Housing Community Recovery Task Force

Work Plan Task 1 - Increase the Supply of Affordable Housing

Leads:

Fred Dodson, Jr. is the chief operating officer and executive vice president of Charlotte-Mecklenburg Housing Partnership, Inc., where he manages the organization's real estate development activities. Before joining the Housing Partnership in 1997, Dodson gained experience directing the Hospitality House of Boone, North Carolina homeless shelter, as well as the New River Valley Habitat for Humanity Affiliate and the Montgomery County Community Shelter, both located in Virginia. Mr. Dodson earned a Bachelor of Science in psychology from Appalachian State University and a Juris Doctor from the University of Tennessee College of Law.

Lee Cochran is senior vice president of development of Laurel Street, a leading mixed-income housing development company experienced in developing high-quality residences for working families and seniors. Based in Charlotte, NC, Laurel Street has a development portfolio of approximately 3,600 units valued at more than $500 million. Lee leads development activities for Laurel Street. His development oversight is from project concept through completion and project stabilization. His prior experience and relationships in mixed income development and with public/private partnerships are leveraged throughout the organization. He has over 20 years of experience in affordable and market rate housing development, including elderly and family housing utilizing a variety of funding structures and sources. Previously, Lee was chief operating officer for Levine Properties. Lee was responsible for working with the City of Charlotte and Mecklenburg County on public/private partnerships for the redevelopment of First Ward, a 30- acre, $700 million mixed-use project in Charlotte's city center. Prior to joining Levine Properties, Lee worked for The Housing Partnership. During his nine years there, Lee helped develop projects that included single-family rehabilitation, multi-family new construction and master-planned development of neighborhoods. Lee served as the organization's chief financial officer during his last three years. He began his experience in real estate with the Housing Authority and Housing Department of the City of Baltimore. He earned a master of public policy degree from Duke University and received a bachelor's in engineering from Duke University.

Covid-19 and Affordable Housing
The Challenges and The Path Forward

Affordable Housing Challenges After Covid-19

The onset of Covid-19 has been sudden, and the health and economic impacts will be felt deeply for the foreseeable future. From the perspective of the affordable housing developer, the crisis has both exposed weaknesses in the traditional financing tools but will hopefully spawn innovations to address the crisis. The lessons to be learned are still a moving target at best. However, some assumptions can now be made. The best we can do at this time is to take wisdom from the past recession and our combined years of development to determine where we stand and where we are heading. We can assume the following:

1. **Tax Credit Pricing is likely to decline**. The social distancing measures that have been put in place to slow the community spread of the virus will have long term economic impacts that have introduced uncertainty into the marketplace. Such risk has a significant effect on the financing tools used to build affordable housing. The only model that we have to determine the extent of the impact is the most recent 2008 financial crisis. During this period, tax credit pricing fell rapidly. Before 2008 it was not unusual for 9% and 4% tax credit pricing to trade for more than $1 per credit. At the depths of the crisis, credit pricing in Charlotte dropped to the low 80 cents per credit. The impact of this dramatic decline was lessened by a drop in construction material and labor costs.

2. **Construction costs remain high.** Before the onset of Covid-19 the construction of affordable housing was challenged by historic increases in construction materials and labor costs. The most apparent cause of the rising costs in the Charlotte market was due to the amount of ongoing construction. Affordable housing developers compete with market-rate developers for materials and labor. There is no indication at present that the inflated costs will decline in the foreseeable future. Such declines did occur during the great recession. Still, for the near future, it is assumed that affordable housing developers in Charlotte will have additional subsidy needs due to high costs and reduced tax credit proceeds.

3. I**nterest rates have fallen, but lenders will adjust.** The Federal Reserve has taken action to reduce interest rates to help prop up the economy. This reduction in rates will be beneficial to affordable housing developments because it will reduce debt service and should lead to reduced subsidy. However, if we learn lessons from the past, it is almost certain that lenders will try to protect their yields by adding a floor to their rates to keep interest rates from falling too low. Developers may be able to negotiate a lower rate, but in this period of uncertainty, there might not be much appetite for negotiation.

4. **Uncertainty can lead to fewer units of affordable housing.** Charlotte is an attractive market for tax credit investors and lenders. However, it is likely that even in the Charlotte market during periods of considerable uncertainty, our traditional investors and lenders will be more cautious about taking risks. Such caution will have downstream effects such as more extended due diligence periods and deal scrutiny. Essentially it is inevitable that

developers will have to bear more of the risks. Some developments may no longer be feasible due to unacceptable risks.

5. **The need for affordable housing will increase, and occupancy will remain high.** It is assumed that the historic rise in unemployment will lead to an equally historic surge in need of affordable housing. Market rate developments can expect an increase in vacancy, but another lessoned during the great recession is that vacancy will not rise significantly in affordable housing developments. Therefore there will be increased pressure to continue to increase the supply of affordable housing to meet the growing need.

6. **The subsidy needed to fund 4% tax credit developments will increase**. The 9% tax credit rate was fixed at 9% during the last recession, but unfortunately, this did not happen for the 4% rate. That rate is established monthly and impacted by market factors. That rate as of May 2020 is 3.08%, which is an all-time low. Plainly stated, this would result in lower tax credit equity proceeds and the need for more low-cost subsidy to make these deals financially feasible.

Possible Federal and State Response to Affordable Housing Challenges After Covid-19

Drawing on past experience with shocks to the affordable housing industry both from the 2008 Great Recession and 2018 Tax Reform, below is a list of possible steps the state and federal government might take to address these challenges.

1. **Fix the 4% Tax Credit at a Real 4% (FEDERAL) -** Currently, the amount of federal Low-Income Housing Tax Credits ('Tax-Credits') awarded to a 4% tax-credit development is a complicated formula related to the eligible costs of the development times a percentage called the "4% tax-credit", but in reality, the percentage varies each month and is currently equal to 3.08%. There have been proposals in Congress for years to fix the percentage at 4% that have come close to passing but have not passed to date. An effort is underway to fix the percentage at 4% as part of the next COVID-19 relief bill. Depending on how the bill is written, success on this effort would immediately increase the amount of federal tax-credits awarded to previously funded developments which would increase the amount of tax-credit equity the developments would get from their investors and serve to plug the funding gaps discussed above.

2. **Allocate Additional Credits to Previously Funded Projects (FEDERAL AND STATE) -** When federal tax reform was enacted in 2018, the lowering of the corporate tax rate caused a steep drop in the amount tax-credit investors were willing to pay for federal Low Income Housing Tax Credits ('Tax-Credits'). As a way to mitigate this effect, Congress also temporarily allocated additional Tax-Credits to the states. The State of North Carolina allowed previously funded 9% Tax-Credit Developments to apply for extra Tax-Credits to make up for the funding shortfall. This fix only helps 9% Tax-Credit Developments.

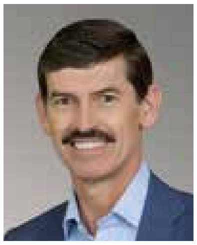
3. **TCAP and Exchange Programs (FEDERAL AND STATE)** - As a response to dramatic drops in pricing for federal Low-Income Housing Tax Credits (‘Tax-Credits’) during the 2008 Great Recession, Congress instituted two programs to help make sure housing production continued. The two programs were called TCAP and Exchange. They worked in slightly different ways, but both were loan programs that were administered by the state finance agencies including the North Carolina Housing Finance Agency (‘NCHFA’). In 2008, Mecklenburg County developments still had tax-credit investors but at much reduced pricing so the need was for gap financing to make up the different. NCHFA administered the TCAP and Exchange program as a total replacement of tax-credit investors so the programs were not used very much in Mecklenburg County. If similar federal programs are instituted again, it will be important that NCHFA structures the programs in a way they can be easily used in Mecklenburg County.

4. **Remove Re-Allocation of Tax-Credits to the East Region for Hurricane Recovery (STATE)** - In the 2019 and 2020 Qualified Allocation Plans (QAP) that govern how Low-Income Housing Tax Credits (‘Tax-Credits’) are awarded in North Carolina, some Tax-Credits that would normally go to the West, Central, and Metro regions were re-allocated to the East Region to assist with Hurricane Recovery efforts. With all regions of North Carolina currently affected by COVID-19, this re-allocation langauge should be removed from the 2021 QAP.

NOVOGRADAC
Journal of Tax Credits™

Insights On Affordable Housing, Community Development, Historic Preservation, Renewable Energy and Opportunity Zones
May 2020 ◆ Volume XI ◆ Issue V
Published by Novogradac

WASHINGTON WIRE



Community Development Tax Incentives Poised to Help Spur COVID-19 Recovery

MICHAEL J. NOVOGRADAC, CPA

The COVID-19 pandemic is wreaking havoc across the nation and has brought an unprecedented shuttering of the United States economy as the entire American population has been under some form of social distancing, quarantine or isolation.

The affordable housing, community development, historic renovation and renewable energy communities have been damaged directly and indirectly by the coronavirus, yet are also uniquely poised to be play a key role in a COVID-19 recovery. This issue of the Novogradac Journal of Tax Credits addresses some of the impact of the coronavirus on the communities we cover and the role they can play to help spur a COVID-19 recovery.

The health and economic wreckage from the COVID-19 pandemic has provoked a variety of government policy reactions, with more most certainly to come.

Initial legislation to address the impact of COVID-19 was quick, with the passage of the Coronavirus Preparedness and Response Supplemental Appropriations Act (H.R. 6074), the Families First Coronavirus Response Act (H.R. 6201) and the Coronavirus Aid, Relief and Economic Security (CARES) Act (H.R. 748)–all coming in a 21-day period in March. As this issue went to press, legislators were finishing up an interim piece of COVID-19 legislation that would replenish funding of Small Business Administration programs created or modified by the CARES Act and were working on a potential fourth phase of legislation that could include a variety of community development and

continued on page 2

continued from page 1

affordable housing incentives. Legislation beyond the fourth phase is also possible.

Bigger Pinch in Low-Income Communities

The COVID-19 pandemic has had disproportionately devastating adverse health and financial consequences for low-income residents and communities. Tenants in low-income housing tax credit (LIHTC) and U.S. Department of Housing and Urban Development (HUD) financed properties are more likely to work in jobs hit hardest by COVID-19: either those fields first hit by layoffs or in many service jobs considered "essential," putting those workers at greater risk of illness.

Owners of LIHTC property (and other rental property) also face financial struggles. One provision of the CARES Act was a moratorium on eviction of tenants in many multifamily properties, including LIHTC developments. It was feared that the no-eviction provision, in combination with job losses, would lead to a significant decrease in rent collected beginning in April–a decrease that might continue until the moratorium is lifted. While the no-eviction provision was widely hailed, the CARES Act lacked sufficient provisions to help property owners address declines in rental income.

The CARES Act included a provision mandating debt payment forbearance for multifamily property owners with federally backed multifamily loans who experienced hardships due to COVID-19. That includes many LIHTC properties. However, forbearance isn't forgiveness, it's just a delay. Property owners will be required to make up the payments missed during the pandemic. Furthermore, there are many other expenses associated with operating rental housing–such as property taxes, insurance, utility costs and maintenance–for which there was no relief provided.

There's another major difficulty facing affordable housing: the effects the pandemic has had on the construction industry and related shutdowns. Even in areas where affordable housing construction continued, builders faced problems in getting materials, completing inspections and more. That is delaying construction and rehabilitation, which further extends the time before these properties will be available for low-income renters. Moreover, once constructed or renovated, it can be challenging to lease up apartments in the midst of shelter-in-place orders. Construction and lease-up delays can lead to unexpected shortfalls in equity financing, adding further financial stress to properties undergoing development. The pending recession will also likely adversely affect LIHTC equity pricing, which is the major source of financing for affordable rental housing.

Similarly, the construction of many properties financed by new markets tax credit (NMTC), historic tax credit (HTC) or renewable energy tax credit (RETC) equity, or opportunity zones (OZ) investment, has stalled or struggled with supply-chain and deadline issues in the early weeks of the COVID-19 shutdown. Those properties similarly face the additional burden of impending deadlines that may be difficult to meet and the possibility of a reduction in equity financing for tax credits or in the amounts invested in OZs.

There are two principal ways the federal government can address damage caused by the COVID-19 pandemic and effects of the shutdown on community development tax incentives, and help spur an economic recovery. One is administrative, the other is legislative.

Administrative Action

To address the consequences of missed deadlines and other COVID-19-related delays, the Internal Revenue Service (IRS) must act. It has, to a degree. The IRS has the ability to extend various deadlines for up to 12 months, based on the federal government's March 13 declaration of a national emergency. The IRS has done that, to a certain extent.

continued on page 3

continued from page 2

The OZ community received good news April 10 when the IRS ruled that any taxpayer whose 180-day period to invest in a qualified opportunity fund after a capital gains event ended on or after April 1 and before July 15 could use July 15 as the deadline. That was helpful, but many stakeholders sought a more flexible rule. Meanwhile, there are other OZ deadlines for which extensions are needed: the 30-month substantial improvement period for property, the 12-month cure period for qualified OZ businesses that cause a qualified opportunity fund to fail the 90 percent investment standard and more.

The LIHTC community also received good news April 10 when the IRS similarly ruled that certain LIHTC deadlines were extended to July 15. That was moderately helpful, but stakeholders needed more expansive and comprehensive extensions. Also in April, based on existing IRS administrative guidance, many states began extending the LIHTC placed-in-service deadlines and the 10 percent test deadlines. That is a good start, but other deadlines (the 24-month period for minimum rehabilitation expenditures, the year-end deadline for restoration for buildings that suffer a casualty, etc.) could also be extended by the IRS, as could many of the property management regulation deadlines: those for physical inspections, tenant file reviews, tenant income recertifications and more.

For NMTC properties, the most important action the IRS could take involves extending deadlines that many community development entities–and their borrowers and investees–will struggle to meet due to COVID-19-related issues. Particularly helpful would be an extension to such requirements as the 12-month reasonable working capital safe harbor and the 12-month period for community development entities to deploy qualified equity investments.

HTC properties face either a 24- or 60-month deadline to meet substantial rehabilitation standards, deadlines that will be difficult to meet for some properties due to the pandemic. To be eligible to claim the HTCs in one year (under transition rule made after tax reform legislation required the HTC to be taken ratably over five years), non-phased HTC properties face a June 20 deadline for substantial rehabilitation, with the property being placed in service by the end of 2020. An IRS extension for those deadlines is needed.

Both wind and solar projects need IRS guidance declaring that if they miss current deadlines due to the pandemic, they don't lose tax credits. The solar investment tax credit (ITC) drops from 26 percent to 22 percent, while the wind production tax credit (PTC) goes from 60 percent to zero for properties that begin construction after Dec. 31, 2020. Pandemic-related construction delays could be devastating unless the IRS provides relief.

The IRS and state agencies should aggressively provide administrative relief.

Legislative Action

Congress worked quickly on the first three COVID-19 bills. The first two focused on the immediate impact of the emergency and providing sick leave. The third–the $2.2 billion CARES Act–included provisions to mitigate the immediate impact of the outbreak.

More relief bills could be coming, starting with a so-called Phase 4 bill.

There was early talk from House Speaker Nancy Pelosi and President Donald Trump about an infrastructure focus on the Phase 4 legislation, talk that could lead to the inclusion of extra NMTC or LIHTC funding or an infrastructure tax credit. The infrastructure-as-focus talk faded, but could come back.

continued on page 4

continued from page 3

A Phase 4, Phase 5 or even Phase 6 bill could include such items as a 4 percent floor for the LIHTC, a lowering of the 50 percent test for bond-financed affordable housing, emergency rental or operating assistance for LIHTC or other rental properties, an increase in annual LIHTC and NMTC allocations, extensions of ITC and PTC, and even an expansion of the OZ incentive.

An obvious boost would be an increase in LIHTC allocation authority–perhaps a two-year 25 percent boost–to jump-start the production of more affordable housing. More LIHTCs would mean more construction to help stimulate the economy and would create more affordable housing–something in even greater after the pandemic economic fallout.

A permanent minimum 4 percent LIHTC is the top ask of affordable housing advocates in COVID-19 relief and recovery legislation. The April rate was 3.12 percent, followed by this month's historic low of 3.08 percent, adding even greater urgency for Congress to act on a provision that already has bipartisan support from more than half of the House and nearly 40 percent of the Senate. A minimum 4 percent rate is a simple way to put more dollars into affordable housing and make more affordable rental housing financially feasible.

Another option is to lower the financed-by threshold for tax-exempt private activity bonds–which are paired with 4 percent LIHTCs–from the current 50 percent of the aggregate basis to 25 percent. That change would increase the amount of affordable housing that could be built within the limits of existing bond volume authority.

An NMTC provision could be in recovery legislation. It's possible that the 2019 round–due out this summer–could see an increase in allocation authority. The 2020 round, authorized for $5 billion in allocations, could see an increase. A multiyear or permanent extension of the NMTC isn't off the table.

Provisions of the Historic Tax Credit Growth and Opportunity (HTC-GO) Act could be part of recovery legislation, including the elimination of the HTC basis adjustment requirement and a boost in the HTC percentage for smaller properties. Again, those legislative changes would encourage more development.

The PTC and ITC both are in their phasedowns, but legislation could extend or renew them to give those job-creating incentives a boost during a time of recovery–and as mentioned earlier, provide relief for properties that face a Dec. 31, 2020, deadline.

Congress has historically included community development and affordable housing incentives in recovery legislation. That should happen again.

What's Next?

As the nation–and world–emerges from the unprecedented pandemic and collateral economic damage, there's no template. Presidential election years are historically difficult times to pass tax legislation, but, as noted in a previous Washington Wire, tax bills have passed in 10 of the past 11 presidential election years.

Community development and affordable housing stakeholders are poised to play a significant role in helping the nation recover. The use of tax incentives to encourage development in hard-hit areas has proven successful over the years and should be called upon again as we slowly emerge from the COVID-19 pandemic.

In a period of previously unimaginable difficulty, the LIHTC, NMTC, HTC, RETCs and OZ incentives are reliable contributors to recovery.

continued on page 5

continued from page 4

This article first appeared in the May 2020 issue of the Novogradac Journal of Tax Credits.

Notice pursuant to IRS regulations: Any U.S. federal tax advice contained in this article is not intended to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties under the Internal Revenue Code; nor is any such advice intended to be used to support the promotion or marketing of a transaction. Any advice expressed in this article is limited to the federal tax issues addressed in it. Additional issues may exist outside the limited scope of any advice provided – any such advice does not consider or provide a conclusion with respect to any additional issues. Taxpayers contemplating undertaking a transaction should seek advice based on their particular circumstances.

This editorial material is for informational purposes only and should not be construed otherwise. Advice and interpretation regarding property compliance or any other material covered in this article can only be obtained from your tax advisor. For further information visit www.novoco.com.

NOVOGRADAC™

CONTACT

CORRESPONDENCE AND EDITORIAL SUBMISSIONS
Alex Ruiz
alex.ruiz@novoco.com
415.356.8088

ADVERTISING INQUIRIES
Christianna Cohen
christianna.cohen@novoco.com
925.949.4216

EDITORIAL MATERIAL IN THIS PUBLICATION IS FOR INFORMATIONAL PURPOSES ONLY AND SHOULD NOT BE CONSTRUED OTHERWISE.

ADVICE AND INTERPRETATION REGARDING THE LOW-INCOME HOUSING TAX CREDIT OR ANY OTHER MATERIAL COVERED IN THIS PUBLICATION CAN ONLY BE OBTAINED FROM YOUR TAX ADVISOR.

ISSN 2152-646X

Housing Task Force

Follow-Up from the May 7, 2020
Task Force Meeting

1. **Question: How many eviction filings have been filed since the courts have been closed?**

   Staff followed up with District Court Judge Kimberly Best to inquire about the current number of evictions filed since the courts were closed. Judge Best shared that there are now 1,800 pending evictions that will take several months to be heard and ruled on.

2. **Question: What is the current balance of the Housing Trust Fund?**

   Following the April 27th allocations awarded by City Council, the remaining Housing Trust Fund balance is $6.8M. That number could change depending on final 9% Tax Credit Awards made in August of this year.