

A TAX-BASED AFFORDABLE HOUSING PROGRAM FOR CANADA

by

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Introduction

- This forum is about applying a US program to Canada
- The US Low Income Housing Tax Credit (LIHTC) is the dominant program for new affordable housing in US
 - Run through the US equivalent of the [Canadian Revenue Agency \(CRA\)](#), not federal housing agency
 - How did this happen?
 - US tax reform in 80s cut tax subsidies to rental
 - The Credit, a last-minute change to reduce impact
- Canada followed US tax reform but did not introduce Credit to help lower income renters.
- I will assume US program is applied to Canada with minimal changes

The problems with the MURBs of the 70s

- Under MURB, tax losses of a “for-profit” deductible from employment income.
 - So surgeon with high earnings
 - Became limited partner in ownership of an apt bldg
 - Got profit (=net income, st.acctg rules) AND tax losses
 - Got tax refund
- MURB provision no benefit to nonprofits
- No limit to revenue loss to federal government
- Public believes that for-profits are unsubsidized and nonprofits subsidized— still not true

The Credit—leveling the tax playing-field

- Provides tax credit **each year for ten years**
(project must be kept in “low income” use for 30 yrs)
- Value of credits (discounted)
 - 70% of construction cost, as base
 - **91% of construction cost** in high cost (rel. to rent) cities
- Investors “buy” the credits from for-profit **OR nonprofit**
- Investors deduct the credit from taxes payable
 - e.g. \$75,000 tax on income minus \$20,000 in credits
=\$55,000 tax to be paid.
 - Surgeon reduces tax by using the credits
 - Contrast: in 70s, reduced tax by using MURB tax loss

Other benefits to investors

- Tax loss from the depreciation deduction
 - So, reduction in tax (*additional* to that from credits)
 - Adds a MURB-like benefit
 - *Only certain* investors (allowed by tax law) can do this
 - Most corporations in US qualify
 - Most Credit investors in US are corporations
- Net positive cash flow from project may flow to investors
 - But probably usually kept by developer (np or for-p)
- Value of property may flow to investors at end of 30 yrs.
 - But kept by developer if nonprofit
 - Probably kept by developer if for-profit

Why are investors willing to buy a share of nonprofits?

- **The overwhelmingly most important component of return is the stream of tax credits**
 - So, term “buying credits.”
- There is also a **tax loss** (giving additional tax reduction) resulting from depreciation deduction, for some investors
- Low risk of negative cash flow because equity from investors means mortgage is small
 - Also, negative cash flow will hurt nonprofit, not investor (=Limited Partner)

The development process for a nonprofit

1. Nonprofit determines whether project is feasible. Needs
 - To find a site.
 - To prepare cost estimates for construction (or rehab)

Needs to determine whether

- sufficient demand/need for units at set rents
- a **syndicator** will sell its credits (& at what fees)
- the **price the credits are expected to fetch** is high enough.

(The syndicator's fees and the price of the credits determine the infusion of **funding** into the project from the credits.)

- a lender will approve the size of mortgage required
- it can get additional subsidies, if needed to make the project feasible. (Subsidies could include donations of land from a municipal government.)

Development process (cont'd)

2. Nonprofit prepares application.

- Needs to specify
 - Target clients,
 - family, elderly, homeless, disabled, mixed
 - income range (e.g. < 60% average income, <50% ave, <40% ave, <30% ave
or, e.g. <125% AHP income limit, 105% AHP limit, <90% AHP limit, <70% AHP limit)
 - Rents
 - Size and types of units
 - Construction cost
 - Other information provincial agency may specify
- Needs to pay attention to criteria agency uses for allocating its credits

Development process (cont'd 2)

3. Submits application to provincial allocating agency
e.g. BC Housing
 - For-profit developers compete against nonprofits
4. Provincial agency awards credits
5. Nonprofits awarded credits firm up financing, build
 - If project falls through, unused credits returned.
6. Completed project **receives the stream of credits**
 - These are **sold through the syndicator.**
7. Credits are distributed to buyers for ten years
 - Projects monitored to ensure rent & income rules met
 - **Nonprofit ensures compliance for 15 years**

QUESTIONS?

Nonprofits and for-profits Credit projects

- Anchorage Alaska nonprofit



- Burlington Housing Authority, Vermont, nonprofit
 - Downtown
 - Apartments for families,
 - 18 1-BR, 13 2-BR, 1-3BR
 - 2 wheelchair accessible
 - Rents: 1-BR, US\$647; 2-BR, \$864; 3-BR, \$1184
 - Market-rate apts but tenants must meet Credit income requirements



- Burlington Housing Authority, Vermont nonprofit
- 18 Single Room Occupancy (SRO) units
- 4 1-BR units
 - Clients: singles approved by Committee on Temporary Shelter



For-profit Credit housing

- Humphrey Management,
 - Village House, Sykesville, Maryland
 - 54 elderly units



- RED Capital Group
 - Anson Park Apartments, Texas
 - 64 family units
 - 2-storey buildings



- Arbor Management
 - Delmar Crossing apartments, Delmar, Delaware
 - 2-BR, garden style
 - 3-BR, townhouse style, 1.5 washrooms
 - Dishwasher, CAC
 - “near Route 13, a few miles from Salisburg, Md”



The landlord (Arbor management)



Help for US nonprofits: 1

From the website

<http://www.enterprisecommunity.org/resources/DSS/index.asp>

Welcome to Enterprise's Housing Developer Support System (HDSS), the comprehensive guide to **affordable rental** and homeownership **housing development for nonprofit organizations**.

The **Housing Developer Support System is a one-stop shop designed to equip nonprofit organizations** with the appropriate information and tools to improve, or expand, their affordable housing production systems. HDSS can also assist nonprofit developers in evaluating alternative housing production methods and "scaling up" their pipeline. The methodologies and tools included in HDSS reflect Enterprise's broad experience developing affordable housing and providing technical assistance to more than 500 community development corporations (CDCs) and municipal agencies across the country.

Help for US nonprofits: 2

From the website: <http://www.lisc.org/section/products/technical>

- LISC offers a wide range of technical assistance in the fields of affordable housing development, organizational capacity building, and community development.
- For 25 years, LISC has provided organizational, business planning, and management systems assistance to **new nonprofit housing** and community development groups. The result is a network comprising 13 national programs, each performing some level of technical assistance to CDCs and nonprofits. That assistance typically centers on:
 - **preparation and appropriation of housing and community development public funding and tax credits;**
 - increasing technical capacity;
 - organizational development, expansion and crisis intervention; and
 - the effective execution of services under successful proposals.
- LISC also provides community organizations with various **training programs, on- and off-line, and a range of loans, grants and other programs.**

Table: effect of credit price & synd. fees

Assume

- Canada long-term bond interest rate is 4.5%
 - For any given construction cost, the higher the interest rate, the greater is each of the ten credits
- Total cost per housing unit is \$180,000
- \$144,000 of that is construction cost.
 - So, tax credits will be valued at \$131,040 (row 4), 91% of construction cost
 - Annual credit will be \$16, 561 (row 5)
 - because the discounted value of ten annual credits is \$131,040.
 - The simple sum of ten credits is \$165,610 (row 6).

Effect of credit price & syndicator's fees (cont'd)

- The numbers in the next rows differ from example to example.
- Example 1 gives numbers for quite high perceived risk.
 - **Investors are willing to pay** only \$111,384 (row 7)
 - 85% of the government's cost of \$131,040
 - **Syndicator's fees** (row 8) are 10%.
 - Deducting fees from investors' funds gives **net equity in the project**, \$100,246 (row 9)
 - Subtracting equity from total cost, \$180,000, gives remaining **funding needed, \$79,754** (row 10)
 - » 44% of total cost

Going from example 1 to 4

- Investors are willing to pay more and more for the credits
 - Investors willing to pay \$151,000 in example 4.
 - Reflects maturing of program and drop in perceived risk
- In last two examples, fees of syndicators fall, as experience, efficiency and competition increase
- Required mortgage plus gap financing (row 10) falls, loan-to-value ratio (row 11) falls.
 - LTV is only 22% in the last example.
- The Credit price (row 12), the amount investors pay per “dollar” of credit, net of syndicators’ fees, rises from 61 cents in the first example to 86 cents in the last one. (if credit price is defined as gross amount investors pay per dollar of credit, the credit price is 67, 73, 78 and 91 cents for examples 1 to 4 respectively.)