DEPARTMENT OF TAXATION
2024 Fiscal Impact Statement

1. **Patron** Joshua E. Thomas

2. **Bill Number** HB 1096
House of Origin:
X Introduced
___ Substitute
___ Engrossed

3. **Committee** House Finance

4. **Title** Enhancement of the Virginia Housing Opportunity Tax Credit

Second House:
___ In Committee
___ Substitute
___ Enrolled

5. **Summary/Purpose:**

For Calendar Years 2023 through 2025, this bill would increase the annual cap on the Virginia Housing Opportunity Tax Credit by $40 million per year from $60 million to $100 million per year. This bill would also make a corresponding increase in the multi-year cap on the Housing Opportunity Tax Credit of $120 million from $255 million to $375 million. The multi-year cap does not apply per calendar year but instead across all calendar years for which the Housing Opportunity Tax Credit is effective.

If enacted during the regular session of the 2024 General Assembly, this bill would become effective January 1, 2024.

6. **Budget amendment necessary:** Yes.

7. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)

8. **Fiscal implications:**

Administrative Costs

The Department of Taxation ("the Department") considers implementation of this bill as routine and does not require additional funding.

Virginia Housing Development Authority ("Virginia Housing") is allowed under the HOTC Act (Section 58.1-439.30.F) to charge an administrative fee to developers awarded the credits, and that administrative fee offsets their costs. In addition, Virginia Housing is self-supporting and does not receive state appropriations.

Revenue Impact

This bill would result in an unknown General Fund revenue impact. The timing of the impact depends on how quickly Virginia Housing awards credits and how quickly taxpayers claim the credits authorized by this bill. This bill could result in an estimated negative General Fund revenue impact of up to $4.6 million in FY 2026 and $8.6 million for FY 2027 and thereafter. This estimate assumes that the $40 million increase in credits for Calendar Years 2024 and 2025 would be fully utilized over a ten-year period, and the $40 million increase in credits for Calendar Year 2023 would be rolled over to 2024 at the statutory permitted rate of fifteen percent. However, if the technical amendment suggested by Virginia Housing on Line 10 is adopted, the estimated negative impact could increase to up to $8 million in FY 2026 and $12 million for Fiscal Years 2027 and each fiscal year thereafter.

9. Specific agency or political subdivisions affected:

Department of Taxation
Virginia Housing Development Authority

10. Technical amendment necessary: Yes. Virginia Housing presented the following technical issue with the bill:

The bill increases the credit amount for years 2023-2025. Virginia Housing has already awarded 2023 credits. Virginia Housing would need to "carry forward" the additional 2023 credits to be awarded in 2024. However, the HOTC Act (Section 58.1-439.30.G) would limit such carry forward to 15%, and part of the additional 2023 credits would exceed that maximum carry forward amount. As a result, a technical amendment would be required to effectuate all of the additional 2023 credits.

11. Other comments:

Federal Low-Income Housing Tax Credit

The federal low-income housing tax credit ("LIHTC") is a nonrefundable income tax credit that was created by the Tax Reform Act of 1986 to provide an incentive for the development and rehabilitation of affordable rental housing. LIHTCs are awarded to developers of qualified rental projects via a competitive application process administered by state housing finance authorities. Typically, developers will effectively "sell" their tax credits to outside investors by entering into limited partnerships or limited liability companies with investors, with 99.99 percent of the profits, losses, depreciation, and tax credits being allocated to the investors as a partner in the partnership or member in the limited liability company. This reduces the debt developers would otherwise have to incur and the equity they would otherwise have to contribute. With lower financing costs, tax credit properties can potentially offer lower, more affordable rents.

Two types of LIHTCs are available depending on the nature of the construction project. The so-called 9 percent credit is generally reserved for new construction, while the so-called 4 percent credit is typically used for rehabilitation projects and new construction that is financed with tax-exempt bonds. Each year, for ten years, a tax credit equal to roughly 4 percent or 9 percent of a project's qualified basis (cost of construction) is claimed. The applicable credit rates have historically not actually been 4 percent and 9 percent. Instead, the credit rates have fluctuated in response to market interest movements so that the program has delivered a subsidy equal to 30 percent of the present value of a project's qualified basis in the case of the 4 percent credit, and 70 percent in the case of the 9 percent credit. For both the 4 percent and 9 percent credit it is the subsidy levels (30 percent or 70 percent) that are explicitly specified under federal tax law, not the credit rates. Since 1986, the 4 percent rate has ranged between 3.15 percent and 3.97 percent, and the 9 percent credit between 7.35 percent and 9.27 percent. Since 2008, however, there has been a floor under the 9 percent credit below which the new construction credit rate cannot fall.

The process of allocating, awarding, and then claiming the LIHTC is complex and lengthy. The process begins at the federal level with each state receiving an annual LIHTC allocation in accordance with federal law. State housing agencies then allocate credits to developers of rental housing according to federally required, but state created, allocation plans. The process typically ends with developers effectively selling allocated credits to outside investors in exchange for equity.

<u>Taskforce and Report to Study Establishment of Virginia LIHTC</u>

During the 2020 General Assembly Session, House Bill 810 was enacted, which required the Department of Housing and Community Development ("DHCD") and the Virginia Housing Development Authority ("VHDA") to convene a stakeholder advisory group ("Task Force") to:

- Determine the most effective and efficient way to administer a Virginia housing opportunity tax credit program,
- Develop draft legislation establishing such an affordable housing credit program, and
- Conduct financial modeling to determine the fiscal impact of such a program to Virginia.

Such legislation also required the Task Force to report its recommendations to the Governor, the Secretary of Commerce and Trade, the Director of the DHCD, and the commissioners of the VHDA by September 1, 2020. Such report, the *Report of the Virginia Housing Opportunity Tax Credit Task Force*, was published in September 2020.

<u>Current Law</u>

Under current law, taxpayers are eligible to claim this credit if they own or are invested in a building used to provide low-income housing. A building qualifies if:

- It was put into service in Virginia on or after January 1, 2021.
- It meets the definition of low-income building provided in §42(c) of the Internal Revenue Code.

This credit equals the amount of the federal low-income housing tax credit Virginia Housing permits for the project.

This credit is subject to an annual cap equal to $60 million per calendar year. Credits issued each calendar year from Calendar Year 2022 through Calendar Year 2025 are not permitted to be claimed immediately. Credits issued each calendar year are allowed ratably, with one-tenth of the total amount of the credits allowed annually for 10 years over the credit period. There is a reduction in the tax credit allowable in the first year of the credit period due to a federal law calculation, and any reduction by reason of such federal law calculation in the credit allowable for the first taxable year of the credit period is allowable for the first taxable year following the credit period.

If the amount of Housing Opportunity Tax Credits issued by Virginia Housing in a calendar year is less than the $60 million annual cap, the balance of such credits, in an amount not greater than 15 percent:

- May be allocated by Virginia Housing for any qualified project in the following calendar year,
- May not be allocated at any time after such following calendar year, and
- May be allocated no later than December 31, 2025.

Any Housing Opportunity Tax Credits amounts issued by Virginia Housing that are later either canceled and returned to Virginia Housing, or recaptured or disallowed may be awarded in the following calendar year, but no later than December 31, 2025.

In addition to the $60 million annual cap, the multi-year cap on the Housing Opportunity Tax Credits program is $255 million. Such cap does not apply per calendar year but instead across all calendar years for which the Housing Opportunity Tax Credit is effective. As a result, such multi-year cap applies for Calendar Year 2021 through Calendar Year 2025.

Virginia Housing must provide information, data, and any other requested advisement on the potential structure and cost of a separately authorized certificated program upon a request from the Chairs of the House Committee on Appropriations, the House Committee on Finance, and the Senate Committee on Finance and Appropriations.

Of the annual cap of $60 million, $20 million must be first allocated exclusively for qualified projects located in a locality with a population no greater than 35,000 as determined by the most recent United States census. Such allocation of Virginia Housing Opportunity Tax Credits constitutes the minimum amount of such tax credits to be allocated for qualified projects in such localities. However, if the amount of such tax credits requested for qualified projects in such localities is less than the total amount of such credits available for qualified projects in such localities, the balance of such credits is permitted to be allocated for any qualified project, regardless of location. In allocating or allowing such credits to qualified projects in such localities, Virginia Housing is required to give equal consideration to qualified projects allocated or allowed a federal low-income housing credit in an amount equal to the 10-year present value calculation of the percentages prescribed under federal law.

Proposed Legislation

For Calendar Years 2023 through 2025, this bill would increase the annual cap on the Virginia Housing Opportunity Tax Credit by $40 million per year from $60 million to $100 million per year. Credits issued each calendar year cannot be claimed immediately, instead the credits issued each calendar year are allowed ratably, with one-tenth of the total amount of credits allowed annually for 10 years over the credit period.

This bill would also make a corresponding increase in the multi-year cap on the Housing Opportunity Tax Credit of $120 million from $255 million to $375 million. Such cap does not apply per calendar year but instead across all calendar years for which the Housing

Opportunity Tax Credit is effective. As a result, such multi-year cap applies for Calendar Year 2021 through Calendar Year 2025.

If enacted during the regular session of the 2024 General Assembly, this bill would become effective January 1, 2024.

Similar Legislation:

SB 512 would establish a nonrefundable income tax credit for the expenses incurred in converting office buildings to residential uses that include affordable housing.

HB 1203 would modify the Communities of Opportunity Tax Credit for landlords to increase the cap from $250,000 to $1 million.

cc : Secretary of Finance

Date: 2/3/2024 ALS
HB1096F161