June 15, 2018

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2018-43)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

RE: Recommendations for 2018-2019 Priority Guidance Plan

To Whom It May Concern:

The National Council of State Housing Agencies (NCSHA) appreciates the opportunity to provide the Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) our recommendations for items that should be included in the 2018-2019 Priority Guidance Plan, as requested in Notice 2018-43.

NCSHA represents the nation's state Housing Finance Agencies (HFA), as well as the HFAs of the District of Columbia, New York City, Puerto Rico, and the U.S. Virgin Islands. HFAs administer the Low Income Housing Tax Credit (Housing Credit) and tax-exempt Housing Bond programs, including the Mortgage Credit Certificate program. In addition, NCSHA represents Housing Credit allocating agencies in each of the states and territories in which an agency other than the HFA administers the Housing Credit. NCSHA and our members deeply value our longstanding partnership with Treasury and IRS in the administration of these essential affordable housing programs.

To support continued effective state administration of the Housing Credit and Housing Bond programs, we urge you to issue the following guidance as quickly as possible.

Housing Credit

(1) Income Averaging

In March 2018, Congress passed the Consolidated Appropriations Act of 2018, which introduced income averaging as a new Housing Credit minimum set-aside. This is the first significant change to the Housing Credit program in quite some time, and has great potential to allow the program to more effectively target extremely low-income households and those in rural areas, while maintaining financial feasibility and rigorous low-income targeting.

States and other Housing Credit industry stakeholders are eager to begin implementing this new election, which became effective as of the date of enactment of the legislation (March 23, 2018). A number of state allocating agencies already have begun establishing guidelines and procedures for income averaging, and we expect more to do so in the coming months.

While allocating agencies do not need extensive guidance related to income averaging, there are a few areas where we believe IRS could provide greater clarity; and thus, NCSHA encourages IRS establish rules for determining next available unit designation in cases when more than one tenant in units of different designated income levels go over income at the same time.

We also urge IRS to provide guidance establishing the calculation method for determining income limits at the various designations allowable under income averaging. Without such IRS guidance, HUD is unable to calculate and issue income limits for designations other than 50 percent and 60 percent of AMI.

NCSHA sent more detailed comments on state implementation of income averaging to Treasury and IRS in a letter dated June 13, 2018, in which we encourage IRS to advise us immediately if it disagrees with any of the areas of state discretion or compliance monitoring positions NCSHA describes in the letter.

We appreciate IRS's quick response in revising Form 8609 to reflect the new minimum set-aside. We also urge IRS to make revisions to Form 8823 to reflect income averaging.

(2) Compliance Monitoring Regulations

In February 2016, Treasury and IRS issued proposed and temporary regulations related to Housing Credit compliance monitoring, first identified in Notice 2012-18. Finalizing these regulations was included in the 2017-2018 Priority Guidance Plan, and NCSHA urges Treasury and IRS to retain this item in the 2018-2019 Priority Guidance Plan.

In establishing final compliance monitoring regulations, NCSHA urges IRS to reconsider a decision it made in the proposed and temporary regulations requiring agencies to base monitoring requirements on the total number of units in each building, rather than the number of units in the overall project if an owner elects to treat each building in a development as a separate property on Form 8609. Instead, NCSHA urges IRS to permit monitoring agencies to consider multiple buildings with a common owner and plan of financing as a single project for monitoring purposes, regardless of the owner's 8609 election.

This would significantly streamline monitoring requirements without sacrificing oversight, and would be especially important for developments composed of scattered site single-unit, duplex, or triplex style buildings, most common in rural areas, which currently undergo disproportionately more inspections than other Housing Credit properties due to IRS's

regulations. These regulations are burdensome for state agency monitoring staff, tenants, and owners, and could result in a disincentive to build scattered site developments.

(3) Further Clarification in Housing Credit Disaster Relief

In April 2018, NCSHA sent formal comments to IRS on Notice 2018-17 regarding possible improvements to Revenue Procedures 2014-49 and 2014-50 related to disaster relief. We encourage IRS to include guidance enacting the recommendations we made in that letter in its 2018-2019 Priority Guidance Plan. In particular, we encourage IRS to:

- provide additional guidance on treatment of residents returning to an affected property following a natural disaster;
- clarify compliance requirements for units not affected by natural disaster; and
- provide guidance on the issue of destroyed records following a natural disaster.

For more information on our natural disaster recommendations, see NCSHA's comment letter dated April 12, 2018.

(4) Guidance concerning over-income tenants in acquisition/rehabilitation properties and properties undergoing Credit resyndication

NCSHA urges IRS to provide guidance on the treatment of existing tenants in assisted affordable housing properties (originally financed with resources other than the Housing Credit, such as HUD, USDA, or other federal or state housing program) that are acquired and rehabilitated with Housing Credits for preservation purposes and existing Housing Credit properties undergoing a resyndication of Housing Credits. As the affordable housing portfolio ages, state agencies are receiving many more Housing Credit applications for developments involving acquisition and rehabilitation of an existing affordable property for preservation purposes. Some of these existing properties received a previous allocation of Credits and are now proposing a substantial rehabilitation and resyndication of Credits.

One significant issue that arises in such deals is the continued qualification of existing tenants who were income-qualified at the time of their initial occupancy but may now exceed the income limit. Under current law, over-income tenants in a Housing Credit development may continue to occupy a low-income unit as long as the next available unit is rented to a tenant who is currently income-qualified. NCSHA recommends that IRS clarify how over-income tenants should be treated for income qualification purposes in the case of an acquisition and rehabilitation of an existing affordable development and/or a Housing Credit resyndication.

(5) Reconsider guidance concerning the loss of Housing Credits upon a casualty loss that is not part of a presidentially declared disaster area

NCSHA recommends that IRS allow for greater flexibility regarding the recapture of Credits resulting from a casualty loss to the extent that the loss is restored within a reasonable period of time, even if that casualty is not associated with a presidentially declared disaster. Current IRS policy provides relief from recapture and credit loss to owners of buildings that suffered a reduction in qualified basis due to a casualty if that casualty resulted from a disaster that is part of a presidentially declared disaster area. However, if a property suffers a casualty loss unrelated to a presidentially declared disaster, the property must be restored and back in service by the end of the calendar year to avoid Credit recapture, regardless of when the casualty loss event occurred.

For example, if a property suffers a fire in December that causes the units to be unavailable for occupancy as of the end of the calendar year, the owner will lose the year's Credit allotment, even though the property was in service for the majority of the year. Conversely, if a property suffers a fire in January and the units are unavailable for most of the year, but back in service by December 31, the owner would not suffer a loss of Credits under current IRS policy. NCSHA recommends that IRS consider amending its policy to provide owners of buildings that suffer a casualty towards the end of the calendar year with more time to restore their property and ensure that it is rented to qualified tenants without suffering a penalty.

Housing Bonds

(1) Regulations Concerning Record Retention Requirements Under §103 for Tax-Exempt Bonds

In July 2006, IRS published Notice 2006-63 requesting comments for record retention standards for tax-exempt bond issues. The Notice stated that IRS was particularly interested in fashioning standards that would allow issuers and others involved in tax-exempt bond transactions to effectively manage their compliance burdens. IRS has taken no further action on this notice.

NCSHA urges IRS to issue final guidance on record retention requirements for tax-exempt bonds, especially concerning the length of time issuers of tax-exempt bonds must maintain loan files. The current rules, requiring issuers to maintain loan records for the life of a bond issue, as well as any refundings of that bond issue plus an additional 6 years, regardless of when the loan is paid off, generate excessive compliance costs, particularly with regard to older loans on which data is not stored electronically. We recommend that IRS require housing bond issuers to maintain files on mortgage loans until three years after the loan has been paid off.

(2) Public Hearing Requirements Under §147(f) for Issuance of Tax-Exempt Bonds

On September 28, 2017, IRS issued a proposed rule (REG-128841-07) simplifying the public approval requirements that apply to private activity bonds (PABs) issued by state and local

government entities. The proposed regulations include a number of provisions allowing HFAs and other PAB issuers to cut unnecessary costs while still allowing for adequate public notice of new bond issues, such as permitting the use of electronic notifications if a state's open meeting laws so allow. IRS first proposed such revisions in a 2008 proposed rule that was never finalized. IRS chose to propose a new rule in 2017, instead of finalizing the 2008 rule, because of technical concerns in the 2008 proposal, as written, would effectively create two overlapping and inconsistent sets of regulations.

The proposed rule also includes special rules for Mortgage Revenue Bond (MRB) issuances that would allow for less specific information to be included for public approval. Specifically, no information would be required on specific names of mortgage loan borrowers or specific locations of individual residences. Instead, issuers would only be required to provide the maximum stated principal amount of qualified mortgage bonds to be issued and a general description of the geographic jurisdiction in which the financed residences will be located.

NCSHA strongly recommends that IRS finalize the 2017 proposed rule. This will allow HFAs and other issuers to save time and money and to bring the federal rules in line with current technology and state laws.

Further, we urge IRS to include in the final rule a provision reducing the time required between the reasonable public notice and public hearing for PAB issuances from 14 days to seven business days, as it initially proposed in 2008. Adopting a shorter public notice period would allow issuers to more optimally structure their issuances to reflect developments in the bond markets, helping them to secure a better price and more efficiently utilize taxpayer resources, while still allowing for robust public input. We do not believe that a truncated notice period will reduce either transparency or public input, as the proliferation of electronic and online communication allows constituents to access public notices and information about proposed issuances instantaneously, instead of having to wait to learn about them in the print or broadcast media.

For more information, please see NCSHA's comments on proposed REG-128841-07, dated December 20, 2017.

(3) Effective Time Period for Updated Income Limits for Qualified Mortgage Bonds

IRS annually releases Revenue Procedures allowing HFAs and other MRB and Mortgage Credit Certificate (MCC) issuers to utilize the U.S. Department of Housing and Urban Development's (HUD) program income limits for the most recent fiscal year (FY). Typically, these updates also prohibit HFAs from relying on those income limits established for the fiscal year two years prior. In recent years, the IRS has not included in this guidance a transition period providing HFAs with time to adjust to the new limits. In fact, the last such Revenue Procedure, released May 11 this year, appears to technically negate the use of FY 2016 income limits retroactively back to April 1.

Requiring HFAs to adopt the new limits immediately is simply untenable and could cause HFAs to have to cancel previous commitments they made to purchase loans. It could also cause borrowers who were depending on using an MCC to help them manage the costs of purchasing a home to have it rescinded just before closing. Such uncertainty would discourage lenders from working with HFAs, hurting HFAs' ability to fulfill their affordable homeownership missions.

Given this, we recommend that IRS guidance clarify that HFAs and other MRB issuers have a grace period to adjust their programs to the new income limits, and that any MRB loans or MCCs financed using the newly expired limits during that period will remain in compliance with federal tax law. IRS also may want to consider longer transition periods for loans or MCCs in high-cost housing areas, as these limits often take a substantially long-time to calculate.

(4) More Flexible use of Carryforward Private Activity Bond Authority for Affordable Housing Purposes

Section 146(f) of the federal tax code allows states to carry forward any unused private activity bond (PAB) volume cap for three additional years. Such carryforward cap may only be used for a limited amount of eligible activities, including Multifamily Housing Bonds, MRBs, and MCCs. HFAs often receive the majority of their state's carryforward cap.

When receiving the carryforward authority, HFAs must designate on IRS Form 8328 specifically how they intend to allocate the carryforward cap over the next three years. The Form includes separate selections for Multifamily Housing Bonds, listed on the Form as "Qualified residential rental projects," and MRB/MCC programs, listed on the Form as "Qualified mortgage bonds or mortgage credit certificates." Consequently, an HFA is required to project both its needs and those of its state's housing market three years into the future and determine how to allocate the new bond cap accordingly.

If an HFA projects incorrectly, or the market changes substantially, they cannot change the allocation. This causes PAB cap to expire when it could be put to use addressing our nation's critical affordable housing shortage.

NCSHA recommends IRS amend Form 8328, and make whatever regulator changes it believes necessary, to allow HFAs and other PAB issuers to allocate any new carryforward cap to a general housing category that can be drawn from to issue Multifamily Housing Bonds, MRBs, and MCCs. This will allow HFAs to most effectively utilize their carryforward to meet their state's specific affordable housing needs.

(5) Mortgage Fees and Effective Interest Rates for MRB Loans

Federal regulations (IRS Reg. § 6a.103A-2(i)(2)(ii)(A)) limit the effective interest rate on MRB-financed mortgages to no more than 1.125 percent over the yield rate being paid to the bond's

investors. When calculating a loan's effective interest rate, originators must take into account all points and fees charged to the borrower, including origination fees.

The purpose of this provision is to ensure that MRBs are used to fulfill their public-purpose of subsidizing affordable low-interest mortgages for low and moderate-income borrowers. However, when factoring in the routine fees associated with the home purchase process, the effective interest rate makes it difficult for lenders to generate revenue on MRB-financed loans. This diminishes lenders' interest in originating MRB loans and participating in HFA programs.

NCSHA recommends IRS amend Reg. §6a.103A-2(i)(2)(ii)(A) so that origination fees, points, and similar amounts charged to the borrower are counted toward the effective interest rate of an MRB loan only to the extent they exceed the limits the Federal Housing Administration (FHA) has placed on such fees for loans insured by its Title II homeownership loan programs. This will allow originators to earn reasonable revenue on HFA program loans while still protecting borrowers from excessive fees.

(6) Covered Investments under the Special Yield Reduction Rule

NCSHA suggests that IRS advance a proposed rule that would amend Yield and Valuation of Purpose Investments in §1.148-5(c)(3)(i)(A) to add "(e)(5)" to the list of permitted investments that may use "yield reduction payments" at the end of their temporary period instead of absolute yield restriction. This will allow any replacement proceeds pledged under the indenture, that do not qualify as a bona fide debt service fund, to be invested at the highest possible yield, with any excess over the bond yield to be paid to IRS. Given that these replacement proceeds are not revenue from the bond sale, we see no reason to subject them to the absolute yield requirement, particularly when any excess yield can simply be paid to Treasury.

Thank you for this opportunity to provide input on the Department of Treasury/Internal Revenue Service 2018-2019 Priority Guidance Plan. If you have any questions, please do not hesitate to contact me.

Sincerely,

Garth Rieman
Director of Housing Advocacy and Strategic Initiatives