NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: Senate Bill 1416 (Second Edition)

SHORT TITLE: Housing Tax Credit Changes/Estate Tax Changes

SPONSOR(S): Senators Kerr and Hoyle

FISCAL IMPACT

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

($million)

	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06	FY 2006-07
REVENUES					
General Fund					
Revised Housing Credit			(8.0)	(9.8)	2.9
Housing Credit Clarified	No estimate available				
Multi-state Estate Tax	No estimate available				
EXPENDITURES					

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

EFFECTIVE DATE: Section 1 (proposed credit) is effective on or after January 1, 2003, and is repealed effective January 1, 2006. Section 2 (current credit) applies to buildings that are allocated a federal credit before January 1, 2003, and for which a federal credit is first claimed for a taxable year beginning on or after January 1, 2002. Section 9 is effective on or after January 1, 2002, and applies to the estates of decedents dying on or after that date. The remainder of the bill is effective when it becomes law.

BILL SUMMARY:
Section 1 of the proposed bill changes the state low-income housing tax credit program from one based on economic tiers established by the Department of Commerce to one based on household income and housing affordability established by the North Carolina Housing Finance Agency (HFA). The bill replaces the current credit that is based on a percentage of the federal tax credits with a credit based on a percentage of the project's basis. Briefly stated, the credit will be 30% of basis in low-income counties, 20% in moderate-income counties, and 10% in high-income counties. The proposed bill removes the credit's mandatory five-year carry forward period and makes the tax credit refundable in one year. The bill gives a developer the choice of a taking a direct tax refund (if credit exceeds tax owed) or a loan from the HFA. It allows the HFA to receive a housing developer's state tax credit from the Department of Revenue and use the

proceeds to issue a 30-year loan back to the developer. Section 1 applies to tax years beginning in 2003.

Section 2 of the bill removes the basis requirement for credit allocations approved in SB 181 in 2001. The 2001 General Assembly allowed a pass-through entity to allocate the state credit among any of its owners, as long as the amount of credit allocated did not exceed the owner's adjusted basis in the pass-through entity.

Section 9 modifies the formula for calculating North Carolina estate tax on estates with property in more than one state. Other bill sections deal with technical changes in the low-income housing credit act and with the sharing of Department of Revenue information on housing credits with the Housing Finance Agency.

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. In 2002, each state receives a tax credit of $1.75 per person that can be used for new construction or rehabilitation of housing. North Carolina has an allocation of $14,086,298 based on a 2000 Census population of 8,049,313. This per capita credit amount is indexed to the CPI beginning in 2003.

The federal credit has helped finance the construction of 21,423 low-income housing units in the state from 1987 to 1999. Federal data in the chart below shows that the more urban areas of the state have benefited most from the federal credit.

	Low-income Units Constructed	%
Tier I	1,799	8.4%
Tier II	1,921	9.0%
Tier III	2,311	10.8%
Tier IV	2,697	12.6%
Tier V	12,650	59.0%
Unidentified	45	0.2%
	21,423	100.0%

North Carolina is one of 12 states that offer a companion state low-income housing credit. North Carolina 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 the state. The credit is 75% of the federal credit for buildings located in Tier 1 and Tier 2 counties and for housing located in 26 eastern counties affected by Hurricane Floyd. The credit is 25% of the federal credit for buildings in Tiers 3, 4, and 5. Tiers 3 through 5 also must comply with the following restrictions:

1) Must be located in a Tier 3 or 4 enterprise area and have at least 40% of its residential units rent restricted and occupied by individuals whose income is 50% or less of median gross income, or
2) Must be located in a Tier 5 enterprise area and have 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:

SECTION 1

In tax years 2000 and 2001, the first two years of the state low-income housing credit, there were 66 projects that received both federal and state tax credits. These 66 projects were awarded $17,880,160 in federal tax credits by the North Carolina Housing Finance Agency (HFA), the credit administrator. Since the federal credit amount is taken each year for ten years, the total federal credit is worth $178,801,600 to the project investors. The North Carolina credit is a percentage of this ten-year total. The mix of 25% and 75% state credits for this two-year allocation period equal an average tax credit of 45% of the $178.8 million federal credit. If investors use 100% of the state credits allocated in 2000 and 2001, the General Fund will expend $80.5 million for credits to low-income housing investors. Since many of these projects are still underway and the credits cannot be used until project completion, there is no data on the actual use of the state credits.

To understand the fiscal impact of the proposed state credit in Section 1 of the bill, the same 66 projects from 2000 and 2001 are used. The HFA provided the General Assembly's Fiscal Research Division with a list of counties they divided into low, moderate, and high income levels. In most cases, the proposed county income structure follows the current tiers: Tier 1 is low-income, Tier 2 is low and moderate income, Tiers 3 and 4 are mostly moderate income, and Tier 5 is high income. The proposed 10% (high), 20% (moderate) and 30% (low) state credits are applied to the basis of the 2000 and 2001 projects. Since the federal credit allocation is equal to 8.6% of the project basis, the basis is determined by dividing the annual federal credit by 8.6%. For example, Maplewood Apartments in Sparta received a federal tax credit allocation of $68,214. This credit divided by 8.6% equals a property basis of $793,186. Since Alleghany is a low-income county, this project would qualify for a 30% credit under the proposed bill and receive a state credit or loan equal to $237,955. (($68,214/. 086)*.3) When all 2000 and 2001 projects are computed using the proposed state credits, the average credit amount for the 66 projects is 20.2%.

The chart below shows a savings to the General Fund over the life of the 2000 and 2001 state credits. Under the current state program, the 2000 and 2001 credits will produce a General Fund loss of $80.5 million over the five to seven years the credits will be used. If the proposed credit was in effect, the General Fund loss would be $36.5 million. In other words, the General Fund would save $44 million under SB 1416 versus the current tax credit.

# of Projects	2002 Tiers	Current State Credit	Proposed State Credit	Savings to GF	Equity to Developers	Benefit to Developers
12	1	$14,422,566	$6,708,170	$7,714,396	$5,769,026	$939,144
15	2	$15,758,674	$7,737,897	$8,020,777	$6,303,470	$1,434,428
11	3	$13,224,492	$6,959,506	$6,264,985	$5,289,797	$1,669,710
12	4	$12,451,138	$6,023,119	$6,428,020	$4,980,455	$1,042,663
16	5	$24,673,814	$9,091,551	$15,582,263	$9,869,526	($777,975)
66		$80,530,684	$36,520,244	$44,010,440	$32,212,274	$4,307,970

While the proposed credit saves General Fund revenue, it is intended to increase funding to housing projects. Most tax credits are sold to investment companies at a discounted price in order to receive the funds immediately instead of five years for the state credits or 10 years for the federal credits. In the equity to developers' column in the chart above, HFA assumes that developers receive 40 cents for every $1 of credit they sell. For the 66 projects in 2000 and 2001, it is estimated that the developers sold their $80.5 million in state credits for $32.2 million. Since the proposed credit is refundable or can be taken as a loan, the 2000 and 2001 credits would have been worth $36.5 million. Compared to the current credit program, the developers would have received an additional $4.3 million to put into their projects. However, 15 of the 66 projects would have received less under the proposed credit than they did selling their current credits.

Section 1 of the bill applies only to tax years 2003 through 2005. The bill does not change the sunset of the credit in 2006. For tax years 2003 through 2005, the proposed tax credit will produce a long term General Fund savings, but will have a short-term loss on a fiscal year basis. The federal credit allocation for 2003 to 2005 is based on the 2002 per capita allocation, but adjusted annually by the CPI. The chart below uses CPI estimates from Economy.com and a population estimate for North Carolina from the 2000 US Census. Based on these assumptions, North Carolina is projected to receive the following federal credit allocations:

	Per capita	CPI	Population	Federal Credit
2002	$1.75		8,049,313	$14,086,298
2003	$1.79	2.0%	8,049,313	$14,368,024
2004	$1.82	2.2%	8,049,313	$14,684,120
2005	$1.87	2.5%	8,049,313	$15,051,223

In the chart below, the annual federal allocation is multiplied by 10 to get the full federal credit amount. The chart assumes the mix of 25% and 75% state credits in 2003 through 2005 will average 45% as it did in 2000 and 2001. From 1987 to 1999, the average construction time for low-income housing financed with federal tax credits ranged from one year for projects with less than 50 units to two years with projects with 100 to 200 units. Based on this experience, the chart for the current and the proposed credits assumes that half of the projects will be completed one year after the credit is allocated and half will be completed two years after the credit allocation. For example, the $64.7 million in 2003 state credits taken over a five-year period will equal approximately $12.9 million per year. If half of the 2003 credits are taken one year after allocation, then $6.5 million in state credits will be redeemed in FY 2004-05. In FY 2005-06, the remaining $6.5 million in state credits will begin their five-year payout. The 2003 credit allocation will not be completely used up until FY 2009-10. This chart assumes 100% utilization of the credits.

CURRENT CREDIT PROGRAM

Allocation	Federal Credit	State Credit		**($Million)**		
Year	X 10 years	45%	2004-05	2005-06	2006-07	2007-08
2003	$143.7	$64.7	$6.5	$12.9	$12.9	$12.9
2004	$146.8	$66.1		$6.6	$13.2	$13.2
2005	$150.5	$67.7			$6.8	$13.5
TOTAL		**$198.5**	**$6.5**	**$19.5**	**$32.9**	**$39.7**

For the proposed program, it is assumed the mix of 10%, 20%, and 30% credits will average 20.2% as it did when applied to 2000 and 2001 credit allocations. This percentage is multiplied against the 10-year federal credit amount. In 2003, the state credit allocation in the proposed program is $29 million. The total credit amount can be taken in the year the project is completed. As in the current credit program, it is assumed that half of the projects will be completed in one year and half in two years, thus the $29 million is divided between FY 2004-05 and FY 2005-06.

PROPOSED CREDIT PROGRAM

Allocation	Federal Credit	State Credit		**($Million)**		
Year	X 10 years	20.2%	2004-05	2005-06	2006-07	2007-08
2003	$143.7	$29.0	$14.5	$14.5		
2004	$146.8	$29.7		$14.8	$14.8	
2005	$150.5	$30.4			$15.2	$15.2
TOTAL		**$89.1**	**$14.5**	**$29.3**	**$30.0**	**$15.2**

DIFFERENCE			**($Million)**		
Current Credit	**$198.5**	**$6.5**	**$19.5**	**$32.9**	**$39.7**
Proposed Credit	**$89.1**	**$14.5**	**$29.3**	**$30.0**	**$15.2**
	$109.4	($8.0)	($9.8)	$2.9	$24.5

The proposed state credit will save the state General Fund $109.4 million over the remainder of the low-income housing tax credit program. However, the chart illustrates a short-term revenue loss due to the timing of the projects. Again, assuming the $198.5 million will be sold for 40% of their value or $79.4 million, the proposed credit program will increase equity funding in housing projects by $9.7 million ($89.1 million in proposed credits - $79.4 million sale of current credits). The proposed tax credit/loan program will eliminate low-income housing tax credits as an investment option for financial institutions, insurance companies, and other interested parties.

SECTION 2

Section 2 is meant to clarify an action taken in the 2001 General Assembly (SB 181, Chapter 431). The housing industry lobbied to allow the bifurcation of the state and federal housing tax credits. Bifurcation simply means that one investor can buy and receive the allocation of the federal credit for a project and another investor can buy and receive the allocation for the state credit for the same project. Allowing bifurcation was supposed to increase the pool of investors for the state credit, but the housing industry says the law is too strict. The language in SB 181 required a pass-through entity to allocate the credit among any of the entity's owners, as long as the amount of credit allocated does not exceed the owner's adjusted basis in the pass-through entity. For example, payment of 40 cents for a $1 tax credit only gave the investor 40 cents of credit if that was the investor's only investment in a project. Section 2 will give a $1 credit to the investor who pays at least 40 cents for the credit.

Since there is no information available from the Department of Revenue on the utilization of low-income housing credits, it is not possible to determine the true fiscal impact from this text change. However, because all previous notes on this tax program have assumed full use of the credit, the full cost of this credit has been factored into General Fund revenue projections. This change will insure the expanded pool of credit investors that was intended by SB 181.

SECTION 9

Research by the North Carolina State Bar Association found that North Carolina is one of only three states that prorate estate tax on multi-state property based on net value versus the more common practice of pro-ration based on gross value. The Department of Revenue has been asked to sample multistate estate tax returns to judge the fiscal impact of this proposal. Since this sample has not yet been provided to Fiscal Research, no estimate is available for Section 9.

SOURCES OF DATA: NC Housing Finance Agency

TECHNICAL CONSIDERATIONS:

Proposed GS 105-129.42(c) allows the Housing Finance Agency to designate high, moderate, and low-income counties and cities each year by publishing a list in the North Carolina Register as part of the Qualified Allocation Plan. The proposed law does not specify what state or federal standard should be used in making this designation. Counties qualify for the current low-income housing tax credit based on their economic tier as defined in the statutes. The General Assembly may want to reduce the agency's discretion in awarding credits by defining what high, moderate, and low-income mean.

Proposed GS 105-129.44 requires the Department of Revenue to report to the Revenue Laws Study Committee by May 1 each year on the status of the credit program. Since the bill places most of the credit administration with the Housing Finance Agency, it would seem more appropriate for this agency to do the annual report.

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