



June 9, 2022

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2023-24)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

RE: Recommendations for 2023-2024 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 2023-2024 Priority Guidance Plan, as requested in Notice 2023-36.

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

NCSHA applauds Treasury and the IRS for finalizing the regulations implementing the Average Income Test (AIT) minimum set-aside last year in a manner that we believe will facilitate its use as a means of serving more low-income households at rent levels they can better afford.

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.

When it published the AIT final rule, IRS published with it temporary and proposed regulations related to record-keeping and reporting requirements. NCSHA and the Novogradac LIHTC Working Group submitted [joint comments](#) in response to the temporary and proposed regulations, suggesting that IRS and Treasury:

- Simplify the process by which the taxpayer must report on unit designations by allowing owners to submit just one group of qualified units to the state for the full applicable fraction, rather than submit both a qualified group of units for the applicable fraction and a qualified group of units within that larger group for purposes of the AIT minimum set-aside. The taxpayer should remain responsible for recording the AIT minimum set-aside qualified group in its books and records; and
- Allow the taxpayer to correct the qualified group of units for the AIT minimum set-aside without requiring state agency approval. This modification is especially important if IRS and Treasury maintain the current requirements related to submitting to the states both qualified groups of units (for purposes of the applicable fraction and for the AIT minimum set-aside).

These two modifications would streamline the requirements without sacrificing compliance with the new minimum set-aside.

(2) 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 in 2020. We encourage IRS to include guidance enacting the recommendations we made in that letter in its 2023-2024 Priority Guidance Plan. In particular, we encourage IRS to:

- 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.

(3) 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.

(4) Application of the Violence Against Women Act to the Housing Credit

Since 2013, the Housing Credit has been considered a “covered program” under the Violence Against Women Act (VAWA), providing protections for Housing Credit tenants who are victims of domestic violence, dating violence, sexual assault, and stalking. However, VAWA does not make conforming changes to the Internal Revenue Code and IRS has never issued guidance providing clarification on the application of VAWA to the Housing Credit.

NCSHA recommends that IRS issue guidance to align the Housing Credit with VAWA. Specifically, IRS should:

- Require all Housing Credit long-term use agreements to be inclusive of VAWA protections;
- Clarify that an owner should treat a tenant who has their lease bifurcated due to violence covered under VAWA as an existing tenant and should not recertify the tenant’s income as if they were a new tenant at initial occupancy;
- Clarify that victims under VAWA qualify under the special needs exemption to the Housing Credit general public use requirement.
- Require owners to incorporate a lease addendum reflecting VAWA protections into every new lease that is executed as well as lease renewals; and
- Provide guidance to Housing Credit agencies on how to address complaints filed pertaining to VAWA violation in Housing Credit properties.

(5) 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

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.

(6) Nonprofit Right of First Refusal

Section 42(i)(7) of the Internal Revenue Code is a statutory safe-harbor that permits the parties to a Housing Credit partnership agreement to give a special Right of First Refusal (ROFR) to a qualified nonprofit to obtain eventual ownership of the property at the conclusion of the compliance period at a minimum below-market purchase price that includes assumption of any outstanding debt, plus exit taxes. In most cases, nonprofit developers have secured this right and exercised it, attaining full ownership of the property while the investor/limited partner exits the program, having claimed all Housing Credits.

However, recently some investors—primarily outside entities who have obtained control of investor partnership interests from the original investors after all tax credits have been claimed—have been challenging the ROFR held by nonprofits and demanding a payoff not contemplated in the partnership agreement as a condition of exiting the partnership. This has led to scores of legal disputes and, in many cases, costly litigation. Nonprofits that do not have the financial wherewithal to fight the limited partner in court are forced to acquiesce to unexpected investor monetary demands which may undermine the long-term financial viability of the property or force the nonprofit to raise rents, decrease resident services, defer maintenance, or even sell the property to cover the pay-off.

The IRS has never issued guidance on section 42(i)(7). IRS guidance could provide clarity and substantially mitigate these disputes that are taking hundreds of millions of dollars out of affordable housing. NCSHA urges IRS to publish guidance that would do the following:

- Clarify that the section 42(i)(7) ROFR is not a state or common law ROFR, but a special right of first refusal under federal law that does not require application of state common law rules including a requirement that a third-party offer, when required, must meet some test of being bona fide.
- Define “property” to include all partnership assets, not just the physical structure of the development;
- Clarify that, unless the partnership agreement provides otherwise, no offer from a third party is required to trigger the ROFR rights of the nonprofit; and

- Clarify that, unless the partnership agreement provides otherwise, limited partner consent is not required to exercise the ROFR, and that the ROFR may be initiated by an offer from any entity, including a related party.

(7) Planned Foreclosure

In the rare instances in which a Housing Credit property is acquired by foreclosure or instrument in lieu of foreclosure, the affordability restrictions are generally terminated. The exception to this rule is if the Secretary of the Treasury determines that the acquisition is part of an arrangement with the taxpayer the purpose of which is to terminate the affordability restrictions. However, it is not practical for the Secretary to make this determination on a case-by-case basis. To our knowledge, the Secretary has never intervened in an affordability termination due to foreclosure or deed in lieu of foreclosure, despite state agencies urging Treasury's intervention in specific cases where they believe a foreclosure to be a "planned foreclosure" for the express purpose of terminating affordability restrictions.

NCSHA strongly urges the Secretary to delegate this authority to state Housing Credit agencies, which are better positioned to make this determination. Upon a foreclosure or instrument in lieu of foreclosure, Treasury should require the owner or successor acquiring the property to provide states with at least 60 days written notice of its intent to terminate the affordability period so that the state has time to assess the legitimacy of the foreclosure. This would strengthen state oversight of the program and reduce the potential for developments to lose affordability restrictions before the full affordability period has elapsed.

(8) 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 2022-2023 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.

(9) Loss of Housing Credits upon a Casualty Loss

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.

(10) Relocation Expenses

When a property is undergoing rehabilitation, it often is safest, most expedient, and most cost-efficient to relocate tenants temporarily while work on their unit is completed. Prior to the publication of the final IRS Audit Technique Guide for the Housing Credit, such costs were typically included in rehabilitation costs, and thus capitalized. However, in the Audit Technique Guide for the Housing Credit, finalized in 2015, IRS took the position that costs incurred to temporarily relocate qualifying tenants during a rehabilitation, such as legal costs, tenant moving expenses, costs for temporarily storing a tenant's property, and temporary housing costs, are expensed as ordinary and necessary business expenses, and thus deductible.²

In the case of the Housing Credit, the result of this position is that relocation costs cannot be considered direct costs of the rehabilitation and thus cannot be included in basis. Housing Credit developers may not have other resources with which they can pay for relocation costs, even if those expenses are deductible. Thus, developers may have to consider rehabilitation with the residents in place, which may take longer, cost more, and reduce the scope of anticipated project modifications in order not to compromise resident safety.

NCSHA urges IRS to modify its guidance to allow relocation costs for a Housing Credit property undergoing rehabilitation to be capitalized rather than deducted. There is precedence allowing relocation costs to be capitalized. In fact, the Audit Technique Guide itself provides that relocation costs in cases of demolition are capitalized, stating, "The costs of relocating tenants out of an acquired building that will be demolished may be associated with the demolition, and if so, are capitalized to the land."³

² IRS Audit Technique Guide for the Housing Credit, Appendix C (page 314)

³ IRS Audit Technique Guide for the Housing Credit, Appendix C (page 308)

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, 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. The negative impact of the policy was particularly acute during the pandemic, when made it harder for HFAs to respond to the rapidly changing housing needs of their constituents.

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) 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 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.

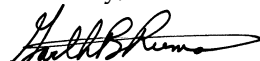
NCSHA recommends IRS amend Reg. §6a.103A-2(i)(2)(ii)(A) so that origination fees, points, and similar amounts charged to the borrower are counted toward the effective interest rate of an MRB loan only to the extent they exceed the limits the Federal Housing Administration (FHA) has placed on such fees 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 would 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 2023-2024 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