



Tax Credit Alert

Recent developments in tax credits

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Housing tax credit and multifamily bond provisions of HR 3221—The Housing and Economic Recovery Act of 2008

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On July 26, 2008, the U.S. Senate gave final congressional approval to the *Housing and Economic Recovery Act of 2008*, HR 3221 (the “Act”) by a vote of 72 to 13, following House passage of the bill earlier in the week by a vote of 272 to 152. The Act, the most comprehensive and substantial housing bill to pass the Congress in decades, now goes to the president, who is expected to sign the bill during the week of July 27. This *Alert* will summarize the provisions of the Act pertaining to the low-income housing tax credit (“Housing Credit”) under Section 42 of the Internal Revenue Code of 1986 (the “Code”) and to multifamily housing bonds (“Multifamily Housing Bonds”) under Section 142(d) of the Code. The Housing Credit provisions are the most significant changes to the program in almost 20 years; it is hoped that the changes will stimulate investment in Housing Credit properties and provide additional flexibility and simplification that will make even more properties financially feasible.

Executive Summary

The Act is far-reaching and, at times, complex, but here is the one paragraph summary of its most significant provisions:

The Act increases the amount of credits that each state can allocate for 2008 and 2009; allows credits to be used to reduce the alternative minimum tax; eliminates recapture bonds; adopts a fixed 9% credit rate through 2013 for new construction and rehabilitation projects that are not financed by tax-exempt bonds; eliminates the concept of “below market federal loans”; allows state agencies to designate particular buildings for 130% basis increase treatment as if they were in difficult development areas; provides that federal rental, operating, and interest reduction payments are not considered federal grants requiring a basis reduction; provides that loans derived from federal grants do not require a basis reduction; allows 50% related parties to qualify for acquisition credits (up from the former 10%); eliminates the 10-year placed-in-service rule for projects financed or assisted pursuant to many federal or similar state programs; specifically permits housing for special needs

populations, housing for groups specified in federal or state housing programs, and artists' housing to qualify for Housing Credits (provided fair housing rules are otherwise met); allows a full one year to meet the "10% test" for carryover allocations; modifies the area median income computation for rural projects and HUD "Hold Harmless" projects; increases the volume cap for tax-exempt housing bonds; and facilitates the use of refunding bonds for housing projects.

These and other provisions are explained in greater detail below. Of course, this is only a general summary; no action should be taken without a careful review of the specific provisions of the Act in the context of particular facts. In particular, the provisions have varying effective dates; whereas most rules apply to projects placed in service after the date of enactment, some are to be treated as if they have always been in the law, and some are effective for projects placed in service after 2007 or for allocations made after 2008.

Temporary Increase in Housing Credits

- For each of 2008 and 2009, the amount of Housing Credits allocated to the states is increased by \$0.20 per capita—to \$2.20. In 2010, the per capita amount will return to its regularly determined amount: \$2.00 plus the inflation increase already built into Section 42.
- The "small state minimum" (which is \$2,325,000 for 2008) is similarly temporarily increased by ten percent for 2008 and 2009.

Effective Dates

- Unless otherwise noted, provisions will generally apply to buildings placed in service after date of enactment (when the president signs the bill).
- The result is that projects that previously received Housing Credit allocations or bond financing but that have yet been placed in service may be able to take advantage of many of the Act's provisions.
- State Housing Credit agencies will need to adopt procedures to deal with potential additional Housing Credit allocations, even for projects that previously received Housing Credit allocations.

The Alternative Minimum Tax

- Housing Credits and rehabilitation credits (under Section 47 of the Code) may be used to offset the Alternative Minimum Tax ("AMT")—effective for buildings placed in service after 2007 for Housing Credits and for rehabilitation expenditures incurred after 2007.
- Interest on Multifamily Housing Bonds, mortgage revenue bonds, and veterans' mortgage bonds is exempt from AMT—effective for bonds issued after enactment.

Recapture Bonds

- The requirement that a bond be posted upon the disposition of a Housing Credit building or interest therein in order to avoid Housing Credit recapture is repealed.
- Recapture bonds are replaced with an extended period for the statute of limitations—three years following a recapture event.
- The recapture bond repeal is effective for dispositions after enactment and for dispositions before enactment if the taxpayer elects the application of the new provisions.

- The result is that outstanding bonds may be retired if the taxpayer elects application of these provisions.

Fixed 9% Credit Rate

- The Act provides a credit percentage of “not less than 9%,” effective for buildings placed in service after enactment and before December 31, 2013, meaning that this provision is temporary. Potentially, fixing the credit rate at 9% could result in approximately 14% more Housing Credits per dollar of qualified basis than the current floating rate of 7.93% for July 2008 produces. Although it is not entirely clear, it appears that this provision would permit owners who had previously “locked in” the Housing Credit rate and whose buildings are placed in service after enactment to take advantage of this provision. However, to the extent that the new computation (qualified basis times credit rate) would result in more Housing Credits than previously allocated, the Housing Credit agency would have to provide an additional allocation. Projects that are not allocated additional credits will at least find it easier to meet the allocation they have received.
- The 9% credit rate applies to non-federally subsidized new construction and substantial rehabilitation buildings (see revised “Definition of ‘Federally Subsidized’ Building” below).
- There is no change for the 4% credit for bond financed projects and acquisition of existing buildings: the credit rate will continue to float as under current law.

Definition of “Federally Subsidized” Building

- The Act eliminates the concept of “below market federal loans.” The result is that new construction and substantial rehabilitation expenditures will qualify for 9% credits even if the project receives a below market federal loan, i.e., a loan from federally appropriated funds with an interest rate below the “applicable federal rate.”
- Tax-exempt bond financed projects will still be considered federally subsidized and therefore will only be eligible for the 4% credit.
 - Example: Projects financed with HOPE VI and HOME loans will qualify for 9% credits even if the interest rate on the loan is below the applicable federal rate.
- The provision prohibiting the 30 percent basis boost for below market HOME loans receiving 9% credits has been repealed.

Changes to Credit Computations

- Any building designated by the Housing Credit agency as needing an increase in credit for financial feasibility may have its eligible basis increased by the agency by up to 30% by treating such a building as being located in a difficult development area (“DDA”). This provision does NOT apply to bond financed projects.
- The Joint Committee on Taxation Explanation (“JCT Explanation”) accompanying the Act states that it is expected that Housing Credit agencies shall set standards for determining which areas shall be treated as DDAs and which projects shall receive additional credits as part of the agency’s Qualified Allocation Plan (“QAP”) and that the agency will publicly express its reasons for such determinations.
- In perhaps the only “tougher” provision of the Act, the minimum rehabilitation threshold (necessary to qualify for Housing Credits) is doubled to be the greater of \$6000 per low

income unit (to be adjusted for inflation) or 20% of the adjusted basis—effective for Housing Credit allocations made and bonds “allocated” after enactment.

- The allowable basis for “community service facilities” located in qualified census tracts is increased to 25% of the first \$15 million of eligible basis plus 10% of additional basis.

Treatment of Federal Grants and Subsidies

The Act clarifies the treatment of federal grants:

- Rental, operating, and interest reduction payments are not considered federal grants requiring a basis reduction. The House Committee Report (which accompanied the passage of HR 3221 in May 2008) and the JCT Explanation direct Treasury to amend its regulations so that a specified list of federal assistance programs and other ongoing payments used to enable the property to be rented to low-income tenants will not be considered federal grants.
- The JCT Explanation further clarifies that loans made from the proceeds of federal grants do not require a basis reduction regardless of the interest rate on the loan (correcting a mistake in the House report on this point).
- The JCT Explanation states that no inference is to be drawn with respect to the treatment of grants made before enactment. We understand that this means that pre-Act grants are intended to qualify for the favorable treatment as well.

Changes to Rules for Acquisition Credits

- The 10 percent related party rule for acquisition credits (prohibiting an identity of interest between buyer and seller of more than 10 percent) is liberalized under the Act to 50%.
- The 10 year last-placed-in-service rule is amended to provide an exception for properties substantially financed, assisted, or operated under Section 8 of the United States Housing Act of 1937; Sections 221(d)(3), 221(d)(4), or 236 of the National Housing Act; Section 515 of the Housing Act of 1949; any other housing program administered by HUD or the Rural Housing Service of the Department of Agriculture; or any other similar state housing programs.

General Public Use

- Projects may still qualify for Housing Credits even if the project has occupancy restrictions or preferences that favor tenants
 - with special needs, or
 - who are members of a specified group under a federal or state housing program or policy that supports housing for such group, or
 - who are involved in artistic or literary activities.
- However, the housing must still be consistent with federal Fair Housing laws.
- The JCT Explanation provides that present law prohibitions continue against using Housing Credits for housing for social organizations, employer-sponsored housing, and various health care facilities.
- This provision applies “before, on, and after” the date of enactment.

Area Median Income (“AMI”) Rules

- Income determinations for Multifamily Housing Bond and Housing Credit projects may not decrease for any year after 2008. This rule puts into statute the policy that had been carried out by HUD for several years.
- For “HUD Hold Harmless” projects, median incomes may be increased by the change in AMI from the prior year.
- HUD Hold Harmless projects are those whose incomes levels were determined in 2007 or 2008 and whose levels were not decreased after the change in income determination methodology (the “American Community Survey” or “ACS”) adopted by HUD in 2006.
 - Example: If City X’s median income was \$50,000 before the change in methodology, and is \$40,000 after the change, HUD’s policy was to “hold harmless” City X and maintain the median income figure of \$50,000. However, until the newly determined median income figure under the ACS surpassed \$50,000, income levels were frozen at \$50,000. In some cases, rents could stay static for several years. For Housing Credit properties, the result in this example is that the rents would not increase until the ACS median income amount exceeded \$50,000. Under the Act, the median income amount that was formerly frozen will be allowed to increase by the amount of actual increase in the newly determined ACS median income amount. In this example, if the actual median income increased from \$40,000 to \$42,000 in a year, that \$2,000 increase would be added to the \$50,000 amount, so the new median income for HUD Hold Harmless projects would then be \$52,000.
- One result is that in affected areas, income and rent determinations for older projects (those whose incomes were determined in 2007 or 2008) will be higher than for new projects.

Miscellaneous Provisions

- The Act repeals the prohibition on the use of Housing Credits with properties that were assisted under the Section 8 Moderate Rehabilitation program.
- The period for satisfying the carryover allocation “10 percent” test is lengthened to one year after the date of the carryover allocation.
- Income recertifications will not be required for 100% low income projects for all Multifamily Housing Bond and Housing Credit projects—effective upon enactment for all such projects.
- QAPs must take into account the energy efficiency and historic nature of projects—effective for allocations after 2008.
- The student rule is amended—a new exception is adopted for students previously in foster care—effective for determinations after enactment.
- Income limits for rural projects (as defined in Section 520 of the Housing Act of 1949) will be measured by reference to the greater of area median income or the national nonmetro median income. This provision does not apply to bond financed projects. Effective for income determinations made after enactment.

Multifamily Housing Bond “Recycling”

The new law allows bonds to be reused for another project without having to use up additional volume cap if certain tests are met.

- Multifamily Housing Bonds may be refunded, with the proceeds used to finance a second project (with no new tax-exempt volume cap required) on a one-time basis if
 - the refunding bond (i.e., a new bond issuance) is issued within six months of the repayment of a loan made with the original (“refunded”) bonds,
 - the refunding bond is issued within four years of the refunded bond’s original issuance,
 - the maturity of the refunding bond is not later than 34 years after the original refunded bond was issued, and
 - the TEFRA approval process is followed for the refunding bond.
- The refunding bond does NOT generate “automatic” Housing Credits. Accordingly, this program will be feasible only if the Housing Credit agency is willing to allocate new 4% credits in connection with the refunding bond or in those areas where “80/20” deals are feasible without Housing Credits (e.g., New York City).
- Effective for repayments of refunded bonds made after enactment.

Multifamily Housing Bond and Housing Credit Coordination

Several provisions were adopted that make the Multifamily Housing Bond rules match the Housing Credit rules:

- The “next available unit” rule, which requires that the next available unit be rented to an income eligible tenant if a low-income tenant’s income goes over the applicable income threshold, will be applied on a building basis (not a projectwide basis) for Multifamily Housing Bond / Housing Credit projects.
- The Housing Credit student rules are applied to Multifamily Housing Bond projects.
- Housing Credit single room occupancy rules are applied to Multifamily Housing Bond projects.
- New rules are effective for determinations after enactment with respect to Multifamily Housing Bonds issued before and after enactment.

Housing Bond Volume Cap Increase

- The tax-exempt volume cap for Multifamily Housing Bonds and mortgage revenue bonds for homeownership is increased by \$11 billion nationally for 2008 under the Act.
- States share in this increase on a per capita basis.
- Authority to issue bonds may be carried forward through 2010.
- Bonds may be used to refinance subprime loans.

GAO Study

- GAO must submit a report to Congress by 12/31/2012 regarding the implementation of the changes made by the Act.
- The study must include an analysis of distribution of credit allocations before and after the enactment of Act.

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