Affordable Housing Benefits from Inflation Reduction Act, Energy Credit Provisions, SLFRF Guidance and Chicago Recovery Plan Guidance

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We have had a good season for affordable housing. While we didn't get any blockbuster changes (like a hoped-for reduction of the 50% low-income housing tax credit ("LIHTC") bond test to 25%), and although the new LIHTC Average Income Regulations have not yet been issued (but are due any day), we did get some new laws and guidance which will benefit affordable housing and LIHTC projects.

I. Inflation Reduction Act – Brings More Energy Credits to Affordable Housing and Provides New Ways to Monetize Energy Credits

On August 16, 2022, President Biden signed into law the Inflation Reduction Act ("IRA"). [1] This slimmed down version of the Build Back Better proposed legislation contains significant enhancements to Energy Credits, including new ways to monetize Energy Credits and increasing the feasibility of using Energy Credits with LIHTC.

A. LIHTC and Other Credits Can be Utilized Against New 15% Corporate Alternative Minimum Tax

One of the headlines of IRA was that, starting in 2023, there will be a 15% alternative minimum tax based on the adjusted financial statement earnings of corporations (to the extent of such earnings in excess of $1 billion). Fortunately, LIHTC and other general business credits (including historic credits, Energy Credits, new market credits) can be used to offset such alternative minimum tax. Regulations will need to be issued to fill in many important details about how this new alternative minimum tax will work.

B. Improvements to the Section 48 Energy Credit for Renewable Energy Property

The Internal Revenue Code's Section 48 energy credit ("§48 Energy Credit") was enhanced, significantly changed and effectively extended for 10 years (although through the slightly different new Section 48E Clean Electricity Investment Credit ("§48E Clean Electricity Credit") discussed

[1] The Inflation Reduction Act can be downloaded from Congress.gov at https://www.congress.gov/bill/117th-congress/house-bill/5376/text.

below for property placed in service after December 31, 2024).[2] The net result is positive for LIHTC projects and creates the potential for as much as 70% tax credit for energy projects meeting all of the requirements below.(In practice, the credit is much more likely to be 30%-50% for most LIHTC projects.) Note that there are many detailed requirements and other specifications related to renewable energy credits which are not contained in this summary.

1. Base Credit Rate is 6%, But Increases to 30% for Most LIHTC Projects

Under the old law, the §48 Energy Credit was 30%, but was phasing out. Under the revised Section 48, for property placed in service after December 31, 2021, the base credit rate is now 6%. However, Section 48(a)(9)(A) increases the 6% rate to 30% rate for (i) smaller projects (less than 1 megawatt), (ii) projects that follow prevailing wage and apprenticeship rules or (iii) projects that begin construction within 60 days of the IRS issuing regulations on prevailing wage and apprenticeship.

> **ATT Insight – LIHTC Projects Should Qualify for at Least a 30% §48 Energy Credit –** Since it would be extremely unusual for a LIHTC project to have a megawatt of power production capacity, qualifying for the 30% rate on solar panels should not be difficult.

2. Extra 10% Bonus If In an Energy Community

Section 48(a)(14) increases the §48 Energy Credit amount by an additional 10% for Projects placed in service after December 31, 2022 and that are located in "Energy Communities". Energy Communities are (i) brownfield sites, (ii) areas with significant employment or tax revenue from fossil fuels and higher than average unemployment, or (iii) census tracts (or adjoining tracts) in which a coal mine closed after 1999 or a coal-fired electric generating unit retired after 2009.

> **ATT Insight – Narrow Incentive –** This is a geographically narrow incentive that will likely apply to only a small percentage of Projects. But if it does apply, it is a significant additional source of funds. Be on the lookout for the government or industry to identify Energy Communities.

3. 10% Bonus for Domestic Content

If the energy property is placed in service after December 31, 2022 and meets certain domestic content requirements—basically meeting certain requirements for how much steel, iron or manufactured product used was produced in the United States—there is an additional 10% §48 Energy Credit if the Project qualifies for the 30% credit as described above. Projects meeting the domestic content requirements but not qualifying for the 30% credit would benefit from an additional 2% §48 Energy Credit, increasing the base rate from 6% to 8%. §48(a)(12).

[2] The §48 Energy Credit and the §48E Clean Electricity Credit will collectively be referred to as "Energy Credits".

ATT Insight – Timing and Net Value Unclear – It may take time for solar manufactures to adjust to domestic production to take advantage of this additional credit amount. Whether the added §48 Energy Credit is enough to offset additional costs of domestic production remains to be seen.

4. Up to 20% Bonus If Selected for "Environmental Justice Solar and Wind Capacity Limitation"

Starting on January 1, 2023, Section 48(e) makes available a bonus of up to either 10% or 20% §48 Energy Credits if a project has an allocation from Treasury of "Environmental Justice Solar and Wind Capacity Limitation" ("EJSW Capacity Limitation"). If a project is allocated a EJSW Capacity Limitation and the solar or wind facility is either part of a qualified low-income residential building project (which includes LIHTC and various other programs) or is a "Qualified Low-Income Economic Benefit Project", up to an additional 20% is allowed. §48(e)(1)(A)(ii). Otherwise, the available boost is up to 10%. §48(e)(1)(A)(i). The increase under this provision is capped at a percentage equal to the EJSW Capacity Limitation divided by the total megawatt nameplate capacity of the energy facility. §48(e)(1)(B). Recapture can also apply to the bonus credit for property that fails to continue to meet the requirements for the bonus.

ATT Insight – Prioritizing Residential Housing? – The annual EJSW Capacity Limitation is 1.8 gigawatts and the maximum EJSW Capacity Limitation allocated to any facility is 5-megawatts. The minimum number of projects that should receive an allocation of EJSW Capacity Limitation is 360. However, a 5-megawatt facility is much larger than any LIHTC project is likely to contain. Given that the statute specifically discussed residential buildings as qualifying for the limitation, we hope Treasury will set-aside or otherwise prioritize a portion of the annual limitation for smaller allocations that could be used for LIHTC or other affordable housing projects.

5. 50% Eligible Basis Reduction Eliminated

Under prior law, both depreciable and eligible basis were reduced by 50% of the amount of §48 Energy Credit received. New Code subsection 50(c)(3)(C) eliminated the reduction to LIHTC eligible basis but appears not to have removed the adjustment to depreciable basis. This change is effective for property placed in service after December 31, 2022.

ATT Insight – §48 Energy Credits More Appealing for LIHTC Projects – Under prior law, the benefit of receiving §48 Energy Credits was partially offset by a reduction in LIHTC eligible basis. The elimination of this reduction will make §48 Energy Credits more appealing for LIHTC projects that do not have excess eligible basis. This should be especially beneficial for Projects qualifying for LIHTC from the use of tax-exempt bonds.

6. Tax-Exempt Bonds May Reduce Credits

If the energy property is financed with tax-exempt bonds, then the §48 Energy Credit is reduced by up to 15%, and in some cases less than 15%. §48(a)(4). This provision applies to property which starts construction after the date the IRA became law, August 16, 2022.

ATT Insight – Possible Avoidance of Bond Credit Reduction – It may be possible to work with bond counsel to have bond documents in a LIHTC Project specifically provide that no bonds are used to finance the energy property. This could avoid any basis reduction.

C. New Section 48E Clean ELECTRICITY INVESTMENT Credit – Replaces §48 Energy Credit for Property Placed in Service After DECEMBER 31, 2024

The new §48E Clean Electricity Credit provides for facilities (i) that are placed in service after December 31, 2024, (ii) that generate electricity and (iii) for which the anticipated greenhouse gas emissions rate is not greater than zero.§48E(b)(3). Typical examples of such property would be wind and solar electricity generation property, but other types of clean electricity generation projects could also qualify. Solar electricity generation property would be the most likely to be used in a LIHTC Project. Note that certain energy storage facilities may also qualify for the credit.

For affordable housing projects using solar panels, the §48E Clean Electricity Credit is very similar to the §48 Energy Credit that it replaces (which is discussed above). The §48E Clean Electricity Credit has a 6% base credit rate boosted to 30% for projects less than 1 megawatt or that meet prevailing wage and apprenticeship rules. It includes bonuses similar to the §48 Energy Credit, including the 10% bonus if a project is in an Energy Community and the 10% bonus for meeting the Domestic Content requirements. There is also the credit bonus of up to 10% or 20% for projects that receive an allocation of “Environmental Justice Solar and Wind Capacity Limitation”. The same tax-exempt bond reductions also exist. Note that while a facility must have a greenhouse gas emissions rate not greater than zero in order to qualify for the credit, such requirements seem likely to be easily satisfied by LIHTC projects using solar panels. Such a provision may allow future technologies to qualify for the credit and thus allows for continued innovation to find clean ways to generate electricity.

The §48E Clean Electricity Credit runs to at least 2032 when it would start phasing down. The extension could be longer, depending on the Country's level of greenhouse gas emissions at that time.

> **ATT Insight – Effectively a 10-year Extension for §48 Energy Credits –** Between the extension and modification of the existing §48 Energy Credit though December 31, 2024 and the addition of the §48E Clean Electricity Credit starting after such date, this is effectively an extension of the §48 Energy Credit for at least 10 years. This stability will be helpful for the industry and investors.

D. Refundable Tax Credits for Tax-Exempt Entities. Transferable Credits for Everyone Else

Starting in 2023, the IRA also creates new ways to monetize certain federal tax credits, including Energy Credits.

1. New Section 6417 - Refunds for Tax-Exempt Entities

Tax-Exempt Entities traditionally have been precluded from directly benefitting from Energy Credits, only deriving indirect benefits if they partnered with taxable entities in complex partnerships and leases. Under new Section 6417, a Tax-Exempt Entity can build energy property and apply for a refund from the IRS equal to the amount of the Energy Credit that would otherwise be available. Section 6417 also applies to certain other energy related tax credits. See §6417(b). For example, a tax-exempt medical clinic could put solar panels on its roof and get a refund in the amount of the Energy Credit to which they would otherwise be entitled.

For these purposes, Section 6417(d)(1) provides that Tax-Exempt Entities are (i) organizations exempt from income tax, e.g. entities exempt from tax under Section 501(c)(3), (ii) State or political subdivisions, (iii) the Tennessee Valley Authority, (iv) Indian Tribal governments, (v) Alaska Native Corporations, and (vi) corporate cooperatives engaged in furnishing electricity in rural areas.

Section 6417(g) provides that normal Investment Tax Credit recapture rules would apply to these refunds.

ATT Insight – Future of Energy Credit Syndication in Tax-Exempt Deals? – Monetizing Energy Credits through a refund will not shift tax ownership, and thus any available depreciation deductions will remain with the tax-exempt entity and cannot be monetized. Accordingly, traditional syndication of Energy Credits may continue to be more appealing for certain projects rather than getting a refund.

ATT Insight – Bridge Lending Opportunities – There will be an opportunity for bridge lenders who are willing to loan funds to projects for construction. Such loans would be repaid from the anticipated credit refund. Bridge lenders would need to be comfortable with both the risks and timing necessary to obtain a refund for loan repayment.

ATT Insight - Partnerships Applying for Refunds – Section 6417 has rules providing that if the facility or property is held directly by a partnership, then the partnership itself must make the refund election. How this section will be interpreted by IRS Regulations will be very important. Regulations may require a tax-exempt entity to be a member of the partnership and require that it would have been entitled to be allocated the Energy Credits if no application for refund had been made. If this is correct, then in order for a Tax-Exempt Entity to monetize say 99% of the Energy Credits, the Tax-Exempt Entity would need to be entitled to 99% of the partnership's profits for the 5-year recapture period. This would create tax-exempt use issues under Section 168(h) that would eliminate bonus depreciation and accelerated depreciation that other partners in the partnership might have valued.

2. New Section 6418 - Sale of Federal Credits by Taxable Entities

New Section 6418 now allows taxable entities to sell their Energy Credits, as well as certain other energy related credits. Importantly, such sale must be to an unrelated tax credit user and must be for cash.§6418(a). The Seller, e.g., a LIHTC Partnership, will not have any taxable income from the sale and the Buyer will not get any deduction related to what it pays for the credit. §6418(b). Because the Seller continues to own the property, it will keep the depreciation on the energy property that gave rise to the credits that are sold.

ATT Insight – Appeal of Sale in LIHTC Transaction? – It will be interesting to see if this method of monetizing credits becomes prevalent in LIHTC transactions where the LIHTC Investor may already be able to use the Energy Credits. Will the LIHTC Investor value the Energy Credits more than a third-party buyer?

ATT Insight – The Return of the Early Incentive Management Fee – By structuring the transaction as a sale, rather than an allocation, of Energy Credits, certain economic limitations traditionally imposed on a General Partner can be eliminated. When structured as an allocation, and syndication of the Energy Credits, General Partners must forego any disproportionate profits (including any incentive management fee) until the sixth year after placement in service because Energy Credits are allocated based on the partners' allocable share of profits. Removing this constraint, for transactions structured as a sale, may be a structuring consideration for Projects with significant early distributable cash.

ATT Insight – Sale Opportunities for Multi-Investor Funds? – Section 6418(a) requires that the sale has to be to an unrelated taxpayer. The traditional related party rules of Sections 267(b) and 707(b) apply. Where the energy property is owned by a LIHTC Partnership, a credit buyer must have less than a 50% interest in profits and capital of the LIHTC Partnership. If the LIHTC Investor is a Multi-Investor Fund, it could be possible to sell the Energy Credits to one Investor if that Investor owns less than 50% of the LIHTC Fund. However, it may often be the case that all of the Investors in the LIHTC Fund are equally interested in Energy Credits and there would be no advantage to selling the Energy Credits to just one Investor.

Although there are some interesting structuring opportunities, it remains to be seen whether or not sales, rather than allocations, of Energy Credits are ultimately advantageous in LIHTC deals.

E. Improvements to Section 45l New Energy Efficient Home Credit

The Section 45L New Energy Efficient Home Credit ("45L Credit") has been substantially improved and may become much more common on LIHTC Projects. While the 45L Credit had expired for units acquired after December 31, 2021, the credit is now extended through December 31, 2032. In addition, the amount of the credit has been substantially increased, as described below, for units acquired after December 31, 2022.

1. Increase in Amount of 45L Credit

Under the new framework, the 45L Credit has 4 tiers of credit amounts for multi-family buildings: $500, $1,000, $2,500 and $5,000 per unit with eligibility based on the requirements described below.

(There is also a $2,500 credit for single-family buildings or manufactured homes that meet energy star requirements and a $5,000 credit for single family homes or manufactured homes that meet "zero energy" requirements.)

a) Energy Star – $500/Dwelling Unit Credit

Multifamily buildings that meet the Energy Star Multifamily New Construction National Program Requirements and Energy Star Multifamily Regional Program Requirements (the "Energy Star Requirements") are entitled to $500 credits per unit. §45L(a)(2)(B)(i).

b) Energy Star + Zero Energy – $1,000/ Dwelling Unit Credit

Buildings that meet both the Energy Star Requirements and which are certified as zero energy homes under the zero energy ready home program of the Department of Energy (the "Zero Energy Ready Requirements") are entitled to $1,000 credits per unit. §45L(a)(2)(B)(ii).

c) Energy Star + Prevailing Wage - $2,500/ Dwelling Unit Credit

Buildings that meet both the Energy Star Requirements and which ensure that laborers and mechanics employed by the taxpayer or subcontractor are not less than prevailing wage (the "Prevailing Wage Requirements") are entitled to $2,500 credits per unit. §45L(g)(1)(A).

d) Energy Star + Zero Energy Read + Prevailing Wage - $5,000/Unit Credit

Building that meet the Energy Star Requirements, the Zero Energy Ready Requirements and the Prevailing Wage requirements are entitled to $5,000 credits per unit. §45L(g)(1)(B).

ATT Insight – More LIHTC Projects Will Qualify – With many LIHTC Projects already required to meet energy star requirements under their state's Qualified Allocation Plans, getting at least the $500/unit Credit may not be difficult.

2. LIHTC Eligible Basis Reduction Eliminated

Under prior law, the Section 45L credit reduced depreciable and Section 42 eligible basis. This has now been modified to provide that Section 42 eligible basis is not reduced by the 45L Credit. Interestingly, because of different wording used in Section 45L, there is a cogent argument that depreciable basis also should not be reduced. The IRS view on this will be important.

ATT Insight – LIHTC and 45L Credits Will Be Combined More Often – Under prior law, the basis reduction together with the minimal benefit to the 45L credits made the use of 45L credits uncommon in LIHTC transactions. The removal of the basis reduction and the increase in the amount 45L Credits will make 45L Credit use much more attractive and common in LIHTC deals.

II. Treasury Adjusts SLFRF Program to Work Better for Affordable Housing

In late July 2022, the Department of Treasury ("Treasury") issued new guidance on using State and Local Fiscal Recover Funds ("SLFRF") that are made available under the American Recovery Plan Act of 2021, Public Law 117-2 (March 11, 2021). The July guidance consisted of an update to Frequently Asked Questions by Treasury, as well as Affordable Housing How-To Guide issued by Treasury. These documents significantly improved the ability to use SLFRF to create affordable housing.

Where to find Final Rule and Other Authority –

- Final Rule - The "Final Rule is located at 31 CFR Part 35 and https://home.treasury.gov/system/files/136/SLFRF-Final-Rule-FAQ.pdf and will be referred to as "Final Rule".
- Treasury FAQ - The most current final Treasury Frequently Asked Questions (the "July Final FAQ") is dated July 27, 2022 and is located at https:/home.treasury.gov/system/files/136/SLFRF-Final-Rule-FAQ.pdf. Treasury had previously issued an interim FAQ dated January of 2022, and the original Final FAQ dated April 27, 2022.
- Treasury Affordable Housing How-To Guide - https://home.treasury.gov/system/files/136/Affordable-Housing-How-To-Guide.pdf

A. Background

SLFRF funds are distributed by Treasury to States and localities to speed up the country's recovery from the economic and health effects of the COVID-19 pandemic and the ongoing recession. The SLFRF program provides governments across the country with the resources needed to:

- Fight the pandemic and support families and businesses struggling with its public health and economic impacts
- Maintain vital public services, even amid declines in revenue resulting from the crisis
- Build a strong, resilient, and equitable recovery by making investments that support long-term growth and opportunity

B. The Loan Blending Problem – Before It Went Away for Affordable Housing

Final Rule 35.6 provides that SLFRF has to be "expended" for eligible uses. Under Section 4.9 of the February 14, 2022 Final FAQ Section, as well as under the July Final FAQ, if a Recipient (the governmental entity that received the funds) loans the funds, then SLFRF is only considered expended to the extent that the Recipient subsidizes the cost of the loan. The present value of the Recipient's loan disbursements that exceed the present value of loan repayments, is considered the "cost of the loan" and fundable by SLFRF funds. Money that the Recipient would receive back in loan repayments was not considered expended. This requires a present value computation of expected payments on the loan and the present value of such payments had to be funded with non-SLFRF money. This required governmental Recipients, or subrecipients—e.g., nonprofits or other entities that were granted funds and then loaned them into LIHTC partnerships—to "blend" SLFRF with other funds. For example, assume that $100,000 was loaned by a state agency to a LIHTC Partnership for 40 years, with no interest and no payments until maturity. Further assume that the agency's cost of funds is 3.5%. In this case, the present value of the repayment is $100,000/(1.035)^40 = $25,257.25. This means that the loan from the state agency could be funded from $74,742.25 of SLFRF and $25,257.25 must be funded from non-SLFRF.

C. Solving the Loan Blending Problem for Affordable Housing

Early on we identified having to "blend" funds for LIHTC transactions as an unnecessary complication and submitted a memo[3] to Treasury stating that the nature of LIHTC Projects was such that such transactions already addressed the concerns Treasury had which led to the creation of the loan blending approach. Fortunately, the new guidance from Treasury is consistent with the request we had submitted.

Under the July Final FAQ and the How-to Guide", loan blending is no longer needed for LIHTC transactions as long as some basic requirements are met. The main requirements are: (1) the Project must forgo the Section 42 Qualified Contract, (2) the loan has to have a term of at least 20 years, (3) the Project must have a covenant enforcing the low-income requirements for at least 20 years, and (4) the loan has to be repaid if the Project fails to meet the LIHTC minimum set-aside requirements, the Project fails to be residential rental housing under Section 142, or the Project violates its extended use agreement. This exception to the loan blending rule presumptively applies to the following:

- National Housing Trust Fund (HTF)
- HOME Investment Partnerships Program (HOME)
- Low-Income Housing Credit (LIHTC)

[3] The memo was submitted jointly by Glenn Graff at Applegate & Thorne-Thomsen and Chris Hornig of Klein Hornig.

- Public Housing Capital Fund
- Section 202 Supportive Housing for the Elderly Program
- Section 811 Supportive Housing for Persons with Disabilities Program
- Project-Based Rental Assistance
- Multifamily Preservation & Revitalization Program
- Affordable housing projects provided by a Tribal government if they would be eligible for funding under the Indian Housing Block Grant program, the Indian Community Development Block Grant program, or the Bureau of Indian Affairs Housing Improvement Program
- Affordable rental housing if the units funded serve households at or below 65% of AMI for a period of 20 years or greater.[4]

ATT Insight – Requirements for No Loan Blending Easy for LIHTC Projects and Affordable Housing – Meeting the requirements to avoid loan blending should be easy for LIHTC Projects and most other affordable housing. This is very good news as the loan blending rules create a number of hurdles and uncertainties.

D. Multi-Use Projects

Section 4.8 of the July Final FAQ also clarifies that projects may include both SLFRF eligible uses and other uses, provided that the SLFRF is used for eligible uses. For example, a Project might include affordable housing and also commercial space that might not otherwise qualify for SLFRF. In such a case, the SLFRF could be used for the affordable housing component and the "Project" for SLFRF purposes would be just the affordable housing. Non-SLFRF would be used to build the other parts of the larger development that contains the affordable housing.

III. "Chicago Recovery Plan" Funds for Affordable Housing

The City of Chicago (the "City") has allocated funds to assist Chicagoans recovering from the COVID-19 pandemic under the Chicago Recovery Plan ("CRP"). Among the variety of different programs under CRP is the availability of some funds for affordable housing. Applegate & Thorne-Thomsen has been working with the City on these funds due to some intricate issues that arose. Originally the funds were slated to be derived from the proceeds of tax-exempt general obligation bonds of the City. However, funding affordable housing from this source meant that such funds could not be used with 9% credits, but only 4% credits.

[4] The How-To Guide also provides that "a broader range of affordable housing investments may also be eligible uses of SLFRF funds under the final rule if they are related and are reasonably proportional to addressing the negative economic impacts of the pandemic and otherwise meet the final rule's requirements. Depending on the needs of the local rental market, it may be reasonably proportional to address the negative economic impacts of the pandemic by funding units (e.g., up to 80% AMI) that do not fall into the presumptively eligible categories listed above."

In addition, due to certain other limitation, such funds could not be directly or indirectly loaned into Projects and instead had to be granted to partnerships owning the building, or possibly granted to a nonprofit followed by a capital contribution to the partnership entity. Such restrictions were creating significant structuring problems for LIHTC projects. Working with the City, they have adjusted the CRP structure to have the funds used to assist LIHTC Projects be derived from the proceeds of taxable bonds, rather than tax-exempt general obligation bonds. Under this new structure, the City is able to loan the funds directly to a LIHTC Partnership. This eliminates the structuring issues and also means the funds aren't restricted to 4% projects.

> **ATT Insight – CRP Funds Now Like Other City Funds and Much Easier to Use –** the City's flexibility to have CRP funds come from taxable bond proceeds effectively means these funds are similar to or even more flexible than other City funds. For example, the City can now make third party nonrecourse loans of CRP funds to projects and that can help generate partnership minimum gain and solve capital account problems.[5]

[5] For an additional discussion about the value of nonrecourse debt in LIHTC projects, see Glenn Graff, Why Does My Tax Lawyer Keep Saying We Need Nonrecourse Debt for My Low-Income Housing Tax Credit Project 27-2 J. Aff. Housing 435 (2018) https://www.att-law.com/post/nonrecourse-debt-for-lihtc-projects/

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