

HOUSE BILL REPORT

E2SSB 6175

As Passed House - Amended:

March 5, 2024

Title: An act relating to providing a sales and use tax incentive for existing structures.

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

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senators Trudeau, Billig, Frame, Kuderer, Mullet, Nguyen, Nobles, Randall, Saldaña, Valdez and Wilson, C.).

Brief History:

Committee Activity:

Housing: 2/19/24, 2/20/24 [DPA];

Finance: 2/23/24, 2/26/24 [DPA(HOUS)].

Floor Activity:

Passed House: 3/5/24, 94-2.

Brief Summary of Engrossed Second Substitute Bill (As Amended by House)

- Provides authorization and program requirements for cities to establish a retail sales and use tax deferral program for the conversion of underutilized commercial property into affordable housing.

HOUSE COMMITTEE ON HOUSING

Majority Report: Do pass as amended. Signed by 11 members: Representatives Peterson, Chair; Alvarado, Vice Chair; Leavitt, Vice Chair; Klicker, Ranking Minority Member; Connors, Assistant Ranking Minority Member; Barkis, Bateman, Hutchins, Low, Reed and Taylor.

Minority Report: Do not pass. Signed by 2 members: Representatives Chopp and Entenman.

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 Borcharding (786-7094).

HOUSE COMMITTEE ON FINANCE

Majority Report: Do pass as amended by Committee on Housing. Signed by 11 members: Representatives Berg, Chair; Street, Vice Chair; Jacobsen, Assistant Ranking Minority Member; Barnard, Ramel, Santos, Springer, Thai, Walen, Wilcox and Wylie.

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

Staff: Kristina King (786-7190).

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 the 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 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. The 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.

Definitions.

"Underutilized commercial property" is defined in the bill as an entire property, or portion thereof, currently used or intended to be used by a business for retailing or office-related or administrative activities. If the property is used partly for a qualifying use and partly for other purposes, the applicable tax deferral must be determined by apportionment of the costs of construction under rules adopted by the department.

Summary of Amended Bill:

Tax Deferral Program—Authorization.

The legislative authorities of cities may authorize a sales and use tax deferral for an

investment project within the city.

The legislative authority may only authorize such a deferral if it finds both of the following in areas proximate to the land on which the investment project is to be built:

- significant areas of underutilized commercial property; and
- a lack of affordable housing.

If a conditional recipient maintains the property for qualifying purposes for at least 10 years, deferred sales and use taxes need not be repaid.

Tax Deferral Program—Cities' Resolution of Intention.

The governing authority of each city which intends to create a tax deferral program for commercial building conversion to affordable housing must adopt a resolution of intention. The resolution may contain any information the governing authority deems appropriate to inform the public, but all resolutions must contain the following:

- the time and place of a hearing to consider the creation of the tax deferral program; and
- information pertaining to:
 - the application process;
 - the approval process;
 - the appeals process for applications denied approval; and
 - any additional requirements, conditions, and obligations that must be followed post-approval of an application.

Application Procedure—Application to City.

Requirements of Applicant.

Owners of underutilized commercial property may apply for a sales and use tax deferral. Applications must be made on forms adopted by the governing authority, be verified by oath or affirmation, include the application fee if any, and contain the following:

- information supporting the requested deferral;
- a description of the investment project and site plan;
- a statement of the expected number of affordable housing units to be created;
- a statement that the applicant is aware of the potential tax liability if the investment project ceases to be used for eligible uses prior to the 10 year requirement;
- a statement that the applicant is aware that the investment project must be completed within three years from the date of approval;
- a statement that the applicant is aware that the governing authority may extend the deadline for completion of construction or rehabilitation for a period not to exceed 24 consecutive months; and
- a statement that the applicant would not have built in this location but for the availability of the tax deferral.

Requirements of City.

A city may approve the application and grant a conditional certificate of program approval

if it finds the following:

- the investment project is set aside primarily for multifamily housing units and the applicant commits to renting or selling at least 10 percent of the units as affordable housing to low-income households;
- the applicant commits to any additional affordability and income eligibility conditions adopted by the local government;
- the investment project is in conformance with all local plans and regulations;
- the investment project will occur on an underutilized commercial property;
- the area where the investment project will occur is located within an area zoned for residential or mixed uses;
- the land where the investment project will occur was not acquired through a condemnation proceeding under the eminent domain statute; and
- the terms and conditions of the implementation of the development are consistent with those of the sales and use tax deferral program, and the requirements of the program have been satisfied.

A city must approve or deny an application within 90 days of its receipt. If approved, the city must issue the certificate of program approval. If denied, the city must provide notice and reasons for the denial in writing. The applicant may appeal the denial.

Application Procedure—Application to Department of Commerce.

Requirements of Recipient.

Before initiation of the construction of the investment project, the recipient of a city-granted conditional certificate of program approval must submit an application to Commerce.

The application must be made in a form and manner prescribed by Commerce, and contain the following:

- a copy of the conditional certificate of program approval issued by the city;
- estimated construction costs;
- time schedules for completion and operation; and
- any other information required by the department.

Requirements of Commerce.

Commerce must rule on the application within 60 days and must provide the recipient with information regarding documentation that they must retain to substantiate the sales and use tax deferral.

New applications are barred after June 30, 2034.

After receiving the conditional certificate of program approval issued by the city and approving an application for exemption, Commerce must issue a sales and use tax deferral certificate for state and local sales and use taxes on each eligible investment project.

The deferral certificate is valid during active construction of a qualified investment project

and expires on the day the city issues a certificate of occupancy for the investment project for which a deferral certificate was issued.

Post-Project Completion—Requirements of Recipient, City, and Commerce.

Recipient.

Within 30 days of receipt of the certificate of occupancy for an investment project under the sales and use tax exemption program, the recipient must file the following with the city:

- a description of the work that has been completed and a statement that the eligible investment project qualifies the property for a sales and use tax deferral;
- a statement of the new affordable housing to be offered as a result of the project; and
- a statement that the work has been completed within three years of the issuance of the conditional certificate of program approval.

City.

Within 30 days of receiving the above noted filings, the city must determine and notify the conditional recipient as to whether the project is consistent with the application and the contract, approved by the city, and thus continues to qualify for a tax deferral.

Recipient.

Within 30 days from receiving the city's determination, the recipient must notify Commerce to report the project is operationally complete so that Commerce can certify the project and determine the qualifying deferred taxes.

Commerce.

Commerce must determine the amount of sales and use tax which qualifies for the deferral. If Commerce determines that purchases were not eligible for deferral, it must assess interest, but not penalties, on the nonqualifying amounts.

The tax deferral is denied if the city determines any of the following:

- the work was not completed within three years of the application date (the city has the discretion to extend the deadline by two years under certain circumstances);
- the work was not constructed consistent with the application or other applicable requirements;
- the affordable housing units to be offered are not consistent with the application; or
- the owner's property is otherwise not qualified for a sales and use tax deferral under this chapter.

If such a denial is determined, the city must notify the recipient within 30 days. Cities can enact ordinances to create an appeal process for recipients who have been denied.

Annual Reporting.

Every year for the first 10 years, within 30 days of the date that the certificate of occupancy for a project built under the sales and use tax exemption program was first issued, a recipient must file the following with the city:

- a statement of the affordable housing units constructed on the property as of the date of filing;
- a certification by the conditional recipient that the property has not changed use;
- a description of changes or improvements constructed after issuance of the certificate of occupancy; and
- any additional information requested by the city.

Both the recipient and the city must file annual reports containing certain information regarding the tax deferral with Commerce.

Within the first 10 years, if a recipient opts to discontinue compliance with the exemption program, or if a city finds that a project no longer complies with the requirements of an exemption program, all deferred taxes are due immediately, with interest, but not penalties.

Deferral is transferable with ownership.

Appropriation: None.

Fiscal Note: Available.

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

Staff Summary of Public Testimony (Housing):

(In support) These projects are difficult as they are complicated and the cost of converting commercial buildings into residential buildings is very high. This bill will help address the housing crisis by working to alleviate some of that cost barrier.

This bill supports our environmental goals by utilizing existing buildings rather than having to build on undeveloped land. Local incentives for the conversion of underutilized commercial buildings into residential units is a practice that is currently being utilized by several other states.

(Opposed) None.

(Other) I believe that this bill should be passed. We have a lot of housing out here. There are people on these special housing programs that are single and live in a three-bedroom house. People need to go in and inspect these units and inspect their renters that are on these housing programs. I think that would make a dent in some of this homelessness that is going on. They need to move these single people into one-bedrooms or studios and put families in those three-bedroom homes.

Staff Summary of Public Testimony (Finance):

(In support) This bill incentivizes the conversion of commercial and nonresidential buildings to residential use. There is an increasingly large number of people who work remotely and shop online and that has led to an increase of vacant commercial buildings. At a time when Washington is facing a housing crisis, it is logical to transition these vacant buildings into housing units. Transitioning these buildings into residential property is not easy from a construction or design standpoint. It is expensive. Plumbing and electrical need extra attention, structural and seismic upgrades must be completed, and nearly all internal walls need to be reconfigured. To make these conversions affordable for the developers and allow them to dedicate some units to affordable housing, tax incentives like the deferral program in the bill are needed. This will help Washington join other states like California, Oregon, Wisconsin, and Illinois who have all put in place similar incentives. This also helps achieve climate goals by utilizing existing structures rather than building new structures.

(Opposed) None.

Persons Testifying (Housing): (In support) Marc Angelillo and Briahna Murray, Urban Housing Ventures; Rico Quirindongo, City of Seattle; Angela Rozmyn, Natural and Built Environments; and McKenzie Darr, NAIOP—Washington.

(Other) Shaun Beals.

Persons Testifying (Finance): Marc Angelillo and Briahna Murray, Urban Housing Ventures; and McKenzie Darr, National Association of Industrial Office Parks—Washington.

Persons Signed In To Testify But Not Testifying (Housing): None.

Persons Signed In To Testify But Not Testifying (Finance): None.