SENATE COMMITTEE ON HOUSING
Senator Scott Wiener, Chair
2021 - 2022 Regular

Bill No:	AB 1288	**Hearing Date:**	5/31/2022
Author:	Quirk-Silva		
Version:	5/17/2022 Amended		
Urgency:	No	**Fiscal:**	Yes
Consultant:	Alison Hughes		

SUBJECT: Income tax credits: low-income housing: California Debt Limit Allocation Committee rulemaking

DIGEST: This bill allows the Tax Credit Allocation Committee (TCAC), in any calendar year in which the California Debt Limit Allocation Committee (CDLAC) has declared a competition for the award of tax-exempt bond authority for qualified residential rental projects, to reallocate some or all of the $500 million that is made available from 4% tax credit projects to 9% tax credit projects.

ANALYSIS:

Existing law:

1) Provides that a low-income housing development that is a new building and is receiving 9% federal Low-Income Housing Tax Credits (LIHTCs) is eligible to receive state LIHTC over four years of 30% of the eligible basis of the building.

2) Provides that a low-income housing development that is a new building that is receiving federal LIHTC and is "at risk of conversion" to market rate is eligible to receive state LIHTC over four years of 13% of the eligible basis of the building.

3) Provides, for 2020 and 2021 calendar years, that up to $500 million may be allocated to 4% tax credit projects pursuant to an authorization in the annual budget or related legislation.

4) Authorizes CDLAC to adopt, amend, or repeal rules and regulations as emergency regulations win accordance with the rulemaking provisions of the Administrative Procedures Act (APA).

5) Requires projects funded by TCAC to begin construction within 180 days of the award. Authorizes the TCAC executive director to extend the 180 days in the event the Governor has declared a state of emergency.

6) Authorizes a taxpayer who receives a tax credit to sell the credit to one or more unrelated parties, as specified.

This bill:

1) Provided up to $500 million to TCAC for the 2020 calendar year, and up to $500 million in the 2021 calendar year and every year thereafter, subject to appropriation in the annual Budget Act.

2) Provides that of the $500 million made available, TCAC may allocate up to $200 million for housing financed by the California Housing Finance Agency (CalHFA) under its Mixed-Income Program (MIP).

3) Provides that for any calendar year in which CDLAC has declared a competition for the award of tax-exempt bond authority for qualified residential rental projects, TCAC may allocate some or all of the credits, except for any credits allocated for housing financed by CalHFA under its MIP, for 9% projects. TCAC shall allocate the remainder of these credits for new buildings that are federally subsidized and that can begin construction within 180 days from the date of the award.

4) Provides that for any calendar year in which CDLAC has not declared a competition for the award of tax-exempt bond authority for qualified residential rental projects, credits shall be allocated for new buildings that are federally subsidized and that can begin construction within 180 days from the date of the award except for any credits allocated for housing financed by CalHFA under its MIP.

5) Provides that in the event of a state of emergency proclaimed by the Governor, the executive director of TCAC may extend the 180-day construction start deadlines.

6) Authorizes the committee to adopt, amend, or repeal rules and regulations without complying with the Administrative Procedures Act, except as follows:

    a) The committee shall provide a notice, as specified, that shall be provided to the public at least 21 days before the close of the public comment period, and the committee shall schedule at least one public hearing, as specified, before the public comment period closes.

b) The committee shall maintain a rulemaking file, as specified, and the final regulation shall be accompanied by a final statement of reasons, as specified.
c) The committee may also adopt, amend, or repeal emergency rules and regulations.

7) Requires projects funded by TCAC to begin construction within a reasonable time, as determined by TCAC.

8) Requires a taxpayer who purchases a tax credit to be eligible to claim that credit in the taxable ear the building is placed in service, as specified.

COMMENTS:

1) *Author's statement*. "AB 1288 will increase the impact of the state's additional investment in Low-Income Housing Tax Credits by deploying these credits more effectively. The current pairing of these state credits with 4% federal credits no longer makes sense at a time when there is a massive backlog of developments seeking 4% federal credits. The line just becomes longer. By granting the Tax Credit Allocation Committee the authority to move these credits to the unconstrained 9% federal tax credit program, California can increase the overall production of new affordable homes."

2) *Background of the federal LIHTC program.* The LIHTC is an indirect federal subsidy developed in 1986 to incentivize the private development of affordable rental housing for low-income households. The federal LIHTC program enables low-income housing sponsors and developers to raise project equity through the allocation of tax benefits to investors. 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.

   Two types of federal tax credits are available: the 9% and 4% credits. These terms refer to the approximate percentage of a project's "eligible basis" a taxpayer may deduct from their annual federal tax liability in each year for 10 years. "Eligible basis" means the cost of development excluding land, transaction costs, and costs incurred for work outside the property boundary. For projects that are not financed with a federal subsidy, the applicable rate is 9%. For projects that are federally subsidized (including projects financed more than 50% with tax-exempt bonds), the applicable rate is 4%. Although the credits are known as the "9% and 4% credits," the actual tax rates fluctuate every month, based on the determination made by the Internal Revenue Service on a monthly basis. Generally, the 9% tax credit amounts to 70% of a taxpayer's eligible basis and the 4% tax credit amounts to 30% of a taxpayer's eligible basis, spread over a 10-year period.

Each year, the federal government allocates funding to the states for LIHTCs on the basis of a per-resident formula. In California, TCAC is the entity that reviews proposals submitted by developers and selects projects based on a variety of prescribed criteria. Only rental housing buildings, which are either undergoing rehabilitation or newly constructed, are eligible for the LIHTC programs. In addition, the qualified low-income housing projects must comply with both rent and income restrictions.

Each state receives an annual ceiling of 9% federal tax credits and they are oversubscribed by a 3:1 ratio. 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 CDLAC. In 2020, the state ceiling for private activity bonds was set at $4.1 billion. The value of the 4% tax credits is less than half of the 9% tax credits and, as a result, 4% federal credits are generally used in conjunction with another funding source, like state housing bonds or local funding sources.

3) *Background of the state LIHTC program.* 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 have also received, or are concurrently receiving, an allocation of the federal LIHTCs. The amount of state LIHTC that may be annually allocated by the TCAC is limited to $70 million, adjusted for inflation. In 2020, the total credit amount available for allocation was about $100 million plus any unused or returned credit allocations from previous years. Current state tax law generally conforms to federal law with respect to the LIHTC, except that it is limited to projects located in California.

   While the state LIHTC program is patterned after the federal LIHTC program, there are several differences. First, investors may claim the state LIHTC over four years rather than the 10-year federal allocation period. Second, the rates used to determine the total amount of the state tax credit (representing all four years of allocation) are 30% of the eligible basis of a project that is not federally subsidized and 13% of the eligible basis of a project that is federally subsidized, in contrast to 70% and 30% (representing all 10 years of allocation on a present-value basis), respectively, for purposes of the federal LIHTCs.

Furthermore, state tax credits are not available for acquisition costs, except for previously subsidized projects that qualify as “at-risk” of being converted to market rate.

Combining federal 9% credits (which amounts to roughly 70%) with state credits (which amounts to 30%) generally equals 100% of a project’s eligible basis. Combining federal 4% credits (which amounts to roughly 30%) with state credits (which amounts to 13%), only results in 43% of a project’s eligible basis.

4) *Effect of Bond Caps.* The 9% credit is first allocated to each state according to its population. In 2021, states were projected to receive LIHTC allocation authority equal to $2.8125 per person, with a minimum small population state allocation of $3,245,625.13. These allocation limits, however, do not apply to 4% credits. The 4% credit is unlimited so long as the project is at least 50% financed with tax-exempt bonds. Therefore, the limiting factor for the 4% credit comes from the overall bond volume cap. As of 2020, California's bond volume cap was $4.1 billion.

5) *$500 million to increase affordable housing production*. On July 31, 2019, AB 101 (Budget Committee, Chapter 159), was signed into law, providing an additional $500 million in state LIHTCs. When the additional $500 million was first made available, the federal tax-exempt bond ceiling of approximately $4 billion had not yet been reached. In 2014, for example, developers only used $80.5 million in annual federal 4% tax credits, significantly less than prior years. This is because, unlike in prior years, there was little supplemental funding from housing bonds or local funding sources to fill the remaining financing gap. The loss of redevelopment funding and state housing bond funds, which were used in combination with 4% federal credits to achieve higher affordability, had made the 4% federal credits less effective.

   The additional $500 million was coupled with tax-exempt bonds and the 4% credit, in part, to encourage developers to fully utilize any remaining federal tax-exempt bonds that were being left on the table. After the $500 million was made available, due to significant state and local housing construction funding, 4% credit applications increased significantly and the bonds became oversubscribed. As a result, CDLAC instituted a competitive process for awarding tax-exempt bonds. The Legislature approved another one time $500 million allocation in the 2021-22 budget, and the Governor’s 2022-23 January budget proposes a third one-time $500 million infusion in the program.

6) *Benefits of $500 million diminish once bond cap is reached*. As noted earlier, the limitation on the 4% credit comes from the bond volume cap, not the credit.

Once the cap is met, the number of additional projects (and to a certain degree units) that can be approved under the 4% credit substantially tapers off. Therefore, continuing to provide $500 million in state credits to 4% credit projects under these conditions will not lead to an increase in the number of total units being built. To truly increase the number of projects approved under the 4% credit, modifications would have to be made to the tax-exempt bond requirements, and California does not have the authority to make those changes.

Projects under the 9% credit, on the other hand, are not limited by the availability of bonds. Projects under the 9% credit are only limited by the availability of credits. All things being equal, if the state provides more LIHTCs under the 9% credit, more units will be built. Therefore, transferring some or all of the $500 million LIHTCs from the 4% credit to the 9% credit when the bond cap has been met, as this bill allows, may actually lead to more housing units being built for the same amount of money.

7) *More transparency*. Current law authorizes CDLAC to adopt regulations pursuant to the APA. With the increased competition for bonds, the committee has embarked on several changes to its regulations in recent years. This bill proposes to remove the requirement for these regulation changes to go through the APA process, thus reducing the overall length of time to make regulatory changes. However, to strike a balance and ensure more transparency and opportunity for stakeholder engagement, this bill specified timelines for notice, hearings, and comments to any future regulation changes.

8) *Construction dates*. TCAC projects that receive a bond award are required to commence construction within 180 days of receipt of their award. The intent to award projects that are "shovel ready." In the advent of COVID-19 and changing market conditions – much of which is outside of the control of the applicants – many projects have been unable to achieve this requirement. This bill proposes to authorize TCAC to require projects to commence construction, instead, within a reasonable time, as determined by TCAC.

9) *Certificated credits*. TCAC awards credits to qualified developers. Generally, developers 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. In this case, the investor becomes an owner of the property to claim the credits.

In 2016, the Legislature created an alternative investment structure, which sought to increase the value of the state credit, called "certificated credits."

Under this model, developers can 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, which have increased the value of the credit. In recent years, around half of the projects receiving state credits chose to "certificate" their credits.

In order to claim the "certificated credits," the Franchise Tax Board requires specified tax forms to be completed by the investor. According to the sponsor, however, it can take time for CDLAC to provide the appropriate forms to the investor, sometimes years. This bill would allow investors who buy the credits to begin claiming them in the year that the development is occupied, increasing the price investors will pay for the credits. According to the sponsor, this will reduce the amount of credits each development needs. This provision is consistent with rules governing federal tax credits.

10) *Double-referral.* This bill was also referred to the Committee on Governance and Finance.

RELATED LEGISLATION:

AB 101 (Committee on Budget and Fiscal Review) — included $500 million in one-time funds to for the 4% LIHTC program.

FISCAL EFFECT: Appropriation: No Fiscal Com.: Yes Local: No

POSITIONS: (Communicated to the committee before noon on Wednesday, May 25, 2022.)

SUPPORT:

California Housing Partnership Corporation (Sponsor)
California State Treasurer
East Bay Housing Organizations
Eden Housing
Midpen Housing Corporation
SV@Home Action Fund

OPPOSITION:

None received.

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