July 30, 2008

Housing Credit Modernization Becomes Law

President Bush today signed into law the most significant modernization of Low Income Housing Tax Credits since 1989, as part of the Housing and Economic Recovery Act of 2008. These Housing Credit changes address both long-standing issues as well as recent changes in the housing and investment markets. Most of the changes apply to buildings placed in service after "the date of enactment", which is today. This means that projects that have already received allocations of Housing Credits but have not yet been placed in service can benefit. Some changes will require state implementation.

- **Facilitating investment.** Key changes are designed to stimulate more investment.

    - **AMT exemption.** Investments based on Housing Credits, Historic Rehabilitation tax credits, and tax-exempt multifamily and single family housing bonds would be exempt from the Alternative Minimum Tax. The AMT exemption applies to Housing Credit properties placed in service after December 31, 2007, historic rehabilitation expenditures in periods after December 31, 2007, and tax-exempt housing bonds issued after today.

    - **Repeal recapture bond requirements.** Under current law, investors disposing of their interests in Housing Credit properties during the 15 year compliance period must post a bond to ensure that future recaptures of tax credits will be repaid, an unnecessary rule that makes investments less attractive. The bill repeals this requirement and replaces it with a change in the statute of limitations for recapture of tax so that the three year period does not begin to run until the IRS is notified by the taxpayer of a recapture event. The recapture bond repeal applies both with respect to future dispositions and to past dispositions if: (1) it is reasonably expected the building will continue to be operated as a qualified low-income building, and (2) the taxpayer elects to be subject to the new longer statute of limitations. This change would increase the liquidity of Housing Credit investments and could effectively reduce the investment holding period from 15 years to 10.

- **More Housing Credit and tax-exempt bond volume**

    - **Housing Credits.** Each state would have an additional $0.20 per capita to allocate in 2008 and 2009; the 2008 amount would rise to $2.20. The small state minimum allocation would also be increased by 10%.

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- **Tax-exempt housing bonds.** States would have additional tax-exempt housing bond authority totaling $11 billion in 2008 for multifamily housing or homeownership. Unused authority may be carried over to 2009 and 2010. Though 2010, homeownership bonds may be used to refinance subprime mortgages.

- **Recycling multifamily bond authority.** When a mortgage provided from a multifamily bond is repaid within four years of the bond's issuance, a re-funding bond may be issued within six months, though the automatic Housing Credit would not be available for the recycled bonds. This provision would enable bond proceeds (with so-called 4% credits) to be used for construction financing, repaid after construction, and then re-funded (without additional credits) to finance other multifamily housing. The re-funding bond must mature within 34 years of the date on which the original bond was issued. This provision applies to repayments of loans received after today.

- **Financial sustainability.** This change would address the problem of frozen rent and income ceilings for many current properties arising from implementation of data from the American Community Survey. Starting in 2009, in areas where rent and income ceilings were frozen in 2007 and 2008, these ceilings would rise along with local incomes. Separately, rent and income ceilings could not drop from year to year, starting in 2009. These changes would apply to both Housing Credits and tax-exempt bonds.

- **More equity for projects.** The bill includes three major changes to help fill financing gaps.

  - **A flat 9% credit rate floor.** The 70 percent present value credit rate is commonly called the "9 percent credit," but because interest rates are low, its actual current value is less than 8 percent annually. The bill would set a 9 percent floor on this rate for new and substantially rehabilitated buildings placed in service after today and before December 31, 2013, provided of course that a state has allocated sufficient credits. This increase could increase credits for a development by about 15 percent, enough to offset all or most of the recent drop in LIHTC prices. No similar flat rate would apply to 30% present value credits.

  - **Allow states to increase eligible basis by 30%.** Under current law, only high cost regions (Difficult Development Areas) and low-income communities (Qualified Census Tracts) are eligible for the extra 30%. This amendment would permit states to extend the extra 30% to properties in other locations if required for financial feasibility according to standards each state would set in its qualified allocation plan. States would also explain publicly their reasons for allocating additional credits to a project. The additional eligible basis would not be available to bond-financed housing.

  - **Repeal most below-market federal loan penalties.** The bill redefines "below-market federal loans" as those funded by tax-exempt bonds. Sponsors would no longer have to use only the 30% present value tax credit or exclude other below-market federal loans (e.g., below-market HUD or USDA loans) from eligible basis. A technical explanation clarifies that eligible basis may include the proceeds of a loan (regardless of its interest rate) funded by a federal grant, such as HOME or CDBG. This change will allow more equity to go to many federally financed projects, as well as simplify financial planning.

- **Targeted people and communities**

  - **Ongoing rent, interest and operating subsidies** will be permitted without reducing the eligible basis on which Housing Credits are calculated. This is a critical priority for serving the homeless and very poor. Previously, a possible interpretation might be that these ongoing subsidies should be treated as federal grants, substantially reducing the tax credits. A technical explanation of the bill by the Joint Committee on Taxation (JCX-63-08) clarifies that ongoing subsidies are not in any event to be treated as federal grants. No inference is intended with respect to buildings previously placed in service.

  - **General Public Use/targeted populations.** The bill clarifies that occupancy preferences and restrictions are permitted to favor tenants with special needs; who are members of a specified group under a Federal or State program or policy; or who are involved in artistic or literary activities. In 2007, IRS auditors began to challenge and prohibit targeting to some groups, asserting such housing fails to be available as required for "general public use". This clarification applies to past as well as future housing.

  - **Community service space** may occupy 25% of the first $15 million of a project's eligible basis and 10% of additional eligible basis within very low-income urban, rural and suburban communities (Qualified Census Tracts). Current law allows a flat 10% of eligible basis for such facilities. This major expansion should accommodate a range of community services important to sustainable communities.

  - **Rural income/rent ceilings** would be based on the greater of (1) AMI as under current law or (2) the national non-metro median income. For this purpose, rural areas follow the USDA/Rural Housing Service definition. The provision applies to all properties for determinations made after today. This would be very helpful in especially low-income rural areas. This provision would not apply to bond-financed properties.

  - **GO Zone bonus depreciation properties.** The new law removes the 12/31/08 deadline for starting construction on certain GO Zone properties eligible for a 50% bonus depreciation incentive. However, the new law retains the progress payment deadline of 1/1/10 and placement in service deadline of 12/31/10.

  - **Students formerly receiving foster care.** Students who formerly received foster care may occupy Housing Credit units, starting after today.

- **Military housing allowance.** Tenant income will not include the basic housing allowance paid to military personnel with respect to Housing Credit buildings located in certain counties (and adjacent counties) where there is a military installation that has experienced personnel growth of more than 20% between 12/31/05 and 6/1/08. Complex effective dates apply.

- **<u>Preservation of affordable housing</u>**

  - **Acquisition of buildings transferred within the previous 10 years.** Current law generally prohibits Housing Credits for the acquisition of properties transferred within the previous 10 years, but it allows the Treasury Department to provide waivers on certain federally assisted properties. The bill replaces this Treasury waiver approach by exempting from the 10-year rule housing assisted by HUD, USDA, or any state program with a similar purpose.

  - **Higher substantial rehabilitation thresholds.** Substantial rehabilitation would have to exceed $6,000 per unit (indexed for inflation) and 20% of building acquisition costs (instead of $3,000/10%). The change would apply to properties receiving allocations of Housing Credits after today.

  - **Allow credits for preservation of extended use Housing Credit properties.** Before, if a Housing Credit building is re-capitalized (e.g., after the initial 15-year compliance period), acquisition credits are available only if at least 90% of the investment interests changed hands. The bill requires only a 51% change, the typical tax code standard and far more achievable in practice.

  - **Section 8 Moderate Rehabilitation properties** could be preserved with Housing Credits. Such properties have been ineligible for Housing Credits for nearly 20 years.

- **<u>Energy efficiency and historic nature.</u>** In allocating Housing Credits starting in 2009, states must consider the energy efficiency and historic nature of proposed projects among the project selection criteria under section 42(m)(1)(C).

- **<u>Simplification</u>**

  - **Re-certifying incomes.** Annual re-certification of tenant incomes would not be required for any year in which no new tenant has an income above the low-income ceiling. This change applies to years ending after today.

  - **Project starting dates.** Projects would have to incur 10% of reasonably expected costs within 12 months of receiving an allocation of Housing Credits, instead of the previously required deadline of six months or the end of the allocation year.

  - **Conforming bond and credit rules.** Three rules applicable to tax-exempt bonds would be conformed to the Housing Credit rules. (1) The next-available unit rule for projects with multiple buildings and some untargeted units, but only if the project receives Housing Credits. (2) Students as eligible tenants. (3) Single-room occupancy housing.

- **GAO Study.** Congress's General Accountability Office will study the effects of these changes, including which projects receive Housing Credits.

- **Changes to HUD and USDA programs.** A separate part of the bill modifies various HUD and USDA programs to improve their coordination with Housing Credits.

    - **LIHTC tenant data collection.** The bill requires state agencies to collect annual data on concerning race, ethnicity, family composition, age, income, housing voucher utilization, disability status and rents. State agencies are to use existing reporting processes to the extent possible and minimize burdens on property owners.

    - **Project-based vouchers (PBVs)** should be easier to use. The bill: (1) permits an initial 15-year contract term, subject to annual appropriations, as well as 15-year renewal terms, and such renewals may be committed when the initial contract is set; (2) permits PBV rents above the LIHTC ceiling rent; (3) limits the use of PBVs to 25% of the units in a *project*, rather than in a *building*; (4) prohibits PBV rents from dropping below the initial PBV rent level; (5) eliminates duplicative subsidy layering reviews; (6) eliminates environmental reviews unless otherwise required; (7) permits PBVs in cooperatives and in elevator buildings; and (8) simplifies voucher rent reasonableness standards.

    - **FHA-insured mortgages** should become easier to use. For LIHTC projects, the bill: (1) eliminates HUD's subsidy layering review unless otherwise required; (2) eliminates cost certification requirements if the loan-to-cost ratio is under 80 percent; (3) bars HUD from requiring the escrow of tax credit proceeds or posting of letters of credit; (4) eliminates duplicative inspections; (5) directs HUD to rely on state monitoring; and (6) establishes a pilot program for streamlined insurance reviews through delegated underwriters.

    - **Section 202 elderly housing** projects using non-HUD funding should move faster. The bill requires HUD to delegate to willing states or localities the processing of such projects once HUD selects them to receive support.

    - **McKinney-Vento Shelter-Plus-Care** funding should become somewhat more flexible. The bill extends completion deadlines to 60 months and permits 15 year contract renewals, subject to annual appropriations.

    - **More broadly**, the bill requires HUD to: expedite approval of HUD projects using LIHTCs; work with the IRS to simplify coordination with LIHTCs and tax-exempt housing bonds; and consult with stakeholders and report to Congress on progress and recommendations. Similarly, the bill requires USDA to: speed the processing of Section 515 project transfers for preservation and rehabilitation; and coordinate with the IRS on such projects.