

MEMORANDIUM

October 3, 2008

Subject: The Housing and Economic Recovery Act of 2008 (The Act)

Congratulation to MHI and all industry members who worked for the passage of the Housing and Economic Recovery Act (H.R. 3221) of 2008 which President Bush signed into law on July 2008.

Among other important provisions, the Act provides for a \$7,500.00 tax credit for qualified first-time homebuyers that can be used to stimulate sales.

Special thanks to Ross Kinsler of the Wisconsin Housing Alliance for his work on the following synopsis of the Act and the Question and Answer section on the new tax credit.

The Act...A Synopsis

Federal Housing Finance Agency: A new Federal Housing Finance Agency is created by the bill which consolidates the regulation of the GSEs (Fannie Mae and Freddie Mac specifically) and the Federal Home Loan Banks. These agencies are now referred to as "entities." The Director of this agency will have to power to regulate the entities and has a requirement to report to Congress on their activities.

FHA Loan Reform: Title I and Title II Loan limits are raised and the insurance aspect of Title I (personal property program) is reformed to mirror Title II (real property).

Title II Loan Limits are raised to the greater of \$271,050 or 115% of local area median home price, the limit cap is raised to \$625,500.

Title I loan limits are raised as follows and the amounts are indexed for future inflation. (Quoting from 12 USC 1703).

- \$25,000 if made for the purpose of financing alterations, repairs and improvements upon or in connection with existing single-family structures; and
- The new limit is \$25,090 (was formerly \$17,500) if made for the purpose of financing alterations, repairs and improvements upon or in connection with existing manufactured homes;

- \$60,000 or an average amount of \$12,000 per family unit if made for the purpose of financing the alteration, repair, improvement, or conversion of an existing structure used or to be used as an apartment house or a dwelling for two or more families;

- The new limit is \$69,678 (was formerly \$48,600) if made for the purpose of financing the purchase of a manufactured home;

- The new limit is \$92,504 (was formerly \$61,800) if made for the purpose of financing the purchase of a manufactured home and a suitably developed lot on which to place the home; and

- The new limit is \$23,226 (was formerly \$16,200) if made for the purpose of financing the purchase, by an owner of a manufactured home which is the principal residence of that owner, of a suitably developed lot on which to place that manufactured home, and if the owner certifies that he or she will place the manufactured home on the lot acquired with such loan within 6 months after the date of such loan.

The down payment requirement on FHA loans will go up to 3.5% (from 3%). The effective date for reforms is immediate upon enactment, but the loan limits will not go into effect until the expiration of the Economic Stimulus limits (December 31, 2008). The law also creates a streamlined processing for FHA condos loans.

Leasehold Requirements: Loans for home involving leased property would be subject to a variety of lease requirements. The lease must: (A) expires not less than 3 years after the origination date of the obligation; (B) is renewable upon the expiration of the original 3 year term by successive 1 year terms; and (C) requires the lessor to provide the lessee written notice of termination of the lease not less than 180 days prior to the expiration of the current lease term in the event the lessee is required to move due to the closing of the manufactured home community, and further provides that failure to provide such notice to the mortgagor in a timely manner will cause the lease term, at its expiration, to automatically renew for an additional 1 year term.

Tax Status of Property for Title II Loans: A provision of the bill removes the requirement that a home subject to a long-term lease must be taxed as real property to qualify for FHA Title II financing. This will make it much easier for community owners in states that have a process for converting homes with long-term leases to real property to secure Title II financing for their residents.

Prior Approval Authority for Mortgage Products: The three entities must obtain prior approval from the Director before launching new mortgage products.

1. **Annual Housing Report.** The Director must report to Congress annually on how well the entities are meeting their goals. The Director also is given enforcement powers to make certain the entities are progressing.

2. **Housing Trust Fund.** A national fund is created to be distributed to the states to assist with affordable housing. Trust Fund is funded by a percentage of profits from the GSEs. In its first years, the Trust Fund would cover costs of any

defaulted loans in FHA foreclosure program. In out years, the Trust Fund would be used for the development of affordable housing.

3. Additional Standard Deduction for Real Property Taxes for Non-itemizers of \$500 (\$1,000 for a joint return).

Cash Down Payments and Prohibition on Seller Provided Down Payments:

A 3.5 percent cash down payment requirement is created which is an increase from 3.0%. Sellers are prohibited from funding down payment programs. These generally operate by a seller making a "contribution" to a non-profit which in turn provides money to the seller's buyer minus an "administrative fee."

Duty to Serve: An affirmative duty is created for the GSE's to serve the manufactured housing industry. This includes the creation of mortgage products for personal property lending.

First Time Homebuyer Tax Credit: A home buyer tax credit of 10% of the home purchase price up to \$7500 is provided for first time homebuyers.

Questions and Answers about the New Tax Credit

No doubt you've heard about the new First Time Home Buyer's Tax Credit which was just signed into law by President Bush. Below in question and answer format the credit is explained. The credit is a refundable credit of up to \$7500 which becomes the equivalent of a no interest loan from the federal government. Pay particular attention to the repayment provisions related to the credit covered in questions 12 to 14 below.

1. Who is eligible to claim the \$7,500 tax credit?

First time home buyers purchasing any kind of home—new or resale—are eligible for the tax credit.

2. What is the definition of a first-time home buyer?

The law defines "first-time home buyer" as a buyer who has not owned a principal residence during the three-year period prior to the purchase. For married taxpayers, the law tests homeownership history of both the home buyer and his/her spouse. For example, if you have not owned a home in the past three years but your spouse has owned a principal residence, neither you nor your spouse qualifies for the first-time home buyer tax credit.

3. What types of homes will qualify for the tax credit?

Any home purchased by an eligible first-time home buyer will qualify for the credit, provided that the home will be used as a principal residence and the buyer has not owned a home in the previous three years. The home can be a manufactured home or a modular home and be real or personal property as long as it is the principal residence and not a second home or investment property.

4. Are there income limits to determine who is eligible to take the tax credit?

Yes. Home buyers who file their taxes as single or head-of-household taxpayers can claim the credit if their modified adjusted gross income (MAGI) is less than \$75,000. For married taxpayers filing a joint tax return, the MAGI limit is \$150,000. The limit is based on the buyer's modified adjusted gross income for the year that the house is purchased, except for certain purchases in 2009.

5. What is "modified adjusted gross income"?

Modified adjusted gross income or MAGI is defined by the IRS. To find it, a taxpayer must first determine "adjusted gross income" or AGI. AGI is total income for a year minus certain deductions (known as "adjustments" or "above-the-line deductions"), but before itemized deductions from Schedule A or personal exemptions are subtracted. On Forms 1040 and 1040A, AGI is the last number on page 1 and first number on page 2 of the form. For Form 1040-EZ, AGI appears on line 4 (as of 2007). Note that AGI includes all forms of income including wages, salaries, interest income, dividends and capital gains.

To determine modified adjusted gross income (MAGI), add to AGI certain amounts such as foreign income, foreign-housing deductions, student-loan deductions, IRA-contribution deductions and deductions for higher-education costs.

6. If my modified adjusted gross income (MAGI) is above the limit, do I qualify for any tax credit?

Possibly. It depends on your income. Partial credits of less than \$7,500 are available for some taxpayers whose MAGI exceeds the phase-out limits. The credit becomes totally unavailable for individual taxpayers with a modified adjusted gross income of more than \$95,000 and for married taxpayers filing joint returns with an AGI of more than \$170,000.

7. Can you give me an example of how the partial tax credit is determined?

Just as an example, assume that a married couple has a modified adjusted gross income of \$160,000. The applicable phase-out to qualify for the tax credit is \$150,000, and the couple is \$10,000 over this amount. Dividing \$10,000 by \$20,000 yields 0.5. When you subtract 0.5 from 1.0, the result is 0.5. To determine the amount of the partial first-time home buyer tax credit that is available to this couple, multiply \$7,500 by 0.5. The result is \$3,750. Here's another example: assume that an individual home buyer has a modified adjusted gross income of \$88,000. The buyer's income exceeds \$75,000 by \$13,000. Dividing \$13,000 by \$20,000 yields 0.65. When you subtract 0.65 from 1.0, the result is 0.35. Multiplying \$7,500 by 0.35 shows that the buyer is eligible for a partial tax credit of \$2,625. Please remember that these examples are intended to provide a general idea of how the tax credit might be applied in different circumstances. You should always consult your tax advisor for information relating to your specific circumstances.

8. Does the credit amount differ based on tax filing status?

No. The credit is in general equal to \$7,500 for a qualified home purchase, whether the home buyer files taxes as a single or married taxpayer. However, if a household files their taxes as "married filing separately" (in effect, filing two returns), then the credit of \$7,500 is claimed as a \$3,750 credit on each of the two returns.

9. Are there any circumstances for which buyers whose incomes are at or below the \$75,000 limit for singles or the \$150,000 limit for married taxpayers might not be able to claim the full \$7,500 tax credit?

In general, the tax credit is equal to 10% of the qualified home purchase price, but the credit amount is capped or limited at \$7,500. For most first-time home buyers, this means the credit will equal \$7,500. For home buyers purchasing a home priced less than \$75,000, the credit will equal 10% of the purchase price.

10. I heard that the tax credit is refundable. What does that mean?

The fact that the credit is refundable means that the home buyer credit can be claimed even if the taxpayer has little or no federal income tax liability to offset. Typically this involves the government sending the taxpayer a check for a portion or even the entire amount of the refundable tax credit. For example, if a qualified home buyer expected, notwithstanding the tax credit, federal income tax liability of \$5,000 and had tax withholding of \$4,000 for the year, then without the tax credit the taxpayer would owe the IRS \$1,000 on April 15th. Suppose now that taxpayer qualified for the \$7,500 home buyer tax credit. As a result, the taxpayer would receive a check for \$6,500 (\$7,500 minus the \$1,000 owed).

11. What is the difference between a tax credit and a tax deduction?

A tax credit is a dollar-for-dollar reduction in what the taxpayer owes. That means that a taxpayer who owes \$7,500 in income taxes and who receives a \$7,500 tax credit would owe nothing to the IRS. A tax deduction is subtracted from the amount of income that is taxed. Using the same example, assume the taxpayer is in the 15 percent tax bracket and owes \$7,500 in income taxes. If the taxpayer receives a \$7,500 deduction, the taxpayer's tax liability would be reduced by \$1,125 (15 percent of \$7,500), or lowered from \$7,500 to \$6,375.

12. Does the credit have to be paid back to the government?

If so, what are the payback provisions? Yes, a portion of the tax credit must be repaid each year for 15 years at a rate of 6.67% of the credit each year. If the home is sold before 15 years, then the remainder of the credit is recaptured upon its sale if there is sufficient capital gain from the sale. For example, a home buyer claiming a \$7,500 credit would repay the credit at \$500 per year. The home owner does not have to begin making repayments on the credit until two years after the credit is claimed. So if the tax credit is claimed on the 2008 tax return, a \$500 payment is not due until the 2010 tax return is filed. If the home owner sold the home, then the remaining credit amount would be due from the profit on the

home sale. If there was insufficient profit, then the remaining credit payback would be forgiven.

13. Why must the money be repaid?

Congress's intent was to provide as large a financial resource as possible for home buyers in the year that they purchase a home. In addition to helping first-time home buyers, this will maximize the stimulus for the housing market and the economy, will help stabilize home prices, and will increase home sales. The repayment requirement reduces the effect on the Federal Treasury and assumes that home buyers will benefit from stabilized and, eventually, increasing future housing prices.

14. Because the money must be repaid, isn't the first-time home buyer program really a zero-interest loan rather than a traditional tax credit?

Yes. Because the tax credit must be repaid, it operates like a zero-interest loan. Assuming an interest rate of 7%, that means the home owner saves up to \$4,200 in interest payments over the 15-year repayment period. Compared to \$7,500 financed through a 30-year mortgage with a 7% interest rate, the home buyer tax credit saves home buyers over \$8,100 in interest payments. The program is called a tax credit because it operates through the tax code and is administered by the IRS. Also like a tax credit, it provides a reduction in tax liability in the year it is claimed.

15. If I'm qualified for the tax credit and buy a home in 2009, can I apply the tax credit against my 2008 tax return?

Yes. The law allows taxpayers to choose ("elect") to treat qualified home purchases in 2009 as if the purchase occurred on December 31, 2008. This means that the 2008 income limit (MAGI) applies and the election accelerates when the credit can be claimed (tax filing for 2008 returns instead of for 2009 returns). A benefit of this election is that a home buyer in 2009 will know their 2008 MAGI with certainty, thereby helping the buyer know whether the income limit will reduce their credit amount.

16. For a home purchase in 2009, can I choose whether to treat the purchase as occurring in 2008 or 2009, depending on in which year my credit amount is the largest?

Yes. If the applicable income phase-out would reduce your home buyer tax credit amount in 2009 and a larger credit would be available using the 2008 MAGI amounts, then you can choose the year that yields the largest credit amount. *The above is provided as general information and should not be used as a substitute for consultation with a qualified tax consultant.*

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