To:	Byron Smith, City Manager Mark Morgan, Assistant City Manager
From:	Clinton Spencer, City Planner
Subject:	Potential Housing Tax Incentives Available
Date:	September 1, 2019

HERMISTON OREGON

Planning Department

Summary

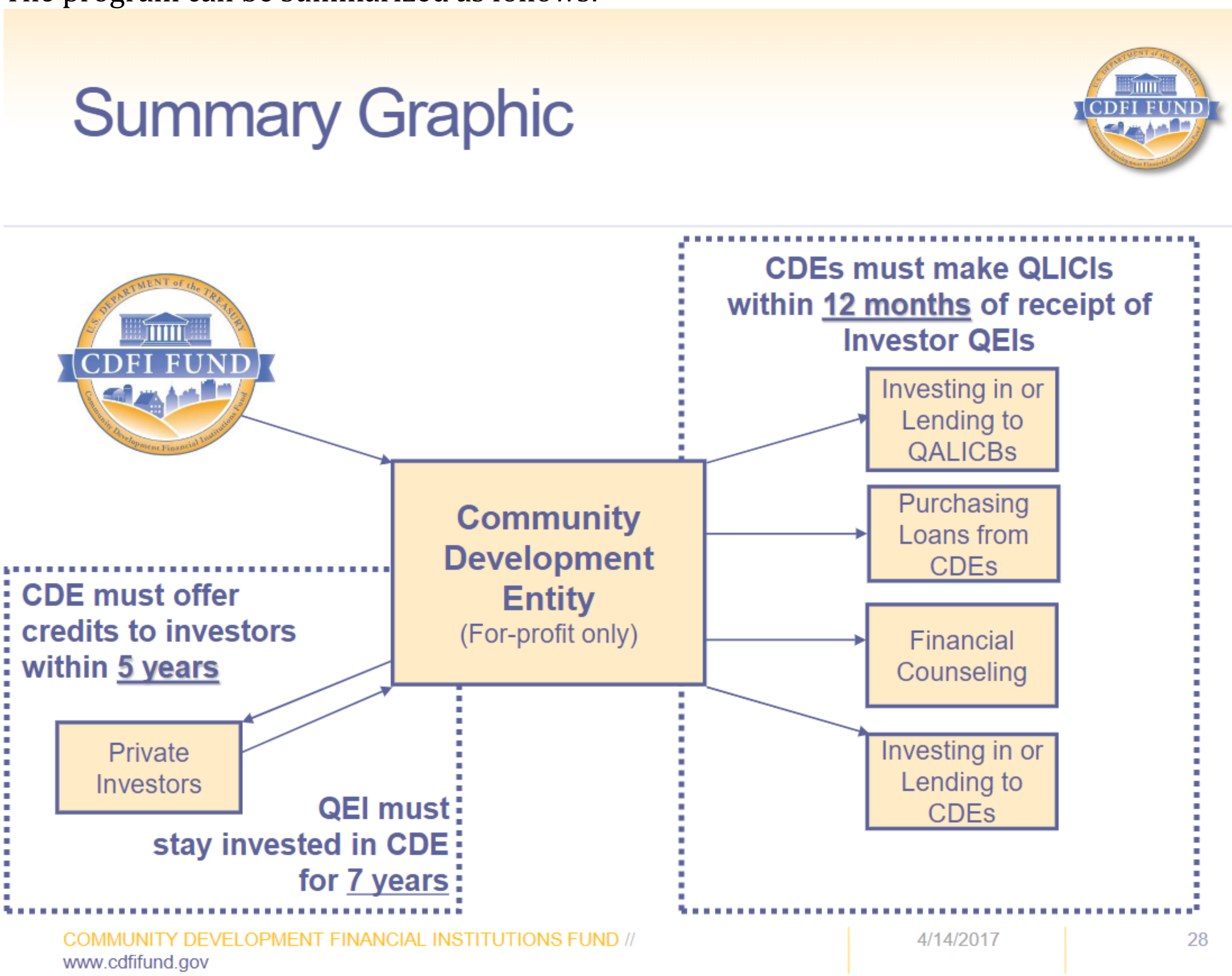
There are federal and state programs aimed at encouraging housing through targeted tax credits. Typically, these programs are designed to encourage investment in economically disadvantaged areas. The New Market Tax Credit is intended to encourage investment through lending money by nonprofit entities. The Opportunity Zone Credit encourages investment by allowing investors to defer capital gains taxes. The Multi-Family Tax Exemption for Transit Oriented Development allows cities to designate specific areas along transit routes for affordable housing and developers choosing to tax advantage can defer property taxes for several years. The Vertical Housing Development Zone also allows property tax exemption when multi-story affordable housing units are constructed. Cities may also choose to defer property taxes upon annexation under certain circumstances, which may be an incentive to speculative annexation of bare land, or elimination of county islands. Ultimately, the programs and incentives available are exclusively (with the exception of annexation property tax deferral) for the promotion and construction of affordable housing within economically challenged areas. These incentives are not for the construction of market rate housing at any location within the city.

New Market Tax Credit (NMTC)

This is a federal program which has been in place since 2000 and has been authorized through the end of 2019. It is based upon income level per census tract. Most of the city is located within census tracts which qualify. It provides a credit for investors against federal income taxes. The city is not the distributor of funds in the NMTC program. A domestic corporation or partnership would be certified as a community development entity and acts as the distributor of funds, such as business loans or housing loans. Investors receive a tax credit of 5% of the original investment each year for three years and 6% for an additional four years. Housing is not the primary focus of the NMTC, rather it is intended to encourage overall investment, primarily in the employment sector, through creation of new commercial opportunities. However, mixed use investments, housing rehabilitation, and new development in a low-income community are all qualifying projects. It is important to note that buildings that derive 80% of gross rental income from renting dwelling units are not eligible for the NMTC. Hermiston's tight rental market makes this the most likely investment to utilize this program and it is specifically excluded from the program. This is not a program the city specifically can take advantage of. However, the city's partners such as Horizon can apply to become lenders.

This is a program that has been nibbled at several times over the years by developers. In fact, NMTC was considered as an option for EOTEC funding early in the process. After researching the necessary steps to take advantage of the program interest has always waned. The city's development market has changed in recent years, specifically prices and rents are higher, it may be an option to consider and revisit.

The program can be summarized as follows:



Source: cdfifund.gov

A good overview of the NMTC program can also be found here:
https://www.cdfifund.gov/Documents/2017%20Introduction%20to%20NMTC%20Program%20Presentation%20For%20Release.pdf

Opportunity Zone Credit

The Opportunity Zone is also a federal tax credit program based upon census tracts. It differs from the NMTC in several key areas. Primarily, it is for the deferral of capital gains taxes. Hermiston has one census tract qualifying as an opportunity zone. This tract is located west of Highway 395, north of Orchard, and south of Punkin Center. The tax credit can be applied to commercial, industrial, housing, and infrastructure development. It is intended to encourage development in low-income areas which is why only the western portion of the city is eligible. It can apply to raw land development and it can also apply to ownership changes. For example, if a building has been vacant for five years, it can be reused by the new qualified owner without having to meet any "substantial improvement" requirements.

The opportunity zone provides an excellent opportunity for multi-family and mixed-use development in the western half of the city. The area around the hospital at the intersection of NW 11th St and W Elm Ave provides several parcels which are likely to qualify for Opportunity Zone benefit. In particular, the Sterling Ridge Apartments may be able to find qualified investors wishing to defer capital gains taxes and move forward with their final phase.

Parcels which are eligible for opportunity zone development

Source: Hermiston GIS

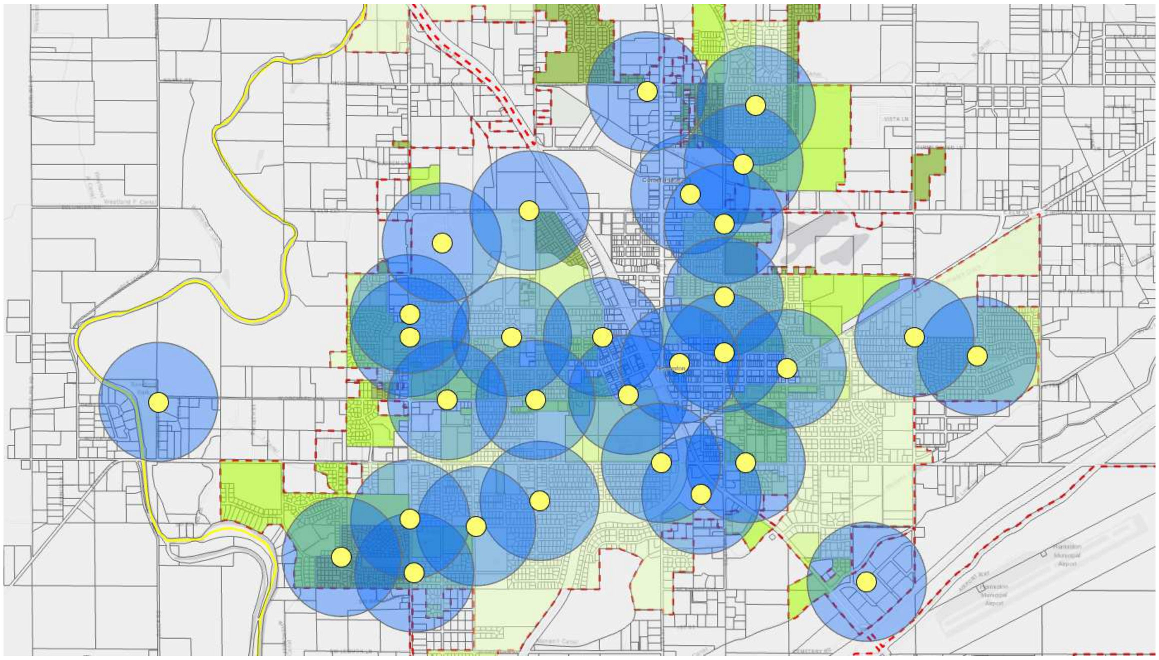
Multi-Family Tax Exemption for Transit Oriented Development

In Oregon it is possible to provide property tax exemptions to owners of multi-family housing in transit-oriented corridors. These corridors are specifically classified in ORS 307.600. Transit oriented development is best defined as new, low-income residential construction located within one half-mile of a light-rail station (not eligible in Hermiston) or within one quarter-mile of a fixed route transit service (the Hermiston HART is eligible for this designation). In order to take advantage of this program, the city must designate specific areas as eligible through a public hearings process and pass an ordinance establishing the area. In essence, this process would be very similar to that used for forming an urban renewal district. The city council would need to declare an area and set development standards (if desired).

When considering development standards, this language is in the code due to the very specific type of development this exemption is intended to encourage. Specifically, where it has been implemented in the Portland area, the city has established maximum rather than minimum parking standards to discourage occupancy by tenants with vehicles and to encourage tenants to use mass-transit only. The city can also use the standards to establish a minimum number of dwellings to be constructed in order to qualify. This exemption is for multi-family development only. However, condos or attached dwellings intended to be sold may still qualify provided that the units are intended to sell at a price which meets affordable housing standards, essentially selling at the median sales price for the city.

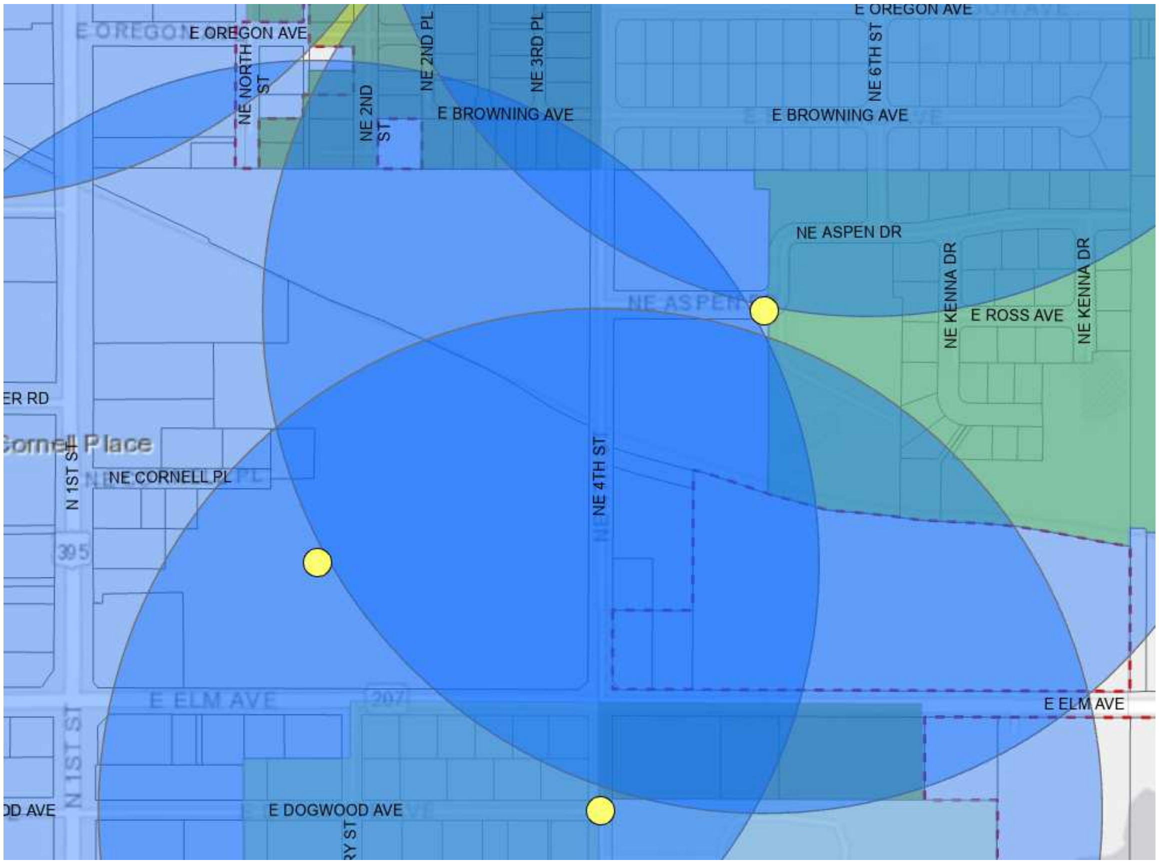
The tax exemption may be granted for up to 10 years. The exemption may apply to the building and its owner in the event of a multi-family rental, or to each subsequent buyer in the event of the sales of single-unit housing in a larger building.

This is an intriguing possibility for Hermiston. There is considerable residential land within a quarter-mile of a bus stop, as shown by the blue rings on the map below.



Transit stops and a ¼ mile radius
Source: Hermiston GIS

It may be worth doing a targeted parcel inventory to determine if/where parcels which are of sufficient size, vacant, and properly zoned exist. The vacant land at the intersection of NE Aspen Drive and NE 4th Street is an example of two parcels which have not developed. However, changing the zoning of those parcels from Commercial to Multi-Family and applying the tax exemption credit could spur multi-family affordable housing at a point serviced by transit services.



Source: Hermiston GIS

<u>Vertical Housing Development Zone (VHDZ)</u>
The VHDZ is functionally similar to the transit-oriented tax exemption, but requires different items to be included. The development must include at least one multi-story building and a portion of the project must be used for non-residential purposes. Additionally, the amount of tax exemption increases as the number of residential floors increases. There is a calculation method required to determine what are termed "equalized floors" based on the area devoted to residential property versus the total area of the project. One equalized floor equates to a 20% property tax exemption, two equalized floors equates to a 40% exemption, three equalized floors equates to a 60% exemption, and five or more floors equates to the maximum 80% exemption.

A city can designate certain properties as a vertical housing zone through a public hearing and ordinance process, similar to the transit-oriented development process. A taxing district may elect not to participate in the zone, in which case that district will continue to levy their usual property tax rate.

Once a VHDZ is in effect, private development may occur and propose to take advantage of the tax exemption. Each phase of the development requires a separate application to the city to utilize the exemption. The development must be monitored and recertified each year and the city may decertify a project if the use of the site falls outside eligibility criteria (such as no longer being used for affordable housing). A total of ten years of exemption are possible. The city may terminate the zone at any time, but properties receiving the benefit within the zone continue to receive the benefit as long as eligibility standards are met.

It is a challenge to think of a property which might benefit from this type of designation. The requirement for non-residential use and multi-story development creates opportunities and challenges. A site which is in the densest, most highly trafficked area of town would be a necessity for the commercial portion to be viable. The necessity for the residential portion to be reserved for affordable units only (not a percentage as in the transit-oriented credit) makes it difficult to attract residential developers. It may be worth some additional consideration, but absent a credible development proposal needing an additional incentive, this is probably not a program which will work for the city in the near term.

Annexation Tax Deferral

ORS 222.111 establishes that a city may provide a tax rate less than the highest tax rate levied upon newly annexed territory for up to ten years. The rate of taxation may increase on a per-year basis each year until the ten-year threshold is met. The city is responsible for preparing the appropriate documents for filing with the assessor's office and notifying the assessor of the rate difference.

This type of slow increase to the city tax rate is attractive to speculative development. There may be interest in using this as a selling point to lands within the UGB which are near the city limits but not annexed. Getting the land annexed may spur interest in development. At a minimum it would assist the city in identifying parcels with owners interested in development.

DLCD Programs

There are no specific programs currently available through DLCD at the state level. There is a pilot program for affordable housing which started in 2018. It was intended to help two communities expand their UGB for housing land. The idea underlying the project is to create a simplified UGB expansion process which could be analyzed and considered as a statewide model. Since Hermiston's UGB is very large, we elected not to apply for this program, but we were represented on the steering committee that created the pilot program.

DLCD offers grants for code assistance targeted at housing code updates. Right now, there is a focus on grant funds available for "space efficient" housing. This type of housing is the cottage cluster, ADU, corner duplex, and multiple units in one dwelling type of development which is heavily favored in the Portland-Metro area. A lot of this type of dwelling is now required to be permitted by HB 2001. It is likely additional code work will be needed in the near future to implement this type of housing.

HB 2003

The 2019 legislative session saw the adoption of HB 2003 which will be a new housing planning mandate for Hermiston. Each eight years the city will be required to adopt a housing production strategy. This will consist of a comprehensive update to the city's housing needs analysis. It will need to consider the available residential land and the likelihood that the land will develop in a manner consistent with the goals of the comprehensive plan. For example, if the majority of the land is likely to develop as detached, single-family housing and the city's plan calls for more attached multi-family, then the city will need to take measures to insure the proper mix of housing types develops. This is likely to result in major amendments to the housing code. For example, the R-3 and R-4 code may need adjusting to eliminate single-family housing as a permitted use if it is determined that the city is over-built on single-family units. The state does offer technical assistance grant funds for this type of work, especially when mandated by legislative action.

Statewide Housing Plan

The Oregon Department of Housing and Community Services is in the process of completing a statewide housing plan. Staff participated in workshops on the preparation of the plan in 2017. The final plan is almost ready. There are two areas that are of particular interest to the city. The first is OCHS' commitment to provide additional funding to provision of housing in rural communities. The goal is to increase housing funds provided to rural communities by 75%. The second is OCHS' plan to increase affordable rental units by 25,000 statewide. These programs need to be monitored as they develop to determine if the city is in a position to take advantage of these programs or actively recruit new housing development provided by OCHS.

Conclusion

In general, tax credits, low interest loans, etc. are intended to accomplish two things, stimulate investment in low income neighborhoods and increase the supply of affordable or low-income housing. Loans and tax credits for market rate housing are not generally available.