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BILL ANALYSIS

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Senate Bill 1206 (as enrolled)

Sponsor: Senator Gerald Van Woerkom

Senate Committee: Commerce and Labor

House Committee: Land Use and Environment

PUBLIC ACT 396 of 2004

Date Completed: 1-26-05

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 were raised regarding the requirements of the NEZ program and how it operated in conjunction with other programs that encourage the development of housing in established communities.

The Act required that a local unit pass a housing inspection ordinance before designating a zone. Some people believed that this requirement precluded some communities, especially smaller ones, from realizing the benefits of designating a zone because they did 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 may have kept some municipalities from participating in a NEZ program. It was 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 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, it was suggested that a NEZ certificate for units in a rehabilitated historic building 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 was suggested that the Act more specifically identify whether such features as roads, rights-of-way, or condemned property break a zone's contiguity.

CONTENT

The bill amended 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" remains in effect for 11 to 17 years, as determined by the local unit's governing body (unless the rehabilitated facility is not**

transferred or sold within six years to a person who owns and occupies it as his or her principal residence).

- Create exceptions to the requirement that an owner or developer apply for a NEZ certificate before a building permit is issued.**
- Specify that contiguity of a zone is not broken by a road, right-of-way, or certain property purchased or taken under condemnation.**

The bill took effect on October 15, 2004.

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 would cost over certain amounts per owner-occupied unit or per nonowner-occupied unit, depending on whether the improvements would be done by a licensed contractor or by the owner, 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, which had included passing a housing inspection ordinance.

Under the bill, a local unit with a population of 20,000 or less is 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 is required to pass a housing inspection ordinance.

Previously, the ordinance had to require that before the sale of a unit in a new or rehabilitated facility for which a NEZ certificate was in effect, an inspection be done to determine compliance with any local construction or safety codes and that a sale not be finalized until there was compliance with those codes. Under the bill, an inspection for compliance with local construction and safety codes still must be made before a unit in a new or rehabilitated facility is sold, and a sale may not be finalized until there is compliance, but the ordinance does not have to include those requirements.

Duration of Certificate

Previously, unless a NEZ certificate was revoked pursuant to the Act, the certificate remained 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 will remain in effect for six to 12 years from its effective date, as determined by the local governmental unit's governing body.

Also, under the bill, unless earlier revoked, a NEZ certificate in effect for a rehabilitated facility constituting all or a portion of a qualified historic building will 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 is not transferred or sold to a person who will own and occupy the facility as his or her principal residence within six years of the NEZ certificate's effective date, the certificate will be revoked. Otherwise, a change in ownership of a rehabilitated facility that constitutes all or part of a qualified historic building that occurs after the effective date of the NEZ certificate will not affect the validity of the certificate, which will remain in effect for the specified period as long as residential housing is the facility's primary purpose.

Under the bill, "qualified historic building" means 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 Neighborhood Enterprise Zone 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 allows an application to be filed after a building permit is issued for a rehabilitated facility, if all or a portion of the facility is a qualified historic building, or for a new facility that is a model home if the area where it is located was designated as a NEZ in July 1993.

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 is not broken by a road, right-of-way, or property purchased or taken under condemnation if the purchased or condemned property is a single parcel before the sale or condemnation.

Other Provisions

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

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

The bill also provides that condominium units within a qualified historic building may 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 provides a much-needed change to the NEZ Act. That requirement evidently kept some smaller local units that otherwise were eligible for the NEZ program from designating zones because enforcing a housing ordinance would be too costly. Although the bill provides an option for those communities to designate neighborhood enterprise zones without adopting a housing inspection ordinance, the Act still requires an inspection for compliance with construction and safety codes before a unit in a new or rehabilitated facility is sold.

Supporting Argument

The previous requirement that a NEZ certificate remain in effect for 12 years was too restrictive. Despite the benefits of a new and rehabilitated housing development, which the Act encourages, some local units apparently wanted 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 gives local units some flexibility to tailor their NEZ program to their own situations.

Supporting Argument

Some developers of property in older urban areas 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 a rehabilitated unit generally must be owner-occupied within two years of the date of the NEZ certificate in order for the owner to qualify for a NEZ tax abatement, 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 forced developers to choose between seeking an income tax credit for themselves or foregoing the full benefit of that credit so that the eventual owner-occupant of a

rehabilitated historic building could receive a NEZ tax break.

In addition, the NEZ Act generally 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 took longer than two years, however, the developer could not 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 may 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 requires 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 is issued, the bill further encourages developers to rehabilitate historic buildings in established communities for housing needs. This, in turn, may 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. The Act, however, does not specify what constitutes contiguity. By providing that contiguity is not broken by a road, right-of-way, or certain condemned property, the bill gives local units some guidance on the issue of contiguity.

Legislative Analyst: Patrick Affholter

FISCAL IMPACT

The bill may 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 will be effective for less than the previously required period of 12 years. It is unknown how many local units will choose to issue certificates with a shorter

effective period, or the properties for which those certificates will be issued. To the extent that shorter-lived certificates are issued, the lower property tax burden afforded under them will be of shorter duration and property taxes to the State and local units will be greater than under the 12-year period.

The revenue increase might be offset because the bill essentially allows a local unit to issue more certificates, but at the same cost as under previous law. For example, instead of issuing one certificate for one property for 12 years, the local unit may issue one certificate on one property for six years and when it expires issue another certificate on another property for six years. The total reduction in property taxes over the 12-year period might be less than, the same as, or greater than under the former 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 revises certain requirements regarding the passage of a housing inspection ordinance by the local unit of government, inspections still are required before the sale of any new or rehabilitated facility for which an enterprise zone is in effect, and local units with a population over 20,000 still must pass a housing inspection ordinance.

The provisions regarding model homes would negligibly reduce school aid fund and local unit revenues, as with the other provisions in the bill, any reduction in school district revenue would result in higher school aid fund expenditures in order to meet guaranteed per pupil funding levels.

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.