NCSHA

June 6, 2019

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2019-30)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

RE: Recommendations for 2019-2020 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 2019-2020 Priority Guidance Plan, as requested in Notice 2019-30.

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.[1] 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) Average Income Test

In March 2018, Congress passed the Consolidated Appropriations Act of 2018 (the Act), which introduced the Average Income Test 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

[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.

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.

Congress made the Average Income Test effective as of the date of enactment of the Act. As such, state Housing Credit agencies have already begun allowing owners to choose the Average Income Test as the minimum set-aside for their projects.

Targeted IRS guidance to resolve ambiguities in implementation of the Average Income Test would provide greater clarity to the Housing Credit industry and help facilitate the success of this new option. Therefore, NCSHA was pleased that Treasury/IRS included income averaging on the 2018-2019 Priority Guidance Plan, and we encourage Treasury/IRS to include this issue again on the 2019-2020 Priority Guidance Plan.

NCSHA urges IRS to resolve the following issues:

- Provide guidance to the U.S. Department of Housing and Urban Development so that it may calculate the income limits at 20, 30, 40, 70, and 80 percent of Area Median Income (AMI) by using the same methodology IRS has already directed HUD to use in calculating the 50 and 60 percent of AMI levels. NCSHA sent a letter to IRS in April, 2019 providing further details on this request.

- Clarify what constitutes a violation of the Average Income Test minimum set-aside. The Tax Code clearly denotes that so long as 40 percent of the units in the project are rent restricted designated low-income units, the minimum set-aside test is met. However, there is disagreement as to whether the 40 percent of units must simply be designated low-income units, at any of the allowable income designations under the Average Income Test, or whether that 40 percent of units must average 60 percent or less of AMI.

- In addition to meeting the minimum set-aside, projects that adopt the Average Income Test must ensure that the income designations of all the low-income units together average no more than 60 percent of AMI. However, it is unclear how Housing Credit agencies should respond if one unit in the project does not meet the owner's intended designation for that unit, but the project's average would still be less than 60 percent of AMI if the state were to allow the owner to adjust the income designation for that unit. For example, a household moves into a unit designated at 30 percent of AMI, but the household's income is at 32 percent of AMI. If the owner were to change the income designation for that unit to a 40 percent unit (with the state's permission to do so), the overall project average income would remain below 60 percent of AMI. We urge IRS to clarify whether the state must issue a Form 8823 in instances such as this.

- If noncompliance in a unit is discovered resulting in a property's average income going above 60 percent of AMI, it is unclear whether the state Housing Credit agency should remove otherwise compliant units from the applicable fraction to the extent needed to reestablish the 60 percent average. For example, a household moves into a unit designated at 30 percent of AMI, but the household's income is at 32 percent of AMI. However, in this case, changing the unit to a 40 percent of AMI unit would result in the overall project exceeding 60 percent of AMI on average. We urge IRS to address whether the applicable fraction must be maintained in instances such as this, even if it means the investor loses Credits on an otherwise compliant unit.

- Average Income Test Properties that also have market-rate units which do not receive Credit allocations must adhere to the Next Available Unit Rule when a low-income resident's income exceeds the income designation for their unit upon recertification. However, it is not clear from the Tax Code at what income level the owner must designate the next available unit if two tenants in two low-income units of different income designations go "over income" at the same time.

- NCSHA also urges IRS to revise Form 8823 to reflect compliance requirements associated with income averaging.

We urge IRS to address all of the above issues in Average Income Test guidance. However, we also encourage IRS not to be excessively restrictive in its guidance. For example, we believe that state Housing Credit agencies should be able to determine policies related to unit designation, whether to allow units to "float" to different income designations, or otherwise modify unit income designations over time so long as the 60 percent average is maintained.

(2) Compliance Monitoring Regulations

In February 2019, Treasury and IRS issued a final rule amending the Housing Credit compliance monitoring regulations. The monitoring requirements IRS adopted in the final rule are a substantial departure from those previously required under temporary regulations that had been in place since 2016. As NCSHA noted in our May, 2019 letter to IRS, the final rule imposes an immense new regulatory burden on state Housing Credit agencies by significantly increasing the unit sample sizes states must monitor for compliance. We believe that any benefit the increase in monitoring would provide is far outweighed by the considerable strain this puts on Housing Credit agencies, owners, tenants, and affordable housing resources.

We believe that due to increased financial cost created by the final rule, it is contradictory to the Administration's efforts to reduce regulatory burden and control regulatory costs, as articulated in Executive Order 13771. State Housing Credit agencies have reported to NCSHA that the new requirements will impose significant financial burden on them and will necessitate hiring additional compliance monitoring staff and increasing payments to outside compliance contractors.

Moreover, while Treasury/IRS noted in the preamble to the 2016 final and temporary Housing Credit compliance monitoring regulations that the agencies had concerns about the application of the previous regulatory requirements and would consider whether to repeal the former 20 percent threshold, the agencies never undertook a formal proposed rule-making process to gather public comments on this specific issue. Instead, the agencies made substantial changes to the compliance monitoring regulations through a final rule, effective immediately upon its publication (though it allowed state agencies until the end of 2020 to update their policies).

Moreover, the final rule also implemented several other major policy changes, including significantly reducing the advance notice period provided to owners and requiring a random sampling technique, as opposed to the risk-based technique most states had used, to choose which units would be monitored. Treasury and IRS did not mention any intention of changing these policies in the 2016 temporary and final regulations, and there was no indication they would do so until the final rule was published in 2019 implementing the changes.

We believe that had the Treasury and IRS published a proposed rule clearly articulating the agencies' interest in repealing the former 20 percent threshold, modifying the advance notice period, and the random sampling requirement, they would have received numerous public comments urging them not to take these actions.

NCSHA urges Treasury/IRS to rescind the 2019 final rule and in its place issue a proposed rule so that the public is given ample opportunity to submit comments to the agencies. We would like to work with the agencies to develop an alternative approach that would strike a balance in maintaining strong standards for inspections while avoiding undue additional burden on state agencies, owners, and tenants.

(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 2019-2020 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.

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

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 face a loss of Credits, 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) 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.

(2) 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.

(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). The Revenue Procedures also prohibit issuers from using the HUD income limits that were established two fiscal 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, Revenue Procedure 2019-21, which establishes the HUD income limits for FY 2019, was published May 2 this year, yet appears to technically negate the use of FY 2017 income limits retroactively back to April 24.

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) 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.

(5) 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 2019-2020 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