



October 18, 2022

The Honorable Adewale O. Adeyemo
Deputy Secretary
U.S. Department of the Treasury

Dear Deputy Secretary Adeyemo:

The National Council of State Housing Agencies (NCSHA), on behalf of all of the Low Income Housing Tax Credit (Housing Credit) allocating agencies, urges the U.S. Department of the Treasury (Treasury) to provide written clarity that the Government Sponsored Enterprises (GSEs), Fannie Mae and Freddie Mac, are not Tax Exempt Controlled Entities (TECE) under Section 168(h)(6)(F)(i) of the Internal Revenue Code. Uncertainty about the status of the GSEs is threatening the Housing Credit equity market and could lead to profound negative effects on affordable rental housing production, especially in underserved rural areas.

Most investors in Housing Credit properties invest through multi-investor funds, allowing them to limit their risk even when these funds invest in underserved markets where investment can be more challenging. In particular, multi-investor funds often finance properties in rural areas or permanent supportive housing developments, whereas a single investor proprietary fund may be unwilling to take on the risk of these types of properties.

While there are important benefits to investors in multi-investor funds, there are also risks. In this instance, should a single investor in a multi-investor funds be classed as a TECE, all investors in the fund would be affected by the loss of certain tax benefits. This is because TECES are not entitled to accelerated depreciation, bonus depreciation, historic rehabilitation tax credits, and certain energy credits, and their involvement in a multi-investor fund taints the fund for all participating investors.

Before the GSEs reentered the Housing Credit equity market in 2018, NCSHA's understanding is the Federal Housing Finance Agency (FHFA) received verbal assurances from Treasury that Fannie and Freddie were not TECES and conveyed that to the GSEs. Since then, Fannie Mae has been involved in a mix of multi-investor and proprietary funds, and it is our understanding that while Freddie Mac has so far opted to invest only in proprietary funds, it recently has been considering expanding to multi-investor funds.

Unfortunately, multi-investor funds that include Fannie Mae have been negatively impacted by concerns raised about the tax treatment of their investments. Until Treasury provides written assurances of the GSEs' status, investor concern about a future Internal Revenue Service interpretation could negatively impact their expected returns.

This is an understandable concern given the negative consequences of such a determination for these investors. It means that some investors are no longer willing to invest in multi-investor funds in which one of the GSEs participates. Thus, unless and until Treasury acts, the uncertainty surrounding this issue is likely to cause Fannie Mae to stop investing in multi-investor funds and prevent Freddie Mac from doing so in the future.

Multi-investor funds are an important way that Fannie Mae meets its Duty to Serve obligations established by FHFA. The GSE's involvement in rural and other underserved communities due to Duty to Serve has been instrumental in ensuring ongoing and fairly priced equity investment in those communities. While Housing Credit equity pricing has decreased in recent years with the drop in the corporate tax rate after passage of the 2017 Tax Cuts and Jobs Act and due to increased risk stemming from the COVID-19 pandemic, many rural and underserved areas would have likely experienced far lower pricing if it were not for the GSEs' involvement in those areas and their Duty to Serve obligations.

Although Fannie Mae may eventually be able to meet its Duty to Serve obligations solely through proprietary funds, we believe that this would have a significant negative impact on many of the regions and communities that rely on Fannie Mae's multi-investor fund activity. Without question, if Fannie Mae were to pull back from multi-investor funds—even if they continued to invest at the same level they do now—it would have a profound impact on their investment portfolio and the landscape for affordable rental housing production.

Fannie Mae's loss to multi-investor funds would have a domino effect on the impact of those funds. Not only would they lose Fannie's investment, but unless those funds could attract new investors to fill the void, the existing investors in the funds may not be willing to take on as significant a proportion of the total fund as they would be left with, jeopardizing the fund itself.

Moreover, certain mission-driven smaller nonprofit syndicators are prominent players in financing these challenging projects in some states. Many of these entities are not set up to provide services for proprietary funds and changing their business model is cost prohibitive. In some states, these smaller nonprofit syndicators are the primary syndicators working in the state, as larger nonprofit and for-profit syndicators are less active in these niche markets. The loss of Fannie Mae from their multi-investor funds would be disastrous for them and the states they serve.

Based on legal analyses we have seen, we believe Fannie and Freddie are not TECES but we recognize that this is a complicated issue to which private sector tax counsel are not in agreement. It does seem clear that the potential abuses for which Congress constructed the tax-exempt controlled entity rules do not apply in this situation. Treasury's relationship with the GSEs established through the preferred stock partnership agreement, and their investment in the Housing Credit program, were not the type of activities intended to be affected by 168(h)(6).

We ask that Treasury provide written clarity that Fannie Mae and Freddie Mac are not Tax-Exempt Controlled Entities so that investors will be willing to invest in multi-investor funds in which the GSE's participate.

We urge Treasury to expedite this action, as Fannie Mae is expected to cease participation in multi-investor funds beginning in 2023 unless the matter is settled.

Sincerely,

A handwritten signature in black ink, appearing to read "Garth Rieman". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Garth Rieman
Director of Housing Advocacy and Strategic Initiatives

cc: Thomas West
Laurn Enrico