



Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536



BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

Senate Bill 1206 (Substitute S-4 as passed by the Senate)
Sponsor: Senator Gerald Van Woerkom
Committee: Commerce and Labor

Date Completed: 7-13-04

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. A number of concerns have been raised regarding the requirements of the NEZ program and how it operates in conjunction with other programs that encourage the development of housing in established communities.

The Act requires that a local unit pass a housing inspection ordinance before designating a zone. Some people believe that this requirement may preclude some communities, especially smaller ones, from realizing the benefits of designating a zone because they do not have the resources to conduct inspections and enforce the required ordinance. Also, the Act's requirement that a NEZ certificate be valid for 12 years could keep some municipalities from participating in a NEZ program. It has been suggested that smaller local units not be required to adopt a housing inspection ordinance and that NEZ certificates be allowed for shorter periods.

In addition, developers have raised concerns about inconsistencies between NEZ certificate requirements and provisions of the Income Tax Act that allow a credit for expenditures associated with rehabilitating historic buildings. To qualify for a tax abatement under the NEZ Act, rehabilitated units must be owner-occupied within two years of the date of the NEZ certificate. Under the Income Tax Act, however, in order to realize the full value of the historic

building tax credit, a developer must retain ownership of the property for five years. To encourage the redevelopment and occupancy of historic buildings, some people believe that a NEZ certificate for units in a rehabilitated historic building should have a longer duration.

Finally, the NEZ Act includes requirements regarding the size and site of property included within a zone. Among the requirements are that the zone be compact and contiguous. It has been suggested that the Act should more specifically identify whether such features as roads, rights-of-way, or condemned property break a zone's contiguity.

CONTENT

The bill would amend the Neighborhood Enterprise Zone Act to do all of the following:

- Allow, rather than require, a local governmental unit with a population of 20,000 or less to pass a housing inspection ordinance before acting upon a resolution proposing a neighborhood enterprise zone.**
- Provide for a NEZ certificate generally to remain in effect for six to 12 years, as determined by the local unit's governing body, rather than for 12 years.**
- Provide that a NEZ certificate for a rehabilitated facility constituting all or part of a "qualified historic building" would remain in effect for 11 to 17 years, as determined by the local unit's governing body (unless the rehabilitated facility were not transferred or sold within six years**

- to a person who would own and occupy it as his or her principal residence).
- Allow an owner or developer to apply for a NEZ certificate after a building permit was issued for a rehabilitated facility, if all or part of it were a qualified historic building.
- Specify that contiguity of a zone would not be broken by a road, right-of-way, or certain property purchased or taken under condemnation.

Under the Act, "new facility" means a new structure or a portion of a new structure that has as its primary purpose residential housing consisting of one or two units, one of which is or will be occupied by an owner as his or her principal residence. The term includes a new individual condominium unit, but does not include apartments.

"Rehabilitated facility" means an existing structure or a portion of an existing structure with a current true cash value of \$80,000 or less per unit that has or will have as its primary purpose residential housing consisting of one to eight units, whose owner proposes improvements that if done by a licensed contractor would cost over \$5,000 per owner-occupied unit or \$4,500 per nonowner-occupied unit and will bring the structure into conformance with minimum local building code standards for occupancy or improve the livability of the units while meeting minimum local building code standards.

Housing Inspection Ordinance

The Act allows the governing body of an eligible local unit of government to designate, by resolution, one or more neighborhood enterprise zones within the local unit. Before acting upon such a resolution, a local unit's governing body must do certain things including passing a housing inspection ordinance. At a minimum, the ordinance must require that before the sale of a unit in a new or rehabilitated facility for which a NEZ certificate is in effect, an inspection be done to determine compliance with any local construction or safety codes and that a sale may not be finalized until there is compliance with those codes.

Under the bill, a local unit with a population of 20,000 or less would be allowed, but not required, to pass a housing inspection ordinance before acting upon the resolution. The governing body of a local unit with a population over 20,000 would be required to pass a housing inspection ordinance. An inspection for compliance with local construction and safety codes still would have to be made before a unit in a new or rehabilitated facility was sold, but the ordinance would not have to include that requirement.

Duration of Certificate

Currently, unless a NEZ certificate is revoked pursuant to the Act, the certificate remains in effect until 12 years from its effective date. Under the bill, except as otherwise provided for a qualified historic building, unless revoked, a certificate would remain in effect for six to 12 years from its effective date, as determined by the local governmental unit's governing body.

Also, unless earlier revoked, a NEZ certificate in effect for a rehabilitated facility constituting all or a portion of a qualified historic building would remain in effect for 11 to 17 years from the certificate's effective date, as determined by the local unit's governing body. If that rehabilitated facility were not transferred or sold to a person who would own and occupy the facility as his or her principal residence within six years of the NEZ certificate's effective date, the certificate would be revoked. Otherwise, a change in ownership of a rehabilitated facility that constituted all or part of a qualified historic building that occurred after the effective date of the NEZ certificate would not affect the validity of the certificate, which would remain in effect for the specified period as long as residential housing was the facility's primary purpose.

Under the bill, "qualified historic building" would mean a property within a NEZ that has been designated a "historic resource" as defined in Section 266 of the Income Tax Act. (That section provides for an income tax credit for certain expenditures associated with the rehabilitation of a historic resource. "Historic resource" includes a publicly or privately owned historic building that is located within a historic district designated by the National

Register of Historic Places, the State Register of Historic Sites, or a local unit acting under the Local Historic Districts Act, or that is individually listed on the State or National Register.)

NEZ Certificate Application

Under the Act, an owner or developer or prospective owner or developer of a proposed new facility, or an owner or developer or prospective owner or developer proposing to rehabilitate property located in a neighborhood enterprise zone, may apply for a NEZ certificate with the clerk of the local governmental unit. With certain exceptions, an application must be filed before a building permit is issued for the new construction or rehabilitation of the facility. The bill would allow an application to be filed after a building permit was issued for a rehabilitated facility, if all or a portion of the facility were a qualified historic building.

Contiguity

Under the Act, a neighborhood enterprise zone must contain at least 10 platted parcels of land and all of the land within it must be compact and contiguous. The bill specifies that contiguity would not be broken by a road, right-of-way, or property purchased or taken under condemnation if the purchased or condemned property were a single parcel before the sale or condemnation.

Other Provisions

The bill would include a model home or a model condominium unit in the definition of "new facility".

The bill specifies that "rehabilitated facility" would include existing or proposed condominium units in a qualified historic building with one or more units, and that a qualified historic building could contain multiple rehabilitated facilities.

The bill also provides that condominium units within a qualified historic building could be held under common ownership.

MCL 207.772 et al.

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

By making it permissive for local units with a population of 20,000 or less to adopt a housing inspection ordinance before designating a neighborhood enterprise zone, the bill would provide a much-needed change to the NEZ Act. That requirement evidently has kept some smaller local units that otherwise are eligible for the NEZ program from designating zones because enforcing a housing ordinance would be too costly. Although the bill would provide an option for those communities to designate neighborhood enterprise zones without adopting a housing inspection ordinance, the Act still would require an inspection for compliance with construction and safety codes before a unit in a new or rehabilitated facility was sold.

Supporting Argument

The present requirement that a NEZ certificate remain in effect for 12 years is too restrictive. Despite the benefits of a new and rehabilitated housing development, which the Act encourages, some local units apparently would like to collect the full tax on NEZ properties before the expiration of 12 years. By allowing a local unit's governing body to set the duration of a NEZ certificate between six and 12 years, the bill would give local units some flexibility to tailor their NEZ program to their own situations.

Supporting Argument

Some developers of property in older urban areas have complained of inconsistencies between the NEZ certificate requirements and the conditions for receiving a tax credit under the Income Tax Act for rehabilitating historic buildings. While the NEZ Act requires that a new facility or a unit in a rehabilitated facility be owner-occupied within two years of the effective date of a NEZ certificate, the Income Tax Act requires a developer to retain ownership of a rehabilitated historic resource for five years in order to receive the full benefit of the income tax credit. This inconsistency may force a developer to choose between seeking an income tax credit for himself or herself or

foregoing the full benefit of that credit so that the eventual owner-occupant of a rehabilitated historic building may receive a NEZ tax break.

In addition to the two-year occupancy requirement, the NEZ Act requires that an application for a certificate be filed before a building permit is issued. If a developer's rehabilitation plan for a historic resource will take longer than two years, however, the developer cannot secure a NEZ certificate before being issued a building permit and have the unit occupied by an owner within two years.

Under the bill, both the developer and the eventual owner-occupant could receive the full benefit of tax breaks available to them under the Income Tax Act and the NEZ Act, respectively. By allowing a NEZ certificate for a rehabilitated facility in a historic building to remain in effect for 11 to 17 years, rather than 6 to 12 years as the bill would require for other property, and allowing the developer of a rehabilitated facility in a historic building to apply for a NEZ certificate after a building permit was issued, the bill would further encourage developers to rehabilitate historic buildings in established communities for housing needs. This, in turn, could serve to mitigate sprawl, encourage efficient use of currently established infrastructure, and help revitalize Michigan's urban communities.

Supporting Argument

The Act includes maximum acreage requirements for a neighborhood enterprise zone (15% of the total acreage within a local unit) and requires that all the land within a zone be compact and contiguous, but does not specify what constitutes contiguity. By providing that contiguity would not be broken by a road, right-of-way, or certain condemned property, the bill would give local units some guidance on the issue of contiguity.

Legislative Analyst: Patrick Affholter

FISCAL IMPACT

The bill could increase or decrease State School Aid Fund revenue and local property tax revenue by an unknown amount. The fiscal impact of the bill primarily reflects the provisions allowing a local unit to issue NEZ

certificates that would be effective for less than the current period of 12 years. It is unknown how many local units would choose to issue certificates with a shorter effective period, or the properties for which those certificates would be issued. To the extent that shorter-lived certificates were issued, the lower property tax burden afforded under them would be of shorter duration and property taxes to the State and local units would be greater than under the current 12-year period.

The revenue increase could be offset because the bill essentially would allow a local unit to issue more certificates, but at the same cost as under current law. For example, instead of issuing one certificate for one property for 12 years, the local unit could issue one certificate on one property for six years and when it expired issue another certificate on another property for six years. The total reduction in property taxes over the 12-year period could be less than, the same as, or greater than under current law, depending upon the taxable value of the properties covered by the certificates. The net effect on revenue of this offset is also unknown.

While the bill would revise certain requirements regarding the passage of a housing inspection ordinance by the local unit of government, inspections still would be required before the sale of any new or rehabilitated facility for which an enterprise zone is in effect and local units still would be able to pass a housing inspection ordinance.

This analysis is preliminary and will be revised as new information becomes available.

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.