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CITY COUNCIL REPORT

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TO: Mayor and Councilmembers

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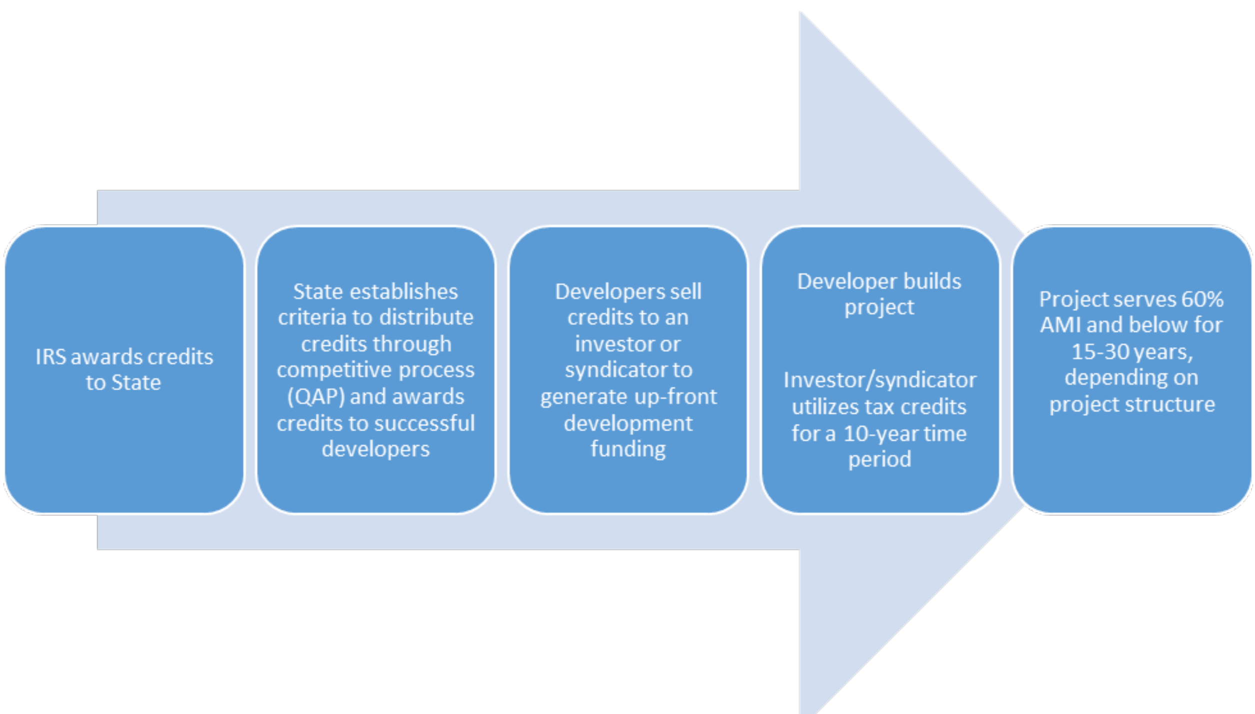
CC: Josh Copley, Barbara Goodrich, Leadership Team

SUBJECT: Overview of Low Income Housing Tax Credit Program and Specific Q&A

This report provides an overview of the Low Income Housing Tax Credit Program and addresses some specific questions recently posed to staff. The text of this CCR relies heavily on language gathered from both the HUD.gov and Arizona Department of Housing website.

The graphic below provides a simple overview of the complex Low Income Housing Tax Credit (LIHTC) process, more in-depth information follows.



Overview of the Low-Income Housing Tax Credit (LIHTC) Program

As part of the Tax Reform Act of 1986, the United States Congress created the Low-Income Housing Tax Credit (LIHTC) (Internal Revenue Code or IRC Section 42) Program to promote the development of affordable rental housing for low-income individuals and families. The Low-Income Housing Tax Credit, rather than a direct subsidy, encourages investment of private capital in the development of rental housing by providing a credit to offset an investor's federal income tax liability. Typically, developers sell these tax credits to investors to raise equity for their construction or rehabilitation projects; this allows them to borrow less than they would have otherwise and to charge lower rents as a result.

Developers qualify for LIHTCs by agreeing to rent units to people with low incomes and to charge rents that are no more than a specified amount determined to be affordable to the population eligible to live in the property.

From 1986 to 1989, federal law required developers to maintain these affordability provisions for at least 15 years. Beginning in 1990, however, new LIHTC properties were required to preserve affordability for 30 years. During the first 15 years, called the initial compliance period, owners must maintain affordability. The second 15 years are known as the extended use period, when owners can leave the LIHTC program through a relief process. Once the 15-year affordability period is over, LIHTC owners who seek and are granted regulatory relief from the program can convert their properties to market-rate units. Some states require longer affordability restrictions, and some LIHTC developments have local financing that comes with longer use restrictions.

In Arizona, the amount of tax credits available for allocation each year by the Arizona Department of Housing (ADOH) is established pursuant to certain requirements of the Internal Revenue Code. Tax Credits are awarded through a competitive process pursuant to ADOH's LIHTC Qualified Allocation Plan or QAP. The procedures followed by ADOH in awarding credits are described in the current QAP and updated annually via a public process.

In order to be considered for Tax Credits in Arizona, the proposed development must involve new construction, substantial rehabilitation or acquisition and substantial rehabilitation.

A development qualifies for low-income housing tax credits if it is residential rental property and meets one of the following requirements:

- At least 20% or more of the residential units in the development are both rent restricted and occupied by individuals whose income is 50% or less of the area median income (AMI) , or
- At least 40% or more of the residential units in the development are both rent restricted and occupied by individuals whose income is 60% or less of the AMI.

Tax Credits may only be claimed on units that have been set aside for participation under the program. Since Tax Credits are awarded on a competitive basis, QAP encourages "targeting" of the units to income levels lower than the federal limits described above. The 2017 income limits for Flagstaff are contained in the chart below. These limits are established by the HUD on an annual basis.

2017 Income Limits by Household Size (AMI)

Household size	30%	50%	60%	80%
1	$13,200	$22,000	$26,400	$35,200
2	$16,240	$25,150	$30,180	$40,200
3	$20,420	$28,300	$33,960	$45,250
4	$24,600	$31,400	$37,680	$50,250
5	$28,780	$33,950	$40,740	$54,300
6	$32,960	$36,450	$43,740	$58,300
7	$37,140	$38,950	$46,740	$62,350
8	$41,320	$41,450	$49,740	$66,350

All of the LIHTC properties in Flagstaff contain only affordable units, despite the ability to mix market-rate units into a development at the point of application. Below is a list of all the LIHTC developments in Flagstaff:

Development	**Number of Units**
Timber Trails Apartments 200 West High Country Trail	64
High Country Estates 250 West High Country Trail	44
Sandstone Highlands (Senior Housing) 300 W. High Country Trail	72
The Village at Lake Mary 3400 S. Lake Mary Rd.	125
Oakwood Village Apartments 3770 S. Yaqui Drive	200
Sharon Manor Apartments	16
Pinehurst at Flagstaff 1001 N. 4th Street	84
Cedar Crest Village 2251 N. Izabel Street	81
Flagstaff Senior Meadows (Senior Housing) 1351 N. Pine Cliff Drive	60
TOTAL	**746**

Several specific questions pertaining to the LIHTC program in relation to the current multi-site affordable housing proposal have been asked, these questions and answers are below:

Q: How does the "term of the 'affordability" for the project work? Who decides what this term is and when is this decision made?

A: Funding sources typically dictate the term of affordability. In the case of the LIHTC program, both the federal and state agency administering the program regulate the term of affordability. As described above, the minimum terms of affordability are contained in the tax code and are not open for negotiation. Other entities involved in financing LIHTC developments, including the City of Flagstaff, can also impose additional requirements, such as a longer term of affordability.

In general, when an application is made for use of LIHTC funds, the affordability conditions are understood – as they are within the enabling regulations for the program itself. The LIHTC program never requires a longer term of affordability, however, because the City of Flagstaff is anticipating participating in the project with a local government contribution, if the City wanted to add a longer term of affordability, this could be done through a development agreement or other documents in partnership with the development entity. These terms would typically be approved by City Council prior to a LIHTC application being turned into ADOH.

Q: Once the Term of Affordability with the developer expires, can the developer redevelop the property either partially or completely? For example, can he/she:

a) **tear down the affordable housing project and replace it with a taller luxury condominium project or a market rate rental project; or**
b) **rezone the property for another use; or**
c) **tear down the affordable housing project and then split the property for single family homes?**

A: Without other restrictions, the simple answer to this question is yes. <u>However</u>, in this specific case, as the City of Flagstaff is the landowner, desired conditions of affordability can be dictated via the transfer process. If Council desires to make the proposed developments permanently affordable, or to establish an affordability period in excess of 15 or 30 years, these terms can be established in a development agreement and/or recorded as a deed restrictions or similar instrument.

Conditions such as affordability time period would typically be included in a Request for Proposals process so that respondents are able to understand the restrictions on the property prior to submitting a proposal.

Q: Do we have any examples in Flagstaff of low income tax credit housing projects where the term of affordability has expired and the developer has changed part or all of the use to something other than affordable housing?

A: No LIHTC projects in Flagstaff have either aged out of compliance or taken advantage of the relief process provided through ADOH. The oldest LIHTC development in Flagstaff was awarded credits in 1994 (constructed in 1996) and the City of Flagstaff participated in the development via a local government contribution, in exchange, the developer agreed to a full 30-year affordability term via a development agreement. In 2013, the property was acquired by a new company for the purposes of rehabilitation through the LIHTC program. The City again participated with a local government contribution and new documents requiring a new 30-year term of affordability were executed.

Of the roughly 800 LIHTC developments statewide, only 20 (or 2.5%) have been deregulated to date.

RECOMMENDATION / CONCLUSION

This report is for information only.