Client Alert

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Treasury and HUD Issue Guidance on Section 1602 and Tax Credit Assistance Programs

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On May 4, 2009, the U.S. Department of Treasury ("Treasury") and the Department of Housing and Urban Development ("HUD") released separate guidance on two programs created by the American Recovery and Reinvestment Act of 2009 (the "Act") that relate to the low-income housing tax credit ("LIHTC"). The Act created the Section 1602 program (the so-called Exchange Program), which permits eligible state housing credit agencies ("Agencies") to "exchange" up to 40% of a state's 2009 LIHTC ceiling and 100% of certain LIHTCs carried forward or returned to the Agency for cash to finance construction or acquisition and rehabilitation of a qualified low-income building.

The Act also provided for an additional $2.25 billion in HOME Program funding to Agencies pursuant to the new Tax Credit Assistance Program ("TCAP Program") to address funding gaps caused by the sharp decline in investor demand.[1] Under the TCAP Program, HUD will award grants pursuant to a formula to Agencies, which in turn will provide subawards for projects that received, or will receive, LIHTC in fiscal years 2007, 2008 and 2009. The following is a summary of the guidance provided by Treasury and HUD on these programs.

Treasury Guidance

Treasury released guidelines and instructions on the application process on May 4 for Agencies that are interested in accepting all or a portion of its eligible Section 1602 grant funds.[2] Highlights from the guidance follow.

[1] For additional information about the Exchange Program and the Tax Credit Assistance Program, see our February 2009 Client Alert titled "The American Recovery and Reinvestment Act of 2009 – Changes Impacting the Tax Credit Market."

[2] *See*, 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, released by the U.S. Treasury Department, Office of the Fiscal Assistant Secretary.

Eligible Participants

Only the Agencies that file Form 8610 (Annual Low-Income Housing Credit Agencies Report) for their state are eligible to apply for and receive grant funds from the Section 1602 program. These Agencies, as sole recipients of the grant funds, must coordinate with other participating agencies within their state and enter into written agreements to ensure that participating agencies comply with all applicable terms and conditions of the program.

Submission Requirements

Treasury is accepting the first round of applications from Agencies beginning May 1, 2009, through June 30, 2009, but will continue to accept applications from Agencies through 2010 for additional grants.[3] Agencies are instructed to send completed applications and the signed Grantee Terms and Conditions electronically to 1602Apply@do.treas.gov. The guidance indicates that Treasury will review each application for eligibility and completeness within 10 working days of receipt.

If the application is complete, Treasury will send the Agency a grant agreement, which serves as the official notification that grant funds have been awarded to the Agency. The grant agreement will incorporate information contained in the Agency's application and the Terms and Conditions.[4] Treasury will then make funds available to the Agency as needed to draw upon for subawards.[5] If an Agency requests additional grant funds, and Treasury approves the request, Treasury will amend the grant agreement accordingly.

Eligible Projects

Agencies may only make subawards to projects which are qualified low-income buildings under Section 42 of the Internal Revenue Code ("Code"). The amount of the subaward must not exceed the amount necessary to ensure the financial feasibility of a project through its 15-year compliance period.

Agencies must make a determination before making any subawards that applicants have demonstrated a "good faith effort" to obtain commitments from tax credit equity investors in lieu of a subaward. It is not yet clear what constitutes a "good faith effort," but each Agency must establish a written process by which they will make such a determination.

The written guidance confirmed that additional LIHTC for the Gulf Opportunity Zone ("Go Zone") and the Midwestern and Hurricane Ike Disaster Areas (including amounts returned from LIHTCs previously allocated in Go Zone and Midwestern and Hurricane Ike Disaster Areas) are not eligible under the exchange program.

[3] At the time Treasury released its guidance, several factors that comprise the 2009 State Housing Credit Ceiling were not known, including the amount of State LIHTC ceiling returned in 2009 and the amount of unused LIHTC carryover allocated to the State from the 2009 National Pool.

[4] The Terms and Conditions include such items as grantee eligibility, project eligibility and permitted uses of funds.

[5] Funds may not be drawn from Treasury in advance of need. Once funds are drawn from the grantee's U.S. Treasury account, they must be expended as a subaward by the grantee within three days, or if grant funds are transferred to another agency, as a subaward by that agency within three days following the date of the transfer by the grantee.

Structured as Grant Funds

Treasury's guidance provides that the assistance must only be in the form of grants, not loans, which raises a number of tax issues.[6] Although there is support in the legislative history of the Act to suggest that grant funds under the Section 1602 program are not taxable income to recipients, uncertainty persists because the reference to the funds as "not taxable income" is not in the law itself.[7] The Act did provide that eligible basis is not required to be reduced by the amount of Section 1602 grant funds. There are unresolved questions, however, as to whether (i) the grant funds should be treated as income (or tax-exempt income) for purposes of increasing partners' capital accounts and (ii) the partnership receiving the grant can include assets acquired with the proceeds in depreciable basis. Rep. Barney Frank, Chairman of the House Financial Services Committee, submitted a formal request to Treasury on June 1, 2009, that Treasury provide additional guidance to clarify that loans are an acceptable form of subaward.

Other Requirements

Agencies that receive grant funds under the Section 1602 program must make all subawards by December 31, 2010. Any grant funds not used to make subawards by this date must be returned to Treasury on January 1, 2011.

Before funds can be disbursed, recipients of subawards must enter into a legally binding agreement, which sets forth all conditions and restrictions of the Section 1602 program and the requirements of Section 42 of the Code, to ensure that a building will remain a qualified low-income building during the 15-year compliance period. The agreement must also include provisions providing for the recapture of the subaward if the project fails to comply with the requirements of the Section 1602 program or with any of the requirements under Section 42 of the Code.

Agencies must submit two quarterly reports to Treasury – a financial status report and a project performance report – within 10 working days after the end of each quarter. The performance report must contain specific information for each project that has received a subaward during the quarter.[8]

Agencies are instructed to perform asset management functions to ensure that recipients of subawards comply with Section 42 of the Code. Agencies must also maintain sufficient program, financial, and accounting records to demonstrate that grant funds were used in accordance with the terms and conditions of the Section 1602 program.

HUD Guidance

In Community Planning and Development Notice 09-03 ("Notice"), HUD set forth the submission, eligibility and program requirements for the implementation of the Tax Credit Assistance Program ("TCAP

[6] The Terms and Conditions provides that "subawards shall be in the form of cash assistance" that is "not required to be repaid unless there is a recapture event," and Agencies are prohibited from using grant amounts for any other purpose. Accordingly, it appears that Agencies may not structure subawards under the Section 1602 program as loans.

[7] On May 6, 2009, Treasury and HUD conducted a webinar to provide additional information on the written guidance. Based on comments made by a representative of Treasury during the webinar, grant funds under the Section 1602 program will not constitute taxable income to the recipient.

[8] The performance report must provide the following information for each project that has received a subaward during the quarter: (i) name of recipient entity; (ii) name of project; (iii) brief description of project; (iv) location of project (city/county, state, zip code); (v) number of construction jobs created; (vi) number of construction jobs retained; (vii) number of non-construction jobs created; (viii) number of non-construction jobs retained; (ix) number of total housing units newly constructed; (x) number of total housing units rehabilitated; (xi) number of low-income housing units newly constructed; and (xii) number of low-income housing units rehabilitated.

Program"). The Notice indicates that additional guidance on the disbursement process, recordkeeping, reporting, and other federal grant requirements will be provided as they become available.[9]

Submission Requirements

Only the Agencies of each of the 50 states, the District of Columbia and the Commonwealth of Puerto Rico are eligible to apply for funds under the TCAP Program. Project owners will apply for TCAP funds directly with the Agency. Agencies were required to submit specified information to HUD within 30 days of the date of the Notice (*i.e.*, by June 3, 2009).[10] The Notice indicated that HUD would review submissions within 10 days of receipt for completeness and provide notice of any deficiencies along with instructions for curing the deficiencies. The TCAP Submission Package includes the following items:

Statement of Intent. Each Agency must indicate whether it will accept the entire amount of its TCAP formula allocation or, if it will request less, the exact amount of TCAP funds it is requesting. The amount requested by the Agency cannot change once the submission is complete. The Agency must also provide information on any federal grant funds it currently administers and the status of its 2009 LIHTC allocation process.

Description of Competitive Selection Criteria. TCAP funds must be awarded on a competitive basis and in accordance with the state's qualified allocation plan. Each Agency must describe in its submission package the selection criteria that it has adopted for competitively awarding TCAP funds, subject only to the requirement that Agencies give priority to projects that are expected to be complete within 3 years from the date of the Act (by February 16, 2012).

Deadlines. Each Agency must describe the procedures that it will use to ensure that it will meet the deadlines set forth in the Act and how it will redistribute funds from projects that fail to meet deadlines. The Act requires Agencies to commit no less than 75% of the TCAP grant within one year of enactment of the Act (by February 16, 2010), and project owners must spend 75% of TCAP funds within two years of enactment of the Act (by February 16, 2011) and 100% of the TCAP funds within three years of enactment of the Act (by February 16, 2012). TCAP funds not expended within three years will be recaptured by HUD.[11]

Accountability and Transparency. Each Agency must publish on its website its selection criteria for TCAP funds and provide a public comment period of not less than five days. Agencies must also describe how the Agency will meet the public comment requirement as well as how it will comply with the accountability and transparency requirements for the duration of the TCAP grant.

Additional Submission Requirements. Each Agency must submit to HUD a Standard Form 424 (Application for Funds), which requires each Agency to have a Data Universal Numbering System (DUNS) number from Dun and Bradstreet. Agencies must also be registered in the Central Contractor Registration.[12]

[9] HUD will continue to post additional requirements and guidance for the TCAP Program at www.hud.gov/recovery/tax-credit.cfm. Questions may also be submitted (but only by eligible grantees) to HUD at TCAP@hud.gov.

[10] HUD states that any Agency which fails to submit the required TCAP Submission Packet will be considered to have declined the receipt of its entire TCAP formula allocation.

[11] Similar to the Section 1602 program, funds may not be drawn down in advance of need, and once drawn, funds must be expended for an eligible cost within three days.

[12] The Notice provides additional information as to how Agencies can obtain a DUNS number and how they can register with the Central Contractor Registration.

Once HUD determines that a submission is complete, HUD will execute a grant agreement (called a TCAP written agreement) with the Agency, which will include applicable TCAP Program requirements, federal grant requirements and reporting requirements required by the Act. The agreement must be recorded and be binding on all owners and successors and may not be executed until the environmental clearance for the project is completed and the request for release of TCAP funds is approved. The Notice provides that HUD will be issuing more specific guidance on requirements for TCAP written agreements in the future.

Eligible Projects and Use of Funds

To receive TCAP funds, a project must need additional funding to be completed and be awarded LIHTC under Section 42(h) of the Code for federal fiscal years 2007, 2008 or 2009 (October 1, 2006 to September 30, 2009). While the Notice provides that projects awarded LIHTC that will also receive bond financing are eligible to receive TCAP funds, it is not clear whether the intent of this language is to permit projects that only receive LIHTC by virtue of tax-exempt bond financing to receive TCAP funds. The Notice also provides that if the only source of LIHTC for a project is Go Zone or Midwestern Disaster Area LIHTCs, the project is not eligible for TCAP funds since it was not awarded LIHTC under Section 42(h) of the Code.[13] The Notice directs Agencies to define an "award of LIHTCs," which must be applied uniformly to all LIHTC projects for purposes of determining eligibility for TCAP funding.

TCAP assistance is subject to the same restrictions (including rent, income, use restrictions and compliance monitoring) as required for LIHTC projects. TCAP funds must be used for capital investment, which according to the Notice means costs that are included in "eligible basis" under Section 42 of the Code.[14]

Structured as Grants or Loans

Unlike 1602 Program funds, TCAP funds may be structured as either a grant or a loan to a project; however, if the TCAP funds are structured as a loan, then to the extent that an Agency is repaid principal or interest on the loan during the grant period, the amounts repaid constitute "program income" that must be expended before any additional TCAP funds can be appropriated to the Agency.

Applicability of Federal Rules

Although TCAP funds were appropriated under the HOME Program, HOME Program rules do not apply, but other federal rules generally applicable to appropriated federal funds do apply,[15] including the following:

- Fair Housing Act
- Davis-Bacon Act
- Age Discrimination Act of 1975
- Title VI of the Civil Rights Act of 1964
- Section 504 of the Rehabilitation Act of 1973

[13] HUD has indicated that Agencies may allocate a nominal amount of Section 42(h) credits through September 30, 2009, concurrent with an award of TCAP grant funds, to projects that have received an award of Go Zone or Midwestern LIHTCs, thereby qualifying such projects for TCAP funding. *See*, TCAP Question and Answer: General TCAP questions, at www.hud.gov/recovery/tax-credit.cfm.

[14] Agencies may not use TCAP funds for administrative costs, and the Act specifically prohibits use of TCAP funds for swimming pools.

[15] The Buy American provisions do not apply to TCAP funds.

- National Environmental Policy Act and related laws
- Lead-Based Paint Poisoning Prevention Act
- Residential Lead-Based Paint Hazard Reduction Act of 1992
- Anti-Lobbying Restrictions
- The Drug-Free Workplace Act of 1988

At the time of this Alert, many questions remain about the Section 1602 program and TCAP Program. Pillsbury will continue to monitor information released by Treasury and HUD about these two programs.

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