TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS
LEGAL DETERMINATION

TO: Interested parties
FILE

FROM: Kevin Hamby
General Counsel

DATE: February 24, 2009

RE: Harmonizing H.R.1 American Recovery and Reinvestment Act of 2009 (ARRA) Title XII Captioned HOME Investment Partnerships Program (Gap Financing for Tax Credit Properties) and Texas Government Code Chapter 2306

QUESTION PRESENTED:

Does the Texas Government Code §2306.111(c) regarding the 95/5 allocation apply to the funds made available for tax credit properties in ARRA HOME Investment Partnerships Program?

SHORT ANSWER:

No. Federal law preempts state law on this issue, and, as specified in ARRA, the funds must be distributed according to the tax credit set asides and regional allocation formula called for under Texas statutes and the QAP.

FACTS:

The ARRA was passed by Congress and signed into law by President Obama on February 17, 2009. This law contains many provisions designed to stimulate the economy. One section of the bill, found in Title XII, relates supplemental funds to provide gap financing for tax credit properties being delivered to the local Housing Finance Agencies in charge of tax credits. This section is titled Home Investment Partnerships Program (at pp. H.R. 1-106-107). The funds are delivered based on the Home Investment Partnerships Program ("HOME") formula, but rather than the usual delivery method, these funds are to be delivered to the State Housing Finance Agency in charge of tax credits. In many states the housing finance agency does not administer the HOME program. Usually, HOME funds are provide to the local HUD office for distribution to participating jurisdictions, and in the case of Texas, a percentage of these are provided to the state for non-participating jurisdictions. This program is new funding not previously available or committed in the Consolidated Plan by the Department. This makes it different than the grant funds made available in §1602 of ARRA, also related to tax credit properties.

LEGAL ANALYSIS:

The Texas Government Code in §2306.111 provides that funds under the Cranston-Gonzales national Affordable Housing Act (42 U.S.C. §12704 et seq.) will be provided to the TDHCA for distribution according to this section. The legislature has directed the allocation of the HOME funds in the following section of the Texas code:

> (c) In administering federal housing funds provided to the state under the Cranston-Gonzalez National Affordable Housing Act (42 U.S.C. Section 12701 et seq.), the department shall expend:
>
> (1) 95 percent of these funds for the benefit of non-participating small cities and rural areas that do not qualify to receive funds under the Cranston-Gonzalez National Affordable Housing Act directly from the United States Department of Housing and Urban Development; and
>
> (2) five percent of these funds for the benefit of persons with disabilities who live in any area of this state.
>
> (c-1) The following entities are eligible to apply for set-aside funds under Subsection (c):
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> (1) nonprofit providers of affordable housing, including community housing development organizations; and
>
> (2) for-profit providers of affordable housing.
>
> (c-2) In allocating set-aside funds under Subsection (c), the department may not give preference to nonprofit providers of affordable housing, except as required by federal law.

This section is commonly referred to as the "95/5 rule." This provision requires that 95% of all HOME funds received by the state go to non-participating jurisdictions, which are usually more rural in nature.

The ARRA, however, directs the state on how to spend these funds and removes the discretion and other distribution criteria normally associated with HOME funds. The ARRA states the funds are to be used exclusively for tax credit properties and "each State shall distribute these funds competitively under this heading and **<u>pursuant to their qualified allocation plan</u>** (emphasis added)." This language preempts any other state provisions regarding the distribution of these funds. The ARRA also provides "that projects awarded low income housing tax credits under section 42(h) of the IRC of 1986 in fiscal years 2007, 2008 or 2009 shall be eligible for funding under this heading. . ."

The TDHCA also administers the Low Income Housing Tax Credit program on behalf of the State of Texas. This program is governed by Texas Government Code Chapter 2306. Part of this Chapter requires the development of a Qualified Allocation Plan ("QAP") or process for awarding tax credits. Plans have been approved in accordance with the statutory requirements and agreed to by the Governor for the years 2007, 2008, and 2009.

The QAP takes into account several statutory requirements for the distribution of funds. Specifically, Texas Government Code §2306.111 states:

> (d) The department shall allocate housing funds provided to the state under the Cranston-Gonzalez National Affordable Housing Act (42 U.S.C. Section 12701 et seq.), housing trust funds administered by the department under Sections 2306.201-2306.206, and commitments issued under the federal low income housing tax credit program administered by the department under Subchapter DD to all urban areas and rural areas of each uniform state service region based on a formula developed by the department under Section 2306.1115 If the department determines under the formula that an insufficient number of eligible applications for assistance out of funds or credits allocable under this subsection are submitted to the

department from a particular uniform state service region, the department shall use the unused funds or credits allocated to that region for all urban areas and rural areas in other uniform state service regions based on identified need and financial feasibility.

(d-1) In allocating low income housing tax credit commitments under Subchapter DD, the department shall, before applying the regional allocation formula prescribed by Section 2306.1115, set aside for at-risk developments, as defined by Section 2306.6702, not less than the minimum amount of housing tax credits required under Section 2306.6714. Funds or credits are not required to be allocated according to the regional allocation formula under Subsection (d) if:

(1) the funds or credits are reserved for contract-for-deed conversions or for set-asides mandated by state or federal law and each contract-for-deed allocation or set-aside allocation equals not more than 10 percent of the total allocation of funds or credits for the applicable program;

(2) the funds or credits are allocated by the department primarily to serve persons with disabilities; or

(3) the funds are housing trust funds administered by the department under Sections 2306.201-2306.206 that are not otherwise required to be set aside under state or federal law and do not exceed $3 million during each application cycle.

(d-2) In allocating low income housing tax credit commitments under Subchapter DD, the department shall allocate five percent of the housing tax credits in each application cycle to developments that receive federal financial assistance through the Texas Rural Development Office of the United States Department of Agriculture. Any funds allocated to developments under this subsection that involve rehabilitation must come from the funds set aside for at-risk developments under Section 2306.6714 and any additional funds set aside for those developments under Subsection (d-1). This subsection does not apply to a development financed wholly or partly under Section 538 of the Housing Act of 1949 (42 U.S.C. Section 1490p-2).

(d-3) In allocating low income tax credit commitments under Subchapter DD, the department shall allocate to developments in rural areas 20 percent or more of the housing tax credits in the state in the application cycle, with $500,000 or more in housing tax credits being reserved for each uniform state service region under this subsection. Any amount of housing tax credits set aside for developments in a rural area in a specific uniform state service region under this subsection that remains after the initial allocation of housing tax credits is available for allocation to developments in any other rural area first, and then is available to developments in urban areas of any uniform state service region.

(e) The department shall include in its annual low income housing plan under Section 2306.0721:

(1) the formula developed by the department under Section 2306.1115 ;and

(2) the allocation targets established under the formula for the urban areas and rural areas of each uniform state service region.

This language requires and the QAP reflects that there is a minimum amount to set aside for at risk properties—including USDA properties and a set aside for rural properties equal to 20% of the total amount or $500,000 per rural region. All funds should be made available first on the Regional Allocation Formula (formula approved by TDHCA in accordance with Texas Government Code §2306.1115) for the 26 regions, as set forth in the QAP. A statewide collapse would occur only if the funds are not requested in any one region. It should be noted that before there can be a statewide collapse the rural set aside must still be met if applications are available whereby any rural deal will get funded first out of the rural set aside before a statewide collapse.

ANSWER:

Federal law directs that these funds shall be distributed according to the state QAP for the purpose of supporting tax credit properties. The distribution by the QAP formula preempts the distribution method described in Texas Government Code §2306.111(c). Therefore the distribution method, regardless whether these funds are characterized as HOME program funds, must follow the distribution called for in §2306.111(d-1) - (e) and in a similar format to the QAP. This effectively distributes the funds as if they were tax credits rather than HOME funds.

Note that there are other issues that may require legal determinations regarding this program, and this determination only attempts to address the issue of who will be eligible for the supplemental HOME funding if the program is approved by the TDHCA Governing Board.