

# **A TAX-BASED AFFORDABLE HOUSING PROGRAM FOR CANADA (cont'd)**

By

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QUESTIONS FROM LAST TIME?

# Syndicators and purchasers

- Why are syndicators *almost* necessary?
  - credits must usually be sold to **many** buyers
    - each has a **limited tax liability to offset**
  - **but** small project (say, about 20 units) might be able to sell credits without a syndicator
- Buyers of credits
  - those confident of having **large tax liability each year** of the ten year period of the credits
    - Insurance cos, financial institutions, medical doctors, high-income retired people,..
  - Some people currently holding REITS
  - BUT Canadian **tax and regulation details important**
    - Restrictions
      - in deduction of loss created by CCA
      - on real estate ownership of banks

# Problems for Canada

- Typical corporation in Canada cannot deduct a loss created by the CCA (=depreciation deduction)
  - Can in US
  - So most **Canadian corporations will find this a less good investment** than corporations in US
  - Unfortunate because corporations purchase almost all credits in US and size of their purchases big
    - selling to corporations **reduces cost of syndications**
- Also, Canada has no legislation requiring some corporations to invest in low income neighbourhoods
  - Credits are a vehicle for this in US
- **BUT plus for Canada**
  - Most nonprofit locations will not be in distressed neighbourhoods
    - so **inherently less risky than in US**

# Syndicators and funds

- Syndicators likely to specialize
  - In the US, **for the nonprofit sector are:**
    - The National Equity Fund, sponsored by the Local Initiatives Support Corporation;
    - Enterprise Community Investment Inc., sponsored by Enterprise Community Partners Inc.
- **Syndicators do more than simply sell** credits
  - Able to make a commitment to a nonprofit developer
  - Reduce risk of investment to ultimate purchaser
    - Investigate developers, projects
    - Monitor compliance, management
- Syndicators set up funds
  - Funds “buy” credits and then sell shares to investors
  - **Spread risk over many projects**

**Example: see reference to syndication below; from <http://www.csh.org>**

**Thanks to Jon Harstone**

- **Anishinabe Wakiagun**
- **SRO for 40 homeless alcoholics, Minneapolis**
- **Project Financing** (all US\$):  
Development type: New Construction  
Development total budget: Approx. \$3.4 million (\$85,000/unit)  
Development sources and amounts:

**Equity syndication \$1.1 million**

Federal Home Loan Bank AHP grant \$200,000

Philanthropy \$300,000

HOME \$265,000

MHFA loans \$825,000

City Neigh. Rvt \$195,000

HUD SHP \$400,000

Other \$100,000



## Credit rent and income requirements

- **Tenant income** must be at or below 60% of median
- **Rent** of Credit unit must be
  - **affordable at an income of 60% of area median**
    - Maximum rent is 30% of this income.

### Example:

Median income for a mother with two children or couple with one child in Toronto about **\$70,000**

– 60% of this is nearly **\$42,000,**

- Max. rent, 2 BR unit about **\$1,050** per month

- Max. income of tenant in 2 BR unit is \$42,000.

- if the income of the family **actually** in the apartment is \$32,000,

rent-to-income ratio is **39%.**

## Problems for helping needy & for compliance

- **Typical** tenant (among ALL tenants) has income about 60% of area median
  - Credit units, without additional subsidy, will tend to attract **typical** renters rather than needy renters
  - **Rents too high for most who are income-eligible**
- Units often attractive to higher income renters
  - But If tenants found to exceed maximum income, credits must be paid back. So investors lose a lot.
    - Non-compliance carries risk of loss of most of the investment

# Additional project subsidies

- Usually needed: additional project subsidies (including below-market mortgages) (“gap funding”). Why?
  - Permitted rent may be above market
    - So rent may need to be lower (reduces revenue)
  - Costs may be too high.
    - In early years, investors may be unwilling to pay enough for credits to bring in sufficient equity,  
so large mortgage may be needed
    - If interest rates go up
- Many sources of subsidy in US, mainly federal (e.g. HOME IV, tax-exempt bonds), some state, some city.
- Some states stack on their own Credit program, e. g. California.

<b>CANON BARCUS COMMUNITY HOUSE</b>		<b>Example of use of below market mortgages</b>			
<b>SOURCES OF FUNDS</b>	<b>AMOUNT</b>	<b>TERMS</b>			
First Mortgage	525,100	Mercy Loan Fund, 5 Years, Fully Amortized, Supported I Care			
Second Mortgage	200,000	AHP			
Third Mortgage (Amortized)	4,366,900	City of San Francisco Prop A Prop A, 15 Years, Conting			
Third Mortgage (Deferred)	3,630,639	City of San Francisco Prop A, 50 Years, Deferred Paym			
	67,148	accrued interest during construction			
Fourth Mortgage	1,122,250	City of San Francisco CDBG, 50 Years, Deferred Paym			
	0	accrued interest during construction			
Fifth Mortgage	689,407	San Francisco Redevelopment Agency HOPWA, 50 year			
	17,063	accrued interest during construction			
Deferred Developer Fee	61,522				
Construction Loan	6,909,394	Conventional Lender, 10 months + 3, 50% average bal			
<b>General Partner @ .1%</b>	<b>1,093,487</b>	<b>Includes \$775,000 GP Equity plus \$318,487 for t</b>			
<b>Limited Partner @ 99.9%</b>	<b>7,034,000</b>	<b>0.8906 per credit dollar</b>			
<b>TOTAL SOURCES</b>	<b>25,716,910</b>				

Canon Barcus (<http://www.csh.org>) Thanks to Jon Harstone



# The role of tenant-based subsidy in US Credit program

**Tenant-based subsidy** needed to help those in most need

## Housing Choice Voucher

### – Unlike Canada's Rent Supplement (RS)

- **tenant must search** for housing unit with landlord willing to take voucher -- but **could be current unit ("in situ")**
- voucher holders **can pay up to 40% of income** for rent
  - » the voucher depends on family-sized-adjusted **median rent**, but landlord free to charge more.

### – Like Canadian Rent Supplement

- Voucher in principle **pays 100% of the affordability** gap
  - but in US, gap depends on median rent, not actual rent
  - **quality** is assured by government inspection
  - usually **large landlords**
  - the **subsidy cheque goes to the landlord**

# Potential role of rent supplements in Canadian Credit program

- In Canada, Credit program could assure RS tenants in for-profit buildings of **security of tenure and stability**.
  - Landlords now
    - eager to sign RS contracts when vacancy rate high
    - but not to renew when vacancy rate is low
- In Canada, Credit could require for-profit buildings to set aside a set % of units for RS
  - Credit projects in US **must accept the voucher**.
    - Credit program provides **an assured supply** of voucher units

# Role of housing allowances for renters in Canada

- Universal—**ALL** eligibles who apply get it; **no waiting list**
- Usually does not eliminate an affordability problem, but reduces it
- **Cheque goes to the tenant**, not the landlord

## For elderly

- Man.,Que.,BC (if BC permits renters in Credit units to get it)
- Property tax credit (depends on rent & income) in Ontario, Man.

## For families with children

- Manitoba, Quebec, Saskatchewan, BC
  - But in BC would not be available
    - if Credit units classed as subsidized housing
    - if no employment income
      - » **so full-year EI beneficiaries ineligible**
  - Eligible single mother, 1 child in Vancouver with income of \$12,000 could receive up to \$236 per month
- **In Quebec and Saskatchewan welfare tenants are eligible**

# Financial results for alternatives, Canada

- Work with Prof. François Des Rosiers of Laval to determine effects of alternative provisions
  - compared the after-tax return to investors for
    - different scenarios
      - 15 year commitment, 30 year commitment
    - Different tax situations
      - Individuals holding profit-making real estate
      - Other individuals
      - Insurance companies, real estate companies
      - Other corporations

Assumed low inflation, 2%, and low mortgage rate, 7%

- currently realistic, but rates much higher in late 80s
- higher rates would reduce return

## Results for non-profits

- Assumed
  - investors get no part of value at end of 30 years
  - but investors receive share of any positive cash flow
- Toronto development, receiving credits valued at 91% of construction cost
  - has **high return**, after tax
  - attractive investment for individuals relative to REIT
- N. B. rent set at the maximum allowed, \$1045 for a two bedroom apt
  - Virtually as high as CMHC 2005 mean.
- BUT when rent is reduced to \$958 (**affordable to family at 50% of median income**),  
**investment still quite attractive.**

# Results, for-profits

- Of interest to the social housing community
  - Increases rental supply
  - **Projects required to take RS tenants (if like US)**
- Project sold at end of commitment period
- Overall returns higher than in the nonprofit case
  - Because of sales proceeds at end
  - Return rises when commitment is 15 years, not 30
    - Profitable to sell as soon as possible after the ten-year stream of tax credits ends
    - But long commitment desirable for security of tenure, and to maintain stock
    - **Trade-off between return** to investors and **security of tenure** for tenants.
- **N. B. Many for-profits have nonprofit partners**

# Other results

## Montreal case

- Result not as good as for Toronto
  - **Actual rents in Montreal less** than the Credit maximum
  - probably true for most cities
- Set rent for a two-bedroom apartment at \$705 per month
  - midway between mean 2005 rent and the Credit maximum
- Return is more than a percentage point less than the Toronto project's, for a 30 year commitment.
- Credit program
  - **less attractive to investors** (lower return) than in Toronto
  - **less desirable to renters** (higher than mean rent) than in To
- But **availability matters**
  - some single mothers, desperate, might find that a unit at a higher-than-average rent is better than no unit at all.

# Warnings

- Results depend on
  - Investors' perception that there is *quite low risk*
  - Ability of syndicators to supply services quite *efficiently*
- Results would be negatively impacted
  - if program believed to be temporary
  - If purchasers dominantly individuals rather than corporations
- But
  - if perceived risk and syndicator efficiency as good as in long-established US program, returns even better
  - **Canada in a position to take advantage of US resources**



**NAHB**  
NATIONAL ASSOCIATION  
OF HOME BUILDERS

From National Association of Home Builders (US) website:

- HOW DO I BECOME A **HOUSING CREDIT CERTIFIED PROFESSIONAL** (HCCP)?  
CURRICULUM AND OTHER REQUIREMENTS
  - MINIMUM OF TWO YEARS EXPERIENCE IN THE LOW-INCOME HOUSING TAX CREDIT INDUSTRY BY GRADUATION
  - TEN HOURS OF LOW-INCOME HOUSING TAX CREDIT TRAINING
  - ADHERENCE TO THE HCCP CODE OF ETHICS
  - PASS THE HCCP EXAMINATION
- ..
- EACH YEAR FOLLOWING YOUR CERTIFICATION, TAKE FOUR HOURS OF CONTINUING EDUCATION AND SUBMIT YOUR CE VERIFICATION FORMS AND ANNUAL RENEWAL FEE (CURRENTLY \$175.00) TO MAINTAIN YOUR HCCP CREDENTIAL IN GOOD STANDING.
- THE EXAM IS DESIGNED FOR CURRENT PRACTITIONERS. IT COVERS **DEVELOPMENT, COMPLIANCE, AND MANAGEMENT** ISSUES

**From National Association of Home Builders website**

**From BOSTON CAPITAL ASSET MANAGEMENT LP presentation dealing with solutions to problems at end of 15 years commitment period**

### **PENDING DISPOSITION**

**Six Victorian houses with 22 units.**

- **Minneapolis. Historic island in the Mississippi.**
- **Master lease from govt agency to community development agency.**
  - **Sublease to operating partnership.**
    - **Further sublease to tenant cooperative. Sublease includes right of first refusal.**
- **Non-profit general partner.**
- **No extended use requirements.**
- **Appraisal assumed continued affordability under Master Lease.**
  - **Tenant cooperative claims sublease entitles cooperative to set rent levels.**

### **PROPERTY DISPOSITION SOLUTION**

- **Transfer to affiliate of tenant cooperative for \$1.**
- **Affiliate grants Residual Receipt Note to operating partnership.**
- **Operating partnership entitled to proceeds from a capital transaction.**
- **Residual Receipt Note remains in place for 5 years.**

## From NCSHA website



The nation's state Housing Finance Agencies (HFAs) created the National Council of State Housing Agencies (NCSHA) as a nonprofit organization more than 30 years ago to coordinate and leverage their federal advocacy efforts for affordable housing.

## Concluding comments

- A low income housing tax credit is desirable for Canada
  - ***nonprofit housing providers could benefit through the tax system just as for-profits do***
  - viability assured to be successful in the current low inflation and interest rate environment.
- The Credit program is misnamed
  - Really, by itself, a ***moderate*** income program
  - But **Credit subsidy provides good base for stacking other subsidies**
- **N. B.** Analysis has assumed that a Canadian Credit program the same as the pioneering US program

- ***Might not have some desirable characteristics*** of US program
  - legislation ***favours nonprofits***
  - projects are ***required*** to take Voucher recipient
    - Will Credit, here, require owners to sign RS contracts?
  - program ***administered by IRS***
    - Will Canadian program be, federally, solely under CRA?
      - if no, might discourage investors and syndicators
        - » Involving a second agency might add unduly to complexity
- ***Canadian program might be more desirable*** than US one
  - Distribute funds to provinces based on ***core need***, not pop?
  - Credits a ***higher % of construction costs*** than in the US?
  - ***MURB*** provisions re-introduced to apply to Credit projects?
    - Make credits desirable to more corps and individuals.
  - ***CMHC might help nonprofits*** with applications for the credits

## The last word

Whatever the final details of the program, it seems likely to mark a ***revolutionary change*** for nonprofits, with luck and good management, assuring them of a solid base for ***funding in the long-term.***