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Low Income Housing Tax Credit Provisions of the Recovery Act of 2009: Tools to Close Financing Gaps in a Weak Tax Credit Equity Market

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On February 13, 2009, both the House and Senate passed the American Recovery and Reinvestment Act of 2009 (the Recovery Act).[1] President Barack Obama signed the bill into law on February 17, 2009. As part of the Recovery Act, Congress attempted to provide funding assistance to stalled Low Income Housing Tax Credit (LIHTC) developments.[2] Since early 2008, the LIHTC industry has seen a precipitous fall in the number of active LIHTC investors, and a corresponding decline in LIHTC equity prices. This fall in equity pricing has led to large financing gaps in development budgets resulting in many stalled LIHTC developments. In the Recovery Act, Congress authorized two major new tools that LIHTC allocating agencies can use to help close financing gaps: the LIHTC cash exchange program (Exchange Program)[3] and the $2.25 billion LIHTC gap financing program (TCAP).[4]

This article outlines the statute that authorizes each of these two new tools, followed by a discussion of the written guidance from the Treasury Department regarding the implementation of the Exchange Program and the written guidance from the Department of Housing and Urban Development (HUD) regarding the $2.25 billion in TCAP financing. This article also reviews issues affecting their implementation. In spite of the need for additional guidance in many areas, LIHTC allocating agencies have aggressively taken steps to implement both tools. Ironically, the creation of these two new tools has actually further stalled many projects over the short run as project developers attempt to assess implications of the new tools. Over

1. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (2009) [hereinafter ARRA]. For additional source information on the Exchange Program and TCAP, *see* http://www.novoco.com/low_income_housing/news/hot_topics/recovery.php.

2. *See* Novogradac & Company, LLP, Low-Income Housing Tax Credit Handbook (West Taxation Series 2009) (1990) for a complete discussion of the LIHTC program.

3. The Exchange Program was created by Section 1602 of the American Recovery and Reinvestment Act of 2009. Treasury refers to the program as the Section 1602 Program. However, the authors have chosen to follow the housing industry practice of referring to the program as the Exchange Program.

4. TCAP was authorized by Title XII of the American Reinvestment and Recovery Act of 2009 under the heading of *Home Investment Partnerships Program. See* http://www.novoco.com/podcast/audio_files/2009/5_12/5_12.mp3 (Novogradac & Company LLP podcast on May 12, 2009, on the Exchange Program and TCAP).

the longer run, however, these new tools are expected to unfreeze numerous LIHTC developments.

I. LIHTC Credit Exchange Program Description

The Recovery Act allows states to exchange a portion of their 2009 allocated LIHTCs for cash grants that can then be used to finance buildings that qualify as low-income buildings under Internal Revenue Code Section 42.[5] This cash exchange program is only effective for credits allocable in 2009,[6] as Congress intended this program to be a temporary fix to the shortage of tax credit equity. By limiting the applicability of the Exchange Program to 2009 LIHTCs only, Congress sent a clear message that program participants should not expect this program to become an ongoing feature of the LIHTC program.[7] Grants under the Exchange Program can be used in conjunction with an allocation of LIHTC, or can be used to finance buildings without an allocation of LIHTC. This program allows states to reduce tax credits otherwise available to developers to finance LIHTC projects. In exchange, the state receives grant funds that can be subawarded to finance eligible projects.

Under the Exchange Program, the U.S. Treasury will provide a grant to housing credit allocating agencies (Credit Agency) that will make subawards of the grant funds to projects.[8] The grant amount, which is granted to the Credit Agency, is equal to the following formula: grant amount = 10 × 85% × LIHTC amount elected by state.[9] This formula essentially allows Credit Agencies to exchange their right to allocate credits for eighty-five cents of grant funds from the federal government per dollar of credit exchanged.

The dollar amount of credits that can be exchanged is subject to certain limits, as a Credit Agency cannot elect to exchange all of its 2009 credits for grants. A Credit Agency can elect to exchange LIHTC up to an amount calculated as the sum of:

(i) 100 percent of unused housing credit ceiling for 2008, if any,

(ii) 100 percent of any previously allocated LIHTCs returned to the state in 2009, if any,

(iii) 40 percent of the state's 2009 per capita based LIHTC allocation, and

(iv) 40 percent of the state's 2009 share of the national pool LIHTCs, if any.[10]

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5. ARRA § 1602(a).

6. *Id*. § 1602(b)(1).

7. Given the continuing weak tax credit equity market, as this article was going to press, legislative efforts to extend the Exchange program were underway. *See* Buzz Roberts, *The Residue of Design*, Novogradac J. of Tax Credit Housing, July 2009, at 12.

8. ARRA § 1602(c)(1).

9. *Id*. § 1602(b).

10. *Id*.

As of July 17, 2009, the U.S. Department of Treasury had awarded over $1.2 billion in grants to twenty-five Credit Agencies.[11]

Upon the transfer of a grant from the U.S. Treasury to a Credit Agency, the Credit Agency can make a subaward of the grant funds to finance the construction or acquisition and rehabilitation of a qualified low-income building, which can include projects without LIHTC allocations. For projects without LIHTC allocations, a subaward may be made only if the Credit Agency makes a determination that such use will increase the total funds available to the state to build and rehabilitate affordable housing. In addition, the Recovery Act requires that the Credit Agency establish a process in which applicants that are allocated credits demonstrate good faith efforts to obtain investment commitments for such credits before the agency makes such subawards.[12] As noted in a frequently asked question (FAQ) document posted on Treasury's Exchange Program website,[13] Treasury has expanded the requirement for "good faith effort to obtain investment commitments" to all projects, whether or not they have received an allocation of LIHTC.[14]

A common misconception that the authors are beginning to see is that industry participants mistake the Exchange Program as an opportunity for a development with an allocation of LIHTC to elect to return its allocation in exchange for a guaranteed amount of exchange proceeds from the Credit Agency. Although the Exchange Program may result in this outcome, the exchange mechanism does not rest at the individual development level. Instead, Credit Agencies elect to exchange a portion of their otherwise available LIHTC allocation, including returned LIHTC allocations, for grant proceeds. The Credit Agencies utilize their competitive processes to make subawards of the grant proceeds to individual developments, in amounts that may or may not correspond to the original LIHTC awards. Individual developments that had, in effect, expected to sell their credits for eighty-five cents through the Exchange Program may be in for a rude awakening, as those developments may possibly receive no subaward under the Exchange Program or may receive a subaward that is substantially less than 85 percent of the credits previously allocated. Interestingly, the Exchange FAQ states that a Credit Agency "has the discretion to award Section 1602

11. Press Release, U.S. Dep't of the Treasury, Treasury Announces $486 Million in Recovery Act Funds to Create Jobs, Provide Affordable Housing (July 10, 2009), *available at* www.treas.gov/press/releases/tg203.htm.

12. *Id*. § 1602(c)(1).

13. *See* Treasury's Exchange Program website, *at* www.treasury.gov/recovery/LIH-grants.html.

14. U.S. Dep't of the Treasury, *Section 1602: Grants to States for Low-Income Housing Projects in Lieu of Low-Income Housing Credits for 2009*, Frequently Asked Questions Q&A 4c (2009), *available at* www.treasury.gov/recovery/docs/FAQs.pdf [hereinafter Exchange FAQ].

funds" and that it is between the Credit Agency and the project owner as to whether any "assurance" is given that Exchange Program funds will be available to the project.[15] As a result, each state will determine how it will administer its competitive process and if any assurance will be given to project owners returning LIHTC and seeking Exchange Program funds. However, project owners should keep in mind that the fact that they are returning credits does not automatically mean they are entitled to any Exchange Program funds, let alone a specific amount.

Unlike many of the other programs instituted by the Recovery Act, the Buy American provisions of the Recovery Act do not apply to the Exchange Program.[16] Additionally, the federal cross cutting requirements such as Davis-Bacon, environmental review, etc., do not apply to recipients of subawards under the Exchange Program.[17] However, the Recovery Act does impose several other requirements. First, any grant funds not used to make subawards before January 1, 2011, must be returned to the Treasury.[18] Second, the Credit Agency must perform its own asset management for buildings funded with a subaward of grant funds.[19] Credit Agencies are allowed to contract for such asset management and may charge the grantees additional amounts to cover the expense of asset management.[20] Finally, a Credit Agency must impose conditions or restrictions, including a requirement for recapture, to ensure that a building receiving a subaward remains a "qualified low-income building" during the fifteen year compliance period.[21] Such recapture will be enforceable by a mortgage lien or similar measures approved by the Treasury.[22] Recaptured funds must be returned to the Treasury.[23]

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15. *Id*. at Q&A 5c.

16. *Id*. at 4d; *see also* Webcast: Statements of Jean Whaley, Grants Award Manager U.S. Dep't of the Treasury, and Marcia Sigal, Policy Division Director, HUD Office of Affordable Housing Programs (May 6, 2009) (*available at* http://rm.ovsmedia.net/ramgen/a1662/o15/hud/2009/0506/wc-11520-en3-off-150k.rm) [hereinafter HUD-Treasury Webcast].

17. Exchange FAQ, *supra* note 14, at Q&A 4d; *see also* HUD-Treasury Webcast, *supra* note 16 (Jean Whaley, Treasury grants award manager, explained that the cross-cutting requirements do not apply because the cross-cutting requirements apply to the appropriation provisions in Division A of the Recovery Act. The Exchange Program is contained in Division B and therefore, the federal cross-cutting requirements do not apply).

18. ARRA § 1602(d).

19. *Id*. § 1602(c)(3).

20. *Id*.

21. *Id*. § 1602(c)(4).

22. *Id*.

23. *Id*.

II. LIHTC Exchange Program Issues

The following is a discussion of the numerous answered and unanswered questions regarding the Exchange Program.

A. Which Credit Agencies Are Eligible to Exchange Credits?

The Recovery Act does not specifically identify which Credit Agencies are eligible to exchange credits. This question is particularly important for states where there may be more than one allocating agency. The Treasury has issued an Application Package[24] for exchanging credits. Page three of the Application Package states that the organization that files form 8610 is the organization that is eligible to exchange credits for a given state.[25] These organizations may suballocate their awards to other allocating agencies within their states.

B. Grants or Loans?

The Recovery Act does not specifically address whether subawards are to be made as grants and/or loans to project owners. Credit Agencies initially believed that they could make either grants or loans. Several states, such as California and Michigan, expressed a desire to use the subawards to make soft loans to finance low-income housing projects. However, the Treasury Department's Application Package states that only grants are permissible under the Recovery Act.[26] Although program participants and Credit Agencies have indicated a desire to have this guidance modified to allow for loans, as this article went to press, only grants are permissible with Exchange Program proceeds.[27] Treasury has indicated that Exchange Program subawards may be in the form of loans if such loans are nonrepayable except in the event of recapture.[28] Such a loan would not be materi-

24. *See* U.S. Dep't of the Treasury, Application and Terms and Conditions: Grants to State for Low-Income Housing Projects in Lieu of Low-Income Housing Credits for 2009 under the American Recovery and Reinvestment Act of 2009, *available at* www.treasury.gov/recovery/docs/LIH_application-package.pdf [hereinafter Application Package].

25. *See id*. at 7 (list of the designated agencies that may exchange credits). *See also* Exchange FAQ, *supra* note 14, at Q&A 2a (discussion of why there is only one designated agency for each state).

26. "The subawards shall be in the form of cash assistance and are not required to be repaid unless there is a recapture event with respect to the qualified low-income building." *See* Application Package, *supra* note 24, at 10. In Q&A 4a in the Exchange FAQ, *supra* note 14, Treasury further stated that subawards of Exchange funds may be made in the form of a loan as long as the loan is noninterest bearing and is only repayable in the event of recapture.

27. *Id*.

28. *See* ARRA § 1602(d)

ally different from a grant subject to a recapture agreement. Some Credit Agencies have indicated a preference for using this type of forgivable loan structure because in some situations it may be an easier method to secure the obligation for recapture.

For the project receiving the subaward in the form of a grant or loan, several other key considerations exist due to the contrasting tax treatment of these two alternatives. Grants might result in taxable income. The Recovery Act does not statutorily address whether grants are taxable income to recipients. However, the Joint Explanatory Statement issued by the Senate and House reconciliation committee accompanying the Recovery Act states that such grants are not taxable income.[29] It was stated in a May 16, 2009, HUD-Treasury webcast that subaward grants will not be taxable income to recipients on the basis of the Joint Explanatory Statement.[30]

Taxpayers should note that even though subawards structured as grants are not taxable income for federal income tax purposes, they may still be taxable for state income tax purposes. The rules of each state will need to be reviewed to determine if the subawards structured as grants are taxable for state purposes. In general, states that automatically conform to federal tax law will likely not include subawards structured as grants in taxable income, whereas states such as California could possibly include them in taxable income. The California treasurer initially indicated that subawards structured as grants would be included in taxable income for California state income tax purposes.[31] However, in subsequent informal discussions with California income tax officials, it appears that subaward grants may not be taxable for California income tax purposes.

Whether subaward grants are taxable in California (and other states that do not automatically conform to federal law) depends, at least in part, on the reasoning as to why they are not taxable for federal income tax purposes. The provisions enacting the Exchange Program did not include a clear, unambiguous statutory change that stated the grants are nontaxable. The Joint Explanatory Statement of the law, however, did include an express statement that the grants would not be taxable income. If these grants are not income under existing law because they constitute general welfare payments, similar to the reasoning in Revenue Ruling

29. *See* Joint Explanatory Statement, Division B-Tax, Unemployment, Health, State Fiscal Relief, and Other Provisions, at 19 (2009), *available at* www.house.gov/billtext/hr1_legtext_crb.pdf.

30. *See* HUD-Treasury Webcast, supra note 16 (Whaley statements). In informal discussions, IRS personnel indicated that they are working on written guidance confirming the nontaxability of Exchange grants.

31. *See* Letter from Bill Lockyer, Treasurer, State of California, to Kenneth Carfine, Fiscal Asst. Sec'y, U.S. Treasury Dep't, et al. (May 11, 2009), *available at* http://www.novoco.com/low_income_housing/resource_files/hot_topics/recovery/ca_lockyer letter_051109.pdf. (May 11, 2009)

2009-19 regarding Payment for Performance under the Home Affordable Modification Program (HAMP), they are likely not income in California. Conversely, if the Internal Revenue Service rules that subawards are not income because the totality of the changes to Section 42 implicitly confirm that the payments were not intended to be income, such payments may be taxable income in California because the state has not conformed these changes to California law.

There are also significant considerations as to whether subawards structured as grants will reduce eligible basis or depreciable basis. The possibility of income recognition, a reduction in eligible basis, or a reduction in depreciable basis in isolation would result in a significant reduction in the attractiveness of the Exchange Program. Moreover, the three in combination could eliminate virtually all of the benefits intended to be delivered.

With respect to a possible reduction in eligible basis equal to the amount of the grant, the Recovery Act added Section 42(i)(9)(B) that specifically provides that "[b]asis of a qualified low-income building shall not be reduced by the amount of any grant [under Section 1602 of the Recovery Act]."[32] It is significant that this section does not specify whether this provision applies to eligible basis or depreciable basis or both. A technical analysis of Section 42(i)(9)(B) would be that the section refers to *basis* as the term *basis* is defined in Section 1012 as the cost of property. Section 1012 basis is the starting point for determining depreciation or gain or loss from the sale of property. Therefore, it seems that a straightforward reading of Section 42(i)(9)(B) is that depreciable basis is not reduced for the receipt of a subaward grant.

In addition to arriving at a conclusion on depreciable basis, it is critical to know whether a subaward grant will reduce eligible basis for purposes of Section 42. Section 1602(c)(1) is clear that subawards can be used for projects that will continue to use LIHTC. Thus, subawards can act to fill a financing gap. However, Section 42(d)(5)(a) requires "[t]he eligible basis of a building shall not include any costs financed with the proceeds of a federally funded grant." Thus, because Exchange Program grants are federal grants, one could conclude that they must reduce eligible basis. However, such an interpretation does not make sense in view of the fact that Exchange Program grants can be used with projects that retain LIHTC but still have a financing gap. If eligible basis was reduced by a subaward grant, that would reduce the amount of LIHTC that a project could support. With less LIHTC, a project's financing gap would increase and require an increased Exchange Program grant—thus creating a vicious cycle. The fact that the Recovery Act includes the provision that basis not be reduced for a subaward grant in Section 42 arguably shows that it was intended that eligible

32. ARRA § 1404; I.R.C. § 42(i)(9)(B).

basis as well as depreciable basis should not be reduced for Exchange Program grants. Fortunately, informal and public statements by the IRS have stated that neither eligible basis nor depreciable basis will be reduced by the amount of any grant received under the Exchange Program. We understand that the IRS intends on issuing written guidance to this effect.

Although the Application Package and Exchange FAQ currently only allow subawards to be structured as grants or loans that can only be repaid in the event of recapture, there have been informal discussions proposing that the Treasury guidance be updated to allow some form of loans that would eventually require repayment. In the event of such a change, some Credit Agencies may choose to provide subawards to building owners in the form of soft loans, with little or no current debt service with repayment due at maturity. Such loans are already commonplace in the financing structures of low-income housing. Soft loans, if respected as loans, avoid the issue of whether there is taxable income or basis reduction from receipt of a grant. However, to be respected as loans, projects must be able to show an ability to repay those loans. Some projects may have difficulty showing an ability to repay the loans, and the loans could be treated as grants for federal income tax purposes.

If Treasury were to allow subawards to be made in the form of soft loans, there would be economic consequences to such a change. The repayment obligation of soft loans makes such loans less attractive to developers of affordable housing than grants or tax credit equity. Recipients of soft loans one day will have to repay the indebtedness through a sale or refinancing, or work out a refinancing or forgiveness. In some projects, Exchange Program funds could end up as a large percentage of the funds used to finance the project. If the project does not have sufficient value to allow for a refinancing when the loan matures and the Credit Agency chose not to forgive the debt at such time, the developer would end up defaulting on the loan resulting in the Credit Agency foreclosing on the project. Thus, a loan structure is much more unfavorable to a developer than a grant. In addition, a soft loan is also less attractive to a developer than tax credit equity, as tax credit equity is generally subordinated to numerous other payments to a developer and ultimately only a small portion of the tax credit equity is likely to be returned in cash to the tax credit equity investor. Given that one of the purposes of the Exchange Program grants is to replace equity when a project cannot find an investor for LIHTC,[33] some practitioners have concluded that awarding subawards as grants or forgivable loans is a result that is closer to the equity investment being replaced.

33. ARRA § 1602(c)(2) requires that applicants that were allocated LIHTC must show that they made a good faith effort to find an investor for the LIHTC before the applicant can receive an exchange grant. Implicit in this requirement is that the Exchange funds are replacing the equity that could not be obtained.

Although not as favorable to developers, Credit Agencies are attracted to making subawards structured as loans, in part, because they believe that they can retain any loan repayments, and use those repayments to fund other housing developments. In the event updated guidance is issued to allow for subawards to be structured as loans, this conclusion would still be unclear as Treasury may argue that any loan repayments must be returned to the federal government.

For subawardees taxed as partnerships for federal income tax purposes, a corollary question is whether partners receive income tax basis for grants that are nontaxable to the partnerships. The general belief among the majority of tax practitioners is that receipt of a subaward grant by the partnership would be treated similar to other tax free income and partners would receive an upward adjustment in their tax basis.[34] Similarly, tax practitioners generally believe that partners would also receive an upward adjustment in their capital accounts for purposes of the capital account maintenance rules of Section 704(b).[35]

C. Exchange of Disaster Area and GO Zone Credits

Although not explicitly addressed in the Recovery Act, it appears that a Credit Agency cannot exchange the supplemental 2009 disaster area or GO Zone LIHTCs for grants.[36] Initially it was unclear if pre-2009 allocations of disaster area LIHTC (or even GO Zone LIHTC) could be returned in 2009 under IRS regulations. If such LIHTC could be returned, for example, by the return of a carryover allocation of disaster area LIHTC, such LIHTC would be eligible for 100 percent exchange. Initial discussions with the IRS revealed its position that, because GO Zone and disaster area LIHTC are lost if not allocated by the end of the relevant year, the result is that such supplemental LIHTC could not be returned in a subsequent year. Therefore, such supplemental LIHTC are ineligible for exchange. Based on a request from the Louisiana Housing Finance Agency for clarification on this issue, Treasury has indicated that GO Zone credits could be returned and reallocated within the GO Zone. However, Treasury went on to state that

34. I.R.C. § 705(a)(1)(B)(2009). *See infra* note 123 and accompanying text.

35. Treas. Reg. § 1.704-1(b)(2)(iv)(b)(3)(2008). *See infra* note 124 and accompanying text.

36. ARRA § 1602(b) only allows credits that are in one of the four subsections of section 42(h)(3)(C) to be exchanged. Section 42(h)(3)(C) defines a state's housing credit ceiling as being the sum of the types of credits listed in the four subsections. Technically GO Zone and Disaster Credits are not one of these four subsections contained in 42(h)(3)(C), but are a separate increase to a state's housing credit ceiling pursuant to a separate statute. See Section 702(d)(2) of the Emergency Economic Stabilization Act of 2008 for more information on Disaster Area credits, and Section 1400N(c) of the Gulf Opportunity Zone Act of 2005 for more information on GO Zone LIHTC.

the Recovery Act specifically allows only credits determined under Section 42 in the calculation of the credits eligible for the Exchange Program.[37] Under the Treasury interpretation, because the additional GO Zone credits are determined under Section 1400N and not under Section 42, they were therefore not eligible for the Exchange Program. Exchange Program guidance issued by Treasury affirmatively states that GO Zone LIHTCs and disaster area LIHTCs cannot be exchanged for grants under the Exchange Program.[38]

Many members of Congress believe that Treasury's interpretation does not reflect congressional intent. The proposed Disaster State Housing Recovery Act of 2009, Senate Bill 1326, was introduced in the Senate on June 23, 2009, and directly addresses this issue. This bill would amend the Recovery Act to clarify that GO Zone LIHTCs and disaster area LIHTCs are eligible for the Exchange Program.[39]

D. Amount and Timing of Subawards

Although not required by the Recovery Act, Treasury has created a limitation on the amount of Exchange Program subawards that a building can receive.[40] In Q&A 4f in the Exchange FAQ, Treasury outlined that the amount of a subaward cannot exceed 85 percent of a building's eligible basis as determined under Section 42(f)(1). The answer goes on to state that for purposes of the eligible basis limitation, eligible basis includes the Section 42(d)(5)(B) 30 percent increase in eligible basis for buildings located in high cost areas.[41] Thus, it appears that a building in such a high cost area may receive a subaward up to 85 percent of 130 percent of the building's eligible basis, i.e., 110.5 percent of eligible basis.

In addition to the 85 percent of eligible basis limitation provided for in the Exchange FAQ, it is noteworthy that the Recovery Act states that all of the requirements of Section 42 apply to qualified low-income buildings receiving Exchange Program funds.[42] For instance, projects receiving

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37. *See* Louisiana's response to Treasury's decision http://www.novoco.com/low_income_housing/resource_files/hot_topics/recovery/la_response_gozoneletter.pdf (April 24, 2009). *See also* Treasury's response to Louisiana's letter and letters from members of Congress http://www.novoco.com/low_income_housing/news/hot_topics/recovery.php

38. Notwithstanding such guidance, many commentators continue to believe that the only method of returning any LIHTC, including GO Zone credits, is under Section 42(h)(3)(C)(iii). Therefore, if GO Zone credit can be returned, they are eligible for exchange under Section 1602(b)(1)(A).

39. Sponsors of the bill include Senators Bayh, Shelby, Landrieu, Vitter, Durbin, Bond, Harkin, Johanns, Wicker, Lugar, Cochran, and Nelson.

40. *See* Exchange FAQ, *supra* note 14, at Q&A 4f.

41. *Id*.

42. ARRA § 1602(c)(2).

Exchange Program subawards are expected to be subject to the 10 percent test and two-year placement in service requirements contained in Section 42(h)(1)(E)(ii). Another requirement of Section 42 is that a project may not receive more LIHTC than is necessary for the project's financial feasibility.[43] Based on the foregoing, Credit Agencies will need to limit the amount of Exchange Program subaward projects receive to the amount needed for financial feasibility even if such amount is less than 85 percent of the project's eligible basis. This requirement serves to further reinforce the purpose of the Exchange Program as a gap filler used by the Credit Agencies for those projects that the Credit Agencies deem appropriate, and not as a dollar for dollar exchange of credits for grants at the project level.

In addition to providing limits on the amount of subawards, Treasury has provided a timing requirement for subawards. Under this rule, a building can receive an Exchange Program subaward only if it was not placed in service in a prior taxable year.[44] Thus, buildings placed in service in 2008 or earlier would not be eligible for financing from Exchange Program subawards in 2009.

E. Costs Eligible for Grant Proceeds

Another issue relates to the specific approved uses of the subaward funds. The Recovery Act provides that "[a] [s]tate housing credit agency receiving a grant under this section shall use such grant to make subawards to finance the construction or acquisition and rehabilitation of qualified low-income buildings."[45] As discussed below, it appears that subawards can be used to pay for any project costs, whether or not such costs are includible in Section 42 eligible basis.[46] However, the Recovery Act contains a specific prohibition on using Exchange Program funds to pay for swimming pools. As such, projects with swimming pools will of necessity need other financing sources. Treasury has specifically allowed Exchange funds to be used to repay equity or loans that have financed the cost of construction of a building or other eligible costs.[47]

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43. Section 42(m)(2) states that "[t]he housing credit dollar amount allocated to a project shall not exceed the amount the housing credit agency determines is necessary for the financial feasibility of the project and its viability as a qualified low-income housing project throughout the credit period."

44. Exchange FAQ, *supra* note 14, at Q&A 3e.

45. ARRA § 1711(c)(1).

46. Exchange FAQ, *supra* note 14, at Q&A 4f specifically addresses what costs may be paid for with Exchange Program funds. The answer states "Section 1602 follows the same requirements as LIHTCs. Section 1602 funds may pay for development costs to the same extent as allowed under Section 42 of the Internal Revenue Code. For example, the acquisition of land is ineligible under Section 1602, as it is under Section 42." This seems to imply that Exchange Program subawards can only be spent on costs which qualify as eligible basis under Section 42.

47. *See id* at Q&A 3f.

Due to some unclear language in the Exchange FAQ, there is some question as to whether Exchange Program subawards may be spent on items such as land and operating reserves that do not qualify as eligible basis under Section 42.[48] Q&A 4f in the Exchange FAQ specifically addresses what costs may be paid for with Exchange funds:

> Section 1602 follows the same requirements as LIHTCs. Section 1602 funds may pay for development costs to the same extent as allowed under Section 42 of the Internal Revenue Code. For example, the acquisition of land is ineligible under Section 1602, as it is under Section 42.

Thus, based on Q&A 4f, one might conclude that land and other noneligible basis items cannot be paid for with Exchange Program subawards.

However, notwithstanding Q&A 4f's specific prohibition on using Exchange Program subawards to pay for land, this conclusion appears to be in error for a number of reasons. First, neither Section 1602 of the Recovery Act nor IRC Section 42 prohibits the use of equity raised from LIHTC investors to pay for land or other ineligible costs.[49] In fact, it is common for equity raised through the sale of LIHTC to be used to pay for land and other costs that do not qualify as eligible basis.[50] Second, the answer to Q&A 4f appears inconsistent with Q&A 4g, which states that subawardees are not required to trace how Exchange Program subawards are used by the project. Finally,

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48. Because Section 42(d) defines eligible basis with respect to a building's adjusted basis, project costs such as land costs and operating reserves are not included in a building's eligible basis.

49. While Section 1602(c)(1) states that Exchange funds must be used to finance the construction or acquisition and rehabilitation of qualified low-income buildings, nothing in Section 1602 or Section 42 specifically limits the costs of qualified low-income buildings to eligible basis. Because low-income buildings are situated on land, it appears to be a reasonable interpretation of Section 1602 to allow for Exchange Program subawards to at least pay for land costs that are a required part of every project. Similarly, the use of operating reserves has been a key component of the success of LIHTC projects and a flexible interpretation allowing Exchange Program subawards to pay for operating reserves adds to the likelihood of the long-term success of projects funded with subawards under the Exchange Program. Finally, because Exchange Program subawards are really replacements for LIHTC equity, it makes sense to allow the Exchange subawards to be spent in the same manner as LIHTC equity.

50. The legislative history of the 130 percent basis boost contained in Section 42(d)(5)(B) indicates that one of the reasons to have a basis boost is to generate equity that could be used to pay for high land costs. *See* H.R. Rep. No. 101-247 (1989) (Committee Report on Pub L. No. 101-239, Omnibus Budget Reconciliation Act of 1989) ("In determining which areas are difficult to develop, the bill provides that the Secretary of HUD consider several factors. It may be costly to produce low-income housing in one area relative to the rest of the country because that area has higher land costs than the rest of the country.").

Q&A 4f is also inconsistent with Q&A 4h, which allows projects qualifying for the 30 percent eligible basis boost pursuant to Section 42(d)(5) to receive grant proceeds up to 85 percent of 130 percent of a project's eligible basis. Because 85 percent of 130 percent equals 110.5 percent, under Q&A 4h a project with $100 of eligible basis could receive up to $110.50. Therefore in this hypothetical example, any limitation that Exchange Program subawards can only be used for eligible basis items would result in $10.50 for which there would be no qualifying costs.

As the article went to press, the authors had informal discussions with personnel assisting Treasury with the Exchange FAQ. These discussions clarified: (1) It was not intended for there to be any limitation on what costs could be paid for with Exchange Program subawards; (2) As with equity generated from LIHTC equity, Exchange Program subawards can be used to pay for land and other noneligible basis items; and (3) Treasury is reviewing whether a clarification of Q&A 4f is needed to remove uncertainty on this issue.

A clarification that there is no limitation on costs that may be paid for with Exchange Program subawards is important because many of the other funding sources used in LIHTC projects, such as tax exempt bonds, HOME loans, and FHA insured loans, have limitations on the types of costs that can be funded with such funds. Therefore, any requirement that subawards be used only to pay for costs included in eligible basis will make it difficult for such projects to find a source of funds for noneligible basis costs, such as land and operating reserves.

F. Grants Will Increase Total Funds for Affordable Housing

Subsection (c) of the Exchange Program portion of the Recovery Act contains the following language concerning subawards:

> (c) SUBAWARDS FOR LOW-INCOME BUILDINGS.—
>
> (1) IN GENERAL.—a state housing credit agency receiving a grant under this section shall use such grant to make subawards to finance the construction or acquisition and rehabilitation of qualified low-income buildings. A subaward under this section may be made to finance a qualified low-income building with or without an allocation under Section 42 of the Internal Revenue Code of 1986, except that a state housing credit agency may make subawards to finance qualified low-income buildings without an allocation only if it makes a determination that such use will increase the total funds available to the state to build and rehabilitate affordable housing. In complying with such determination requirement, a state housing credit agency shall establish a process in which applicants that are allocated credits are required to demonstrate good faith efforts to obtain investment commitments for such credits before the agency makes such subawards.[51]

51. ARRA § 1602(c)

The statute provides that for a project without an allocation of LIHTC to be eligible for a subaward, the Credit Agency must determine that the subaward will increase the total funds available to the state to build and rehabilitate affordable housing.[52] However, the following sentence states that in complying with such a determination, applicants that are allocated credits must demonstrate good faith efforts to find investment commitments. Thus, the statute is unclear as to whether the requirement regarding the "increase in total funds" applies to projects without an allocation, with an allocation, or both.

The process of making this determination is rife with questions. For example, if a project cannot find an investor, but there is another project (say in an urban area) that could use the allocation of credits, does allowing the subaward really increase the total funds available to the state? Presumably, this interpretation will not be used because such a result would prevent subawards from being used in rural areas that are already hit hard by a lack of interest from LIHTC investors. Treasury guidance issued to date has declined to specify the basis for which this determination is to be made. In fact, Treasury seems to have focused exclusively on the "good faith effort" requirement discussed in part G below. One explanation may be that it is assumed that if the good faith effort requirement is satisfied, i.e., the project could not get sufficient LIHTC equity, that inherently means that using Exchange funds will increase the amount of affordable housing funds in the state.

G. Good Faith Effort to Find Investor Commitments

On a similar note, questions abound regarding the requirement that applicants that are awarded credits must demonstrate good faith efforts to obtain investment commitments for credits before the agency makes subawards. It is unclear whether a project would be required to demonstrate that no investor was interested in its tax credit equity or if merely demonstrating that the investor was paying less than a predetermined price (say $0.85 per credit) would be sufficient. Presumably with credit prices for most of the country well below $0.85 per credit, and with the Recovery Act imposing a ceiling on the amount of credits that could be exchanged by the Credit Agency, most states will be forced to accept less than $0.85 per credit for many of their investments, with the Exchange Program used to fill any remaining financing gaps. Alternatively, a middle approach might require a demonstration that the project was not financially feasible at the credit pricing offered before subawards would be offered under the Exchange Program. Treasury guidance received to date has declined to impose requirements, but it does direct the Credit Agencies to make their own determination.[53] As Credit Agencies issue their guidance, some have offered a

52. American Recovery and Reinvestment Act of 2009 § 1602(c)(1).
53. *See* Exchange FAQ 4b.

preference under the exchange program for efficient syndications based on minimum credit price points, some of which are less than $0.85.[54]

Continuing with this requirement, the specific language requiring a good faith effort is confusing. It seems to imply that before a subaward is made to a project without an allocation, the Credit Agency must establish a process in which applicants that are allocated credits have made a good faith effort to find an investor. Although this is possibly a drafting error in the Recovery Act, it seems contradictory to dictate that the Credit Agency must establish a process for projects with allocations that is applicable only to projects without an allocation. The Exchange FAQ has clarified this area by providing that all projects must demonstrate that there was a good faith effort to obtain investment commitments for tax credits.[55] Treasury has also stated that for projects that are using an allocation of LIHTC and are also seeking an Exchange Program subaward, a good faith effort must be made to find investor equity for the portion of the project that would be paid for with the subaward.[56] Inasmuch as it is required under the Recovery Act, Credit Agencies will also need to outline procedures to identify how a project that does not have an allocation can show that it made a good faith effort to find an investor for its possible allocation. Is a certification by the developer of such efforts sufficient, perhaps with a list of investors who have been contacted? Or would Credit Agencies require some sort of reverse commitment letters, such as a letters from investors expressing a lack of interest? If such a letter were required, would investors be willing to expend the effort to write them?

H. Requirements for Non-LIHTC Projects

The Recovery Act allows for subawards of grant funds to finance qualified low-income buildings without LIHTC allocations, but such buildings are to be subject to the same limitations as a project receiving an allocation of credits.[57] Statements by Treasury personnel indicate that this provision will be interpreted to include a 10 percent test[58] and carryover allocation

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54. Louisiana, for example, has outlined rules which provide a preference for projects receiving $0.80 or more for LIHTCs. California has set a floor of $0.70 for equity pricing. (Regulation Section 10323 (d)(2)). For an ongoing list of Credit Agency implementation of the Exchange Program and TCAP, *see* http://www.novoco.com/low_income_housing/news/hot_topics/recovery.php.

55. Exchange FAQ, Q&A 4c.

56. "The developer must first demonstrate that the developer has made a good faith effort (in accordance with the procedure the state housing credit agency puts in place) to obtain investment commitments for tax credits for the portion that would be covered by the Section 1602 funds." Exchange FAQ, Q&A 3a.

57. American Recovery and Reinvestment Act of 2009 § 1602(c)(2).

58. Section 42(h)(1)(E) allows current year LIHTC to be allocated to buildings that are placed in service in future years if (1) "the building is placed in service not later than the close of the second calendar year following the calendar year in which

requirements on subawards.[59] Although official guidance has not been released on these issues, based on the Treasury personnel statements, it appears that Treasury's position with respect to the 10 percent test is that the project would need to have incurred 10 percent of the project's land and building costs within one year of the date of the subaward agreement.[60] Similarly, the project would need to be placed in service by the end of the calendar year that falls two calendar years after the date of the subaward agreement. Similar questions exist regarding the applicability of requirements relating to extended use requirements, deep rent skewing, amenities, and qualified allocation plan requirements. The Recovery Act appears to imply that extended use agreements will be required.[61] However, in the absence of specific guidance, each of these items will need to be determined by each individual state.

I. Process for Obtaining Grants and Subawards

A major consideration for each Credit Agency will be outlining the process whereby subawards will be made, to which projects they will be made, and on what basis they will be made. As this article went to press, most Credit Agencies are in the process of drafting proposed rules to govern the process.[62]

By allowing 100 percent of returned credits and unused credits to be converted to grants, the Exchange Program should help projects that have

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the allocation is made", and (2) "[the] building . . . is part of a project [in which] the taxpayer's basis in such project (as of the date which is 1 year after the date that the allocation was made) is more than 10 percent of the taxpayer's reasonably expected basis in such project (as of the close of the second calendar year [after the date of the allocation]".

59. Jeanne Whaley, Dep't of Treasury & Paul Handleman, Internal Revenue Service at the National Council of State Housing Agencies Conference (June 17, 2009).

60. Note that if the project is retaining some LIHTC from a prior allocation, the project must continue to satisfy the 10% and 2-year requirements of the original allocation in order to maintain the viability of the original LIHTC allocation.

61. § 1602(c)(2) states that "Any such subaward with respect to any qualified low-income building shall be made in the same manner and shall be subject to the same limitations (including rent, income, and use restrictions on such building) as an allocation of housing credit dollar amount allocated by such state housing credit agency under Section 42 of the Internal Revenue Code of 1986".

62. A late arriving requirement from the Exchange FAQ is that Credit Agencies must take into account Exchange Program subawards in determining if a state has met its Section 42(h)(5) requirements for allocating 10% of the state's LIHTC to projects that include a qualified nonprofit organization. Exchange FAQ, Q&A 7a ("Along with credit allocations, Section 1602 funds must be included in determining whether a state has met its non-profit set-aside requirement. A subaward is taken into account for purposes of the 10 % non-profit set-aside requirement at the time the subaward is made to the owner of a project that involves a qualified nonprofit organization described in Section 42(h)(5)(B) of the Internal Revenue Code.

received credits but have been unable to find a tax credit investor. With the cooperation of the state, such projects may be able to return their pre-2009 credits and receive a subaward. This process will likely require that any project applying for such treatment demonstrate financial feasibility based on the proposed size of the subaward.

The Recovery Act does not specify the process and timeline to be used by Credit Agencies to apply for grants. However, Treasury has published an Application Package,[63] has received numerous applications for funds, and has announced over $1.2 billion in awards. Treasury has stated that Credit Agencies may apply as often as they wish.[64]

The Recovery Act does not specify the mechanics of disbursing the subawards. Guidance received to date requires that the funds received by the Credit Agency must be disbursed within three days from the date they are drawn from the Treasury. Due to the very tight three-day window to disburse the funds, very little, if any interest income is likely to be earned by the Credit Agency. However, any interest greater than $200 must be returned to the Treasury.[65] Credit Agencies will need to decide how they will disburse the subawards to projects selected to receive the funds. A likely option would be a construction draw basis where the Exchange funds would be used to pay for costs as they are incurred. Based on Treasury guidance,[66] Credit Agencies could also disburse funds to repay loans or equity that have financed the construction of the building. However, the ability to disburse funds in this manner will be limited by the willingness of construction lenders to fund prior to equity or equity replacement Exchange Funds being expended by the project.

J. Deadline for Disbursement

The Recovery Act requires that any grant funds not used to make subawards before January 1, 2011, be returned to the Treasury. Many practitioners and Credit Agencies initially interpreted this requirement to mean that subawards had to be made before January 1, 2011, but that funds could be disbursed after this date. However, initial guidance from Treasury stated that a subaward must be disbursed before January 1, 2011, or must be returned to Treasury.[67] As this article went to press, the Treasury released

The Credit Agency needs to calculate the credit equivalent of the Section 1602 funds in determining whether its set-aside obligation has been met. Under these facts, the subaward would count in determining whether the 2009 non profit set-aside requirement is met if the subaward is awarded to the project owner in 2009.").

63. Application Package, note 15.

64. *See* U.S. Dep't of the Treasury, Funding Announcements (2009), http://treas.gov/press/releases/tg145.htm and http://www.treas.gov/press/releases/tg156.htm.

65. Application Package at 13.

66. Exchange FAQ, Q&A 3f.

67. *Id*.

interim guidance providing that credit agencies can disburse Exchange funds through December 31, 2011, provided that the subaward is made prior to December 31, 2010, and "the subawardee has, by the close of 2010, paid or incurred at least 30 percent of the subawardee's total adjusted basis in land and depreciable property. . . ."[68] The Treasury has also noted that the subawardee must also have expended the funds before January 1, 2012. This raises an interesting question as to whether subaward proceeds would be deemed expended if such funds are used to fund operating reserves. The authors understand that Treasury personnel initially stated that such a use would not meet the requirement to expend the funds by January 1, 2011. However, based on the Exchange FAQ, the expected revision to Q&A 4f,[69] and questions that have directly been sent to Treasury, the authors understand that Treasury is reconsidering this issue. Because subawards are allowed to be used to pay for costs in the same manner as LIHTC equity and because LIHTC equity is commonly used to fund operating reserves, it would be a strange result to prohibit such a use because the use of the funds does not meet a ministerial requirement for the funds to be expended prior to January 1, 2011.

K. Asset Management

The Recovery Act requires that Credit Agencies engage in asset management functions for projects receiving a subaward.[70] It is unclear exactly what services will be included in the asset management function. Syndicator asset management services tend to occur at various times during the year and examine the health of the project above and beyond a review of tenant files and rents. The purpose of this rule seems to be to fill the void normally provided by investors that typically provide asset management services. It is generally believed that one of the keys to the success of the LIHTC program is the multiple levels of oversight at the developer and syndicator/investor level as well as compliance audits at the state level.[71] The elimination of the syndicator/investor asset management function was likely seen as a weakness in the grant approach, and therefore state asset management was required.

One curious feature of the Recovery Act is that the state asset management function appears to be required even where subawards are given to a project that also has an allocation of tax credits. This will create a duplication of asset management functions by the state and the syndicator/investor. In theory, Credit Agencies could contract with a syndicator to provide asset management services that the syndicator had planned to perform by

68. Payments in Lieu of Low Income Housing Tax Credits, 31C.F.R. § 32 (2009).

69. *See supra* notes 48-50 and the accompanying text.

70. American Recovery and Reinvestment Act of 2009 § 1602(c)(3).

71. *See also* Michael J. Novogradac, *The Exchange Provision of ARRA: An Incomplete Solution for the LIHTC Industry*, Novogradac Journal of Tax Credit Housing, Mar. 2009, at 8.

virtue of its investment. However, conflict of interest issues would have to be addressed in such an arrangement. In addition, because states are separately required to audit projects and file IRS Forms 8823 in cases of noncompliance, there may be concerns from project owners as to how state participation in asset management will interact with state audits and the issuance of Forms 8823. A primary role of syndicator/investor asset management is to proactively identify and correct issues before a Credit Agency commences an audit. One has to wonder if a state's asset management function will similarly work in such a problem avoidance role as opposed to an audit/enforcement role. For example, if a problem observed during asset management could trigger issuance of a Form 8823 or cause the grant to be recaptured, the process could become adversarial.

The Recovery Act specifically allows Credit Agencies to charge a fee for asset management.[72] Treasury has indicated that fees charged may not exceed costs.[73] Credit Agencies have the right to contract for these services from third parties. Many Credit Agencies have already made the decision to contract for these services from third parties.[74]

L. Recapture of Grant Proceeds

The Recovery Act requires that a subaward be recaptured in the event the building ceases to be a low-income building.[75] This recapture requirement is different from tax credit recapture which is only for one-third of credits claimed to date for years one through ten, and decreasing to zero between years eleven and fifteen. The calculation of recapture under the Exchange Program will be extremely important to project owners, as it will impact the attractiveness of this financing compared to other sources of financing that may have less onerous restrictions. Thus, it is paramount to understand both what a recapture event is and how the amount of recapture is calculated.

A Section 42 LIHTC recapture event traditionally occurs from a reduction in a building's qualified basis,[76] which is generally triggered by a reduction in the percentage of low-income units/floor space. The Recovery Act's subaward recapture language literally requires recapture only if a building fails to be a "qualified low-income building."[77] Section 42 defines a qualified low-income building as a building that is part of a project that meets the "minimum set-aside" of either (1) 20 percent of units being

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72. American Reinvestment and Recovery Act of 2009 § 1602(c)(3).

73. Application Package at 10.

74. *See* Jennifer Dockery, *Industry Participants Seek Guidance, Offer Solutions for TCEP*, Novogradac Journal of Tax Credit Housing, May 2009, at 14.

75. American Reinvestment and Recovery Act of 2009 § 1602(c)(4).

76. I.R.C. § 42(j)(1)(2009).

77. *Id*. For examples of recapture computation see Examples 1 and 2 of Exchange FAQ Q&A 9b.

rented to persons at 50 percent of area median income, or (2) 40 percent of units being rented to persons at 60 percent of area median income. Thus, if recapture was limited to situations where a building violates the minimum set-aside, a project receiving a subaward could end up with significantly fewer low-income units than expected but still not trigger recapture.

Treasury addressed how recapture is triggered in Q&A 9b of the Exchange FAQ. Under the Exchange FAQ, recapture occurs anytime a building's applicable fraction under Section 42(c)(1)(B) falls below the greater of (1) the minimum set-aside elected for the building under Section 42(g)(1), or (2) the percentage that the Section 1602 Exchange subaward bears to the building's eligible basis (1602 fraction).[78] Where a building qualifies for the 130 percent basis boost under Section 42(d)(5)(B), the eligible basis for purposes of computing the 1602 fraction is increased by the 130 percent boost.[79]

The recapture rule is modified slightly where the applicable fraction contained in the building's Section 42(h)(6)(B)(i) extended use agreement is less than the 1602 Fraction. In such a case, recapture will occur only if the building's applicable fraction falls below the greater of (a) the building's minimum set-aside, or (b) the applicable fraction contained in the extended use agreement.[80]

The Exchange FAQ implies that recapture is on a building-by-building basis, as opposed to a projectwide basis, but does not provide any guidance as to how Exchange proceeds are apportioned among buildings in a multiple building project. Some commentators have recommended that the proceeds be allocated among the buildings pursuant to the subawardee document or other regulatory agreement.[81] If no agreement exists, they suggest that project owners should be allowed to allocate the Exchange Program subaward among the buildings using any reasonable method adopted by the taxpayer, such as relative affordable square footage or number of affordable units.[82]

Another critical facet of recapture is how much recapture is due when a recapture event occurs. In this regard, Treasury has adopted a rule that incorporates some aspects of Section 42 recapture but diverges in other respects. Exchange FAQ Q&A 9c provides that when a recapture event occurs, the entire amount of the subaward is due, less 6.67 percent (1/15th)

78. Exchange FAQ, Q&A 9b.

79. *Id*.

80. *Id*.

81. Letter to Michael Mundaca, Acting Assistant Secretary (Tax Policy), Department of the Treasury by The LIHTC Working Group (July 30, 2009), http://www.novoco.com/low_income_housing/resource_files/advocacy/letter_arra_section1602_073009.pdf.

82. *Id*.

of the subaward for each full year of the building's fifteen-year compliance period that was completed without a recapture event. The 6.67 percent reduction effectively means that each year of the fifteen-year compliance period, one-fifteenth of the subaward becomes non-recapturable. This is similar to the result for LIHTC under Section 42.[83]

The Exchange FAQ diverges from the Section 42 approach in that Section 42 only requires full recapture where the project fails the minimum set-aside. Under Section 42(j)(2), where the minimum set-aside is satisfied but qualified basis is reduced, only credits earned on the reduction in qualified basis are recaptured. In contrast, under the Exchange Program, any reduction in the applicable fraction below the required amount,[84] no matter how small, results in full recapture for the portion of the grant attributable to the uncompleted fifteen-year compliance period. As a result, the consequences of a recapture event under the Exchange Program can be much more severe than the consequences of recapture under Section 42. The authors recommend that Treasury allow Credit Agencies to provide for significant cure periods in their recapture agreements. Such an approach would avoid situations where a minor violation could trigger recapture that could result in the Credit Agency or the Treasury owning the project.[85]

M. Eligibility of Tax Exempt Bond Projects

Based on the Recovery Act, projects eligible for tax credits by virtue of being financed by tax exempt bonds are eligible for a subaward as long

83. Section 42(j) of the Code effectively provides that the recapture of LIHTC decreases over time. For a failure to meet the minimum set-aside, the net effect of recapture is that the amount subject to recapture and lost future LIHTC goes down by 1/15th for each year completed during the compliance period. For example, assume a failure to meet the minimum set-aside in the 7th year of the compliance period, i.e. 6 full years (40%) of the 15-year Section 42 compliance period had been successfully completed. Full recapture due to a failure to meet the minimum set-aside during the 7th year would result in a forfeiture of 1/3 of the LIHTC taking during the first 6 years and no additional credits for the last 4 years of the 10-year credit period. The LIHTC taken during the first 6 years would have been 60% of all the expected LIHTC to be generated during the Project. Giving back 1/3 of this LIHTC by recapture results in the taxpayer keeping 40% of the total expected LIHTC, thus the taxpayer loses 60% of the LIHTC (20% through recapture and 40% through loss of future LIHTC).

84. *See supra* text accompanying notes 78-80.

85. Many projects will not have any significant equity in them and subawards may completely replace what was originally hoped to be tax credit equity. Thus there will likely be no deep pocketed partner that could pay the recapture with the result that the only method to enforce recapture would be for the credit agency to foreclose on the project. Allowing a reasonable cure period will allow developers to correct noncompliance issues rather than have the government end up owning projects. Governmental ownership of projects is the opposite of the public-private partnership which underlies the LIHTC program and has resulted in a very successful program over the last 23 years.

as those buildings meet the definition of a qualified low-income building. Any project with a qualified low-income building is eligible for a subaward under Section 1602(c)(1). Because LIHTC projects financed with tax exempt bonds will, by definition, have qualified low-income buildings, such projects are eligible for subawards. Treasury has also issued guidance confirming that 4 percent projects are eligible if the buildings meet the definition of a qualified low-income building.[86]

N. Reporting Requirements

The Recovery Act imposes transparency and reporting requirements related to funds authorized under the Act.[87] Treasury has issued guidance to identify that quarterly reports must be filed by Credit Agencies within ten working days after the end of each calendar quarter.[88] The reports must contain information on the subawards made, detail for each recipient project, jobs created and retained, and housing units constructed or rehabilitated. Additional guidance is expected regarding the methodology used to calculate report jobs created and jobs retained.[89]

O. GAAP Accounting

The receipt of Exchange funds raises several accounting issues under generally accepted accounting principles (GAAP), such as whether subawards received as grants under the exchange program should be recognized as income and, if so, over what period? U.S. GAAP treatment will depend on whether the grant is considered received for the acquisition of assets or for the provision of affordable rental housing. If viewed as for the acquisition of assets, there are two distinct alternatives, namely, immediate income recognition for the grant proceeds, or a reduction in the cost basis of the assets. If viewed as for the provision of affordable rental housing, the receipt of grant proceeds would be recorded as deferred income, and the income would likely be recognized over the fifteen year compliance period corresponding with the Exchange Program recapture period.

III. Tax Credit Assistance Program (TCAP)

The Recovery Act includes an additional $2.25 billion of funds available to Credit Agencies to fill financing gaps for developments with LIHTC awards.[90] HUD has named this program the Tax Credit Assistance Program (TCAP). TCAP funds are distributed proportionately among the

86. Application Package at 9.
87. The American Recovery and Reinvestment Act of 2009 Title XV.
88. Application Package at 11.
89. Exchange FAQ Q&A 8a.
90. American Reinvestment and Recovery Act of 2009 Title XII specifically addresses all aspects of the tax credit assistance program under the heading of *Home Investment Partnerships Program*.

various Credit Agencies based on the allocation of 2008 HOME Funds for each state, Washington, D.C., and Puerto Rico. Credit Agencies from all fifty states, plus the District of Columbia and Puerto Rico were required to apply to HUD by June 3, 2009, or risk losing their proportional share of TCAP funds.[91] Credit Agencies can use their allocation of these funds to make awards to LIHTC projects facing financing gaps. Eligible projects include projects with an award of LIHTC received in federal fiscal year 2007, 2008, or 2009. The Recovery Act specifically prioritizes projects to be completed within three years.

Funds available under the tax credit assistance program must be committed and expended quickly to meet certain benchmarks outlined in the Recovery Act.[92] First, 75 percent of funds for each state must be committed by Credit Agencies by February 16, 2010. Any uncommitted funds below the 75 percent threshold will be distributed to other Credit Agencies. Second, 75 percent of the TCAP funds for each Credit Agency must be spent by February 16, 2011. Any unspent funds below the 75 percent threshold at the conclusion of the second year will be redistributed to other Credit Agencies. Finally, projects must spend 100 percent of the funds by February 16, 2012. Any unspent funds at the conclusion of the third year will be recaptured by HUD.[93]

TCAP funds are subject to several requirements under the Recovery Act. First, TCAP funds must be expended for capital investments in LIHTC projects, and projects receiving these awards must comply with the same limitations as ordinarily imposed by the Credit Agency. Second, Credit Agencies must provide asset management services to the recipient projects, or contract for performance of these services at the owner's expense.[94] Third, Credit Agencies must post online all information on recipients of the financing and the qualified allocation plan outlining the competitive process used to allocate the financing, and must grant access to project information to HUD. Finally, the Recovery Act specifically identifies that grants from the assistance program do not reduce eligible basis. Neither the Recovery Act nor the Conference Report excludes TCAP grants from taxable income. This is a notable difference in the treatment of TCAP financing versus subawards under the Exchange Program and may result in TCAP recipients preferring to receive loans of TCAP funds rather than TCAP grants.

91. *See* U.S. Department of Housing and Urban Development, Memo on Implementation of Tax Credit Assistance Program 3 (2009), http://portal.hud.gov/pls/portal/docs/PAGE/RECOVERY/PROGRAMS/TCAP_RESOURCES/TCAP%20FUNDING%20NOTICE.PDF (hereinafter HUD Memo)

92. HUD Memo § IV.C. at 6-7.

93. *Id*.

94. *Id*.

Chart 1 compares the tax consequences of TCAP and Credit Exchange monies.

Chart 1

	TCAP		**Credit Exchange**	
	Grant	**Loan**	**Grant**	**Loan***
Taxable Income:				
—Federal?	Yes	No	No	No
—State?	Yes	No	Maybe**	No
Reduce Depreciable Basis?	No	No	No	No
Reduce Eligible Basis?	No	No	No	No

* Treasury guidance has indicated that only grants may be made under the exchange program. *See supra* text accompanying note 27.
**Determination of the taxability of exchange grants will vary by state depending on whether state tax law conforms to federal tax law.

Note: The conclusions contained in this chart represent the authors' views of how the receipt of TCAP and Exchange funds will be treated. Guidance from the Treasury Department and the IRS is expected and such guidance could alter the conclusions above.

IV. Tax Credit Assistance Program Issues

A. Fiscal Year 2007, 2008, and 2009 Awards

The Recovery Act states that projects awarded tax credits in fiscal years 2007, 2008, and 2009, are eligible for TCAP funds.[95] The federal government has a September 30 fiscal year end, so many legal practitioners have argued that only projects with tax credit awards received by September 30, 2009, can qualify. Others have argued that this provision merely states that these projects are "eligible," but does not state that "only" these projects are eligible. Treasury has issued specific guidance that only projects with an award of credits made before September 30, 2009, can qualify. Treasury has decided not to set a rule as to when credits are awarded and what an award is.[96] Instead, Treasury is allowing each Credit Agency to determine at what

95. ARRA at 106-107. The TCAP provisions are contained on pages 106-107 of the Recovery Act and such provisions will hereinafter be referred to as the "TCAP Provision".

96. The Recovery Act does not use some of the common terms used in reference to credits such as an allocation or reservation. The fact that a non-defined term has been used has given Treasury flexibility to allow Credit Agencies to determine what actions constitute an award within their state.

point credits are awarded in their state.[97] Treasury has said Credit Agencies can determine that an award occurs as early as the date the agency approves the project, publishes a list of the approved projects, or sends letters to the projects notifying them that credits have been awarded. Interestingly, the TCAP provision states only that an award must be received by the end of fiscal year 2009, but does not require that the credits awarded need to be from the 2009 credit ceiling. As a result, HUD has indicated that projects that receive a forward allocation of 2010 credits prior to September 30, 2009, would be eligible for TCAP funds.

B. Eligibility of Tax Exempt Bond Projects

The TCAP provision's use of the term *award* raises the question of when an award of credits exists for LIHTC projects that use tax exempt bonds to receive their credits. HUD has confirmed that LIHTC tax exempt bond projects can qualify for TCAP funds.[98] Because tax exempt bond projects do not require an allocation from a state's volume cap credit ceiling, it is unclear what actions need to have occurred to demonstrate that it has received an award by September 30, 2009.[99] Would a state conclude that an award occurs as late as when bonds are issued, when a Section 42(m)(1)(D) letter[100] is issued by the Credit Agency, or perhaps as early as when the

97. HUD Memo § III.B at 4 ("The state housing credit agency must also define an 'award of LIHTCs' which can be as early as the date of public notice of the funding decision for a particular project. The same definition of 'award of LIHTCs' must be uniformly applied to all LIHTC projects for the purpose of determining project eligibility for TCAP funding.")

98. *Id*; *See also* U.S. Department of Housing and Urban Development, TCAP Question and Answer: General TCAP Questions, Question 2 http://portal.hud.gov/pls/portal/docs/PAGE/RECOVERY/PROGRAMS/TCAP_RESOURCES/TCAP%20GENERAL%20QUESTIONS%20AND%20ANSWERS.PDF (hereinafter HUD TCAP Q&A)

99. Although the Recovery Act uses the term award, confusingly in answering the question of whether bond financed projects are eligible for TCAP funds in the HUD Q&A, HUD used the term allocate. "Are projects that have bond financing and so-called 4 or 9 percent credits eligible for TCAP funding? Answer: All projects which receive an allocation of LIHTCs under Section 42 of the IRC between October 1, 2006 and September 30, 2009 are eligible to receive TCAP funding if they meet all of the selection criteria established by the TCAP grantee and can meet the statutory deadlines for expenditures established by the Recovery Act." HUD Q&A, Question 2. Presumably HUD meant to say awarded. *See* HUD Memo § IV.A at 4 ("Projects awarded LIHTCs that will also receive bond financing are eligible to receive TCAP funds.").

100. Section 42(m)(1)(D) states that a project will not receive any credits due to bond financing unless the Project satisfies the state's qualified allocation plan. Credit Agencies typically document satisfaction of this requirement by issuing a letter to bond financed projects confirming that, based on the application, the project satisfies the state's qualified allocation plan.

bond issuer issues an inducement with respect to the bonds? HUD appears to also be leaving to the Credit Agencies the determination of when an award occurs for bond projects. Initial indications from Credit Agencies suggest that the date selected by many Credit Agencies may be the date a Section 42(m)(1)(D) letter is issued.

C. Eligibility of Projects That Return Credits

Under the TCAP provision, a project must have been awarded LIHTCs to be eligible for TCAP funding. An initial question arose as to whether projects that had previously received an allocation of credits but could not find an investor could return their credits and still be eligible for TCAP funds. Such projects actually "had been awarded credits" and therefore had arguably satisfied the literal language of the TCAP Provision.[101] Treasury addressed this question during the HUD-Treasury webcast and stated that projects which returned their credits were not eligible for TCAP funds.[102] However, such projects could receive a new award of credits and therefore be eligible for TCAP funds.

HUD has given a partial answer as to what amount of credits a project must receive in order to be eligible for TCAP funds. In the answer to Q&A 1 in the HUD Q&A, Treasury indicated that projects need only have a nominal allocation of credits from the state credit ceiling in order to be eligible for TCAP funds. HUD guidance during the HUD-Treasury webcast indicates that nominal means "some." Unfortunately HUD has declined to define "some." Most practitioners believe that the terms *nominal* and *some* imply any amount greater than zero. Based on the foregoing, planning opportunities exist as the Credit Agency could reallocate a nominal amount of credits to a project that has returned its credits, or projects wishing to return their credits could return all but a nominal amount of their credits. Those projects would be eligible for TCAP funding.

HUD's revision to the TCAP Memo provided the following additional discussion regarding the requirement for TCAP projects to have an allocation of LIHTCs:

> All TCAP projects must have LIHTCs. The housing credit agency may reduce the amount of the credits originally awarded based on current market conditions. However, the entire credit allocation may not be returned to the housing credit agency. The project must maintain eligible basis and comply with all other requirements of Section 42 throughout the compliance period and there must be equity investment(s) in the project for the credits.[103]

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101. American Recovery and Reinvestment Act of 2009 at 106.

102. Webcast: Statement of Marcia Sigal, Policy Division Director, U.S. Dep't of Housing and Urban Development Office of Affordable Housing Programs (June 10, 2009) (*available at* http://ms.istreamplanet.com/hud/200906.asp?vid=1224_305_NoCat2).

103. HUD Memo § IV.A at 5.

Statements by HUD personnel indicate that HUD is backing off of the nominal allocation approach in the HUD Q&A and is instead looking for projects to retain as much LIHTC as possible, subject to existing market conditions.[104] Although HUD statements on this topic are somewhat cryptic, it still appears that state credit agencies may award a nominal amount of LIHTC if their underwriting concludes that there is insufficient LIHTC investor interest for a larger LIHTC allocation and also that there is a lack of interest by the project developer in purchasing those credits.

D. Eligibility of Projects with GO Zone or Disaster Area Credits

Under the TCAP provision, to be eligible for TCAP funding, a project must have an award of LIHTCs. Many practitioners have hypothesized that an allocation of GO Zone or Disaster Area credits would be sufficient to meet this requirement under the Recovery Act as originally enacted based on the view that such credits are allocated under Section 42. Unfortunately, Treasury issued guidance indicating that GO Zone and Disaster Area credits do not meet this requirement.[105] However, Treasury did indicate that a nominal amount of credits could be allocated from the state credit ceiling to those projects, and they would therefore meet the requirement based on that nominal allocation of credits.

Congress disagreed with this interpretation and passed a bill that became law on June 24, 2009, that clarifies that GO Zone and Disaster Area credits do meet this requirement.[106]

E. Eligible Costs

The TCAP statutory language states that TCAP funds are for "capital investments in low-income housing tax credit projects."[107] This appears to require that TCAP funds must be spent on capital items, and therefore an important issue is what constitutes a *capital investment*. A restrictive interpretation of capital investment could make it difficult for some projects to utilize TCAP funds. Costs of the project building obviously seem to qualify. Some practitioners had also believed that because land costs are typical of costs that are capitalized for both tax and accounting purposes, such costs would be eligible for TCAP funds. In addition, projects typically capitalize an operating reserve that serves the project to ensure viability on a long-term basis. Thus, a flexible interpretation of capital investment would facilitate the use of TCAP funds to bridge financing gaps. HUD initially

104. Webcast: Statement of Cliff Taffet, Director, Office of Affordable Housing Programs, U.S. Dep't of Housing and Urban Development (June 10, 2009) (*available at* http://ms.istreamplanet.com/hud/200906.asp?vid=1224_305_NoCat2).

105. HUD TCAP Q&A, Question 1.

106. The Supplemental Appropriations Act, Pub. L. No. 111-32, 123 Stat 1859 (2009) § 1204. *See also* HUD Memo § IV.A at 4.

107. American Recovery and Reinvestment Act, H.R. 1 at 106.

interpreted the capital investment requirement very narrowly, but as this article went to press HUD had revised its guidelines to provide a limited amount of additional flexibility.[108]

HUD's initial position was that TCAP funds could only be spent on eligible basis items.[109] Because of this position, projects with other financing that have use restrictions would have had a difficult time using the TCAP funds because there may be no financing to pay for land, operating reserves, and other costs that are not includible in eligible basis. However, on July 27, 2009, HUD revised the guidance in the HUD Memo and clarified that in addition to eligible basis costs, TCAP funds can be spent on "costs of land acquisition, on-site demolition costs, and hazardous material remediation costs."[110] This change is significant as land costs can be a significant portion of the costs of a low-income housing project and the inability to use TCAP funds would have created a significant problem for some projects. However, the HUD position continues to create a difficult issue with respect to funding operating reserves or other costs that are a necessary part of a low-income housing project but that are not includible in eligible basis.

Closely related to the types of funds for which TCAP can be spent is how HUD will require a project to document the costs for which TCAP funds are used. HUD initially indicated some flexibility on this issue in stating that TCAP funds did not directly have to be traced to show they were spent on eligible basis items.[111] However, other comments by HUD personnel have indicated that direct tracing may be required; it currently appears that HUD is going to require direct tracing of TCAP funds to eligible basis costs. This is an important issue for projects. If direct tracing is not required, TCAP funds could be used for an ineligible cost as long as the project's eligible basis and land-related costs exceed the amount of TCAP funds by the time the project was completed. This would significantly simplify funding timing issues for projects. If direct tracing is required, projects will need to closely monitor available sources to make sure that unrestricted funds are available when noneligible basis costs must be paid.

HUD requirements also provide that Credit Agencies must return any TCAP funds used for ineligible costs or used in projects that are never

108. HUD Memo § IV.A at 5.

109. *See* May 3, 2009, HUD Memo on Implementation of Tax Credit Assistance Program § IV.A at 4, prior to the July 27, 2009 revisions (*available at* http://www.novoco.com/low_income_housing/resource_files/hot_topics/recovery/cpd_notice_09-03.pdf).

110. HUD Memo § IV.A at 5.

111. Webcast: Statement of Cliff Taffet, Director, Office of Affordable Housing Programs, U.S. Dep't of Housing and Urban Development (May 18, 2009) (*available at* http://www.meetingslive.net/nixon_peabody/archive/launch.htm).

completed or fail to meet the requirements of the LIHTC program.[112] If a project fails to maintain compliance with the TCAP requirements, the Credit Agency must seek specific performance with the TCAP written agreement.[113] Credit Agencies also have no repayment obligation in the event of a foreclosure of the project if the Credit Agency took reasonable actions to ensure compliance and the long-term viability of the project.[114]

F. Federal Cross-Cutting Requirements

TCAP funds have been appropriated by Congress and therefore a number of federal requirements must be met by projects receiving TCAP funds. The HUD Memo[115] contains a definitive list of the various federal requirements, a full discussion of which is beyond the scope of this article. However, some of these requirements are significant and can be an impediment or burden on projects.

1. Davis-Bacon Prevailing Wages

Projects receiving TCAP funds must comply with the Davis-Bacon prevailing wage requirement.[116] This provision requires that laborers and mechanics hired by contractors and subcontractors must be paid prevailing wages in compliance with the Davis-Bacon Act.[117] For projects that did not contain other federal funds that required compliance with Davis-Bacon, the addition of Davis-Bacon can add significant costs.

2. Environmental Review

The TCAP language in the Recovery Act specifically states that the environmental review requirements of Section 288 of the HOME Investment Partnership Act apply, and that states must assume responsibility for complying with the National Environmental Policy Act and related laws. While the responsibility for the environmental review is on each state, a state may designate the Credit Agency to perform the review.[118] A critical feature is that TCAP funds cannot be committed to a project before completion of the environmental review process. In addition, no choice limiting activi-

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112. HUD Memo § IV.A at 5.
113. *Id.*
114. *Id.*
115. *See* Exchange FAQ Q&A 8a.
116. American Recovery and Reinvestment Act of 2009 § 1606.
117. HUD TCAP Q&A, Q&A 2(HUD has stated that "Davis-Bacon requirements will not apply retroactively to a project for which the construction contract was awarded, and/or for which construction started prior to notice of Recovery Act funding. Instead, Davis-Bacon requirements will be effective prospectively, as of the date Recovery Act funding is approved for the project by the TCAP grantee."), *available at* http://portal.hud.gov/pls/portal/docs/PAGE/RECOVERY/PROGRAMS/TCAP_RESOURCES/TCAP-DB-QA.PDF
118. HUD Memo at 10.

ties[119] can be performed on the site until the environmental review process is completed. Performing a choice limiting activity before the process is complete may disqualify a project for TCAP funds.[120]

G. Combining TCAP and Exchange Funds to Avoid Tax Problems

For many LIHTC projects, TCAP funds will be used to close financing gaps caused by a reduction in equity pricing or LIHTC investor interest. In cases where there is little or no LIHTC investor interest, there may be a relatively small amount LIHTC equity left and TCAP funds may substantially replace LIHTC equity that would have been present in better economic times. If a project retains a relatively small amount of LIHTC and receives a very large TCAP award,[121] the result may be that the LIHTC investor has an unusually low amount of equity when compared to the total project costs. The result may be that losses from depreciation and other expenses may deplete the investor's equity during the project's ten-year LIHTC credit period. Such depletion may prevent the investor from being allocated LIHTC earned for years after its equity, i.e. positive capital account, has been exhausted.[122] If capital account problems are projected to prevent the LIHTC investor from receiving the amount LIHTC that it expects, the LIHTC investor would not make its investment.

However, this situation could be avoided if the TCAP loan was reduced and some Exchange funds were added to the project's financing. Under partnership tax accounting rules, the receipt of an Exchange Program grant should increase the capital account of the partner to which it is allocated[123] as well as such partner's basis in its partnership interest.[124] Thus, the conversion of a portion of a contemplated TCAP loan to an Exchange Program grant may cure situations where the investor's capital account would be depleted during the credit period and the investor could not continue to be allocated the LIHTCs.

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119. *Id*. (Choice-limiting activities include "any activity that will result in a physical change and/or acquisition, including leasing, or disposition of real property.)

120. *Id*.

121. Note that the same issue exists if funds other than TCAP funds are used to make up for a shortfall in equity. For example, a large loan of HUD HOME funds would have the same potential problems and such problems could be similarly solved by replacing some of the HOME funds with an Exchange Program grant.

122. A detailed discussion of partnership capital accounts, minimum gain and credit allocations is beyond the scope of this article. For a discussion of such issues, *see* NOVOGRADAC & COMPANY, LLP, LOW-INCOME HOUSING TAX CREDIT HANDBOOK § 3:226 (West Taxation Series 2009)(1990)

123. Treas. Reg. § 1.704-1(b)(2)(iv)(b)(3)(2008) (a partner's capital account is increased by allocations of income and gain, including income and gain exempt from tax).

124. I.R.C. § 705(a)(1)(B) (a partner's outside basis is increased by its distributive share of income exempt from tax).

In addition to alleviating capital account issues, conversion of a portion of a large TCAP loan to an Exchange grant would reduce the overall debt of the project. Many TCAP loans will be structured to provide that no payment on the loan is required until the loan matures, e.g., at the end of a project's thirty-year extended use period. However, for some LIHTC projects attempting to show that the project will be able to repay deferred payment loans when due may be difficult and may raise issues as to whether the TCAP loan and other similar deferred payment loans should really be considered a taxable grant. Again, the conversion of some of the TCAP loan to an Exchange Program grant would make it easier for a project to show that there is an expectation that the remaining debt would be repaid at maturity and thus would not be a grant.

Finally, many projects struggle with so-called exit taxes at the end of the fifteen-year compliance period. In general, such taxes occur where the investor's capital account has been depleted and the investor has actually had its capital account become negative. The presence of a larger TCAP loan and proportionately small investor equity may result in larger exit taxes than are normally seen with LIHTC projects. If such a project is contemplated to have significant exit taxes, this fact may cause investors to become less interested due to the expected exit tax liability.[125] However, the replacement of a portion of a TCAP loan with an Exchange Program grant would increase the investor's starting capital account. This would result in the investor's capital account being less negative or even positive at the end of the fifteen-year compliance period.

Because of the federal requirements that accompany TCAP funds, Credit Agencies may be tempted fill all of the financing gaps of projects that already satisfy the federal requirements with TCAP loans. However, such large TCAP loans may result in capital account, exit tax, and debt repayment problems. If developers and Credit Agencies can quickly identify projects that will face such situations, the Credit Agency may be able to modify the financing to reduce the TCAP loan somewhat and insert some Exchange funds. Some of the situations where there may be capital account and exit tax problems would be where (1) portions of the project are financed with debt from the general partner or a party related to the general partner, including deferred developer fee; (2) where the general partner or a party related to the general partner has made a significant capital contribution to the project partnership; and/or (3) where the general partner or a party related to the general partner has guaranteed partnership financing. However, the financing and projected tax implications for each project are

125. Often the general partner of a LIHTC partnership will be obligated to pay any investor exit taxes that occur at the end of the 15-year compliance period. However, when the exit taxes become significant, there may be doubt by the investor as to the ability of the general partner to fulfill such obligation at the end of the 15-year compliance period.

different, and developers should speak to their tax professionals early in the process to assess whether such problems are likely to occur.

V. Conclusion

The current economic climate has resulted in a virtual freeze of most affordable housing created using LIHTC. The TCAP and Exchange Programs are vital new resources that should allow many projects to go forward. However, these funds cannot begin flowing until the program rules are known. HUD and Treasury have begun issuing guidance and Credit Agencies are now formulating plans for how to disburse the funds. However, certain questions must be answered in a definitive manner before the funds can be used. The IRS must address grant income and basis issues before developers can feel assured that there will be no negative tax result from the use of such funds. Because no subawards under the Exchange Program can be disbursed without a recapture obligation, Treasury must continue to clarify the recapture issues, specifically the ability of project owners to cure issues and avoid recapture. Hopefully HUD, Treasury, the IRS, and Credit Agencies will take a practical view to the programs and implement rules that will facilitate building affordable housing rather than create roadblocks. Developers, even in the absence of the required guidance, must work with their advisors to quickly begin integrating the rules (or expected rules) of TCAP and the Exchange Program to identify financing structures that can be used for their projects and identify any critical hurdles that must be met for their projects to go forward. Implications of large TCAP loans should be evaluated and it should be determined whether Exchange funds will be necessary to avoid tax problems. With very short time frames to use the subawards under the Exchange Program and TCAP funds, speed is of the essence and developers do not have the luxury of waiting for definitive guidance before trying to structure projects to work with the funds.

The affordable housing industry needs to remain vigilant to ensure that the new programs are implemented without causing damage to the gains accomplished by the program over the past twenty-three years. In particular, the Exchange Program is a significant shift in the nature of the public-private partnership that has been the bedrock of the LIHTC program. States must provide asset management, but questions exist as to whether this will be a sufficient replacement for the analysis and resources that syndicators and investors bring to LIHTC projects. On the same note, Credit Agencies need to give careful thought as to how they design their particular TCAP and Exchange Program to fund projects that will have long term viability. Although there are many questions and uncertainties swirling around the TCAP and Exchange Programs, Congress chose a wise approach to create new programs rather than watch the country's affordable housing production be significantly curtailed. While the implementation to date seems headed in a good direction, only time will tell how well these programs truly address the affordable housing crisis.