HOUSE BILL REPORT
HB 2308

As Reported by House Committee On:
Housing
Finance

Title: An act relating to housing affordability tax incentives for existing structures.

Brief Description: Concerning housing affordability tax incentives for existing structures.

Sponsors: Representatives Walen, Hutchins, Robertson, Santos, Barkis and Shavers.

Brief History:
Committee Activity:
Housing: 1/22/24, 1/29/24 [DPS];
Finance: 2/2/24, 2/5/24 [DP2S(w/o sub HOUS)].

Brief Summary of Second Substitute Bill

- Authorizes city governing authorities to establish a sales and use tax deferral program for inputs used during a commercial property conversion from commercial use into residential buildings that contain affordable housing units for low-income households for no less than 10 years.

HOUSE COMMITTEE ON HOUSING

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 12 members: Representatives Peterson, Chair; Alvarado, Vice Chair; Leavitt, Vice Chair; Klicker, Ranking Minority Member; Connors, Assistant Ranking Minority Member; Barkis, Bateman, Entenman, Hutchins, Low, Reed and Taylor.

Minority Report: Without recommendation. Signed by 1 member: Representative Chopp.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not part of the legislation nor does it constitute a statement of legislative intent.

Staff: Austin Borcherding (786-7094).

Background:

Retail Sales and Use Tax.
Retail sales taxes are imposed on retail sales of most articles of tangible personal property, digital products, and some services. A retail sale is a sale to the final consumer or end user of the property, digital product, or service. If retail sales taxes were not collected when the user acquired the property, digital products, or services, then use tax applies to the value of property, digital product, or service when used in this state. The state, all counties, and all cities levy retail sales and use taxes. The state sales and use tax rate is 6.5 percent; local sales and use tax rates vary from 0.5 percent to 4.0 percent, depending on the location.

Tax Incentives for Creating or Developing Affordable Housing.
The Multi-Family Property Tax Exemption.
All property is subject to a tax each year based on the highest and best use, unless a specific exemption is provided. The Multi-Family Property Tax Exemption (MFTE) exempts real property associated with the construction, conversion, or rehabilitation of qualified, multiple-unit residential structures located in residential targeted areas contained within an urban center.

The MFTE applies only to the value of the construction, conversion, or rehabilitation projects and does not exempt the value of the underlying property or other improvements on the property.

The MFTE on qualifying property lasts for eight consecutive years. However, the exemption is available for a 12-year period if the owner commits to renting or selling at least 20 percent of multiple-family housing units as affordable housing to low- and moderate-income (LMI) households.

For the purpose of the MFTE, affordable housing is housing for low- to moderate-income households that does not exceed one-third of the household's monthly income. Low-income households must have an income that is no more than 80 percent of the median income of their county. Moderate-income households must have an income between 80 and 115 percent of the median income of their county.

Low-Income Housing Tax Credit Program.
The Washington State Housing Finance Commission (Commission) administers the Low-Income Housing Tax Credit (LIHTC) program, which finances construction of low-income housing through federal tax incentives. Housing financed through the LIHTC program must be affordable to households with incomes at 60 percent of the area median income (AMI) or less. LIHTC provides an indirect subsidy to housing developers where federal tax credits are allocated at the state level. The Commission awards these state tax credits to developers under two different LIHTC programs. Under one LIHTC program, after a

competitive application process in which projects are evaluated and scored according to established policy criteria, a developer may receive a 9 percent tax credit that typically generates equity for 70 percent of a project's development cost. Scoring categories include type of population served, targeted income levels, length of commitment to keeping units affordable, project costs, project location, and developer type. Tax credits are limited to an annual allocation to each state on a per capita basis. The Commission partners closely with the Department of Commerce (Commerce) to align the competitive process with the state Housing Trust Fund (HTF), where, for example, 75 percent of projects under this program included HTF funding in 2019. Nonprofits and housing authorities are typical recipients, although for-profit developers are eligible under this program especially when establishing partnerships with nonprofits. Under a second LIHTC program, a developer may receive a combination of a 4 percent tax credit and tax-exempt bonds that typically generates equity for 30 percent of a project's development costs as long as 50 percent of the costs are financed by tax-exempt bonds. Tax credits are unlimited in this program. Typical eligible recipients are nonprofits, housing authorities, and for-profit developers. Under both LIHTC programs, the developer transfers the credits to an investor that funds the housing. The investor becomes a majority owner of the housing and uses the credit to reduce its federal income tax liability. The developer uses the money received from the investor to build low-income housing.

Summary of Substitute Bill:

Property Tax Exemption Program.
A city governing authority (City) may establish a Property Tax Exemption Program (Program) for commercial properties which are converted into multiunit residential buildings that contain affordable housing units for low-income households.

"Governing authority" means the legislative authority of a city having jurisdiction over the property for which an exemption may be applied.

"Low-income household" refers to households whose income is at or below 80 percent of the area median income where the building is located.

"Affordable housing" means either of the following:
- residential rental housing rented by a household whose monthly housing costs do not exceed 30 percent of the 80 percent cutoff to qualify as a low-income household based on AMI; or
- residential homeownership housing that is owned or occupied by a low-income household whose monthly housing costs do not exceed the percentage of family income that may be spent on monthly housing costs, including utilities other than telephone, established by Commerce.

To qualify for a property tax exemption, the building must:

- be a building whose immediate prior use was predominantly or exclusively for commercial use; and
- have a complete project permit application submitted to the City or county prior to January 1, 2029.

Under the Program, the value of qualifying property is exempt from ad valorem property taxation for 30 successive years starting the year after application for exemption is approved.

To be eligible for the tax exemptions, the property must be in compliance with the following for the entire exemption period:

- a minimum of 20 percent of the residential units must be rented or sold as affordable housing units to low-income households for a period no less than 30 years;
- units that are rented to low-income households at the time of the exemption application must remain as affordable housing and are additive to the percentage of required affordable housing units; and
- affordable housing units must be distributed throughout the building and be comparable to market rate units in the building.

<u>Program Application</u>.
Once an application for exemption is approved, the following must occur:

- the approving City and the applicant must enter into a contract stipulating that a tax exemption will be provided if the applicant complies with the requirements of the exemption;
- within two years, the applicant must submit proof of compliance with those requirements; and
- within 30 days of receipt of the applicant's proof of compliance, the City must determine whether the affordability of the units is consistent with the requirements of the exemption.

If an application is denied, the reasons for the denial must be provided in writing and notice of the denial must be issued within 10 days of the denial. An applicant may appeal this decision, and the appeal must be submitted within 30 days after the applicant's receipt of the denial decision.

The application expiration date is December 31, 2029.

<u>Requirements of Owners</u>.
The owner of a property which receives a tax exemption, must:

- obtain from each tenant living in a designated affordable housing unit an annual certification of family size and annual income in a form acceptable to the City; and
- file an annual report with the City indicating the following:
    - family size and annual income for each tenant living in a designated affordable

housing rental unit, and a statement that the property is in compliance with the exemption Program's affordable housing requirements;
- a statement of occupancy and vacancy;
- a schedule of rents charged in market rate units; and
- any other information required by the City to determine compliance with exemption requirements.

If an owner intends to discontinue compliance with the affordable housing requirements of the Program, the owner must notify tenants and the jurisdiction 60 days before the owner's discontinuance.

If the owner intends to convert any affordable housing rental units to market rate units before the 30-year exemption period or after the exemption period ends, the owner must:
- provide tenants of affordable housing rental units with notification of intent to provide the tenant with rental relocation assistance; and
- provide tenant relocation assistance in an amount equal to one month's rent to a low-income household within the final month of the low-income household's lease.

<u>Requirements of Cities</u>.
A City that issues a tax exemption must report the following to Commerce every year:
- the number of tax exemption certificates granted;
- the number and type of units in building properties receiving a tax exemption;
- the number and type of units meeting affordable housing requirements;
- the total monthly rent amount for each affordable and market rate unit; and
- the dollar amount of the tax exemption issued for each conversion and the total dollar amount of tax exemptions granted within the City.

If the City is notified by the owner, or if the City discovers that a portion of the property no longer meets the qualifications of the tax exemption, the tax exemption is canceled, and the following apply:
- additional real property tax must be imposed on the property, and additional interest is owed upon the amounts of the additional property tax;
- a penalty is owed in the amount equal to 20 percent of the additional property tax imposed under this section; and
- the additional tax, interest, and penalty are a lien on the real property and attach at the time the property or portion of the property is removed from exempted status.

When a City plans to cancel a tax exemption, the City must notify the taxpayer and the county assessor. The owner may appeal the determination within 30 days of the date of the notice by filing a notice of appeal with the clerk of the governing authority.

If a City adopts an existing building conversion exemption program to provide the tax exemptions described above, it must modify that program to include the qualifying standards for affordable housing described above.

Tax Incentives for Property Conversion.
An exemption is created for sales and use tax imposed on goods and services incorporated as a component of a conversion of a commercial building into affordable housing.

To qualify for the sales and use tax exemption, the owner of a commercial building which is converted into affordable housing must rent or sell a minimum of 10 percent of the residential units in the property to low-income households for at least 10 years. If the owner intends to discontinue compliance with the affordable housing requirements or the department discovers that eligibility conditions for the exemption are no longer met, the owner must repay the total amount of the exemption received plus a 20 percent penalty.

Substitute Bill Compared to Original Bill:

As compared to the original bill, the substitute bill:
- removes residential multiunit buildings which are converted from market rate to affordable housing as a category of building eligible to receive the tax exemptions provided by the bill. This leaves only buildings which are converted from commercial to affordable housing as eligible for the tax exemptions; and
- removes an internal reference inconsistency.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill takes effect 90 days after adjournment of the session in which the bill is passed.

Staff Summary of Public Testimony:

(In support) This bill creates incentives for the production of affordable housing by providing a means to leverage existing buildings for that purpose. This is important for areas where there is not much land left to build on. The bill takes much of the vacant space we see now and utilizes it to create the affordable housing we need. This bill helps our climate by reducing impacts of commuting and by tearing down or building new structures. This bill helps economic vitality of downtown areas by filling empty spaces, and it utilizes space that is available now making it something we can begin doing immediately.

Work has been done to determine the appropriate number of affordable units to produce a public benefit by creating affordable housing units the way that this bill seeks to encourage. The private sector needs to be involved in our solution to the affordable housing issues we face. This bill provides that by applying to existing buildings rather than waiting for new buildings which face issues including supply issues. These projects are challenging and the incentives this bill provides seeks to address those challenges.

Work has been done to understand what number of affordable units is the right number to produce a public benefit by creating affordable housing units the way that this bill seeks to encourage.

Commercial to residential conversion projects are very expensive due to the unique challenges they present. The incentives this bill provides will make it feasible for developers to begin working on these projects where before they may have chosen not to due to cost concerns.

In commercial real estate we live and die on a five to seven year leasing cycle and leases put in place before COVID-19 will begin to terminate over the next 12 to 18 months leaving a commercial cliff that threatens the viability of downtowns across the state. We urgently need to consider incentives can be used to revitalize commercial buildings while also providing needed housing options. This bill provides such an incentive.

This bill would provide one more tool for us to add to our toolbox to help incentivize that workforce housing for both renters and homeowners.

(Opposed) None.

Persons Testifying: Representative Amy Walen, prime sponsor; Tim Cavanaugh, Marc Angelillo, and Briahna Murray, Urban Housing Ventures; Chris Batten, 135; Teri Stripes, City of Spokane; Carl Schroeder, Association of Washington Cities; Angela Rozmyn, Natural and Built Environments; and Representative Spencer Hutchins.

Persons Signed In To Testify But Not Testifying: None.

HOUSE COMMITTEE ON FINANCE

Majority Report: The second substitute bill be substituted therefor and the second substitute bill do pass and do not pass the substitute bill by Committee on Housing. Signed by 10 members: Representatives Berg, Chair; Street, Vice Chair; Jacobsen, Assistant Ranking Minority Member; Barnard, Chopp, Ramel, Santos, Springer, Thai and Wylie.

Minority Report: Without recommendation. Signed by 2 members: Representatives Orcutt, Ranking Minority Member; Wilcox.

Staff: Kristina King (786-7190).

Summary of Recommendation of Committee On Finance Compared to Recommendation of Committee On Housing:

The second substitute bill makes the following changes to the substitute bill:

- It removes the property tax exemption program for commercial conversions.
- It creates a sales and use tax deferral program for the following:
    - the sale or charge made for tangible personal property incorporated as a component in the building that is converted from a commercial building into affordable housing; and
    - labor and services rendered for the entire building during the conversion of a commercial building into affordable housing.
- The building, before the conversion, must:
    - be a building whose immediate prior use was predominantly or exclusively for commercial use; and
    - have a complete project permit application submitted to the city or county prior to January 1, 2029.
- The program requires the property owner to commit to 20 percent of affordable housing units for at least 10 years. The conversion must:
    - contain a minimum of 20 percent of residential units in a multiunit residential building subject to a tax deferral under this chapter, which must be rented or sold as affordable housing units to low-income households for a period no less than 10 years to address local market conditions; and
    - distribute the affordable housing units throughout the building and be comparable in terms of quality, living conditions, size, and mix of unit types to market rate units in the building.
- The property owner must apply to the city for a conditional certificate of program approval before December 31, 2029.
- After receiving the conditional certificate from the city, the property owner must apply to the Department of Revenue (DOR) for a sales and use tax deferral certificate for state and local sales and uses taxes.
- Qualifying sales and use taxes are exempted during construction.
- Each year during the 10-year affordability period, the property owner is required to file an annual report with the city that certifies the owner is meeting the affordability requirements.
- If a property owner intends to discontinue the existence of affordable housing units within the building after the 10-year period is complete, the owner must provide qualifying low-income housing tenants relocation assistance in an amount equal to one month's rent.
- After the 10-year affordability period is complete, the city and the DOR will verify that the owner met all affordability requirements. If the city or the DOR find that the owner does not meet the affordability requirements, the deferred taxes are immediately payable.
- It makes various administrative and technical changes.

Appropriation: None.

Fiscal Note: Available. New fiscal note requested on February 5, 2024.

Effective Date of Second Substitute Bill: The bill takes effect 90 days after adjournment of the session in which the bill is passed.

Staff Summary of Public Testimony:

(In support) There have been several iterations of this bill the past few years. The housing crisis in our state cannot be fixed by using our state capital and operating budgets. The private sector must be engaged to help solve this problem. Many current housing conversion projects are on hold due to high interest rates, labor shortages, and supply chain issues. This bill is the result of trying to think creatively about how to use existing buildings that are often vacant to create affordable homes for people. It also recognizes that converting commercial buildings to residential use is not straightforward and can be costly. Sometimes internal walls, plumbing, and electrical needs to be redone, and to make projects a reality, an incentive to do that is necessary. This bill also creates climate benefits by reducing long commutes, reducing waste because a lot of our landfills are full of construction material, and advancing equity by creating mixed income and mixed-use buildings that will help bring economic vitality back to downtowns and suburban areas. Most importantly, the bill quickly addresses affordability by reducing existing market rate rents and increases housing supply by adding units created from the commercial to residential conversions.

(Opposed) None.

Persons Testifying: Representative Amy Walen, prime sponsor; McKenzie Darr, National Association for Industrial and Office Parks-Washington Chapter; and Marc Angelillo, Urban Housing Ventures.

Persons Signed In To Testify But Not Testifying: None.