MEMORANDUM

TO: RECIPIENTS OF SECTION 1602 FUNDING
FROM: NORM HARROD AND STEPHEN LATHOM
SUBJECT: 30% TEST REQUIREMENTS
DATE: OCTOBER 11, 2010
CC:

Background: This memo is intended to provide owners of projects receiving an award of Section 1602 funds with information regarding expenditure obligations required by the American Recovery and Reinvestment Act of 2009 (ARRA). As implemented by the Department of Treasury, all recipients of Section 1602 funding must either:

a) have fully disbursed all Section 1602 funds by December 31, 2010 (this would include having not only drawn the funds from Authority but would require that the Authority have subsequently drawn down the funds from Treasury prior to year end); or

b) have paid/incurred at least 30% of the project’s adjusted basis costs “in land and depreciable property” by December 31, 2010.

For projects that have met the “30% Test” requirement, Treasury will allow the expenditure of Section 1602 funds on that project to continue into 2011. Since very few projects have fully expended their Section 1602 funding, the Authority expects that nearly all recipients of Section 1602 funding in Michigan will be required to meet the 30% test.

It is important to note that the 30% Test does not require that any Section 1602 funds have been disbursed on a given project. A development can meet the 30% test by incurring at least 30% of the project’s anticipated adjusted basis by year-end even if those costs were paid with other financing sources such as tax-exempt mortgage proceeds, TCAP funds, LIHTC equity, USDA financing, etc.

Additionally, the 30% test is based on the same methodology as the 10% carryover requirements that most industry participants are already familiar with. Treasury Regulation §1.42-6 provides the foundation for these requirements, and the key distinction is that the 30% Test requires projects be further underway. Owners should consult their accountants if they have detailed questions, but generally with the exception of land, most costs not included in eligible basis do not count toward the 30% Test. So the upfront establishment of reserves, payment of initial asset management fees, permanent financing fees, or partnership costs cannot be counted toward the 30% Test.

According to guidance from Treasury, projects that fail to meet the 30% Test as of December 31st will be ineligible to receive additional Section 1602 funds after that date, and any un-disbursed Section 1602 awards on such projects will be revoked and
returned to Treasury. However, an owner’s obligation to finish the project will remain, and failure to complete the project and provide qualified low-income housing will result in a recapture of any Section 1602 funds having already been received.

Treasury has provided states with direction on how to assess and document if projects have met the 30% Test. The Authority has modified the Treasury “Subawardeee Report of Expenditures” to include submission directions and a MSHDA project number field.

Interim Certification: In order to identify projects at greatest risk of failing the 30% Test, the Authority is requiring that all recipients of Section 1602 funding submit an “Interim Subawardee Report of Expenditures.”

All projects receiving Section 1602 funds must submit the Interim Report to the Authority no later than Friday, November 5, 2010. Projects that have met or exceeded the 30% Test prior to October 31, 2010 may submit their Interim Subawardee Report at any time prior to this deadline.

The Interim Subawardee Report must be accompanied by an Independent Account’s Report on Applying Agreed-Upon Procedures identifying whether or not the 30% Test has been met by October 31, 2010. Projects that meet the 30% Test requirements by October 31, 2010 will not be required to submit an Independent Account’s Report with the Subawardee Report of Expenditures as of December 31, 2010.

Projects that have not met the 30% Test by October 31st will be contacted by appropriate Authority staff to assess project progress and determine whether or not the project can meet the 30% Test requirements by year-end. Additionally, projects that have not met the 30% Test by October 31st will be required to submit a second Independent Account’s Report on Applying Agreed-Upon Procedures concurrently with their December 31st report.

Year End Certification Requirements: Using the “Subawardeee Report of Expenditures as of December 31, 2010,” project owners are required to report on their expenditures as of the end of the year. Owners should note that they will be required to certify, under penalty of perjury, how much in adjusted basis costs have been “incurred” as of the close of business on December 31, 2010. To assist with this certification, owners are encouraged to consult with their accountant and/or legal counsel to ensure that this test has been properly satisfied.

Since Treasury is requiring the Authority to report on the percentage of adjusted basis costs incurred on all projects—including those that have otherwise drawn down all Section 1602 funds—all projects receiving Section 1602 funds must submit this form to the Authority no later than Wednesday, January 5, 2011.

As of January 1, 2011, no draws of Section 1602 or other Authority-held funds will be approved on projects that have not submitted the Subawardee Report of Expenditures as of December 31, 2010.

Independent Account Requirements: Owners should further be aware that the definition of “incurred” varies depending on whether the LDHA recipient of Section 1602 funds has chosen to use cash or accrual accounting methods. In particular, LDHA entities using the accrual method should consult the Treasury Regulations at §1.461-4 to determine when a cost has been “incurred.” Again, all owners should refer to Section 42 of the Internal Revenue Code and Treasury Regulation §1.42-6 for further guidance regarding the requirements for the 30% Test.
Owners should also consult with their accountant and/or legal counsel if they have additional questions about how to characterize costs.

As noted above, owners are required to submit an Independent Accountant’s Report on Applying Agreed-Upon Procedures with the Interim Subawardee Report. Only projects that have met or exceeded the 30% Test, as supported by an independent accountant, by October 31, 2010 will be allowed to self-certify costs incurred as of December 31st.

For those projects that do not meet the 30% Test by October 31, 2010, the Subawardee Report of Expenditures as of December 31, 2010 must be accompanied by another Independent Accountant’s Report on Applying Agreed-Upon Procedures.

Questions: If you have any questions regarding your project’s progress toward the 30% Test, please contact your assigned Closing Specialist (or for Reinvestment and Innovation Program transactions your assigned Transaction Specialist).

All submissions must be sent to:

Carol Thompson  
Low Income Housing Tax Credit Program  
Michigan State Housing Development Authority  
735 East Michigan Avenue, PO Box 30044  
Lansing, Michigan 48909
30% TEST REQUIREMENTS

QUESTIONS AND ANSWERS

Q1: A project has anticipated adjusted basis of $1,000,000, and as of December 31, only $299,900 in eligible costs have been incurred. That is 29.99% of the adjusted basis, can the expenditure percentage be rounded up to 30% for purposes of the 30% Test?

A1: No, Treasury has indicated that the 30% Test is an absolute test and rounding up from a figure below exactly 30% is not acceptable.

Q2: Can a project meet the 30% Test by purchasing building materials and storing them?

A2: Owners should consult with their accountants and/or legal counsel to fully understand the issues involved. However, Authority policy does allow disbursement of mortgage loan proceeds for materials that are purchased and properly stored on site. Additionally, under certain circumstances, materials purchased by the owner and stored off-site may be considered “incurred” costs.

In order to draw funds for materials stored off-site—including mortgage loan proceeds from the Authority—the following process and considerations must be followed:

1. Along with the MSHDA payment request form; Contractor must provide a complete list of all stored building materials, including copies of the invoices for all such materials.

2. A letter of credit payable to MSHDA for the amount of materials stored offsite must be provided.

3. Building materials stored off-site must be in the actual possession of either prime contractor or subcontractors seeking payment.

4. All stored materials are subject to 10% retainage.

Q3: Can an owner of a Reinvestment Program Project count the existing basis it has in the land and property being rehabbed toward the calculation of meeting the 30% Test, or must the test be met based on the “new” transaction for which the 1602 funds were awarded?

A3: The so-called “pre-existing” basis in the project does not count toward the 30% Test. The 30% Test applies to the project in the subaward agreement, which in the case of a Reinvestment Program transaction is only the rehabilitation. The “prior” project in which the property was acquired would not be part of the cost basis for the 30% Test associated with the “rehabilitation only” transaction for which Reinvestment Program funding was awarded. Any basis an owner currently has in the land and any un-depreciated value it may have in the existing project would not be included, and the 30% Test would apply only to the “new” transaction.

Note that for most 4% of 9% Equity Support or 9% Tax Credit Exchange transactions, acquisition of land can be counted toward the 30% Test.

Q4: My project includes several funding sources including Section 1602 Funds. However, I plan to use local HOME funding and other funding sources at closing to purchase the property and
begin construction. As a result, I do not believe I will expend 30% of my Section 1602 funding by the end of the year. Will I fail the 30% Test?

**A4:** Provided 30% of the project’s anticipated adjusted basis is incurred by year-end, the 30% Test will be satisfied even if not Section 1602 funds have been drawn down. In many projects, the specific needs of the transaction require that other funding sources be the first ones used in a transaction; owners with questions about the construction-period schedule of sources and uses should consult their assigned Closing Specialist or Transaction Specialist.