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

June, 2021 Joint Committee on Finance Paper #314

State Housing Tax Credit
(General Fund Taxes -- Income and Franchise Taxes)

[LFB 2021-23 Budget Summary: Page 211, #10]

CURRENT LAW

The federal low-income housing tax credit (LIHTC) provides tax credits to developers of properties serving low-income residents. For 30 years, properties must reserve 20% of units for households with incomes below 50% of county median income, or 40% of units for households with an average income below 60% of county median. Residents pay 30% of their income as rent, including utilities. In exchange, developers receive federal tax credits claimable each year for 10 years.

The federal LIHTC is offered at two levels, a more valuable credit (9% credit) limited to total allocation of $16.4 million each year in Wisconsin under a competitive process, and a less valuable credit (4% credit) provided on an unlimited basis to any development meeting eligibility criteria. Credit values are determined based on the present value of construction costs for a given development, with the 4% credit providing federal tax credits over the 10-year credit period generally equal to at least 30% of the present value of construction costs associated with a project, and the 9% credit providing at least 70% of construction costs. These amounts vary based on market conditions. As of June, 2021, the federal Internal Revenue Service reports the 4% and 9% credits equal approximately 38% and 86% of the present value of a development, respectively.

Developments supported by the 4% credit also receive additional subsidy in the form of financing supported by federal tax-exempt bonds, which have more favorable interest rates. Each year, states are allocated an amount of federal tax-exempt bonding authority ("volume cap"), adjusted annually to reflect cost-of-living increases. For 2021, this amount is $110 per capita, or $325 million, whichever is greater. The Wisconsin Housing and Economic Development Authority (WHEDA) provides a portion of this authority to finance 4% LIHTC projects.

The state housing tax credit was created under 2017 Wisconsin Act 176, and is a nonrefundable tax credit claimable against individual income, corporate income/franchise, and insurance premiums taxes. The state credit is administered by WHEDA, which awards state credits as a match to the federal 4% LIHTC. Act 176 limited WHEDA to certifying credit claims of no more than $42 million annually, equal to awarding $7 million in credits annually that are claimed each year for six years. State credit recipients must maintain compliance with the same low-income requirements as federal properties, and finance their development with federal tax-exempt bonding.

Table 1 shows allocations of the federal 4% credit and state credit since 2018, the first year state credits were awarded. In instances where WHEDA does not fully allocate a prior year's credit, it is allowed to allocate credits under that authority in subsequent years, such as under the 2020 award cycle. Once fully phased in, the current limit will result in an annual reduction in state tax revenue of $42 million.

TABLE 1

State Housing Tax Credit and Federal 4% Low-Income Housing Tax Credit Allocations

Year	Projects	Federal 4% LIHTC	State HTC	Low-Income Units
2018	9	$6,632,587	$6,620,994	1,065
2019	11	7,008,948	6,243,491	796
2020	11	7,958,843	7,947,444	1,009
2021	16	13,286,027	7,112,492	1,334
Total	47	$34,886,405	$27,924,421	4,204

Specific requirements for applications and scoring of housing tax credits are laid out in the Authority's qualified allocation plan (QAP). Under the plan, properties receiving state or federal housing tax credits must receive a determination that identifies a need for housing in a given market, as well as the need for tax credit support 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, among other factors: (a) serve 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; (h) are located in rural areas without recent credit awards; and (i) are ready to proceed with construction. The QAP also specifies allocation of credits amongst different categories of need, with applicants competing in their respective category for a portion of total available credits. For the state credit, 2021 awards are split into categories of: (a) projects in rural areas (25% of available credits); (b) projects in small urban municipalities (20%); (c) projects that provide supportive services for persons at risk of homelessness to at least 25% of residents (10%); and (d) a general allocation (45%).

DISCUSSION POINTS

1. As seen in Table 2, Wisconsin has awarded an average of approximately $15.4 million each year in federal 9% credits to developments in Wisconsin since 2016. The process for receiving 9% credits is competitive, and approximately 41% of eligible requests were funded from 2016 to 2021. Projects that do not win a competitive 9% credit may consider applying for the noncompetitive 4% credit, which is available to any project meeting eligibility criteria, including being financed with federal tax-exempt bonds and the same low-income requirements under the 9% credit. However, given the lower value of the 4% credit, projects may not be financially feasible when financed with solely the 4% credit. As noted previously, as of June, 2021, the federal 9% credit provides tax credits equal to roughly 86% of total construction costs, and the federal 4% credit provides tax credits equal to roughly 38% of construction costs.

TABLE 2

Federal 9% Low-Income Housing Tax Credit Requests and Awards

Year	Requested Amount	Eligible Requests	Federal 9% Award	Unmet Requests
2016	$19,425,247	$19,147,095	$15,873,653	17%
2017	25,483,353	19,181,017	10,751,265	44
2018	28,140,769	25,320,304	14,833,291	41
2019	39,218,280	34,629,797	19,856,399	43
2020	35,926,992	30,502,746	16,478,419	46
2021	29,623,810	28,794,924	14,730,616	49
Total	$177,818,451	$157,575,883	$92,523,643	41%

2. To address unmet demand for the 9% credit, the state housing tax credit was created as a supplement to the 4% credit. In general, WHEDA allocates the state credit in an amount equal to the federal 4% credit awarded to a project, up to the state limit of $1.4 million in credits per project, and limited by the total allowable allocation of state credits under the program. However, during the 2021 allocation, WHEDA awarded state credits at a lower ratio relative to federal credits due to limited available state credits. Combined with a federal 4% credit, an equal match of state credits results in tax credits equal to approximately 61% of project costs. While not as high of a proportion of construction costs as a competitive 9% credit, the combined state credit and federal 4% credit with financing supported by tax-exempt bonds represents a significant subsidy for prospective projects that may make many projects financially feasible in lieu of credits under the federal 9% program.

3. Assembly Bill 68/Senate Bill 111 would extend the period that the state housing tax credit may be claimed from six to 10 years, and increase from $42 million to $100 million the total amount WHEDA may certify to be claimed annually. The bill would also allow the Authority to waive the current requirement that a development receiving state housing tax credits be financed with federal tax-exempt bonds if the Authority determines allowable bonding authority under the federal volume cap will be insufficient to finance developments in any given year. As written, the bill does

not have an initial applicability provision, meaning credits awarded prior to the enactment of the bill could be claimed for 10 years, rather than six. The administration reports it intends for the provision to apply only to new projects, and alternatives would incorporate an initial applicability to projects awarded credits after January 1, 2022.

4. The proposed increase of the state credit would consist of two components: (a) an increase in the number of years an awarded credit may be claimed from six to 10; and (b) an increase in the number of credits that may be awarded each year from $7 million to $10 million. The proposal under AB 68/SB 111 would be expected to reduce state income and franchise tax revenue by an additional $58 million annually by 2033-34 once fully phased in.

5. An increased length of credit claims has the effect of increasing the value of the credit for a recipient receiving an award. That is, under current law, if allocated as a match to the federal 4% credit, the state credit provides a subsidy of approximately 23% of the present value of construction costs of a project. If the state credit were extended from six to 10 years, the state credit would provide a subsidy of approximately 38%. If the state credit were provided as an equal match to the federal credit under the proposed increased credit length, the federal 4% and state credit combined would be expected to provide a total subsidy equal to about 76% of the present value of construction costs, not including any additional savings from tax exempt bond-supported financing.

6. Increasing the value of the state credit would increase the number of projects that would be financially feasible if allocated credits, which would increase demand for credits, and resulting construction of affordable housing. Thus, an increased credit value would be intended to increase participation in the state program. However, as seen in Table 3, demand for state credits has grown significantly since the program's inception, and only 46% of eligible requests were met in 2021. Thus, increasing the value of the state credit could be considered unnecessary given the high demand for state credits under their current valuation.

TABLE 3

State Housing Tax Credit Applications and Awards

Year	Requested Amount	Eligible Requests	State Award
2018	$10,421,246	$7,385,579	$6,620,994
2019	14,504,588	6,247,317	6,243,491
2020	12,099,423	8,970,848	7,947,444
2021	16,163,468	15,509,343	7,112,492
Total	$53,188,725	$38,113,087	$27,924,421

Note: Some applications may withdraw or be determined ineligible, resulting in incomplete allocations in some years.

7. Under current law, WHEDA may not award state credits for projects unless it is

determined that such subsidy is necessary for the financial feasibility of a project. Thus, WHEDA could offset the increased allocation period by decreasing the amount of credits provided per project. Notably, as demand was high for credits during the 2021 allocation, WHEDA provided smaller allocations of state credits to more projects, and did not provide an equal match to federal credits for most projects. Thus, regardless of the length and resulting value of a state credit, WHEDA would retain significant discretion in allocating credits to projects to maximize their effectiveness and provide subsidies only as is necessary for financial feasibility. Further, the federal LIHTC is provided over 10 years, and increasing the length of the state credit from six to 10 years would align it with the credit period under federal law.

8. An increased annual credit allocation would increase the number of projects able to be supported by tax credits each year. As noted previously and seen in Table 3, demand has exceeded availability of credits in recent years. Since the state housing tax credit's inception, credits have been provided to 73% of requests, which may suggest demand is sufficient to justify additional state housing tax credits. However, if $10 million in state housing tax credits had been available each year, requests would not have been sufficient to allocate available credits. Thus, the Committee could consider providing a lower additional allocation of state housing tax credits.

9. An analysis by the National Low-Income Housing Coalition, using U.S. Census Bureau data, concluded that Wisconsin's housing shortage disproportionally impacts its lowest-income households. Wisconsin has an estimated 188,100 households earning less than 30% of median income, but 69,000 residences that are considered affordable for those families. For the lowest-income households, an estimated 86% spend more than 30% of household income on rent. Provision of additional funding for state housing tax credits would increase the availability of affordable housing that costs no more than 30% of household income.

10. As the state housing tax credit is typically allocated to match federal 4% credits, provision of additional housing tax credits could be considered a more cost-effective approach to encouraging the development of low-income housing in Wisconsin than other state-operated programs not able to receive unlimited federal matching funds. When a project is not financially feasible if provided only federal 4% credits, a state credit may fill a gap in funding necessary to realize development and capture federal funding that otherwise would not have been used to support housing in Wisconsin. For example, before the creation of the state housing tax credit, WHEDA allocated an average of $1.4 million in federal 4% credits each year from 2005 to 2017 to support construction of an average of 421 low-income units each year. From 2018 to 2021, after the state housing tax credit was created, WHEDA allocated an average of $8.7 million in federal 4% housing tax credits each year to support an average of 1,051 low-income units each year.

11. It may be that high demand for housing tax credits is representative of significant capacity for development of low-income housing projects and that additional credits are unnecessary. That is, it is possible some portion of projects could be modified to become financially feasible without receiving state housing tax credits, and credits may be provided to developers for behavior they would have otherwise conducted regardless of state credits. Thus, additional credit allocations could be ineffective at incentivizing new development.

12. While the Authority generally provides state credits as a match to the federal 4% credit,

there is no requirement under current law that limits awards to the amount of 4% credit awarded. In several instances during the 2021 allocation, WHEDA provided state credits greater than the federal 4% credit allocated to a project. If the Committee wished to increase the total available state housing tax credits in order to leverage available federal 4% credit funding, it could consider limiting WHEDA awards of state housing tax credits to no more than the federal 4% amount awarded to any given project. Creating such a requirement would limit credit awards to a certain proportion of total project cost, in effect creating a match requirement for developers to contribute a certain proportion to project financing. Such a requirement would limit provision of state credits to projects that are more cost-effective and thus extend the relative impact of state credits offered for development of low-income housing.

13. As part of its expansion of the state housing tax credit, AB 68/SB 111 would authorize WHEDA to waive the requirement that a development receiving state housing tax credits be financed with federal tax-exempt bonds if the Authority determines that available tax-exempt bonding authority is insufficient to finance developments in a given year. Under current law, state housing tax credit developments must receive financing with tax-exempt bonding, as is required for developments receiving federal 4% credits. As tax-exempt bonding allows for lower-cost lending to developments, use of tax-exempt bonding limits the amount of state housing tax credit necessary to make a project financially feasible. Thus, the requirement for use of tax-exempt bonding limits the impact to state tax revenues of developing state housing tax credit properties.

14. Given the significant proposed increase in allocations of state housing tax credits, it is possible that federal tax-exempt bonding may be insufficient to offer financing to proposed projects. In the event such tax-exempt bonds were not available, WHEDA would still be able to offer state housing tax credits. As the provision applies only if such tax-exempt bonding were not available, priority would still be given to projects subsidized with tax-exempt bonding. However, regardless of this provision, federal 4% credits would remain available only to projects financed with tax-exempt bonding, as required under federal law.

15. Given the shortage of affordable housing for low-income residents in Wisconsin, high demand for state and federal low-income housing tax credits, and the opportunity to leverage additional available federal 4% credits for development of low-income housing in Wisconsin, the Committee could consider increasing the cap on allocation of state housing tax credits in Wisconsin. Consideration could be given to the proposal under AB 68/SB 111 to raise the annual cap to $100 million, equal to $10 million per year over a longer credit period of 10 years [Alternative 1]. It is estimated that the increase under Alternative 1 would not reduce state tax revenues during the 2021-23 biennium, but would begin reducing state tax revenues by an additional $750,000 in 2023-24 and $3,750,000 in 2024-25, phasing in to a total additional decrease of $58 million by 2033-34.

16. Given demand for state credits in recent years, the Committee could consider a smaller increase to the credit cap. If the Committee wished to increase the amount of credits available, but not their value, it could increase the annual cap to $60 million, equal to $10 million per year over the six year credit period under current law [Alternative 2]. It is estimated that the increase under Alternative 2 would not reduce state tax revenues during the 2021-23 biennium, but would begin reducing state tax revenues by an additional $750,000 in 2023-24 and $3,750,000 in 2024-25, phasing in to a total

additional decrease of $18 million by 2029-30.

17. If the Committee wished to ensure increased credit allocations were provided to leverage federal 4% credits provided to projects, it could specify that the allocation of state housing tax credits to a given project not exceed the federal 4% credit awarded to that project [Alternative 3], as has generally been the practice for state housing tax credit projects in recent years.

18. If the Committee elected to increase state housing tax credit allocations, it could also consider providing WHEDA the authority to waive the requirement that a state housing tax credit-supported development be financed with tax-exempt bonding if it determines available tax-exempt bonding were insufficient in any given year [Alternative 4]. If the Committee were concerned about additional tax credits supporting behavior that is already occurring, it could also take no action, and state housing tax credits would be capped at $42 million, equal to $7 million per year claimable over six years [Alternative 5].

ALTERNATIVES

1. Increase the total amount of state housing tax credits that WHEDA may certify to be claimed to $100 million and allow credits to be claimed each year for 10 years. Specify that the increased cap apply first to projects awarded credits after January 1, 2022. (It is estimated that the increase would not reduce state tax revenues during the 2021-23 biennium, but would begin reducing state tax revenues by an additional $750,000 in 2023-24 and $3,750,000 in 2024-25, phasing in to a total additional decrease of $58 million by 2033-34.)

2. Increase the total amount of state housing tax credits that WHEDA may certify to be claimed to $60 million, equal to $10 million per year over the six-year credit period under current law. Specify that the increased cap apply first to projects awarded credits after January 1, 2022. (It is estimated that the increase would not reduce state tax revenues during the 2021-23 biennium, but would begin reducing state tax revenues by an additional $750,000 in 2023-24 and $3,750,000 in 2024-25, phasing in to a total additional decrease of $18 million by 2029-30.)

3. Limit the allocation of state housing tax credits to a given project to no more than the amount of federal 4% low-income housing tax credits awarded to that property.

4. Allow WHEDA to waive the requirement that a state housing tax credit-supported development be financed with tax-exempt bonding if it determines available tax-exempt bonding were insufficient in any given year.

5. Take no action.

Prepared by: Rory Tikalsky