Recommendations to the Executive Office of Housing and Livable Communities on the Housing Development Incentive Program (HDIP)

Contact: André Leroux, aleroux@massinc.org or 617-251-3861

Background

The Healey-Driscoll Administration, like the Baker-Polito Administration before it, has proposed expanding the Housing Development Incentive Program (HDIP) state tax credit from its current cap of $10 million per year to a permanent cap of $30 million per year. The Legislature is also on record with numerous supportive votes. In 2020 and 2022, both the House Ways and Means Committee and the Senate Ways and Means Committee included this proposal in their respective economic development bills that passed their chambers and proceeded to conference committee. Gateway City mayors, managers, and economic development leaders strongly support expanding HDIP and have made it one of their top policy priorities.

HDIP's flexibility has proven to be one of its greatest strengths, helping projects overcome a range of development barriers across 26 different Gateway City real estate markets. The demand for HDIP funding far exceeds available credits because construction and financing costs have risen even faster than rents over the last few years and private financing for housing remains difficult in many of our cities. In fact, Gateway Cities produced only half as many homes in the decade of the 2010s compared to the 2000s. This creates a strong case for scaling up the HDIP program. The current funding pipeline extends up to five years and could become a ten-year backlog if a sunset provision goes into effect on January 1, 2024.

Summary

MassINC's Gateway Cities Innovation Institute believes that HDIP's transparency and administration could and should be improved when it becomes a more significant housing production program. The Executive Office of Housing and Livable Communities already has the authority to review HDIP project underwriting and ensure that each development contributes to a healthy mix of incomes in the surrounding community. That means the agency can endorse 100% market-rate projects in places that lack such units, while encouraging income restrictions in stronger markets where they can be supported. The agency has no obligation to allocate state tax credits to any project.

However, MassINC cannot recommend implementing a "one-size-fits-all" affordability standard. Gateway Cities already contend with many costly regulatory requirements and construction challenges related to building code, historic preservation, parking, aging infrastructure, zoning and more. Imposing income restrictions can be especially burdensome for small and mid-sized developers, including many woman- and minority-owned businesses, that lack the dedicated staff and deep pockets necessary to manage a portfolio of subsidized units.

HDIP provides an average of $23K in state tax credits per unit, which falls far short of paying for income restricted units that may require $400K or more per unit in subsidy. That explains why requiring income restrictions at any level fundamentally changes each project's economics and would force nearly all HDIP applicants to seek additional public funding from the Low-Income Housing Tax Credit or other state sources. This would delay construction further and increase competition for limited affordable housing funds.

Furthermore, such a policy change would shift funds away from our most challenged cities and make infill projects, smaller projects, and Main Street redevelopments less feasible. Perversely, this would result in less geographic equity and greater concentration of poverty in places like Fall River, Fitchburg, and Springfield.

In this scenario, MassINC projects that rather than building 12,000 homes over the next ten years, HDIP would produce less than 1,000 net new units, with fewer projects located in our most challenged cities.

Cities ranging from Chelsea to New Bedford have already seen their housing production plummet in recent years, and housing construction across Gateway Cities remains well below the historical levels of the 1970s and 1980s. This lack of production, combined with the relocation of displaced residents from the Boston area, has intensified competition with existing Gateway City residents for available homes. It is this dynamic which has caused the price spikes in Gateway Cities, not HDIP or new construction in general.

In conclusion, MassINC recommends that expanding HDIP under its current rules, coupled with better EOH oversight, will best address overall housing affordability by creating dense urban infill that supplements and relieves pressure on existing neighborhood homes. Creating a wider variety of housing choices will help small cities attract jobs, support local businesses, and retain families at a wider range of income levels.

<u>RECOMMENDATIONS FOR ADMINISTERING HDIP TO PROMOTE MIXED-INCOME COMMUNITIES</u>

1. **<u>Require projects applying for state HDIP tax credits to submit a statement of need.</u>** Defined as follows: "Statement of need", a description of the census tract, housing development district, and city at large, prepared by municipal staff or independent consultant, paid for by the project proponent, and certified by the chief executive of the municipality, which includes information about demographics, diversity of housing stock, number and percentage of income-restricted units, estimated vacancy rates and number of units available, and current fair market rents or sales prices. The project proponent must submit an accompanying letter stating how the proposed project will contribute to increased residential growth, expanded diversity of housing supply, neighborhood stabilization, and economic development within the housing development zone.

2. **<u>Assess regional market conditions.</u>** EOH should evaluate the evolving housing market conditions in each Gateway City annually and characterize them as "strong," "emerging," or "segregated." "Strong" Gateways have overheated housing markets and could maximize project affordability or forgo state tax credits altogether; "emerging" markets show signs of independent private housing investment and should apply HDIP funds to offset special costs such as inclusionary zoning or historic preservation; and "segregated" cities are those places where the private housing market functions poorly and contains high levels of economic segregation. Despite these categories, EOH should retain discretionary flexibility to account for special circumstances and should ensure that all Gateway Cities are being served appropriately by the program.

3. **<u>Set aside one-third of HDIP tax credits for small and medium projects, as well as for developers who build equity in the community.</u>** Removing from the equation the 10 largest projects (out of 97) that have been funded, the average HDIP project size is 33 units. This is a sweet spot. Gateway City

downtowns are full of mid-sized, underutilized buildings or vacant lots and these types of properties should be targets for redevelopment with HDIP. Larger properties, such as mill buildings, are more likely to be redeveloped by a large developer with additional forms of subsidy. HDIP could and should support home-grown developers, which contributes to retaining and diversifying local wealth. These could be property owners who want to give back to their community and improve their buildings, as well as women and minority-owned businesses who help diversify construction investment. These types of developers may be more inexperienced and require greater support, patience, and flexibility from EOH through the development process.

4. **Undertake a project-by-project evaluation, including looking at the project's underwriting, to determine the merits of awarding state HDIP tax credits.** While it is unlikely that any project proponent would invest the time and staff resources required to apply for HDIP's modest tax credits without truly needing them, the agency still has the obligation to safeguard the public interest and direct funding to worthy projects. Agency staff has the expertise to conduct this review and ascertain that a tax credit allocation is reasonable to avoid abuse of the program.

5. **Comply with statutory requirements for program reporting, transparency, and enforcement.** With the most acute demands of the pandemic behind us, the agency has no reason not to track and make publicly available the information that it already collects while administering the HDIP program. Public records requests by nonprofits should not be required to obtain basic information. The Legislature, with the support of MassINC and the Mass Law Reform Institute, included the following provisions in the *Partnerships for Growth Act* passed on January 5, 2021.

> Annually, on or before the first Wednesday in December, the department shall file a report detailing its findings of the review of all certified housing development projects that it evaluated in the prior fiscal year to the commissioner of revenue, to the joint committee on revenue and the joint committee on housing and community development. The report shall include, but not be limited to: (i) a list of municipalities with approved HD zones; (ii) a list of housing development projects that have received certification; (iii) information about each housing development project, including the site address, project sponsor, range of rents of the residential units, type of residential units, number of each type of residential unit, number of affordable rental units for persons whose income is not more than 60 per cent of the area median income and the number of affordable owner-occupied units for persons whose income is not more than 80 per cent of the area median income; and (iv) the total amount of qualified project expenditures for which a tax credit was issued or reserved pursuant to section 5 for each housing development project, the year the credit was issued and the completion or estimated completion year of the housing development project."

The following enforcement language was also included in the *Partnerships for Growth Act*:

> (e) The department shall review each pending project proposal and completed certified housing development project not less than once every 2 years. The certification of a project may be revoked by the department if: (i)(A) the municipality that approved the project proposal files a petition that satisfies the authorization requirements for a municipal application or the petition of the director of the department; and (B) the department determines, after an independent investigation, that representations made by the sponsors in its project proposal are materially different from the conduct of the sponsors subsequent to the certification and such difference is found to frustrate the public purposes that the certification was intended to advance; or (ii) the project no longer meets the criteria in this

section. Upon revocation, the commonwealth and the municipality may bring a cause of action against the sponsors for the value of any economic benefit received by the sponsors prior to or subsequent to such revocation.

Under this section, revocation shall take effect on the first day of the tax year in which the department determines that a material variance commenced. The commissioner of revenue may, as of the effective date of the revocation, disallow any credits, exemptions or other tax benefits allowed by the original certification under this section. The commissioner shall issue regulations to recapture the value of any credits, exemptions or other tax benefits allowed by the certification under this section.

6. **<u>Return to accepting project applications on a rolling basis. Do not limit communities to one funded project per year.</u>** We understand why EOH implemented these procedures given the long backlog of projects and limited agency resources, but they have caused difficulties for communities. With a larger program, we believe that they could return to a rolling basis. Each HDIP project should be evaluated on its own merit on a first-come, first-serve basis. Gateway City housing development opportunities must be seized promptly to minimize overhead costs. Communities should not be punished for successfully teeing up multiple HDIP housing projects; they should be rewarded for their initiative.

7. **<u>Consolidate oversight and increase staff dedicated to the program.</u>** Currently, out of necessity, multiple DHCD staff members spend a small portion of their time managing elements of HDIP. Even if this continues to be the case—a variety of expertise may be needed to review the housing development districts, local TIE agreements, and administer the tax credits—there should be a single program coordinator to manage the program components effectively and report to the Legislature and the public.

8. **<u>Process "TIE-only" projects efficiently and remove them from the tax credit pipeline.</u>** With the current years-long wait for HDIP tax credits, an increasing number of projects are working with their municipalities to proceed with local property tax exemptions only. This usually requires a greater contribution from the municipality to make the project work, but the tradeoff results in greater speed and simplicity. Since this involves no cost to the state, EOH should not clutter the tax credit pipeline but process them in an expedited fashion. Our reading of the statute is that TIE agreements must be evaluated within 90 days or they will be automatically approved. See clause (iii) of subsection (b) of Chapter 40V: "*The department shall evaluate and either grant or deny any project proposal not later than 90 days from the date of its receipt of a complete project proposal and failure to do so by the department shall result in approval of such project for a term of 20 years*." DHCD should document and report on these TIE-only projects along with the state tax credit projects; to date, this information has not been released.

These recommendations will enable all Gateway Cities to create the market housing mix that they need while maximizing private housing production and investment in the commonwealth.