Legislative Fiscal Bureau
One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873
Email: fiscal.bureau@legis.wisconsin.gov • Website: http://legis.wisconsin.gov/lfb

February 7, 2018

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Senate Bill 706/Assembly Bill 869: State Low-Income Housing Tax Credit

Senate Bill 706 (SB 706) was introduced on January 19, 2018, and was referred to the Senate Committee on Revenue, Financial Institutions and Rural Issues. On February 2, the bill was withdrawn from that Committee and rereferred to the Joint Committee on Finance.

Assembly Bill 869 (AB 869), a companion bill to SB 706, was introduced on January 19, 2018, and was referred to the Assembly Committee on Housing and Real Estate.

CURRENT LAW

The Wisconsin Housing and Economic Development Authority (WHEDA) is responsible for administration of the federal Low-Income Housing Tax Credit (LIHTC) on behalf of the state. The LIHTC encourages the development of multifamily properties with below-market rents for low-income households by providing tax credits, which typically are sold to investors in exchange for up-front financing. Properties receiving the credit must reserve at least 20% of units for households with incomes at or below 50% of the county median income, or 40% of units for households with incomes at or below 60% of county median income. Monthly rent for these units, including utilities, is intended to be no more than 30% of income for tenants.

The LIHTC is provided in two forms, a 4% credit and a 9% credit, and the credit may be claimed for each of the 10 years beginning with the year the development is placed into service. Over the 10-year credit period, the 4% credit provides financing equal to 30% of the present value of construction costs of the low-income units in the development, not including land. This 4% credit is adjusted monthly by the U.S. Department of the Treasury based on the federal cost of borrowing, averaging approximately 3.25% throughout 2017. Similarly, the 9% credit is intended to provide financing equal to 70% of the present value of construction costs. Due to 2015 changes,

the 9% credit is no longer adjusted monthly and is fixed at 9%, with a resulting present value that fluctuates but is generally higher than 70% of construction costs.

The 9% credit is provided on a competitive basis with an allocation of approximately $13.6 million annually provided to Wisconsin during 2017 and 2018. The 4% credit is available to properties with at least 50% of their eligible construction costs financed with tax-exempt bonds, which are issued under a federal volume cap allocated to the state. It should be noted that properties receiving the 9% credit generally are not eligible for tax-exempt bonding to help finance construction.

Specific requirements for the application process and scoring procedure are laid out in the Authority's Qualified Allocation Plan (QAP). Under the plan, properties receiving either the competitive 9% or non-competitive 4% credit must receive a determination that identifies a need for housing in a given market, as well as the need for LIHTC support in order to be financially feasible. Further, applicants must undergo a scoring process that determines eligibility, with a minimum score necessary to receive the credit. Scoring gives preference to developments that: (a) provide to a variety of income levels; (b) are located in lower-income areas; (c) are energy efficient and sustainable; (d) have units suitable for larger families; (e) provide supportive services; (f) are accessible to disabled persons; (g) rehabilitate or stabilize a neighborhood; and (h) are ready to proceed with construction, among others.

WHEDA currently administers the federal LIHTC program in Wisconsin. Under the arrangement, WHEDA collects fees on applications for credits and monitoring of developments to cover administrative costs related to the program. For the 2016-17 fiscal year, WHEDA reports application fees of $1.71 million and monitoring fees of $2.27 million. Monitoring fees are collected from developments as part of annual reviews to determine compliance with required low-income unit set-asides and income-based rent restrictions.

SUMMARY OF BILL

SB 706/AB 869 ("the bill") would require WHEDA to administer a state-level nonrefundable tax credit, similar to the federal LIHTC, that could be claimed against the individual income tax, the corporate income/franchise tax, and the insurance premiums tax. The credit could not be claimed against the alternative minimum tax under the individual income tax. WHEDA would develop a program to certify developments and issue allocation certificates, which would certify that the owner of the development is eligible to claim the stated amount of tax credits each year for six years. The bill gives WHEDA discretion as to the amount of credit that would be allocated to any given entity, subject to an annual aggregate cap for the program. The bill provides that WHEDA may carry forward any previously unallocated or recaptured credits, in addition to its yearly maximum allocation. The bill also requires WHEDA to give preference to developments located in cities, towns, or villages with populations fewer than 150,000.

As written, the bill specifies, in part, "The aggregate amount of all state tax credits the authority certifies persons to claim in allocation certificates issued under [the bill] in the same calendar year may not exceed $42,000,000." WHEDA would also be authorized to award

unallocated credits from previous calendar years and any credits revoked or cancelled by WHEDA. One reading of the bill is that the amount of tax credits claimable may not exceed $42 million in any year, plus allowances for unallocated or recaptured credits. However, the provision could also be interpreted as authorizing WHEDA to issue $42 million worth of allocation certificates per year, which would then be claimed each year for six years, for a total of up to $252 million annually, if WHEDA were to certify the maximum amount of credits each year. Fiscal notes produced by WHEDA and the Department of Revenue (DOR) interpret the provision to limit all claimable credits to $42 million annually. Further, the bill drafting file indicates an intention for $7 million in credits to be earned for each of the six years in the credit period. While it appears the intent and agencies' current interpretation of the bill favors a maximum cost of $42 million per year, this provision could be clarified to avoid future interpretation contrary to the provision's intended effect.

Property owners would be eligible for the credit as long as: (a) the project meets low-income requirements necessary to receive the federal LIHTC; (b) the development receives financing with tax-exempt bonding; (c) WHEDA determines the credit is necessary for the financial feasibility of the proposed construction; and (d) the development is compliant with Title VIII of the Civil Rights Act, pertaining to protection from discrimination related to race, color, religion, national origin, sex, familial status, or disability. WHEDA would be required to issue the certificates in accordance with the QAP, which includes a scoring procedure for issuing credits, as discussed above. Under the bill, property owners would be required to maintain compliance with low-income and non-discrimination requirements for at least 15 years. In the event a development provides less than the contracted amount of low-income units, claimants would be subject to recapture of tax credits in the same manner as the federal credit, consisting of a calculation of actual available low-income units relative to the amount of credits already claimed.

Under the bill, WHEDA would be required to report annually to the Legislature on the number of allocation certificates issued, the location of developments receiving certificates, authorized rents or set-asides for each development, and the developments' demographic, household, and income characteristics. As part of the report, WHEDA would be required to conduct an analysis, using demographic and market data, to examine how developments receiving credits are addressing the need for affordable housing, including an examination of remaining disparities in the communities.

Partnerships, limited liability companies (LLCs), and tax-option corporations (S corporations) would not be allowed to claim the state low-income housing credit, but the eligibility for, and the amount of, the credit would be based on their payment of amounts eligible for the credit. A partnership, LLC, or S corporation would have to compute the amount of credit that each of its partners, members, or shareholders could claim and would have to provide that information to each of them. For shareholders of an S corporation, the credit could be allocated in proportion to the ownership interest of each shareholder. Partnerships and LLCs could compute the credit to be claimed by partners or members in proportion to their ownership interests or as provided in a written agreement among the partners or members that is entered into no later than the last day of the taxable year of the partnership or LLC for which the credit is claimed. Any partner or member that claims the credit as allocated by a written agreement would have to provide a copy of the

agreement with the tax return on which the credit is claimed. The claimant would be solely responsible for any tax liability arising from a dispute with DOR related to claiming the credit.

Under current law, the amount of a business tax credit claimed is generally included in the claimant's computation of income or subtracted from the basis of the underlying asset on which the credit is claimed. Credits that primarily affect individuals and families, such as the property tax/rent credit, are generally excluded from the computation of income. The bill would treat the proposed state low-income housing credit similar to how an individual income tax credit is treated, rather than a business tax credit, and would not include the amount of the credit in the taxpayer's income computation.

As noted, the credit would be nonrefundable, meaning the credit can only be claimed to the extent a claimant has a state tax liability. Any credit amount claimed but unable to be used by the claimant could be carried forward for the following 15 years. DOR would be authorized to administer the credit, and take any action, conduct any proceeding, and proceed as authorized under state income/franchise tax laws. State tax provisions related to timely claims, assessments, refunds, appeals, collection, interest, and penalties would apply to the credit.

These provisions would take effect on the day following publication of the bill and would first apply for taxable years beginning after December 31, 2017.

FISCAL EFFECT

According to data of 4% credit awards in Wisconsin provided by WHEDA, $17.8 million in credits have been allocated to 59 projects from 2005 to 2017. A summary of 4% LIHTC allocations can be found in Table 1. The amount allocated each year fluctuates considerably based on a variety of characteristics including: (a) market demand for housing; (b) construction costs; and (c) the availability of bonding and other financing.

Since the federal 4% program is not capped in the same manner as the 9% credit, recent allocations may provide a basis for understanding market demand for the federal 4% credit and a potential state-level credit. However, a number of factors may influence future federal 4% allocations. Investment interest in LIHTC projects is dependent on current federal tax law and economic conditions because LIHTC investors use the property's credit allocation to offset federal tax liabilities. Lower federal corporate tax rates under the Tax Cuts and Jobs Act of 2017 have decreased demand for credits as many potential investors have reduced tax liabilities and thus lower need for offsetting credits. Conversely, introduction of a state LIHTC may supplement the federal credit and increase the financial feasibility of certain projects, increasing demand for the federal credit above historical trends shown in Table 1. The net result of these competing effects is indeterminate.

TABLE 1

Federal 4% LIHTC Allocations in Wisconsin

Year	Low-Income Units	Credit Amount	Projects
2005	120	$205,100	3
2006	584	1,379,100	8
2007	476	1,165,200	6
2008	322	810,200	3
2009	97	117,800	2
2010	220	692,300	5
2011	1,406	3,623,100	4
2012	34	334,900	1
2013	528	1,439,100	3
2014	209	732,400	3
2015	309	1,029,500	5
2016	574	3,667,300	9
2017	592	2,602,700	7
Total	5,471	$17,798,700	59
Average	421	$1,369,100	4.5

NOTE: Includes projects for which credits have been reserved, but not yet awarded.

As discussed previously, federal LIHTC awards are typically sold by developers to investors in order to provide upfront financing of the project. As part of the sale, the credits are transferred to the investors, who will then claim them over the 10-year federal credit period. As written, the bill lacks language authorizing the transfer of credits in this manner. It is expected that without such language, demand for, and utilization of, the state credit likely would be lower than that for the federal credit, or a state credit created with transferability provisions.

Under the bill, WHEDA is not limited to a percentage-of-construction-costs calculation as under the federal credit, and would have discretion as to the amount of credit allocated to any given project. It is possible WHEDA would make higher allocations on a per-project basis than any federal awards, as the Authority's per-project allocation is limited only by the overall cap of the program. Additionally, it is unclear to what extent WHEDA would award state credits to projects already awarded federal credits or placed into service before passage of the bill. The bill specifies an award must be necessary for the financial feasibility of a project, and such financial feasibility of previously awarded federal projects already would have been established independent of a state-level award. However, as LIHTC prices have declined by approximately 15% from their peak in late 2016, it is possible developments that have been reserved but not yet awarded credits may require and pursue additional financing under a state-level program. Any fiscal effect from supplemental awards to pending projects is uncertain, and is excluded from this estimate.

Given considerations of market demand for the credit, limitations on transfer of the credit to investors, and substantial WHEDA discretion in administering the state LIHTC, it is difficult to provide a precise fiscal estimate. Allocations of $500,000 to $3.5 million annually could be

expected if WHEDA were to provide a state-level credit matching typical federal 4% credits awarded for recent projects. Table 2 shows estimated credits claimed against state taxes by fiscal year assuming WHEDA allocates $1.5 million in credits each year, consistent with the average allocation of federal 4% credits in the 10-year period from 2008 to 2017. The estimates in Table 2 illustrate how the credit would be expected to phase in by 2025-26, with successive years of credit allocations being claimed as developments are placed into service. It is assumed projects would take two years from award to placement into service due to construction time, which delays the initial fiscal effect of the bill until 2020. Claims could further be carried to later fiscal years if claimants had insufficient tax liability against which to apply the nonrefundable credits. It is assumed the bill would not have any fiscal effect in the 2017-19 biennium.

TABLE 2

Fiscal Effect for 2017-18 and Future Years –
$1.5 Million Annual Allocation

Fiscal Year	Fiscal Effect
2018	$0
2019	0
2020	375,000
2021	1,875,000
2022	3,375,000
2023	4,875,000
2024	6,375,000
2025	7,875,000
2026 and annually thereafter	9,000,000

Table 3 outlines the estimated annual cost of the credit once fully phased in across a range of possible yearly allocations. Table 3 assumes consistent credit allocations of the amount shown beginning in 2018-19 and continuing each year thereafter. Under these assumptions, the annual estimated fiscal effects would occur starting in 2025-26. Although the table assumes consistent allocations, the bill authorizes WHEDA to carryover unallocated or recaptured credits from previous years into its current-year allocation. As a result, future years could have fiscal effects greater than those outlined in the table if WHEDA were to award accumulated credits not used in previous years.

The fiscal effect outlined in Table 3 assumes a maximum allocation of $42 million in total claimable credits per year. As previously discussed, while this interpretation is accepted by the administering agencies, the bill as written could be interpreted to allow costs up to $252 million per year. Table 3 represents a range of allocations to a maximum as possible under the interpretation of a $42 million annual cap in credits. Excluded from the table is a fiscal effect of the bill interpreted under a $42 million annual cap in new certifications ($252 million annual cap in credits).

TABLE 3

State LIHTC Annual Fiscal Effect – Fully Phased In

Average Yearly Allocation	Fiscal Effect
$500,000	$3,000,000
1,000,000	6,000,000
1,500,000	9,000,000
2,000,000	12,000,000
2,500,000	15,000,000
3,000,000	18,000,000
3,500,000	21,000,000
4,000,000	24,000,000
4,500,000	27,000,000
5,000,000	30,000,000
5,500,000	33,000,000
6,000,000	36,000,000
6,500,000	39,000,000
7,000,000	42,000,000

In its fiscal note attached to the bill, WHEDA indicates that it intends to assess fees in a similar fashion to the federal program to cover administration costs associated with the state-level credit. WHEDA reports it expects to realize cost efficiencies in administration of the state program if credits are allocated to the same projects as the federal credit. No estimate of potential fee revenues is available at this time. Because WHEDA is an independent authority, any fees it receives from program administration would not be considered part of the state budget.

Prepared by: Rory Tikalsky