

## Memorandum

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To : State Agency Clients

From: Anthony S. Freedman

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Re: Tax Credit Assistance Program – HUD Guidance

### **Gap Financing HOME Funds.**

The American Recovery and Reinvestment Act of 2009, PL 111-5 (the “Recovery Act”), signed into law on February 17, 2009, includes \$2.25 billion in special HOME funds intended to facilitate the production of projects awarded low-income housing tax credits in “fiscal years” 2007, 2008 and 2009.<sup>1</sup> On May 4, 2009, HUD published Notice CPD-09-03 (the “HUD Notice”), setting forth “the submission requirements, eligible uses of funds, and program requirements” for TCAP. The full text of the HUD Notice is available at the HUD TCAP website, a link to which is included at the end of this memo. State-by-state allocation amounts are also provided on the website, and HUD invites (and responds to) questions from program participants through the website.

Simultaneously, the Treasury Department released guidance for the program, also authorized by the Recovery Act, under which housing credit agencies may exchange low-income housing tax credit authority for cash grants from Treasury, to be used for qualified low-income housing projects. The exchange program is the subject of a companion memo to this one.

### **Program Requirements.**

1. Although the funds are appropriated under the HOME program, they are not subject to HOME requirements, but rather to low-income housing tax credit requirements and the standards and procedures set out in the HUD Notice.

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<sup>1</sup> The HUD Notice explains how this requirement is interpreted and applied.

- The funds go to *state<sup>2</sup> housing credit agencies* (as opposed to “Participating Jurisdictions” under the regular HOME Program), which select the projects to which they are to be awarded. For this reason, the HUD Notice refers to the credit agencies as the “grantees.”
- The HUD Notice specifically provides that HOME program regulations under 24 CFR Part 92 and consolidated planning requirements under 24 CFR Part 91 do not apply to TCAP funds.
- Tax credit targeting, income and rent rules will apply, as opposed to HOME requirements.

2. The statute provides that the funds are for projects that have received or receive simultaneously “an award of low income housing tax credits” under section 42(h) of the Internal Revenue Code in fiscal years 2007-2009.

- The HUD Notice permits housing credit agencies to define what constitutes an “award” of credits for this purpose, as long the definition is applied uniformly to projects in the state. In this respect, the Notice states that an award may be “as early as the date of public notice of the funding decision for a particular project.” Thus, an agency that, by Board action no later than September 30, 2009, designates a list of projects to receive tax credit allocations may deem those projects to be eligible for TCAP, even if reservation letters or Carryover Allocations have not been executed for those projects. Similarly, for bond-financed projects, the housing credit agency can define an “award” of credits to include, for example, the issuance of a “satisfies the requirements of the QAP” letter pursuant to Code section 42(m)(1)(D).
- Projects that received allocations in 2007 and 2008 would also be eligible.
- The HUD Notice, however, makes clear that projects must actually *have* tax credits in order to be eligible for TCAP funding. Thus, eligible projects would *not* include projects that have traded in *all* of their credits under the exchange program, nor would they include projects with GO Zone credits or disaster credits or projects that *never* received an award of tax credits. HUD’s suggested solution for these otherwise-ineligible projects is that they be given “at least a nominal amount of low income housing tax credits with low income housing tax credit requirements for the period required by section 42 of the Internal Revenue Code.” As previously noted, bond-financed projects getting credits can be eligible.

3. The funds must be awarded competitively in accordance with the requirements of the Recovery Act and “pursuant to the existing QAP” of the housing credit agency.

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<sup>2</sup> As with the exchange program, funds go to the designated state housing credit agency in states in which there are multiple housing credit agencies. These agencies may suballocate funds to other credit agencies in the state.

- The quoted language, which is from the HUD Notice, is apparently intended to make clear that agencies do not have to amend or modify their QAPs in order to reflect their means of awarding the TCAP funds. Indeed, the Notice states that agencies “are neither required nor expected to amend their QAPs.” As with the exchange program, however, agencies will have to determine that their state administrative procedures acts permit them to award funds in this fashion under their existing administrative authority.
  - The HUD Notice requires that credit agencies give priority in the award of funds to projects that are expected to be completed within 3 years of the date of enactment of the Recovery Act (by February 16, 2012). Beyond that “main selection criterion,” each agency “is otherwise free to design its competitive process and adopt any other selection criteria it chooses.”
  - Given the timeframes in the law and HUD’s requirements, as further explained below, agencies must begin developing procedures and criteria for making awards of TCAP funds through a public and competitive process immediately.
4. TCAP funds can be granted or loaned to a project.
- HOME funds are normally provided to projects as below-market loans, but the TCAP legislation refers to grants. The HUD Notice states that funds may be granted or loaned to eligible projects.
  - The law provides that TCAP funds do not reduce eligible basis. As a result, owners and agencies may wish to treat them as grants, thereby avoiding the “true debt” analysis that is required of loans. However, absent a special rule by IRS, any such grants would likely constitute taxable income to the recipient, so it is reasonable to assume that the loan structure will be most common – at least where there is not a tax-exempt entity to be the recipient of the TCAP grant.
  - The HUD Notice explains that repayments of principal or interest on TCAP loans received during the three-year period when grants are being made are treated as “program income” and must be expended within that period so as not to be lost.
5. TCAP funds may be used for “capital investment” in eligible tax credit projects.
- The HUD Notice makes clear that these funds may be used for eligible basis expenditures.
  - TCAP funds may not be used for agency administrative, program or monitoring costs. While agencies may be compensated for their asset management expenditures – as in the tax credit exchange program – it appears that project owners will have to pay these types of expenses with either project revenues or non-TCAP (probably non-exchange program) funds.

- Properly allocating expenditures to permissible costs, which is a regular feature of tax-exempt bond financings, will likely have to be a part of the construction servicing function in TCAP and the exchange program.
6. HUD’s timeframes for housing credit agencies are very tight.
- The HUD Notice requires state housing credit agencies wishing to receive TCAP funds to submit a complete “TCAP Submission Packet” *within 30 days of the Notice* – by June 3, 2009. The packet must include the following information: statement of the credit agency’s intent to accept TCAP funds, including whether the agency wants the full amount of TCAP funding available or a specified lesser amount; a statement detailing the other Federal grant funds administered by the credit agency; a statement regarding the status of the 2009 tax credit allocation process; a description of the agency’s selection criteria and weightings for the award of TCAP funds; the manner in which the agency will define an “award” of tax credits for purposes of project eligibility; the agency’s procedures for the award and expenditure of TCAP funds to ensure that it and its project owners can meet the Recovery Act’s deadlines, including procedures for redistributing funds from projects that do not meet deadlines; procedures demonstrating the agency’s effort to comply with the Act’s “accountability and transparency requirements.”
  - The application must explain the agency’s project selection process and criteria for projects to receive funding. In order to meet this requirement, the agency must make that information available to the public and accept comments for a five-day period. *This publication and comment process must be completed before the agency can submit its application.*
  - HUD commits to review TCAP submission packets for completeness within 10 days of receipt.
7. Time is of the essence for projects as well as housing credit agencies.
- Agencies are required to *commit* at least 75% of TCAP funds within one year of the date of enactment of the Recovery Act – by February 16, 2010.
  - Project owners must *spend* – and agencies must report that owners have spent – 75% of funds within two years of the date of enactment and 100% within three years.
  - Grant funds not expended by the end of the three year period will be recaptured by HUD.
  - Owners who fail to expend TCAP funds in timely fashion are subject to having their funds withdrawn and “redistributed” by the housing credit agency to a “more deserving” projects in the state. The HUD Notice requires agencies, in their agreements with project owners, to “specify a schedule for the expenditure of TCAP funds and outline the circumstances under which TCAP funds will be recaptured if the project owner fails to meet the schedule.” Establishing and monitoring the expenditure schedule, thus, become part of the agency’s asset management responsibilities.

- The HUD Notice appears to leave it up to the agencies to determine what sanctions to impose upon project owners who fail to meet expenditure timelines, but it emphasizes the recapture and redistribution obligations noted above.
- Tight timeframes also govern disbursements of TCAP funds. As with exchange program funds, the HUD Notice explains that TCAP funds cannot be drawn from Treasury by the agency in advance and must be expended for eligible costs within 3 days of drawing.

8. Housing credit agencies are required to perform “asset management functions” to assure project compliance with Section 42 requirements and each project’s “long term viability.”

- This monitoring is to be performed at the owner’s expense, but cannot be paid for with TCAP funds.
- This obligation extends substantially beyond an agency’s normal monitoring and compliance activities under Treasury Regulations §1.42-5. It extends to supervision of construction draws and the disbursement schedule, and provision for recapture, at minimum.
- The HUD Notice also imposes substantial reporting obligations upon agencies as grantees, essentially parallel to the reporting requirements under the exchange program. These include quarterly reports as to: total amount of TCAP funds received; amount of TCAP funds expended or obligated to projects or activities, including unobligated balances; a detailed list of all projects or activities for which TCAP funds were expended or obligated, including: project name, description, completion status, and estimates of the numbers of jobs created and retained.

9. The HUD Notice expands on the statute’s mandate that various so-called “crosscutting requirements” applicable to federal financial assistance, generally, apply to TCAP.

- Under the Recovery Act, Davis Bacon will apply to *any* project receiving TCAP funds. The HUD Notice says, further, with regard to projects already under construction, “it *may* be possible to obtain a determination, under 29 CFR 1.6(g), that Davis-Bacon requirements apply prospectively to the construction project, as of the date of the TCAP award.” (Emphasis supplied.)
- Environmental review responsibilities under the National Environmental Policy Act (NEPA) and related laws<sup>3</sup> are substantial. In particular, the HUD Notice states: “*No TCAP funds may be committed to a project before completion of the environmental review process.*” (Emphasis in original.) Under the HOME provision that applies, the State government must assume NEPA review responsibility, which responsibility can be assigned to the housing credit agency (or the appropriate state environmental authority). Ordinarily, the environmental review process must be completed before construction begins. In this instance, however, HUD acknowledges that construction may already be

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<sup>3</sup> The statute makes specific reference to section 288 of the HOME Investment Partnerships Act, which incorporates the environmental requirements.

under way on projects seeking TCAP funding, and provides that, once an owner *applies* for TCAP funds, “undertaking any ‘choice-limiting’ activity prior to successful completion of the environmental clearance review” is prohibited. As a practical matter, however difficult for owners, this will likely require a stoppage of construction on projects seeking TCAP funding, pending completion of the environmental review process.

- Affirmative fair housing marketing requirements, Section 504 of the Rehabilitation Act of 1973 (concerning accessibility for the handicapped), and various lead based paint prevention and remediation requirements also apply to projects receiving TCAP funds, as do a number of more technical provisions.
- Using authority granted by the TCAP statute, HUD Secretary Donovan has waived the applicability of the Uniform Relocation Act and Section 3 of the HUD Act of 1968 (concerning business and employment opportunities for low-income persons) to TCAP projects.
- A more detailed description of the various crosscutting requirements discussed in this section is beyond the scope of this memorandum.

10. HUD is required to establish a website listing all projects receiving awards, the amount of each award, and a link to a housing credit agency website that describes the award-making process.

- The focus on transparency and accountability appears throughout the HUD Notice and may be expected to characterize all subsequent provision of assistance under the Recovery Act.
- The HUD Notice indicates that HUD will incorporate “imposes significant accountability, transparency and reporting requirements” into its TCAP grant agreements with state housing credit agencies.

HUD materials about TCAP and the link to state-by-state allotments may be found at the following website:

<http://www.hud.gov/recovery/tax-credit.cfm>

The HUD Notice is at:

<http://www.hud.gov/utilities/intercept.cfm?/recovery/notice.pdf>

The general HUD Recovery Act website is at:

<http://www.hud.gov/recovery/>

State-by-state allotments may be found at:

<http://www.hud.gov/recovery/tcaprecovery.xls>

Please do not hesitate to call me with questions.

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