LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 87TH LEGISLATIVE REGULAR SESSION

March 29, 2021

TO: Honorable Morgan Meyer, Chair, House Committee on Ways & Means

FROM: Jerry McGinty, Director, Legislative Budget Board

IN RE: **HB1556** by Murphy (Relating to the Texas Economic Development Act.), **As Introduced**

Estimated Two-year Net Impact to General Revenue Related Funds for HB1556, As Introduced : a positive impact of $8,654,000 through the biennium ending August 31, 2023. The fiscal impact becomes negative beginning in fiscal year 2026 increasing to a cost of ($132.6 million) in fiscal year 2031.

The bill would make no appropriation but could provide the legal basis for an appropriation of funds to implement the provisions of the bill.

General Revenue-Related Funds, Ten- Year Impact:

Fiscal Year	**Probable Net Positive/(Negative) Impact to *General Revenue Related Funds***
2022	$3,768,000
2023	$4,886,000
2024	$5,585,235
2025	$3,734,969
2026	($2,150,124)
2027	($23,406,510)
2028	($68,068,049)
2029	($92,012,790)
2030	($118,426,778)
2031	($132,645,045)

All Funds, Ten-Year Impact:

Fiscal Year	**Probable Savings/(Cost) from** ***General Revenue Fund*** **1**	**Probable Revenue Gain/(Loss) from** ***General Revenue Fund*** **1**	**Probable Savings/(Cost) from** ***Foundation School Fund*** **193**	**Probable Savings/(Cost) from** ***School Districts*** **LOCAL-SCHOOL**
2022	($932,000)	$4,700,000	$0	$0
2023	($764,000)	$5,650,000	$0	$0
2024	($764,000)	$6,800,000	($450,765)	($9,000,000)
2025	($764,000)	$8,150,000	($3,651,031)	($57,000,000)
2026	($764,000)	$9,800,000	($11,186,124)	($204,000,000)
2027	($764,000)	$11,750,000	($34,392,510)	($476,000,000)
2028	($764,000)	$14,100,000	($81,404,049)	($813,000,000)
2029	($764,000)	$16,900,000	($108,148,790)	($1,189,000,000)
2030	($764,000)	$20,300,000	($137,962,778)	($1,608,000,000)
2031	($764,000)	$24,350,000	($156,231,045)	($2,099,000,000)

Fiscal Year	*Change in Number of State Employees from FY 2021*
2022	10.0
2023	10.0
2024	10.0
2025	10.0
2026	10.0
2027	10.0
2028	10.0
2029	10.0
2030	10.0
2031	10.0

Fiscal Analysis

The bill would substantially restructure, and extend for ten years, the school district maintenance and operations taxes (M&O) property tax relief program in Chapter 313 of the Tax Code. Rather than limit for ten years the appraised value of certain newly constructed properties, the chapter would exempt such property's value from most of a school district's M&O rate for up to ten years. Unlike the current limitation program, renovations or expansions of existing facilities could become exempt under provisions of the bill.

The bill would amend Section 151.359 of the Tax Code to remove the prohibition on certain data centers in the sales tax exemption programs from participating in the Chapter 313 program.

The bill would repeal Chapter 313, Subchapter C of the Tax Code, related to projects in strategic investment areas or certain rural school districts. Projects with limitation agreements approved before the effective date of the bill would continue under current law for the life of those agreements.

The bill would modify the definition of qualified investment to include a building or a permanent, nonremovable component of a building that, as part of a discrete project that increase the value of the building or component, is renovated, expanded, or otherwise improved during the applicable qualifying time period. The bill would also modify definition of qualified property to include renovations and expansions.

Implementing the provisions of the bill would replace the current ten levels of minimum required “qualified investment” amounts (ranging from $1 million to $100 million) with two possible minimum qualified investment amounts. The minimum “qualified investment” in school districts with a property value per student above the state average would be $50 million. For districts below the state average, it would be $10 million.

The bill would amend Section 313.024 of the Tax Code to remove certain eligibility categories and add utility scale battery energy storage facilities as a new eligibility category.

The bill would amend Section 313.025 of the Tax Code to modify the application requirements and application review process. Under the provisions of the bill, applicants would be required to submit the application and an application fee of $50,000 to the Comptroller instead of the school district.

The bill would amend Section 313.026 of the Tax Code to require the Comptroller to determine that the exemption would not financially harm the school district.

Implementing provisions of the bill would exempt the portion of the appraised value of the person's qualified property that arises from the project from a school district's Tier 1 M&O tax, as defined by Section 45.0031(a) of the Education Code. The portion of the appraised value would also be exempt from the up-to-nine "copper pennies" of tax effort in the enrichment tax rate tier defined by Section 45.0032(b) of the Education Code. The otherwise exempt portion of value would be subject to the up-to-eight "golden pennies" of tax effort in the enrichment tier described by Section 45.0032(b)(1) of the Education Code.

The bill would amend Section 313.027 of the Tax Code to provide that the exemption period could not exceed 10 years, eliminate requirements requiring in the agreement the protection of future district revenues, and prohibit supplemental payments in any exemption agreements.

The bill would add Section 313.0277 of the Tax Code to require a recipient company to remit annually to the state for vocational education purposes up to 10 percent of their tax benefit if the total wages of new employees plus half of contractor's compensation did not exceed 10 percent of the tax benefit.

The bill would amend section 313.032 of the Tax Code, to modify data elements required in a report of compliance with agreements prepared by the Comptroller for the Legislature. The Comptroller would be required to verify a random sample of the data, using a sample of at least 33 percent of the data.

The bill would amend Section 48.202(b) of the Education Code to subtract the Chapter 313 property's tax levy attributable to the eight "golden pennies" on the otherwise exempt value of the project from the Texas Education Agency's computation of a district's enrichment tax rate (DTR).

The bill would amend Section 48.256 of the Education Code to specify that property value lost to the new exemption, or value lost to projects executing limitation agreements under Subchapter B or C would be excluded from TEA's calculations of a school district's state-certified district property value (DPV), thus increasing state aid to a school district, or reducing a district's required school finance equalization payments. Implementing the provisions of the bill would eliminate the requirement that revenue protection payment for based on prior-year values for all Chapter 313 projects. This change in methodology would significantly change a company's revenue protection payments to districts.

The bill would eliminate all job and wage requirements associated with the current limitation program.

Note: This legislation would do one or more of the following: create or recreate a dedicated account in the General Revenue Fund, create or recreate a special or trust fund either in, with, or outside of the Treasury, or create a dedicated revenue source. Legislative policy, implemented as a Government Code 403.095, consolidated special funds (except those affected by constitutional, federal, or other restrictions) into the General Revenue Fund as of August 31, 1993 and eliminated all applicable statutory dedications as of August 31, 1995. Each subsequent Legislature has reviewed bills that affect funds consolidation. The fund, account, or revenue dedication included in this bill would be subject to funds consolidation review by the current Legislature.

Methodology

Annual "model classes" of future applicants to the Chapter 313 program were created from an analysis of project data, and applications submitted between 2013 and 2020. Data collected from 509 Chapter 313 participants in 2020 indicate that the estimated lifetime school levy reductions for the projects applying in 2015, 2016, 2017, 2018, and 2019 is as follows, respectively: $780 million, $948 million, $1 billion, $1.4 billion, and $1.9 billion. The class of 2023 represents the first year of applications under the bill after the chapter expires under current law. In an attempt to take into account the impact of the coronavirus pandemic on program participation on the estimated size of the first class of Chapter 313 applicants applying in 2023, the size of the estimated 2020, 2021, and 2022 model classes were reduced by about a third below what trendlines based on actual data would have indicated, and then trended according to historical growth rate. Class sizes after 2023 were assumed to increase by 8 percent annually.

This bill would extend the program for ten years after 2022, but would also significantly change the program structure, and go into effect September 1, 2021.

Estimates for school levy reductions arising form Chapter 313 applications received after September 1, 2021 and during 2022 were calculated separately from estimated levy reductions from applications received after 2022, as current law does not expire until December 31, 2022. For the 16 months of applications received before December 31, 2022, only incremental levy reductions attributable to changes in program structure under the bill are estimated. (Estimates of levy reductions due to Chapter 313 applications received under current law during the remainder of 2021 and in 2022 are not in this estimate.)

The bill proposes a number of changes to the Chapter 313 program that increase local school district levy losses, and increase the net tax benefit to program participants.

The bill would eliminate "supplemental payments" which would increase the net tax benefit for companies under the program. This change to the program would reduce the amount of gross tax benefits shared by the company with the school districts.

The bill would eliminate "revenue protection" payments for all future projects, which would increase a company's net tax benefits compared to the current program. Eliminating supplemental payments and revenue protection payments for future projects would directly affect estimates of local school levy losses arising from those projects. The Comptroller's office estimates that the increased net benefit received by companies would likely increase program usage.

The change from a limitation structure to an exemption structure in the bill would in almost all circumstances increase a company's net tax benefits and overall reduce school M&O levies. One way to analyze such a change is to examine a selection of Chapter 313 projects of various sizes, and types, in various school districts, with various depreciation rates. Levy reductions from a set of 81 sample projects were compared under the current law system and the proposed exemption system under the bill. Levy reductions under the bill were about 25 percent higher than under current law provisions. Under the provisions of the bill, most companies would get a significant percentage reduction in their school M&O tax bill, regardless of the amount of taxable value of the property in the agreement. In the current system, companies pay a full M&O rate on value up to the limitation amount in the school district. The increase in the program benefits to agreement holders will likely increase usage of the program.

Eliminating the chapter's current job and wage requirements would increase the number of participant companies. Many companies do not participate in the Chapter 313 program because their projects do not meet job and wage requirements. Eliminating such requirements would create a larger potential pool of Chapter 313 applicants, likely increasing use of the program.

Recipient companies would be required to remit annually to the state for vocational education purposes up to ten percent of their tax benefit if the total wages of new employees plus half of contractor's compensation do not exceed ten percent of the tax benefit. The majority of current projects report payroll that exceeds 10 percent of the tax benefit, however, with increased tax benefits proposed under this bill, it is possible that some companies may not meet the 10 percent threshold. The amount of funds collected by the state under this provision cannot be estimated.

Under the current limitation structure, projects only receive a tax benefit in years in which the taxable value of a project is about the value limitation amount. Companies maximize their benefit by enrolling projects in which they expect the tax value of the property to exceed the limitation amount for the entire period the limitation is in effect. Under the provisions of this bill, companies that demonstrate meeting the investment requirements during the qualifying time period will receive the exemption for the full exemption period, irrespective of property value. This aspect of the new program may significantly increase the number of program applicants.

Under the provisions of the bill, the tax benefits are triggered by investment amounts, not property value, allowing smaller projects to enroll in the program. For the 509 active projects in the Comptroller's most recent report on the Chapter 313 program, their maximum taxable value was approximately 78 percent of their reported investment. The increased importance of qualified investments in determining eligibility for the exemption will likely require additional verification or audits of investment figures reported by applicants.

The provisions of the bill substituting two qualified investment amounts for the levels in the current program would likely result in most districts seeing a threshold decrease, likely increasing use of the program.

The provisions of the bill that would allow project expansions, renovations, and refurbishments to qualify for the property tax relief benefits of Chapter 313 would increase the number of projects eligible for the program. Refurbishments and renovations of existing large and small manufacturing facilities and renewable energy projects in Texas have occurred without Chapter 313 tax incentives. Granting a property tax exemption for renovations or expansions of facilities already located in Texas would increase the amount of property eligible for the Chapter 313 program, and increase school property tax levy reductions.

Wind farms are one example of Chapter 313 projects very likely to renovate (repower) and become eligible for multiple Chapter 313 agreements under provisions of the bill. There are 210 wind farms with active Chapter 313 agreements. ERCOT records indicate that 22 wind farms have repowered or are in the process of repowering. All but a few of those wind farms have been in the Chapter 313 program. If federal subsidies for wind power continue, it is expected that many of the wind farms in the Chapter 313 program may repower sometime relatively soon after the end of the 10-year Chapter 313 limitation.

Most manufacturing projects regularly renovate or upgrade their facilities to maintain productivity and remain competitive. The petrochemical industry receives about two-thirds of the benefits of the Chapter 313 program, and has a specific term for these periods of maintenance, retrofitting, and upgrading: turn-arounds. The cost of these turn-arounds can exceed the required minimums of qualified investment under the provisions of the bill. Turn-arounds for some types of petrochemical facilities can reportedly be as frequent as every three to five years.

Texas has substantial amounts of industrial property that undergoes regular refurbishments. Providing tax benefits through the Chapter 313 program would significantly increase use of the program, allowing companies to have multiple agreements for the same project or facility, and potentially providing an ongoing tax benefit for companies that undergo regular renovations or refurbishments.

Implementing the provisions of the bill would add utility scale battery energy storage facilities as a new eligibility category. Recent ERCOT reports on battery energy storage projects indicate 92 stand-alone battery storage projects are in the planning stages as of February, 2021, with an estimated megawatt capacity of 13,975. While Chapter 313 was not a determining factor for those 92 projects, they are an indication of the potential growth of the battery industry in Texas and are useful for projecting the number of future projects that may utilize the program. Based on National Renewable Energy Laboratory (NREL) estimates of between $804 and $1,463 per kilowatt (KW) of storage battery power capacity, the rough value of all the 92 proposed projects would be between $10 billion and $20 billion. But many planned projects in ERCOT reports do not actually materialize. For illustrative purposes, if a number equal to 10-20 percent of these stand-alone battery storage projects in the February 2021 ERCOT report participated in the revamped Chapter 313 program, the estimated gross lifetime tax benefit for that 10-20 percent would be somewhere between $83 million and $303 million. As utility scale battery storage is a new technology, the number of such projects applying in the future cannot be estimated, but could be large. The fiscal impact of adding battery electric storage projects to the Chapter 313 program could be significant, but cannot be estimated.

The estimated cost to the Foundation School Program is $0.5 million in fiscal year 2024, $3.7 million in fiscal year 2025, increasing to $156.2 million in fiscal year 2031.

To the extent that some projects would not locate in Texas "but for" the Chapter 313 program, the estimated local revenue reductions shown in the table may not create a state cost through the Foundation School Program.

Under the provisions of the bill, the Comptroller's office would collect a $50,000 application fee, which would be deposited to the General Revenue Fund. From 2017 to 2020, the comptroller received from 68 to 113 applications each year, with an average of 94. Ninety-four applications would generate $4.7 million per year in general revenue. Based on the analysis of the provisions in the bill, there may be significantly more applications filed each year. For purposes of this analysis, an annual increase of 20 percent per year is assumed.

The Comptroller's office reports that the administrative costs to implement the provisions of the bill would total $932,000 in fiscal year 2022 and $764,000 in each subsequent year. The administrative cost estimate includes one-time technology cost of $168,000 in fiscal year 2022. The cost estimate reflects the funds that would be necessary to hire 5 Program Specialist IIIs, 1 Auditor V, and 4 Auditor IIIs. It is anticipated that implementing the provisions of the bill to expand eligible projects to include renovations and expansions of existing facilities would increase the application workload. Provisions of the bill that require verifying on a random sample basis at least a third of the data submitted by agreement holders for accuracy and reporting the findings to the Legislature; and auditing agreements receiving an exemption to return to the state up to ten percent of their annual tax benefit if the wages of new employees plus half of contractor's compensation do not exceed ten percent of the tax benefit will require program specialists to conduct data verification and auditors to audit agreement holders' annual payments to the state. The bill would require the Comptroller to determine that the exemption would not financially harm the school district. The Comptroller's office indicates that it does not have the capability to make such a determination, and would have to hire new employees and/or contract with a vendor to fulfill this responsibility. The Comptroller's office would only be able to make that determination at the time of a project's application, and could make that determination only based on the Texas school finance system at the time.

Technology

The Comptroller's office reports a one-time technology cost of $168,000 in fiscal year 2022 to update the design and coding of the existing database, submission forms, user interface, and reporting tools.

Local Government Impact

The estimated impact to units of local government is reflected in the table above.

Estimated school district levy losses in the years 2032 through 2049 due to the 10-year Chapter 313 program extension and other changes to Tax Code Chapter 313 in the bill are approximately $55.2 billion.

Source Agencies: 304 Comptroller of Public Accounts

LBB Staff: JMc, KK, SD, BRI, CPA, AH