

**DEPARTMENT OF HOUSING AND  
URBAN DEVELOPMENT**
**24 CFR Part 200**

[Docket No. FR-5290-P-01]

RIN 2502-A173

**Prohibition of the Escrowing of Tax  
Credit Equity**
**AGENCY:** Office of the Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

**ACTION:** Proposed rule.

**SUMMARY:** This proposed rule would conform HUD's Federal Housing Administration (FHA) multifamily mortgage insurance regulations to a provision in Title VIII of the Housing and Economic Recovery Act of 2008 that prohibits a requirement that tax credit sales proceeds be placed into escrow, at the time of initial endorsement, for assurance of project completion and to pay the initial service charge, carrying charges, and legal and organizational expenses incident to the construction of the project. This rule would not prohibit HUD from requiring escrows of funds for other purposes, such as for working capital. The rule would also make other changes intended to reduce burdens on the use of tax credits.

**DATES:** *Comments Due Date:* December 8, 2009.

**ADDRESSES:** Interested persons are invited to submit comments regarding this proposed rule. There are two methods for comments to be submitted as public comments and to be included in the public comment docket for this rule. Regardless of the method selected, all submissions must refer to the above docket number and title.

1. *Submission of Comments by Mail.* Comments may be submitted by mail to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 10276, Washington, DC 20410-0001.

2. *Electronic Submission of Comments.* Interested persons may submit comments electronically through the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov). HUD strongly encourages commenters to submit comments electronically. Electronic submission of comments allows commenters maximum time to prepare and submit comments, ensures their timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the [www.regulations.gov](http://www.regulations.gov) Web site can be viewed by other commenters and

interested members of the public. Commenters should follow the instructions provided on that Web site to submit comments electronically.

**Note:** To receive consideration as public comments, comments must be submitted through one of the two methods specified above. Again, all submissions must refer to the docket number and title of the rule. *No Facsimile Comments.* Facsimile (FAX) comments are not acceptable.

*Public Inspection of Public Comments.* All properly submitted comments and communications submitted to HUD will be available, without charge, for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address. Due to security measures at the HUD Headquarters building, an advance appointment to review the public comments must be scheduled by calling the Regulations Division at 202-708-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number through TTY by calling the toll-free Federal Information Relay Service at 800-877-8339. Copies of all comments submitted are available for inspection and downloading at [www.regulations.gov](http://www.regulations.gov).

**FOR FURTHER INFORMATION CONTACT:** Iris Agubuzo, Project Manager, Policy Division, Office of Multifamily Housing, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 6158, Washington, DC 20410-8000, Telephone 202-402-2662 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number through TTY by calling the toll-free Federal Information Relay Service at 800-877-8339.

**SUPPLEMENTARY INFORMATION:**
**I. Background**

The low-income housing tax credit is a tax incentive provided under section 42 of the Internal Revenue Code of 1986, 26 U.S.C. 42, to increase the availability of low-income housing. Section 42 provides a nonrefundable income tax credit to owners of qualified buildings. Qualified buildings are newly constructed or substantially rehabilitated buildings in which a percentage of the units are designated for low-income rental housing, or certain newly acquired, federally subsidized buildings. The owner of a qualified building may claim a credit against taxes for 10 years equivalent to the applicable credit percentage, dependent on the type of building, multiplied by the qualified basis of the building. The qualified basis is the applicable fraction of the eligible basis

of the building. The fraction is calculated by one of two methods, either the floor space devoted to low-income units as a percentage of the total floor space of residential units, or the number of low-income units in the building as a percentage of the total number of units. To calculate the tax credit, the qualified basis is multiplied by a percentage that differs depending on the type of building, the year it was placed in service, and possibly other factors affecting the eligible basis, as stated in the statute. The owners of low-income housing buildings must apply to state and local agencies for the tax credits, which are actually granted only by state governments. The owners that receive tax credit allocations can then sell or syndicate the tax credits.

The New Markets Tax Credit is a tax credit provided under section 45D of the Internal Revenue Code of 1986, 26 U.S.C. 45D. This tax credit is for investments in a qualified community development entity that uses "substantially all" of the investment to make qualified low-income community investments, and designates the investment for the purposes of section 45D. The credit given is an applicable percentage of the investment at the date of initial issue, as determined under the statute.

The historic tax credit referenced in 24 CFR 200.54 is a credit against taxes for rehabilitation of historic structures authorized under section 47(a)(2) of the Internal Revenue Code of 1986, 26 U.S.C. 47(a)(2). The amount of the credit is 20 percent of the qualified rehabilitation expenditures for certified historic structures, or 10 percent for qualified rehabilitated buildings first placed in service before 1936, other than certified historic structures. The program is jointly administered by the U.S. Department of the Interior and the U.S. Department of the Treasury, and applies to rehabilitation of certified historic structures.

Section 2834(c) of HERA, Public Law 110-289 (approved July 30, 2008) adds a new section to the National Housing Act. This new section is codified at 12 U.S.C. 1715s, which is section 228 of the National Housing Act (this is a previously repealed section). This new section states, in relevant part:

(b) Acceptance of Letters of Credit.—In the case of an insured mortgage covering a tax credit project, the Secretary may not require the escrowing of equity provided by the sale of any low-income housing tax credits for the project pursuant to section 42 of the Internal Revenue Code of 1986, or any other form of security, such as a letter of credit.

This provision changes the practice allowed by current HUD regulations and

policies, which is to require a substantial portion of the low-income housing tax credit equity under 26 U.S.C. 42 to be placed in escrow for potential future use over the life of the project at the time of initial endorsement. That requirement often means that mortgage borrowers, who have not realized their tax credit proceeds at this point, would have to obtain costly bridge loan financing. This requirement has had an inhibiting effect on the building of new low-income housing tax credit projects.

The new law prevents HUD from requiring the escrow of tax credit proceeds. HUD believes that, as a result, the need for bridge loans will be substantially reduced and hence make multifamily housing more available and affordable. The new law does not prohibit HUD from requiring the use of monies, which may derive from tax credit proceeds, for upfront expenses. Such an amount would vary depending on the underwriting requirements of the project.

HUD's regulation at 24 CFR 200.54 is designed to allow HUD to require a payment of funds sufficient to ensure project completion. That regulation states: "The mortgagor shall deposit with the mortgagee cash deemed by the Commissioner to be sufficient, when added to the proceeds of the insured mortgage, to assure completion of the project and to pay the initial service charge, carrying charges, and legal and organizational expenses incident to the construction of the project." (24 CFR 200.54 undesignated introductory paragraph.) The regulation also allows for a "lesser cash deposit" in cases where "required funding is to be provided by a grant or loan from a Federal, State, or local government agency or instrumentality." However, because proceeds from tax credits are not explicitly mentioned, HUD's position has been that the allowance of a "lesser cash deposit" does not apply in cases where a portion of the funding will be realized from tax-credit proceeds. To be considered sufficient, HUD deemed it necessary to require the escrowing of all, or a substantial portion of, an amount equal to the tax credit proceeds expected to be realized. Thus, HUD has required a substantial cash deposit, often derived from a bridge loan, in such cases.

On July 22, 2008, HUD issued Mortgagee Letter 2008-19, entitled "Streamlined Processing of Multifamily Mortgage Insurance Applications Involving Low-Income Housing Tax Credits." This mortgagee letter reduced the amount of tax-credit proceeds required for the cash escrow from 100

percent of such proceeds to a varying amount, but generally at least 20 percent of such proceeds, unless HUD authorizes a lower amount. This aspect of the mortgagee letter is now superseded by the new statutory provision, which precludes the "escrowing of equity provided by the sale of any low-income housing tax credits [emphasis added]."

## II. This 2009 Proposed Rule

This proposed rule would conform 24 CFR 200.54 to section 2834(c) of HERA, codified as 12 U.S.C. 1715s. The regulatory section would now specifically prohibit HUD from requiring the escrowing of equity from the sales of tax credits. This change is mandated directly by the statute, so HUD has no discretion in this regard.

In addition, the proposed rule would change the current treatment of historic and new market housing tax credits, which are not controlled by the statute. Hence, HUD has some discretion as to how these types of tax credits are considered in the underwriting of projects. Specifically, the escrow requirement would be eliminated when equity is provided from these types of tax credits. Finally, proceeds from New Market Tax Credits would be added to 24 CFR 200.54(b) as a type of funding that need not be fully disbursed prior to the disbursement of the mortgage proceeds, where approved by the Commissioner.

## III. Findings and Certifications

### *Environmental Impact*

This proposed rule does not direct, provide for assistance or loan and mortgage insurance for, or otherwise govern or regulate, real property acquisition, disposition, leasing, rehabilitation, alteration, demolition, or new construction, or establish, revise or provide for standards for construction or construction materials, manufactured housing, or occupancy. Accordingly, under 24 CFR 50.19(c)(1), this proposed rule is categorically excluded from environmental review under the National Environmental Policy Act of 1969 (42 U.S.C. 4321).

### *Regulatory Flexibility Act*

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601 *et seq.*) generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities.

In accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), this

proposed rule was reviewed before publication, and the undersigned certifies that this rule does not have a significant economic impact on a substantial number of small entities. There are no anticompetitive discriminatory aspects of the rule with regard to small entities and there are no unusual procedures that need to be complied with by small entities. This rule will allow mortgagors to retain more of their tax credit proceeds and, in many cases, relieve them of the need to take out a costly bridge loan to pay the costs for assurance of completion. Therefore, this rule, in conformance with statutory mandate, removes a costly regulatory requirement and does not impose any substantial economic impact on small entities.

Therefore, the undersigned certifies that this proposed rule will not have a significant economic impact on a substantial number of small entities, and that an initial regulatory flexibility analysis is not required.

### *Executive Order 13132, Federalism*

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial direct compliance costs on state and local governments and is not required by statute, or the rule preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the executive order. This proposed rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the executive order.

### *Unfunded Mandates Reform Act*

Title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531-1538) (UMRA) establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments, and on the private sector. This proposed rule does not impose any federal mandates on any state, local, or tribal government, or on the private sector, within the meaning of UMRA.

### **List of Subjects in 24 CFR Part 200**

Administrative practice and procedure, Government contracts, Organization and functions (Government agencies).

### **Catalog of Federal Domestic Assistance**

The Catalog of Federal Domestic Assistance (CFDA) program numbers for the programs related to this rulemaking are 14.112, 14.123, 14.126, 14.134,

14.135, 14.138, 14.139, 14.151, and 14.155.

For the foregoing reasons, HUD proposes to amend 24 CFR part 200 as follows:

#### **PART 200—INTRODUCTION TO FHA PROGRAMS**

1. The authority citation for part 200 continues to read as follows:

**Authority:** 12 U.S.C. 1702–1715z–21; 42 U.S.C. 3535(d).

2. Revise § 200.54 to read as follows:

##### **§ 200.54 Project completion funding.**

(a) Except as provided in paragraph (c) of this section, the mortgagor shall deposit with the mortgagee cash deemed by the Commissioner to be sufficient, when added to the proceeds of the insured mortgage, to assure completion of the project and to pay the initial service charge, carrying charges, and legal and organizational expenses

incident to the construction of the project. The Commissioner may accept a lesser cash deposit or an alternative to a cash deposit in accordance with terms and conditions established by the Commissioner, where the required funding is to be provided by a grant or loan from a federal, state, or local government agency or instrumentality.

(b) An agreement acceptable to the Commissioner shall require that funds provided by the mortgagor under requirements of this section must be disbursed in full for project work, material, and incidental charges and expenses before disbursement of any mortgage proceeds, except that low-income housing tax credit syndication proceeds, historic tax-credit syndication proceeds, New Markets Tax Credits proceeds, or funds provided by a grant or loan from a federal, state, or local governmental agency or instrumentality under requirements of this section need not be fully disbursed before the

disbursement of mortgage proceeds, where approved by

(c) In the case of a mortgage insured under any provision of this title executed in connection with the purchase, construction, rehabilitation, or refinancing of a multifamily tax credit project, the Commissioner may not require:

(1) The escrowing of equity provided by Low-Income Housing Tax Credits for the project pursuant to Title 26, section 42 of the Internal Revenue Code of 1986;

(2) The escrowing of equity provided by historic rehabilitation tax credits, New Markets Tax Credits, or any other form of security, such as a letter of credit.

Dated: *September 4, 2009.*

**David H. Stevens,**

*Assistant Secretary for Housing—Federal Housing Commissioner.*

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