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Missouri State Auditor

Economic Development

Low Income Housing Tax Credit Program

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Missouri State Auditor

CITIZENS SUMMARY

Findings in the audit of the Department of Economic Development, Low Income Housing Tax Credit Program

Background

The Department of Economic Development (DED), Missouri Low Income Housing Tax Credit (LIHTC) Program started in 1990. The Missouri Housing Development Commission (MHDC) manages this tax credit program, which is designed to supplement the federal LIHTC. Tax credits must be used for new construction, rehabilitation, or acquisition and rehabilitation. The LIHTC is the state's largest tax credit program and had $144 million in redemptions in fiscal year 2013.

Program Cost and Efficiency

While the LIHTC program has helped provide thousands of units of affordable housing for low income Missourians, options exist to improve the efficiency of the tax credit model. Annual redemptions are projected to increase to and remain around $200 million per year through 2018. Of the 10 states with state LIHTC programs, Missouri ranked highest in state LIHTC funding, and was one of only two states with a per capita rate exceeding $20. Six states had per capita rates of $5.14 or less. Actual state LIHTCs issued and redeemed have greatly exceeded 1997 MHDC projections provided to the General Assembly. In the fiscal note, the MHDC estimated the average allocation rate would be 50 percent of the federal credit, but the MHDC has allocated essentially 100 percent of the federal amount since 1998. Since fiscal year 1997, the MHDC has authorized $842 million more LIHTCs than projected. The MHDC has taken action to reduce costs by implementing some of the recommendations in our prior LIHTC audit.

Currently, only $0.42 of every tax credit dollar issued actually goes toward the construction of low income housing; the remainder goes to the federal government in the form of increased federal income taxes; to syndication firms; and to investors. The MHDC could improve the efficiency of Missouri's LIHTC by (1) converting to a certificated credit model (possibly combined with the use of not-for-profits or government entities to eliminate federal taxation), (2) making the credits refundable, (3) using a direct appropriation to fund low income housing directly from state revenues, also utilizing not-for-profit organizations or government entities, and (4) reducing the number of years over which the tax credits are spread.

The program has no sunset provision. By adopting a sunset provision for the LIHTC program, the General Assembly could better determine whether the program is achieving its intended purpose and whether program funding levels are appropriate. In addition, state law allows claiming the same project costs under two or more tax credit programs. This "stacking" of tax credits can be lucrative for developers, but generates no additional economic activity or state benefit.

Economic Impact

The economic impact of the LIHTC program reported to the legislature by the DED is likely overstated. The department's analysis assumes no low income housing construction would occur if not for the state credit; however, since the federal LIHTC is available, some low income housing activity would likely occur even without the state LIHTC program. Moreover, even considering the overstatement, the LIHTC program results in a very low return on investment. The fiscal year 2013 analysis shows the program returned $0.08 in state revenue for every dollar spent and created approximately 63 new full-time jobs. With redemptions of $144 million in 2013, the program costs the state approximately $61,000 per unit of housing or $2.3 million per job.

In the areas audited, the overall performance of this program was **Fair.***

*****The rating(s) cover only audited areas and do not reflect an opinion on the overall operation of the entity. Within that context, the rating scale indicates the following:

Excellent: The audit results indicate this entity is very well managed. The report contains no findings. In addition, if applicable, prior recommendations have been implemented.

Good: The audit results indicate this entity is well managed. The report contains few findings, and the entity has indicated most or all recommendations have already been, or will be, implemented. In addition, if applicable, many of the prior recommendations have been implemented.

Fair: The audit results indicate this entity needs to improve operations in several areas. The report contains several findings, or one or more findings that require management's immediate attention, and/or the entity has indicated several recommendations will not be implemented. In addition, if applicable, several prior recommendations have not been implemented.

Poor: The audit results indicate this entity needs to significantly improve operations. The report contains numerous findings that require management's immediate attention, and/or the entity has indicated most recommendations will not be implemented. In addition, if applicable, most prior recommendations have not been implemented.

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Missouri State Auditor

Honorable Jay Nixon, Governor
and
Kip Stetzler, Acting Executive Director
Missouri Housing Development Commission
and
Mike Downing, Director
Department of Economic Development
Jefferson City, Missouri

We have audited certain operations of the Missouri Low Income Housing Tax Credit Program in fulfillment of our duties under Chapter 29, RSMo and Section 620.1300, RSMo. The scope of our audit included, but was not limited to 2 years ended June 30, 2013. The objectives of our audit were to:

1. Analyze the costs and benefits of the program to determine if it is an effective and efficient use of state resources.

2. Evaluate the internal controls over significant management and financial functions related to the program.

3. Evaluate compliance with certain legal requirements related to the program.

4. Evaluate the economy and efficiency of certain management practices and operations.

For the areas audited, we (1) determined the current program structure is an inefficient method of funding low income housing activity, but due to weaknesses in program data, other aspects of program effectiveness and efficiency could not be adequately determined, (2) identified no deficiencies in internal controls, (3) identified no significant noncompliance with legal provisions, and (4) identified the need for improvement in management practices and procedures.

Except for the matter discussed in the last paragraph of the Scope and Methodology, we conducted our audit in accordance with the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides such a basis.

The accompanying Management Advisory Report presents our findings arising from out audit of the Missouri Low Income Housing Tax Credit Program.

Thomas A. Schweich
State Auditor

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Missouri Low Income Housing Tax Credit Program Introduction

Background

Missouri Low Income Housing tax credit (LIHTC) program started in 1990 and is established under Section 135.350 to 135.363 RSMo. The tax credit has no sunset or expiration date. The Missouri Housing Development Commission (MHDC)[1] manages this tax credit program that is designed to supplement the federal LIHTC, which began in 1986. Tax credits must be used for new construction, rehabilitation, or acquisition and rehabilitation. The LIHTC had $144 million in redemptions in fiscal year 2013, making it the state's largest tax credit program. See Appendix C for redemption information on all state tax credits.

The Internal Revenue Service (IRS) allocates federal LIHTCs[2] to each state based on population. The funding level was $1.75 per capita in 2002 and has been adjusted annually for inflation beginning in 2003. For 2013, federal funding levels were $2.25 per capita, which for Missouri equals $13.5 million (per year for 10 years). Guidelines for the federal LIHTC are contained in Section 42 of the IRS tax code.

Owners of a project to which the federal credit is allocated receive a federal credit equal to 9 percent of the qualified basis[3] of the project for 10 years. Projects financed with tax-exempt bonds receive a federal tax credit equal to 4 percent of the qualified basis.[4] Projects seeking 9 percent credits are awarded on a competitive basis. Projects seeking 4 percent credits have historically been awarded based on the availability of tax-exempt bond financing. Starting in 2007, the MHDC implemented a process that prioritizes 4 percent project applications to help ensure the best projects receive priority access to available bond funding.

In 1990, Missouri began supplementing the federal program by allocating state income tax credits equal to 20 percent of the federal total. In 1994, the state credit increased to up to 40 percent of the federal credit for areas that lost housing in the 1993 flood. In 1997, the state credit increased to up to 100 percent of the federal credit for all areas and remains at that level.

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[1] The MHDC includes the Governor, Lieutenant Governor, Attorney General, State Treasurer and six persons appointed by the governor with the advice and consent of the Senate. An Executive Director manages MHDC operations. MHDC is part of the Department of Economic Development.

[2] The allocation relates to 9 percent projects only.

[3] Qualified basis is the total cost to develop the property, less items not subject to depreciation (land and reserves) and the cost of market rate units. A project's qualified basis may be increased by 30 percent if it is located in a difficult to develop area as determined by the federal Department of Housing and Urban Development (HUD).

[4] Actual tax credit rates are not exactly 9 percent and 4 percent, and vary on a monthly basis. The tax credit rate is determined so that the actual expected present value of the subsidy over the 10-year period equals 70 percent of the project's eligible basis in the case of the 9 percent credit, and 30 percent for the 4 percent credit. The rates are calculated and released monthly by the United States Treasury.

The credit is limited to a percentage of the qualified basis, based upon depreciable basis, and the percentage of affordable units in the development. The minimum number of qualifying units is (1) 40 percent of the total number of units affordable to persons at 60 percent of the median income or (2) 20 percent affordable to persons at 50 percent of the median income. Missouri's annual Qualified Allocation Plan (QAP) establishes the selection criteria, federal preferences, and MHDC priorities for proposal selection. Congress has delegated the administration of the federal LIHTC to state housing agencies (the MHDC in Missouri) to assure that good quality housing would be available where it is most needed. The MHDC is responsible for the allocation of federal and state credits and assuring compliance with the regulations. The compliance process includes periodic physical inspections of the property as well as reviews of management and occupancy procedures during a minimum 15-year compliance period.

The tax credit is non-refundable,[5] and non-transferable. Section 135.352.4, RSMo, allows the credits to be carried back 3 years to offset prior tax liability or carried forward for 5 years to offset future tax liability. The tax credits are used by investors who must acquire an ownership interest in the development partnership and may be redeemed against state income tax, corporate franchise tax, financial institution tax, or insurance company premium tax.

Housing tax credits in other states

Missouri is one of 13 states that have established state tax credits for housing. Seven states[6] utilize a state LIHTC in addition to the federal credit, three states[7] utilize a contribution credit that is dependent upon contributions to not-for-profit organizations, and three states (Arkansas, Missouri, and Vermont) use a combination of a LIHTC and contribution credit. Missouri's contribution credit is called the Affordable Housing Assistance Program, and is separate from the state LIHTC program. Of the 10 states that utilize a state LIHTC, six use a 10-year credit period like Missouri, while four use a shorter timeframe. See Appendix B for 2012 funding information on each state utilizing a LIHTC.

Application and approval process for state and federal credits

Developers (for-profit and not-for-profit) are eligible to apply for tax credits. Applicants must demonstrate prior, successful housing experience and engage the services of housing professionals, such as architects, attorneys, accountants, contractors, and property managers with demonstrable tax credit and housing experience. Developers must have the

[5] The tax payer must have a tax liability the credit can be offset against.
[6] States that utilize only a state LIHTC in addition to the federal credit are California, Georgia, Hawaii, Massachusetts, New York, North Carolina, and Utah.
[7] States that utilize only the contribution credit are Connecticut, Illinois, and New Mexico.

financial capacity to successfully complete and operate the proposed housing development. Proposed housing developments must:

- Meet a demonstrated affordable housing need
- Provide housing for low income persons and families
- Demonstrate local support
- Leverage tax credit funding with other financing and/or rental assistance
- Be economically feasible
- Balance sources and uses of funds

The MHDC sets the application and selection schedule annually. Typically, a Notice of Funding Availability is published during the month of June. Once the notice is released, an application packet is available on the MHDC website or by mail. The deadline for proposal submission is typically in late September, and MHDC staff make recommendations to the commission in December. The MHDC sets project cost limits at 125 percent of established HUD guidelines for 8 designated metropolitan areas[8] in the state; with any projects outside these areas limited to 100 percent of the HUD guideline cost limit. Tax credits are issued to approved project owners over a 10-year period once the housing is ready for occupancy, which is typically 2 years after project approval. The MHDC will not approve projects for state LIHTCs without also approving the project for federal credits. Projects are generally limited to $7 million[9] in state credits and $7 million in federal credits. The state credit has the same guidelines as the federal credit.

Tax credit sale and investment process

Developers typically recruit investors to become part of a limited partnership arrangement where tax credits are transferred. The arrangement is often administered by a syndicator who is responsible for ensuring project compliance with federal tax code rules. Several of the more active syndicators in the state are directly affiliated with developers who are also active in the program. As a general partner, the developer has a small ownership percentage in the project, but has the authority to build and maintain the project on a day to day basis. The investors, as limited partners, have a large ownership percentage in the project with an otherwise passive role. Investors look at the credit, which can be used to offset tax liabilities, as part of their return on investment. Investors may also receive tax benefits related to project operating losses, interest on debts, and deductions such as depreciation and amortization.

[8] The eight designated metropolitan areas established are Jefferson City, Columbia, St. Louis, Springfield, McDonald County, Kansas City, St. Joseph, and Joplin.
[9] $700,000 in annual credits over 10 years.

Syndicators told us the investors receiving the federal tax credit are usually different than the investors receiving the state tax credits. Insurance companies have become big investors in LIHTC projects in Missouri and are redeeming a large portion of the state LIHTCs. The insurance companies use the credits to offset insurance company premium taxes.

Tax credit recapture

MHDC staff monitors compliance with federal LIHTC requirements. If non-compliance is identified the owner has up to 45 days to correct the problem, unless an extension is granted. MHDC staff will re-inspect the project, evaluate the status of the compliance problem and file a report with the IRS regardless of whether or not the problem was corrected. Reported uncorrected non-compliance issues may result in recapture of a portion of federal and state tax credits redeemed on the projects. IRS staff determines if federal LIHTCs will be recaptured.

State law[10] mirrors the federal law regarding recapture of tax credits Projects receiving federal LIHTC allocations since 1987 must comply with eligibility requirements for a period of 15 taxable years, beginning with the first taxable year of a project's credit period. Projects receiving credit allocations after December 31, 1989 are required by the IRS code to comply with eligibility requirements for an additional 15 years beyond the initial 15-year compliance period, a total of 30 years. This additional 15-year period is referred to in the IRS code as the "extended use period." However, after the initial 15-year compliance period some low income housing projects may be eligible[11] for conversion to market-based rents if the property owner chooses to opt out of the low income housing program.

Tax credits authorized redeemed

The MHDC has authorized an average of $143.4 million in credits per year in 9 percent state credits for fiscal years 2012 and 2013, with the same amount being authorized in federal credits, while redemptions averaged $154 million per year. In addition, while the annual level of 4 percent credits was limited to $60 million with a legislative change in 2009, the MHDC authorized an average of $38.6 million per year in 4 percent state credits during fiscal years 2012 and 2013. In contrast, 4 percent tax credit authorizations averaged $89.7 million per year for the 5 years prior to the legislative change. Appendix A, lists detailed information of credits authorized and redeemed by fiscal year, and cumulative credits outstanding or pending issuance.

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[10] Section 135.355, RSMo.

[11] Depends on the other types of financing besides tax credits used on the project and other conditions.

Low income housing units built

Approximately 46,700 low income housing units have been approved for construction using the state LIHTC since 1998.[12] The table below lists the number of units approved with state LIHTC during the 5 years ended June 30, 2013.

Low income units approved by credit type - state fiscal years 2009 through 2013

Type	2009	2010	2011	2012	2013	Total
9 Percent	913	1,529	1,017	751	1,359	5,569
4 Percent	1,272	864	51	1,009	1,004	4,200
Total	2,185	2,393	1,068	1,760	2,363	9,769

Source: MHDC data

Reporting

The DED provides the General Assembly and the public key program information for the LIHTC program through the tax credit activity report.

Agencies administering tax credit programs are required under Section 33.282, RSMo, to submit the estimated amount of tax credit activity for the next fiscal year to the State Budget Director for submission to the Chairmen of the Senate Appropriations and House Budget Committees. In addition to the estimates of tax credit activity, the agencies must also include a cost-benefit analysis of the program for the preceding fiscal year. The annual estimates and cost-benefit analyses are submitted on forms called tax credit activity reports. State law requires the tax credit activity report be submitted to the State Budget Director by October of each year and to the Chairmen of the Senate Appropriation and House Budget Committees by January 1 each year.

Scope and Methodology

To gain an understanding of the performance of the state LIHTC program, we interviewed various individuals involved in all aspects of the program, including MHDC staff, developers and their representatives, tax attorneys, an architect; representatives of three syndication firms, a lobbyist representing developers, and a Certified Public Accountant with a firm involved in the program. We also discussed tax credit redemptions with a representative of the Department of Revenue (DOR), and discussed tax credit reporting with representatives of the Department of Economic Development (DED). Our review also included visits to two completed LIHTC project sites.

We obtained data from MHDC staff on the number of housing units approved by the commission, and the number of projects converted to market-based housing during the 5 years ended June 30, 2013. We also obtained information on tax credit authorizations from MHDC staff and tax credit redemptions from MHDC and DOR staff.

[12] Data prior to 1998 was not obtained due to the time required for MHDC staff to compile it.

To understand how Missouri's state LIHTC program compares to the LIHTC programs of other states, we obtained information from various sources, including interviews with state housing agency representatives with the states of Arkansas, California, Connecticut, Georgia, Hawaii, Illinois, Massachusetts, New Mexico, New York, North Carolina, Utah, and Vermont.

To develop projections of future tax credit activity and liability, we reviewed historical trends in tax credits awarded, authorized, issued and redeemed including data presented in Appendix A. We also reviewed historical information related to the federal LIHTC allocation, including population and allocation rates. We based projections for future years on historical trends, with an emphasis on more recent history. Future 4 percent tax credit activity is limited to a maximum issuance of $60 million per year ($6 million per year for 10 years).

To evaluate aspects of program management, we reviewed the project selection process, project cost review process, and planning process to determine the state's long-term housing needs. We also reviewed the annual LIHTC cost-benefit analysis the MHDC reports to the legislature as part of the state budget process. In addition, we compared Missouri's program to best practices established by the National Council of State Housing Agencies.

To evaluate potential improvements to the program, we reviewed reports from the Missouri Tax Credit Review Commission. The commission was created by the Governor in July 2010, and charged with reviewing the state's tax credit programs and making recommendations for greater efficiency and enhanced return on investment. The commission released reports in November 2010 and December 2012.[13]

To evaluate state LIHTC recapture procedures, we interviewed MHDC staff and obtained information from MHDC on project non-compliance reported to the IRS during the 2 years ended June 30, 2013. We tested procedures in place to monitor ongoing projects for any noncompliance, which would result in potential recapture, and observed a sample of related site inspections.

We obtained aggregate totals of annual tax credit redemptions for state tax credits and recaptured LIHTCs for fiscal years 2008 through 2012 from the DOR. In accordance with the Missouri Supreme Court decision in the case of *Director of Revenue v. State Auditor* 511 S.W.2d 779 (Mo. 1974), auditors are not provided individual tax returns. As a result, auditors were

[13] The December 2012 report included a supplemental report that we also reviewed.

not able to verify the completeness and accuracy of redemption data provided.

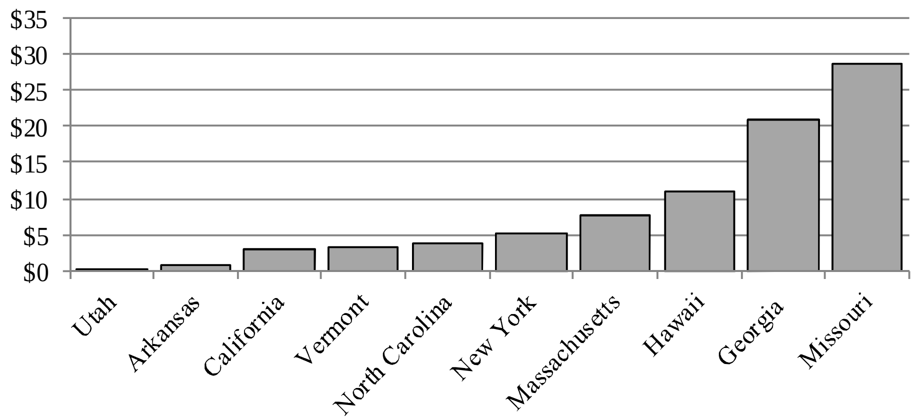
1. Program Cost and Efficiency

While there is no dispute the Low Income Housing Tax Credit (LIHTC) program has helped provide thousands of units of affordable housing for low income Missourians, this audit evaluates the economic efficiency of the current program. Missouri leads the nation in state LIHTC spending, on a per capita basis, and the amount of tax credits issued for low income housing has exceeded initial fiscal note projections. Options exist to improve the efficiency of the tax credit model, since currently only $0.42 of every tax credit dollar issued goes toward the construction of low income housing, with the remainder going to the federal government in the form of increased federal income taxes, to syndication firms, and to investors. In addition, the program has no sunset provision and applicants can receive multiple tax credits for the same expenditures.

1.1 Total program costs

In 2012, Missouri ranked highest in state LIHTC funding, with $28.60 spent on a per capita basis. Of the 10 states with state LIHTC programs, Missouri was one of only two states with a per capita rate exceeding $20, while 6 states had per capita rates of $5.14 or less.

2012 Per Capita Funding for States with State LIHTC Programs

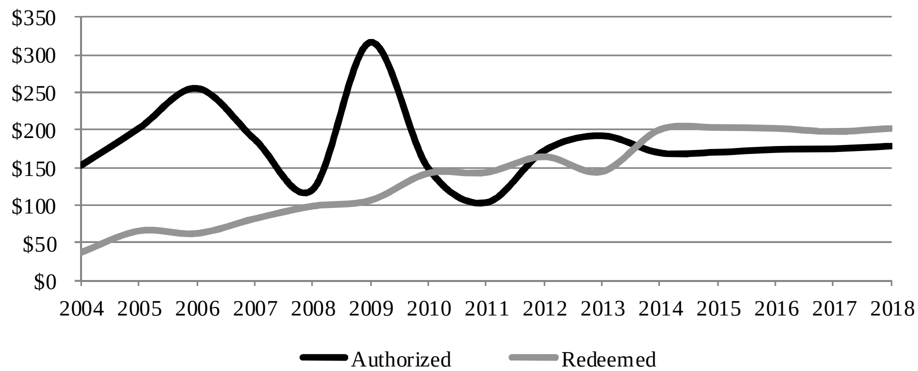


Source: SAO analysis

Projection of future tax credit activity

Based on actual tax credits awarded in recent years, we projected tax credits to be authorized, redeemed, and outstanding through 2018. Assuming tax credits are awarded at a pace consistent with prior years, our projections estimate a cumulative total of $3.4 billion in credits will be authorized and approximately $2.1 billion in credits will be redeemed, leaving an estimated $1.3 billion in credits outstanding or pending issuance by 2018. The chart on the following page depicts actual credits authorized and redeemed from 2004 through 2013, and projected authorizations and redemptions through 2018. Annual redemptions are projected to increase to and remain around $200 million per year through 2018.

Actual and estimated LIHTC authorized and redeemed - Fiscal year 2004 to 2018



Source: SAO projections based on MHDC and DOR data

Limits on total tax credits issued are high

Missouri's annual limit on 9 percent LIHTCs is significantly higher than all but one of the other 9 states with state LIHTC programs. State law limits the amount of 9 percent credits to 100 percent of the federal LIHTC allocation. All 10 states with state LIHTC programs limit the annual amount of credits authorized. Missouri is one of 4 states that utilizes a percentage of the federal allocation to determine the annual limit. While Missouri and Georgia authorize credits of 100 percent of the federal allocation, Hawaii limits state LIHTCs to 50 percent, and Utah to only 10 percent of the annual federal allocation. The remaining 6 states utilize some form of set dollar value limit.

Prior to 1997, Missouri law[14] primarily limited the annual amount of state credits to 20 percent of the federal allocation. In 1997, the law was changed to allow the MHDC to authorize up to 100 percent of the federal allocation. Missouri law[15] currently limits the amount of 4 percent credits to $60 million per year.

Credits issued and redeemed exceed MDHC projections

Actual state LIHTCs issued and redeemed have greatly exceeded 1997 MHDC projections provided to the General Assembly. In 1997, state law changed to increase the state credit to up to 100 percent of the federal credit. In the final fiscal note to the house bill, MHDC staff reported state credits would continue to be allocated at 20 percent of the federal credit in most parts of the state, but the MHDC would increase the allocation to 100 percent in rural areas and areas where it is difficult to develop affordable housing. MHDC estimated in the fiscal note the average allocation rate would be 50 percent of the federal credit. However, the MHDC has allocated essentially 100 percent of the federal amount since 1998. In addition, the estimate did not consider increases in the amount of annual federal LIHTCs available for 9 percent projects, and did not consider any estimate of credits issued for 4 percent projects. In total, since fiscal year

[14] Section 135.352.2, RSMo.
[15] Section 135.252.3, RSMo.

1997, the MHDC has authorized $842 million more LIHTCs than projected (based on the average annual authorizations estimated in the 1997 fiscal note).

Prior recommendations implemented

The MHDC has taken action to reduce costs by implementing some of the recommendations in our prior LIHTC audit,[16] including reducing the builder's fee percentage to be consistent with National Council of State Housing Agencies guidance, and reducing project cost limits. The MHDC reduced project cost limits from a maximum of 140 percent of HUD guidelines in metropolitan areas, down to 125 percent of HUD guidelines for 2011 and 2012. Our review of the 67 projects (9 percent only) approved in 2011 and 2012 showed development costs for 21 of those projects (31 percent) exceeded the HUD guideline, which represents an improvement from our prior LIHTC audit where we found 55 percent of projects to be over the HUD guideline, To reduce costs further, MHDC reduced the project cost limits down to 100 percent of HUD guidelines for fiscal year 2014. In addition, MHDC has made improvements in the project selection and evaluation process based on recommendations from the prior report.

1.2 Efficiency

The current LIHTC model is inefficient because only a portion of each dollar of tax credit goes toward low income housing. The current model finances low income housing construction at an effective interest rate of over 19 percent.[17] The MHDC awarded $192 million in state LIHTCs during fiscal year 2013, which will be redeemed over the next 10 to 15 years. The 2013 tax credits awarded will be converted into approximately $80.6 million in equity[18] to be used for the construction and development of low income housing.

The primary cause of the credit's inefficiency is the federal tax implications of end users using the tax credit to reduce their amount of state taxes paid. The reduction of a user's state taxes paid results in the loss of a portion of the federal tax deduction for state taxes paid, thereby increasing the user's federal tax liability. As a result, the price of the state credit is automatically reduced by approximately 35 percent.[19] The value of credit is further reduced by the 10-year discount period and syndicator discounts (if the developer uses a syndicator to sell the credits).

[16] Report number 2008-23, *Analysis of Low Income Housing Tax Credit Program*, issued in April 2008.
[17] Rate calculated by assuming $42 million was borrowed and $100 million was paid over 10 years to repay the debt.
[18] Assuming MHDC's current pricing floor of $.42 per $1 of credit.
[19] The highest marginal federal corporate tax rate for 2012 and 2013.

The inefficiency of the current model was noted in the Tax Credit Review Commission's December 2012, supplemental report, which stated "the state is borrowing money in connection with (the LIHTC) at a higher rate than that charged to the most risky of borrowers at a time when Missouri's credit rating is among the highest of all states. This should be a source of great embarrassment to Missouri." However, the Tax Credit Review Commission's primary recommendation to improve the efficiency of the current LIHTC model was to eliminate the existing tax consequences by getting the federal tax law changed, which does not appear likely.

Options to improve efficiency

Several options exist to improve the efficiency of Missouri's LIHTC, including (1) converting to a certificated credit model, potentially combined with the use of not-for-profit organizations to eliminate federal taxation, (2) making the credits refundable, (3) the use of a direct appropriation to fund low income housing directly from state revenues, also utilizing not-for-profit organizations, and (4) a reduction in the number of years the tax credits are spread over.

Certificated credit model

Under a certificated credit model a state housing agency issues certificates investors could purchase to reduce their state tax liability. Under this model, the end investor does not join the developing partnership, but instead is purchasing a transferable asset, increasing the attractiveness of the state credit to potential investors.

Missouri could achieve a sales price of approximately $.65 per credit dollar[20] utilizing a certificated credit model. The majority of the price increase that results from a change to a certificated model is due to a change in the tax treatment of state tax credits. As opposed to Missouri's current system where a portion of federal tax deduction is lost due to a reduction of state taxes paid, the use of certificates allow investors to apply state tax credits used as deduction on their federal income taxes. However, the sale of a certificated credit would then be treated as the sale of an asset and would be subject to capital gains taxes at the federal level.

An industry professional said to avoid tax consequences to the development partnership, tax credits would have to be issued to not-for-profit housing organizations. These agencies convert the credits into cash, without paying taxes on the transaction, allowing the partnership and its investors to avoid any federal tax consequences associated with the income provided by the state tax credits. This approach was endorsed by the 2010 Tax Credit Review Commission.

[20] Price assumes a 10-year credit and is similar to the price achieved for New York state credits. States utilizing a 5-year credit, such as Massachusetts, can receive prices in the mid-to-upper $.70 range.

Refundable credit model

In a refundable model the credits could be redeemed by the user regardless of their existing tax liability, and would provide an advantage to the state by making redemptions of the credits more predictable. A refundable option would be particularly effective if the credits were to become certificated, since transferable and refundable credits would be very marketable. If a refundable feature was added to the LIHTC, it would need to be structured such that each of the annual 10-year installments would be refundable separately over the 10-year stream. The Tax Credit Review Commission did not discuss the refundable credit option for the LIHTC in either report issued.

Direct appropriation

The simplest and most economically and administratively efficient change possible to the state's low income housing program would be the use of a direct appropriation from the state. Not-for-profit organizations would also need to be involved in a direct appropriation model to avoid federal tax consequences and for 100 percent of the state's money to go towards the construction of low income housing. If not-for-profit organizations were not used, the efficiency of the program would still be improved over the current model since tax credits would not need to be sold to third parties. This method would subject low income housing funding to the annual budget process.

Issuance timeframes

Reducing the timeframe tax credits are issued over would help improve the efficiency of the credit. With credits currently being issued in a 10-year stream, the value of the stream of credits is significantly discounted when developers convert the credits to equity for construction. By reducing the timeframe the credits are issued over, a reduced amount of credits can produce the same amount of equity for construction. This change was endorsed in the Tax Credit Review Commission's November, 2010 report, which indicated as much as a 30 percent increase in equity due to the reduction of the tax credits from a 10-year stream to a 5-year stream.

1.3 Sunset provision

As noted in Report No. 2010-47, *Tax Credit Cost Controls*, issued in April 2010, state law does not include a sunset provision for many tax credits, including the LIHTC program. The Sunset Act, passed in 2003, provides for new programs to sunset after a period of not more than 6 years unless reauthorized by the General Assembly or the program is exempted from the Sunset Act. The Act requires the Committee on Legislative Research to review applicable programs before the sunset dates and present a report to the General Assembly regarding the sunset, continuation, or reorganization of each affected program. However, the LIHTC program was created prior to the Sunset Act and is exempted.

By adopting a sunset provision for the LIHTC program, the General Assembly can better determine whether the program is achieving its intended purpose and whether program funding should be increased, decreased, or eliminated.

1.4 Use of multiple incentives

As noted in Report No. 2012-117, *Division of Business and Community Services*, issued in September 2012, state law does not prohibit claiming the same project costs under two or more tax credit programs. This "stacking" of tax credits can be lucrative for developers and additional tax credits are issued while no additional economic activity or state benefit is generated.

Companies may claim certain project costs under the Low Income Housing, Historic Preservation, Brownfield Remediation, and the Neighborhood Preservation Tax Credit programs. Between fiscal years 2000 and 2011, the state issued tax credits totaling approximately $738 million for 117 projects that received funding from two or more of these tax programs.

In December 2012, the Tax Credit Review Commission recommended changes when Brownfield, Historic Preservation, and Low Income Housing Tax Credits or any combination thereof are awarded to a single project. The commission recommended a specific ordering process and Brownfield credits would be calculated first based on eligible remediation expenditures. Next, the eligible Historic Preservation credit expenditures would be reduced by the amount of Brownfield credits. Finally, the Brownfield and Historic Preservation credits would be deducted from the total expenditures eligible for the Low Income Housing Tax Credit. The DED should work with the General Assembly to establish cost containment provisions regarding project costs claimed under multiple tax credit programs.

Similar conditions previously reported

Similar conditions to sections 1.1 and 1.2 were noted in our prior audit report on the LIHTC.

Recommendations

The General Assembly:

1.1 Evaluate and consider implementing a limit on the amount of LIHTCs awarded annually.

1.2 Evaluate and consider changes to improve the efficiency of the current LIHTC model.

1.3 Establish a sunset provision for the LIHTC program.

1.4 Establish cost containment provisions regarding project costs claimed under multiple tax credit programs.

2. Economic Impact

The economic impact the DED reports to the legislature regarding the LIHTC is likely overstated. However, even considering this overstatement, the LIHTC program results in a very low return on investment. The fiscal year 2013 analysis for the LIHTC shows the program returns $.08 in state revenue for every dollar spent,[21] and created approximately 63 new full-time jobs. With redemptions of $144 million in 2013, the program cost the state approximately $61,000 per unit of housing, or $2.3 million per job. DED staff prepare the cost-benefit analysis for MHDC based on information and assumptions provided by MHDC staff.

The economic impact reported to the legislature appears overstated because it assumes *no* low income housing construction would take place if not for the state credit. However, since the federal LIHTC is available to the state, some low income housing activity would occur even without the state LIHTC program. The fiscal year 2012 tax credit activity report provided to the legislature estimates approximately 40 percent of LIHTC units would still be feasible without the state credit. Therefore, it is not reasonable to attribute all low income housing economic impact to the state credit. Considering only the low income housing activity that occurs due to the state program would allow the DED to provide the legislature a more accurate assessment of the economic impact of the state LIHTC program.

Recommendation

The Department of Economic Development consider the low income housing activity that would take place without the state LIHTC when calculating the economic impact attributable to the program.

Auditee's Response

The LIHTC, like several other tax credit programs, was not primarily designed to impact the economy; therefore, while a fiscal cost-benefit analysis is required by statute, it should be viewed in context of the program's other goals. Many non-economic tax credit programs also provide community value that cannot be easily quantified in dollar terms further disadvantaging the activity when fiscal analyses is done. Cost-benefit analyses can still be informative in these situations, but should be viewed with these constraints in mind and with other measures that more directly relate to the program's goals.

Since a standard reporting of fiscal cost-benefit analyses is required, regardless of the tax credit's goals, the DED strives to conduct assessments with as much consistency as possible. If findings support a lower activity level assumption in the LIHTC program then those figures can be incorporated into the annual assessment.

[21] $11.9 million in total economic benefit to the state, divided by $151.8 million in total cost equals $.08 returned per $1 invested.

Low Income Housing Tax Credit Activity

The following table shows the amount of LIHTCs authorized and redeemed, as well as the cumulative balance of credits outstanding or pending issuance.

Fiscal Year		Amount Authorized	Amount Redeemed	Cumulative Outstanding or Pending Issuance[1]
1994	$	22,027,870	55,706	21,972,164
1995		22,862,860	646,237	44,188,787
1996		30,106,140	1,072,649	73,222,278
1997		54,177,540	2,027,362	125,372,456
1998		85,806,200	2,907,544	208,271,112
1999		101,367,660	4,323,281	305,315,491
2000		80,455,840	10,105,111	375,666,220
2001		113,735,120	12,368,170	477,033,170
2002		125,558,880	19,474,343	583,117,707
2003		134,388,920	29,978,473	687,528,154
2004		202,644,630	36,916,831	853,255,953
2005		183,106,160	65,392,601	970,969,512
2006		273,640,430	61,963,798	1,182,646,144
2007		169,445,790	81,646,784	1,270,445,150
2008		120,120,070	98,305,085	1,292,260,135
2009		316,175,550[2]	105,967,104	1,502,468,581
2010		149,068,200	142,141,458	1,509,395,323
2011		102,960,000	143,055,387	1,469,299,936
2012		171,894,310	164,208,547	1,476,985,699
2013		192,000,000[3]	144,082,976	1,479,238,119
Totals	$	2,651,542,170	1,126,639,447	

[1] The $1.48 billion in outstanding credits may include some credits no longer eligible for redemption due to time expiration or project non-compliance. Current law does not require the Department of Revenue to maintain this information.

[2] MHDC's administrative process has historically resulted in the authorization of credits one fiscal year after commission approval. In fiscal year 2009, the MHDC changed its procedures to align the authorizations with the fiscal year in which credits are approved. The fiscal year 2009 authorizations account for credits approved in both fiscal year 2008 and 2009.

[3] Credits are issued upon completion and occupancy for an approved project, which can take up to 2 years for most projects. Few if any credits have been issued for fiscal years 2012 and 2013 approved projects as of August 2013. Issued credits for a project may be slightly more or less than the amount authorized for the project.

Source: MHDC and SAO analysis

Per Capita Low Income Housing Funding by State

Based on interviews with other state housing agencies we determined the amount of state LIHTCs awarded in 2012, by state. Using 2012 Census Bureau population data, we calculated per capita LIHTCs awarded.

State	Credits Awarded	2012 Population	Per Capita
Missouri	$ 171,894,310	6,010,688	28.60
Georgia	205,000,000	9,815,219	20.89
Hawaii	15,122,910	1,374,810	11.00
Massachusetts	50,000,000	6,587,536	7.59
New York	100,000,000	19,465,197	5.14
North Carolina	37,000,000	9,656,401	3.83
Vermont	2,000,000	626,431	3.19
California	111,831,403	37,691,912	2.97
Arkansas	2,500,000	2,937,979	0.85
Utah	750,000	2,817,222	0.27

Source: Interviews with other state housing agency officials and MHDC.

The credit amount represents the annual tax credit awarded, multiplied by the duration of the tax credit. Like Missouri, state credits in Georgia, Hawaii, New York, Arkansas, and Utah are 10-year credits (10 percent redeemable each year for a period of 10 years). The other states' credits varied, with North Carolina having a one year credit, California having a 4-year credit, and Massachusetts and Vermont having 5-year credits.

Tax Credit Redemptions

The following table shows redeemed tax credits for fiscal years 2010 through 2013 for all state tax credit programs. We did not audit the information.

	Year Ended June 30,			
Program	2010	2011	2012	2013
Adoption (Special Needs)	$ 1,894,187	1,346,454	1,036,226	744,155
Affordable Housing Assistance	11,647,956	4,880,797	5,629,466	7,406,988
Agricultural Product Utilization Contributor	114,674	466,048	1,468,156	1,267,239
Alternative Fuel Vehicle Refueling Property[1]	0	23,365	45,690	69,454
Bank Franchise	2,013,584	4,233,673	2,333,619	2,559,444
Bank Tax Credit for S Corporation Shareholders	1,823,612	2,787,708	5,523,276	4,533,837
Brownfield Jobs/Investment	1,650,222	1,620,384	1,660,626	68,693
Brownfield Remediation	17,590,273	11,432,109	16,967,400	6,378,613
Business Use Incentives for Large-Scale Development (BUILD)	8,306,413	10,976,914	6,591,948	8,212,533
Business Facility	2,883,729	5,682,965	4,867,041	4,572,711
Certified Capital Business[2]	495,459	586,135	411,014	590,235
Charcoal Producers[1]	14,642	521,380	59,595	0
Children in Crisis	420,857	587,137	629,456	792,368
Community Development Corporation[2]	5,915	22,703	224	231
Development	1,589,618	1,001,142	3,856,648	3,863,814
Developmental Disability Care Program	n/a	n/a	0	7,819
Disabled Access	12,526	26,273	24,791	14,603
Distressed Areas Land Assemblage	6,731,635	13,534,347	7,558,203	1,651,415
Domestic Violence	789,233	757,609	988,996	851,517
Dry Fire Hydrant[1]	2,634	7,715	3,124	0
Enhanced Enterprise Zone	2,916,392	4,000,689	7,324,093	6,451,698
Enterprise Zone	1,479,702	1,128,432	232,990	557,312
Examination Fees and Other Fees	5,227,134	4,974,981	4,926,191	5,886,105
Family Development Account	3,000	25,000	10,616	95
Family Farms Act	104,798	49,825	53,948	32,032
Film Production	1,925,158	1,563,218	4,839,217	56,665
Food Pantry	793,734	1,081,076	796,156	72,822
Health Care Access Fund	0	0	0	0
Historic Preservation	107,973,542	107,767,393	133,937,747	78,814,711
Homestead Preservation[1]	2,478,624	773,465	0	0
Life and Health Guarantee Association	0	3,260,829	3,306,409	5,664,124
Low Income Housing	142,141,458	143,055,387	164,208,547	144,082,976
Maternity Home	762,701	726,355	1,354,431	1,138,969
MDFB Bond Guarantee	0	0	0	0
MDFB Infrastructure Development	13,970,215	25,597,348	33,444,754	14,804,416
Missouri Automotive Manufacturing Jobs Act	n/a	0	0	0

Appendix C
Tax Credit Redemptions

Program	Year Ended June 30, 2010	2011	2012	2013
Missouri Health Insurance Pool	7,896,391	10,931,565	14,318,218	16,874,865
Missouri Property and Casualty Guarantee Association	592,308	(53)	0	0
Missouri Quality Jobs	14,238,179	27,936,799	35,431,828	39,278,156
Neighborhood Assistance	10,065,993	8,513,472	9,757,095	7,392,113
Neighborhood Preservation	6,739,123	4,427,639	2,159,654	1,232,214
New Enterprise Creation[2]	77,098	11,499	25,000	0
New Generation Cooperative Incentive	3,287,882	1,984,424	826,953	2,100,091
New Jobs Training	3,228,601	3,175,559	4,090,193	3,081,261
New Market	0	1,199,285	15,385,989	12,934,464
Pregnancy Resource	1,198,394	1,103,384	1,892,183	1,194,477
Property Tax	118,594,589	114,886,668	117,603,638	113,962,551
Public Safety Officer Surviving Spouse	11,910	16,861	32,793	78,249
Qualified Beef	0	9,447	219,062	522,858
Rebuilding Communities	1,553,894	1,277,135	1,388,190	1,430,329
Qualified Research Expense[1]	890,135	n/a	n/a	n/a
Residential Dwelling Accessibility	23,040	20,086	6,501	10,258
Residential Treatment Agency	47,599	323,376	283,501	292,396
Retain Jobs	8,145,996	5,758,163	2,403,687	1,960,931
Self-Employed Health Insurance	652,850	1,428,143	1,847,045	1,811,060
Shared Care	159,222	44,152	70,004	41,645
Small Business Incubator	219,014	107,549	166,336	68,441
Small Business Investment (Capital)[1]	0	1,701	(19,395)	0
Transportation Development[1]	9,176	52,124	9,342	12,510
Wine and Grape Production	112,057	29,411	61,598	15,301
Wood Energy	1,546,453	3,818,378	2,282,401	3,563,209
Youth Opportunities	4,405,158	3,589,991	4,979,138	3,906,263
Total	$ 521,458,689	545,145,614	629,311,552	512,911,236

n/a - Tax credit did not exist in this fiscal year.

[1] The tax credit has expired or has been repealed. Redemptions may be reported due to carry forward provisions.
[2] The tax credit program has met the cumulative program cap.

Source: Office of Administration, Department of Revenue, and tax credit administering agencies