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Housing Legislation Signed by President on July 30, 2008

On July 30, 2008, the President signed the Housing Assistance Tax Act of 2008 (the "Legislation"). The Legislation contains provisions that will provide benefits to the multifamily and single family housing markets. Below is a general summary of those provisions. References to the Code are to the Internal Revenue Code of 1986, as amended.

I. GENERAL BOND PROVISIONS

Temporary Volume Cap Increase. The volume cap for tax-exempt housing bonds (i.e., bonds issued under Sections 142(d) and 143 of the Code to finance multifamily housing or single family housing) is increased by, for 2008 only, an additional $11 billion. All proceeds from single family mortgage bonds issued using the additional volume cap must be used within 12 months of the date of issuance of such bonds. Additional volume cap from 2008 may be carried forward by a State to 2009 and 2010 only, and only if used for issuing multifamily and single family housing bonds. *Because each State has its own procedures to allocate volume cap and in many cases allocation cycles are linked to a calendar, it is possible that many States will need to develop special procedures (some may even need new legislation) to allocate this volume cap if it is to be used in 2008.*

Alternative Minimum Tax. The Legislation provides that for bonds issued after the date of enactment, tax-exempt interest on single family, veterans mortgage and multifamily housing bonds ("Housing Bonds") (i) is not an item of tax preference for purposes of the alternative minimum tax, and is not included in the corporate adjustment based on current earnings. The new law does not apply to interest on any refunding bond unless the legislation applied to the interest on the refunded bond (or the original bond in a series of refundings).

Bonds Guaranteed by Federal Home Loan Banks. Under prior law, interest paid on bonds issued by State and local governments was not excluded from gross income if such bonds were Federally guaranteed (with certain exceptions, primarily for housing). The Legislation provides that, if certain requirements are satisfied, bonds issued by State and local governments are not treated as Federally guaranteed by reason of any guarantee provided by any Federal Home Loan Bank after the date of enactment of the Legislation, provided that (i) such Federal Home Loan Bank made a guarantee of such bond in connection with the issuance and (ii) such bond is issued before January 1, 2011. *We note that, if a bond benefiting from a Federal Home Loan Bank letter of credit is reissued after January 1, 2011, it will become taxable because a reissuance of bonds is a refunding for tax purposes and the new "refunding bond" would be considered issued after January 1, 2011.*

II. MULTIFAMILY HOUSING

A. Tax-Exempt Private Activity Bonds for Multifamily Housing

Recycling. The Legislation specifically authorizes an issuer to recycle multifamily housing volume cap where the initial loan of bond proceeds is repaid within four years of the initial issuance of the bonds. This new recycling is accomplished by linking what otherwise would have been two separate bond issues. The proceeds of one bond issue, the first issue, are loaned to a developer as a short term loan (most likely a construction loan) of no more than four years in duration. At the point the construction loan is repaid (or within six months thereafter) a second bond issue is issued (or the first issue is reissued) to make a separate loan to a different developer (most likely a long term loan).

The second issue, absent the Legislation, would have been treated as a new money issue for tax purposes and would have required new volume cap. Under the Legislation, the second issue is deemed to be a "refunding" issue not requiring new volume cap as long as the bonds and the loans fit the following parameters: (i) the issue date of the second, "refunding," issue must not be more than four years after the issue date of the first issue; (ii) the proceeds of the repayment of the loan made with the first issue must be used to make the second loan within six months after the first loan is repaid; (iii) the TEFRA approval for the second project must be received before the "refunding" bonds are issued; (iv) only one recycling of a given bond issue is permitted; and (v) the second project will not (absent further clarification of the low-income hosing tax credit rules) be eligible for the 4 percent low income housing tax credits associated with multifamily housing bond volume cap. *A principal application of this new rule will be to allow bond proceeds used to provide construction financing for a project benefitting from Section 42 tax credits to be recycled, once that construction loan is repaid, to make a permanent loan on a non-tax credit project. Thus, the volume cap used on a construction loan should not be considered wasted any longer.*

See Section II., C. below for additional provisions that affect both multifamily housing bonds and low-income housing tax credits.

B. Low-Income Housing Credit Provisions

Temporary Increase in the Low-Income Housing Tax Credit Volume Limits. Prior to the passage of the Legislation, each State was generally limited on an annual basis to $2.00 per State resident of low-income housing tax credits to allocate to qualifying multifamily housing projects. In addition, the minimum annual cap of $2,350,000 applied for certain small population States. The Legislation increases the limit to $2.20 per resident for calendar years 2008 and 2009 and increases the minimum annual cap for certain small population states by 10 percent of the otherwise available amounts in 2008 and 2009.

Credit Rate Modification. The Legislation provides a temporary applicable percentage of not less than 9 percent (applicable to the 70 percent of the present value of the buildings qualified basis) for newly constructed non-Federally subsidized buildings placed in service after the date of enactment of the Legislation and prior to December 31, 2013.

Federally Subsidized Building. Under prior law, a building was not generally eligible for the 70 percent credit if any part of the eligible basis of the building was "Federally subsidized". The Legislation eliminates below market loans and assistance provided under the HOME Investments Partnership Act or the Native American Housing Assistance and Self Determination Act of 1996 from the definition of a "Federal subsidy" for this purpose. Now only tax-exempt financing will now cause a building to be not generally eligible for the 70 percent credit.

Eligible Basis for Enhanced Credit. The Legislation adds a new type of high-cost area eligible for an enhanced low-income housing tax credit (i.e., 30 percent "basis boost"). The new type is defined as any building designated by the State housing credit agency requiring the enhanced credit in order for such building to be financially feasible.

Substantial Rehabilitation Requirement Increased. The Legislation increases the minimum rehabilitation expenditure required in order to claim low-income housing tax credit in an acquisition/rehab transaction to an amount that is equal to the greater of (i) at least 20 percent of the adjusted basis of the building being rehabbed (10 percent under prior law); or (ii) at least $6,000 per low-income unit being rehabbed ($3,000 under prior law). This provision is effective for acquisition/rehab projects that receive low-income housing tax credit allocations or tax-exempt bond allocations after the date of enactment of the Legislation.

Community Service Facility. The Legislation increases the proportion of the costs of a community service facility which may count towards adjusted basis of a project under the low-income housing tax credit rules to an amount equal to the sum of: (i) 25 percent of so much of the eligible basis of the qualified low-income housing tax credit project of which it is a part as does not exceed $15,000,000 plus (ii) 10 percent of any excess over $15,000,000 of the eligible basis of the qualified low-income housing credit project of which it is a part.

Federal Grants. The Legislation clarifies prior law regarding the reduction to basis upon receipt of Federally-funded grants during the compliance period providing that basis is not reduced for (i) Federally-funded grants to enable property to be rented to low-income tenants received during the compliance period if such grants do not increase the taxpayer's basis in the building and (ii) loans made to owners of qualified low-income housing projects from the proceeds of Federally-funded grants.

Related Persons. The Legislation repeals the prior 10 percent attribution rule and provides that persons are related for the purpose of determining the eligible basis of an existing building acquired by purchase if they are related under Sections 267(b) or 707(b) of the Code (which generally uses a 50 percent attribution rule).

10 Year Placed in Service Rule. Under prior law, the low-income housing tax credit was generally not permitted with respect to existing buildings unless there was a period of at least 10 years between the date of acquisition and the later of the date the building was last placed-in-service or the date of the most recent nonqualified substantial improvement. The Legislation waives the 10 year rule with respect to any Federally or State-assisted building.

Various Simplification and Reform Measures. The Legislation contains the following changes to the Low-Income Housing Tax Credit rules:

1. Low-income housing tax credits will be permitted for buildings receiving moderate rehabilitation assistance under Section 8(e)(2) of the United States Housing Act of 1937.

2. The carryover allocation of the low-income housing tax credit beyond the calendar year for a building that is not placed in service during the calendar year in which the credit is allocated is permitted if (i) more than 10 percent of the taxpayer's reasonably expected basis in the project is incurred as of 12 months after the allocation is made (6 months under prior law) and (ii) the building is placed in service not later than the close of the second calendar year following the calendar year of the allocation (no change to prior law).

3. The bond posting requirement for a change in ownership of a building during the low income housing tax credit compliance period is eliminated. The statute of limitations for assessment of a deficiency in the tax paid by a taxpayer as a result of a credit reduction following such a change in ownership is extended to 3 years after the Secretary of the Treasury is notified of noncompliance with the low-income housing credit rules.

4. The criteria upon which each State must develop a plan for allocating credits among potential low-income housing projects are expanded to include: (i) the energy efficiency of the project and (ii) the historic nature of the project.

5. A new exception to the rule that student housing does not qualify for the low-income housing credit applies in the case of a student who was previously under the care and placement responsibility of a foster care program.

6. The area median gross income in rural areas (as defined in Section 520 of the Housing Act of 1949) is determined by reference to the greater of the otherwise applicable area median gross income standard, or the national nonmetropolitan median gross income.

7. The general public use requirement for a project to be eligible for the low-income housing tax credit was clarified and provides that the requirement will not be violated solely because of restrictions or preferences that favor tenants (i) with special needs, (ii) who are members of a specified group under a Federal program or State program or policy that supports housing for such a specified group, or (iii) who are involved in artistic and literary activities.

Basic Housing Allowance—Military. For purposes of the 20-50 test and the 40-60 test, the Legislation allows the basic housing allowance received by the military to be excluded from income for the low-income tax credit eligibility rule for certain qualified buildings during a temporary period.

Low-Income Housing and Rehabilitation Credits—AMT. Under prior law, business tax credits generally could not offset the alternative minimum tax liability. Under the Legislation, the tentative minimum tax is zero for purposes of determining the tax liability limitation with respect to the low-income housing tax credit and the rehabilitation credit; thus, the low-income housing credit and the rehabilitation credit may offset the alternative minimum tax liability.

See Section II., C. below for additional provisions that affect both multifamily housing bonds and low-income housing tax credits.

C. Provisions Affecting Both Multifamily Housing Bonds and Low-Income Housing Tax Credits

Certain Tax Credit – Tax-Exempt Bond Conforming Changes.

1. The Legislation conforms the tax-exempt bond and low-income housing credit rules with respect to the so-called "next available unit rule." The rule will now be applied on a building by building basis (under prior law, the rule was applied on a project by project basis under the tax-exempt bond rules).

2. The Legislation conforms the tax-exempt bond rule with respect to students to the current low-income housing tax credit rule.

3. The Legislation conforms the tax-exempt bond rule to the low-income housing tax credit rule with respect to single-occupancy housing under Section 42(i)(3)(B)(iv) of the Code.

The new Legislation applies to the above determinations for periods beginning after the date of enactment of the Legislation regardless of whether the bonds financing a project were issued. *Some issuers will need to consider whether to permit regulatory agreements to be amended to account for the new provisions. Other regulatory agreements may be deemed amended without action because they are deemed amended whenever federal tax law changes. Developers should review their regulatory agreements before assuming that the new rules will take effect for existing projects without amendment to their existing documents.*

HUD Hold Harmless Policy. Generally, the Legislation provides that a determination of area median gross income may be not less than the determination for the preceding calendar year. Further, the area median gross income for the project is the greater of (i) the amount determined without regard to the special rule for HUD hold harmless impacted projects or (ii) the sum of the area median gross income determined under the HUD hold harmless policy with respect to the project for 2008 plus any increase in area median gross income after 2008. The Legislation makes this change because HUD published reduced area meridian income for some areas in 2008 which caused compliance issues for multifamily housing developers.

Exception from Requirement that Tenants Certify Income Annually. Generally, in the case of an entirely low-income project, the Legislation waives the annual tenant and annual recertification requirements. This provision is effective for years ending after the date of enactment and thus, may apply to bonds issued prior to the such date. Many existing tax regulatory agreements specifically require such annual income recertifications by tenants regardless of the federal tax rule. Issuers whose regulatory agreements are not automatically amended with changes in federal tax law will need to consider whether to continue to require annual recertifications, and developers will need to review their regulatory agreements to assess whether to request an amendment.

III. SINGLE FAMILY HOUSING PROVISIONS

First-Time Homebuyer Credit. Generally, the Legislation expends the existing District of Columbia first time home buyer credit to apply nationally and increases the amount of the credit from $5,000 for individuals and married couples to the lesser of $7,500 or 10 percent of the purchase price of the home. The credit is phased out for individuals with modified adjusted gross income between $75,000 and $95,000 (between $150,000 and $170,000 for joint filers).

Standard Deduction for State and Local Real Property Taxes. The Legislation allows tax payers who take the standard deduction to take an additional deduction equal to by the lesser of (i) the amount allowable to the taxpayer as a deduction for State and local taxes under Section 164(a)(1) and (ii) $500 ($1,000 for a married individual filing jointly).

Qualified Subprime Loans. A new exception is added to the new mortgage requirement for single family housing bonds which permits the use of such bonds to refinance a qualified subprime loan (defined as an adjustable rate residential mortgage loan originated after December 31, 2001 and before January 1, 2008 that the issuer determines would be reasonably likely to cause financial hardship to the borrower if not refinanced). The proceeds of the bonds issued for such purpose must be used within 12 months from the date of issuance of the bonds. Qualified subprime loans cannot be refinanced by bonds issued after December 31, 2010.

Presidentially Declared Disaster Areas. Under prior law, single family housing bonds generally could not be used to finance a mortgage for a homebuyer who had an ownership interest in a principal residence in the 3 years preceding the execution of the mortgage. Such requirement is waived for residences located in Presidentially declared disaster areas in the case of bonds issued after May 1, 2008 and before January 1, 2010.

IV. CERTAIN GO ZONES INCENTIVES

Additional Counties in GO Zone. For GO Zone bonds, the Legislation added Colbert County, Alabama and Dallas County, Alabama for purposes of defining the GO Zone.

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