

insights

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Reinstatement of a LIHTC LURA following foreclosure

Note: This post is the final part of a [continuing series on the Credit Report Blog](#) on the subject of workouts and bankruptcies involving low-income housing tax credit (LIHTC) projects.

In [our last post](#) we discussed the lender's remedy of foreclosure. A foreclosure typically extinguishes the LIHTC Land Use Restriction Agreement (LURA) that contains the rent and occupancy restrictions on a LIHTC property, thereby disqualifying the property from receiving any remaining tax credits. However, in many cases this is not the lender's desired outcome. Rather, the lender would like to preserve the property as a LIHTC property and take advantage of the value of any remaining tax credits. The lender usually accomplishes this result by either reinstating the existing LURA following the foreclosure sale or encumbering the property with a new LURA.

How is a LURA reinstated?

The process for reinstating a LURA following foreclosure varies from state to state and property to property. In some cases, the appropriate state housing agency will want to record a document that reinstates the same LURA that was terminated by the foreclosure. In other cases, the state agency will prefer to negotiate and record an entirely new LURA. The lender and its counsel should work with representatives of the designated housing finance agency on a mutually acceptable process. We recommend that the lender or its counsel contact the appropriate state agency and discuss a reinstatement of the LURA prior to beginning the foreclosure process. State housing agencies are generally extremely cooperative in working with a foreclosing lender to preserve the property as an LIHTC property.

How long does a lender have to reinstate a LURA following foreclosure?

[Section 42](#) of the Internal Revenue Code is not entirely clear on the issue of how long a lender has to reinstate a LURA. One part of Section 42 suggests that the LURA must be reinstated prior to the end of the calendar year in which the foreclosure sale takes place. *See* 26 U.S.C. § 42(h)(6)(A) ("No credit shall be allowed by reason of this section with respect to any building for the taxable year unless an extended low-income housing commitment is in effect as of the end of such taxable year."). However, a different part of Section 42 suggests that the lender has one year to reinstate the LURA, even though the LURA may not be in effect as of the end of a calendar year. *See* 26 U.S.C. § 42(h)(6)(H) ("If during a taxable year, there is a determination that an extended low-income housing agreement was not in effect as of the beginning of such year, such a determination shall not apply to any period before such year and subparagraph (A) shall be applied without regard to such determination if the failure is corrected within 1 year from the date of the determination.").

Each state housing agency with which we have discussed this issue has agreed with our conclusion that the better reading of Section 42 is that the lender has one year to reinstate the LURA. Nevertheless, since it is the IRS that will ultimately decide whether the credits are allowable, the more conservative approach is to reinstate the LURA prior to the conclusion of the taxable year in which the foreclosure takes place (unless there is a good reason to delay doing so).

What is the impact of a reinstatement of the LURA?

A lender's decision to reinstate (or preserve) the LURA should not be taken lightly. Once a LURA is reinstated following foreclosure, the reinstatement is permanent and the lender cannot decide at some later point to terminate it.

A reinstatement of the LURA will preserve the right of future owners of the property to claim tax credits for periods following the foreclosure, provided that the property is operated in compliance with the LURA. Under Section 42 of the Internal Revenue Code, tax credits allowable during a year in which the foreclosure takes place are to be



allocated between the prior and new owners of the property based on the number of days during the year in which the property (or interest) was held by each. *See* 26 U.S.C. § 42(f)(4).

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