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May 5, 2009

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Re: American Recovery and Reinvestment Act – Low Income Housing Impacts

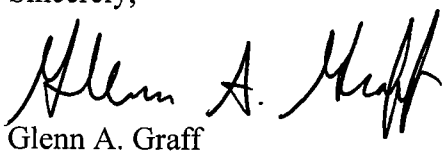
Dear Gentlepersons:

Enclosed are comments concerning the Low-Income Housing Tax Credit Exchange Program and Tax Credit Assistance Program contained in the American Recovery and

Reinvestment Act of 2009, P.L. 111-5 as prepared by the below-identified members of the Tax Credit-Equity Financing Committee of the American Bar Association Forum on Affordable Housing and Community Development Law ("ABA Forum"). These comments represent the individual views of those members who prepared them and do not represent the position of the American Bar Association, ABA Forum or the ABA Forum's Tax Credit–Equity Financing Committee. **We request that these comments be reviewed for possible responses during the May 6, 2009 webcast.**

Forrest Milder, Angela Christie and I had principal responsibility for preparing these comments. Substantive contributions were made by Alan Cohen and Michael Haun.

Sincerely,



Glenn A. Graff
Co-Chair, Tax Credit–Equity Financing Committee of the American Bar Association Forum on Affordable Housing and Community Development Law

I. EXECUTIVE SUMMARY

The American Recovery and Reinvestment Act of 2009, P.L. 111-5 ("ARRA") was signed into law on February 17, 2009. ARRA includes a number of provisions addressing the problems that the country is facing in efforts to create low-income housing. This letter focuses on the following three provisions of ARRA which have a substantial impact on the creation of low-income housing:

- Division B, Section 1602 – Grants to States for Low-Income Housing in Lieu of Low-Income Housing Credit Allocations for 2009
- Division B, Section 1404 – Coordination of Low-Income Housing Credit and Low-Income Housing Grants
- Division A, Home Investment Partnership Program (recently named the "Tax Credit Assistance Program" or "TCAP")

This letter also responds to the issuance of the following documents:

- U.S. Department of Housing and Urban Development May 4, 2009 Notice entitled "Implementation of the Tax Credit Assistance Program (TCAP)" (hereinafter referred to a the "HUD TCAP Notice")
- The U.S. Department of the Treasury Application and Terms and Conditions: Grants to States for Low-Income Housing Projects in Lieu of Low-Income Housing Credits for 2009 under the AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009 (hereinafter referred to as the "Exchange Application Package")
- TCAP Question and Answer: General TCAP Questions posted at http://www.hud.gov/recovery/tcap-general-qa.pdf. (hereinafter "TCAP Q&A")

The economic difficulties faced by the country, and in particular the low-income housing industry have resulted in a tremendous reduction in the construction of low-income housing. Thousand of projects across the country representing up to billions of dollars of construction and tens of thousands of low-income units are currently on hold pending guidance regarding the above provisions of ARRA. We have drafted this letter to provide suggestions for the issuance of guidance regarding the above sections and for inclusion in the May 6, 2009 webcast.

II. DISCUSSION

A. TAXABLE INCOME AND BASIS ISSUES RELATED TO EXCHANGE SUBAWARDS.

Question 1 – Are subawards of grants pursuant to Section 1602 of Division B ("Exchange Provision") taxable income to the recipients?

Answer 1 –Grants of subawards are not taxable income to the recipients.

Subawards of exchange funds are designed to function in two roles: (1) to fill the financial gap in projects that have an allocation of low-income housing tax credits ("LIHTC") under Section 42 of the Internal Revenue Code of 1986, as amended ("Code") but for which there are insufficient funds to build the project, and (2) for projects with no LIHTC investor interest, the subawards will be used to construct qualifying low-income buildings without the LIHTC as a funding source. Because the Exchange Provision requires adherence to requirements of Code Section 42, the grants cannot exceed the amount that the project will need for financial feasibility.

If the receipt of a grant of subaward funds was taxable to the recipient, then a portion of the grant would end up being paid back to the Treasury as tax on the grant income. This would increase the financial gap of the project and require additional subawards to make the project financial feasible. In this regard, we note that Congress seemed to understand the necessity of not imposing tax on the receipt of funds under the Exchange Provision as the Joint Explanatory Statement states that "Grants under this provision are not taxable income to the recipients."

In conclusion, we request guidance confirming that a grant of a subaward pursuant to the Exchange Provision will not result in taxable income to the recipient.

Question 2 – Is either the "basis" or "eligible basis" of a qualified low-income building funded with a grant of a subaward reduced in an amount equal to the subaward?

Answer 2 – Neither the basis nor eligible basis of a qualified low-income building is reduced due to the presence of a grant of a subaward.

Under general rules of tax law, the receipt of a non-taxable grant will result in the recipient receiving no basis in the asset purchased with the grant funds. However, Section 1404 of ARRA added a new Section 42(i)(9)(B) which provides that "Basis of a qualified low-income building shall not be reduced by the amount of any grant described in subparagraph (A)." The reference to "basis" logically would appear to be a reference to basis as defined under Section 1011. Thus it appears that ARRA has provided that a building's depreciable basis would not be reduced by the amount of a grant of subaward funds.

Section 42(i)(9)(B) does not directly address a project's eligible basis for purposes of Code Section 42. We note that Section 42(d)(5)(A) provides that "The eligible basis of a building shall not include any costs financed with the proceeds of a federally funded grant." However, we believe that Congress intended that eligible basis should not be reduced for such a grant. As discussed above, it is clearly intended by the plain words of the statute that such grants can be used to fill financial gaps for projects that continue to use LIHTC as a funding source. However, if the receipt of a grant reduced a project's eligible basis, then the amount of LIHTC that could be supported by the project would be reduced. This would increase the financial gap

of the project and require additional grants of subaward funds which would then further decrease a project's eligible basis and LIHTC repetitively. Given the Congressional limits on the amount of LIHTC which can be exchanged, this conclusion does not seem to fit the purpose of ARRA as the exchange program funds would not be able to create the intended qualified low-income buildings. We also note that if depreciable "basis" as discussed in the preceding paragraph is reduced for the amount of the grant, eligible basis would also be reduced creating the same financial shortfall issue.

In conclusion, we request guidance confirming that neither the eligible basis nor Section 1011 basis of a building must be reduced for the receipt of a grant of subaward funds.

B. RECAPTURE UNDER THE EXCHANGE PROVISION

Question 3 - What noncompliance triggers recapture under the Exchange Provisions?

Answer 3 – Section 1602(c)(4) states that recapture applies if a building does not remain "a qualified low-income building" during the compliance period. Under Section 42(c)(2), a building is a qualified low-income building as long as it is part of a qualified low-income housing project. Section 42(g)(1) defines a qualified low-income housing project as any project for residential rental property which is rent restricted and meets either the 20-50 or 40-60 minimum set-aside test, i.e either 20% of the units are rented to person's with incomes at or below 50% of area median gross income or 40% of the units are rented to persons with incomes below 60% of area median gross income. As a result, Section 1602(c)(4) seems to be stating that a building would only need to meet the minimum set-aside under Section 42(g)(1) to avoid recapture. Recapture under Section 42(j) is tied to decreases in qualified basis and since there is no computation of qualified basis concept with respect to subaward grants, it is reasonable to assume that recapture is only required when a building fails to meet the minimum set aside under Section 42(g)(1). In such a case, recapture of the entire "remaining" grant is required if the owner does not correct the non-compliance in a manner and timeframe acceptable to the Agency.

We anticipate that Agencies may desire to have stricter recapture requirements in that an Agency may choose to require an applicable fraction that exceeds the minimum set-aside. In such a case, we believe a reasonable approach would be that recapture would equal the amount of the "remaining" subaward multiplied by the difference between the Agency's required applicable fraction and the actual applicable fraction at the end of the year. Agencies should have the discretion not to impose recapture where the qualified low-income building continues to satisfy the minimum set-aside and therefore the requirements of Section 1602(c)(4) are being met.

Question 4 – Does the amount to be recaptured decrease over the compliance period?

Answer 4 – This is not addressed in the statutory language. However, given the linkage between the Exchange Provisions and Section 42, we believe that it is appropriate to use a

similar approach. Section 42(j) of the Code effectively provides that the recapture of LIHTC decreases over time. For a failure to meet the minimum set-aside, the net effect of recapture is that the amount subject to recapture and lost future LIHTC goes down by 1/15th for each year completed during the compliance period. For example, assume a failure to meet the minimum set-aside in the 7th year of the compliance period, i.e. 6 full years (60%) of the 15-year Section 42 compliance period had been successfully completed. Full recapture due to a failure to meet the minimum set-aside during the 7th year would result in a forfeiture of 1/3 of the LIHTC taking during the first 6 years and no additional credits for the last 4 years of the 10-year credit period. The LIHTC taken during the first 6 years would have been 60% of all the expected LIHTC to be generated during the Project. Giving back 1/3 of this LIHTC by recapture results in the taxpayer keeping 40% of the total expected LIHTC, thus the taxpayer loses 60% of the LIHTC (20% through recapture and 40% through loss of future LIHTC). Therefore, we believe it would be consistent with Section 42 for the amount of a subaward subject to recapture to be reduced by 1/15th for each year that the building satisfies the minimum set-aside. Thus after successful completion of 6 years, the "remaining" grant that could be recaptured would be 9/15^{ths} of the original grant or 60%.

Question 5 – Does the taxpayer have an opportunity to cure before recapture is triggered?

Answer 5 – Since a reasonable cure period is permitted before recapture of low-income housing tax credits occurs under traditional LIHTC allocations, a similar cure period should be permitted before recapture occurs with respect to exchange subawards. The Agency should have the discretion to determine the length of time for a cure period to be considered "reasonable".

Question 6 – Does a state need to secure the recapture obligation by a lien?

Answer 6 – The Act indicates that the recapture obligations may be secured by a lien. While liens may be required in most situations, there should be some flexibility to waive the lien requirement where the project's financing restrictions prohibit subordinate liens. In addition, permissible liens would include mortgages, regulatory agreements, land use restriction agreements or other agreements that encumber the property. See also the discussion in Question 10.

Question 7 – If a lien is obtained to secure the recapture obligation, can the lien be subordinated?

Answer 7 – For the recapture grants to be useful in transactions it is essential that the liens be subordinate to all financing required to make the project feasible. We note that low-income housing extended use agreements that are required under Section 42(h)(6) can be terminated in the event of foreclosure. Without such subordination or allowance for termination, it may become impossible for projects to receive any financing other than subawards even where the project would otherwise be eligible for such financing.

Question 8 – Do state housing agencies have any obligation to repay recapture to the Treasury?

Answer 8 – The Exchange Provision states that "any such recapture shall be payable to the Secretary of the Treasury." To the extent that an Agency is able to collect the recapture amount from the recipient of the subaward, the Agency needs to repay that amount to the Treasury. However, a state agency's obligation to repay amounts to Treasury should be limited to the amount collected from the subaward recipient less its related collection expenses.

C. NATURE OF SUBAWARDS PURSUANT TO EXCHANGE PROVISIONS?

Question 9 – What costs can subawards be used for?

Answer 9 – The Exchange Provision provides that subawards can be used to finance the construction or acquisition and rehabilitation of a qualified low-income building. It is not clear from this language if there is a limitation on the costs for which subawards can be used. For example, a building generally cannot be acquired without also acquiring the ground underneath the building. We note that the equity provided in a project qualifying for LIHTC is not restricted on the types of costs funded with equity dollars. Such equity is frequently combined with other financing which may have restrictions on how it can be used. In such cases, the equity commonly pays for land or other such non-qualifying costs.

We believe that Congress contemplated that some buildings could be entirely financed with subawards. For example, some qualified low-income buildings have extremely low rents in order to provide occupancy for tenants with little or no income. In such a case the qualified low-income building may not be able to support any financing other than exchange subawards. However, in these cases, if a subaward could not be used to acquire the project land, it would be impossible for the project to be completed. In addition, part of the success of the LIHTC program is due to the fact that Agencies and LIHTC investors require substantial reserves to be set aside to allow the projects to survive unexpected costs or decreases in rental income. Therefore restricting the use of subawards for costs such as these would undermine the long-term feasibility of many projects. As a result, subawards should be allowed to be used for project costs as permitted in the reasonable discretion of the Agencies.

Alternatively, to the extent that it is determined that there are limitations on what costs can be funded by subawards, direct tracing of subaward funds should not be required provided that subaward recipients can document compliance by establishing that the allowable acquisition, construction and rehabilitation costs of the qualified low-income building equal or exceed the amount of the subaward. In this regard we believe that the aforementioned documentation would be sufficient to satisfy the provision of the Exchange Application Package which states that a credit agency must have sufficient procedures to "permit the tracing of funds to a level of expenditure adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes."

Question 10 – Can an Agency choose to give a subaward to a taxpayer in the form of a loan?

Answer 10 – ARRA seems to permit an Agency to structure a subaward as a grant subject to a recapture lien or a secured non-interest bearing loan that will be forgiven at the end of the 15-year compliance period if recapture has not occurred. In either situation the Agency is meeting its obligation to secure recapture and we believe either structure would be deemed a grant (that is exempt from income tax as described above). However, it is not clear from the Exchange Application Package whether an Agency may choose to make a subaward to a taxpayer in the form of a loan that does not provide for forgiveness or which bears interest. The Exchange Application Package states the following: "The subawards shall be in the form of cash assistance and are not required to be repaid unless there is a recapture event with respect to the qualified low-income building." This seems to indicate that subawards should not require repayment to the credit agency but we request confirmation on this point.

We believe that there may be unintended consequences created from such non-forgivable loans. To the extent that subawards were intended to mimic the attributes of the LIHTC equity that they replace, we note it would be inconsistent to require a taxpayer to repay a subaward. In addition, requiring a taxpayer to repay a large subaward will diminish or eliminate any possible appreciation in the property. Given the restricted rents on qualified low-income buildings, cash flow is often severely limited and an owner's primary economic incentive related to a building is such building's appreciation over time. However, the elimination of a taxpayer's opportunity to profit from a building's appreciation will result in a lessening of a taxpayer's incentive to ensure that the building is well managed. Furthermore, the owner's will have little incentive to invest additional funds to maintain the building over time.

In the event that it is determined that such non-forgivable loans may be made, we believe that the Agency should retain the ability to forgive such loans in the future. However, if it has been determined that the grant of subawards does not create taxable income as discussed above, it should also be confirmed that a subsequent forgiveness of a subaward loan will not create taxable discharge of indebtedness income at such time. Without such clarification, tax implications will severely impact an Agency's future ability to preserve low-income housing by forgiving or restructuring a subaward loan. In addition, guidance would also be needed as to whether there is any obligation on an Agency to return to Treasury any principal or interest collected on exchange funds where there was no event of recapture.

D. ELIGIBILITY OF GO ZONE AND MID-WESTERN DISASTER CREDITS FOR THE EXCHANGE PROGRAM?

Question 11 – Are LIHTC awarded created under Section 1400N(c) or LIHTC awarded pursuant to Section 702 of the Emergency Economic Stabilization Act of 2008 eligible for the Exchange Program?[1]

Answer 11 – Yes. We are aware of the discussion in the Exchange Application Package as well as the correspondence between the Louisiana Housing Finance Agency ("LHFA") and Treasury on this issue. In the April 27, 2009 letter from Mr. Michael F. Mundaca, it was indicated that GO Zone Credits could be returned and reissued, but that such credits were not eligible for the exchange program because they are determined under Section 1400N(c). We respectfully disagree with this position and agree with LHFA. Treasury has confirmed that GO Zone Credits can be returned, however, the only method to return an LIHTC is through Section 42(h)(3)(C)(iii). Under Section 1602(b)(1)(A) of ARRA, a State may exchange up to 100% of LIHTC returned under Section 42(h)(3)(C)(iii). Therefore, returned GO Zone and Disaster Credits should qualify for the Exchange program.

E. TAX CREDIT ASSISTANCE PROGRAM ISSUES

Question 12 – Can TCAP funds be awarded to projects with GO Zone or Disaster Credits?

Answer 12 – We have reviewed the HUD TCAP Notice and the TCAP Q&A Question 1 and we respectfully disagree with the conclusions contained therein. The TCAP provision of ARRA provides that the TCAP funds can only be awarded to owners of projects who have received or receive simultaneously an award of low-income housing tax credits under section 42(h) of the Code. While GO Zone and Disaster Credits are created pursuant to statutory sections outside of Section 42, the creation of such Credits is inherently included in Section 42(h). Both the GO Zone Credit and Disaster Credit statutes increase the amount of the Housing Credit Ceiling under Section 42(h)(3)(C). Section 42(h) provides the rules for how Agencies may allocate their housing credit ceiling. For example, it is likely that all 2008 Disaster Credits were awarded pursuant to a carryover allocation of Section 42(h)(1)(E). As such, recipients of either GO Zone or Disaster Credits are eligible to receive TCAP funds provided that the other requirements of the TCAP provisions are satisfied.

Question 13 – Can TCAP funds be awarded to projects that receive LIHTC through the issuance of tax-exempt obligations?

Answer 13 – We have reviewed the TCAP Q&A Question 2 and request clarification. In response to "Are projects that have bond financing and so-called 4 or 9 percent credits eligible

[1] LIHTC awarded pursuant to Section 1400N(c) will be referred to as "GO Zone Credits". LIHTC awarded pursuant to Section 702 of the Emergency Economic Stabilization Act of 2008 will be referred to as "Disaster Credits".

for TCAP funding", the answer is "[a]ll projects which receive an allocation of LIHTCs under Section 42 of the IRC between October 1, 2006 and September 30, 2009 are eligible to receive TCAP funding. . . ." While it appears that this language approves the use of TCAP funds on tax-exempt bond financed projects, additional clarification would be helpful. Should the Q&A be interpreted to provide that a tax-exempt bond financed project must receive a Form 8609 by September 30, 2009? This interpretation seems contrary to the goal of providing economic stimulus. In order to meet that deadline a project would have needed to commence construction well before ARRA was passed in order to complete construction and receive a Form 8609 by September 30, 2009. An interpretation more consistent with the ARRA requirement that tax credits must have been "awarded" would be that tax-exempt bonds projects satisfy this requirement where the bonds have been issued and the project has received initial certifications under Code Section 42(m)(1)-(2) that the project is in compliance with the credit agency qualified allocation plan and that the issuer or credit agency had made a determination as to the amount of LIHTC needed for financial feasibility prior to September 30, 2009. In fact, consistent with the approach taken in the HUD TCAP Notice, the issue of what constitutes an "award" could be left to a state credit agency and such credit agency could be given broad discretion to determine that award could occur as early as issuance of an inducement resolution from the issuer of the tax-exempt bonds.

F. FEDERAL CROSSCUTTING REQUIREMENTS FOR EXCHANGE SUBWARDS

Question 14 – Do the various crosscutting federal grant requirements apply to Exchange subawards?

Answer 14 – No. While the HUD TCAP Notice is clear in stating that the various federal cross-cutting federal grant requirements must be met by projects that receive TCAP funds, the Exchange Application Package does not list this as one of the requirements for a subaward. Confirmation that such requirements do not apply would be extremely helpful to the affordable housing community. We believe such a conclusion is appropriate as the Exchange Provision is not part of the appropriations section of ARRA, Division A, and therefore the crosscutting requirements should not apply. This conclusion is supported by the fact that there are many shovel ready LIHTC projects that can be quickly started by using Exchange funds to replace the shortage of LIHTC equity. However, LIHTC projects that have been structured without other federal funds would not normally need to meet the crosscutting requirements. Imposition of these requirements would substantially slow down these projects as they would need to be restructured to satisfy the various requirements. It is noteworthy that given that the Exchange funds were intended to mimic the effect of LIHTC equity, LIHTC equity would not have imposed such substantial restrictions. We believe it is proper to infer that if Congress had desired to impose such drastic restructuring of projects participating in a program in Division B the tax section of ARRA, then Congress would have explicitly addressed this issue.