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September 2009 because the field office decided to provide a higher level of oversight to ensure the housing agencies were in compliance with environmental review regulations. The officials told us that this extra scrutiny was a direct result of issues that they identified in the course of conducting their remote and on-site reviews of Recovery Act grants.

HUD has recognized that housing agencies may be moving more slowly in obligating their regular Capital Funds in part because of having to also manage their Recovery Act funds. In its fiscal year 2011 budget request for the Capital Fund, HUD is requesting approximately \$450 million less than it requested for fiscal year 2010. HUD notes in its request that this reduced amount takes into consideration the additional \$4 billion appropriated to the Capital Fund in the Recovery Act. According to HUD's request, there remains an estimated \$18 to \$24 billion backlog of modernization needs that housing agencies are trying to address through the Recovery Act funds and their regular Capital Fund grants.

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## Congress Responded to Declining Demand for Low-Income Housing Tax Credits by Creating Two New Programs

In recent years, the Low-Income Housing Tax Credit (LIHTC) program has been regarded as the primary vehicle for affordable housing production and preservation. In 2008 and 2009, the program was severely disrupted when the credit markets collapsed and project owners could not obtain backing for projects that would have qualified for the credit. In February 2009, Congress created two new programs as part of the Recovery Act—the Tax Credit Assistance Program (TCAP), administered by HUD, and the Grants to States for Low-income Housing Projects in Lieu of Low-income Housing Credits Program under Section 1602 of the Recovery Act (the Section 1602 Program), administered by Treasury.<sup>159</sup> These programs address the gap in financing for LIHTC projects caused by the decline in investor demand and the resulting low prices for tax credits.

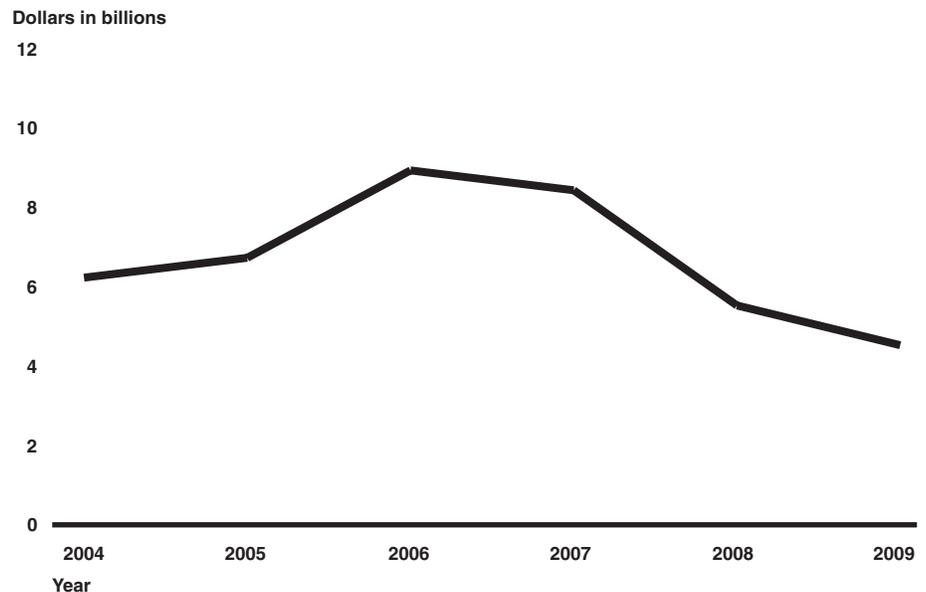
Congress established the LIHTC program in 1986 as an incentive for project owners and investors to provide affordable rental housing for households with incomes at or below specified levels. The incentive was needed because rental income and other returns from investment in low-

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<sup>159</sup>Pursuant to the Recovery Act, GAO is to review the use of funds of programs included under the act's Division A, Appropriations Provisions. TCAP is a Division A program, while the Section 1602 Program is included under Division B, Tax and Other Provisions. GAO chose to include the Section 1602 Program in its review because, like TCAP, it supplements the LIHTC program, and state housing finance agencies (HFA) are implementing the two programs simultaneously.

income housing would generally not be sufficient to cover the costs of developing and maintaining such properties. Under the LIHTC program, Treasury allocates tax credits to state housing finance agencies (HFA), which in turn award the tax credits to affordable rental housing projects. Project owners sell the tax credits to private investors and use the proceeds (tax credit equity) to build affordable housing. In return for contributing tax credit equity to the projects, private investors receive tax credits over a 10-year period. Projects must comply with LIHTC requirements for 15 years, including maintaining affordable housing units. Since its inception in 1986, the LIHTC program has provided financing for more than 1.7 million units of affordable housing and attracted increasing levels of equity that reached nearly \$9 billion in 2006. Equity generated by the sale of LIHTCs began to decline in 2007, dropped sharply to about \$5.5 billion in 2008, and was predicted to fall to about \$4.5 billion in 2009 (see fig. 19).

**Figure 19: Total Estimated Tax Credit Equity, 2004–2009**

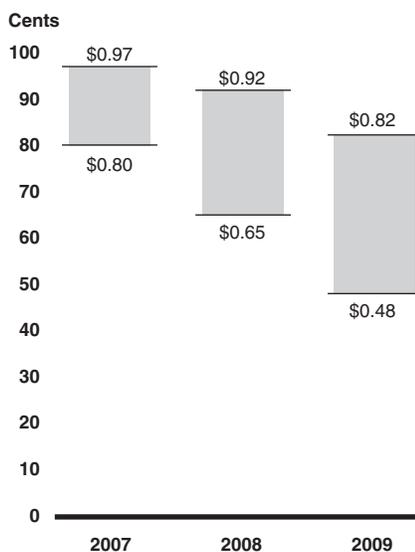


Source: Ernst & Young estimates.

The onset of financial struggles for large national banks and for Fannie Mae and Freddie Mac contributed greatly to the decline in demand for tax

credits.<sup>160</sup> As the demand for tax credits declined, so did the prices investors were willing to pay for them. The price paid per dollar of credit has declined since 2007, creating funding gaps in projects that had received tax credit allocations in 2007 and 2008. As a consequence, many planned construction and rehabilitation projects have stalled. Figure 20 summarizes the range of average prices per tax credit paid at closing in 2007, 2008, and 2009 as reported by the HFAs. For example, the 54 HFAs reported that average tax credit prices paid by investors in 2007 range from a high of 97 cents to a low of 80 cents. By 2009, the averages had dropped to 82 cents and 48 cents, respectively.

**Figure 20: Range of Average Price Paid Per Tax Credit at Project Closing in 2007, 2008, and 2009**

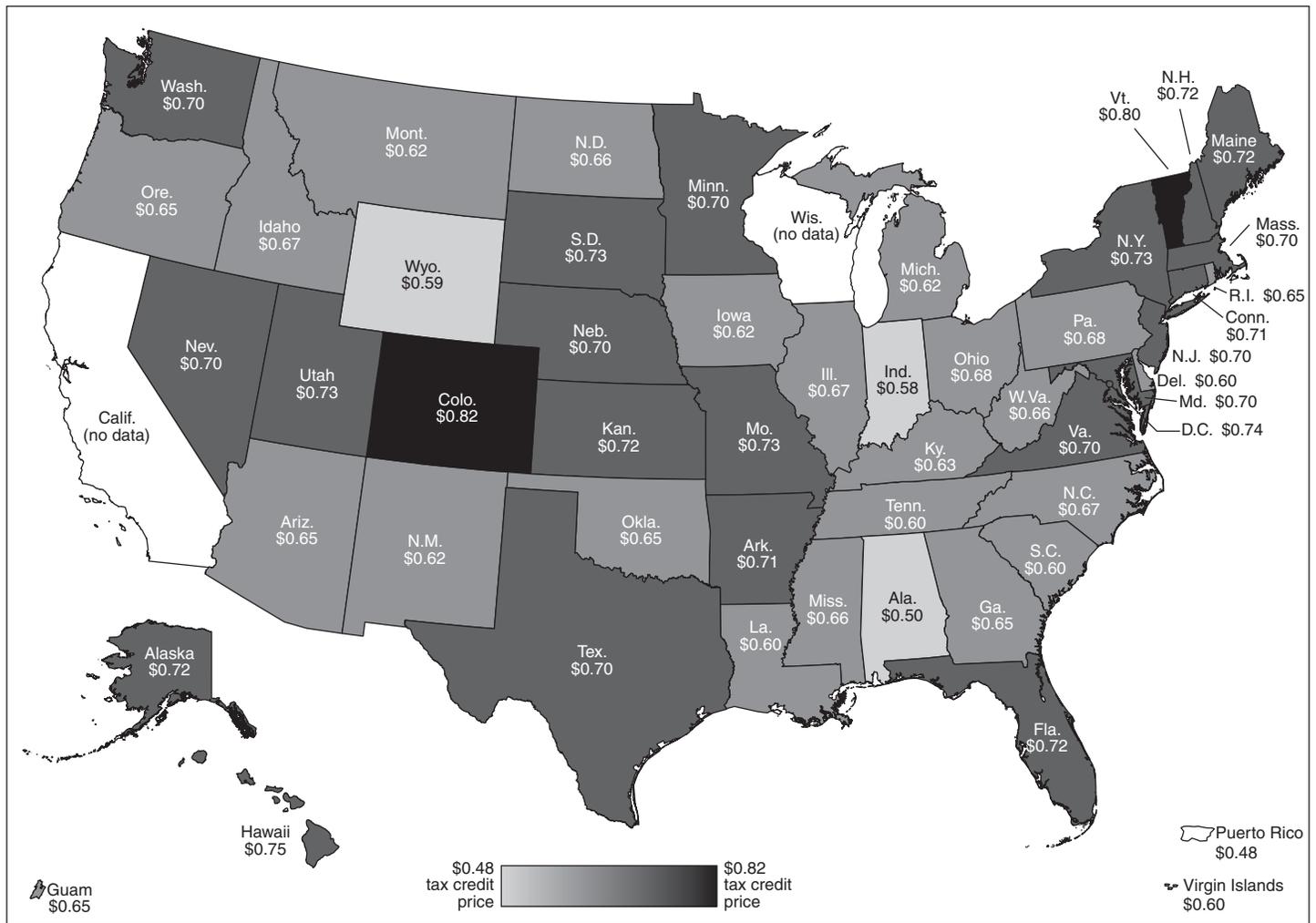


Source: GAO survey of HFAs.

<sup>160</sup>Large banks, Fannie Mae, and Freddie Mac purchased the majority of LIHTCs in recent years. Congress established Fannie Mae and Freddie Mac with two key housing missions: to (1) provide stability in the secondary market for residential mortgages and (2) serve the mortgage credit needs of targeted groups such as low-income borrowers. On September 6, 2008, the Federal Housing Finance Agency placed Fannie Mae and Freddie Mac into conservatorship out of concern that their deteriorating financial condition (\$5.4 trillion in outstanding obligations) would destabilize the financial system. See GAO, *Fannie Mae and Freddie Mac: Analysis of Options for Revising the Housing Enterprises' Long-term Structures*, [GAO-09-782](#) (Washington, D.C.: Sep. 10, 2009).

Figure 21 shows the range of average LIHTC price at project closing for each HFA in 2009. For example, Colorado reported the highest average tax credit price (82 cents) and Puerto Rico reported the lowest (48 cents).

**Figure 21: Average LIHTC Prices at Closing, by HFA in 2009**



Source: GAO survey of HFAs; Map Resources (map).

The two new programs that Congress designed, TCAP and the Section 1602 Program, would be implemented by the HFAs themselves as a means of boosting the production of affordable housing projects, including those that had been stalled by decreased demand and falling prices. These

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programs were designed primarily as stopgap measures for affordable housing until demand for LIHTC could be restored.

- TCAP provides gap financing to be used by HFAs in the form of grants or loans for capital investment in LIHTC projects through a formula-based allocation to HFAs.<sup>161</sup> HUD obligated \$2.25 billion in TCAP funds to HFAs. The HFAs were to award the funds competitively according to their qualified allocation plans, which explain selection criteria and application requirements for housing tax credits (as determined by the states and in accordance with Section 42 of the Internal Revenue Code).<sup>162</sup> Projects that were awarded low-income housing tax credits in fiscal years 2007, 2008, or 2009 were eligible for TCAP funding, but HFAs had to give priority to projects that were “shovel-ready” and expected to be completed by February 2012. Also, TCAP projects had to include some tax credit equity from the sale of LIHTCs. HFAs must commit 75 percent of their TCAP awards by February 2010 and disburse 75 percent by February 2011. Project owners must spend all of their TCAP funds by February 2012. As of the end of April 2010, 52 HFAs were participating in the program, and all (except for South Carolina) had committed 75 percent of their funds by February of this year.<sup>163</sup> HUD can recapture TCAP funds from any HFA whose projects do not comply with TCAP requirements. In these cases, HFAs are responsible for recapturing funds from project owners. Furthermore,

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<sup>161</sup>HFAs in each state, the District of Columbia, Puerto Rico, Guam, and the U.S. Virgin Islands receive LIHTC allocations. The Recovery Act directed HUD to distribute TCAP funds in accordance with the fiscal year 2008 HOME Investment Partnerships Program (HOME) formula allocations to state participating jurisdictions, thereby limiting the funds to states as defined by the HOME (HOME formula). Guam and the U.S. Virgin Islands are defined as “insular areas” under HOME, rather than as “states,” and therefore, did not receive TCAP funds. While TCAP funds were distributed based on the HOME formula, HOME requirements generally do not apply to TCAP funds.

<sup>162</sup>This report uses the terms obligation and outlays when discussing funds that HUD and Treasury provide to HFAs. By obligation, we mean that the respective federal agencies have entered into agreements with HFAs for a specified amount of funds. By outlays, we mean that the federal agencies have released funds to an HFA. We use the terms commitments and disbursements to discuss funds provided by HFAs to projects. By commitments we mean the HFA has entered into an agreement to provide funds to a project owner. By disbursement we mean that the HFAs have released funds to project owners.

<sup>163</sup>HUD told us that South Carolina did not make the 75 percent commitment deadline because it did not have enough projects that needed TCAP assistance and that met the threshold requirements. HUD has requested that all HFAs tell HUD whether they will have uncommitted funds. HUD plans to reallocate uncommitted funds, including any from South Carolina, during the summer of 2010 to HFAs that need additional TCAP assistance.

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because TCAP funds are federal financial assistance, they are subject to certain federal requirements, such as Davis-Bacon<sup>164</sup> and the National Environmental Policy Act (NEPA).<sup>165</sup> These acts, respectively, require that projects receiving federal funds pay prevailing wages and meet federal environmental requirements.

- The Section 1602 Program allows HFAs to exchange returned and unused tax credits for a payment from Treasury at the rate of 85 cents for every tax credit dollar. HFAs can exchange up to 100 percent of unused 2008 credits and 40 percent of their 2009 allocation.<sup>166</sup> HFAs may award Section 1602 Program funds to finance the construction or acquisition and rehabilitation of qualified low-income buildings in accordance with the HFA's Qualified Allocation Plan, which establishes criteria for selecting LIHTC projects. Section 1602 Program funds may be committed to project owners that have not sold their LIHTC allocation to private investors, as long as the project owner has made good faith efforts to find an investor. However, some HFAs have required Section 1602 Program projects to include some tax credit equity from private investors. Section 1602 Program funds are subject to the same requirements as the standard LIHTC program, and like TCAP funds, may be recaptured if a project does not comply with the requirements. HFAs may submit applications to Treasury for Section 1602 Program funds through 2010. The last day for HFAs to commit funds to project owners is December 31, 2010, but they can continue to disburse funds for committed projects through December 31, 2011, provided that the project owners paid or incurred at least 30 percent of eligible project costs by the end of 2010. Congress appropriated 'such sums as may be necessary' for the operation of the Section 1602 Program. The Joint Committee on Taxation originally estimated the budget impact of this program at \$3 billion. As of the end of April 2010, however, Treasury had obligated more than \$5 billion to HFAs in Section 1602 Program funds. A Treasury official stated that the agency did not expect to receive many additional applications before the December 31, 2010 deadline. Section 1602 Program funds are not considered by Treasury to be federal financial assistance and, therefore, the Section 1602 Program is not subject to many of the

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<sup>164</sup>40 U.S.C. 3141-3144, 3146-3148

<sup>165</sup>42 U.S.C. 4321et seq.

<sup>166</sup>Forty-nine HFAs, the District of Columbia, Puerto Rico, Guam, and the U.S. Virgin Islands participated in the Section 1602 Program to date. New York is the only state that has not requested Section 1602 Program funds as of May 1, 2010.

requirements placed on TCAP. On December 9, 2009, the U.S. House of Representatives passed the Tax Extenders Act of 2009 (H.R. 4213), which includes an extension of the Section 1602 Program for 1 year. The Senate passed the bill renamed the American Workers, State, and Business Relief Act of 2010 with amendments on March 10, 2010. As of May 1, the bill was awaiting reconciliation.

Figure 22 summarizes the similarities and differences between the two programs.

**Figure 22: Summary of Major TCAP and Section 1602 Program Requirements**

	 <b>TCAP</b>	 <b>Section 1602 Program</b>
<b>Administered by:</b>	HUD	Treasury
<b>Submissions:</b>	Statement of Intent to receive TCAP funds from HFAs due to HUD June 3, 2009. Single application.	Rolling applications from HFAs to Treasury accepted through December 31, 2010. Multiple applications accepted.
<b>Allocation method/type:</b>	Formula allocation, to be administered as grant or loan program.	Exchange of tax credits at \$0.85/\$1.00, to be administered as a cash payment or noninterest bearing, nonrepayable loan program.
<b>Tax credits required in funded projects?</b>	Yes	No
<b>Reporting requirements:</b>	Complex (IDIS, RAMPS, federalreporting.gov)	Simple (Treasury Spreadsheet)
<b>Other requirements:</b>	Federal requirements apply (NEPA, Davis Bacon, and others)	
	Projects must adhere to requirements of the Section 42 LIHTC program (rent, income, use restrictions)	
	HFAs responsible for asset management	
	HFAs must impose recapture conditions and restrictions	

Source: GAO analysis of TCAP and Section 1602 Program information.

As of April 30, 2010, HUD reported that it had made outlays of about \$371 million (16.5 percent) from the \$2.25 billion in TCAP funds obligated to all HFAs. Treasury had made outlays of about \$742 million (13.6 percent) from the \$5.45 billion in Section 1602 Program funds obligated to all HFAs. In five previous Recovery Act reports, we have collected and reported data

on programs receiving substantial Recovery Act funds in 16 selected states and the District of Columbia. These 16 states and the District of Columbia together have about 65 percent of the U.S. population and will receive an estimated two-thirds of the TCAP funds and about 60 percent of the Section 1602 Program funds. Figure 23 lists the TCAP and Section 1602 Program obligations and outlays for the 16 states and the District of Columbia as of April 30, 2010.

**Figure 23: TCAP and Section 1602 Obligations and Outlays for the 16 States and the District of Columbia as of April 30, 2010**

	TCAP	Obligations	Outlays	Percentage	Section 1602 Program	Obligations	Outlays	Percentage
Arizona		\$32.3	\$13.5	41.7%		\$37.6	\$0.0	0.0%
California		325.9	25.5	7.8		478.1	42.4	8.9
Colorado		27.4	7.2	26.5		17.8	5.6	31.5
Washington, D.C.		11.6	5.7	49.3		33.8	0.2	0.7
Florida		101.1	16.7	16.5		580.4	22.9	3.9
Georgia		54.5	13.3	24.4		195.6	27.6	14.1
Illinois		94.7	22.9	24.2		264.5	16.9	6.4
Iowa		19.0	4.5	23.9		72.8	33.9	46.6
Massachusetts		59.6	10.2	17.1		110.3	4.1	3.8
Michigan		64.0	9.2	14.4		285.9	12.3	4.3
Mississippi		21.9	0.0	0.0		29.7	0.0	0.0
New Jersey		61.2	3.6	5.9		123.5	29.5	23.9
New York		252.7	63.7	25.2		0.0	0.0	0.0
North Carolina		52.2	3.0	5.8		95.0	48.9	51.4
Ohio		83.5	5.5	6.6		118.1	19.5	16.5
Pennsylvania		95.1	17.8	18.7		229.9	76.0	33.0
Texas		148.4	4.6	3.1		594.1	15.2	2.6
Total		1,504.9	227.0	15.1		3,267.0	355.0	10.9

Dollars obligated (in millions)  
 Dollars outlaid (in millions)

Source: GAO analysis of HUD and Treasury data.

The differences in the TCAP obligations across the states and the District of Columbia are a result of HUD's HOME formula, which is based on

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State Housing Finance  
Agencies Expected TCAP and  
the Section 1602 Program to  
Help Fund More Than 116,000  
Units Subject to LIHTC  
Requirements Nationwide

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population size and which HUD used to set the amount of TCAP funds for each HFA as required by the Recovery Act. This formula results in larger states receiving more TCAP funds. The difference in the Section 1602 Program obligations across the states and the District of Columbia is the result of the levels requested by each HFA. In those states that had a larger number of unused and returned tax credits and in which there was a demand for affordable housing projects, the HFAs may have requested a larger obligation of Section 1602 Program funds. The difference in spending across the 16 states and the District of Columbia depends on the level of construction activity, the HFA's implementation timeline, and when the HFA requested Section 1602 Program funds. For example, Treasury officials told us that the Mississippi Home Corporation requested funds for the first time in February 2010. As figure 23 shows, Arizona, Colorado, New York, and the District of Columbia have disbursed more than 25 percent of their TCAP funds, and Colorado, Iowa, North Carolina, and Pennsylvania have disbursed more than 25 percent of their Section 1602 Program funds.

To determine the magnitude of the impact that HFAs expected from the two programs, we conducted a Web-based survey of all 54 HFAs that received TCAP and Section 1602 Program funds. All HFAs responded.<sup>167</sup> Almost two-thirds of the HFAs (35) reported that the two programs would have a high impact on developing a healthy affordable housing market, and an additional 14 said that the two programs would have some impact. Four thought that the two programs would have "little or no" impact, and one did not know. The HFAs reported that they were expecting to develop or rehabilitate more than 116,000 tax credit units in about 1,700 projects using TCAP and the Section 1602 Program.<sup>168</sup>

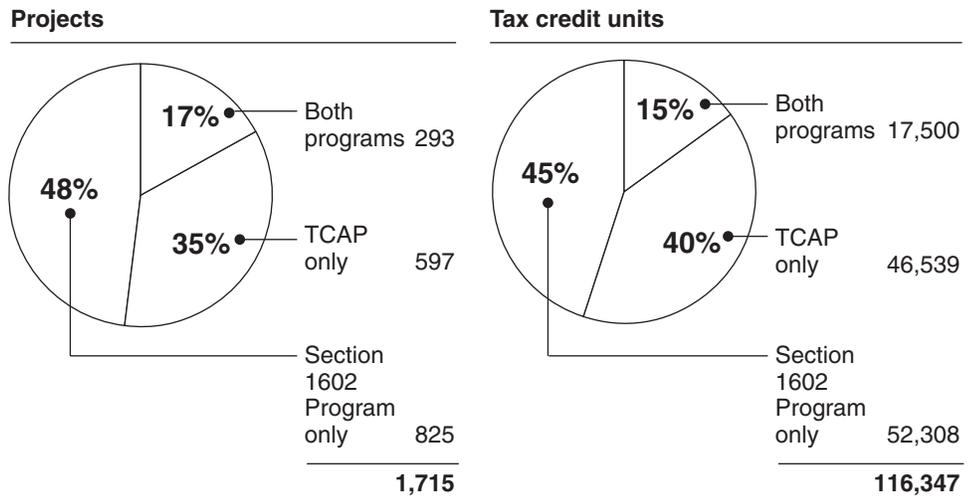
Figure 24 illustrates the number of projects and tax credit units that states expect to develop under each program and, in some instances, by combining programs.

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<sup>167</sup>We also interviewed a cross-section of HFAs and conducted site visits of projects that had received either TCAP or Section 1602 Program funds. The Georgia, Illinois, Ohio, and Pennsylvania appendixes in the e-supplement of this report provide information on our site visits ([GAO-10-605SP](#)).

<sup>168</sup>A "tax credit unit" is a unit that is subject to rent and income restrictions under the LIHTC requirements.

**Figure 24: Number of Projects and Tax Credit Units Expected to Be Developed under TCAP and the Section 1602 Program**



Source: GAO survey of HFAs.

HFAs told us that 411 of the 1,715 projects expected to be developed had previously been stalled—that is, construction had been put on hold due to financing issues. Of these stalled projects, HFAs said that 63 had received LIHTC allocations in 2007, 242 had received allocations in 2008, and 106 had received allocations in 2009. About 129 of the 411 stalled projects were restarted with TCAP funds, 178 were restarted with Section 1602 Program funds, and about 50 were restarted using both TCAP and Section 1602 Program funds. The remaining projects (54) were either restarted without TCAP or Section 1602 Program funds or remained stalled.

As previously noted, about 16.5 percent of TCAP funds and 13.6 percent of Section 1602 Program funds had been disbursed by HFAs to projects as of April 30, 2010. Many projects are in the planning or early construction phase and, therefore, significant amounts of funds have not been disbursed. Other projects, however, are further along. Figure 25 includes examples of TCAP and Section 1602 funded projects in various phases of development.

**Figure 25: Examples of TCAP and Section 1602 Program Funded LIHTC Projects**



Denver Gardens located in Denver, Colorado is a 100 unit project funded with TCAP funds by the Colorado Housing and Finance Authority (CHFA). CHFA's Denver Gardens was the first TCAP project in the country to receive TCAP funds. The project owner of Denver Gardens is rehabilitating all units and common areas including expanding the activities room pictured on the right.



Southview Senior Apartments is a 40 unit building for seniors in Des Moines, Iowa. The Iowa Finance Authority (IFA) committed Section 1602 funds to the project after the project's initial investor refused to provide its Tax Credit Equity just after the project owner had finished construction. The Section 1602 funds filled a substantial financing gap, and the project owner was able to make arrangements with a new investor despite the drop in tax credit prices over time. IFA told us that this project would have faced foreclosure without the assistance of Section 1602 program funds.



The project owner of Bayside Village in Pascagoula, Mississippi is preserving the exterior windows and many of the blackboards and lockers in the historic renovation of a high school built in 1937. The school will be renovated into 57 apartment units for the independent elderly using Section 1602 Program funds from the Mississippi Home Corporation.

Source: GAO.

Consistent with Recovery Act requirements to give priority to TCAP projects expected to be completed by February 2012 and to meet

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commitment and disbursement deadlines under both the TCAP and Section 1602 Program, HFAs reported that the most important criterion for selecting projects under both programs was the project owners' ability to meet program deadlines. In both survey comments and follow-up interviews, HFAs cited readiness to proceed as the major determinant in drafting selection criteria for both programs. In the case of TCAP, HFAs noted previous compliance with federal requirements such as NEPA and Davis-Bacon as the second most important selection criterion. HFAs indicated that the status of financing was critical for both programs. Most of the selection criteria reflect the priority for shovel-ready projects, such as having engineering and construction drawings completed and plans submitted for local approval. Figure 26 ranks HFA selection criteria based on the relative frequency with which HFAs responding to our survey reported that a particular criterion was very important when committing TCAP and Section 1602 Program funds.

**Figure 26: Ranking of HFA Selection Criteria Based on Level of Importance for TCAP and Section 1602 Program Funds**

TCAP	Selection criteria ranking	Section 1602 Program
<b>1</b> Ability to complete project within program deadlines		
Project has met or will meet federal requirements including prevailing wage and environmental review	<b>2</b>	Status of financing
Status of financing	<b>3</b>	Development team capacity and track record
Commitment of investors	<b>4</b>	Extent to which projects meet critical housing needs in your state.
Development team capacity and track record	<b>5</b>	Status of engineering and construction drawings completed
Status of engineering and construction drawings completed	<b>6</b>	Certified documentation of estimated date of closing
<b>7</b> Submission of plans or approvals to local government		
Extent to which projects meet critical housing needs in your state.	<b>8</b>	Amount of tax credits with investor commitment
Certified documentation of estimated date of closing	<b>9</b>	Job creation
Job creation	<b>10</b>	Tax credit allocation year (e.g., preference for projects allocated older tax credits)

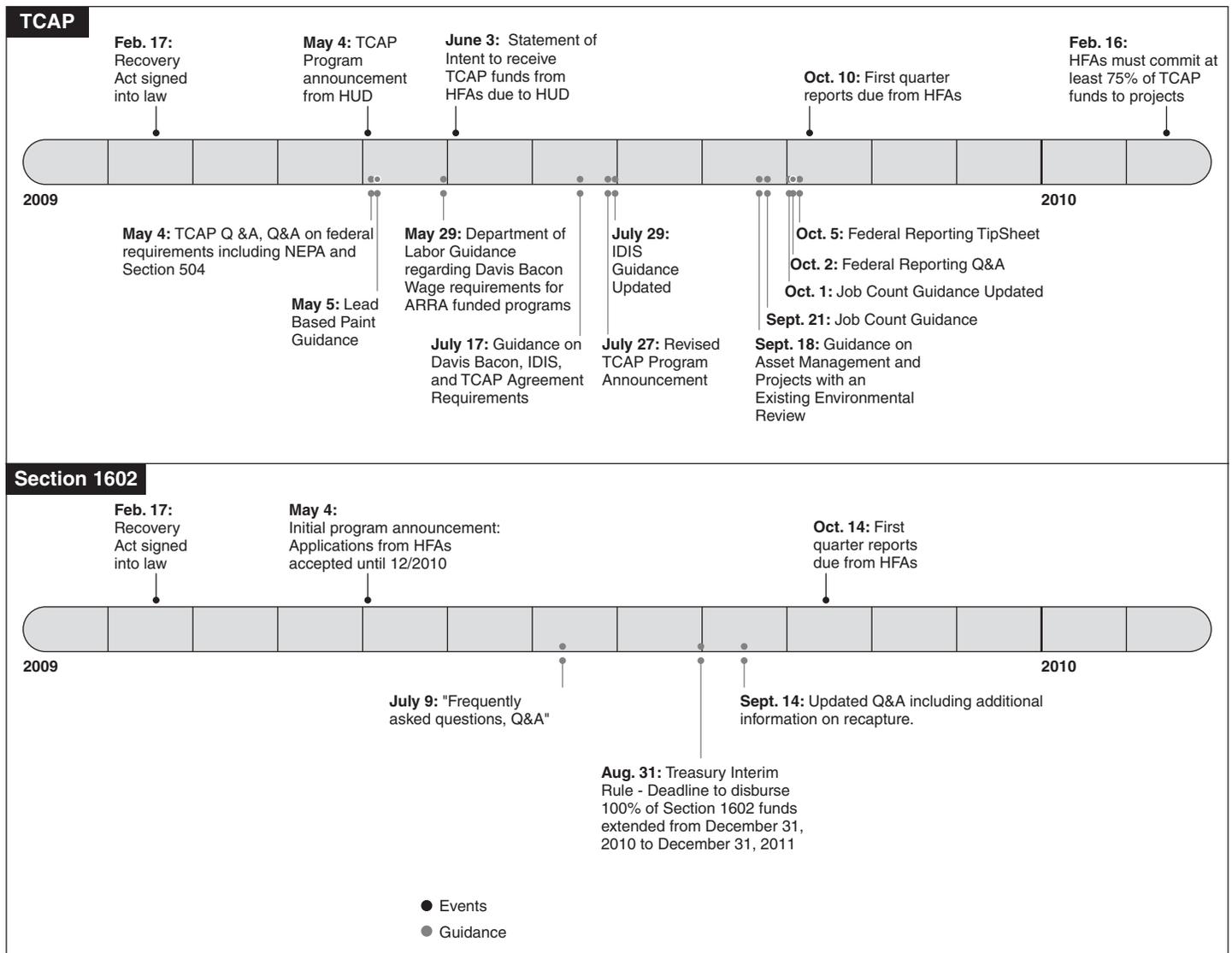
Source: GAO survey of HFAs.

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**HUD and Treasury Had Limited Resources and Time to Develop New Program Guidance**

Because TCAP and the Section 1602 Program were new programs for HUD and Treasury, respectively, the agencies needed to develop guidance that covered all aspects of the programs. Further, both TCAP and the Section 1602 Program had to be structured to be consistent with the existing LIHTC program, so the guidance had to be carefully crafted. Moreover, HUD had to develop additional guidance to address the federal requirements that applied to TCAP. To meet these challenges, HUD and Treasury issued initial program guidance in early May 2009 and followed up with clarifying guidance as shown in the following Figure 27.

**Figure 27: Timeline of TCAP and Section 1602 Program Implementation, February 2009-February 2010**



Source: GAO analysis of TCAP and Section 1602 Program information.

The timing of HUD’s guidance for TCAP, which HUD revised frequently, presented challenges to some HFAs. HUD required that HFAs apply for TCAP funds by June 3, 2009, just 30 days after the initial program announcement. According to our survey, by July 31, 2009, at least 16 HFAs had begun accepting applications from project owners for TCAP funds. However, HUD continued issuing clarifying guidance on certain TCAP

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requirements on 10 separate dates between May and November 2009. In our Web survey of 54 HFAs, 10 HFAs noted challenges in program implementation related to HUD's gradual release of guidance. However, many HFAs recognized the challenges posed by the creation of a new program and, when asked whether they were satisfied with the assistance they received, gave HUD a positive score. Overall, about two-thirds (34) of the HFAs told us that they were very or somewhat satisfied with HUD assistance. Nine responded that they were somewhat dissatisfied, and one said that it was very dissatisfied. Nine HFAs said they were neither satisfied nor dissatisfied, and one HFA did not answer the question. In response to open-ended questions about HUD assistance, 10 HFAs specifically commented on the challenge of developing the program given the timing of TCAP guidance.

According to HUD officials, developing TCAP (and its associated forms and guidance) represented a significant challenge because the agency was granted no additional administrative resources. HUD's Office of Affordable Housing Programs administers TCAP, and four existing staff from the HOME program have been given the additional task of working part-time on the program. In addition to the limited resources dedicated to developing and administering the program, HUD officials noted the tight statutory timelines for implementation as a challenge to developing guidance. Congress passed the Recovery Act in February 2009, and HUD issued its initial announcement on TCAP in May 2009 so that HFAs could begin to implement TCAP at the state level. As we have seen, HUD must ensure that TCAP recipients are compliant with federal requirements such as Davis-Bacon and NEPA and must also meet the recipient reporting requirements of the Recovery Act. HUD noted that creating guidance on these requirements took special consideration, especially because some of the requirements were unfamiliar to many participants in the LIHTC program.

Treasury also faced challenges in implementing a new program that had to be consistent with the existing LIHTC program within a short time frame. Treasury officials told us that they operate the Section 1602 Program with five staff who work on the program about 25 percent of the time. Unlike TCAP, where HUD did not receive funds for administrative expenses, Treasury received funds to assist in its implementation of the Section 1602 Program. According to Treasury officials, of the amount appropriated to Treasury under the Recovery Act to cover administrative expenses, approximately \$3 million has been made available to the Office of the Fiscal Assistant Secretary to operate both the Section 1602 and Section 1603 (Renewable Energy) Programs. The program director said that staff

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assigned to the program also had the benefit of guidance from two Internal Revenue Service (IRS) staff that were very knowledgeable with LIHTC requirements. Treasury's approach was to issue guidance at the beginning of the program and then follow up with clarifying "Frequently Asked Questions" in response to specific inquiries posed by industry participants such as HFAs, project owners, and attorneys. Treasury issued its initial program announcement in May 2009 as well but did not provide additional guidance until July, when it issued clarifications in the form of frequently asked questions, which it updated in September 2009. Treasury designed a program that accepted multiple applications from HFAs for an extended period (until December 31, 2010). This approach allowed HFAs time to gauge needs and apply for funds accordingly. Treasury noted that the speed at which the program needed to be implemented combined with the need to make the program guidance consistent with existing LIHTC rules took time and posed challenges. However, because the Section 1602 Program was not subject to the same federal requirements as TCAP, Treasury was able to develop a more streamlined program.

Overall HFAs were pleased with the assistance Treasury provided. In response to our survey, the majority of HFAs (46) reported that they were very or somewhat satisfied with Treasury's assistance, 6 were neutral, and 1 was dissatisfied. In response to an open-ended question asking for comments on the type of assistance received from Treasury, 20 HFAs said that Treasury staff were responsive to their inquiries. A few HFAs commented that the guidance was sensible (6), but others said that it was delayed or unclear (7).

HFAs Expressed Concerns with Restrictions on Structuring Section 1602 Program Disbursements and Potential Liability for Recapture of Funds under Both Programs

**HFAs Were Concerned about Requirements for Structuring Section 1602 Program Disbursements**

HFAs said they were limited by Section 1602 Program restrictions that prevented them from structuring their disbursements to project owners as conventional loans. Treasury's initial program announcement on May 1, 2009, required HFAs to disburse Section 1602 Program funds as grants rather than loans, and later clarified its guidance to allow non-interest-bearing, nonrepayable loans. Treasury guidance states that funds are repayable in the event of recapture due to noncompliance. In response to our open-ended survey questions on how the Section 1602 Program could be improved and how HFAs plan to manage program compliance, seven HFAs recommended changing Treasury's guidance to allow HFAs to disburse funds as repayable loans. In our follow-up interviews, HFAs cited three reasons for their concerns.

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First, some HFAs we interviewed told us that grants and the loans allowed by Treasury were more difficult to secure and enforce in both the short- and long-term than conventional loans. HFAs told us that using conventional loans gave them a better bargaining position when negotiating with other lenders to establish the order in which funds will be repaid when due and upon events of default. HFAs also said they can use loan provisions to demand repayment in the event the project owner does not comply with Section 1602 Program requirements and the funds need to be recaptured and returned to Treasury during the 15-year compliance period. Further, HFAs said courts are more familiar with enforcing conventional loans.

Second, some HFAs we interviewed reported that projects may be capable of covering debt service and noted that the inability to require these projects to repay Section 1602 Program funds represented a lost source of funding for future affordable housing development by HFAs. One national investor with whom we spoke also noted that while repayable loans might pose some accounting concerns for investors, repaid loans would be a source of needed resources in further developing affordable housing. This investor stated that if HFAs could choose how to structure disbursement of these funds on a case-by-case basis, they could optimize the use of federal funds while ensuring that the structure fits the investor's terms for the transaction.

Third, some HFAs said that Section 1602 Program funds should be treated the same as TCAP funds. Both programs were designed to provide gap financing for LIHTC projects. HUD allows HFAs to provide TCAP funds to projects through grants or loans and gives the HFAs flexibility to make the decision on a case-by-case basis. The Director of the Office of Affordable Housing Programs, which implements TCAP, told us that TCAP is included under the HOME section of the Recovery Act and so HUD allowed loans as it does under the HOME program. Further, HUD said that the Recovery Act did not prohibit HFAs from making loans by HFAs to project owners, and thus HUD gave HFAs the flexibility to make loans or grants as appropriate for each project. In contrast, a Treasury official told us that Treasury considered allowing conventional loans after receiving feedback from HFAs and project owners; however, Treasury determined that the Recovery Act did not provide the authority for HFAs to issue loans. Without the flexibility to disburse Section 1602 Program funds as conventional loans, HFAs would be limited in securing their interests and enforcing program requirements in the short- and long- term.

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## **Many HFAs Fear That They Could Be Liable for Recapture of TCAP and Section 1602 Program Funds**

HFAs raised concerns about their liability for recapturing and repaying funds to Treasury and HUD if project owners failed to comply with LIHTC requirements. Although TCAP and the Section 1602 Program helped provide gap financing for low-income housing projects, 16 of the 54 HFAs in our survey responded to open-ended questions by citing concerns about HFA liability under both the TCAP and Section 1602 Program recapture provisions. HFAs are responsible for returning funds to HUD and Treasury if a project is not placed in service or fails to comply with LIHTC requirements. Under both programs, HFAs are responsible for imposing recapture conditions and restrictions on project owners. In contrast, under the conventional LIHTC program, HFAs are not liable for recapturing funds if a project owner fails to comply with LIHTC requirements. Rather, their obligation is to report any noncompliance to the IRS, and the IRS takes any further action with respect to recapture.

With respect to TCAP, HFA officials told us that they viewed HUD's guidance on recapture as too stringent because HUD required HFAs to fully return all TCAP funds to HUD if a project owner did not comply with TCAP deadlines or LIHTC requirements. In contrast, the conventional LIHTC program requires project owners, rather than the HFAs, to return a graduated amount of their tax credits, with the amounts based on the timing of the noncompliance over the 15-year compliance period.

With regard to the Section 1602 Program, in May 2009, Treasury provided initial guidance on recapture, but the information was unclear about recapture amounts and HFA liability in the event it is unable to recapture funds from project owners. In September 2009, Treasury clarified that the amount recaptured would be the amount of the Section 1602 Program award minus one-fifteenth of the total for each year of the 15-year compliance period in which compliance was not at issue. Also, it established that if an HFA was unable to collect the recapture amount from a liable party, then Treasury would not require the HFA to return the Section 1602 Program funds for that project, as long as the HFA took "all appropriate actions" to collect the funds from the liable party. While some HFAs said that Treasury's September guidance was helpful, others said they thought Treasury should more clearly specify what it would consider appropriate actions.

Treasury officials told us they are concerned that any attempt to apply a nationwide definition of "appropriate action" to all HFAs and to all

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circumstances could be counterproductive. Treasury officials said that noncompliance is fact specific and actions appropriate in one instance are not necessarily appropriate in other instances. State laws as well as specific contract terms may also impact HFA actions. Additionally, Treasury officials were concerned that HFAs may interpret such guidance as a justification to limit their activities to those provided in the guidance in circumstances where other actions may be more appropriate. Treasury said they will be conducting compliance reviews with each HFA and suggested that a more effective approach may be to discuss and evaluate each HFA's plans with respect to recapture during the reviews. However, we believe that the absence of clearly defined actions that HFAs must take could lead to inconsistent enforcement of the recapture requirement across HFAs. Treasury can make clear that these actions represent the minimum that should be done but are not the only actions HFAs are expected to take to recapture funds from project owners.

In our interviews with HFAs, one HFA official told us that concerns about risk and liability related to recapture of funds from either program delayed his agency's board decision to approve participation in the programs. As a result, this agency did not request Section 1602 Program funds under Treasury's rolling application process until February 2010, thereby delaying the implementation of the Section 1602 Program in his state. In addition, in response to an open-ended question in our survey that asked about managing the recapture provisions, HFAs noted they were unsure whether they would have sufficient resources to return funds to HUD or Treasury if they were unsuccessful or delayed in obtaining funds from the project owners. Two HFAs commented on state law limitations to enforcing recapture or the possibility of lengthy court proceedings related to enforcing recapture. These challenges are made more complex without the HFA knowing what efforts they need to take to meet Treasury requirements in taking appropriate actions. Without greater specific guidance for HFAs on what constitutes appropriate recapture actions, Treasury cannot fully ensure consistent program compliance across all locations.

#### HFAs Reported Other Challenges Associated with Implementing TCAP

Responses to our survey of the 54 HFAs suggested that implementing TCAP challenged the agencies in several ways. As we have seen, many HFAs reported that both TCAP and the Section 1602 Program had a high impact in terms of funding construction projects, particularly those that had been stalled. TCAP contained requirements that were not included in the LIHTC or Section 1602 Programs. HFAs said these requirements increased their administrative costs and prevented them from fully reporting TCAP program impact. As TCAP is a temporary program in

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which HFAs had committed more than 75 percent of funds and project owners are taking steps to comply with these requirements, it may not be feasible to fully consider and address these issues. The HFAs' perception of these issues may be useful to policymakers in designing similar programs in the future.

First, TCAP was subject to the Davis-Bacon provisions of the Recovery Act, which require that all laborers and mechanics employed by contractors and subcontractors on Recovery Act-funded projects be paid at least the prevailing wage, including fringe benefits.<sup>169</sup> This provision applied to all TCAP projects, regardless of size. In contrast, Davis-Bacon is not triggered under other HUD programs unless the project includes a minimum number of units. For example, Davis-Bacon is not triggered unless a project financed with HOME funds includes 12 or more units. Forty-eight HFAs reported that a total of 681 projects (40 percent of all expected TCAP projects) would not have been required to comply with Davis-Bacon prior to receipt of TCAP funds. In a prior report, we found that federal, state, and local officials responsible for programs that are newly subject to Davis-Bacon requirements had mixed views on the extent to which they expected these requirements would affect program costs.<sup>170</sup> Our survey of HFAs participating in TCAP generally showed that they expected increases in both the cost to administer the program and delays in construction as a result of meeting these requirements. In one case, the requirement more than doubled an HFA's monitoring workload compared with its past HOME-funded projects. In addition, 32 HFAs reported increases in administrative costs of up to 10 percent due to complying with Davis-Bacon monitoring and reporting. HFAs also reported increases in project development costs as a result of applying Davis-Bacon wages. Fifteen HFAs said that they expected increased project costs of up to 5 percent, 9 reported increases of 5 to 10 percent, 4 reported increases of 11 to 15 percent, and 6 reported increases of 16 to 20 percent. Figure 28 shows the expected administrative and project development costs related to Davis-Bacon compliance.

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<sup>169</sup>Section 1606 of the Recovery Act applies Davis-Bacon to all programs under Division A of the act, which includes TCAP.

<sup>170</sup>GAO, *Recovery Act: Officials' Views Vary on Impacts of Davis-Bacon Act Prevailing Wage Provision*, GAO-10-421 (Washington, D.C.: Feb. 24, 2010).

**Figure 28: Expected Percentage Cost Increases for Complying with Davis-Bacon, by HFA Survey Response**

Expected cost increase associated with Davis Bacon compliance	Number of HFAs	
	Increased HFA administrative costs	Average increased per project development costs
None	6	4
More than 0% to less than 5%	17	15
5-10%	15	9
11-15%	2	4
16-20%		6
21-25%		2
26-30%	2	2
More than 30%	3	1
Don't Know (Did not respond)	8 (1)	8 (3)

Source: GAO survey of HFAs.

Some HFAs, project owners, and investors reported that projects in rural areas were likely to face the most difficulties in introducing Davis-Bacon wages because the wages negotiated in construction contracts in rural areas are often lower than wages required by Davis-Bacon. For example, an HFA we interviewed told us that one of its rural project owners applied for Section 1602 Program funds, which do not require Davis-Bacon compliance, because it expected the Davis-Bacon wages would make its projects cost-prohibitive. In our prior reports, we recognized that HUD, in implementing its Lead Hazard Reduction Program under the Recovery Act, reported that grantees were provided additional time to complete their work plans to ensure contractors understood Davis-Bacon requirements. Federal officials and program participants should consider the needed time and costs for meeting these requirements as they establish plans and guidance. Likewise, in creating similar programs with differing requirements, policymakers should recognize that program participants will select those projects with the least restrictions.

Second, the Recovery Act requires TCAP projects to comply with NEPA requirements for environmental reviews. HFAs told us that they expected this requirement would delay the start of construction on TCAP projects. Twenty HFAs expected up to a 3-month delay in start of construction between a project owner's application for TCAP funds and HUD's

approval to use TCAP funds, 19 HFAs expected a 3 to 6 month delay, and 6 expected a 6 to 9 month delay (see fig. 29). One HFA stated that it set a 120-day closing deadline on project owners after committing TCAP funds and that the environmental review process was the most common reason projects could not meet this deadline.

**Figure 29: Number of HFAs Citing Delays in Starting Construction Caused by NEPA Compliance**

	Number of HFAs
Expect up to a 3 month delay	20
Expect a 3-6 month delay	19
Expect a 6-9 month delay	6
Answered "Don't Know"	2
Did not answer the questions	7

Source: GAO survey of HFAs.

Half of the HFAs expected up to a 5 percent increase in HFA administrative costs related to compliance with NEPA. HFAs said that the costs, which must be paid from HFA funds, relate to staff time and contract fees for outsourcing NEPA reviews and compliance monitoring. One HFA we conducted a follow-up interview with reported that the cost would be about \$160,000 in staff time and resources. Another HFA reported the cost of hiring an engineering firm to conduct environmental reviews was \$200,000. Four of the 10 HFAs we interviewed told us that some projects were delayed because the HFA had to repeat the NEPA process for projects in which a different funding entity had already completed a previous review. For example, if a local jurisdiction had completed an environmental review for a project under the HOME program that later received a commitment of TCAP funds from an HFA, in many cases, the project would have to undergo a second NEPA review. A HUD official told us that unless the environmental condition of the property had changed since the completion of the last review, the new review should be straightforward because the HFA can accept the existing environmental tests and studies. However, even in the case where there is no change in environmental condition, the HFA still must comply with paperwork and public notice requirements. The HUD official we interviewed said that in these circumstances, the administrative and public notice process adds a minimum 30-day delay to the release of TCAP funds. HUD could not tell us the number of projects that needed second NEPA reviews. One HFA with no NEPA experience told us that it had selected

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TCAP projects with previously-completed NEPA reviews because it understood that no additional review would be required for these projects. When it discovered that it would need to hold a public comment period, this HFA initially thought that HUD had changed its NEPA guidance. Later this HFA recognized that it had misunderstood the process. In the future, clearer guidance from federal officials to recipients that have little experience with program requirements may avoid such misunderstandings. Also, federal officials should consider how to best implement streamlined processes while ensuring compliance with environmental assessment provisions.

Finally, HFAs also noted that they were concerned about underreporting jobs that TCAP funds created because of OMB's requirement that they count only jobs directly resulting from TCAP funding. However, in some cases, TCAP funds were used to purchase land or acquire existing properties and therefore had limited, if any, direct jobs impact. But most of the HFAs we followed up with said that most of the projects receiving TCAP funds would not have moved forward without TCAP and that no jobs would have been created or retained without the injection of those funds. We previously reported that some program recipients were concerned with how jobs were counted.<sup>171</sup>

## Conclusions

HUD and Treasury had limited resources and time to develop two new programs, TCAP and the Section 1602 Program, respectively. Overall, HFAs have been satisfied with assistance received from HUD and Treasury and report that the programs will have a high impact on the health of affordable housing in their states. However, two major concerns noted by HFAs in our survey and follow-up interviews related to what constitute appropriate HFA actions for recapture of Section 1602 Program funds if the project owners fail to comply with program requirements and the inability to structure Section 1602 Program financing as conventional loans.

Under the TCAP and Section 1602 Program, HFAs have greater responsibility for recapturing funds than they do under the conventional LIHTC program. Treasury requires HFAs to return a portion of the funds

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<sup>171</sup>GAO, *Recovery Act: Recipient Reported Jobs Data Provide Some Insight into Use of Recovery Act Funding, but Data Quality and Reporting Issues Need Attention*, [GAO-10-223](#) (Washington, D.C.: Nov. 19, 2009) and *Recovery Act: One Year Later, States' and Localities' Uses of Funds and Opportunities to Strengthen Accountability*, [GAO-10-437](#) (Washington, D.C.: Mar. 3, 2010).

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from project owners who have not complied with LIHTC requirements. Some HFAs said they were concerned about paying back funds themselves if they could not recover funds from the owners. Although Treasury has said that HFAs would not be liable if they had taken all appropriate actions to collect the funds, it has not specified what actions they would have to take in order to avoid liability. Treasury expressed concern that a definition of appropriate actions that would apply nationwide would be counterproductive, because each case of noncompliance was likely to be different. Further, Treasury feared that HFAs would seek to meet only the established standards and would not pursue all possible avenues for recapturing funds on a case-by-case basis and that it preferred to discuss and evaluate each HFA's plans with respect to recapture during compliance reviews. However, the absence of clearly defined actions that HFAs must take could lead to inconsistent enforcement of the recapture requirement across HFAs. Treasury can make clear that these actions represent the minimum that should be done but are not the only actions that HFAs are expected to take to recapture funds from project owners.

Treasury's decision that Section 1602 Program funds must be administered as a grant or non-interest-bearing, nonrepayable loan limits the leverage HFAs have in enforcing and securing their interests. It also limits HFAs' ability to enforce compliance over projects in both the short- and long-term and prevents HFAs from using repaid Section 1602 Program funds for affordable housing development. The primary Treasury official overseeing the Section 1602 Program told us that they were aware of these concerns, but that the Recovery Act did not provide the authority for HFAs to disburse funds as interest-bearing, repayable loans. While the precise extent of Treasury's authority under the statute is not clear, we agree that the Recovery Act does not explicitly state that Treasury can permit the HFAs the flexibility to disburse Section 1602 funds as interest-bearing loans that provide for repayments.<sup>172</sup> Allowing HFAs to choose whether the disbursement of Section 1602 Program funds as grants or interest-bearing loans that require repayment, as they can under the TCAP program, would simplify enforcement and better secure their interests.

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<sup>172</sup> Under the Section 1602 Program, the Treasury Department disburses "grants" to the HFAs and they, in turn, disburse the grants as "subawards" to the project owners. *See* section 1602(c)(1) ("A State housing credit agency receiving a grant under this section shall use such grant to make subawards to finance the construction or acquisition and rehabilitation of qualified low-income buildings.").

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Recommendation to the Secretary of the Treasury

In order to increase the likelihood that HFAs will comply with Treasury's requirements for recapturing funds, the Secretary of the Treasury should define what it considers appropriate actions by HFAs to recapture funds in order to avoid liability when they are unable to collect funds from project owners that do not comply.

Matter for Congressional Consideration

To provide HFAs with greater tools for enforcing program compliance, in the event the Section 1602 Program is extended for another year, Congress may want to consider directing Treasury to permit HFAs the flexibility to disburse Section 1602 Program funds as interest-bearing loans that allow for repayment.

Agency Comments and Our Evaluation

We provided a draft of this report to Treasury for review and comment. In a response from an official from the Office of the Fiscal Assistant Secretary, Treasury stated that it agreed with the recommendation that Treasury define what it considers to be appropriate action by HFAs to recapture funds in order to avoid liability. Treasury added that it believed any additional guidance must be focused on assisting HFAs in better understanding their obligations by providing more clearly defined standards and expectations, yet be sufficiently flexible to take into account these variations.