

Date of Hearing: April 27, 2016

ASSEMBLY COMMITTEE ON HOUSING AND COMMUNITY DEVELOPMENT

David Chiu, Chair

AB 2842 (Thurmond) – As Amended April 12, 2016

SUBJECT: Workforce Housing Tax Credit Pilot: property taxes: income taxes: insurance taxes: credits: low-income housing: sale of credit

SUMMARY: Authorizes \$100 million in state workforce housing tax credits for qualified buildings that serve households between 60% and 80% of the area median income (AMI) in twelve counties with the highest fair market rents in the state as determined by the U.S. Department of Housing and Urban Development (HUD). Specifically, **this bill:**

- 1) Defines "low-income household" to mean a household with an income that is greater than 60% of AMI but not higher than 80% of AMI.
- 2) Expands the property tax welfare exemption to include an owner of a property that is eligible for and receives a workforce housing tax credit for housing units with an income that is greater than 60% of AMI but not higher than 80% of AMI.
- 3) Creates a state workforce housing tax credit for qualified low-income buildings for households with incomes that are greater than 60% of AMI but not higher than 80% of AMI.
- 4) Provides that the workforce housing tax credit will be equal to 20% of the project's unadjusted allocated basis not to exceed \$50,000 per unit.
- 5) Defines a "qualified low-income building" to mean a building that is eligible for and can qualify for federal Low-Income Housing Tax Credits (LIHTC) except that all of the following apply:
 - a) Eligible projects are either acquisition or substantial rehabilitation of a building that is at least 20 years old or is a new development;
 - b) No more than 50% of the units in a project are eligible for state LIHTC;
 - c) Prohibits workforce housing tax credit from being used to supplant existing affordable housing units that are not eligible for a workforce housing tax credit including any units where the income of the household is less than 80% of AMI and the rent of the existing unit is at least 20% below market rate at the time the tax credit is allocated;
 - d) At least 40% of the units in a project are for households with incomes that are greater than 60% of AMI but not higher than 80% of AMI.
 - e) A project is located in one of twelve counties that HUD has identified as having the highest fair market rents in the state.
- 6) Requires Tax Credit Allocation Committee (TCAC) to post on its Internet Web site annually the counties that can qualify for the workforce housing tax credit.

- 7) Provides that a taxpayer does not have to have currently or previously been allocated a federal LIHTC in order to be allocated a workforce housing tax credit.
- 8) Provides that a taxpayer that is allocated a workforce housing tax credit can also be allocated a state or federal LIHTC.
- 9) Prohibits a workforce housing tax credit from being allocated to a taxpayer that received a federal LIHTC for units with a household income that is greater than 60% of AMI.
- 10) Requires an applicant for a workforce housing tax credit to demonstrate to TCAC that in the city in which the project is located that the area median income for the average rental unit is above the area median income for the project.
- 11) Provides that if a taxpayer does not use the entire workforce housing tax credit in the first year it can be carried over to the following year and for up to fourteen years if necessary until the credit is exhausted.
- 12) Allows a workforce housing tax credit to credits to be taken over four years like a state LIHTC.
- 13) Requires housing units funded using the workforce housing tax credit must be provided at an affordable rate or at substantially below-market rate for 55 years in the same manner as LIHTC housing units.
- 14) Requires workforce housing tax credit to be allocated on a first-come-first served basis.
- 15) Requires TCAC to report the following information to the Legislature once all the credits are allocated:
 - a) The total number of units for which the tax credits were allowed;
 - b) The geographic areas of the tax credit allocations; and
 - c) A recommendation as to whether the tax credits should continue to be allowed.
- 16) Allows a taxpayer to make an irrevocable election to sell all or any portion of the workforce housing tax credit to an unrelated party, provided that the consideration received by the taxpayer from the sale of the workforce housing tax credit equals at least 80% of the credit amount.
- 17) Requires the taxpayer to report to the TCAC, within 10 days of the sale of the credit, certain specified information regarding the purchase and sale of the credit, as provided by the TCAC.
- 18) Requires TCAC to provide an annual listing to the Franchise Tax Board (FTB), in a form and manner agreed upon by TCAC and FTB, of the taxpayers that have sold or purchased a workforce housing tax credit.
- 19) Applies to projects that receive a preliminary reservation beginning on or after January 1, 2017.

- 20) Prohibits a sale of the workforce housing tax credit to more than one unrelated party or a resale of the credit by the unrelated party to another taxpayer or party.
- 21) Specifies that the taxpayer that originally received the workforce housing tax credit will remain solely liable for all obligations and liabilities imposed on the taxpayer by law with respect to the credit, none of which shall apply to any party to whom the credit has been sold or subsequently transferred.
- 22) Disallows a sale of a workforce housing tax credit if the taxpayer was allowed the credit on any of his/her tax returns.
- 23) Allows the taxpayer who has made an election to sell a workforce housing tax credit, with the approval of the Executive Director of TCAC, to rescind this election if the consideration for the credit falls below 80% of the amount of the credit after TCAC reservation.
- 24) Authorizes FTB to prescribe rules, guidelines, or procedures, as specified.
- 25) Requires TCAC to enter into an agreement with FTB to pay any costs incurred by FTB in the administration of the workforce housing tax credit that was sold.
- 26) Repeals the sunset date, thus making permanent the provisions allowing the state workforce housing credit to be allocated within the partnership agreement differently than federal LIHTC credits.
- 27) Takes effect immediately as a tax levy.

EXISTING LAW:

- 1) Allows a state tax credit for costs related to construction, rehabilitation, or acquisition of low-income housing. This credit, which mirrors a federal LIHTC credit, may be used by taxpayers to offset the tax under the Personal Income Tax (PIT), the Corporation Tax (CT), and the Insurance Tax (IT) laws.
- 2) Requires the California TCAC to allocate each year the California LIHTC credits based upon qualifications of the applicant and proposed project. The California LIHTC credit is available only to projects that have received an allocation of the federal LIHTC credit.
- 3) Limits the annual aggregate amount of the state LIHTC credit to \$70 million, as adjusted for an increase in the California consumer price index from 2002, plus any unused LIHTC credits for the preceding calendar year and any LIHTC credits returned in the calendar year. The California LIHTC credit awarded may be claimed as a credit against tax over a four-year period.
- 4) Requires TCAC to certify the amount of tax credit allocated. In the case of a partnership or an S Corporation, a copy of the certificate is provided to each taxpayer. The taxpayer is required, upon request, to provide a copy of the certificate to the FTB.
- 5) Allows, until January 1, 2016, the partnership agreements formed to construct low-income housing projects to allocate the state LIHTC credits to investors in a manner that differs from

the proportional allocation of the federal LIHTC credits by disconnecting federal tax rules that apply to partnerships, to which California conforms.

- 6) Authorizes the Legislature to exempt from taxation property used exclusively for religious, hospital, or charitable purposes, as specified. (California Constitution Article XIII, Section 4(b).) The Legislature has implemented this "welfare exemption" in R&TC Section 214.
- 7) Exempts low-income housing developments operated by non-profit organizations, as specified.
- 8) Imposes a "certification requirement" on low-income housing owners seeking the welfare exemption. Specifically, the law requires a project's owner to "[c]ertify that the funds that would have been necessary to pay property taxes are used to maintain the affordability of, or reduce rents otherwise necessary for, the units occupied by lower income households."

FISCAL EFFECT: Unknown. 2/3 vote.

COMMENTS:

Background: In 1986, the federal government authorized the LIHTC program to enable affordable housing developers to raise private capital through the sale of tax credits to investors. Two types of federal tax credits are available and are generally referred to as nine percent (9%) and four percent (4%) credits. In 1987, the legislature authorized a state LIHTC program to augment the federal tax credit program. State tax credits can only be awarded to projects that also receive federal LIHTCs, except for farmworker housing projects, which can receive state credits without federal credits. Investors can claim the state credit over four years. TCAC has authority for approximately \$70 million in state tax credits each year. Projects that receive either state or federal tax credits are required to maintain the housing at affordable levels for 55 years.

TCAC administers the programs and awards credits to qualified developers who do not have sufficient tax liability to use the credits themselves so they sell those credits to private investors who use the credits to reduce their federal or state tax liability. The developer in turn invests the capital into the affordable housing project. Under current law, investors must become an owner of the property to claim the credits.

New state workforce housing tax credit: This bill would create a \$100 million workforce housing tax credit for housing units with an income that is greater than 60% of AMI but not higher than 80% of AMI. The amount of credits that a workforce unit could receive would not exceed \$50,000 per unit. The credits would be awarded on a first-come-first-serve basis to developers. The credits would only be available in twelve counties that HUD has identified as having the highest fair market rents in the state. Currently those counties are: Contra Costa, Napa, Marin, Monterey, Orange, San Diego, San Francisco, San Mateo, Santa Barbara, Santa Clara, and Ventura.

Federal credits can only be awarded to projects that serve households that make up to 60% of AMI. State credits are paired with federal credits so that developers can generate enough equity to finance a project. The new workforce housing credit proposed by this bill would be unable to leverage federal tax credits; it's unclear whether developers would be able to generate

enough additional subsidies to reduce the rents of these units to reach between 60% and 80% of AMI.

The Welfare Exemption for low-income housing developments: Article XIII, Section 4(b) of the California Constitution authorizes the Legislature to exempt from taxation property used exclusively for religious, hospital, or charitable purposes, as specified. The Legislature has implemented this "welfare exemption" in R&TC Section 214. AB 2144 (Filante), of the 1987-88 Regular Session, amended R&TC Section 214 specifically to exempt low-income housing developments operated by non-profit organizations. As noted in the Senate Revenue and Taxation Committee analysis, AB 2144's proponents argued that the property tax funds then being paid "could better be used in furtherance of the goals of providing low income housing."

The owner of a property that receives LIHTC is eligible for a welfare exemption. The state and federal LIHTC serve households that make 60% of AMI or below. This bill proposes to create a new workforce housing tax credit program that would finance housing units for households at 60% to 80% of AMI. Because the welfare exemption only applies to the existing LIHTC program the units receiving workforce housing tax credits would not be eligible for the welfare exemption. This bill would add the new workforce housing tax credit as a property eligible for a welfare exemption.

Sale of credit to unrelated party: This bill would allow a developer who receives an award of state workforce housing credit to sell the credits to an investor without requiring the investor to be part of the ownership entity for the project, typically a limited liability partnership. A developer could sell the tax credit to one or more unrelated parties if they received at least 80% of the value of the credit. Allowing for the sale of workforce housing credits to investors with no ownership in the project will increase the value of the credits. Non-profit affordable housing developers, who do not have the required tax liability on their own, must seek out private equity investments for their developments. Under current law, investors must become owners of the property to claim the credits against their state tax liabilities. Due to the fact that state taxes are deductible from federal taxes, a reduction in the state tax liability increases the federal tax liability for the investor. With the federal corporate tax rate at 35%, investors will generally invest no more than 65 cents for each dollar of state credit. Allowing a developer who is awarded state credits to sell the credits to an investor without admitting the investor to the ownership partnership will increase the credit closer to one dollar for each dollar of credit. Last year, SB 377 (Beall) would have allowed the sale of state LIHTC to a third party without an ownership stake in the project. That bill was vetoed by the Governor and the author has reintroduced it this year.

Purpose of this bill: According to the author, "All state funds that subsidize the development of multi-family housing are effectively capped at 60% of the Area Median Income (AMI). State programs, as well as federal programs that incent development for units below market rent are capped. And the only existing program which goes to 80% AMI, the Multifamily Housing Program, is an overly-subscribed competitive program where advantage is given for lower-income developments—the implication of which is that no development occurs above 60% AMI. The consequence of this lack of gap-financing is that there are no rent-restricted units developed above 60% AMI which for the most part is justifiably below what the market provides. However, in high-cost metropolitan areas, the free market does not naturally provide housing for many above that income designation. The consequence of this lack of investment has been the displacement of vital workers, many workers whom, despite their contribution to the community,

cannot live within it—such as healthcare workers, education professionals, firefighters, and others."

Related legislation: AB 2817 (Chiu) increases the allocation of state LIHTC by an additional \$300 million and makes changes to the state LIHTC to allow for greater leveraging of 4% federal LIHTC. This bill passed out of this committee 7-0 and is currently pending hearing in the Assembly Committee on Revenue and Taxation.

Policy Issues:

- 1) This credit would be awarded on a first-come-first-serve basis rather than on a competitive basis. The committee may wish to consider if the bill should be amended to require the credit be awarded on a competitive basis to encourage the best and highest use of the credit.
- 2) After all the workforce housing tax credits are awarded, TCAC is required to report back to the Legislature on whether the workforce housing tax credits achieved their intended purpose. The committee may wish to require the report to include the number of units that are occupied by qualified low income households at the time the report is completed and how many tenants are paying an affordable rent at the time the report is completed.
- 3) This bill prohibits workforce housing tax credit from being used to replace existing units that are already affordable housing units including units where the households are making less than low-income and the rents for those units is at least 20% below market rate at the time the tax credit is allocated. The intent of this provision may be to prevent the workforce housing tax credit from being used for a naturally occurring affordable unit that is not subsidized. The committee may wish to consider if these protections are strong enough to prevent against the displacement of existing low-income tenants or if these provisions should be strengthened. Additionally, the bill should include a mechanism for determining the market rate for rent in order to determine if a rent is "below market rent."
- 4) The bill prohibits a housing unit that is financed using workforce housing tax credit to also be financed using federal LIHTC. It unclear why this provision is needed since the workforce housing tax credits are above the income limit for federal LIHTC.

Committee amendments:

- 1) Delete the requirement that the workforce housing tax credits be allocated on a first-come-first-served basis.
- 2) Require the report that must be submitted at the conclusion of the pilot program to include the number of units that are occupied by qualified low income households and how many tenants are paying an affordable rent at the time the report is completed.
- 3) Add to the definition of a "qualified low-income building" that units funded by the workforce housing tax credit be at least 20% below market rate at the time the tax credit is allocated.
- 4) Delete the \$100 million appropriation in the bill.

Technical amendments:

On page 22, line 24, after "(2)," insert "lower"

Double referred: If AB 2842 passes this committee, the bill will be referred to the Committee on Revenue and Taxation.

REGISTERED SUPPORT / OPPOSITION:

Support

California Council for Affordable Housing

Opposition

None on File

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