The Arizona Department of Housing
2009 Information Bulletin

REGARDING PROGRAMS:  RENTAL DEVELOPMENT

REGARDING FUNDING SOURCES:  Low Income Housing Tax Credit Program

The American Recovery and Reinvestment Act of 2009 (ARRA), allows the Arizona Department of Housing ("ADOH", “the Department”) to elect to exchange 2007, 2008 and 40% of its 2009 per-cap credit for a cash grant from Treasury in lieu of awarding Low Income Housing Tax Credits (LIHTC).

Unlike the traditional 9% LIHTC program, ARRA imposes additional requirements on the Department which create liabilities and public expectations that do not exist within the standing program.

The award of funds under the 9% Tax Credit Exchange Program (“the Exchange Program”) will be at the Department’s discretion. The Department will underwrite these applications in a manner consistent with conventional bank underwriting. This review process varies from the traditional 9% review in several regards.

PROGRAM REQUIREMENTS

Development Team Capacity:  Due to the short deadlines for expenditure of Exchange Funds, evaluation of development team financial and technical capacity is critical and will take into account all dealings with development team members. Applicants or development team members with recent or unresolved performance, compliance or financial issues, or questionable credit worthiness may not be eligible for funding. In determining the capacity of the development team, the Department may consider the financial status of commercial properties in which development team members hold and equity interest in Arizona and other states. Development team capacity includes any issues arising since the original award of tax
credits. The Department may restrict award of Exchange Program funds to project sponsors who can provide guarantees sufficient to cover the Owner’s statutory recapture obligations to the Department of Treasury.

Underwriting: The Department will re-underwrite all projects requesting funding from the Exchange Program. Underwriting will be based on the capacity of the development team and the characteristics of the project. Underwriting will be more conservative because of the Department’s increased participation in the direct funding of projects. Minimum debt service ratios, operating cost thresholds, project reserves, and other standards specified in the Qualified Allocation Plan (QAP), may be restricted for the purposes of qualifying a project for Exchange Program funding.

ADOH Project Involvement: As outlined in greater detail below, ongoing involvement from the Department has increased. This includes interaction during the development, construction, and lease-up periods as well as during the operational life of the project. Therefore, as a condition of award of Exchange Program funds the Department may require project sponsors to make the Department a party to any operating or management agreement for the project property with the regulatory power and authority that are usually accorded a tax credit investor for the purpose of protecting viability of the project. In addition, the Department may designate a third-party asset manager be admitted as a party to the operating agreement or designated as a special limited partner or member.

Projects that are not feasible and viable within the maximum exchange program award—calculated based on the LIHTC reservation being returned—will be rejected.

ELIGIBILITY REQUIREMENTS

Eligible Applicants: Only Applicants with a reservation of 9% Low Income Housing Tax Credits from 2007 or 2008 annual ceiling amounts are eligible to apply. Sponsors of projects that received an allocation of tax credits in the 2008 Resubmittal Allocation Round are not eligible to apply for Exchange Program funding because those projects were reserved tax credits from the 2009 tax credit ceiling amount. In order to apply for the Exchange Program, Applicant’s are required to make an irrevocable offer to return and revoke their prior credit award by no later than August 7, 2009. Applications for Exchange funds must be submitted by no later than 4:00 p.m. Arizona time, August 21, 2009.

Failure to Syndicate: The Exchange Program is intended for otherwise viable projects that received a reservation of tax credits but are unable to secure an equity investor after making “good faith efforts to obtain investment commitments for such credits.” The Department will require that applicants submit a narrative description of the efforts they have made to syndicate their credit awards, including documentation such as copies of correspondence, emails, and meeting notes. In general, the Department will require applicants to demonstrate that they have made commercially reasonable efforts to syndicate their credits. Applicants who, in the judgment of the Department, could sell or could have reasonably sold their credits and successfully completed the development are not eligible for Exchange Program funds. ADOH may verify efforts to secure an equity investor.

In exceptional cases and subject to funding availability, the Department may provide Exchange Program funds to projects that have an equity investor. In such cases the amount of the equity investment exceed the amount Exchange Program funding.
Eligible Recipients: Exchange Program applicants will be selected for funding based on the following eligibility criteria: a) financial and technical capacity of the development team to undertake and complete the project on time; b) satisfactory underwriting of the feasibility and viability of the project based on an updated market study, appraisal, construction schedule, and development costs; c) a determination by the Department of a project’s readiness to proceed and ability to be completed within timeframes necessary for the Department to comply with federal commitment and/or expenditure deadlines.

The updated construction schedule must demonstrate that the project is “shovel ready” and capable of expending Exchange Program assistance by no later than November 30, 2010. The Department may revoke funding for Projects that do not commence construction within 90 days of notice of award of funds.

Total updated development costs should be equal to or less than the development costs submitted with the original application for tax credits. Updated development costs that are substantially greater than the costs reported in the original application for tax credits may disqualify the project from funding through the Exchange Program.

In order to receive funding under the Exchange Program, the funding recipient must be a project owner duly organized and authorized to conduct business in Arizona as provided by the applicable QAP.

Source of Funding: While the Department initially expects to fund the Exchange Program with funding from the federal Section 1602 Program, the Department specifically reserves the right to fund any application to the Exchange Program with any source of funding available. To the extent the Department determines that the project qualifies for another source of funding, such as the Neighborhood Stabilization Program or the federal Tax Credit Assistance Program, such funding may be offered to fund an application. Applicants will be required to submit additional documentation necessary to comply with the program requirements and regulations relevant to any other funding source the Department intends to use.

Maximum Funding: The Department does not intend to award funding to individual developments in excess of the cash value of credit awards returned from those projects. Although the Department of Treasury allows the Department to exchange tax credits for cash assistance at a value of $0.85 per tax credit, cash assistance awards shall be further discounted or reduced as necessary to limit the amount of funding to an amount that is sufficient to make the project feasible based on underwriting and gap analysis. In such cases, the maximum award may be less than the cash value of the returned tax credits. In any event, Exchange Program funding cannot exceed an amount equal to 85% of the eligible basis of a qualified low-income housing project.

Ongoing Oversight and Asset Management: Projects receiving Exchange Program funds must meet all the requirements of I.R.C. § 42 and the QAP. It is important to note that ARRA specifically requires the Department to “perform asset management functions to ensure compliance with section 42 ... and the long-term viability of buildings funded by [the Section 1602 Program].” In making such a requirement, Congress established specific expectations that exceed all compliance functions previously expected of the Department as a LIHTC allocating agency.

To ensure compliance and long-term viability of a project, developments receiving assistance under the Exchange Program will be subject to a variety of oversight and asset management requirements by the Department. The Department may enforce these requirements through a third-party asset management
services provider. The requirements include, but may not be limited to: design review, construction and disbursement oversight construction and progress monitoring, and ongoing review by the Department. Oversight will be similar to those requirements imposed by private equity providers and will include submission of monthly income and expense reports, annual audits, annual budget reviews, and periodic capital needs assessments. The asset manager with the advice and consent of the Department shall have the authority to remove and replace the general partner or managing member of the project owner, the project manager and/or the developer and construction contractor in the event that the project fails to comply with program requirements or achieve performance measures.

**Form of Assistance:** The Department’s preference is to award Exchange Program funds to a development in the form of a promissory note secured by a deed of trust, typically subordinate only to an amortizing permanent loan. Loans will be interest free and deferred during the initial 15 year compliance period. However, it is unclear at this time whether U.S. Treasury rules will permit an effective loan structure. The Department will award Exchange Program funds in a manner consistent with Federal requirements. The loan award and associated documents may include, but may not be limited to, a regulatory agreement, a deed of trust, and personal and/or corporate guarantees from the sponsor and/or underlying individual owners of the ownership entity.

In the event the Department elects to fund an application with other sources, funding will be provided in the form of a loan, and may be subject to different terms and conditions.

In consideration of an award of Exchange Program funds, the Department will require the project to waive its rights to a qualified contract.

**Applicability of Affordability Requirements:** Applicants for the Exchange Program will be subject to the eligibility and affordability requirements such as income targeting, extended affordability, and other factors leading to points of the Qualified Allocation Plan under which the original allocation of tax credits was made. Per unit cost ceilings and market study requirements shall also be governed by the QAP and QAP amendments applicable to the project. Developments will be required to meet or exceed the commitments made in their original applications for Low Income Housing Tax Credits under the applicable QAP. Otherwise, Applicants agree that the project must meet the additional underwriting requirements required by ADOH including but not limited to the underwriting requirements of Section 7 of the 2009 QAP.

**Development Timing:** In order to satisfy disbursement requirements imposed by Treasury, developments seeking funding under the Exchange Program must demonstrate to the Department’s satisfaction that all E Program funds awarded to a project may be properly incurred and reimbursed by the Department prior to December 31, 2010. Any funds not disbursed by December 31, 2010, will be revoked. The Department reserves the right to impose earlier deadlines and will award funds only to projects that can demonstrate an ability to properly expend all Exchange Program funding by November 30, 2010.

**Developer Fees:** Developer fees will be recalculated based on revised project costs. Developer fees under the Exchange Program may not exceed the fee anticipated under the original LIHTC reservation. The Department will require that at least 40% of the developer fee be deferred and repaid through the duration of the compliance period.

**Recapture:** ARRA requires that an award of Exchange Program funds be recaptured in the event of noncompliance with LIHTC affordability and rent restrictions. The recapture obligation will be secured by a lien on the project, which ADOH expects will be subordinate to the project’s mortgage financing. As the
U.S. Treasury provides more information about recapture obligations and requirements, ADOH will assure that these are reflected in program documents.

**Recovery Act Transparency, Accountability, and Reporting Requirements:** ARRA contains new and unprecedented levels of oversight, scrutiny, and reporting. Applicants should be aware that the Department is responsible for reporting on a variety of project features and outcomes including job creation and retention, development costs, projects awarded, and other reporting requirements of the ARRA. While we are working to incorporate these data features into standard reporting processes through the third-party asset manager, federal requirements are still being developed and may not be fully available when funds are initially committed to projects. As a result, Applicant’s must comply with any ADOH reporting requirements established to comply with current or future, state or federal reporting requirements imposed as a result of the ARRA implementation.

**Ongoing Implementation Flexibility:** As with other aspects of implementing the ARRA provisions, the Department recognizes the difficult environment for affordable multifamily housing development. We will continue to be as proactive and transparent as possible in the implementation of the Exchange Program, but applicants should plan for continued changes, updates, and modifications to this and other ARRA related programs.

The Department reserves the right to make program changes and waivers as needed to ensure that the Exchange Program is quickly, efficiently, and effectively implemented and complies with all federal requirements. Developers with questions or concerns about the applicability of this program to their projects are encouraged to contact the Department to discuss the specific status of their projects.

The Department will publish updates, amendments, and/or questions and answers related to the Exchange Program in an effort to clarify remaining issues, respond to feedback, or otherwise communicate with the development community.

**Fees:** The Department shall require the project to cover the reasonable costs of asset management services.

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