AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009

As this Affordable Housing Alert is being sent, the U.S. House of Representatives has approved the American Recovery and Reinvestment Act of 2009 ("ARRA") by a vote of 246-183. The U.S. Senate is expected to follow suit shortly, perhaps by late this afternoon. President Obama is expected to sign this stimulus bill on Monday, February 16, 2009. While far-reaching in its scope and size, the legislation includes two provisions of particular importance to the affordable housing community that are designed to help address the moribund tax credit equity marketplace.

Credit Exchange. ARRA permits state housing agencies to elect to exchange their unused tax credits for a grant ("Credit Exchange Grant") from the federal government at the exchange rate of $8.50 for each dollar of tax credit (that is, a "tax credit price" of $.85, as it is commonly understood). Under Section 1602, a state housing agency may exchange up to 40% of its 2009 tax credit volume cap for such grants. Importantly, 100% of any unused 2008 credits and 100% of any returned credits previously allocated qualify for the exchange. As discussed below, this may provide planning opportunities for existing projects where the tax credit pricing is below $.85.

Section 1602 (attached below) establishes the following guidelines for the credit exchange system:

- Credit Exchange Grants may only be made to finance the construction, or acquisition and rehabilitation of "qualified low-income buildings" within the meaning of the low income housing tax credit ("LIHTC") rules.
- Credit Exchange Grants may be made to buildings even if they do not have an LIHTC allocation if (i) the state housing agency makes the determination that such Credit Exchange Grant will increase the total funds available to such state for the development of affordable housing, and (ii) the grant recipients first demonstrate "good faith efforts" to obtain tax credit equity investments.
- Recipients of Credit Exchange Grants must follow Section 42 in all respects as to affordability, compliance and monitoring, and use restrictions.
- Credit Exchange Grants are subject to recapture (payable to the U.S. Treasury) in the event of a tax credit noncompliance event.
- Credit Exchange Grants are not taxable income to the grant recipient and do not reduce LIHTC eligible basis (a unique tax anomaly). This treatment makes it unnecessary for grant recipients to employ unwieldy mechanisms to avoid taxable income treatment.

Gap Equity. The appropriations provisions of ARRA (attached below) fund $2.25 billion under the HOME program to state housing agencies to be used essentially as "gap equity" to fill in the financing gap ("Gap Equity") created by falling tax credit pricing. While the allocation system is largely left up to each state housing agency, ARRA provides the following basic structure:

- Gap Equity is available for projects awarded LIHTCs in 2007, 2008, and 2009.
- State housing agencies must give priority to projects that can be completed within three years of ARRA's enactment.
- State housing agencies are required to distribute Gap Equity based upon a competitive process and pursuant to the states' qualified allocation plans (no such process currently exists, of course).
- Gap Equity recipients must follow Section 42 in all respects as to affordability, compliance and monitoring, and use restrictions (in lieu of HOME requirements).

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- Gap Equity will not reduce LIHTC eligible basis. It is presumed that the Gap Equity will actually be distributed as soft loans as it is appropriated under the HOME program but ARRA does not clarify this point. The language refers to projects “eligible for funding” and then indicates that eligible basis is not reduced for “the amount of any grant described” in this provision. Accordingly, the tax treatment is open to question.

What Is Missing. ARRA is also notable for what is missing from the legislation. Early on, especially based on certain comments from U.S. Representative Barney Frank, there was some hope that the U.S. Treasury would directly or indirectly become an active purchaser of tax credits in order to support the anemic tax credit market. There was also an effort to increase the yield on LIHTC investments by “frontloading” the tax credit delivery in order to spur investment. Neither provision made its way into ARRA.

Opportunities and Uncertainties. ARRA was rushed through Congress and in some respects it shows. While this haste has created some uncertainties, at least initially, it also provides some opportunities given the state of the tax credit marketplace. Foremost is the possibility for developers to turn in 2008 credits in return for Credit Exchange Grants priced at $.85, which is in excess of the market today. This approach would require assistance from state housing agencies since the returned credits belong to the state and not the developer, but this opportunity could spur additional housing production to the benefit of all.

It is very unclear how state housing agencies will distribute Gap Equity other than it must be on a competitive basis and projects must be expected to be completed within three years. Since it is likely that the Credit Exchange program will be used to support 9% transactions, and given current investor disinterest in 4% projects relative to 9% projects, the Gap Equity might reasonably be used to buttress the 4% program. While it is unclear what competitive system will be employed, it is to be hoped that state housing agencies will, to some extent, take advantage of the current market system in place. Tax credit investors have established sophisticated and exacting due diligence processes, which brings discipline to the market. It would make sense if Gap Equity were only made available to projects that met those standards.

Congress has made it clear that ARRA’s stimulus funds are to be funneled into the economic system quickly. Accordingly, ARRA will have a substantial and immediate impact upon the affordable community. Because much of the funding and allocation process is left up to state housing agencies, there will clearly be the need for significant dialogue between those agencies and interested stakeholders from the lender, investor, and developer worlds.

ARRA’s affordable housing provisions are unique and require careful consideration and analysis. This summary does not constitute tax advice and readers are advised to contact their tax advisors to determine how ARRA may impact their activities and how to employ ARRA’s Credit Exchange and Gap Equity provisions advantageously.

Section 1602 (PDF)

ARRA Home Appropriation (PDF)

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