

Date of Hearing: April 25, 2018

ASSEMBLY COMMITTEE ON HOUSING AND COMMUNITY DEVELOPMENT

David Chiu, Chair

AB 3072 (Chiu) – As Amended April 17, 2018

**SUBJECT:** Income taxes: credits: low-income housing: farmworker housing

**SUMMARY:** Increases the state Low-Income Housing Tax Credit (LIHTC) Program by \$300 million and eliminates the cap on individual tax payers claiming the LIHTC for a taxable year. Specifically, **this bill:**

- 1) Provides that the dollar limitation for the offset for rental real estate activities for an individual tax payer in computing taxable income does not apply to the LIHTC.
- 2) Beginning in 2019 and each calendar year thereafter, increases the amount of state LIHTC by an additional \$300 million, as adjusted for inflation. The additional \$300 million is not available to a new qualified low-income housing building that receives a federal 9% credit.
- 3) Beginning in 2019, increases the amount of LIHTCs set aside for farmworker housing from \$500,000 to \$25 million. Amounts that are unallocated or returned shall be added to the total aggregate amount that may be allocated by the Tax Credit Allocation Committee (TCAC).
- 4) Eliminates the provision allowing TCAC to swap state LIHTCs for federal LIHTCs for buildings located in a Difficult to Develop Area (DDA) or a Qualified Census Tract (QCT) provided that the amount of the credit is computed on 100% of the qualified basis.
- 5) Eliminates the provision allowing state LIHTCs to be provided to qualified low-income housing projects in a DDA or QCT that are restricted to having 50% of occupants be special needs households.
- 6) Modifies the allocation of state LIHTCs that may be awarded to a federally subsidized low-income housing project receiving a federal 4% LIHTC as follows:
  - a) A new qualified low-income housing building is eligible for a cumulative state LIHTC over four years of 50% of the qualified basis of the building, provided that the building is not located in a DDA or a QCT.
  - b) An existing qualified low-income housing building that is not located in a DDA or QCT is eligible for a cumulative state LIHTC over four years of 13% of the qualified basis.
- 7) Requires TCAC to ensure that an increase in the basis boost due to a project being located in a DDA or QCT does not cause the state LIHTC to exceed 50% of the qualified basis for a new low-income housing building and 13% for an existing low-income housing building.
  - a) A qualified low-income housing building is eligible for a cumulative state LIHTC of 95% of the qualified basis over four years if it meets all of the following requirements:
    - i. It is at least 15 years old;

- ii. It is serving households of very low-income or extremely low-income such that the average maximum household income is not more than 45% of the area median gross income adjusted for household size;
  - iii. It would have insufficient LIHTCs due to the building's low appraised value to complete substantial rehabilitation; and,
  - iv. The substantial rehabilitation will be complete with this 95% state LIHTC of the qualified basis.
- b) A qualified low-income housing building that is eligible for a cumulative state LIHTC of 95% may not receive a cumulative state LIHTC over four years of 13% for an existing qualified low-income housing building that is not located in a DDA or QCT.
- 8) Defines "extremely low income households" as having the same meaning as in Health and Safety Code (H&SC) Section 50053.
- 9) Defines "very low income households" as having the same meaning as in H&SC Section 50053.

**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, may be used by taxpayers to offset the tax under the Personal Income Tax, the Corporation Tax, and the Insurance Tax laws.
- 2) Requires TCAC to allocate each year the California LIHTC based upon qualifications of the applicant and proposed project. The California LIHTC is available only to projects that receive an allocation of the federal LIHTC.
- 3) Limits the annual aggregate amount of the state LIHTC to \$70 million, as adjusted for an increase in the California consumer price index from 2002, plus any unused LIHTC for the preceding calendar year and any LIHTC returned in the calendar year. The state LIHTC awarded may be claimed as a credit against tax over a four-year period.
- 4) Allows a taxpayer to make an irrevocable election to sell all or any portion of the state LIHTC to an unrelated party, subject to both of the following conditions:
  - a) The consideration received by the taxpayer from the sale of the LIHTC equals at least 80% of the credit amount; and,
  - b) The purchaser of the credit is a taxpayer allowed a state or federal LIHTC in connection with a project in this state in the same taxable year as the credit purchased, or any previous taxable year.
- 5) Applies the sale of credits to projects that receive a preliminary reservation beginning on or after January 1, 2016, and before January 1, 2020. A LIHTC purchaser may resell the credit once, subject to all of the applicable requirements. The sale of a tax credit is disallowed if the taxpayer was allowed the credit on any of his/her tax returns.

- 6) Permanently allows the state LIHTC to be allocated within the partnership agreement differently than federal LIHTCs, or irrespective of whether the agreement has substantial economic effect.
- 7) Allows a taxpayer, with the approval of TCAC, to rescind the election to sell all or any portion of the LIHTC allowed if the consideration falls below 80% of the amount of the LIHTC.
- 8) Treats the sale of a credit for federal and state income tax purposes as a sale of property. Therefore, the seller is required to report gain from the sale. The gain from the sale of the credit is the excess of the total consideration received over the seller's basis in the credit. The total amount of consideration received is the sum of any money received plus the fair market value of the property (other than money) received. Since the seller's basis in the credit is \$0 (zero), the seller will recognize and report gain on the full amount of consideration received.
- 9) Requires that \$500,000 of the LIHTC be set aside for farmworker housing developments and provides that the farmworker tax credit awards are not dependent on receiving a federal LIHTC.
- 10) Defines "farmworker housing" to mean housing in which at least 50% of the units are available to, and occupied by, farmworkers and their households.
- 11) Allows TCAC to permit an owner to temporarily house non-farmworkers in vacant units in the event of a disaster or other critical occurrence provided there are no pending qualified farmworker applications for residency.
- 12) Allows TCAC to award state LIHTCs to developments in a QCT or a DDA, if the project is also receiving a federal LIHTC, under the following conditions:
  - a) The amount of state credit is computed on 100% of the qualified basis of the building; or,
  - b) If the usage of at least 50% of the units in a low-income housing building is restricted to special needs households, the amount of an allowable state LIHTC may not exceed 30% of the eligible basis of the building.
- 13) Defines a "QCT" as any census tract designated by the federal Department of Housing and Urban Development (HUD) in which either 50% or more of the households have an income that is less than 60% of the area median gross income or that has a poverty rate of at least 25%.
- 14) Defines a "DDA" as an area designated by HUD on an annual basis that has high construction, land, and utility costs relative to area median gross income.

**FISCAL EFFECT:** Unknown.

**COMMENTS:**

Affordable housing shortage: According to the Legislative Analyst, California needs to produce approximately 180,000 units of housing per year to keep up with population growth – we

produce less than half that amount. The lack of affordable housing has the most significant impact on low-income renter households. In the current market, 2.2 million extremely low-income and very low-income renter households are competing for 664,000 affordable rental units. Of the 6 million renter households in the state, 1.7 million are paying more than 50% of their income toward rent. The National Low Income Housing Coalition estimates that the state needs an additional 1.5 million housing units that very-low income Californians can afford.

Low-Income Housing Tax Credit Program: 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 9% and 4% credits. TCAC administers the program and awards credits to qualified developers who can then sell those credits to private investors who use the credits to reduce their federal tax liability. The developer in turn invests the capital into the affordable housing project.

Each state receives an annual ceiling of 9% federal tax credits. In 2015 it was \$2.30 per capita, which worked out to \$94 million in credits in California that can be taken by investors each year for 10 years. Unlike 9% LIHTC, federal 4% tax credits are not capped, however they must be used in conjunction with tax-exempt private activity mortgage revenue bonds which are capped and are administered by the California Debt Limit Allocation Committee

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. Projects that receive either state or federal tax credits are required to maintain the housing at affordable levels for 55 years.

Changes to the LIHTC: AB 3072 would increase the state LIHTC allocation by an additional \$300 million to fill the gap in funding that was created by the loss of redevelopment and the exhaustion of state voter-approved bonds. In addition to increasing the total amount of state LIHTC, AB 3072 proposes to increase the amount of state tax credits awarded to a project that is also receiving 4% federal tax credits from 13% to 50% of the qualified basis. This would more than triple the amount of equity that an investor purchasing a state tax credit would receive, which would bring the return on 4% credits in line with 9% credits and result in greater affordability for the project.

Federal LIHTC can be used anywhere in the state, but projects are given an additional 30% boost on their eligible basis if the project is located in a DDA or a QCT. Because these areas by definition have a higher poverty level and there is a higher concentration of extremely low-income or homeless individuals and families, housing needs deep subsidy to make it affordable. Existing state law does not allow state tax credits to be awarded in DDAs and QCTs with one exception: housing developments where 50% of the units are for special needs populations. The rationale for this prohibition is projects in these areas can qualify for more federal tax credits and therefore are already advantaged. AB 3072 would also allow state tax credits to be awarded to projects without regard to DDA or QCT status, with the main purpose of providing enough state tax credits to match the value of a 9% federal tax credit.

AB 3072 includes a set-aside from the \$300 million increase to the LIHTC program of \$25 million for farmworker housing. There is currently a \$500,000 set-aside of low-income housing tax credits for farmworker housing developments serving farmworkers and their families. AB

3072 would require any unused credits from the \$25 million set-aside to go to qualified non-farmworker housing projects that don't receive funding under the main program.

Many low-income housing developments in the state are older and in need of rehabilitation. These projects need higher levels of equity investments because of their age, level of repairs needed, and the low rents. It is hard for these projects to compete for state tax credits because the assessed value is low and therefore the eligible basis upon which the amount of tax credits the project can qualify for is also low. To assist these older projects, AB 3072 would allow them to receive state tax credits of 95% over four years. To qualify, projects would need to be at least 15 years old, serve low and extremely low-income households, be a single room occupancy, in a rural area, and have insufficient state credits to complete substantial rehabilitation due to a low appraised value.

Impact of Federal Tax Package on LIHTC: As a result of the H.R. 1, the Tax Cuts and Jobs Act, California will lose 48,870 affordable rental homes, 55,230 jobs, \$4.6 billion in business income, and \$1.7 billion in local, state, and federal taxes. The federal reduction in the corporate tax rate from 35% to 21% will have significant effect on the price of federal LIHTC. Novogradac & Company, LLC (Novogradac), a certified public accountant, estimates the price of the federal LIHTC has dropped from \$1.03 in March of 2016 to \$0.89 in December of 2017.

Although the price of the federal credit has been reduced, the decrease in the federal corporate tax rate could result in an increase in value to the state LIHTC. In general the state LIHTC equity pricing for allocated credits is strongly inversely correlated to the investor's federal income tax rate. According to Novogradac, "there is an inverse correlation because the state credit that reduces the investor's federal deduction for state income taxes, such that the higher the federal tax rate, the less valuable the state credit. When the corporate federal rate was 35%, state LIHTC equity prices were generally in the range of, but slightly greater than, 65 cents. Now that the federal rate has been reduced to 21%, equity pricing for allocated state credits is expected to increase, possibly in the range of 20 percent." An increase in the state LIHTC could help mitigate the loss resulting from the federal tax change.

In addition to increasing the total amount of the credit, California can make changes to tax law to increase the value of the state LIHTC. California uses "modified conformity" to federal income tax law, meaning it mirrors federal law, with certain exceptions. California's modified conformity to the federal passive activity loss rules restricts the ability of individual investors to use state LIHTCs. California caps the amount of passive activity for rental real estate activities an individual can offset with a state tax credit. According to Novogradac, "a revision to state tax law exempting state LIHTCs from the passive activity loss rules could significantly increase the state LIHTC equity pricing, even more so since tax reform limits individual taxpayers' federal deductions for state and local income taxes to \$10,000 and subjects individuals to federal tax rates that are significantly higher than corporate rates." The new federal tax law also establishes an individual tax rate of 37%, compared to a corporate rate of 21%. Individuals will have a greater incentive to invest in state tax credits.

This bill would expand the ability of individual tax payers to claim the LIHTC by eliminate the \$75,000 cap on an individual tax payer's offset for passive rental real estate activities in computing taxable income.

Related legislation:

AB 71 (Chiu) would have eliminated the mortgage interest deduction on second homes, increases the state Low-Income Housing Tax Credit (LIHTC) Program by \$300 million, and makes changes to the LIHTC. *This bill died on the Assembly Floor.*

AB 571 (Eduardo Garcia, Chapter 372, Statutes of 2017) made changes to the farmworker housing tax credit set-aside within the state LIHTC Program and to the Department of Housing and Community Development's Office of Migrant Services.

AB 2817 (Chiu) would have increased the state Low-Income Housing Tax Credit (LIHTC) Program by \$300 million, and makes changes to the LIHTC. *This bill died on the Suspense File in Senate Appropriations Committee.*

AB 35 (Chiu) would have increased the state Low-Income Housing Tax Credit (LIHTC) Program by \$300 million, and makes changes to the LIHTC. *This bill was vetoed by the Governor. Veto message below:*

*I am returning the following nine bills without my signature:*

*Assembly Bill 35*

*Assembly Bill 88*

*Assembly Bill 99*

*Assembly Bill 428*

*Assembly Bill 437*

*Assembly Bill 515*

*Assembly Bill 931*

*Senate Bill 251*

*Senate Bill 377*

*Each of these bills creates a new tax credit or expands an existing tax credit.*

*Despite strong revenue performance over the past few years, the state's budget has remained precariously balanced due to unexpected costs and the provision of new services. Now, without the extension of the managed care organization tax that I called for in special session, next year's budget faces the prospect of over \$1 billion in cuts.*

*Given these financial uncertainties, I cannot support providing additional tax credits that will make balancing the state's budget even more difficult. Tax credits, like new spending on programs, need to be considered comprehensively as part of the budget deliberations.*

Double-referred: This bill was also referred to the Committee on Revenue and Taxation where it will be heard should it pass out of this committee.

**REGISTERED SUPPORT / OPPOSITION:****Support**

California Housing Consortium  
Non-Profit Housing Association of Northern California

**Opposition**

None on file

**Analysis Prepared by:** Lisa Engel / H. & C.D. / (916) 319-2085