DEGC

TO: Council Member Latisha Johnson

FROM: Kevin Johnson, President & CEO
Detroit Economic Growth Corporation (DEGC)

DATE: March 29, 2023

RE: FY 2023-24 Budget Analysis

Please accept this correspondence in response to questions in your memorandum dated March 27, 2023.

1. **Does the DEGC conduct studies to evaluate the success of lapsed tax abatements?**

DEGC does not conduct compliance reviews on incentives. The compliance of incentives is the function and role of the City of Detroit's Civil Rights and Inclusion Department.

2. **Does the DEGC believe tax abatements/incentives will always be necessary to develop in Detroit or is there a goal to sunset?**

Tax abatements/tax incentives are authorized by the Michigan Legislature and signed into law by the Governor—the sunset date [end date] of each incentive is included in the legislation. For your review, Exhibit A of this correspondence describes the most commonly used incentives and their sunset dates. The enabling legislation empowers local government units to grant property tax incentives to facilitate and foster economic growth. Some of the most critical outcomes of tax incentives are their ability to drive increased employment opportunities, support physical improvements to the built environment through the redevelopment of blighted properties and underutilized land assets, and their ability to normalize the operating environment to achieve long-term sustainability. While local governments are enabled to utilize tax incentives in their communities, the State Tax Commission (STC) ultimately approves tax incentives subject the local jurisdictional support.

In recent years, Detroit has made significant strides to position itself as a destination for businesses to locate and expand. However, much work remains. It is imperative that we continue to leverage Detroit's assets and set the city to be on par with competing Tier I and Tier II cities. The most productive way to accomplish this is to advance a progressive economic development policy that creates a competitive business and real estate investment environment.

The necessity for using tax incentives in Detroit is principally a result of high property tax millage rates and inherent structural disadvantages that create a cost prohibitive business environment. Detroit's property taxes are the highest in the nation with an effective tax rate at ~4.21% of market value on commercial values over $1 Million. Likewise, from a state perspective, the City of Detroit has one of the highest millage rates across the State of Michigan and also levy's additional taxes including a 2% corporate income tax on businesses, a 5% utility user's tax on businesses, and individuals pay 1.2%-2.4% in individual income tax, which impedes Detroit's competitiveness.

Below is an illustration of the Property Tax Mills in Detroit as compared to neighboring communities.

City	Detroit	Pontiac	Auburn Hills	Novi	Troy
Tax Mills	87 Mills	53 Mills	53 Mills	52 Mills	50 Mils

Secondarily, tax incentives serve as a mitigant to high interest rates and construction costs. Since March 2022, the Federal Reserve Bank has raised interest rates nine times[1]. Banks and other lenders respond accordingly to actions by the Fed by raising interest rates of loans to businesses and developers. Today's construction costs remain, on average, 30% higher than pre-Covid levels due to raw material cost increases and supply-chain constraints on equipment and building supplies.

[1] Source: Federal Reserve Bank Board of Governors

Tax incentives are an essential component of a comprehensive intervention strategy to mitigate the effects of higher taxes and the other market factors impeding business growth and real estate development. From a business attraction and real estate development strategy, tax incentives are typically paired with other economic incentives tools from the State of Michigan, Detroit's public authorities, federal programs and subordinated debt from financial intermediaries.

Creating viable and sustainable opportunities has its set of complexities and DEGC takes is diligent to ensure the necessity of incentives. DEGC performs an exhaustive and rigorous financial analysis to determine the strategic, economic, and fiscal benefits the City can expect by supporting a proposed development project with tax abatements and other incentives. We also perform a "but for" analysis. This analysis answers two questions, "Could the project move forward without the incentives?" And "is the project worth investing in without the incentives?" Tax incentives (i.e. tax abatements) are only recommended for City Council approval if the answer to both questions is "No." Moreover, the project must demonstrate a positive net benefit for the city over the life of the incentives. Meaning a project must provide the City with financial benefits that exceed the cost of the incentive.

Until the City's tax structure is overhauled to a point where it can compete on an even playing field locally and nationally, tax incentives and other economic development resources will be necessary to attract business, provide well-paying jobs, and grow the economy. Moreover, a "level setting" of market-related challenges that have been discussed must occur to make business attraction feasible without incentives. The same applies to real estate development.

One last important factor concerning the conversation about tax incentives that must be considered is the grave need for affordable housing in Detroit. From a revenue perspective, there is a cost associated with including affordable housing units in a residential or mixed-use project developed by the private sector. Within the current economic environment, if real estate developers are required to pay for the cost of such units with increased equity, this will have an adverse impact on the investment returns necessary to attract equity.

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In summary, the State Legislature institutes tax abatement/incentive legislation, and sunset dates for each abatement are included. Incentives, including property tax abatements, will be required until structural and market-related force change, making incentives unnecessary to effectuate business growth and real estate investment and development.

Sincerely,

Kevin Johnson,
President and CEO

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Exhibit A

Legislation for property tax abatements is established by the State of Michigan legislature and signed into Michigan law by the Governor. As mentioned, the legislation empowers local governments to grant property tax abatements to facilitate and foster economic growth and job creation. Furthermore, real estate tax abatements allow local communities to compete nationally and globally to attract new jobs and spur real estate development. The most commonly used tax abatements in Detroit and their sunset dates are listed below:

The Commercial Rehabilitation Act, PA 210 of 2005, as amended, affords a tax incentive for the rehabilitation of commercial property for the primary purpose and use of a commercial business or multi-family residential facility. The property must be located within an established Commercial Rehabilitation District. Exemptions are approved for a term of 1-10 years, as determined by the local unit of government. The property taxes are based on the previous year's (before rehabilitation) taxable value. The taxable value is frozen for the duration of the certificate. **The legislation will sunset on 12/31/25.**

The Neighborhood Enterprise Zone Act, PA 147 of 1992, as amended, provides for the development and rehabilitation of residential housing located within eligible distressed communities. New and rehabilitated facilities applications are filed, reviewed, and approved by the local government unit but are also subject to review at the State level by the Property Services Division. The State Tax Commission (STC) is responsible for the final approval and issuance of new and rehabilitated facility certificates.

As amended, the Commercial Redevelopment Act (known as the Commercial Facilities Exemption), PA 255 of 1978, affords a tax incentive for the redevelopment of commercial property for the primary purpose and use of a commercial business enterprise. The property must be located within an established Commercial Redevelopment District. Exemptions are approved for a term of 1-12 years as determined by the local unit of government, and the taxable value is frozen for the duration of the certificate. For restored facilities, the property taxes are based upon the previous year's (before restoration) taxable value and 100% of the mills levied. For new or replacement facilities, the property taxes are based on the current year's taxable value and 50% of the mills assessed. **The legislation will sunset on 12/31/25.**

The Obsolete Property Rehabilitation Act (OPRA), PA 146 of 2000, as amended, provides property tax exemptions for commercial and commercial housing properties that are rehabilitated and meet the requirements of the Act. Properties must meet eligibility requirements, including a statement of obsolescence by the local assessor. The property must be located in an established

Obsolete Property Rehabilitation District. Exemptions are approved for a term of 1-12 years as determined by the local government unit. The property taxes for the rehabilitated property are based on the previous year's (before rehabilitation) taxable value. The taxable value is frozen for the duration of the exemption. Additionally, the State Treasurer may approve reductions of half of the school operating and state education taxes for a period not to exceed 6 years for 25 applications annually. **The legislation will sunset on 12/31/26.**