

Section 1602: Grants to States for Low-Income Housing Projects in Lieu of Low-Income Housing Credits for 2009

FREQUENTLY ASKED QUESTIONS AND ANSWERS

The following questions and answers are intended to assist Section 1602 recipients to understand and comply with program requirements. They are organized in the same order as the Grantee Terms and Conditions.

These questions and answers are not a substitute for reading and understanding the Recovery Act, Terms and Conditions, Section 42 of the Internal Revenue Code, or other regulatory requirements.

1. Application Process

1a. Question: Page 2 of the application package says that Treasury accepts applications from State housing credit agencies for the first portion of the funds in May and June 2009. Does this mean that an agency which does not apply in May or June loses the opportunity to do so subsequently?

Answer: A State housing credit agency which is listed as a Designated Agency on pages 7 and 8 of the application package may submit applications in 2009 and 2010. The application package used the May-June 2009 time frame to encourage agencies to begin as soon as possible to address the State's low-income housing needs and the priorities of the American Recovery and Reinvestment Act of 2009.

1b. Question: How many applications may the designated State housing credit agency submit to Treasury?

Answer: There is no limit to the number of applications the designated State housing credit agency may submit provided the total amount requested does not exceed the total amount of funds allowed for under Section 1602(b).

2. Awardee Eligibility

2a. Question: Why is there only one State housing credit agency designated per State as an eligible recipient of Section 1602 funds? How were these agencies chosen?

Answer: The low-income housing tax credits (LIHTCs) that a State may allocate every year are derived from that State's Housing Credit Ceiling. The State Housing Credit Ceiling is comprised of four components. The maximum amount of Section 1602 funds to a State keys off the four components that make up the 2009 State Housing Credit Ceiling. Historically, one State housing credit agency per State tracks the State Housing Credit Ceiling and annually reports credit information to the Internal Revenue Service. Since Section 1602 funds are inextricably linked to the State Housing Credit Ceiling, the Section 1602 program applies the same principles and uses the designated State housing credit agency as the recipient. This also helps to ensure that total Section 1602 funds and credits allocated do not exceed the

2009 State Housing Credit Ceiling as the Designated Agency is responsible for tracking both Section 1602 funds and allocated credits.

3. Eligible Projects

3a. Question: May Section 1602 funds be used in developing a building where the building receives both credit allocations and Section 1602 funds?

Answer: Yes, a building may use both tax credits and Section 1602 funds. However, the developer must first demonstrate that the developer has made a good faith effort (in accordance with the procedure the State housing credit agency puts in place) to obtain investment commitments for tax credits for the portion that would be covered by the Section 1602 funds.

3b. Question: Does infusion of Section 1602 funds in a stalled LIHTC building change the placed-in-service date?

Answer: No. When any LIHTCs remain in a stalled building that utilizes 1602 funds, the placed-in-service date for the building does not change. The placed-in-service rules that apply to buildings with LIHTCs also apply to buildings with Section 1602 funds.

3c. Question: May Section 1602 funds be used in a development with tax exempt bonds?

Answer: Yes.

3d. Question: Is the Section 1602 program meant as a one-for-one exchange at the building level? For example, if a building has \$500,000 of allocated LIHTCs, can the owner return credits to the applicable state allocating agency, in return for the same amount in Section 1602 funds?

Answer: The Section 1602 program is sometimes called the Exchange program. However, this does not mean that a building that has been allocated LIHTCs must exchange these LIHTCs in order to receive Section 1602 funds. The "Exchange program" refers to the exchange that takes place at the state level, where the Designated Agency exchanges all or part of the State Housing Credit Ceiling (to the extent permitted under Section 1602) for Section 1602 funds.

3e. Question: May Section 1602 funds be used in a project that was placed in service prior to 2009?

Answer: Section 1602 follows the requirements that govern credit allocations. Just as a building that had received a credit allocation and was placed in service prior to 2009 cannot return the allocation for a new allocation in 2009, the same building cannot return the credit allocation for Section 1602 funds. Similarly, a binding commitment to allocate credit in 2009 for a project placed in service prior to 2009 also does not qualify as the binding commitment relates to an allocation of credit, not Section 1602 funds (which were not available at the time the binding agreement was made).

3f. Question: May Section 1602 funds be used in a project that is substantially complete, and the project owner cannot obtain investor commitments for tax credits?

Answer: Provided the building was not been placed in service prior to 2009, Section 1602 funds may be subawarded to a substantially complete building, assuming all other requirements have been met. The Section 1602 funds could be used to repay equity or loans that have financed the construction of the building or for some other eligible costs.

3g. Question: May a State agency be an owner in a building receiving Section 1602 funds?

Answer: No, there is an inherent conflict in awarding Section 1602 funds for a project in which the State agency has ownership. However, State agencies are permitted to have a one percent or less de minimis ownership in a building with Section 1602 funds.

4. Use of Awarded Funds

4a. Question: May State housing credit agencies make subawards in the form of loans to the subawardees?

Answer: As item 4.b of the Terms and Conditions indicates, State housing credit agencies make subawards in the form of cash assistance to the subawardees. The cash assistance will not be required to be repaid, unless there is a recapture event with respect to the low-income building. The cash assistance can be in the form of a loan which is non-interest bearing and non-repayable at any time, except in the event of recapture during the 15-year compliance period.

4b. Question: Items 4.e and 4.f of the Terms and Conditions require the State housing credit agency to establish and to implement a written process for determining that an applicant for a subaward has demonstrated a good faith effort to obtain investment commitments for tax credits in lieu of a subaward prior to making a subaward. Does Treasury have standards for the process?

Answer: Treasury is relying on State housing credit agencies to establish and to implement a fair and open process that meets the needs in their area and fits with local investment conditions.

4c. Question: Must every project, whether it has or has not received an allocation of LIHTCs, make a good faith effort to obtain investment commitments for LIHTCs before being considered for a subaward?

Answer: Yes.

4d. Question: Do the "Buy American" provisions in the American Recovery and Reinvestment Act of 2009 apply to the Section 1602 program?

Answer: No.

4e. Question: Do other cross-cutting Federal requirements apply to the Section 1602 program, such as the National Environmental Policy Act and Davis-Bacon?

Answer: The National Environmental Policy Act and Related Laws and Davis-Bacon Prevailing Wage Rates do not apply to qualified low-income buildings funded with subawards, unless otherwise applicable. Cross-cutting Federal requirements, which would otherwise apply to LIHTC buildings, apply through statutory requirements and other regulations and rules governing Section 42 of the Internal Revenue Code.

4f. Question: Which costs are eligible to be paid with Section 1602 funds?

Answer: Section 1602 follows the same requirements as LIHTCs. Section 1602 funds may pay for costs to the same extent as equity raised from LIHTCs under Section 42 of the Internal Revenue Code.

4g. Question: Are subawardees required to “trace” how the Section 1602 funds are used in the project?

Answer: No. Subawardees are not required to trace (i.e., track the sources and uses of each expenditure in the development project) the use of Section 1602 funds. This follows the practice of LIHTCs.

4h. Question: What is the maximum amount of a subaward?

Answer: The amount of the subaward cannot exceed 85 percent of the amount of a building's eligible basis as determined at the end of the first year of the credit period (as defined in Section 42(f)(1) of the Internal Revenue Code) and, also for this purpose, eligible basis includes any increase for buildings located in high cost areas under Section 42(d)(5)(B). The subawardee must maintain sufficient documentation to demonstrate that the allowable construction, acquisition, and rehabilitation costs of a qualified low-income building equal or exceed the amount of the subaward.

5. Written Agreements and Disbursements to Subawardees

5a. Question: May State housing credit agencies charge an application fee to potential subawardees?

Answer: No. The Section 1602 statutory language allows a State housing credit agency to collect reasonable fees from a subaward recipient to cover expenses associated with the performance of the agency's asset management responsibilities. Within this context, reasonable fees to reimburse an agency for its compliance monitoring responsibilities are, like fees charged for asset management responsibilities, permissible. However, the statutory language concerning fees does not specifically extend to any other State housing credit agency's fee.

5b. Question: The LIHTC program benefits accrue to taxpayers over a ten-year period. Are the Section 1602 funds paid over a ten-year period?

Answer: The purpose of the Section 1602 program is to provide funds to develop low-income housing where there is a funding gap. Once the State housing credit agency has made a subaward to a project, the agency will make funds available to

the project when there is a need to pay an invoice/bill. This procedure is similar to other Federal programs, such as HOME or the Community Development Block Grant program.

5c. Question: What kind of assurances can a State agency give a project owner who would like to participate in Section 1602 but does not want to give up a LIHTC allocation without an assurance Section 1602 funds will be subawarded in exchange?

Answer: The State agency has the discretion to subaward Section 1602 funds and any assurances are a matter between the State Agency and the project owner. As for whether the State agency will receive funds from Treasury, Treasury awards Section 1602 funds to State credit housing credit agencies who are eligible to receive funds and complete the required application. There is no competition for the funds at the Federal level.

6. Asset Management

6a. Question: What is the compliance period for projects receiving Section 1602 funds?

Answer: Just as with LIHTCs, buildings receiving Section 1602 funds are subject to a 15-year compliance period. Similarly, there must be in effect an extended use agreement between the taxpayer and agency for the period prescribed under section 42(h)(6)(D).

7. Compliance with the 2009 State Housing Credit Ceiling

7a. Question: If a project which has been awarded 2009 credit under the non-profit set-aside under Section 42(h)(5) of the Internal Revenue Code is unable to find an equity investor and requests to return the credit to the State housing credit agency for Section 1602 funds, does the subsequent subaward qualify as meeting the State's 2009 set-aside obligation?

Answer: Along with credit allocations, Section 1602 funds must be included in determining whether a state has met its non-profit set-aside requirement. A subaward is taken into account for purposes of the 10 percent non-profit set-aside requirement at the time the subaward is made to the owner of a project that involves a qualified non-profit organization described in Section 42(h)(5)(B) of the Internal Revenue Code and it is intended by the agency and owner that the project be included among those projects that satisfy this requirement. The State must calculate the credit equivalent of all Section 1602 subawards and LIHTC allocations made during 2009 pursuant to Section 42(h)(5) to ensure compliance with this set-aside requirement. Under these facts, the subaward would count in determining whether the 2009 non profit set-aside requirement is met if the subaward is awarded to the project owner in 2009 and it is intended by the agency and owner that the requirements of Section 42(h)(5) apply to the project.

8. Reporting

8a. Question: Will Treasury provide guidance on how to report on jobs created and jobs retained?

Answer: Treasury sent out guidance on reporting in July 2009.

8b. Question: If Section 1602 funds are provided to a building and the building has no LIHTCs, should the State housing credit agency and the subawardee complete Form 8609?

Answer: Yes. The State housing credit agency should complete boxes A, B, C, D, and E, and lines 5 and 6 in Part I of the Form 8609. The subawardee should complete lines 7, 8b, 9b, 10a, 10c, and 10d of Part II of the Form 8609 and send the completed form to the State housing Credit agency, not the IRS. If Section 1602 funds are provided to a building with LIHTCs (and therefore the subawardee is already required to file the form with the IRS), then the subawardee should be required to send a copy of the completed form to the State housing credit agency.

9. Recapture

9a. Question: Will the Section 1602 program use IRS Form 8823, Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition?

Answer: IRS Form 8823 should *not* be filed with the Treasury Department or the IRS to report noncompliance or building dispositions that result in recapture of subawards under Section 1602. State housing credit agencies should only use Form 8823 to notify the IRS of noncompliance or building dispositions where LIHTCs are involved. State housing credit agencies may, however, use the form internally to document recapture relating to buildings with subawards whether or not LIHTCs are involved.

9b. Question: When does a Section 1602 recapture event occur?

Answer:

A Section 1602 recapture event occurs any time within the 15-year compliance period (as defined in Section 42(i)(1) of the Internal Revenue Code) the applicable fraction of a building under Section 42(c)(1)(B) falls below the percentage of Section 1602 funds that comprise the eligible basis of the building (the Section 1602 percentage), or below the minimum set-aside elected for the building under Section 42(g)(1), whichever is greater. However, the preceding sentence does not apply if the applicable fraction specified in the extended use agreement with respect to the building under Section 42(h)(6)(B)(i) is lower than the Section 1602 percentage. Instead, a Section 1602 recapture event takes place any time within the 15-year compliance period the applicable fraction of the building under Section 42(c)(1)(B) falls below the applicable fraction specified for the building in the extended use agreement under Section 42(h)(6)(B)(i), or below the minimum set-aside elected for the building under Section 42(g)(1), whichever is greater.

For purpose of calculating the Section 1602 percentage, eligible basis includes any increase for buildings located in high cost areas under Section 42(d)(5)(B) of the Internal Revenue Code.

Example 1. Assume that \$1.5 million of Section 1602 funds were awarded to a building with an eligible basis of \$4.5 million. The building has 100 residential units of similar size and construction and is fully occupied by low-income tenants as of the close of the first year of the credit period (as defined in Section 42(f)(1) of the Internal Revenue Code). Assume also that the 20/50 minimum set-aside under Section 42(g)(1) was elected for the building and that the applicable fraction specified in the extended use agreement for the building is 100% (i.e., 100% of the total units are required to be maintained as low-income units). The Section 1602 percentage is .333 (i.e., \$1.5m/\$4.5m). A Section 1602 recapture event will not occur until the applicable fraction of the building under Section 42(c)(1)(B) decreases below .333 (i.e., less than 34 of the units are occupied by qualifying low-income tenants). Had instead the 40/60 minimum set-aside been elected for the building, then a Section 1602 recapture event will not occur until the applicable fraction of the building decreases below .40 (i.e., less than 40 of the units are occupied by qualifying low-income tenants), as the minimum set-aside elected for the building (i.e., .40) exceeds the Section 1602 percentage (i.e., .333).

Example 2. Assume the same facts as Example 1, but instead of 100%, the applicable fraction of the building under Section 42(c)(1)(B) of the Internal Revenue Code is .50 (i.e., only 50 of the 100 units are occupied by low-income tenants as of the close of the first year of the credit period) and the applicable fraction specified in the extended use agreement for the building is also .50 instead of 100%. Assume further that Section 1602 funds awarded to the building are \$3 million instead of \$1.5 million. The Section 1602 percentage is .667 (i.e., \$3m/\$4.5m). Because .667 exceeds the .50 applicable fraction specified in the extended use agreement for the building, a Section 1602 recapture event will take place if the applicable fraction of the building under Section 42(c)(1)(B) falls below the .50 applicable fraction specified in the extended use agreement. In other words, a Section 1602 recapture event will occur under these facts if there is any decrease in the applicable fraction under Section 42(c)(1)(B) during the building's compliance period.

9c. Question: What amount is owed when a recapture event takes place?

Answer: The full amount of the Section 1602 subaward is owed minus 6.67 percent (1/15th) for each full year of the building's 15-year compliance where a Section 1602 recapture event has not occurred.

9d. Question: Who pays the penalty when a recapture event takes place?

Answer: The Section 1602 legislation requires the State housing credit agency to impose conditions or restrictions on a subawardee to assure that the building remains a qualified low-income building during the compliance period. These conditions or restriction would also apply to any subsequent owner during the compliance period. The State housing credit agency is bound to enforce its provisions and return the recapture penalty to the Treasury.

If the State agency is unable to collect the recapture amount from a liable party, Treasury would not require the State agency to return the recapture penalty

provided the State agency took all appropriate actions to collect the funds from the liable party.

9e. Question: Why doesn't the Section 1602 recapture procedures mirror the LIHTC recapture procedures in Section 42(j) of the Internal Revenue Code?

Answer: The procedures differ because differences between grants and LIHTCs make it difficult to apply credit recapture rules in the context of subawards.

9f. Question: Is there a cure period in the event of noncompliance?

Answer: State agencies may, in their discretion, work with subawardees in the event of noncompliance to put in place a plan, with milestones and schedules, to remedy an incidence of noncompliance. If the building does not return to compliance within the time period prescribed by the State agency, the penalty amount would be due within a reasonable period of time, such as 90 days, from the closing date of the State agency's cure period.

9g. Question: Does Treasury require a first lien on buildings to ensure recapture?

Answer: Treasury does not require liens on buildings utilizing 1602 funds. Similarly, if a lien is employed as an enforcement device, it is not required that the lien take precedence over other liens on such buildings. State agencies have the discretion to use methods they deem appropriate to assure that the buildings funded by Section 1602 remain qualified low-income buildings during the compliance period and that recapture penalties, upon enforcement, are satisfied.

10. Financial Management

10a. Question: How will Section 1602 funds be available to State housing credit agencies?

Answer: Treasury is using the Payment Management System operated by the Federal Department of Health and Human Services to make funds available to State housing credit agencies.

10b. Question: When must a State housing credit agency register in the Payment Management System?

Answer: Upon award, Treasury informs the Payment Management System. The awardee, then, receives instructions via email within two business days of the date of the award letter (or five business days of the date Treasury receives a completed Form 1199 if not already provided) describing how to access the Payment Management System to draw down Section 1602 funds.

10c. Question: What financial management forms must a State housing credit agency submit?

Answer: State housing credit agencies submit a Federal Financial Report after the end of each calendar quarter. The FFR is part of the Payment Management System process.

11. Disallowance, Suspension, and Termination

11a. Question: How is Treasury able to suspend funding to a State housing credit agency?

Answer: The Payment Management System allows Treasury to place a temporary hold on individual accounts.

11b. Question: How will Treasury monitor the State housing credit agencies?

Answer: Treasury has developed a compliance monitoring checklist and expects to monitor (either remotely or on-site) in the first year every State housing credit agency participating in the Section 1602 program. In the following years, Treasury will monitor on a needs-assessment basis.

12. Return of Unused Award Funds

12a. Question: How will Treasury implement 31 CFR Part 32.1, published in the Federal Register on August 31, 2009?

Answer: The interim final rule is effective on the date of publication in the Federal Register. State agencies that have received awards prior to publication of the rule may rely on it.

Treasury will take two actions. For those State housing credit agencies with Section 1602 awards now, Treasury will amend the terms and conditions of their award. Treasury will modify the terms and conditions in the on-line application form for use by future State housing credit agency applicants.