMES ▪ OPERATING COSTS ▪ PRIVATE SECTOR CAPITAL INVESTMENT ▪ ECONOMIC DEVELOPMENT ▪ COMPETITIVENESS

Businesses, Non-Profits, Other Private Organizations

OLO anticipates that Expedited Bill 25-23 would have overall positive impacts on certain private organizations in the County in terms of the Council's priority economic indicators.

The economic impacts of the Bill depend on whether it would affect the amount of development taxes paid by residential and commercial property developers. OLO concludes the Bill may reduce total development taxes paid by developers for the following reasons.

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[4] Ibid.

[5] Montgomery County Code, Sec. 2-81B.

First, Council staff analysis projects the changes to the biennial tax rate adjustments would result in a net revenue loss of about $24.5 million in FYs24-28. If accurate, the revenue loss over this time would reflect the reduction in development taxes paid by developers.

Second, the County calculates the transportation impact tax using biennial percent changes in the Engineering-News Record's Baltimore Construction Cost Index. As shown in Table 1, the biennial percent changes in January in odd years had exceeded 20% at certain periods. While future inflation in construction costs is highly uncertain, recent trends suggest that the 20% inflation cap may reduce transportation development tax rates at certain points in the future.

Third, the Council staff analysis indicates that the projected percentage increases for the school development taxes are significantly higher than 20%, thereby indicating that the inflation cap may reduce school development taxes in the future.

Table 1. Two-Year Change in Cost Construction Index

	2015	2016	**2017**	2018	**2019**	2020	**2021**	2022	**2023**
Jan	**3%**	0%	**2%**	20%	**23%**	8%	**6%**	11%	**20%**
Feb	2%	0%	5%	24%	20%	6%	6%	12%	13%
Mar	2%	0%	5%	23%	19%	6%	8%	13%	.
Apr	0%	4%	7%	19%	16%	6%	12%	16%	.
May	-1%	5%	8%	18%	16%	6%	14%	18%	.
Jun	0%	6%	9%	18%	19%	5%	12%	22%	.
Jul	-1%	6%	20%	20%	9%	4%	15%	22%	.
Aug	-2%	6%	20%	21%	9%	3%	16%	23%	.
Sept	0%	6%	20%	20%	8%	3%	17%	23%	.
Oct	1%	4%	18%	23%	8%	4%	13%	22%	.
Nov	0%	4%	20%	23%	8%	6%	11%	20%	.
Dec	0%	4%	20%	23%	8%	7%	11%	19%	.

If the changes to the biennial tax rate adjustments reduce total development impact tax, then the Bill would reduce operating expenses for certain commercial and residential developers (holding all else equal).

However, certain developers likely would pay higher development taxes due to the provision in the Bill that biennial tax rate adjustments exceeding 20% be carried over and added to the next biennial adjustment. Thus, the Bill likely would increase operating expenses (holding all else equal) for development projects following 20%+ increases in construction cost inflation.

OLO is unable to determine whether the Bill would induce commercial and residential development in the County that otherwise would not occur. However, OLO notes that the total decrease in development tax revenues projected by Council staff (if accurate) may be insignificant to induce development given the many factors responsible for development and the complex relationship between tax cuts and private sector investment.[6]

[6] Trombka, Establishing and Maintaining a Business Friendly Environment.

Residents

OLO anticipates that Expedited Bill 25-23 would have a minor impact on certain residents in the County in terms of the Council's priority economic indicators. In theory, a decrease in development impact taxes could cause developers to spend more on labor, thereby potentially increasing employment opportunities for residents. However, OLO cannot determine whether the total decrease in development tax revenues would be significant enough to induce job creation given the complex relationship between tax cuts and job creation.[7]

Net Impact

OLO anticipates that Expedited Bill 25-23 would have an overall impact on economic conditions in the County in terms of the Council's priority economic indicators. If the changes to the biennial tax rate adjustments reduce total development impact tax, then the Bill would reduce operating expenses for certain commercial and residential developers (holding all else equal). However, OLO is unable to determine whether the Bill would induce job creation or development that otherwise would not occur due to uncertainty about the magnitude of future construction costs and the total decrease in development impact taxes as well as the complex relationships between tax cuts and private sector investment/job creation.

DISCUSSION ITEMS

First, given that the Planning Department is responsible for calculating the development impact tax rates for schools, Councilmembers may want to consider consulting with department personnel regarding the potential for the Bill's cap on 20%+ inflation to reduce rates in the future.

Second, Councilmembers may want to consider alternative formulas for the carry over provision in the Bill (e.g., carrying over the excess amount rather than percentage).

Finally, Councilmembers may want to consider whether further analysis should be performed to determine whether the Bill would induce job creation or development that otherwise would not occur.

WORKS CITED

County Development Impact Fees and Building Excise Taxes in Maryland: Amounts and Revenues. Department of Legislative Services. December 2013.

Montgomery County Code. Sec. 2-81B, Economic Impact Statements.

Montgomery County Council. Introduction Staff Report for Expedited Bill 25-23, Taxation – Development Impact Taxes for Transportation and Public School Improvements – Amendments. Introduced on May 18, 2023.

Trombka, Aron. Establishing and Maintaining A Business-Friendly Environment: A Literature Review. OLO Report 2022-9. July 26, 2022.

[7] Ibid.

CAVEATS

Two caveats to the economic analysis performed here should be noted. First, predicting the economic impacts of legislation is a challenging analytical endeavor due to data limitations, the multitude of causes of economic outcomes, economic shocks, uncertainty, and other factors. Second, the analysis performed here is intended to *inform* the legislative process, not determine whether the Council should enact legislation. Thus, any conclusion made in this statement does not represent OLO's endorsement of, or objection to, the Bill under consideration.

AUTHOR

Stephen Roblin (OLO) prepared this report.