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Affordable Housing Legislation Finalized - Passage Expected This Week.

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The Housing and Economic Recovery Act of 2008 (H.R. 3221) (the "Act") is poised for passage perhaps as soon as this Friday, July 25, 2008. This morning, the White House indicated that President Bush was withdrawing his veto threat and would in fact sign the bill as soon as it was brought before him. This afternoon, the House of Representatives voted overwhelmingly in favor of the bill by a margin of 272-152. While some procedural wrangling is expected in the Senate, the bill should pass in the Senate in the next day or two.

H.R. 3221 is the centerpiece legislation designed to assist in the recovery of the real estate and finance markets. It was described today in Washington D.C. as "the most important piece of housing-related legislation that we have seen in more than a generation." Importantly, the Act makes a number of significant changes to low income housing tax credit and tax exempt bond rules that should also spur affordable housing development. The following briefly describes the most important affordable housing provisions in the Act:

- **Alternative Minimum Tax Relief**. The Act provides that low income housing tax credits and rehabilitation tax credits may be used against AMT. Further, tax exempt interest on Housing Bonds will be exempted from AMT. These provisions are considered very significant for the currently anemic tax credit equity market. Many former tax credit investors who are in AMT are now expected to re-enter the market due to this change. Although the impact of the AMT relief is expected to be material, opinions differ strongly as to whether the impact on the tax credit equity market will be

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immediate or will play out over a longer term. This provision is effective for buildings placed in service after December 31, 2007, and for tax exempt bonds issued after the Act's date of enactment.

- **Increase in 9% Tax Credits**. The Act temporarily increases the amount of 9% Tax Credits available by approximately 10% for 2008 and 2009.
- **Elimination of Recapture Bonds**. The Act eliminates the requirement that a recapture bond be posted upon a transfer or disposition of an affordable housing project. Under the Act, in order to avoid recapture, the only requirement is that there must be a reasonable expectation that the affordable housing project continue to be operated as such. This change should greatly streamline the transfer process and ultimately make tax credit equity investment more portable and thus increase tax credit equity participation. Although the repeal is effective as of the enactment of the Act, it is retroactively applicable to any affordable project where the "reasonable expectation" is met.
- **Elimination of 10 Year Holding Requirement**. The Act makes a very important change affecting existing properties seeking acquisition tax credits. Previously, in order to qualify for acquisition credits, an existing building could not have been placed in service within the past 10 years. The Act exempts from this 10 Year Hold any "federally-assisted" or "state-assisted" project. This exemption applies to any project which is "substantially assisted, financed or operated" under (i) Section 8, Section 221(d)(3) or (d)(4), Section 236, Section 515 programs or "any program administered" by HUD or the Department of Agriculture's Rural Housing Service, or (ii) any state program "similar in purpose." This provision is effective for projects placed in service after the enactment date of the Act.
- **Related Party Rules.** Under existing law, acquisition tax credits are not available where a project is acquired from a "related party." Even as little as a 10% relationship between the buyer and seller would trigger this related party concern. The Act provides that at least a 50% commonality of interest exist between the buyer and seller before the related party rules come into play. This provision is effective for projects placed in service after the enactment date of the Act.
- **Fixing 9% Credit.** The 9% Credit "floats" based upon interest rate changes (for example, the August, 2008 tax credit percentage for the "9% Credit" is actually 7.94%). The Act will fix the credit percentage at 9% for any projects placed in service after the enactment date and before December 31, 2013, effectively increasing the amount of the 9% credit allocable to a project. There is no similar fixing of the credit percentage for the 4% Credit.
- **Public Use Requirement.** The Act liberalizes the requirement that affordable housing projects utilizing bonds or credits be available to "the general public." Under the Act, the general public use test will met even if there are occupancy "restrictions or preferences" that favor tenants with special needs, members of a specified group under a Federal or state program, or tenants "who are involved in artistic or literary activities." This provision is effective for projects placed in service after the enactment date of the Act.
- **Increase in Rehabilitation Expenditures.** The Act doubles the minimum amount of rehabilitation expenditures that must be expended on an existing building to the greater of (i) 20% of the building's adjusted basis or (ii) $6,000 per unit, adjusted for inflation. This provision is effective for projects placed in service after the enactment date of the Act.
- **Recycling Bond Volume Cap**. The Act in effect permits bonds that have been issued for an affordable project to be "recycled" where the original project pays off the bond loan. In such instances, the original bonds may then be used to fund new projects as refunding bonds. The new loan must be made within 6 months of the repayment of the

original loan. This provision will effectively increase the amount of bond cap available in many states where bonds are otherwise being redeemed.

The Act makes many other changes to the low income housing tax credit and tax exempt bond rules, including the use of bonds for SROs, increasing tax credits for Community Facility Centers, authorizing states to provide 130% boosts for projects with 9% credits, clarifying when grants will reduce eligible basis, eliminating low interest federal loans from the definition of "federally subsidized," and better coordination between the tax credit and bond rules.

We have provided a link to the final form of H.R. 3221 for your review (the tax credit and bond provisions are found beginning on page 602). At nearly 700 pages, the Act is obviously complex. Clearly, there will be many questions concerning the application of these new requirements. The above layman's explanation is no substitute for careful planning and interested parties are urged to contact their tax advisors about the Act.

Please do not hesitate to contact Steve Ryan (415.262.5150), Ofer Elitzur (415.262.5165) or Lisa Weil (415.262.5175) of our Affordable Housing Practice Group if you have any questions concerning this legislation.