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BILL ANALYSIS

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Senate Bills 529 and 530 (as enrolled)
House Bill 4540 (as enrolled)
Sponsor: Senator Martha G. Scott (S.B. 529)
Senator Buzz Thomas (S.B. 530)
Representative Edward Gaffney, Jr. (H.B. 4540)
Senate Committee: Finance
House Committee: Commerce

PUBLIC ACTS 338 & 339 of 2005
PUBLIC ACT 340 of 2005

Date Completed: 3-1-06

RATIONALE

The Neighborhood Enterprise Zone (NEZ) Act allows eligible local governmental units to designate neighborhood enterprise zones within which the owner or developer of property may receive a NEZ certificate that exempts new or rehabilitated housing from the property tax and subjects it, instead, to a specific neighborhood enterprise zone tax. The facility, but not the land on which it is located, is exempt from ad valorem real property taxes collected under the General Property Tax Act. It was suggested that the Act be expanded to allow local governments to offer NEZ certificates for existing housing that is not in need of significant renovation.

Apparently, residents living in some Detroit neighborhoods have seen their property taxes increase significantly as their homes have spiked in value during the past few years. The problem has been exacerbated by the so-called property tax "pop-up" that occurs when a parcel that has increased in value changes hands. (Although annual property tax increases are capped under the General Property Tax Act, when property changes hands, the new owner must pay the tax on the property's full value.) Reportedly, homeowners in Detroit's most desirable neighborhoods have increasingly been leaving for areas with lower property taxes, while other people are reluctant to buy a high-priced home in the city. It has been pointed out that Detroit has suffered from a substantial population decrease in recent years and cannot afford to continue losing residents and the tax revenue they generate. Some people believe that

allowing a NEZ certificate to be issued for an owner-occupied homestead facility would help Detroit and other eligible cities to attract and retain homeowners.

CONTENT

Senate Bill 529 amended the Neighborhood Enterprise Zone Act to prohibit the State Tax Commission from issuing a NEZ certificate for a homestead facility unless it meets the requirements in a definition of "homestead facility" (contained in Senate Bill 530); and require the Commission to determine whether a homestead facility complies with the Act.

Senate Bill 530 amended the Act to do the following:

- Allow the owner of a homestead facility to file an application for a NEZ certificate with the clerk of the local governmental unit.
- Allow the application to be filed after a building permit is issued.
- Establish the effective date of a NEZ certificate issued for a homestead facility.
- Allow an NEZ certificate issued after December 31, 2005, to be effective for up to 15 years.
- Allow a local unit of government to extend a certificate issued before January 1, 2006, for an additional three years.

- Limit the total acreage of NEZs containing only homestead facilities.
- Extend various provisions of the Act to homestead facilities.

House Bill 4540 amended the Act to impose the NEZ tax on the owner of a homestead facility who has been issued a NEZ certificate; provide for the calculation of the tax on a homestead facility; provide for the phase-out of the NEZ tax on all facilities subject to the tax, beginning two years before the certificate expires; provide for the disbursement of the proceeds of the NEZ tax on homestead facilities; and exempt from the NEZ tax a homestead facility located in a renaissance zone.

The bills took effect on January 3, 2006.

Senate Bill 529

The bill prohibits the State Tax Commission from issuing a NEZ certificate for a homestead facility unless it meets the requirements of the definition of "homestead facility" in Section 2(e) (which was added by Senate Bill 530).

Under the Act, the Commission must determine whether a new facility or rehabilitated facility complies with the requirements of the Act. The Commission must make this determination within 60 days after receiving an approved application for a rehabilitated facility, and not later than 30 days, or if an approved application is received after October 31, within 45 days after receiving an application for a new facility. Under the bill, the Commission also must determine whether a homestead facility complies with the requirements of the Act, and make the determination within the time frame that applies to a rehabilitated facility.

Senate Bill 530

Definitions

Under the bill, "facility" means a homestead facility, a new facility, or a rehabilitated facility. The bill defines "homestead facility" as an existing structure, purchased by or transferred to an owner after December 31, 1997, that has as its primary purpose residential housing consisting of one or two units, one of which is occupied by an owner

as his or her principal residence, and that is located within a subdivision platted pursuant to State law before January 1, 1968.

The bill includes a county seat in the Act's definition of "local governmental unit", which otherwise means a qualified local governmental unit as the term is defined under the Obsolete Property Rehabilitation Act. (Under that Act, "qualified local governmental unit" means one or more of the following: a city or township with a median family income of 150% or less of the statewide median family income as reported in the 1990 Federal decennial census that meets other listed criteria; a village with a population of 500 or more as reported in the 1990 Federal decennial census located in an area designated as a rural enterprise community before 1998; or a city that has a population of more than 20,000 or less than 5,000 and is located in a county with a population of 2 million or more according to the 1990 Federal decennial census and, as of January 1, 2000, had an overall increase in the State equalized valuation of real and personal property of less than 65% of the statewide average increase since 1972 as determined for the designation of eligible distressed areas under the State Housing Development Authority Act.)

Under the NEZ Act, "owner" means the record title holder of, or the vendee of the original land contract pertaining to, a new facility or a rehabilitated facility for which an NEZ certificate is applied for or issued. The bill also refers to a homestead facility.

NEZ Acreage

For neighborhood enterprise zones containing only new facilities or rehabilitated facilities or any combination of new or rehabilitated facilities, the bill retains the provision under which the total acreage of the neighborhood enterprise zones designated under the Act may not exceed 15% of the total acreage contained within the boundaries of the local governmental unit. Under the bill, the total acreage of neighborhood enterprise zones containing only homestead facilities must not exceed 10% of the total acreage contained within the boundaries of the local governmental unit or, with the approval of the board of commissioners of the county in which the NEZ is located if the county does not have

an elected or appointed county executive or with the approval of the board of commissioners and the county executive if the county has an elected or appointed county executive, 15% of the total acreage contained within the boundaries of the local governmental unit.

NEZ Certificate Application

Under the Act, the owner or developer or prospective owner or developer of a proposed new facility or an owner or developer or prospective developer proposing to rehabilitate property located in a neighborhood enterprise zone may file an application for a NEZ certificate with the clerk of the local governmental unit. The application must be filed in the manner and form prescribed by the State Tax Commission. The bill also allows the owner of a homestead facility to file an application for a NEZ certificate with the clerk of the local governmental unit. The bill requires the clerk to provide a copy of each homestead facility application to the assessor for the local governmental unit.

Under the Act, in certain situations, an application for a NEZ certificate may be filed after a building permit is issued. The bill also allows an application for a NEZ certificate for a homestead facility to be filed after a building permit is issued.

The Act requires an application for a NEZ certificate to include, among other things, a general description of the new facility or proposed rehabilitated facility and the dimensions of the parcel on which the facility is or will be located. Under the bill, these requirements also apply to a homestead facility. Additionally, the bill requires an application to contain a statement by the owner of a homestead facility that the owner is committed to investing a minimum of \$500 in the first three years that the certificate for a homestead facility is in effect and committed to documenting the minimum investment if required to do so by the assessor of the local governmental unit.

NEZ Certificate

A NEZ certificate must be in the form provided by the State Tax Commission and include a legal description of the real

property on which the new facility is to be located or the legal description of the rehabilitated property or, under the bill, the legal description of the homestead facility.

The bill specifies that, notwithstanding any other provisions of the Act, for any certificate issued as a result of the bill's enactment, the effective date of the certificate is the first day of the tax year following the year the certificate is approved by the Commission.

Under the Act, with certain exceptions, the effective date of a NEZ certificate is December 31 in the year in which a new facility or rehabilitated facility is substantially completed and, for a new facility, occupied by an owner as a principal residence, as evidenced by the owner's filing of certain certificates with the assessor of the local assessing unit. One of the required certificates for a new facility is an affidavit executed by an owner affirming that the new facility is occupied by an owner as a principal residence. Under the bill, this requirement also applies to a homestead facility.

Certificate Revocation

Under the Act, the NEZ certificate for a new facility is automatically revoked if the new facility is no longer a homestead as defined in Section 7a of the General Property Tax Act (i.e., a dwelling or a unit in a multipurpose or multidwelling building that is subject to ad valorem taxes and is owned and occupied as the principal domicile by its owner). Under the bill, this provision also applies to a homestead facility.

The NEZ Act requires the State Tax Commission to revoke the certificate for a new facility or a rehabilitated facility that ceases to have as its primary purpose residential housing. Also, if the governing body of a local governmental unit determines that a new facility or a rehabilitated facility is not in compliance with any local construction, building, or safety codes and notifies the Commission by certified mail of the noncompliance, the Commission must revoke the certificate. The bill extends these provisions to a homestead facility.

Certificate Duration/Transfer

Previously, except as otherwise provided, and unless earlier revoked, a NEZ certificate had to remain in effect for six to 12 years from its effective date, as determined by the governing body of the local governmental unit. Under the bill, this applies to a NEZ certificate issued before January 1, 2006. A NEZ certificate issued after December 31, 2005, must remain in effect for six to 15 years from its effective date, as determined by the governing body of the local governmental unit. The governing body of a local governmental unit that issued a NEZ certificate for a new or rehabilitated facility before January 1, 2006, may extend the certificate for an additional three years if the extension is approved by resolution before the original certificate expires.

Under the Act, if a new or rehabilitated facility is sold or transferred to another owner who otherwise complies with the Act and, for a new facility, uses it as a principal residence, the certificate must remain in effect. Under the bill, if a homestead facility is sold or transferred to another owner who otherwise complies with the Act and uses the homestead facility as a principal residence, the certificate must remain in effect.

Assessed Valuation Determination

Under the Act, the assessor of each local governmental unit that contains a new or rehabilitated facility for which a NEZ certificate is in effect must determine annually, with respect to each new or rehabilitated facility, the assessed valuation of the property comprising the facility having the benefit of a NEZ certificate and the amount of ad valorem property tax that would have been paid with respect to each new facility and rehabilitated facility under the General Property Tax Act, if the certificate had not been in force, and the assessed valuation on which the neighborhood enterprise zone tax is based for a rehabilitated facility. Under the bill, these provisions also apply to a homestead facility.

House Bill 4540

Under the NEZ Act, except as otherwise provided, a specific tax known as the NEZ tax is levied on the owner of a new facility,

or a rehabilitated facility to which a NEZ certificate is issued. The facility, but not the land on which it is located, is exempt from ad valorem real property taxes collected under the General Property Tax Act. Under the bill, the owner of a homestead facility to which a NEZ certificate is issued also is subject to the specific tax, and a homestead facility is exempt from property taxes.

The bill specifies that, except as otherwise provided, the amount of the neighborhood enterprise zone tax on a homestead facility is the sum of the following:

- One-half the number of mills levied for operating purposes by the local governmental unit in which the NEZ is located multiplied by the current taxable value of the homestead facility not including the land.
- One-half the number of mills levied for operating purposes by the county in which the NEZ is located multiplied by the current taxable value of the homestead facility not including the land.
- The total number of mills collected under the General Property Tax Act, for the current year by all taxing jurisdictions within which the homestead facility is located excluding the number of mills levied for operating purposes by the local governmental unit and county in which the facility is located multiplied by the current taxable value of the facility not including the land.

In the year two years before the year in which the NEZ certificate expires for a homestead facility, for a new facility or a rehabilitated facility in which the NEZ certificate was issued after December 31, 2005, or for a new facility or a rehabilitated facility in which the NEZ certificate was extended three years, the NEZ tax is the sum of the following:

- Five-eighths the number of mills levied for operating purposes by the local governmental unit in which the NEZ is located multiplied by the current taxable value of the facility not including the land.
- Five-eighths the number of mills levied for operating purposes by the county in which the NEZ is located multiplied by the current taxable value of the facility not including the land.

-- The total number of mills collected under the General Property Tax Act for the current year by all taxing jurisdictions within which the facility is located excluding the number of mills levied for operating purposes by the local governmental unit and county in which the facility is located multiplied by the current taxable value of the facility not including the land.

Under the bill, in the two successive years, the fraction of the number of mills levied for operating purposes by the local governmental unit and the number of mills levied by the county increases by one-eighth.

The bill requires local tax collection officers to disburse the proceeds of the NEZ tax collected as described above each year to the State, cities, townships, villages, school districts, counties, and authorities in an amount equal to the sum of the proceeds of the NEZ tax collected on the facility multiplied by a fraction in which the numerator is the number of mills levied by the taxing unit that was used to calculate the specific tax on the facility, and the denominator is the total number of mills levied by all the taxing units that was used to calculate the specific tax in which the property is located.

Under the Act, a new facility or a rehabilitated facility located in a renaissance zone under the Michigan Renaissance Zone Act is exempt from the NEZ tax to the extent and for the duration provided pursuant to that Act, except for that portion of the NEZ attributable to a special assessment or a tax described in Section 7ff(2) of the General Property Tax Act (which lists the taxes from which real and personal property in a renaissance zone is not exempt). Under the bill, a homestead facility located in a renaissance zone also is exempt from the NEZ tax, subject to the same exception.

MCL 207.776 & 207.777 (S.B. 529)
207.772 et al. (S.B. 530)
207.779 (H.B. 4540)

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Detroit has lost about 600,000 residents in the past 30 years, and there is a concern that residents, especially those living in high-priced housing, will continue to flee the city and further erode its tax base. The bills allow Detroit and other eligible cities to rebuild their tax base by encouraging residents to return to or remain in the city, and purchase and improve existing housing. Eventually, after their NEZ certificate expires, the homes will be subject to the full ad valorem property tax. The bills also promote owner-occupied housing and neighborhood stability by requiring that a property owner make some improvements to the property and actually live on the premises in order to receive a homestead NEZ certificate. During the past few years, several business tax packages have provided tax breaks to companies that remain in Michigan's urban areas, and residents who live in those communities should receive the same types of incentives.

Opposing Argument

By expanding the number of residential facilities that are eligible to receive a NEZ certificate, the bills might significantly decrease property tax revenue for the communities in which a zone is located.

Legislative Analyst: J.P. Finet

FISCAL IMPACT

Senate Bill 529 will have no effect on State revenue or expenditures, but House Bill 4540 and Senate Bill 530 will reduce State and local property tax revenue by an unknown amount. The actual amount of any changes will depend upon the specific characteristics of the parcels affected by the bills, the amount of property included in neighborhood enterprise zones containing homestead facilities, the number of communities that choose to use the provisions related to homestead facilities, the existing exemption certificates granted extensions under the bills, and the number of exemption certificates (of any type) granted in future years.

The bills' impact concerning homestead facilities can be illustrated using the City of Detroit as an example. Between 35,000 and 50,000 homes, with an average taxable value of \$44,000 for 2006 property taxes, have been sold in Detroit since January 1,

1998. This represents between about 20% and 30% of all owner-occupied housing units in Detroit. It is unknown what portion of the total acreage of Detroit these homes represent, but if the average lot size for those homes equaled the average lot size in Detroit, it would suggest that not all of these units could be located in a NEZ consisting of homestead facilities, as approximately 25,000 homes would comprise 15% of the total acreage. Based on 2005 millage rates, if 25,000 homestead facilities, with an average taxable value of \$44,000 (and assuming that the value excluding the land comprises approximately 85% of the taxable value) were included in neighborhood enterprise zones and affected by the bills in 2006, the bills would reduce revenue to Wayne County by approximately \$2.6 million and revenue to the City of Detroit by approximately \$9.3 million. The effect on any future home sales is unknown, given that it is expected that homes that have been sold since January 1, 1998, could possibly claim all of the certificates that would be available given the 15% limit on acreage. If certificates remain to be granted for future home sales, or some homes are (or have been) resold, the fiscal impact in the early years will be less than in this example.

The bills also allow certificates for homestead facilities to be transferred. However, as with the law regarding new or rehabilitated facilities, the bills do not alter the procedures regarding changes in taxable value that occur when property is transferred. Additionally, while the bills require the owner of a homestead facility to indicate a commitment to investing at least \$500 in the homestead facility during the first three years a NEZ certificate is in effect, the bills do not provide that a certificate may be revoked if the investment does not occur.

The bills' impact concerning new and rehabilitated facilities will be to reduce both local and State property tax revenue. By increasing the length of time for which a certificate may be effective, the bills will reduce State and local property tax revenue for that property. However, the bills may not affect property tax revenue from new or rehabilitated facilities if new certificates are not granted for other qualifying facilities because the local unit extends the current certificates on existing property. Certificates

for new facilities and rehabilitated facilities reduce both State education tax revenue and property taxes to local units of government. Reductions to local school districts are offset by higher School Aid Fund expenditures, in order to maintain per-pupil funding guarantees. Currently, neighborhood exemption zones are estimated to reduce local property tax revenue by approximately \$7.1 million in FY 2005-06.

Fiscal Analyst: David Zin

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.