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NH&RA's Council For Energy Friendly Affordable Housing
Residual Receipt Accounts Memo
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National Housing & Rehabilitation Association's (NH&RA) Council for Energy Friendly Affordable Housing (CEFAH) supports the provisions outlined in Section 4 of HR 4099—"USE OF RESIDUAL RECEIPTS AND RESERVE FOR REPLACEMENTS FUNDS FOR GREEN RETRO FITS OF FEDERALLY ASSISTED RENTAL HOUSING." This proposal as drafted would allow owners of HUD-assisted affordable housing to borrow residual receipt account funds to undertake green retrofit measures.

The option for owners to borrow against the residual receipt is a little understood but essential component of this provision. For many owners of eligible properties, a draw-down of residual receipt account funds would result in a taxable event, generating phantom income to the partnership. This would dissuade many eligible properties from participating in the program and undertaking energy retrofits.

<u>Why Does A Grant/Draw-Down Constitute A Taxable Event?</u>
In order to understand the potential tax implications of this issue it is important to understand the different financing mechanisms that were utilized by owners of eligible projects. For a variety of reasons, there were two primary accounting structures used by new regulation Section 8 owners.

<u>Example 1.</u>
In this example Section 8 owners did not pay taxes on the rental income deposited into the residual receipt accounts. Since technically the funds paid into residual receipt accounts on new regulation Section 8 properties belong to HUD (rather than the owner) it was common practice for accountants to treat these deposits as a liability to HUD and therefore, an expense to the partnership. This liability essentially cancels out the corresponding rental income, resulting in a tax neutral status.

In this example, residual receipt account funds that are released to the property owner (typically a partnership or LLC) for energy retrofits are no longer a liability to HUD and there for would be treated as taxable income. Since the income is reportable as taxable income but does not generate cash flow for the partnership this would be phantom income. This negative tax consequence is a major deterrent for project's limited partners, likely resulting in the rejection of the funds.

Solution: One potential solution is to allow for the option to structure the release as a loan to the partnership for the purposes of energy retrofits or other eligible activities. This solution will ultimately result in a stronger performing and more financially secure property. Since HUD is subsidizing the utilities on many of the properties it will also result in decreased financial burden to HUD. It should be noted that if an owner opts to structure the release as a loan it will be a ‘real’ loan with a reasonable repayment requirement, increasing the likelihood that that the residual receipt accounts will be replenished over time.

Example 2.

For a variety of reasons some new regulation Section 8 owners opted to pay taxes on the income deposited into residual receipt accounts from the outset. In these cases a drawdown from the residual receipt accounts would not be a taxable event. It would not be necessary for these partnerships to borrow residual receipt account funds to avoid phantom income, although there may be other reasons why an owner and the property would benefit from the loan structure.

Example 3.

Pre-new regulation subsidized projects operated under a different set of rules governing the ownership and use of residual receipt accounts. Unlike new regulation Section 8 projects, the excess income paid into residual receipt accounts for Section 221(d)(3) BMIR and Section 236 belongs to the property—not to HUD. As a result, taxes were paid on the rental income deposited into residual receipt accounts from the outset. In these cases a drawdown from the residual receipt accounts would not be a taxable event. It would not be necessary for these partnership to borrow residual receipt account funds to avoid phantom income.

Additional Note:

In considering the clarification of residual receipt account uses, CEFAH encourages HUD and Congress to reconsider other project rehabilitation needs beyond energy efficiency/retrofits that could improve the properties financial viability, performance, security and maintenance. Many HUD-Assisted properties have a backlog of deferred maintenance or have functionally obsolescent features that need updating that CEFAH believes would be an appropriate use of residual receipt account funds but do not necessarily fit into the category of a green retrofit.

About NH&RA:

NH&RA is a national trade association comprised of professionals involved in the development and management of affordable housing. Our members have developed, own and/or manage the majority of HUD-Assisted and low-income housing tax credit units around the country.

Our Council for Energy Friendly Affordable Housing (CEFAH) is a working group that is focused on improving the energy and utility performance of the nation’s multifamily affordable housing portfolio. If you have any questions about NH&RA or CEFAH please feel free to contact Thom Amdur at 202-939-1753 or tamdur@housingonline.com or visit our website www.housingonline.com.