Low Income Housing Tax Credit Report
December 5, 2012

Introduction

The Low Income Housing Tax Credit Committee (hereinafter Committee) of the Missouri Tax Credit Review Commission (hereinafter Commission) held three meetings to receive comments from members of the public and to consider possible updates and changes to the reports the Committee filed with the Commission during the 2010 tenure of the Missouri Tax Credit Review Commission. Those meetings were held in Jefferson City, Missouri on November 15, 2012, Springfield Missouri on November 30, 2012, and December 6, 2012, by teleconference.

Scope of Committee's Meetings

The public meetings received almost no public participation. The Committee was only able to achieve a quorum for one of the meetings, the final meeting of December 6, 2012. *As a result there was minimal dialogue and a limited exchange of ideas.*

General Consensus of Committee on Cuts to the LIHTC Program

The Committee is very concerned with the state of affordable housing in Missouri. As will be demonstrated in the following sections of this report, there has been a substantial deterioration in the availability of affordable housing. Low to moderate income individuals have been most greatly affected by the *Great Recession*, seeing their real incomes decline while the costs of housing, transportation and other basic necessities continue to rise.

The need for affordable housing is greater today than it was in 2008 when the recession began and is greater than it was when we met in 2010. It is expected to continue to worsen. Correspondingly we understand the need to reduce the budget and as a result we are, ***with great reluctance and great concern***, proposing reductions in the state low income housing program. We are proposing these reductions because we believe they are expected as part of our charge to reduce the overall amount of state credits but we are doing it with the reluctance of knowing the pain that will be experienced by those in the low to moderate income levels will be far greater than that experienced by cuts in other programs.

It is for the Commission and the legislature to decide the extent credits that provide necessities should be reduced to spare others. We have no real basis for making the recommendation for the size of our proposed reduction. It is, for the most part, arbitrary and intended to meet an objective of overall reduction in tax credits.

One thing is clear, the lower to moderate income individuals have been most greatly affected by the *Great Recession* with some of the most vulnerable people, such as our senior citizens, being the most threatened. As a result, the committee was reluctant to recommend any cuts to the program when we cannot provide adequate workforce housing or housing for our disabled or our seniors. We know the cuts we are proposing will only worsen their plight.

Update: General Status of Affordable Housing for Period Subsequent to 2010 Commission Hearings and Recommendations.

During the Commission's proceedings in 2010 the country was mired in what has popularly been referred to as the Great Recession. In 2010 it was unclear exactly when the recession would end and which sectors of the economy would be the first to experience growth and which would lag behind.

It was clear, housing, which usually leads the country out of recessions, would lag behind other sectors and continue to be a drag on the economy for some time. There were predictions that housing would recover in a year or two as new construction had ground to a near halt and excess units would be absorbed. Others were less optimistic and suggested it could take many years for the housing sector to recover to near normal activity.

The impact of the recession on affordable housing was also unclear. While our 2010 report observed that conditions were worsening, no one knew whether the deterioration in the availability of affordable housing and the increase in the need for such housing, was a short term or long term problem. We now know that there has been a continuing deterioration in the conditions affecting low to moderate income people; they have tended to suffer from decreased, a lower employment rate, and an increasing shortage of housing.

Because of the growing need for affordable housing, the Commission should weigh that fact when evaluating the low income housing tax credit program against other programs that are not providing *an essential item for survival* (a roof over one's head) as opposed to promoting some other worthwhile goal *that does not address a vital necessity of life.* It was suggested for example that the historic credit was a *luxury credit* that in good times was very worthwhile for preserving history but in hard times perhaps it took away from credits that served the basic needs of the state's citizens.

Low to moderate income people were hit hardest by the recession. A simple Google search will provide a large amount of data to support the fact that low to moderate income individuals have suffered the most in losing housing and in efforts to find affordable housing. Furthermore they make up a large segment of individuals who lost their homes to foreclosure.

The fact that low to moderate income families and seniors are seeing a continuing deterioration in the availability of affordable housing is not subject to serious debate. As a result, caution needs to be exercised in the amount by which programs that serve those in need of a home are reduced. The impact of any reduction will be felt by seniors and working families who have suffered through the recession and continue to do so.

In “**LOSING GROUND** – The Struggle of Moderate-Income Households to Afford the Rising Cost of Housing and Transportation” a report prepared by the Center for Housing Policy, October 12, 2012, the authors noted that transportation and housing costs for moderate income people have risen to the point that:

> For households earning 50 to 100 per cent of the median income of their metropolitan area, nearly three-fifths (59%) of income goes to housing and transportation costs. For these households, the growing costs of place[1] are particularly burdensome, leaving relatively little left over for expenses such as food, education, and health care, not to mention savings.[2]

In “Rental Market Stresses: Impacts of the Great Recession on Affordability and Multifamily Lending,” a report from the Joint Center for Housing Studies of Harvard University, July 2011, it is clear that the housing situation for lower income individuals continues to worsen.

While vacancy rates in housing may have increased during the recession (although currently recovering), “the Great Recession did little to halt the long-term erosion of rental housing affordability.”[3] In fact conditions have worsened with renters squeezed by higher rents and energy costs.[4] By the fourth quarter of 2010 rents began to rise in most markets, but the income of renters could not keep pace.[5] Thus, while one might expect to see housing affordability increase for lower income individuals, the economic downturn has instead made matters worse.

“Rental affordability has not improved in the wake of the financial crisis. Indeed, *renter incomes have fallen more than housing costs****, leaving more renters with housing cost burdens than before the recession***.”[6] **With rent burdens rising sharply among low income and middle income renters more and more renters are seeing more than half of their income being devoted to housing.[7] For lower income individuals, the rent to income ratio for renters has risen to 63.6%. For renters below the federal poverty level it has risen to 71%.[8]**

The gap between the number of units necessary to serve lower income people and the units that actually exists, is worsening. There are only approximately 6 units available for every 10 people who need affordable housing and only 3.5 for those considered very low income.[9]

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[1] Costs in place and housing and transportation costs are used interchangeably.
[2] See Executive Summary page 1 of Losing Ground.
[3] Rental Market Stresses: Impacts of the Great Recession on Affordability and Multifamily Lending, at page 1.
[4] Id.
[5] Rental Market Stresses: Impacts of the Great Recession on Affordability and Multifamily Lending, at page 2.
[6] Rental Market Stresses: Impacts of the Great Recession on Affordability and Multifamily Lending, at page 5.
[7] Id.
[8] Rental Market Stresses: Impacts of the Great Recession on Affordability and Multifamily Lending at page 6.
[9] Id. at page 15.

"The Great Recession brought financial stress to renter households and rental property owners alike. Although the economic downturn brought rent and energy price increases to a halt, *renter's incomes fell even more sharply*. *As a result, the plight of low income renters has only worsened-not just in the past two years but over the decade as a whole.* Indeed, by virtually every measure, rental affordability has been on the decline since at least 1960."[10]

In summary, the plight of low income senior citizens, families in need of workforce housing, disabled veterans, those transitioning to independent living from mental illness and many others, has deteriorated even more since 2010. Housing is an essential need for every person and family and affordability is critical otherwise those affected cannot afford proper food, medical care, clothing and medication. Their basic needs are therefore compromised. This credit serves to put a roof over the heads of many who would otherwise not be able to find an affordable place to live. It is truly a necessity credit not a luxury credit and we must be mindful that conditions for those affected are now worse than they were at the time of our initial report and recommendations.

Home Funding

The Missouri Housing Development Commission (MHDC) is also experiencing substantial cuts to the HOME Funds it receives from the Department of Urban Development (HUD); a cut from approximately 15 million to 9.1 million in 2012 (approximately 40%) and another projected cut of up to 10% in 2013. These reductions in funding will ultimately affect the funds available to finance projects, primarily through lending activity, and will therefore have a further impact on the availability of affordable housing.

Special Needs

State Agencies are more and more frequently attempting to expand the role of affordable housing to meet the needs of those in our society who have special needs frequently where other funding was previously present. That in turn drives up the cost of "special needs affordable housing" which requires greater reserves and therefor more credits, and makes less housing available for the traditional low to moderate worker (workforce housing). Those categories include physical, mental and developmentally disabled individuals. Serving those with special needs reduces the burden placed on the state through other programs such as Medicaid.

Issues and Recommendations for the Commission

The Need for MHDC to Communicate Major Policy Changes and the Opportunity for the Investment and Development Community to Comment Before Policy Changes are Implemented

[10] Id. at Page 33. Emphasis added.

When the LIHTC program was created by Congress the intent was to create a partnership with the private sector to build and manage low income housing. The perception of the investment and development community is that the Commission acts unilaterally for the most part. The development and investment communities have little, if any, prior notice or input prior to the implementation of broad sweeping changes. This can result in unintended consequences.

The Committee discussed this in the context of the extension of the applicability of the Davis Bacon requirements on out state housing which requires developers to pay wages on the Kansas City/St. Louis scale as opposed to what the true "prevailing wage" is in outstate Missouri. The result is out-state housing is far more expensive to build and thus fewer units can be built. Had the Commission had the benefit of developer input to understand the impact of extending Davis – Bacon to out-state Missouri it might not have occurred. Perhaps the Commission can revisit this decision and revisit the concept of involving the LIHTC community at large before making far reaching decisions with far-reaching consequences.

Unused Credit Carry Forward

If LIHTC's are not authorized or are authorized and not used then the unused credits shall be added to the pool of LIHTC available for the next calendar year and thereafter until used.

Permit Stacking of the State LIHTC credit with the State Historic Credit in Counties Where the Population is less Than 50,000

LIHTC should be cut appropriately but the cut should be kept to the minimum amount necessary to maintain providing low income housing.

Setting a Cap for the State LIHTC

The current limit for Missouri LIHTCs is approximately 13.5MM per year for the 10 year credit and 60MM for the 4% bond credit. The total authorized current credits is therefore 19.5MM annually. The committee recommends lowering the 9% credit to 11.5 annually and the 4% credit to 2.0 annually for a total of 13.5MM or a reduction of approximately 30% of the current authorizations. The 60MM bond credit was previously lowered to 60MM from a high of approximately 90MM. (and off of the high X 1840+ probably 125) check. 4% was as high as 190MM capped at 60 in 2009.[11]

Implement Changes for Tax Credit Amounts for Projects with an Application Date of 2013

Projects with an application date of 2012 have already been underwritten and it would cause considerable difficulty if anticipated reductions in the state credits were effectively reduced retroactively. Therefore the changes in the credit amounts should apply to 2013 applications.

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[11] The 4% credit was previously reduced from 90MM and to that from a previous uncapped amount that an as high as 190MM.

<u>The possibility of transitioning to a 5 year credit- idea advanced by Commissioner Mr. Van Matre</u>

In its 2010 reports the Committee discussed a number of possible approaches to making the 10 year housing tax credit more efficient. One of those approaches was to shorten the term of the credit from 10 years to 5 years. By doing so, the credit would become more efficient. However, because there are currently 10 years of outstanding credits the switch to a 5 year credit would initially cause an increase in the total credits even if the number of 5 year credits was substantially below that of the current 10 year credit. Charts demonstrating the bubble affect were attached to that report, and can be viewed in those reports.

The practical issue which the committee felt hindered the shortening of the credit from 10 years to five years is the bubble that would be created during the five-year period. In other words the total cost of the program would increase as the ten-year credits burned off creating an obstacle to implementation during a time when the budget needed to be reduced, not increased.

Mr. Van Matre observed that toward the end of the 5 year credit the number of 10 year credits outstanding would be diminishing, and that there might be a way to transition from a 10 year credit to a 5 year credit. The result would be once the transition was complete, the state would have a more efficient credit. Mr. Van Matre suggested that perhaps the five-year credit could actually be a seven-year credit and that a percentage of the credit that would not increase the total amount of credits being redeemed each year would be redeemable during the first 5 years and the balance during the last 2 years. The exact calculations must be worked out to determine what percentage of the credits can be redeemed without creating a bubble.

Because the annual amount of the 5 year credit would be less than a 10 year credit it would only defer a relatively small portion of the credit to the last 2 years.

<u>The following discussion was initiated by Commissioner Craig Van Matre and then reduced to writing by Mr. Van Matre for consideration</u>

<u>Mr. Van Matre's Proposal:</u> In response to the need for affordable housing and the simultaneous need to ameliorate the adversity caused by residential foreclosures, the state could offer tax credits to persons who acquire a previously vacant and foreclosed upon single family residence in targeted areas. Obviously the program should not be open to expensive homes in areas where few (if any) other foreclosed upon residences exist. The tax credit would be equal to a material percentage –perhaps 25%-- of the costs incurred in both acquiring and then rehabilitating the residence. Qualification for the credit would require that the occupants of the residence following such rehabilitation meet the same criteria as those who now occupy LIHTC properties, but they could be either renters or owners (or renters with a right to buy at a

later date). The rent charged would have to be limited in the same manner as rent for LIHTC projects. The credits could be certificated and be transferable, so that the person rehabilitating the residence would have the ability to use the proceeds from the sale of the credit to finance the rehabilitation costs. To expand upon the potential permutations such a program might offer: a community development organization could take title to a group of eligible properties from lenders, sell them to developers at discounted prices, use cash thus generated to make neighborhood improvements, and thus arrest and reverse the decline in property values now taking place.

Recommendation was to implement some form of this program with funding of 60MM for each of 2 years. Funding for this would be taken from savings in LIHTC and 30M from the HTC authorization.

MHDC Target Cost does not apply to a Project not using Missouri LIHTCs

The MHDC establishes target maximum costs per unit for projects receiving LIHTC. Chairman Gardner suggested that if a project receives federal low income housing tax credits but does not use state low income housing tax credits (e.g. a project using federal low income housing tax credits and historic credits state and or federal) it should not be subject to the cost per unit test recognizing that historic tax credit projects are by definition more expensive on a cost per unit basis. Motion failed but a recommendation was made to refer the proposal to the Commission.

Davis- Bacon

The Davis-Bacon Act requires contractors to pay what is commonly referred to as the "prevailing wage" for projects. However contractors in out state Missouri frequently do not fill out the necessary forms to determine what the prevailing wage should be in the less metropolitan areas. Therefore, the prevailing wage for rural county may be set by the only prevailing wage data the Department of Labor has which may effectively mean St. Louis wages in Aurora, Missouri. Our charge is to make the program more efficient and build as much housing as possible. The effect of Davis-Bacon is to make the program *less efficient* and to reduce the amount of housing that can be built.[12]

Mr. Gardner raised the possibility of suspending Davis-Bacon in outstate Missouri for 2 years so that MHDC could compel contractors doing business on MHDC projects to keep and forward to MHDC records on what they paid in out state Missouri. MHDC could then accumulate that data and establish a fair wage for outstate Missouri.

[12] This the view of the Chairman.

An issue was raised as to whether such a recommendation fell within the jurisdiction of either the Committee or the Commission. Chairman Gardner's motion to make it a recommendation of the Committee failed. However, an amended motion passed which calls for the referral of this issue to the Commission in order that the Commission might consider the appropriateness of considering the issue and the appropriate action to be taken.

AHAP

The AHAP credit is a one-time credit that may be allocated to an eligible donor for 55% of the total value of an eligible to donation. There are two types AHAP credits: (1) Production credits for donations related to construction, rehabilitation, and rental assistance activities; and (2) Operating Assistance credits that help fund the operating cost of the nonprofit organization. The program offers 10 million of Production credits and 1 Million in Operating Assistance credits annually. The members present discussed that it might be good to reduce the Production credits to 6.0M annually and increase the Operating Assistance credits to $2.0M annually.

The Committee discussed the fact that legislators are expecting a cut from all programs and to an extent the actual need for the program is irrelevant to them. A 30% reduction in the LIHTC would be well received by legislatures.

The Committee discussed the proposed HTC 30% cut, which isn't really a cut as the full cap isn't being used anyway. Cap proposed at either $90 or $100, which is what they're currently using already. HTC is also proposing carrying forward any unused cap. The Committee discussed the diminishing need for Historic renovation in the St. Louis area.