# NORTH CAROLINA GENERAL ASSEMBLY

## LEGISLATIVE FISCAL NOTE

**BILL NUMBER**: Senate Bill 181 (Senate Finance Committee Substitute)

**SHORT TITLE**: Pass – Through Entity/ Housing Tax Credit

**SPONSOR(S)**: Senators Harris, et al.

**FISCAL IMPACT**

**Yes ( )** **No ( )** **No Estimate Available (X)**

| | FY 2001-02 | FY 2002-03 | FY 2003-04 | FY 2004-05 | FY 2005-06 |
|---|---|---|---|---|---|
| **REVENUES** | | | | | |
| General Fund | see ASSUMPTIONS AND METHODOLOGY | | | | |
| **EXPENDITURES** | | | | | |

**PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED**: Department of Revenue; Housing Finance Agency

**EFFECTIVE DATE**: This act is effective for taxable years beginning on or after January 1, 2001, and applies to buildings that are placed in service on or after January 1, 2001.

**BILL SUMMARY**: The bill authorizes a pass-through entity (limited partnership, general partnership, joint venture, Subchapter S corporation, or limited liability company) to allocate a low-income housing credit to any of its owners at its discretion. In effect, this legislation allows developers of low-income housing to sell federal and state low-income housing tax credits to separate investors. This legislation is similar to the bifurcation or separate sale of federal and state historic rehabilitation tax credits that was approved in the 1999 Session of the General Assembly (S.L. 1999, Chapter 381).

The credit amount allocated must not exceed the owner's adjusted basis in the pass-through entity. If the credit is ever forfeited, the forfeiture applies to the owners in the same proportion as the credit was allocated. The Senate Committee Substitute expanded the credit to be taken against the gross premiums tax on insurance companies.

**BACKGROUND:** In the Tax Reform Act of 1986, Congress created the Low Income Housing Tax Credit (LIHTC) program to fund housing for low- and moderate-income households. Each state receives a tax credit of $1.25 per person that can be used for new construction or rehabilitation of housing. Last year Congress increased the per capita credit to $1.50 in 2001 and $1.75 in 2002, and then indexed the credit to the CPI beginning in 2003.

General Statutes 105-129.16B authorizes a state income tax credit equal to a percentage of a taxpayer's federal tax credit for low-income housing constructed in North Carolina. The credit is 75% of the federal credit for buildings located in Tier one and Tier two counties and 25% for buildings located in all other Tiers. Eligible low-income housing must meet one of the following criteria:

1) located in a Tier one or two enterprise area,
2) located in a Tier three or four enterprise area and has at least 40% of its residential units rent restricted and occupied by individuals whose income is 50% or less of median gross income, or
3) located in a Tier five enterprise area and has at least 40% of its residential units rent restricted and occupied by individuals whose income is 35% or less of median gross income.

The credit is taken over five years beginning when the federal credit is first claimed for the building. The federal credit requires that the low-income housing be used for that purpose for at least 30 years.

**ASSUMPTIONS AND METHODOLOGY**:

Most housing finance experts agree that passage of SB 181will increase the competition for state low income housing tax credits, but the statutory mandates on the number of rent controlled units in a project may continue to prevent developers in high tier counties from seeking state tax credits. Competition in the tax credit market affects the price paid for a credit put up for bid, but may not increase the participation of developers in the state credit program.

Credit Competition

The IRS allocates the per capita low-income housing tax credits to state housing agencies such as the North Carolina Housing Finance Agency (NCHFA). The NCHFA reviews housing project proposals and awards the tax credits to project developers. The developer sells the state and federal credits to a syndicator to acquire financing for a project. Under current North Carolina law, a syndicator must purchase both the state and the federal credits. This restriction limits the number of investors able to purchase the state tax credit primarily to in-state groups. The Community Affordable Housing Equity Corporation in Raleigh purchases approximately half of the state tax credits. First Union is another major purchaser of housing tax credits.

Opinion varies on whether the ability to sell the state and federal credits independent of each other will increase or decrease the value of the state tax credit. Officials with two of the nation's largest tax credit syndicators , Boston Capital Corporation and Sterling Financial Group, believe the ability to purchase the state credit without purchasing the federal credit will increase the marketability of the state credit. SB 181 will permit Fannie Mae, purchaser of one fourth of the nation's low-income housing credits, to purchase North Carolina credits for the first time. However, the Community Affordable Housing Equity Corporation believes that the market price for the state credit will be reduced from approximately 50 cents per dollar of credit to 25 cents per dollar of credit. This group thinks national investors will pursue the federal credits but will not compete for the state credit. An official with the St. Louis Equity Fund also believes SB 181 would drive down the value of the state credit because investors in state credits have less control over a housing project. SB 181 will have an impact on the price paid a developer for a tax credit, but the jury is still out on whether it will increase or decrease credit values.

A change in credit price does not affect the revenue gain or loss to the General Fund. The revenue impact from SB 181 will occur only if it changes housing developers' utilization of the state tax credit.

State Credit Barrier

In Tier three, four and five counties, state requirements for the number of rental units reserved and the percent of median gross income for renters is more stringent than federal guidelines. Officials with the North Carolina Housing Finance Agency believe the state standards are too difficult for developers to meet, especially in Tier five counties.

| | | Percentage of Units | Rent Controlled | Median Gross Income |
|---|---|---|---|---|
| Federal | Option 1 | 20% | Yes | 50% |
| Federal | Option 2 | 40% | Yes | 60% |
| State | Tiers 3 and 4 | 40% | Yes | 50% |
| State | Tier 5 | 40% | Yes | 35% |

One developer in Western North Carolina used the federal credit on his project in a Tier five county, but did not apply for the state tax credit because of the 35% median income limit. The developer felt that the use of the state credit would not provide the income mix of renters that he promised the city leaders.

2000 State Credit Allocation

In calendar year 2000, the North Carolina Housing Finance Agency reported that 70% of the projects (25 of 36) receiving the federal low-income housing tax credit also requested the state low-income housing credits. All 7 projects in Tier one and two counties and all 6 projects in Tier three and four flood relief counties utilized 100% of their 75% state tax credits. However, only 12 of the 23 projects (52%) in Tier three and five counties utilized the 25% state tax credits. Ten of the eleven projects rejecting the state tax credit were in Tier five counties such as Guilford, Wake, Buncombe, and Forsyth. Only 5 of the 15 (33.3%) Tier five projects used the state tax credit.

This data seems to confirm that the rent restrictions in higher tier counties prevent the 100% utilization of the state tax credit. Without a change in the state rental standards, the North Carolina Housing Finance Agency does not believe SB 181 will in itself increase the percentage of state credits used. However, if the market price for credits increased sufficiently to provide more capital to a housing project, a developer might be willing to accept the state rent guidelines. Unfortunately, this fiscal note cannot project the price syndicators are willing to pay for a state credit after passage of SB 181 or the willingness of a developer to enter the state tax credit marketplace.

**TECHNICAL CONSIDERATIONS**:

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