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Can 2020 Bond-Financed Projects Take Advantage of the fixed 4% Rate in the Pending COVID-19 Legislation? - Nixon Peabody

The just-signed COVID-19 legislation finally fixes the bond-financed LIHTC credit rate to be at least 4%, but there are transition rules. In this alert, we discuss how those rules apply to several deal structures, particularly projects with 2020 bonds.

By now, you are well aware that the COVID-19 legislation provides a 4% fixed low-income housing tax credit (LIHTC) rate for bond-financed affordable housing projects that meet certain requirements. As you will see from the transition rule in the next section, the fixed-rate should plainly apply to bond-financed projects that rely on 2021 bonds and are entirely placed in service after 2020. And for the sake of completeness, we'll note that for ***non-bond financed*** projects, the fixed 4% rate applies to acquisitions of used buildings ***provided*** the credits were ***allocated after 2020***.

With those general rules out of the way, this NP alert discusses (i) possible strategies for projects with 2020 bonds as well as (ii) the treatment of used projects acquired before 2021 but financed with post-2020 bonds.

The law

Under the pending COVID-19 relief legislation, for a bond–financed project to qualify for the 4% floor, the building has to:

- Be placed in service after 2020, and
- Comply with this language: "in the case of any building any portion of which is financed with an obligation described in section 42(h)(4)(A), any such building if any such obligation which so finances such building is issued after December 31, 2020."

The big picture

One question that we are getting a lot is whether projects with undisbursed 2020 bond proceeds can qualify for the new 4% floor. To answer this question, the tax credit community would genuinely benefit from a statement from the IRS or a "Blue Book" report from one of the congressional committees (which have been known to take nine months to two years) to answer the questions discussed below. Without such government guidance, whether to claim fixed 4% credits for projects relying on bonds sold in 2020 but not "drawn down" until 2021 or later is entirely about two things: (i) risk-taking and (ii) 42(m) letters.

Risk-taking

We refer to risk-taking because it is ***possible*** to write a legal opinion where the project relies on 2020 bonds, but some or all of the bonds are drawn down in 2021. As you may remember, this comes from a position taken previously by the IRS where “the shoe was on the other foot.” A few years ago, the law for tax-exempt bonds got ***worse*** for bond issuances after a certain date, so everyone ran out and issued bonds ahead of the law change and sat on the proceeds. And the IRS said, “Not so fast; we’re going to define issuance to mean when you draw down the proceeds!” And as a result, the bonds were now considered to be “issued” later, and they no longer escaped the new rules.

But now, when everyone wants the ***opposite*** result and for the bonds to, in fact, be delayed, it’s hard to say whether the IRS will apply the same “draw-down” rule. If it did, then many 2020 bonds that still have undrawn funds would be treated as 2021 “issuances” eligible for the fixed-rate. On the other hand, the IRS might say that ***this time***, “issuance” has the traditional, common-sense meaning, and the fixed-rate only applies to bonds that are literally sold after 2020.

But truth is, it’s the parties’ risk anyway. Any legal opinion will be based on decent precedents and wouldn’t be “wrong.” It would be the parties’ choice to take the chance. And, we suppose the parties ***might*** take that chance, figuring, “Come on, will the IRS really threaten the stability of a low-income project because the parties took a defensible if aggressive position?” This is really a question for the sponsors and investors. How big a risk is too big a risk? Given the uncertainty involved, NP does not currently plan to issue opinions on 2020 bonds possibly qualifying for the 4% floor without further guidance from the IRS or a congressional report.

42(m) letters

The second issue is 42(m). The state agency has to find that the project ***needs*** the credits. If the parties close a deal on 3.1% credits, and then the owners ask the agency to bless an increase to 4%, won’t the parties have to revaluate the sources of financing, and the state agency revise its assessment of how much credit authority is needed? And, vice versa, if they start at 4%, and have to go downwards, won’t there be similar problems? What will the parties do with a closed deal that suddenly gets 4% credits? Build a larger/better project? Reject one of the soft financing sources? Pay off the development fee faster? (If the state will allow it!) And if we go in the other direction (planning to claim 4% credits, only to have the IRS or a congressional committee issue an unfavorable notice or report), how are we going to shrink the project or bring back the soft sources that were previously dropped?

It seems that a project sponsor has to go in one direction or the other. It must either take the position that it is entitled to 4% credits, get the state to agree, and adjust sources and uses accordingly, or conclude that it is stuck at (approximately) 3.1% and leave everything alone.

Using some 2021 bonds

There’s also the possibility of using ***some*** 2021 bonds. I do think that a project ***partially*** funded with 2021 bonds ***should*** work. I have heard it said that relying on partial-2021 bonds wasn’t intended, but the new Code provision uses the word ***“any”*** FOUR times—the rules apply to any building if ***any*** portion is financed by volume cap bonds, provided ***any*** such building is financed by ***any*** such obligation issued after 2020. I think it will be hard for anyone in Congress to say, “We didn’t mean what we plainly wrote.”

So, if a $6M project has $3.1M of 2020 bonds, and it goes back to the state and asks for $100K of 2021 bonds, this looks like “any” part of the building was financed by bonds that “any” part of came from a post-2020 issuance.

One important qualifier: we’re not talking about ***refunding*** bonds. The statute refers to obligations described in Section 42(h)(4)(A), which thereby incorporates the “taken into account under Section

146” language that use to trouble the IRS legal team. They thought this language meant that refundings don’t qualify a project for LIHTCs. Whether or not you agree with that view, the new legislation does not give you any new ammunition. So, when we talk about an additional $100K of bonds, we’re referring to a “fresh” $100K of bonds on top of what you already have (i.e., now you have $3.2M of bonds in our illustration).

Having said this with confidence, we must also say that we have heard colleagues and industry insiders express doubt about this idea as well, especially where the 2021 portion of the bonds is as small as we have suggested here.

And, even if you buy this argument, this still brings you back to the 42(m) conundrum. If you get 4% credits, you are still going to have to get state agency sign off on what you do with them. So, at this time, it’s not clear whether a small issuance of 2021 bonds can enable a project to claim fixed 4% LIHTCs.

Acquisitions of used facilities in 2020 with 2021 bonds

Finally, there is one other deal structure that we have already seen, and there will undoubtedly be more.

Suppose a used building is acquired by an LIHTC partnership in 2020, and it is already occupied. It gets “official action” at the time of acquisition so that the acquisition can be bond-financed. However, the actual bond issuance is indisputably in 2021. On those facts, these seem to be two “separate buildings” for tax credit purposes. One building, the acquisition, fails the first part of the transition rule, on account of being placed in service in 2020, and, therefore, gets the floating rate. On the other hand, the rehabilitation, treated as a separate new building under Section 42, seems to pass both parts of the rule and should get a fixed-rate.

Going forward

We’ll try to keep you updated as other ideas and issues are presented. On the Blue Book concept, we made a suggestion to one of the housing trade groups based on something that happened with another tax credit. A few years back, when the historic tax credit was modified, recognizing that Blue Books take a very long time to be issued, the Historic Tax Credit Coalition got a leading senator to make a statement on the floor of the Senate about how the new provision should be interpreted. It gave the investors and their lawyers comfort about writing opinions. Of course, it should be remembered that Congress could take the opposite view. Some have suggested that the statutory language was intended to keep the fiscal cost down by foreclosing the possibility of favorable treatment for pre-2021 projects and that any interpretation of the Code provisions should be made with that result in mind. In other words, it is possible that, if asked, a Congressional leader would ***not*** give the answer we are hoping for.

Nixon Peabody

by Forrest David Milder

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