

# REAL ESTATE FINANCE

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## IRS Provides Guidance Regarding The New Housing Legislation

By H. Richard Hagen

*H. Richard Hagen, a partner with Chapman and Cutler LLP, has served as bond counsel and underwriter's counsel on a wide variety of public finance transactions, including taxable and tax-exempt single family and multifamily financings, pollution control facilities, environmental facilities and transactions involving utility cooperatives in several parts of the United States. Mr. Hagen can be reached at rhagen@chapman.com.*

After the new housing legislation under HR 3221 (2008 Housing Act) was passed by Congress and signed into law, many questions arose as to how to implement the new laws and how to interpret the language in the bill, including questions about uses of the additional \$11 billion in volume cap (2008 Housing Act Volume Cap), the amount of such volume cap each State will receive, carryforward of volume cap and information reporting. On September 17, 2008, the Internal Revenue Service (IRS) issued Notice 2008-79 (Notice) that is intended to provide guidance on allocations, carryforwards, information reporting, and uses of the additional bond volume cap, and guidance on the use of qualified mortgage revenue bonds to refinance certain subprime mortgage loans. In addition, the Notice contains a list providing the allocations of the \$11 billion volume cap to the States, the District of Columbia and possessions of the United States. The Notice is effective as of July 30, 2008, the date of enactment of the 2008 Housing Act.

The following is a summary of some of the more significant elements of the Notice.

### **\$11 BILLION ADDITIONAL VOLUME CAP**

Each state receives a unified annual state tax-exempt private activity bond volume cap for

most private activity bonds (General Volume Cap) based on a predetermined formula. The IRS applied such formula to the 2008 Housing Act Volume Cap and provided a list showing how much of the 2008 Housing Act Volume Cap is allocated to each State, the District of Columbia and possessions of the United States.

### **CARRYFORWARD FLEXIBILITY**

The Internal Revenue Code (the Code) provides for a mechanism to carryforward unused General Volume Cap for three years. The 2008 Housing Act amended the Code to provide that any carryforward of 2008 Housing Act Volume Cap may be used only for qualified housing issues that are issued by the end of calendar year 2010. As a result, many questions arose relating to how 2008 Housing Act Volume Cap would be carried forward in relation to how General Volume Cap would be carried forward. The Notice provides that 2008 Housing Act Volume Cap should be tracked and accounted for separately from General Volume Cap and that for purposes of both initial allocations and carryforwards of 2008 Housing Act Volume Cap and General Volume Cap, including, without limitation, the "first-in, first-out" ordering rule for carryforwards of General Volume Cap under the Code, an issuer may in its discretion utilize 2008 Housing Act Volume Cap or carryforwards of 2008 Housing

Act Volume Cap *either before or after* the use of General Volume Cap or carryforwards of General Volume Cap.

The ability to “mix and match” the use of carryforward allocation provides state and local housing issuers with the flexibility to manage their respective single family programs to address the 12 month “targeted area” set aside requirement and the overall length of a program’s mortgage origination period within the constraints of the “12 month rule” for 2008 Housing Act Volume Cap.

The Notice goes on to state that, in applying the carryforward rules under the Code, regarding identification of carryforward purposes for 2008 Housing Act Volume Cap, it is sufficient to identify such carryforwards for use for “qualified housing issues” allowing issuers to retain the flexibility to use such carryforwards for the different types of qualified housing issues as their needs dictate. In addition, an issuer who files a proper carryforward election for 2008 Housing Act Volume Cap may assign any portion of that 2008 Housing Act Volume Cap to another eligible issuer in the State. However, issuers should be mindful that the laws of certain States may prohibit any such assignment and may require the issuer to identify projects when applying for allocation that would effectively eliminate the flexibility provided by the Notice.

### **REFINANCING OF QUALIFIED SUBPRIME LOANS UNDER THE 2008 HOUSING ACT**

The 2008 Housing Act provides temporary authority to refinance qualified subprime loans with qualified mortgage bonds that are issued by the end of calendar year 2010 pursuant to General Volume Cap as well as 2008 Housing Act Volume Cap. The 2008 Housing Act defines the term “qualified subprime loan” as an adjustable rate single-family residential mortgage loan made after December 31, 2001 and before January 1, 2008 that the issuer determines would be reasonably likely to cause *financial hardship* to the borrower if not refinanced. The Notice provides that issuers may base determinations with respect to likely financial hardship to borrowers on reasonable estimates made in good faith.

The 2008 Housing Act requires that the general 42 month origination period be shortened to 12 months with respect to the use of proceeds to refinance qualified subprime loans with qualified mortgage bonds. The Notice clarifies that for qualified subprime loan refinancings to be funded from qualified mortgage bonds that have received an allocation of General Volume Cap (as opposed to 2008 Housing Act Volume Cap), an issuer may make proceeds of such bonds available for use

for qualified subprime loan refinancings during the permitted 12 month origination period for such loans, and then either redeem bonds from unused proceeds or make such proceeds available for regular qualified mortgage loans under the Code for the balance of the permitted 42 month origination period for such loans under the general rules for qualified mortgage bonds before redemption of bonds from unused proceeds. Qualified mortgage bonds that receive an allocation of 2008 Housing Act Volume Cap must apply all unused proceeds to the redemption of bonds after the 12 month period.

### **INFORMATION REPORTING AND CARRYFORWARD ELECTIONS FOR USE OF 2008 HOUSING ACT VOLUME CAP**

The Notice provides that, subject to updated forms and procedures promulgated by the IRS, an issuer of a qualified housing issue that uses 2008 Housing Act Volume Cap should file IRS Form 8038 as modified by the instructions set forth in the Notice and issuers with unused 2008 Housing Act Volume Cap at December 31, 2008 should elect to carryforward such cap by filing a separate IRS Form 8328 as modified by the instructions set forth in the Notice. Issuers who have both unused General Volume Cap and 2008 Housing Act Volume Cap should file separate carryforward elections for each of those carryforwards. A carryforward election for General Volume Cap should follow the instructions on IRS Form 8328 and a carryforward election for 2008 Housing Act Volume Cap should follow the instructions on IRS Form 8328 with the modifications provided in the Notice.

An issuer who issues private activity bonds using either General Volume Cap or 2008 Housing Act Volume Cap and expects to use the proceeds for the refinancing of qualified subprime loans in accordance with the 2008 Housing Act is required to attach a schedule to IRS Form 8038 indicating the amount of the proceeds that are reasonably expected to be used for such refinancing based on a reasonable good faith estimate of the amount of bond proceeds expected to be used for this purpose. Issuers who fail to utilize the full amount indicated on such schedule are permitted to apply such unused amounts to the financing of mortgage loans otherwise eligible to be financed under § 143 of the Code.

### **USE OF 2008 HOUSING ACT VOLUME CAP FOR MCCS**

The Notice clarifies that an issuer may exchange unused authority to issue private activity bonds with 2008 Housing

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Act Volume Cap for authority to issue mortgage credit certificates but only if the indebtedness to which the mortgage credit certificate relates is incurred within 12 months of the date of the election not to issue an amount of private activity bonds which it may otherwise issue during the calendar year.

The Notice further clarifies that an issuer may elect to issue mortgage credit certificates to refinance qualified subprime loans if it otherwise satisfies the requirements of the 2008 Housing Act relating to such loans. Any such qualified subprime loan refinancing must be incurred within 12 months after such election. Further, an issuer must make any such election with respect to such mortgage credit certificates by December 31, 2010.

### TEMPORARY AUTHORITY FOR FEDERAL HOME LOAN BANKS TO GUARANTEE TAX-EXEMPT BONDS

The 2008 Housing Act provides a temporary exception to the general restriction against Federal guarantees of tax-exempt bonds for certain guarantees made by Federal Home Loan Banks by making the restriction inapplicable to a guarantee by a Federal Home Loan Bank made in connection with the *original issuance* of a bond during the period beginning on the date of enactment of the 2008 Housing Act and

ending on December 31, 2010 (or a renewal or extension of a guarantee so made). The Notice clarifies that both bonds for new money purposes and refunding bonds for refinancing purposes may be treated as *originally issued* during the relevant period and, as a result, are eligible for Federal Home Loan Bank guarantees.

### CONCLUSION

Notice 2008-79 was a timely response by the IRS to issues raised by housing practitioners regarding the implementation of the 2008 Housing Act. While Notice 2008-79 provided needed clarification and interpretation of a number of aspects of the 2008 Housing Act, there are a few unresolved issues, such as, among other things, how an issuer can comply with the 12 month "targeted area" set aside requirement for a single family mortgage bond issue using only 2008 Housing Act Volume Cap in light of the fact that bonds issued using the 2008 Housing Act Volume Cap must be redeemed with unused proceeds 12 months after they are issued. Currently, the only way to satisfy the requirement is to blend 2008 Housing Act Volume Cap with General Volume Cap. No doubt issuers and their bond counsel will continue to discover shortcomings of the 2008 Housing Act which will help keep those working at the IRS fully employed as they continue to provide needed guidance.

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