LHC Draft Legal Guidance

Re: Transfer Issues for Buildings In Existing Qualified Low-Income Housing Tax Credit Projects Prior to End of their Extended Use Period

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Under Section 42 (g), once a taxpayer elects to use a particular set-aside test with respect to a qualified low-income housing project, the election is irrevocable. Thus, if a taxpayer had previously elected to use the 20-50 test under section 42(g)(1) (A) or the 40-60 test under section 42(g) (1)(B) with respect to a low-income housing project, the taxpayer may not subsequently elect to use the average income test under section 42(g)(1)(C) with respect to that low-income housing project.

Louisiana Housing Corporation ("LHC") Legal staff has been advised that tax credit applications ("Applications") for low-income housing tax credits ("LIHTCs") have included buildings from existing qualified low-income housing projects prior to the end of their Extended Use Periods. For example, developers have submitted new applications for 9% credits and received awards in which the new projects were composed of some but not all of the income-restricted units from one or more existing qualified low-income housing projects prior to the end of their Extended Use Periods.

LHC has been forced to take a closer examination of "partial sales/project split sales" and has now identified problematic issues. Since the set-aside test is irrevocable, a recapitalization with new credits in which the new owner inadvertently elects income averaging or a different set-aside than was originally elected the first time the units were placed in service may not be permitted. Partial sales/project split sales transactions may create situations in which the original qualified low-income housing project is no longer feasible and viable. These issues would be even more problematic with mixed source developments with differing ongoing monitoring requirements.

For those projects awarded 9% credits in a prior funding round which fall under the terms of this memo, the LHC internal and outside legal and program staff will work with those developers to take necessary actions to try to prevent the loss of those allocations of credits. In cases where a property has been divided to create a new project or numerous projects, the new LIHTC project(s) must retain the same set-aside test as the units originally had in the project first funded with 9% credits. If income averaging was selected for the new project, the project will have to be restructured to go forward with the original set-aside test in place for the income-restricted units. Also, any remaining units not configured into a new LHC-financed project will have to provide underwriting evidence they will still be feasible and viable without the transferred units for the entirety of their extended use period. Program staff will identify low-income housing projects within their Extended Use Periods involving partial sales/project split sales to determine appropriate next steps.

Going forward, LHC will add language to the Qualified Allocation Plan/Tax Credit Regulatory Agreements/Compliance Monitoring Agreements that reflects that any transfers of projects to new owners for recapitalization with the same units as in the original projects funded with LHC funds may be transferred, subject to the usual LHC procedures. As a general rule, LHC will not approve partial transfers of some units (but not all units) of a pre-existing LHC-funded property except for the following situations: 1) properties subject to a right of first refusal/lease to purchase by a low income tenant, or 2) in cases with casualty losses/condemnations where the units were not rehabbed within the time allowed by the IRS. The stated exceptions would be reviewed and permitted for transfer where appropriate on a case by case basis. The following portions of this memo clarify the circumstances under which LHC will permit transfers of buildings and their residential units prior to the end of their Extended Use Periods.

- The Applicable Fraction for residential units of a "qualified low-income housing project" during the Extended Use Period will be based on the set-aside under Section 42(g)(1) of the Internal Revenue Code (Code) irrevocably elected by the original Taxpayer.

- The "extended low-income housing commitment" required by Section 42(h)(6) of the Code mandates the use of an applicable fraction that will not be less than the applicable fraction in the extended use commitment contained in the Tax Credit Regulatory Agreement (TCRA) recorded by the original Taxpayer. Section 42(h)(6) of the Code further prohibits the disposition of any portion of a building to any person "unless all of the building to which such agreement applies is disposed of to such person." Section 42(h)(6) of the Code further requires the "extended low-income housing commitment" to be binding on all successors of the original Taxpayer.

- Based on the statutory requirements, a building developed with low-income housing credits (LIHTCs) may not be recapitalized with LIHTCs following the Compliance Period and during the building's Extended Use Period unless the applicable fraction irrevocably elected under 42(g)(1) by the successor Taxpayer recapitalizing the building is **not less** than the applicable fraction in the extended use commitment executed and recorded by the original Taxpayer.

- The set-aside test irrevocably elected by the original Taxpayer for a building applies during the Extended Use Period for that building and is binding on all successor Taxpayers during the original Extended Use Period for that building. The applicable fraction irrevocably elected by the successor Taxpayer to recapitalize a project may never be less than the applicable fraction in the extended use commitment.

- If the original Taxpayer elected the 20-50 set-aside test for a building, a successor Taxpayer may not recapitalize the building following the Compliance Period during the original

Extended Use Period using either the 40-60 set-aside test or the Average Income Test (AIT).

- If the original Taxpayer elected the 40-60 set-aside test for a building, a successor Taxpayer may recapitalize the building and irrevocably elect the 20-50 set aside test but **may not** recapitalize the building using AIT following the Compliance Period during the original Extended Use Period.

I. **<u>Transfers During Credit Period for any Building</u>**: The Credit Period for any building is Ten (10) Years beginning with taxable year within which building is placed in service or at Taxpayer's election, the succeeding taxable Year. See IRC 42((f)(1).

A. <u>Transfers During Credit Period of all Buildings in a Qualified Low-Income Housing Project</u>: LHC routinely permits the transfer or sale of all buildings in a Qualified Low-Income Housing Project from an existing taxpayer to another taxpayer if, among other conditions, the purchasing taxpayer assumes all of the legal obligations of the transferring taxpayer. The legal obligations to be assumed include the Tax Credit Regulatory Agreement ("TCRA") and the Extended Use Agreement embedded in the TCRA as well as the Compliance Monitoring Agreement.

B. <u>Transfers of Buildings Foreclosed Upon</u>: If a building has been taken by foreclosure or deed in lieu of foreclosure, LHC's TCRA will automatically terminate unless the lender contacts the LHC to modify the extended use agreement or to suspend or delay the automatic termination of the TCRA. Absent such modification or suspension, LHC will file IRS Forms 8823 with the IRS and the building taken by foreclosure or deed in lieu of foreclosure will no longer be subject to compliance monitoring. However, the acquisition costs of such existing buildings foreclosed upon by a lender may be included in an Application for new LIHTCs only if a period of at least 10 years exists between the date of its acquisition by a new taxpayer and the previously placed in service date as required by IRC 42(d)(2)(B)(ii). The foreclosed upon building must be resold by the lender within 12 months of such foreclosure as required by IRC 42(2)(d)(2)(D)(i)((IV). An exception to disregarding the 10 year period for claiming new LIHTCs on the acquisition costs may also be permitted if the building is a federally- or State-assisted building pursuant to IRC 42(d)(6). No approval from LHC will be required to include buildings foreclosed upon by a lender in a new LIHTC Application.

II. **<u>Transfers after Credit Period During 15-Year Compliance Period</u>**: The Compliance Period means, with respect to any building, the period of 15 taxable years beginning with the 1st taxable year of the Credit Period with respect thereto. See IRC 42(i)(1).

A. Transfers of all Buildings in a Qualified Low-Income Housing Project: Similar to transfers of Buildings during the Credit Period described in I(A) of this memorandum, LHC will routinely permit the transfer or sale of all buildings in a Qualified Low-Income Housing Project during the last five years of the 15-year compliance period from an existing taxpayer to another taxpayer if, among other conditions, the purchasing taxpayer assumes all of the legal obligations of the transferring taxpayer. The legal obligations to be assumed include the TCRA and the Extended Use Agreement embedded in the TCRA as well as the Compliance Monitoring Agreement.

B. Transfers of Buildings Foreclosed Upon: There may be LIHTCs that remain to be claimed following the Credit Period during the Compliance Period. Unless a lender contacts the LHC to modify the extended use agreement or to suspend or delay the automatic termination of the TCRA, LHC will file IRS Forms 8823 with the IRS and the building taken by foreclosure or deed in lieu of foreclosure will no longer subject to compliance monitoring.

III. Transfers after the 15-Year Compliance Period During the Remaining 15-Year Extended Use Period: No LIHTCs will remain to be claimed following the Compliance Period during the balance of the Extended Use Period.

A. Transfers of all Buildings in a Qualified Low-Income Housing Project: Similar to transfers of Buildings during the periods described in I(A) and II(A) of this memorandum, LHC will routinely permit the transfer or sale of all buildings following the 15-year Compliance Period from an existing taxpayer to another taxpayer if, among other conditions, the purchasing taxpayer assumes all of the legal obligations of the transferring taxpayer. The legal obligations to be assumed include the Extended Use Agreement embedded in the TCRA as well as the Compliance Monitoring Agreement.

B. Transfers of Some but not all buildings in a Qualified Low-Income Housing Project: LHC will not routinely permit transfer of some but not all buildings in a Qualified Low-Income Housing Project during the Extended Use Period.

IV. Recapitalizations After 15-Year Compliance Period During the Extended Use Period: LHC will routinely permit transfer of all buildings in a Qualified Low-Income Project during the Extended Use Period to a single new taxpayer in connection with a new Application for new LIHTCs. LHC will not permit the single new taxpayer to elect the Average Income Test provided for in IRC 42(g)(1)(C) unless the transferred Qualified

Low-Income Project was originally a mixed income project or the Application evidences an increase in the number of residential units to permit the imputed income limitation of such additional residential units to exceed 60 percent of area median income while simultaneously restricting the imputed income limitation of the original residential units at the original elected set aside percent of area median income.