

**ARIZONA DEPARTMENT OF HOUSING
LOW-INCOME HOUSING TAX CREDIT PROGRAM**

**PROCEDURE FOR ISSUANCE OF DECLARATION OF AFFIRMATIVE LAND USE AND
RESTRICTIVE COVENANTS AGREEMENT FOR FORECLOSED PROPERTIES**

1. INTRODUCTION

1.1. Definitions

1.1.1. Unless otherwise noted capitalized terms used in this procedure have the same meaning in Section 42 of the Internal Revenue Code (“the Code”).

1.1.2. “Acquiring Entity” means the applicant identified in the Application to Continue LURA.

1.1.3. “Application to Continue LURA” means an application submitted pursuant to this procedure on a form provided by the Department.

1.1.4. “Code” or “I.R.C.” means the Internal Revenue Code.

1.1.5. “Foreclosure” means transfer of a Property my means of a Trustee’s Deed, an order or judgment of court in a judicial foreclosure or bankruptcy proceeding, or an instrument in lieu of foreclosure.

1.1.6. “Identity of Interest” means, as to the original Tax-Credit Investor and any proposed new Tax-Credit Investor, common control by a syndicator of both such entities, and/or common ownership (directly or through an affiliate) of 50% or more of the interests in each Tax-Credit Investor.

1.1.7. “LIHTC Eligibility” means the eligibility of a project to be considered for the LIHTC Program as a result of the Department’s agreement to perform ongoing compliance monitoring and to enter into an extended low income housing commitment with respect to such project. LIHTC Eligibility does not mean that the I.R.S. will determine that the project meets all other requirements of Section 42 of the Code or that any project owner will actually receive low income housing tax credits with respect to a project.

1.1.8. “LIHTC Program” means the Low Income Housing Tax Credit (“LIHTC”) program requirements described by I.R.C. § 42 and other relevant provisions of the Internal Revenue Code, its implementing regulations, and relevant IRS guidance.

1.1.9. “Original Taxpayer” means the Owner that is a party to the Declaration of Affirmative Land Use and Restrictive Covenants Agreement that bound the property prior to the foreclosure.

1.1.10. “Project” means the LIHTC Project that is requesting the Department continue reporting related to LIHTC Eligibility.

1.1.11. “Property Manager” means a property management company or on-site property management employee with significant experience in managing LIHTC Projects, or in limited circumstances with the approval of the Department, an inexperienced property management company or owner working with an approved compliance consultant with significant experience in LIHTC Program compliance issues.

1.1.12. “Qualified Allocation Plan” means the plan adopted by the Arizona Department of Housing in accordance with I.R.C. § 42(m)(1) as such plan may be modified from time to time. Any citation to a specific provision of the Qualified Allocation Plan shall refer to similar language in an amended plan.

1.1.13. “Supplemental Compliance Monitoring” means compliance monitoring undertaken by the Department for the purpose of reinstating a Project to LIHTC Eligibility in accordance with this procedure.

1.1.14. “Tax Credits” means tax credits as described in the LIHTC Program.

1.1.15. “Tax-Credit Investor” means the party which has made or firmly agreed to make an equity investment in the Original Taxpayer or Acquiring Entity in exchange for Tax Credits, together with any party authorized to act on behalf of the Tax-Credit Investor hereunder or under the limited partnership agreement, operating agreement or other similar organizational agreement relating to the Project.

1.2. Internal Revenue Code Section 42(h)(6)(E)(i)(I) provides that the Extended Use Period for a Qualified Low-Income Housing Project building terminates on the date that the building is acquired by foreclosure (or an instrument in lieu of foreclosure). A taxpayer may not claim tax credits on a building that does not meet the requirements of the Code for an Extended Low-Income Housing Commitment. See I.R.C. § 42(h)(6)(A).

1.3. Arizona Department of Housing (“the Department” or “ADOH”) satisfies the requirement of the LIHTC Program for an Extended Low-Income Housing Commitment by requiring taxpayers to execute a Declaration of Affirmative Land Use and Restrictive Covenants Agreement (“LURA”). Typically the LURA specifically provides for termination in the event that a LIHTC Project building is acquired through foreclosure or an instrument in lieu of foreclosure.

1.4. In addition, ADOH is required to perform annual and periodic compliance monitoring and reporting of LIHTC properties. See I.R.C. § 42(m)(1)(B)(iii); Treas. Reg. 1.42-5. In the event that ADOH learns that an LIHTC project has been transferred through foreclosure or instrument in lieu of foreclosure it will cease compliance monitoring of the project or otherwise enforcing the terms of the LURA except as may be necessary to enforce the requirements for the three-year deregulation period described in I.R.C. § 42(h)(6)(E)(ii).

1.5. Purchasers acquiring a multifamily rental project out of foreclosure that was subject to a LURA may wish to have the Department continue monitoring and reporting related to the LIHTC Eligibility of the project so that the Purchaser may benefit from any Tax Credits still available for the project. The Department understands that the Internal Revenue Service (“IRS”) will permit an Acquiring Entity to claim LIHTCs for a building acquired through

foreclosure as long as an Extended Low-Income Commitment is in place during the tax year and the building is otherwise in compliance with the requirements of LIHTC Program, but each Acquiring Entity is responsible for confirming with the IRS that based on its unique facts and circumstances that it will be eligible to claim LIHTCs after the purchase of a project that has been subject to foreclosure.

1.6. In consideration of the foregoing the Department will consider an Application to Continue LURA through the process and procedures described below.

2. DEPARTMENT CONTINUATION OF REPORTING RELATED TO TAX CREDIT ELIGIBILITY

Continuation of Department reporting related to tax credit eligibility means:

2.1. The Department will execute legal agreements (“Reporting Agreements”) necessary to satisfy the requirement for an Extended Low-Income Housing Commitment as that term is used in I.R.C. § 42; and,

2.2. The Department will resume monitoring the Project and notify the IRS of compliance or noncompliance with the requirements of the LIHTC Program.

2.3. Disclaimer. The authority to determine whether a building qualifies as part of a Low-Income Housing Project after issuance of IRS Forms 8609 rests with the IRS. Execution of any Reporting Agreement, compliance monitoring activity by ADOH or any communication between ADOH and the IRS concerning the Project does not guarantee that the IRS will recognize a claim for LIHTCs. It is the duty of the entity acquiring the foreclosed Project to comply with the requirements of the LIHTC Program and the Reporting Agreement.

3. OWNER ELIGIBILITY

ADOH may determine that continued Department reporting related to LIHTC Eligibility for an Acquiring Entity is not in the public interest if:

3.1. The Department concludes that grounds for disqualification described in Section 2.5 (I) of the 2011 Qualified Allocation Plan apply to one or more general partners or managing members (or similar constituents of the Acquiring Entity) authorized under the terms of a limited partnership agreement, operating agreement or similar document among such constituents to exercise day-to-day management and control of the Project.

3.2. There is an Identity of Interest between the original Tax-Credit Investor and the proposed Tax-Credit Investor that does not exercise day-to-day management or control of the Acquiring Entity.

3.3. The Department will not base a decision not to continue Department reporting related to LIHTC Eligibility solely on the facts that such continued reporting might benefit a prior project Lender, owner, or Tax-Credit Investor, although the Department may refuse to continue reporting related to LIHTC Eligibility if there is reasonable evidence that there would be substantial non-compliance with the required Reporting Agreements.

4. CONDITIONS FOR CONTINUED REPORTING RELATED TO TAX CREDITS

As consideration for the Department's agreement to continue reporting related to Tax Credits, the Acquiring Entity shall:

- 4.1. Submit a complete Application to Continue LURA on the form provided by the Department including a narrative statement that explains how continued reporting is in the public interest and identifies issues that the Department should consider in its review, and any documents required by the Application to Continue LURA;
- 4.2. Pay the application fee in the amount of \$3,000.00 to cover the cost of review of the Application to Continue LURA, underwriting, and legal review, and as partial consideration for any Reporting Agreement;
- 4.3. Pay any delinquent annual compliance monitoring fee amounts;
- 4.4. In the event that the Application to Continue LURA does not include payment of delinquent annual compliance monitoring fees described in Section 4.3, then the Application to Continue LURA shall include payment of the refundable Supplemental Compliance Monitoring fee equal to the amount of the annual, nonrefundable, compliance monitoring fee described in Section 6.7 of the 2011 Qualified Allocation Plan. Except in instances when Supplemental Compliance Monitoring is performed at the request of a foreclosing lender as provided in Section 5.7 of this procedure, in the event that the Department rejects the Application to Continue LURA, the Supplemental Compliance Monitoring fee will be refunded to the Acquiring Entity. Notwithstanding any provision of this Section, the Department will not continue reporting related to LIHTC Eligibility for a project that has not complied with the requirements of Section 4.3;
- 4.5. State whether the Acquiring Entity has obtained the documents necessary to satisfy the record keeping requirements of Treas. Reg. 1.42-5;
- 4.6. Provide any information and documents reasonably required by the Department to assist its review of the Application to Continue LURA;
- 4.7. Provide a letter of intent from any proposed Tax-Credit Investor that describes the amount of its equity contribution and the total tax-credit dollar amount that the entity intends to claim;
- 4.8. Demonstrate to the satisfaction of the Department that the Acquiring Entity meets the eligibility requirements described in Section 3 of this procedure;
- 4.9. Demonstrate to the satisfaction of the Department that the Project is financially viable if operated and maintained in accordance with the proposed terms and provisions of the Reporting Agreement, which must in all cases be approved by the Department, through the end of the Compliance Period;
- 4.10. Demonstrate to the satisfaction of the Department that the Acquiring Entity has the financial capacity to maintain and operate the Project accordance with the Reporting Agreement;

4.11. Demonstrate to the satisfaction of the Department that the Acquiring Entity has retained a Property Manager with experience operating LIHTC properties in accordance with the requirements of the LIHTC Program;

4.12. Consent to and facilitate compliance monitoring of the Project by ADOH staff;

4.13. Address outstanding or newly discovered instances of noncompliance in accordance with Section 5, below; and,

4.14. Execute a Reporting Agreement satisfactory to the Department that will satisfy the requirements for an Extended Low-Income Housing Commitment in accordance with I.R.C. § 42(h)(6)(B) and otherwise provide for the maintenance and operation of the Project in accordance with the Qualified Allocation Plan and Department guidance. Among other things, the Reporting Agreement will run with the land and require the Acquiring Entity and the entity's successors and assigns to indemnify the Department from any claims arising out of the ownership or operation of the Project. Furthermore, the Reporting Agreement shall require the Acquiring Entity to waive the right to a Qualified Contract as described by I.R.C. § 42(h)(6)(E)(II).

5. COMPLIANCE MONITORING AND CONTINUED MONITORING RELATED TO TAX CREDIT ELIGIBILITY

5.1. The Department will approve the Application to Continue LURA (subject to the terms of these procedures as further described herein) if it determines, based on information included in the Application, that:

5.1.1. the acquiring owner meets the eligibility requirements described in Section 3;

5.1.2. the acquiring owner and its Property Manager demonstrated the experience and capacity to operate and maintain the Project as in accordance with the LIHTC Program; and,

5.1.3. continued monitoring of the Project related to LIHTC Eligibility is in the public interest and will preserve the inventory of affordable housing in Arizona.

5.2. Upon approval of the Application to Continue LURA and payment of the fees described in Section 4.4, above, the Department will schedule, if it has not already done so, a Supplemental Compliance Monitoring visit for the Property.

5.3. Upon Supplemental Compliance Monitoring by ADOH, the supplemental Compliance Monitoring fee becomes nonrefundable.

5.4. In the event that the Department concludes, based on the Application to Continue LURA and information collected during the monitoring visit, that: (i) the requirements of Section 5.1 have been met; and (ii) all delinquent annual compliance monitoring fees have been paid, the Department will:

5.4.1. Notify the Acquiring Entity of instances of noncompliance through a findings letter. The findings letter will describe uncorrected instances of noncompliance of record prior to

the date of foreclosure as well as instances of noncompliance discovered during the monitoring visit;

5.4.2. Execute a Reporting Agreement upon submission by Acquiring Entity of an action plan describing measures to correct the instances of noncompliance described in the findings letter within the applicable correction periods of the LIHTC Program; and,

5.4.3. Notify the IRS of transfers of ownership of the Project of which the Department has notice from the date of the foreclosure or instrument in lieu of foreclosure until the effective date of the Reporting Agreement.

5.5. Upon execution of the Reporting Agreement the Department will reinstate the Project to its roll of active LIHTC projects for the purpose of annual compliance monitoring. In the event that the Acquiring Entity does not correct outstanding instances of noncompliance within the correction periods set forth in Treas. Reg. 1.42-5, ADOH will issue the appropriate IRS Forms 8823 to the IRS if it has not previously done so.

5.6. The Department will not provide notice to the IRS correcting instances of noncompliance described in IRS Forms 8823 issued before the foreclosure of the Project until the Acquiring Entity demonstrates that the instances of noncompliance have been corrected. Notwithstanding the foreclosure of the Project, the correction periods described in Treas. Reg. 1.42-5 shall apply as if the foreclosure had not occurred. For example, the period beginning on the date of foreclosure and ending on execution of the Reporting Agreement shall not toll the three-year time limit for notification of the IRS that an instance of noncompliance has been corrected.

5.7. Upon request by a foreclosing lender that has or intends to acquire or sell the Property through the foreclosure process or instrument in lieu of foreclosure, the Department will schedule a Supplemental Compliance Monitoring visit. The Department will, upon payment of the Supplemental Compliance Monitoring Fee, issue a findings letter to the Lender in accordance with Section 5.4.1, above for the Lender's in its evaluation of the project. As a condition of receipt of such letter, the lender will acknowledge that such findings letter is not enforceable against the I.R.S. and that it is not a representation or warranty by the Department that any units deemed by the Department to be in compliance with the LIHTC Program are eligible for the Tax Credit.

6. ADMINISTRATIVE REVIEW

A determination by ADOH to: 1) reject an Application to Continue LURA; or 2) refuse to continue reporting and monitoring the LIHTC eligibility of the Project as that term is used in Sections 2.1 and 2.2 of this procedure is an Appealable Agency Action with a right to an administrative review hearing through the Arizona Office of Administrative Hearings in accordance with A.R.S. §§ 41-1092 through 41-1092.12.