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Low-Income Housing and Historic Tax Credits: The Housing and Economic Recovery Act of 2008

On July 30, 2008, the President signed into law the Housing and Economic Recovery Act of 2008 (the "Act"). This alert provides a brief summary of the provisions of the Act pertaining to the low-income housing tax credit (the "Housing Credit") and to the historic tax credit (the "Historic Credit"). The amendments are designed to stimulate investment in Housing Credit and Historic Credit properties and thus are generally favorable to taxpayers. Except as noted below, the provisions of the Act apply to projects placed in service after July 30, 2008.

Temporary Increase in the Housing Credit Volume Limits

- For calendar years 2008 and 2009, the Act increases the amount of Housing Credits provided annually to each state from \$2.00 to \$2.20 per resident. In 2010, the volume limits will return to the prescribed levels had this provision not been enacted.
- The Act also temporarily increases the minimum annual cap for certain small population states (currently, \$2,325,000 for 2008) by 10% for 2008 and 2009.
- These provisions are effective for Housing Credit allocations made for calendar years after 2007.

Modifications to the Applicable Percentage and the Definition of "Federally Subsidized" Building

- The Act provides a temporary applicable percentage of "not less than 9%" for nonfederally subsidized newly constructed and substantially rehabilitated buildings placed in service after the date of enactment and before December 31, 2013. The applicable percentage for August 2008 otherwise would have been 7.94%, so the fixed 9% rate is a significant increase.
- The Act does not change the 4% applicable percentage for bond-financed projects and for the acquisition of existing buildings.
- The Act limits the definition of a federal subsidy for purposes of the Housing Credit to any obligation the interest on which is exempt from tax under Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"). Thus, "below market federal loans" will not prevent a property from qualifying for 9% credits.

Modifications to Credit Computations and the Definition of Eligible Basis

- The Act adds, in addition to qualified census tracts and difficult development areas, a third type of high-cost area that is eligible for an enhanced Housing Credit. This third type of high-cost area

is defined as any building designated by the state housing credit agency as requiring the enhanced Housing Credit for such building to be financially feasible and is not subject to the current 20% population limitation. This provision does not apply to bond-financed projects.

- The Act doubles the minimum rehabilitation threshold necessary to qualify for Housing Credits, which is equal to the greater of 20% of the adjusted basis in the building being rehabbed or \$6,000 per low-income unit (indexed for inflation). All other related present law rules remain in effect. This provision is effective for Housing Credit allocations and tax-exempt bond allocations made after the date of enactment.
- The Act increases the allowable basis for “community service facilities” located in qualified census tracts to 25% of the first \$15 million of eligible basis plus 10% of additional basis.

Treatment of Federal Grants

- The Act provides that no basis reduction is required for federally funded grants to enable the property to be rented to low-income tenants received during the compliance period if those grants do not otherwise increase the taxpayer’s eligible basis in the building.
- The Treasury is directed to modify Section 1.42-16(b) of the Treasury regulations to provide that a specified list of federal assistance programs and other ongoing payments designed to enable the property to be rented to low-income tenants will not be considered federal grants.
- In addition, the Joint Committee on Taxation Explanation clarifies that loans made from the proceeds of

federally funded grants, regardless of their interest rate, do not require a basis reduction.

Modification of Rules Pertaining to Acquisition Credits

- Under current law, for a building to be acquired by purchase, it may not be acquired from a related party. The definition of “related party” for purposes of this rule is the same as the definition used in Code Sections 267(b) and 707(b)(1). However, under current law, 10% is substituted for 50% in determining the threshold level of ownership in certain partnerships and corporations. The Act repeals this 10% attribution rule, and instead applies the definition of Code Sections 267(b) or 707(b)(1) without modification.
- The Act amends the “10-year look-back” rule by providing an exception for properties substantially financed, assisted or operated under Section 8 of the United States Housing Act of 1937 (“Section 8”); Sections 221(d)(3), 221(d)(4) or 236 of the National Housing Act; Section 515 of the Housing Act of 1949; any other housing program administered by HUD or the Rural Housing Service of the Department of Agriculture; or any other similar state housing program. The present law exception related to certain depository institutions in default remains unchanged.

Recapture Bonds

- The requirement that a bond be posted upon any change in ownership of a Housing Credit building or any interest therein to avoid Housing Credit recapture is repealed.
- However, the bond posting requirement is replaced with an extended

three year statute of limitations following a recapture event.

- These changes are effective for dispositions of interests in Housing Credit buildings after the date of enactment and for dispositions before enactment if the taxpayer elects to apply the new provisions.

Coordination of Housing Credit and Multifamily Housing Bond Rules

The Act adopts several provisions that coordinate the rules applicable to multifamily housing bonds (“Multifamily Housing Bonds”) with the rules applicable to Housing Credits.

- The Act provides that the “next available unit” rule, which requires the next available unit in a project to be rented to an income-eligible tenant if a low-income tenant’s income goes over the applicable income threshold, is to be applied on a building basis (as opposed to a project basis) for both Multifamily Housing Bond and Housing Credit projects.
 - The Act applies the Housing Credit student rules and Housing Credit single-room occupancy rules to Multifamily Housing Bond projects.
 - These changes are effective for determinations of the status of qualified residential rental projects made after the date of enactment regardless of when the Multifamily Housing Bonds were issued.
- #### **Area Median Income Modifications**
- The Act provides that area median income (“AMI”) determinations for Multifamily Housing Bond and Housing Credit projects may not decrease for any year after 2008.
 - In the case of “HUD Hold Harmless” projects, the determination of AMI is

the greater of (1) the amount determined without regard to the special rule for HUD Hold Harmless projects or (2) the sum of the AMI determined under the HUD Hold Harmless policy with respect to the project for 2008 plus any increase in AMI after 2008.

- This provision applies to determinations of AMI for calendar years after 2008.

General Public Use

- The Act clarifies that a project that otherwise meets the general public-use requirements will not fail to meet the requirement solely because of occupancy restrictions or preferences that favor tenants:
 - with special needs, or
 - who are members of a specified group under a federal or state program or policy that supports housing for such a specified group, or
 - who are involved in artistic or literary activities.
- This provision applies to buildings placed in service before, on or after the date of enactment.

Miscellaneous Housing Credit Provisions

- The Act eliminates the present law prohibition against providing the Housing Credit to buildings receiving moderate rehabilitation assistance under Section 8.
- The period for satisfying the requirement that 10% of the taxpayer's reasonably expected basis be incurred is lengthened to one year

after the date of the carryover allocation.

- The Act provides that states must also take into account energy efficiency and the historic nature of projects in allocating Housing Credits among potential low-income projects. This provision is effective for allocations made after December 31, 2008.
- A third exception is added to the student housing rule that applies in the case of a student who was previously in foster care. This provision is effective for determinations made after the date of enactment.
- The Act modifies the measurement of AMI limits for rural projects (as defined in Section 520 of the Housing Act of 1949). Such limits will be measured by reference to the greater of AMI or the national nonmetropolitan median gross income. This provision does not apply to bond-financed projects and is effective for income determinations made after the date of enactment.
- Under the Act, the basic housing allowance provided by the military is not included in income for the Housing Credit income eligibility rule for qualified low-income buildings, as defined in the Act, subject to certain eligibility rules. This provision is effective for income determinations made after the date of enactment.
- The annual income recertification requirements for Multifamily Housing Bond and Housing Credit projects are waived for 100% low-income projects, effective for years ending after the date of enactment.

The Alternative Minimum Tax

- The Act treats the tentative minimum tax as equaling zero for purposes of determining the tax liability with respect to the Housing Credit and the Historic Credit, which allows for the Housing Credit and the Historic Credit to offset AMT liability.
- This provision is effective, in the case of the Housing Credit, for buildings placed in service after December 31, 2007, and, in the case of the Historic Credit, for rehabilitation expenses incurred after December 31, 2007.

Historic Credit Modifications

- The Act increases the percentage limitation from 35% to 50% for purposes of the tax-exempt use property safe harbor as applied to Historic Credit transactions. Thus, for purposes of determining rehabilitation expenditures eligible for the Historic Credit, nonresidential real property is treated as tax-exempt use property only if the portion of the property leased to tax-exempt entities in disqualified leases exceeds 50% of the total property.
- This provision is effective for expenditures taken into account for periods after December 31, 2007.

A copy of the Act is available at http://www.house.gov/apps/list/press/financialsvcs_dem/hr3221_bill_text.pdf and a copy of the JCT Explanation is available at <http://www.house.gov/jct/x-63-08.pdf>. For further information, please contact Cameron N. Cosby (ccosby@hunton.com; (804) 788-8604).

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