December 2, 2021

Ms. Nicole Cimino
Branch Chief
Office of Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Mr. Michael Novey
Associate Tax Legislative Counsel
Office of Tax Policy
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Ms. Cimino and Mr. Novey:

The undersigned organizations, representing all sectors of the Low Income Housing Tax Credit (Housing Credit) industry, strongly urge The Internal Revenue Service (IRS) and U.S. Department of the Treasury (Treasury) to issue a final rule on the Housing Credit Average Income Test (AIT) minimum set-aside with the consensus modifications noted below, or announce its intention to publish a new proposed rule for public comment.

As you know, IRS' October 2020 proposed rule has substantially chilled interest in the AIT set-aside since it was published last year, and we do not expect many developers or investors to elect the set-aside until IRS and Treasury act.

More than 80 Housing Credit stakeholder organizations expressed concerns about the proposed rule via formal written comments in December, 2020 and oral testimony at the IRS public hearing on the regulations in March, 2021. These stakeholder organizations represent all facets of the Housing Credit industry, including state Housing Credit allocating agencies, multifamily developers, nonprofit organizations, syndicators, investors, state equity funds, legal and accounting professionals, property managers, compliance experts, and others.

While some details of the comments varied, the organizations collectively agreed that the approach initially envisioned in the proposed rule creates a level of risk not intended by Congress that investors and developers will be reluctant to assume.

The groups also agreed that the proposed rule's prohibition against modification of unit designations would make practical implementation of AIT next to impossible, especially for properties financed with multiple subsidies and/or those with rental assistance contracts.

Finally, the organizations agreed that the proposed rule sets up potential conflicts with federal laws such as the Fair Housing Act, the Violence Against Women Act, and Section 504 of the Rehabilitation Act of 1973.

Accordingly, the undersigned organizations urge IRS and Treasury to prioritize issuing a final rule implementing the AIT that makes the following changes:

<u>Meeting the AIT minimum set-aside</u>: Below are two slightly different approaches to meeting the average income minimum set-aside test. Either approach would work in practical application.

- Approach 1: Consider the AIT minimum set-aside satisfied as long as 40 percent of the units in the property have a designation that averages 60 percent or less of area median income (AMI). In addition, the project should meet an overall average test of no more than 60 percent of AMI across all low-income units. If a unit is out of compliance causing the project-wide average to go above 60 percent of AMI, this should be considered noncompliance for that unit, but not a violation of the minimum set-aside, as long as 40 percent of the units' designations still meet the 60 percent average. In order for a unit to maintain its designation, the owner must make reasonable attempts to lease the unit at its designation (consistent with IRS Revenue Ruling 2004-82). An out of compliance unit should maintain its designation if the owner can demonstrate due diligence when completing the initial income certification. We believe this solution is consistent with a literal reading of the tax code and congressional intent, while also providing sufficient penalty for noncompliance without creating excessive and unnecessary risk that will negate investor interest. In addition, the requirement for an owner to demonstrate due diligence for a unit to maintain its designation reduces the risk of bad actors.

- Approach 2: Consider the AIT minimum set-aside satisfied as long as 40 percent of the units in the property are in compliance and have designations averaging 60 percent or less of AMI. In addition, the project should meet an overall average test of no more than 60 percent of AMI across all low-income units. If a unit is out of compliance causing the project-wide average to go above 60 percent of AMI, this should be considered noncompliance for that unit, but not a violation of the minimum set-aside, as long as 40 percent of the units are in compliance and still meet the 60 percent average. As with approach 1 above, we believe this solution is consistent with a literal reading of the tax code and congressional intent, while also providing sufficient penalty for noncompliance without creating excessive and unnecessary risk that will negate investor interest.

  Examples illustrating both approaches:

A project with 10-units designated in the following manner (project-wide average of 60 percent):

Unit	Designation
101	20%
102	50%
103	50%
104	60%
105	60%
106	60%
107	70%
108	70%
109	80%
110	80%

In this example, unit 101 is found to have an event of noncompliance under category 11a (Household Income Above Income Limit Upon Initial Occupancy), but the owner can demonstrate due diligence when making that determination.

Approach 1: Unit 101's noncompliance would result in a reduction of the building's qualified basis, but would remain designated as a 20 percent unit for purposes of the project average under IRC §42(g)(C)(ii)(II). Unless the noncompliance is egregious in nature—with conspicuous, flagrant, and systemic noncompliance including the failure to make reasonable attempts to comply with the requirements of the program—or with careless, reckless, or intentional disregard of program requirements, a unit maintains its designation. When an event of noncompliance is determined to be egregious in nature, the unit's designation is no longer included in the project's average. If the project's average exceeds 60 percent as a result of a unit losing its designation as a result of egregious noncompliance, the project will have failed the minimum set-aside.

Approach 2: While Unit 101 is not in compliance, the AIT minimum set-aside is not violated because units 102, 103, 104, and 105 constitute 40 percent of the units in the property and together have an average below 60 percent. As with approach 1, Unit 101's noncompliance would result in a reduction of the building's qualified basis, but not a violation of the minimum set-aside.

Modifications to Unit Designations: We urge you to allow owners to modify unit designations, pursuant to state agency policies. States should be able to allow unit designation modifications to enable floating units, in which the overall property average does not change, and other modifications—even if it changes the average in the property—as long as the average remains below 60 percent of AMI. Unit designation changes should always be allowed if necessary to adhere to the Fair Housing Act, VAWA, Section 504 of the Rehabilitation Act of 1973, or any other relevant federal or state statute.

Casualty Loss: We urge you to provide an exception and/or additional flexibility when AIT noncompliance results from a casualty loss. The final rule should specify that unit designations should continue to count towards satisfying the project average if caused by casualty loss.

Mitigating Actions: We urge you to modify and expand the mitigating actions described in the proposed rule and the preamble thereto, including by adopting the alternative mitigating action described in the preamble and providing a period of up to one year from the date the noncompliance was discovered for correcting a violation of the minimum set-aside. The final rule should clarify that unit designation changes are considered a mitigating action to correct noncompliance. These changes to allowable mitigating actions will be essential, especially if IRS and Treasury do not change the approach to meeting the AIT minimum set-aside envisioned in the proposed rule.

Existing AIT Developments: If IRS/Treasury do not make the above changes to the rule, we urge you to extend further relief to existing developments that elected the AIT set-aside prior to publication of the proposed rule by providing an opportunity and a reasonable period to choose a different minimum set-aside, and to grandfather existing residents—who have been allowed occupancy in good faith in accordance with the statute and state agency policies—without a reduction in qualified basis.

As always, we greatly appreciate your consideration of our comments as you work to finalize this important program guidance. Please let us know if we can answer any questions or provide additional information to expedite publication of the final AIT rule.

Sincerely,

Affordable Housing Investors Council
Affordable Housing Tax Credit Coalition
Applegate & Thorne-Thomsen, P.C.
CohnReznick LLP
Costello Companies
CREA
Enterprise
Holland & Knight LLP
Housing Advisory Group
Housing Partnership Network
LISC
Mercy Housing Lakefront

MG Housing Strategies
Michaels Organization
National Affordable Housing Management Association
National Affordable Housing Trust
National Association of Affordable Housing Lenders
National Association of Home Builders
National Association of State and Local Equity Funds
National Council of State Housing Agencies
National Equity Fund
National Housing & Rehabilitation Association
National Multifamily Housing Council
Novogradac
Preservation of Affordable Housing, Inc.
R4 Capital LLC
RBC Community Investments, LLC
Red Stone Equity Partners LLC
RubinBrown
Stewards of Affordable Housing for the Future
The NPR Group
Vitus Group

cc: Lily Batchelder
Tia Boatman Patterson