National Council *of*
State Housing Agencies

July 1, 2019

CC:PA:LPD:PR (REG-120186-18)
Room 5203, Internal Revenue Service
Post Office Box 7604, Ben Franklin Station
Washington, DC 20044.

Re: 26 CFR Part I, REG–120186–18, Investing in Qualified Opportunity Funds

Dear Sir or Madam,

On behalf of the nation's state Housing Finance Agencies (HFAs), the National Council of State Housing Agencies (NCSHA)[1] appreciates the opportunity to provide comments on the second round of IRS proposed regulations implementing the Opportunity Zone tax incentive.

Opportunity Zone investments have significant potential to benefit economically distressed communities and their low- and moderate-income residents by generating increased levels of affordable housing development, small business startup and expansion, and new community infrastructure.

State HFAs have decades of experience working to revitalize distressed communities, many of which are now designated Opportunity Zones. This experience includes administration of the federal Low Income Housing Tax Credit (Housing Credit) program and issuance of tax-exempt private activity bonds, two of our nation's primary tools for the preservation and development of affordable housing.

---

[1] NCSHA is a nonprofit, nonpartisan organization. None of NCSHA's activities related to federal legislation or regulation are funded by organizations that are prohibited by law from engaging in lobbying or related activities.

HFAs also administer other federal and state affordable housing programs and vital programs that finance other job-creating activities such as economic development, infrastructure, and small business development.

While the thoughtful guidance provided by IRS in these proposed regulations will help to generate significant investment in Opportunity Zones, two issues addressed in the regulations will adversely impact the ability to develop affordable housing in these areas.

To enhance the effectiveness of the Opportunity Zone incentive and prevent unintended negative consequences for low-income residents of Opportunity Zones, we strongly encourage IRS to reconsider these policies in finalizing the regulations:

Special Inclusion Rule for Partnerships

To enable the development of desperately needed affordable housing in Opportunity Zones, and thus prevent possible displacement of low-income residents, potential investors are attempting to structure transactions that leverage Opportunity Zone incentives with Housing Credits.

Unfortunately, the proposed regulations include a provision that will significantly discourage investor interest in affordable housing in Opportunity Zones. This provision is the special inclusion rule that changes the calculation of the amount of gain included in gross income for partnerships and S corporations.

This special inclusion rule is inconsistent with the general calculation of gain provided in the Opportunity Zone statute, and NCSHA strongly encourages IRS to amend or remove this special rule to prevent a detrimental impact on the ability to develop affordable housing in Opportunity Zones.

Because of passive loss rules, individual investors are significantly limited in their ability to invest in Housing Credit developments. The vast majority of current Housing Credit investors are banks and financial service companies and most of these companies do not typically generate capital gains. Housing Credit investors do not generally realize appreciation on their investments due to the statutory Housing Credit program requirement for a minimum of 30 years of restricted rents. These restricted rents limit potential appreciation, so the 10-year Opportunity Zone gain exclusion benefit is less valuable to Housing Credit investors than it is to other investors.

While the general calculation of gain rule, as provided in the Opportunity Zone statute, provides a benefit to Housing Credit investors for the typical loss in value over time for Housing Credit investments, the effect of the special inclusion rule in the proposed regulations is a dramatic reduction in the value of the Opportunity Zone incentive to Housing Credit investors.

As a result, many investors are not targeting affordable housing investments in Opportunity Zones. This result is contrary to the intent of the Opportunity Zone legislation and at odds with the critical need for affordable housing in these distressed communities. Unless IRS changes this rule, the Opportunity Zone incentive will have virtually no positive impact on the preservation and development of affordable housing in these communities. Thus low-income households living in Opportunity Zones may not be able to remain in those communities to take advantage of the revitalization brought by the new investments, as they may no longer be able to afford the housing there.

NCSHA supports the additional technical amendments to this section of the proposed regulations as proposed by the Novogradac Opportunity Zone Working Group, of which we are a member.

Definition of Original Use and Five-Year Vacancy Rule

In the first round of proposed regulations last October, IRS solicited comment on the definition of original use—including whether some period of abandonment or underutilization of tangible property or vacant real property should erase a property's history of prior use in the Opportunity Zone—and if so, what period would be consistent with the statute.

In our comment on the proposed regulation, NCSHA encouraged IRS to consider land or property vacant for a period of at least one year as meeting the original use requirement, consistent with Enterprise Zone Facility Bond rules.

In this second round of proposed regulations, IRS provided additional guidance on this issue requiring property to be unused for a period of at least five years to meet the Opportunity Zone original use requirement.

This five-year vacancy period is unreasonably long and will significantly discourage investment in recently abandoned properties in Opportunity Zones. The rule will also negatively impact other investments in Opportunity Zones that are in close proximity to these vacant parcels, which will likely remain vacant for at

least five years because of this rule.

Vacant land represents a largely untapped asset for the redevelopment of the distressed communities Opportunity Zones are intended to strengthen. Recent research suggests that nearly 17 percent of the land area in large U.S. cities is vacant[2] and many smaller communities have underutilized parcels that could be developed as community assets as well.

Given the impact of land prices on housing costs, vacant land represents an especially beneficial opportunity for generating new affordable housing development in Opportunity Zones.

Accordingly, NCSHA strongly encourages IRS to reconsider the proposed five-year vacancy rule and instead consider land or property vacant for a period of at least one year as meeting the Opportunity Zone original use requirement.

This safe harbor would facilitate the redevelopment of vacant and abandoned properties in distressed communities and greatly enhance the impact of the Opportunity Zone incentive.

NCSHA and our HFA members are excited to help realize the potential of the Opportunity Zone program and to facilitate investments in distressed communities using HFA affordable housing and economic development tools. Thank you for considering our comments as you finalize this critical program guidance.

Sincerely,

Stockton Williams
Executive Director

---

[2] Galen D. Newman, Ann O'M. Bowman, Ryun Jung Lee & Boah Kim (2016) A current inventory of vacant urban land in America, Journal of Urban Design, 21:3, 302-319, DOI: 10.1080/13574809.2016.1167589