

December 22, 2021

Ms. Virginia Sardone
Director, Office of Affordable Housing Programs
U.S. Department of Housing and Urban Development
451 Seventh Street SW, Room 7164
Washington, DC 20410-7000

Re: HOMEfires Volume 16, Number 1 Guidance: Granting HOME Loan Funds Loaned to Owners

Dear Ms. Sardone:

The following organizations thank you and the U.S. Department of Housing and Urban Development (HUD) for all the work you are doing to deploy critical affordable housing resources from the American Rescue Plan. We write due to shared concerns that guidance provided in *HOMEfires Volume 16, Number 1: Granting HOME Funds Loaned to Owners* (HOME 2021 Guidance) will hinder affordable rental housing financed by nonprofits through the HOME Investment Partnership Program (HOME) and HOME-American Rescue Plan (HOME-ARP).

The HOME 2021 Guidance states that a Participating Jurisdiction (PJ) may not grant or provide HOME funds to a project sponsor that then lends the HOME funds to an owner of an affordable housing project. This revision to the guidance undermines a structure that has been used successfully for many years under the HOME program; whereby nonprofit developers of affordable housing access forgivable loans under the HOME program that are in turn loaned to the project owners allowing for the maximum benefits under the Low-Income Housing Tax Credit (LIHTC) program. This structure has allowed PJs to help strengthen nonprofit affordable housing developers while enabling equity to be available at the project level to develop supportive housing projects and units for extremely low-income families.

As discussed further below, we strongly urge HUD to repeal this guidance outright. Short of that, we would request that HUD: (i) clarify that the guidance will not be applied retroactively to previously closed projects; and (ii) waive these requirements with respect to the \$5 billion in HOME-ARP funding. Finally, we encourage HUD to work with officials from the Treasury Department to issue guidance specifying that the HOME-ARP dollars shall not be treated as federal grants when deployed in LIHTC properties.

Background on HOME and Low-Income Housing Tax Credits

The ability of PJs to pass HOME funds through to nonprofit sponsors has been an important structuring provision for affordable rental housing over the past three decades. Prior to the HOME 2021 Guidance, PJs would grant HOME funds, either directly or through forgivable loans, to sponsors, almost all of whom were nonprofits. The nonprofits would then use the funds either to make capital contributions (which would reduce tax credit basis per Section 42(d)(5), discussed below) or to make interest bearing loans to the Project.¹ Provided that the investor was able to show that the sponsor loans could be repaid, those loans remained in tax credit basis. In addition, interest bearing loans create valuable losses for the investor and allowed investors to pay a higher price for their investment in the project. If the sponsor loans could not be projected to be repaid, the funds were usually restructured to be contributed as capital to the project to avoid taxable income to the investors, which would generally reduce the price paid for the investment. The loans and capital contributions both provided an interest in the Project to the nonprofit

¹ Although post-2008 interest on federally sourced loans is no longer required.

(or controlled subsidiary) that permitted it to have a long-term interest in the Project, and increased its ability to control and retain sales proceeds. In addition to providing much needed capital contributions to housing properties, this structure financially strengthened nonprofits as the HOME loans were repaid.

When HOME funds come directly from PJs to the tax credit project owner, like sponsor loans, the HOME funds generally need to be structured as loans with no forgiveness features. If the loans are forgivable, most investors require that the loans be shown as grants at the time the funds are loaned (rather than when they are forgiven), based on longstanding Internal Revenue Service (IRS) guidance. As with sponsor loans, the receipt of grant funds from the PJ (either as a forgivable loan or as a direct grant) has a negative impact on the equity available to the project as the income from the grants reduces the investor's yield. If the funds are being received directly from the PJ, there is no opportunity for the funds to come into the project as capital².

Background on the HOME 2021 Guidance

Because the HOME 2021 Guidance removes the ability to make grants to nonprofit sponsors to pass through to projects, projects that cannot show that the HOME loans could be repaid are hit with a double financial penalty—they cannot generate tax credits with the HOME funds³ and the HOME funds to the projects, regardless of how they are documented, are treated as taxable grants to the project. The IRS has provided guidance that if a federal grant is loaned to a project, the federal grant characteristics are removed. Losing the ability to make capital contributions, reduces the economics and flexibility that housing nonprofits had in projects prior to the HOME 2021 Guidance.

We believe the HOME 2021 Guidance is an unnecessarily restrictive interpretation of the law and regulations. The Cranston-Gonzalez National Affordable Housing Act (the Act) provides that PJs must monitor compliance “through binding contractual agreements with owners *and otherwise* (emphasis added).”⁴ The regulations further provide that the “agreement between the participating jurisdiction and a *for-profit or nonprofit housing owner, sponsor, or developer* must describe the address of the project . . . the use of the HOME funds and other funds for the project . . . and a complete budget. These items must be in sufficient detail to provide a sound basis for the participating jurisdiction to effectively monitor performance under the agreement to achieve project completion and compliance with the HOME requirements (emphasis added).”⁵ That section of the regulations also provides that there be a written agreement that meets the requirements of the definition “commit to a specific local project”, which states: “If the project consists of rehabilitation or new construction . . . the participating jurisdiction . . . and project owner have executed a written legally binding agreement under which HOME assistance will be provided to the owner for an identifiable project”⁶ The provisions of this definition add the requirement that the HOME assistance will be provided to the owner and that the owner be a party to the written agreement. *The definition does not state, though, that a sponsor or developer may not also sign the written agreement or that the HOME assistance could not flow through a sponsor or developer, just that the written agreement should have the owner as a party and that the agreement should set out the parameters of how the funds will be made available to the owner.*

² Note that one exception to the grant concern is that grants that are operating subsidies (so a substitute for rent such as would be available from the HOME-ARP program) would not generally have a negative impact on the investor's yield, as rent subsidies, such as Section 8, are typically treated as income when received.

³ Section 42(d)(5) provides that “The eligible basis of a building shall not include any costs financed with the proceeds of a federally funded grant.”

⁴ Part A, Section 226

⁵ 24 C.F.R. 92.503(c)(3)(i)

⁶ As defined in 24 C.F.R. 92.2

Since both the Act and the 92.503(c)(3)(i) regulations provide for a broader role of other parties in the HOME process, we think that the rules, as they were implemented prior to the issuance of the HOME 2021 Guidance, were a reasonable interpretation of the Act and regulations, and that the conclusions in the HOME 2021 Guidance are not required by either. We strongly agree that in all cases the PJ's documents should include provisions that allow it to directly enforce the HOME restrictions in the written agreement. However, we contend that in most Projects, the PJ has such rights as a result of the written agreement or the structure of HOME restrictive covenants and/or loan documents, and that such rights can be provided through a tri-party agreement among the owner, PJ and grant recipient/developer/sponsor.

We believe that limiting pass through of the HOME funds is a problematic change in policy that frustrates the goal of increasing available affordable rental housing, particularly for extremely low income families – and that it will be particularly detrimental to PJs' deployment of the \$5 billion in HOME-ARP resources targeting our nation's most at-risk populations. **We therefore recommend that HUD:**

- 1) Withdraw the HOME 2021 Guidance and permit transactions to be structured with pass-through HOME funds,** to permit maximum flexibility to increase affordable housing and strengthen nonprofits; or, if not,
- 2) Explicitly state that it will not require the restructuring of any previously closed projects** (unless HUD determines that the PJ does not have the right to enforce the HOME restrictions/requirements), as the lack of previous guidance and statutory ambiguities should mean that such prior transactions are grandfathered in based on decades of prior practice. This will also ensure nonprofits aren't put in financial risk from HUD compliance actions.⁷

Impact on HOME-ARP Funds

It would be particularly concerning if the HOME 2021 Guidance is applied to projects receiving supplemental HOME-ARP funds. It's anticipated that HOME-ARP awards to individual projects could be much higher than the typical HOME award to a tax credit project. Therefore, the income issues related to grant treatment will be more pronounced and cause larger yield issues for investors, while failing to create leverage for the HOME-ARP resources as the funds are likely to be excluded from tax credit basis. In addition, the underwriting requirements will make loan treatment for large awards of those funds unfeasible for many projects, as the projects will not be able to generate sufficient operating income to repay large amounts of debt (even with no interest) in markets with relatively low market rents; as even after the end of the HOME income restrictions there would be no reasonable likelihood that the value of the project would be sufficient to repay the debt.

We also believe that because of the larger HOME-ARP allocations, it will be difficult for many projects to show that all of the HOME-ARP funds could be loaned to a project and treated as true debt. If funds cannot be treated as true debt, an alternate way to provide funds to the projects (prior to the HOME 2021 Guidance) would have been to use a capital contribution through a general partner entity owned in whole or in part by the nonprofit sponsor of the project as a pass-through of HOME funds. By using a pass-through structure, a Housing Credit project is able to avoid grant income concerns related to receipt of HOME resources. The HOMEfires guidance increases the cost of using HOME-ARP funds in Housing Credit projects and will decrease the ability of PJs to leverage the HOME-ARP funds with LIHTC equity.

⁷ For instance, the HOME grants to nonprofits may have been used to support financial covenants in loan agreements or formed the basis of financial performance metrics in other subsidy documents, as well as providing income to the nonprofits when the loans are repaid, as discussed above.

This issue previously arose with the Section 202 Housing for the Elderly program. The American Homeownership and Economic Opportunity Act of 2000 (the 2000 Act) made various amendments to that program. Among other provisions, the 2000 Act amended 42 U.S.C. Section 8013(h)(5) by providing that “Notwithstanding any other provision of law, assistance amounts provided under this section may be treated as amounts not derived from a Federal grant.” Although this section does not refer to Section 42 of the Internal Revenue Code, the language is clear that funding of capital commitments that were passed through to nonprofit sponsors would not be considered federal grants under federal law. We believe that similar guidance may be necessary to permit the HOME-ARP funds to be fully utilized and leveraged in LIHTC transactions.

For the reasons stated above, and to the extent that HUD is not intending to withdraw the HOME 2021 guidance altogether as we propose above, **we request that HUD update the guidance to explicitly exempt HOME-ARP funds**, to the extent that it requires the funds be given directly to the owner of the Project rather than to a nonprofit for use as a grant, loan or capital contribution to the housing owner from such entity. We note that the ARP provides HUD with broad statutory and regulatory waiver authority to deploy HOME-ARP funding.

Furthermore, given the urgent need to deploy HOME-ARP funds to communities and populations in need, and because of the likelihood that these funds will constitute much larger sources of capital contributions for projects serving homeless and at-risk populations than typical HOME contributions, we would also request that **HUD work with the Treasury Department to issue guidance clarifying that HOME-ARP funds should not be treated as federal grants**, thereby allowing them to be granted to nonprofit sponsors and then provided as capital contribution to projects. This will allow HOME-ARP funds to be eligible to generate tax credits and significantly improve the leverage of these resources with private equity investments.

We thank you for considering our comments and please contact Mark Kudlowitz (mkudlowitz@lisc.org), LISC Senior Director of Policy, if you need additional clarification or follow up on any of the recommendations provided in this letter.

Sincerely,

Affordable Housing Tax Credit Coalition
Corporation for Supportive Housing
Enterprise Community Partners
Housing Partnership Network
Local Initiatives Support Corporation/National Equity Fund
National Alliance of Community Economic Development Associations
National Association of Affordable Housing Lenders
National Housing and Rehabilitation Association
National Housing Conference
National Housing Trust
National NeighborWorks Association
Stewards of Affordable Housing for the Future