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DATE: July 31, 2008
TO: Tax Credit Allocation Committee Stakeholders
FROM: William J. Pavão, Executive Director
SUBJECT: The Housing and Economic Recovery Act of 2008 (H.R. 3221) -
Corrected

President Bush has signed H.R. 3221 into law, changing several provisions of the federal Low Income Housing Tax Credit (LIHTC) program. The California Tax Credit Allocation Committee (TCAC) staff is preparing information regarding these changes, and will address several of them with stakeholders as we learn more about them and propose complementary programmatic changes. With this memorandum, staff is advising stakeholders about six (6) federal changes that require the California Tax Credit Allocation Committee (TCAC) to decide an appropriate policy immediately. The specific changes are summarized below, along with staff's intentions and proposed recommendations to the Committee at its August 20, 2008 meeting.

Additional Credit in 2008

Under the provisions of H.R. 3221, California will receive another \$0.20 per capita in tax credit volume cap for 2008 and again in 2009. This means that California will have an additional \$7.3 million in annual federal 9 percent (9%) credits available for allocation this year. TCAC staff intends to recommend that the Committee add these credits into the State set-aside/apportionment formula for the current, second round competition. This would assure that California meets its federal obligation to award at least ten percent of its federal credits to nonprofit sponsors, and its State statutory obligation to make 20 percent of its annual credits available to rural areas. In addition, this methodology would assure that each of the regulatory priority set-asides and geographic regions have access to their fair share of the augmented 2008 credits.

Eligible Basis Increases Outside of Federally-Designated Areas

Under federal law a project located within a federally-designated Difficult to Develop Area (DDA) or Qualified Census Tract (QCT) may use 130 percent (130%) of the project's basis for calculating the project's federal credits. This basis boost was meant to provide additional equity to projects in high-cost or impoverished areas. H.R. 3221 now allows the State to designate other areas or project types for such a boost.

California state law created a State low income housing tax credit to complement the federal credit. By statute, the State credits were intended to provide additional equity to projects that could not claim 130% of a project's basis under federal law. In essence, the

California State credits were intended to help non-DDA/QCT projects with additional credits.

The proposed federal authority would, as a practical matter, supplant a state resource that is available in ample supply. Committing additional federal credit per project under the proposed authority could reduce the number of projects receiving federal credits while leaving ample State credits untapped.

For the 2008 second round, staff will recommend that the Committee continue to rely upon federally-designated DDAs and QCTs for purposes of accessing the federal 130% basis boost. Going forward, non-DDA/QCT areas may continue to apply for and access State credits to attract in additional equity. Staff will engage the stakeholder community in a dialog as to whether circumstances would ever warrant permitting a federal credit boost in addition to a State credit award. Such a combination may require a State statutory change.

Using the Fixed Nine Percent Applicable Percentage

Nine percent credit projects placed in service after July 30, 2008 shall use an applicable percentage of not less than 9%. This provision includes projects currently being considered in TCAC's second funding round. However, TCAC will continue to underwrite the current pending applications as they were presented, using the 8.0 percent credit factor. When these and earlier-awarded projects are placed-in-service, TCAC will use the 9% applicable percentage when preparing Form 8609s. However, using the higher applicable percentage at that time will not result in a larger credit allocation than was reserved for the project initially.

For 2009, TCAC will use the 9% credit factor in its application forms and underwriting.

Annual Resident Income Recertifications

Effective July 30, 2008, 100 percent (100%) tax credit property owners no longer need to annually recertify resident household incomes. That is, residents must continue to be income qualified upon initial residency, but need not be recertified thereafter. Property files will still need to contain thorough third-party verifications of income upon initial occupancy.

TCAC staff intends to propose a State regulation amendment for 2009 requiring that each household undergo one annual recertification upon the first anniversary of their tenancy. First year recertifications frequently detect erroneous initial certification information and thereby help assure compliance with federal rules.

In light of TCAC staff's intentions stated above, TCAC strongly urges property owners to continue performing one annual recertification upon the first anniversary of any residents who have moved into the property within the last year. For all other current residents of 100% tax credit properties, property owners may discontinue annual recertifications immediately.

Modified Substantial Rehabilitation Requirement:

Under previous federal law, to qualify for 9% federal tax credits, rehabilitation expenditures were to equal the greater of:

- At least 10 percent of the adjusted basis of the building being rehabilitated; or

- At least \$3,000 per low-income unit in the building being rehabilitated.

H.R. 3221 increases the minimum rehabilitation expenditures to the greater of an amount that is:

- At least **20 percent** of the adjusted basis of the building being rehabilitated; or
- At least **\$6,000** per low-income unit in the building being rehabilitated. The new provision also indexes the \$6,000 amount for inflation.

While California's minimums exceed these new federal standards, the 20% standard may affect some projects. The new law applies to 9% credit buildings receiving carryover allocations, and 4% credit buildings receiving bond allocations, after July 30, 2008. TCAC will assure the adequacy of rehabilitation cost percentages for all 2008 first round 9% projects and applications currently being reviewed in the 2008 second round. Staff will also review all 4% tax credits projects yet to be allocated credits at placed in service. If it is determined that a rehabilitation project has not met the new test, TCAC will contact the applicant to discuss options for the project.

Foster Youth Exempted from Student Rule

Effective July 30, 2008 units occupied by students previously receiving foster care are no longer disqualified as tax credit units by virtue of that fact alone. That is, such an individual may be a full time student and reside within a tax credit unit.

Conclusion

This memorandum is intended to address issues of immediate concern and interest to LIHTC stakeholders in California. TCAC staff will promptly post additional memoranda as we learn more and formulate policy proposals regarding additional provisions of H.R. 3221. Please contact your regional analyst or, for compliance matters, the compliance management team with any questions regarding these matters.