Section 1602 - Payments to States for Low-Income Housing Projects in Lieu of Low-Income Housing Credits for 2009

Recapture Guidance

Background

State housing credit agencies (state agencies) are responsible for ensuring that subawardees of Section 1602 funds comply with the requirements of Section 42 of the Internal Revenue Code (IRC) and its regulations (see Program Terms and Conditions Provision 6: Asset Management). State agencies are also responsible for including a requirement in any subaward providing for recapture in the event of noncompliance and for enforcing that requirement by taking reasonable action to recapture funds when necessary (Program Terms and Conditions Provision 9a: Recapture). The purpose of this guidance is to assist State agencies in determining what actions are reasonable when noncompliance occurs.

Definition of Recapture Event

A Section 1602 recapture event occurs any time within the 15-year compliance period (as defined in Section 42(i)(1) of the Internal Revenue Code) the applicable fraction of a building under Section 42(c)(1)(B) falls below the percentage of Section 1602 funds that comprise the eligible basis of the building (the Section 1602 percentage), or below the minimum set-aside elected for the building under Section 42(g)(1), whichever is greater.

However, the preceding sentence does not apply if the applicable fraction specified in the extended use agreement with respect to the building under Section 42(h)(6)(B)(i) is lower than the Section 1602 percentage. Instead, a Section 1602 recapture event takes place any time within the 15-year compliance period the applicable fraction of the building under Section 42(c)(1)(B) falls below the applicable fraction specified for the building in the extended use agreement under Section 42(h)(6)(B)(i), or below the minimum set-aside elected for the building under Section 42(g)(1), whichever is greater.

Amount of Funds Owed

The full amount of the Section 1602 subaward is owed to the Treasury minus 6.67 percent ($1/15^{th}$) for each full year of the building's 15-year compliance in which a Section 1602 recapture event has not occurred.

Agency Obligation

State agencies are required to impose conditions or restrictions on a subawardee to assure that the building remains a qualified low-income building during the compliance period. These conditions or restrictions would also apply to any subsequent owner during the compliance period. The State housing credit agency is bound to enforce its provisions and, in the event of noncompliance and subsequent recapture, to return the recapture penalty to the Treasury.

If the State agency is unable to collect the recapture amount from a liable party, Treasury would not require the State agency to return the recapture penalty provided the State agency took all appropriate actions to collect the funds from the liable party as described below.

Avoiding Noncompliance
State agencies are responsible for determining whether subawardees are compliant with the requirements of IRC Section 42 and its regulations and must have procedures in place for monitoring Section 1602 subawardees to identify and correct issues of noncompliance during the compliance period. To the extent practicable, such procedures must be consistent with IRS regulations and guidance applicable to monitoring compliance with low-income housing tax credit requirements. For example, the compliance monitoring requirements under section 1.42-5 of the Treasury Regulations would apply generally to 1602 subawards. However, because the 1602 program is not administered by IRS, the notification to the IRS procedure under section 1.42-5(e)(3) would not apply to 1602 subawards.

Actions to ensure subawardee compliance should take place during each phase of the project including at selection and subaward and while construction is underway as well as during the 15-year compliance period. The goal is to avoid a recapture situation, as it would put the tenants at risk.

It is important to exercise due diligence prior to entering into a subaward agreement and to make the subawardee aware of its compliance responsibilities and the consequences of noncompliance, such as possible debarment from state programs and the obligation of owing funds to the US Treasury in the event of noncompliance. For example, a state agency could include a section on compliance responsibilities and sanctions for noncompliance as part of the subaward agreement or as a notice to subawardees. It is also essential to keep in contact with the subawardee during construction and throughout the compliance period.

Noncompliance
In the event of noncompliance, state agencies have the discretion to work with the building owner to avoid recapture and bring the building into compliance. If, despite the efforts of the state agency, the owner does not bring the building into compliance or the state agency is unable to find a new owner to take over the building, Treasury expects the state agency to take reasonable action to recapture funds. Reasonable action is dependent on the remedies available under state law as well as the particular facts and circumstances of the situation. The actions below are not intended to be a set of required actions but rather are intended to assist state agencies in determining best practices.

- Work with subawardees in the event of noncompliance to put in place a plan, with milestones and schedules, to remedy an incidence of noncompliance. State agencies should actively monitor any such plan to ensure milestones and schedules are being met.

- Look for a new owner who will bring the building into compliance.

- Send a written demand notice to the owner requiring repayment in full.

- Agree to repayment in the form of a repayment plan if the State agency determines that a repayment plan is the best means to obtain payment. State agencies may not accept offers in compromise without the prior written approval of Treasury.

- Take all appropriate administrative and judicial actions, including, if applicable, enforcement of personal guarantees and liens. Appropriate actions may include, but

are not limited to, setoff, referral to private collection agencies, credit bureau reporting, and litigation. Any fees associated with enforced collection may be added to the debt and retained by the State if permissible under state law.

- Keep written records of all actions taken and the results thereof.

Reporting Noncompliance

State agencies report noncompliance to Treasury in the following way:

1. Notify the 1602 Program Team, by email, identifying the subawardee and BIN, problem, and actions being taken.
2. Report to the 1602 Program Team, by email, the status within 90 days and, subsequently, the outcome of any follow-up actions requested by Treasury.

As indicated in the Frequently Asked Questions document, state agencies do not submit Form 8823 to Treasury or IRS for noncompliance, unless a building also is funded with LIHTCs.