NCSHA

May 28, 2021

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2021-28)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

RE: Recommendations for 2021-2022 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 2021-2022 Priority Guidance Plan, as requested in Notice 2021-28.

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) Compliance Monitoring Regulations

NCSHA greatly appreciates the proposed rule IRS and Treasury issued July 7, 2020 on Housing Credit compliance monitoring regulations (REG-123027-19) allowing Housing Credit agencies to monitor the lesser of 20 percent of the units in a building or the number provided in

[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.

the Minimum Unit Sample Size Reference Chart. We strongly support the proposed rule and urge IRS and Treasury to finalize it as soon as possible.

We also urge IRS to reconsider the reduction in the reasonable notice period that agencies must give owners before an upcoming physical inspection or review of low-income certification. Previous IRS/Treasury regulations issued in 2019 reduced that notice period from 30 days to 15 days, which we do not believe allows sufficient time for state agencies, owners, or managers to prepare for an inspection.

(2) Average Income Test

In October 2020, IRS and Treasury issued proposed regulations relating to the implementation of the Average Income Test (AIT) minimum set-aside, authorized by the Consolidated Appropriations Act of 2018.

NCSHA and other Housing Credit stakeholder organizations and businesses expressed concerns about IRS' approach to AIT implementation for a number of reasons. We believe the approach initially envisioned in the proposed rule creates an excessive and unnecessary level of risk that investors and developers will be reluctant to assume. Further, the proposed rule's prohibition against modification of unit designations will make practical implementation of AIT next to impossible, especially for properties financed with multiple subsidies and/or those with rental assistance contracts. Lastly, 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.

We strongly urge IRS and Treasury to prioritize issuing a final rule implementing the AIT that makes the following changes:

- The AIT minimum set-aside should be considered met so long as 40 percent of the units in the property have an average of 60 percent or less of AMI. In addition, the property should have to 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 property-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, so long as 40 percent of the units still meet the 60 percent average.

  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.

- The final rule should allow owners to modify unit designations, so long as the state Agency allows for that in its policies and the state Agency consents to the change. Unit designation changes should always be allowed if needed to adhere to the Fair Housing

Act, VAWA, §504 of the Rehabilitation Act of 1973, or any other relevant federal or state statute.

States should be able to allow either of these types of modifications to unit designations:

- Floating units in which the overall property average does not change. For example, Unit 1A, previously a 40 percent-designated unit, can become an 80 percent-designated unit if Unit 2A, previously an 80 percent-designated unit, becomes a 40 percent-designated unit.

- Modifying individual unit designations even if it changes the average in the property, so long as the average remains below 60 percent of AMI. For example, Unit 1A was previously a 40 percent-designated unit in a property that averaged 56 percent. Unit 1A becomes a 50 percent-designated unit, raising the property average to 58 percent.

It is critical that IRS act as soon as possible to issue a final rule with these modifications or announce its intention to publish a new proposed rule for public comment, as the current proposed rule has substantially chilled developer and investor interest in AIT since it was published last year. We do not expect many developers or investors to opt for the AIT set-aside until IRS and Treasury act.

(3) Minimum 4 Percent Credit Rate

In February 2021, NCSHA sent a letter to IRS and Treasury requesting guidance on implementation of the minimum 4 percent credit rate for Housing Credit buildings financed with tax-exempt bonds and for property acquisition as established in the Consolidated Appropriations Act of 2021. We encourage IRS to include guidance enacting the recommendations we made in that letter in its 2021-2022 Priority Guidance Plan. In particular, we encourage IRS to:

- clarify whether Housing Credit properties financed by tax-exempt bonds issued in 2020 and 2021 are eligible for the minimum 4 percent credit rate, regardless of the relative amount issued in each year;

- provide guidance on application of the minimum 4 percent credit rate in Housing Credit properties that utilize so-called "draw-down" bonds, in which the bond issuer provides volume cap authority for a bond and an individual property (or properties) make multiple draws from that bond authority over time as financing is needed; and

- specify whether a previous binding election by a taxpayer to fix the credit percentage remains in force or if the new minimum 4 percent credit rate supersedes the previous election.

(4) Disaster Housing Credits

In February 2021, NCSHA sent a letter to IRS and Treasury requesting guidance on additional Housing Credit authority provided by the Consolidated Appropriations Act of 2021 for states that experienced major disasters last year. We encourage IRS to include guidance enacting the recommendations we made in that letter in its 2021-2022 Priority Guidance Plan. In particular, we encourage IRS to:

- specify the exact population of each qualified disaster zone so the state Housing Credit allocating agencies can calculate their respective annual state credit ceilings accurately;

- provide guidance on the designation procedure required by the legislation to extend the Housing Credit 10 percent test deadline and the placed in service deadline for projects located in qualified disaster zones; and

- confirm that states may reallocate disaster credits in eligible areas in subsequent years if returned to the state agency following original allocation in 2021 or 2022, consistent with previous IRS treatment of returned disaster credit allocations.

(5) COVID-19 Relief

NCSHA greatly appreciates the temporary relief provided by IRS Notices 2020-53 and 2021-12 in response to the disruption caused by the COVID-19 pandemic on Housing Credit development and construction activity and the ongoing operation of Housing Credit properties. We also appreciate IRS responsiveness to NCSHA's recommendations for relief from program deadlines and additional accommodations to keep the program operating during the pandemic.

As the country continues to recover from the impact of the pandemic, we encourage IRS to include necessary updates to this guidance in its 2021-2022 Priority Guidance Plan.

(6) 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 2021-2022 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.

(7) 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.

(8) 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

NCSHA thanks Treasury for recently publishing guidance (Revenue Procedure 2021-19) giving issuers 90 days to implement the new income limits for the Mortgage Revenue Bond (MRB) and Mortgage Credit Certificate (MCC) programs each year. NCSHA has asked IRS to establish such a transition period in the past and appreciates IRS' action on this recommendation.

We suggest IRS take the following actions to further improve the effectiveness of Housing Bond programs.

(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, Mortgage Revenue Bonds (MRBs), and Mortgage Credit Certificates (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 regulatory 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) 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.

(4) 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 2021-2022 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