PROPERTY TAX INCENTIVES AND CITY GROWTH AND DEVELOPMENT - BACKGROUND MEMORANDUM

Sections 6 and 7 of 2017 Senate Bill No. 2166 (appendix) provide for Legislative Management studies relating to property tax incentives and city growth and development. Section 7 of the bill directs a study of the duplicative application of property tax incentives, including benefits received by properties located in both a tax increment financing (TIF) district and a renaissance zone. The study also must include consideration of the duration for which a single property may benefit from the use of multiple property tax incentives and the impacts on the remainder of the property tax base that is not receiving property tax incentives.

Section 6 of the bill directs a study of the impact of city growth and infill development on property taxes. The study requires an evaluation of the return on investment for state and community projects. The study also must examine factors affecting city development patterns, including the impact of transfer payments between state and local governments; the cost of government services and infrastructure, including future liability; the amount of tax revenue generated per increment of assumed liability for downtown areas; and whether certain areas of a city generate more revenue than expenses while other areas generate more expenses than revenue.

PROPERTY TAX INCENTIVES

North Dakota law provides discretionary authority for cities and counties to provide property tax exemptions. This authority includes property tax exemptions for new or expanding businesses, under North Dakota Century Code Chapter 40-57.1; improvements to property, under Chapter 57-02.2; new single-family residential or townhouse or condominium property, early childhood services property, pollution abatement improvements, certain builder-owned property, and affordable rental property, under Section 57-02-08; renaissance zone property under Chapter 40-63; and TIF districts under Chapter 40-58.

New or Expanding Business Exemption

In 1969 the Legislative Assembly created Chapter 40-57.1 to provide an economic development tool to cities, for property inside city limits, and counties, for property outside city limits. The primary economic development tool in Chapter 40-57.1 is authority of cities or counties to grant partial or complete property tax exemptions or the option to make payments in lieu of taxes for a limited period of time after negotiation with a potential project operator. The chapter also allows a project to receive an exemption from state income taxes for up to 5 years if approved by the State Board of Equalization.

After negotiation with a potential project operator, a city or county may grant a partial or complete property tax exemption for buildings, structures, fixtures, and improvements for up to 5 years from the date of commencement of project operations. The maximum length of a property tax exemption may be extended to 10 years if the project produces or manufactures a product from agricultural commodities. The option to make payments in lieu of taxes may be extended through the 20th year from the date of commencement of the project.

The property tax exemption or option to make payments in lieu of taxes is available for any revenue-producing enterprise. The income tax exemption available under Chapter 40-57.1 is limited to a primary sector business or a tourism business and may not be received by a business receiving a property tax exemption under tax increment financing.

Exemption of Improvements to Buildings

In 1973 the Legislative Assembly created Chapter 57-02.2 to provide cities and counties discretionary authority to allow property tax exemptions for improvements to commercial and residential buildings and structures. The exemption is allowed if the city, for property within city limits, or the county, for property outside city limits, has adopted a resolution allowing the exemption. The duration of an exemption for improvements is limited to 5 years and does not apply to residential property unless the property is at least 25 years old.

New Single-Family Residential Property Exemption

Section 57-02-08(35) allows the governing body of the city, for property within city limits, or the governing body of the county, for property outside city limits, to approve by resolution a property tax exemption for up to $150,000 of the true and full value of new single-family and condominium and townhouse residential property. The exemption applies for the first 2 taxable years after the taxable year in which construction is completed and the residence is owned and occupied for the first time.

Early Childhood Services Building Exemption

Section 57-02-08(36) allows the governing body of the city, for property within city limits, or of the county, for property outside city limits, to grant a property tax exemption for the portion of a building used primarily to provide early childhood services by a licensed provider or used primarily as an adult day care center. The exemption is not available for property used as a residence.

Pollution Abatement Improvement Exemption

Section 57-02-08(37) allows the governing body of the city, for property within city limits, or the governing board of the county, for property outside city limits, to grant a pollution abatement improvement property tax exemption. An agricultural or industrial facility required to comply with local, state, or federal environmental quality standards may qualify for the exemption. The exemption only applies to the portion of the property's valuation that is attributable to the pollution abatement improvement.

Builder-Owned Single-Family Residential Property Exemption

Section 57-02-08(42) allows the governing body of the city, for property within city limits, or the governing body of the county, for property outside city limits, to approve by resolution an exemption for new single-family residential property. The exemption applies for the taxable year in which construction began and the next 2 taxable years if the property remains owned by the builder, remains unoccupied, and special assessments and taxes on the property are not delinquent. A builder may receive an exemption for no more than 10 properties in each jurisdiction in a taxable year.

Affordable Rental Property Exemption

Section 57-02-08(43) provides a property tax exemption for affordable residential rental property. To qualify, the Housing Finance Agency must certify to the county director of tax equalization that the residential rental property complies with various requirements, including mandatory income and rent restrictions. The property owner of a property qualifying for the exemption is required to make payments in lieu of property tax in an amount equal to 5 percent of the balance of the total annual rents collected during the preceding calendar year, minus utility costs for the property.

Renaissance Zone Exemptions

Pursuant to Chapter 40-63, any incorporated city may apply to the Department of Commerce, Division of Community Services, to designate a portion of the city as a renaissance zone. The application must specify the proposed duration of the zone, which may not exceed 15 years, include a resolution from the governing body of the city stating persons and property within the zone will be exempt from taxes pursuant to Sections 40-63-04 through 40-63-07 if the renaissance zone designation is granted, and include a development plan consisting of:

- A map of the proposed zone, which identifies geographic boundaries and blocks, a description of the properties and structures on each block, a listing of the properties and structures to be targeted for potential zone projects, and the present use and condition of those properties and structures;
- A description of the existing physical assets in the zone, particularly natural or historical assets, and a plan for incorporating or enhancing those assets;
- An outline of the goals, objectives, and proposed outcomes for the zone to be used to gauge the success of the completed zone;
- A description of the promotion, development, and management strategies that will be used to maximize investment in the zone;
- A plan for the development, promotion, and use of a renaissance fund organization or, if the city is not ready to commit to establishing a renaissance fund organization, a statement indicating the city's desire to submit a plan for approval of a renaissance fund organization at a later date; and
- Evidence of community support and commitment from residential and business interests, which beginning August 1, 2017, pursuant to 2017 Senate Bill No. 2166, must include letters of support from the governing bodies of each county and school district that contain property located within the boundaries of the proposed zone.

The proposed zone must be located wholly within the boundaries of the city submitting the application, contain both residential and commercial property, and not be in excess of 34 square blocks unless the population of the city exceeds 5,000. If the population of a city exceeds 5,000, a zone may be expanded at a rate of one additional block for each additional 5,000 in population, not to exceed a maximum size of 49 blocks. All blocks within the proposed zone must be contiguous, with the exception of one area of noncontiguous blocks not to exceed three square blocks. A city may not propose or be part of more than one renaissance zone.

An approved zone may be extended or modified in various ways before its expiration date. If the approved zone is less than the maximum allowable size, a city may apply to the Division of Community Services to expand the zone. The blocks in an approved expansion are eligible for up to 15 years of zone status. A city also may apply to have blocks within a zone, which have either achieved the desired goals or not progressed, removed from the zone and replaced with alternative blocks contiguous to the original zone. Upon approval by the Division of Community Services, the initial 15-year duration of a zone also may be extended in increments of up to 5 years.

The primary incentives for property owners or purchasers of renaissance zone property are income and property tax exemptions.

Income Tax Exemptions

1. An individual who purchases or rehabilitates single-family residential property as a primary residence as a zone project is exempt from up to $10,000 of personal income tax liability for 5 taxable years after the date of occupancy or completion of rehabilitation.
2. A taxpayer that purchases, leases, rehabilitates, or makes leasehold improvements to residential, public utility infrastructure, or commercial property for any business or investment purposes as a zone project is exempt from tax on the first $500,000 of income per year derived from all business or investment locations. The exemption is available for 5 taxable years beginning with the date of purchase, lease, or completion of rehabilitation.
3. If the cost of a new business purchase, leasehold improvement, or expansion of an existing business as a zone project exceeds $75,000, and the business is in a city with a population not exceeding 2,500, an individual taxpayer may elect to take an income tax credit of $2,000 per year for up to 5 taxable years in lieu of the exemption on income derived from the taxpayer's business or investment locations.
4. If a property owner not participating in a renaissance zone project is required to make changes in utility services or building structure because of changes to property that is part of a zone project, the owner of the nonparticipating property is entitled to an income tax credit equal to the amount of investment required to complete the required changes.
5. A credit against individual and corporate income tax is allowed for investments in historic preservation or renovation of property in a renaissance zone. The credit is equal to 25 percent of the amount of investment, up to a maximum of $250,000. The credit may be claimed in the year in which the preservation or renovation is completed, and any excess credit may be carried forward for up to 5 taxable years.
6. A credit against individual income and corporate income tax is allowed for investments in a renaissance fund organization. The credit is equal to 50 percent of the amount invested and any excess credit may be carried forward for up to 5 taxable years. The total amount of credits allowed for investments in renaissance fund organizations made by all taxpayers in all tax years is limited to $10.5 million.

Property Tax Exemptions

A city may grant a partial or complete property tax exemption for up to 5 taxable years, following the date of purchase or completion of rehabilitation, on:

1. Single-family residential property, exclusive of the land, if the property was purchased or rehabilitated by an individual as a primary place of residence as a zone project; and
2. Buildings, structures, fixtures, and improvements purchased or rehabilitated as a zone project for any business or investment purpose.

The State Board of Equalization may grant a partial or complete property tax exemption for up to 5 taxable years, following the date of rehabilitation, on public utility infrastructure rehabilitated as a zone project.

Tax Increment Financing

North Dakota law on TIF districts was first enacted in 1973 and is contained in Chapter 40-58, which is the chapter on urban renewal. A city may establish a TIF district by adopting a resolution finding that one or more slum or blighted areas or industrial or commercial properties exist which require development, rehabilitation, or conservation in the public interest. The city must prepare a development or renewal plan and hold a public hearing for consideration of the plan. After the hearing, the governing body may approve the plan. Approved development or renewal plans must be filed with the Department of Commerce, Division of Community Services.

To implement the plan, the city may borrow money and accept financial assistance from any available source. The city may appropriate funds and make expenditures to carry out the plan. The city may issue bonds to finance the project and may issue refunding bonds to retire bonds previously issued.

Tax increment financing is used as the repayment mechanism for bonds issued for a development plan. Property values within the TIF district are "frozen" for property tax purposes at the time the district is established. Taxing districts with taxable property situated in the TIF district may continue to levy property tax against the frozen value of the properties. As the district is developed and property values increase, the city may impose a TIF district special fund levy against any valuation exceeding the frozen value of properties in the district. The valuation exceeding the frozen value is referred to as the "incremental value" of the property. Revenue from the TIF district special fund levy is placed in a special fund and used to repay bonds or other financing for TIF district projects.

As an alternative to sale of bonds for a TIF district, the city may grant a total or partial property tax exemption for the project to provide assistance to a project developer. The property tax exemption only applies to the incremental value of the property and may not extend for more than 15 years.

The governing body of a municipality shall file a report with the Department of Commerce by July 31 of each year following a year a TIF district was in place. The report must include the name of the tax increment financing district, the total outstanding indebtedness of the district, and the balance of funds on hand. When the cost of projects in the district and any related indebtedness has been fully paid and all bonds have been retired, any amount on hand in the tax increment special fund must be distributed by the county treasurer to the state and all political subdivisions having power to tax the property in amounts proportionate to the amount of tax losses.

EVALUATING PROPERTY TAX INCENTIVES

Interim committees have studied property tax incentives in the past on several occasions. The 2009-10 interim Taxation Committee reviewed the potential for overlapping territory in renaissance zones and TIF districts as part of a directive pursuant to 2007 Senate Bill No. 2032 to study property tax reform and relief in each interim through 2012. At the conclusion of its study, the committee recommended 2011 Senate Bill No. 2048, to prohibit a parcel of property from being located within a renaissance zone and a TIF district and 2011 Senate Bill No. 2050, to prohibit agricultural property from being incorporated into a TIF district and to limit the duration of a TIF district to 20 years. The Legislative Assembly ultimately amended both bills from their original form.

Senate Bill No. 2048 (2011), as enacted, required a city with a renaissance zone to file an annual report with the Department of Commerce identifying property within the zone also included in a TIF district. The report must identify the property, provide the expected duration of inclusion of the property in the TIF district and the renaissance zone, and identify any property and income tax benefits of the property and the expected duration of those benefits. The bill also required the Department of Commerce to deliver an annual report compiling the information to a Legislative Management interim committee on taxation issues or upon request of any other interim committee of the Legislative Management. Senate Bill No. 2050 (2011), as enacted, revised the definition of "blighted area" to exclude agricultural property and required a city governing body to file a development or renewal plan that is being financed through tax increment financing with the Department of Commerce. The bill restricted a TIF district established after July 1, 2011, from using the same base year for purposes of computing tax increments for longer than 25 taxable years and required the governing body to select a new base year, no more than 15 years old, after the 25-year period expires. The bill also required the governing body of a municipality to conduct a public hearing before approving development or renewal plans and required the filing of an annual report with the Department of Commerce for each development or renewal are in existence at the end of a calendar year.

In continuing the study of property tax reform and relief, the 2011-12 interim Taxation Committee discussed the inability of a city or county to withdraw a property tax exemption granted to a new or expanding business. The committee's study led to the recommendation of 2013 House Bill No. 1046, to allow a city or county to reduce or revoke a previously granted property tax exemption for new or expanded business property if the city or county finds the property is not being used in the manner intended when the exemption was granted.

The 2013-14 interim Taxation Committee was tasked with studying the effectiveness of local property tax exemptions and other economic development incentives pursuant to 2013 Senate Bill No. 2314. The committee did not receive any testimony suggesting changes to locally granted property tax exemptions or economic development incentives. The committee's study revealed the majority of the responsibility for determining if a property tax or economic development incentive benefits the entire community falls on the granting entity. The committee did not receive concrete evidence on whether the granting of incentives resulted in other taxpayers in the city or county ultimately deriving any measurable benefits. The committee did not recommend any legislation as a result of its study.

POSSIBLE STUDY APPROACH

The following is a proposed study plan for the committee's consideration in its studies of property tax incentives and city growth and development:

1. Receive testimony from representatives of the Tax Department and the Department of Commerce regarding the duplicative application of property tax incentives and the duration for which a single property may benefit from the use of multiple property tax incentives.
2. Receive testimony from representatives of local governing bodies regarding the short- and long-term impacts of property tax incentives on taxing district revenues.
3. Receive testimony from representatives of the Bismarck City Commission regarding the recent decision to end Bismarck's TIF district and extend the city's renaissance zone program.
4. Receive testimony from economic development groups and associations regarding growth and development in taxing districts that offer property tax incentives.
5. Receive testimony from city representatives regarding factors that influence city development patterns, including the impact of transfer payments between state and local governments and the cost of government services and infrastructure.
6. Develop recommendations and any bill drafts necessary to implement the recommendations.
7. Prepare a final report for submission to the Legislative Management.

ATTACH:1