Written Testimony Opposing S.B. 36

Tony DiBlasi, Chief of Asset Management
Ohio Capital Corporation for Housing
Senate Ways and Means Committee
April 2, 2019

Chairman Terhar, Vice-Chair Roegner, Ranking Member Williams and members of the Senate Ways and Means Committee, my name is Tony DiBlasi, and I serve as the Chief of Asset Management at Ohio Capital Corporation for Housing (OCCH), a not-for-profit organization based in Columbus whose mission is to cause the creation and rehabilitation of affordable housing. Over OCCH's 29-year history, we have been involved 740 affordable housing developments in 86 of Ohio's 88 counties, representing over 40,000 apartment units.

As a financial intermediary, OCCH raises monies from investors who have engaged in the federal affordable housing program known as the Low Income Housing Tax Credit (LIHTC) program – made possible by Ronald Reagan's Tax Reform Act of 1986. This program encourages private-sector investment in the production, oversight and delivery of affordable housing across the country, and moved the decision-making authority from the federal government in Washington DC to the states (and specifically in Ohio, to the Ohio Housing Finance Agency – OHFA - which administers the LIHTC program).

I am one of several persons here today providing testimony in opposition to S.B. 36. Following me, you will hear from developers and owners of affordable housing who will describe the negative impact S.B. 36 would have both on the financial performance of their portfolios, along with the negative ramifications for the residents being housed. You will hear from two attorneys: one involved in the Notestine Manor case that has been so prominently referenced in the previous hearings; and the other providing a historical overview of the various Ohio Supreme court cases that span nearly 40 years, providing context for this conversation.

<u>Overview of Affordable Housing Programs</u>

It is important to recognize that there are numerous 'flavors' of affordable housing, and that our nation's approach to the delivery of affordable housing over the decades has produced an 'alphabet soup' of programs. For your reference, I have provided the Committee with written remarks titled "About Affordable Housing" where I attempt to provide a high-level overview of the most prominent active affordable housing programs in-play across our state today. In doing so, I provide a high-level overview of the structure of the LIHTC program, and address some of the cost concerns referenced in previous hearings.

The varying programs (some providing direct rent subsidy to tenants, and some not) add to the complexity of the valuation question related to the varying types of affordable housing. But, as you will hear in subsequent testimony, the Ohio Supreme Court has done a very nice job clarifying how to account for the valuation of affordable housing, taking into account the various types of housing programs in existence today.

Rebuttal to Previous Testimony

I have also provided written testimony entitled "For the Record", where a number of misstatements or misrepresentations from the sponsor and those providing proponent testimony are challenged. Some of the key points that are rebutted include:

1. The *Notestine Manor* case **did not** change the valuation methodology, nor did it represent new law (as asserted in previous testimony)

2. The Ohio Supreme Court **did not** ask for this legislation, rather, Justice Dewine asked why this housing (having a charitable purpose) isn't exempt from taxation in the first place

3. The *Notestine Manor* case **did not** produce a cash windfall to its owners (as asserted in previous testimony)

I encourage you to study the "For the Record" document as a rebuttal these and several other points referenced in the previous testimony.

Ohio's LIHTC Portfolio, Pre 2009

You should know that prior to 2009, significant segments of Ohio's affordable housing portfolio were under tremendous financial stress, as the 'Use Restrictions' were not uniformly being considered by county Auditors. Only after the *Woda Ivy Glen* decision issued by the Ohio Supreme Court in 2009 did we finally realize relief with the valuation methodology, where the Court required that the 'Use Restrictions' be considered when determining the valuation of affordable housing. Two of the attorneys offering testimony after me (Karen Bauernschmidt and Mark Snider) were both involved in the original *Woda Ivy Glen* case, and can provide additional information about that important decision.

Here's the bottom line: Senate Bill 36 would be tremendously damaging to Ohio's affordable housing stock. It would result in real estate valuations that do not align with (nor be supported by) the rents that these projects are legally permitted to charge, resulting in tremendous financial stress and the eventual loss of the affordable housing stock, along with the significant economic loss to the underlying investors.

If there is a 'problem' at all today with the valuation of affordable housing in Ohio, it is that certain county Auditors appear to be philosophically opposed to affordable housing and elect to ignore Ohio Supreme Court decisions along with specific provisions of ORC 5713.03 which states that real estate should be valued "... as if unencumbered *but subject to any effects from the exercise of police powers or from other governmental actions*..." [Emphasis added] The language in ORC 5713.03 was amended in 2012 to deliberately reference "police powers and other governmental actions" to purposely *align with* and *reinforce* language found in the 2009 *Woda* decision.

As you will hear from the following opponent testimony, Senate Bill 36 would produce significant harm and should not be adopted. Thank you for your kind attention and for considering this testimony. I am available to answer any question you may have.

Respectfully Submitted,

FOR THE RECORD

Tony DiBlasi, Chief of Asset Management
Ohio Capital Corporation for Housing
Rebuttal to Sponsor and Proponent Testimony Related to Ohio S.B. 36
Senate Ways and Means Committee

FROM SPONSOR TESTIMONY
February 27, 2019

ASSERTION: The *Notestine Manor* case completely changed the valuation methodology and represents 'new law'

The facts are as follows: To the contrary, the *Notestine Manor* decision further clarified and aligned all of the previous case law and is fully consistent with ORC 5713.03. The *Notestine* ruling aligned with the full body of work of the Ohio Supreme Court dating back to 1980, and did not represent any 'new law' nor did it represent any change in the valuation methodology.

The facts of the *Notestine* case revolved around a very specific type of affordable housing (a HUD 202/PRAC) that was still under construction when it received its $811,120 valuation from the Logan County Auditor, despite the fact it was not yet even operational. The Auditor ignored the Use Restrictions that were associated with this affordable housing project, and incorrectly applied the 'cost approach' when determining its value, citing the value of the grant from the U.S. Department of Housing and Urban Development (HUD) to construct the property as the basis for the valuation (and ignoring the Restrictive Covenant). Once the property was built, the original HUD-established rents were only $407 per unit per month (and that rent payment included all utility charges). The *Notestine* decision addresses the scenario where the government-imposed rents are set BELOW market rate rents.

For a more complete summary of the case law related to the valuation of affordable housing in Ohio since 1980 please refer to the corresponding paper titled *"Notestine Manor and the History of Property Tax Valuations of Affordable Housing in Ohio".* One will note that with its most recent decisions, the Ohio Supreme Court remains fully aligned with its previous decisions while further clarifying preferred valuation methodologies (consistent with the Ohio Constitution and previous court precedent) as it relates to some of the different flavors of affordable housing.

To be clear, the *Notestine* decision was fully consistent with nearly 40 years of case law established by the Ohio Supreme Court, and did NOT represent any significant deviation from existing law.

ASSERTION: The Court asked the Legislature for new law

The facts are as follows: In its *Notestine Manor* ruling, Justice Dewine (in providing a dissenting opinion in the 5-2 ruling) noted that housing with a charitable purpose (as is the case with *Notestine*) could or should be *exempt* from taxation altogether. As such, if the court was seeking legislative action, it was to ELIMINATE the tax burden for certain types of affordable housing, NOT increase the valuations for all affordable housing as proposed with S.B. 36.

It is a misrepresentation to suggest that the dissenting Justice was asking for the language put forth in S.B. 36. To the contrary, we believe the Court was suggesting that affordable housing with a charitable purpose should be *exempt* – not imposed with a higher valuation.

ASSERTION: Low valuations (as supported in the *Notestine Manor* case) produce a new cash windfall for the property owners

The facts are as follows: Affordable housing projects are structured with the assumption that the valuation is based on its 'true value', consistent with the requirements of the Ohio Constitution. Since the 2009 Ohio Supreme Court ruling *Woda Ivy Glen v. Fayette County Board of Revision*, Ohio's affordable housing projects have been successful (often after engaging in the legal appeal process) in securing appropriate valuations that account for the government-imposed Restrictive Covenants that result in rents that are less than market rents.

S.B. 36 would result in values that far exceed the 'true value' of these assets, as it would require valuation based on rents that are not legally permissible. Adoption of S.B. 36 would result in the dramatic increase of real estate taxes across Ohio's portfolio of affordable housing properties.

It is noteworthy that affordable housing properties have high administrative costs (driven by the significant amount of paperwork required to ensure applicants meet eligibility requirements) and receive a suppressed level of revenue (as the Restrictive Covenants limit the rent that can be charged as a condition of the requirements of the federal program(s)). As such, these projects operate with very narrow margins. An inappropriate valuation results in a corresponding tax burden that cannot be paid with the limited cash proceeds from operations, placing the banks who hold the mortgages at great risk of financial loss. With the adoption of S.B. 36, banks and lenders will realize significant financial losses for the existing affordable housing stock, and put at risk any future affordable housing developments as they would be economically unfeasible.

ASSERTION: Developers of affordable housing get 'FREE MONEY' that is wasteful

The facts are as follows: It is true that developers of affordable housing receive either grants, low-interest loans or tax credits to allow for the affordable housing to be constructed. The reality is that WITHOUT some form of financial support, these projects would not be financially

feasible and could never be constructed. How possibly could a developer build a financially viable housing project with a tax valuation that assumes market rents in the instance where they are unable to receive a full market rent? How would the developer be able to cover the expense of their mortgage? In short, they would be unable to do so.

The grants or tax credits developers receive allow for decent, safe and sanitary housing to be constructed with only a modest mortgage on the property (commensurate with the low rents that are collected). If not for the grants or tax credits, the mortgage would be too large, and the corresponding rents (to support the mortgage) would not be affordable. As such, the grants or tax credits that allow these properties to be constructed are a critical component of the affordable housing program. Without the grants or tax credits, affordable housing would not be financially viable and could not exist.

FROM PROPONENT TESTIMONY
March 5, 2019

ASSERTION: The valuation of Notestine Manor should have been established based on the construction costs.

The facts are as follows: Despite ORC 5713.03 and long-standing case law that required the county Auditor to consider the Use Restrictions associated with this affordable housing project, the Auditor inappropriately elected to establish valuation based on the cost-approach, which the courts appropriately rejected. The Auditor ignored his duty to apply the appropriate valuation method in performing his work, which the courts correctly reversed.

ASSERTION: "Widows trying to make it on Social Security...pay more" in taxes is the result of the lower valuation of affordable housing projects.

The facts are as follows: It is true that the local school board receives exactly the same amount of revenue as approved by the taxpayers as result of the 'equalization process.' Meaning, a valuation that considers the Use Restrictions (resulting in a lower valuation) does not reduce the monies received by the local school board, rather, taxpayers in the same class pay slightly more through the equalization process. To be clear, however, multifamily affordable housing is categorized as Class 2 Commercial and as such, any adjustments to other taxpayers are not 'widows' (being Class 1 Residential), but rather commercial establishments.

In the case of Notestine, there was in fact a $55,735.85 refund due back to the owner that did impair the school board, as the window to 'equalize' taxes had long past. If the Auditor, however, had applied the appropriate valuation methodology at the onset (i.e., used the income approach) versus inappropriately using the cost approach method, the school board would *not* have been harmed and would not have realized a loss. This underscores the importance of the Auditor to appropriately set valuations up-front for this asset class, consistent with ORC 5713.03 and long-standing case law.

ASSERTION: Everything was fine until 2009 (i.e., the *Woda* decision) and we should return to pre-2009 valuation methods

The facts are as follows: Prior to 2009, Ohio's affordable housing portfolio was in a state of crisis as a significant percentage of affordable housing projects were under severe financial stress as result of unstainable valuations. Abandoning the 'income approach' methodology for affordable housing (as proposed by S.B. 36) would have a tremendously negative impact on Ohio's affordable housing portfolio, resulting in the loss of much-needed affordable units and financial loss to the lenders.

During Kelly Gorry's proponent testimony on March 5, 2019, she noted that the proposed legislation "...reinstates the historical valuation methodology that existed prior to 2009." And in fact, it would. And to be abundantly clear, ***Ohio's affordable housing portfolio was in a state of crisis prior to 2009***, as the real estate valuations prior to 2009 failed to account for the deed restrictions that placed limits on the income these properties could generate, and they were valued as if they had no such rent limitations. The result? Much of Ohio's LIHTC portfolio was operating below break-even operation, thereby producing severe financial stress across the portfolio, putting the real estate at risk of foreclosure and placing investors' dollars at risk.

Only after the *Woda Ivy Glen* ruling issued by the Ohio Supreme Court in 2009 did we finally realize relief with the valuation methodology, where the Court required that the 'Use Restrictions' be considered when determining the valuation of affordable housing.

Prior to the *Woda Ivy Glen* decision (and in response to the valuation crisis facing the affordable housing industry), affordable housing practitioners mobilized and were working tirelessly to combat the issue of inappropriate tax valuations. Prior to 2009, affordable housing practitioners were working with (then) Governor Taft and thereafter, Governor Strickland to seek support for legislation to require that Use Restrictions be considered when valuing affordable housing projects. But, once the Ohio Supreme Court ruled that Use Restrictions must be considered as the key holding in its *Woda* decision, those legislative efforts were set aside, as the affordable housing industry had found relief from these crushing tax valuations. It should be noted that even back in 2009, the majority of states across the country had already resolved this issue (either by legislation or the judicial process) where the deed restrictions were required to be taken into account in the valuation of affordable housing.

ASSERTION: "This legislation will not create an excessive valuation for subsidized housing."

The facts are as follows: This proposed legislation would have a devastating impact on all flavors of affordable housing in Ohio. Proponents are purposefully attempting to confuse the question by honing-in on a small segment of affordable housing that also includes a direct tenant subsidy component. Hence, their reference to 'subsidized housing' in the proponent testimony. The majority of affordable housing projects developed in Ohio over the past 15 years do *not* have any project-based subsidy where the tenant rents are being subsidized. For example, in a typical affordable housing project developed utilizing the Low Income Housing Tax Credit (LIHTC), the tenant does not receive any form of direct subsidy, but the rents they are charged are affordable (meaning, below a typical rent that would be charged at a market rate project). The proponents of S.B. 36 completely ignored these facts in their testimony.

About Affordable Housing

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Ohio Capital Corporation for Housing
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April 2, 2019

About Ohio Capital Corporation for Housing (OCCH)

Later this year, OCCH will celebrate its 30-year anniversary. Over that 30-year period, OCCH has raised $4.25B from investors who have engaged in the federal affordable housing program known as the Low Income Housing Tax Credit (LIHTC) program – made possible by Ronald Reagan's Tax Reform Act of 1986. This program encourages private-sector investment in the production, oversight and delivery of affordable housing across the country, and moved the decision-making authority from the federal government in Washington DC to the states (and specifically in Ohio, to the Ohio Housing Finance Agency which administers the LIHTC program).

Who are the underlying investors in the LIHTC program in Ohio? Investors OCCH has worked with include national banks, such as J.P. Morgan Chase and U.S. Bank; regional banks such as Fifth Third, Huntington and Key Bank; along with countless community banks, including Park National Bank, WesBanco Bank, Peoples Bancorp, Civista Bank, LCNB Bank, RiverHills Bank and many, many others.

In my role as the Chief of Asset Management at OCCH I am responsible for providing oversight for the 40,000 units of affordable housing across the 86 Ohio counties where we monitor investments. I have been fighting the real estate tax valuation battle for the entirety of my 16 year tenure at OCCH, as tax valuations *prior* to the landmark 2009 Ohio Supreme Court ruling known as the *Woda Ivy Glen* case were exceedingly high and were not sustainable. Regrettably, tax valuations *after* the 2009 court ruling have not consistently taken into account the legally required Use Restrictions across our portfolio, despite the courts clear instruction to do so.

Overview of the various types legacy affordable housing types in Ohio

Affordable housing is a complicated topic, as it is an 'alphabet soup' of programs offered by a number of federal agencies and programs, each with their own rules and characteristics. The following is a brief list of the major 'legacy' affordable housing programs found across Ohio.

Most are familiar with **Public Housing**, as it has been in existence since the 1930s where the U.S. Department of Housing and Urban Development (HUD) provides resources directly to local housing authorities to administer affordable housing.

HUD is involved in a number of other programs as well, including the **Project-Based Section 8** program. Project-based Section 8 properties were once a prominent source of affordable housing production, where the government would offer a loan to construct this housing and in turn, offer rent subsidies to the low-income residents in the form of a long term Housing Assistance Payment (or HAP).

The **HUD 202** program is another flavor of a HUD program, creating housing for those over the age of 62 and/or the disabled while providing rental assistance to the extremely low-income residents. While the 202 program has been in existence since 1959, it has been through numerous iterations over the years.

HUD properties built after 1993 were built with a 'new' version of the 202 program called **202/PRAC** (Project Rental Assistance Contract). I make note of the 202/PRAC program as the Notestine Manor property (which was referenced by the Sponsor and during proponent testimony) is actually a HUD 202/PRAC. You will hear other testimony later today that will clarify the facts surrounding the *Notestine Manor* case.

The U.S. Department of Agriculture (USDA) administers a number of affordable housing programs through **Rural Housing Services** (RHS), offering low interest loans, grants and sometimes direct tenant subsidy called Rental Assistance (RA). Several of the RHS programs are comparable to the HUD Section 8 program, but designed for rural areas and governed by a different set of regulations.

The Low Income Housing Tax Credit (LIHTC)

For the past 30 years, the **Low Income Housing Tax Credit** (LIHTC) program has been THE primary driver of affordable housing production as it is the clear and preferred vehicle for affordable housing production today. It has been successful because (unlike the previous iterations of affordable housing production, listed above) the decision-making process has been moved to the state, and private-sector discipline (where professional operators are fully engaged) bring industry best practices and intense levels of oversight.

It is noteworthy that at most LIHTC properties, there is NO direct tenant subsidy rather, the rents are required (through recorded Deed Restrictions) to be affordable to those with modest incomes, and paid for by those residents earning modest wages. Today, however, it is common to see the LIHTC program layered on top of aging HUD, Public Housing and USDA properties, as the LIHTC program is one of the only vehicles available today to revitalize and recapitalize our aging affordable housing stock.

The Structure of a LIHTC Deal

Professional real estate developers (be they for-profit or not-for-profit), engage in a highly competitive application process managed by the Ohio Housing Finance Agency in an effort to secure an allocation of LIHTC. In a typical year, only 1 in 3 applications are funded.

Once an applicant secures an allocation of LIHTC, they 'sell' the LIHTC to an underlying investor in exchange for cash. The cash is used to cover approximately 70% of the project's construction costs and in turn, (assuming the project remains in full regulatory compliance for a 15-year period), the investor is able to reduce their federal income tax liability. In return, the project agrees to a 30 year period where the rent levels are reduced and the housing is made available only to those with modest incomes (memorialized in the 30-year Restrictive Covenant).

This innovative program has many benefits:

- The states are able to establish local priorities and determine how to allocate the LIHTC as they deem most appropriate (versus the federal government doing so)
- The program encourages involvement from the private sector (investors, syndicators, developers) yielding far more professionalism and depth of oversight compared to previous federal programs
- Risks are incurred by Investors and developer/owners -- If an owner or developer fails to perform, the underlying investor incurs severe tax penalties, thereby producing a system where all parties are held to a high standard and are subject to intense monitoring
- Encourages private-public partnerships

The Economic Incentive for Developers
In the traditional real estate market, a market-rate developer earns fees through cash distributions derived from rental income, or realizing gains from the sale of the development. A typical real-estate owner in the multifamily, market rate world will hold an asset for 3 to 7 years before executing a transaction to sell the asset or 'cash out'.

The incentive structure for developers of affordable housing, however, is much different. As result of the high administrative burden to third party verify all income and assets for every applicant and resident (to comply with the federally mandated regulatory requirements) the administrative burden is very high, resulting in operating costs that are more onerous than a market-rate development. Additionally, the rents are (by design) below market (as required by the Restrictive Covenant). Low rents and significant administrative burdens result in a LIHTC property having very narrow operating margins (that oftentimes perform at or below break-even operations). As result, 'cash flow' is never the incentive for an owner of affordable housing.

Additionally, "cashing out" or a sale of the real estate is also not possible, as the tax benefits associated with the LIHTC program require a 15 year hold period, with an additional 15 year "extended use period" mandated by the state. As such, a developer of affordable housing is not compensated (or motivated) by the potential sale of the asset. And even if they *were* able to sell, the value would be suppressed as result of the inability to generate market-rate rents (as result of the Restrictive Covenant that keeps the rents affordable).

Recognizing that the typical 'profit motives' do not exist for LIHTC housing developments, it was necessary to establish an allowable 'developer fee' as a way of incentivizing developers to engage in this program. In its September 2018 report providing an analysis of the LIHTC program, the United States Government Accountability Office noted:

> *"LIHTC projects may be less attractive financially for developers than market-rate projects because they yield lower profits from rental income. Accordingly, allocating agencies allow a developer fee, for which tax credit equity generally pays. For the projects in our sample, developer fees represented about 11 percent of development*

costs at the median. In comparison, market-rate developers are generally compensated through rental income or from the sale of their developments."[1]

While developers of LIHTC affordable housing projects are able to earn a developer fee as compensation for their efforts, they also share risks with the investors. If a property falls out of regulatory compliance resulting in financial penalties to the underlying investor, the Partnership Agreements associated with a LIHTC property typically requires the developer to also share in the financial losses by repaying the investor for a portion of the tax penalties. As such, the developer fee typically earned by the developer may be 'at risk' of recapture for a considerable period of time, should the developer/owner fail to maintain regulatory compliance.

Use Restrictions Must Be Considered

While there is a complicated mix of affordable housing programs in existence across the state, on some level, the question of real estate tax valuation of affordable housing is a very simple matter. If engaged in a federal affordable housing program where the rents are suppressed as result of a federally required deed restriction, those restricted rents should be considered when determining the value of the real estate.

ORC 5713.03 and well-established case law from the Ohio Supreme Court have already taken these matters into account.

[1] United States Government Accountability Office, *Low-Income Housing Tax Credit*, GAO-18-637, page 19 (Washington, D.C.: September 18, 2018)