Bridging the Gap with Monetization of Low-Income Housing Tax Credits

Affordable Housing

INDUSTRY ALERT

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Background

In today's tough economic environment, developers of affordable housing projects are having difficulty finding investors to fund projects. Developers may want to consider the Section 1602 program as an alternative to equity investors. It is expected that the Section 1602 program will temporarily fill the gap left by a diminished investor demand for low-income housing tax credits. The Section 1602 Program will allow projects for construction or acquisition and rehabilitation of low-income housing to continue where developers are unable to proceed due to lack of investors.

The Section 1602 Grant Program

Under Section 1602 of the American Recovery and Reinvestment Tax Act of 2009 ("Section 1602"), state housing credit agencies (HCA's) are eligible to receive Section 1602 Grants to states for low-income housing projects in lieu of Low-income Housing Credits under Section 42 of the Internal Revenue Code ("the Code") for 2009. HCA's may apply to the U.S. Treasury for an exchange of returned or unused 2007 and 2008 tax credits, as well as 40 percent of the HCA's 2009 tax credit ceiling. Tax credits are exchanged at the rate of $0.85 per $1 of tax credit. The HCA receiving the grant uses the funds to make sub-awards to finance the construction or acquisition and rehabilitation of qualified low-income buildings with or without an allocation under Section 42 of the Code. The sub-awards are subject to the same requirements as low-income housing credits under Section 42.

HCA's are required to return to the Treasury any funds not used to make sub-awards by December 31, 2010. However, once a sub-award has been made, a HCA can continue to disburse funds for the sub-award through December 31, 2011, provided the project is at least 30 percent complete by the end of 2010. HCA's make sub-awards in the form of cash assistance which 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.

Eligibility

To be eligible for Section 1602 funds, the developer must first demonstrate a good faith effort to obtain an investor for the tax credits that would have been used to finance the project. Section 1602 funds may be used to finance an affordable low-income rental project that receives both credit allocations and Section 1602 funds. Section 1602 funds may also be used in a project that is substantially complete but whose owner was unable to obtain investor commitments for tax credits, provided the building was not placed in service prior to 2009 and assuming all other requirements have been met. The Section 1602 funds could be used to repay equity or loans that financed the construction of the building or for other eligible costs.

The maximum amount of a sub-award is 85 percent of the amount of a building's eligible basis as determined at the end of the first year of the credit period and, for this purpose, eligible basis includes any increase for buildings located in high cost areas under Section 42(d)(5)(B). Although many sub-awards have already been made from each State HFA's initial request, many will be requesting additional funds.

For example, the State of Maryland Department of Housing and Community Development intends to seek approval of an additional $36 million as it receives returned 2008 tax credits – a move many affordable housing developers will greatly appreciate.

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