May 30, 2025

Internal Revenue Service
Attn: CC:PA:01:PR (Notice 2025-19)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

RE: Recommendations for 2025-2026 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 2025-2026 Priority Guidance Plan, as requested in Notice 2025-19.

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) Alignment with HUD Programs on HOTMA and NSPIRE Implementation

Housing Opportunity Through Modernization Act

[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 U.S. Department of Housing and Urban Development (HUD) is in the process of finalizing implementation of the Housing Opportunity Through Modernization Act (HOTMA) of 2016, which is intended to streamline processes across HUD programs and reduce burdens on affordable housing providers. HOTMA makes major reforms to the way that income and assets are calculated for HUD program eligibility, including for Section 8 rental assistance programs. The HOTMA final rule became effective on January 1, 2024, and full compliance for all applicable HUD programs will be mandatory as of January 1, 2026, unless HUD provides a further extension.

The IRS' Housing Credit regulations at 1.42-5 require state Agencies to calculate tenant income "in a manner consistent with the determination of annual income under section 8 of the United States Housing Act of 1937 (Section 8)." Thus, it is our understanding that income determination established by HOTMA, by virtue of its application to Section 8, is applicable to the Housing Credit program. Many state Agencies have already begun steps to implement HOTMA income determination policies for the Housing Credit program. But clarity on HOTMA's applicability to the Housing Credit program is necessary to avoid confusion, inconsistent rules, and treating properties differently depending on whether they receive HUD assistance or not.

We urge IRS to issue guidance clarifying HOTMA's application to the Housing Credit program and directing state Agencies to implement HOTMA procedures for the Housing Credit program consistent with HUD's implementation schedule; specifically, by the time full compliance for all HUD programs is required.

In addition, IRS needs to update Revenue Procedure 94-65, which provides that income from assets valued at or below $5,000 does not need to be considered as part of the income calculation for low-income tenants. HOTMA allows income from assets valued at under $50,000 to be excluded from the calculation of tenant income. We urge IRS to update Revenue Procedure 94-65 to make it consistent with HOTMA's rules related to income from assets.

National Standards for the Physical Inspection of Real Estate

HUD's Real Estate Assessment Center (REAC) is finalizing implementation across HUD programs for the National Standards for the Physical Inspection of Real Estate (NSPIRE), which replaces both the Housing Quality Standards (HQS) and Uniform Physical Condition Standards (UPCS) physical inspection assessment methodologies. NSPIRE is intended to standardize the inspection process across HUD programs and prioritize health and safety over physical appearance to better reflect the true physical conditions of properties.

While the NSPIRE protocol has been mandatory for some HUD programs since mid-2023, HUD has provided an extension for implementation for the Section 8 Housing Choice Voucher, Project Based Voucher, and all programs under HUD's Community Planning and Development

office (which includes the HOME Investment Partnerships program and Housing Trust Fund; both of which are commonly used with the Housing Credit) until October 1, 2025.

The IRS' Housing Credit regulations at 1.42-5(d)(2)(ii) allow state Agencies to inspect properties using "the uniform physical condition standards for public housing established by HUD (24 CFR 5.703)." NSPIRE is now the standard provided at 24 CFR 5.703, having replaced UPCS, which is now obsolete. We urge IRS to clarify NSPIRE's application to the Housing Credit and modify 1.42.5 to remove the word "uniform" in the clause quoted above to avoid confusion with the no longer operational UPCS. It should also direct state Agencies to implement the NSPIRE protocol for the Housing Credit program consistent with HUD's implementation schedule.

In the interest of consistency with NSPIRE, we also urge IRS to change the requirement for reasonable notice period that agencies must give owners before an upcoming physical inspection or review of low-income certification. Under NSPIRE, REAC provides a 28-day reasonable notice period, while Housing Credit compliance regulations currently provide only a 15-day reasonable notice period. The Housing Credit requirement does not allow sufficient time for state agencies, owners, or managers to prepare for an inspection. We believe a 28-day notice period is reasonable and requirements such as this should be consistent across programs.

(2) Nonprofit Right of First Refusal

IRC 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, some investors—primarily outside entities who have obtained control of investor partnership interests from the original investors after all tax credits have been claimed—are 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.
- 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.

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

Since 2013, the Housing Credit has been a "covered program" under the Violence Against Women Act (VAWA), providing protections for Housing Credit tenants and applicants who are victims of domestic violence, dating violence, sexual assault, and stalking. However, IRS has never issued guidance regarding the application of VAWA to the Housing Credit.

Absent guidance from IRS, state Agencies have used their Qualified Allocation Plans and other tools to compel housing providers to comply with VAWA and NCSHA has adopted in its Recommended Practices in Housing Credit Administration procedures related to VAWA implementation. Despite these steps, we believe it is important for IRS to acknowledge VAWA's application to the Housing Credit and provide uniform guidance along the following lines:

- Require all Housing Credit long-term use agreements to be inclusive of VAWA protections.
- Clarify that survivors/victims under VAWA qualify under the special needs exemption to the Housing Credit general public use requirement.
- Prohibit owners from denying assistance to applicants solely due to reasons directly related to the applicant having experienced VAWA violence.
- Prohibit evictions of existing residents due to VAWA violence committed against them and clarify that an incidence of violence covered by VAWA does not constitute good cause eviction of a resident who experienced such violence if the resident otherwise meets tenant occupancy rules.
- Require owners to have policies on acceptable unit transfers, referencing HUD's emergency transfer guidance and forms.
- In an instance in which a resident perpetrates violence covered by VAWA against a co-resident, resulting in the eviction of the perpetrator, IRS should clarify that the owner must allow the survivor the option of remaining in the unit or transferring to an alternative unit consistent with the owner's unit transfer policy. If the survivor chooses to remain in the unit, IRS should require the owner to allow for lease bifurcation, treating

the survivor as an existing tenant and should not recertify the resident's income as if they were a new tenant at initial occupancy.

- Require owners to incorporate a lease addendum reflecting VAWA protections into every new lease that is executed as well as lease renewals.
- Provide guidance to Housing Credit agencies on how to address complaints filed pertaining to VAWA violation in Housing Credit properties.

We do not believe an amendment to Section 42 is needed in order for IRS to take this action. As NCSHA suggested in a December 2023 letter to leadership at IRS, Treasury, HUD, and the Department of Justice (DOJ), the Memorandum of Understanding to which these agencies are party applying the Fair Housing Act to the Housing Credit provides precedence for how IRS could proceed in this effort, so that it may direct state Agencies and other stakeholders to VAWA resources at HUD and establish enforcement procedures that could include involvement by DOJ.

(4) 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. As noted above, IRS should further modify the compliance monitoring regulations to provide a 28-day reasonable notice period, consistent with NSPIRE, in the final rule.

(5) Average Income Test

NCSHA applauds Treasury and the IRS for finalizing the regulations implementing the Average Income Test (AIT) minimum set-aside in 2022 in a manner that we believe facilitates its use as a means of serving more low-income households at rent levels they can better afford. 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 that 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. We urge IRS and Treasury to finalize the temporary and proposed regulations for record-keeping and reporting requirements consistent with our recommendations.

(6) Finalize Low Income Housing Credit Audit Technique Guide for Completing Form 8823

IRS Publication 5913, *Low Income Housing Credit Agencies Report of Noncompliance or Building Disposition Audit Technique Guide (Guide for Completing Form 8823)*, is an essential resource for the state Housing Credit allocating agencies that are required to monitor program compliance in all Housing Credit developments and for the Housing Credit industry overall. The Guide provides critical guidance on maintaining compliance with program rules, as well as determining and documenting noncompliance. It also provides detailed line-by-line instructions for completion of Form 8823, *Low Income Housing Credit Agencies Report of Noncompliance or Building Disposition,* which the state agencies submit to IRS in case of any property noncompliance.

The Guide was last materially updated in 2011. Since that time, the Housing Credit statute and relevant program guidance have both changed significantly in ways that dramatically impact program compliance. Most notably, the Housing Credit now includes a third minimum set-aside, the Average Income Test (AIT), that includes a complex set of rules for maintaining compliance and for correcting noncompliance. While these rules have been detailed in IRS regulation, they should also be reflected in the Guide to ensure proper monitoring of AIT compliance and reporting of noncompliance. In addition, the significant changes to income and asset calculations included in HOTMA, to physical inspection standards included in NSPIRE, and to VAWA compliance all should be addressed in an updated Guide consistent with our comments above.

As IRS works to finalize the updated Guide, we strongly encourage providing the state Housing Credit agencies responsible for monitoring program compliance an opportunity to review and comment on a formal draft of the revisions.

(7) Over-Income Tenants in Subsidized Properties Undergoing Syndication for Rehabilitation

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. 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.

If a property is already a Housing Credit property and has applied for a resyndication in order to undergo a rehabilitation, IRS guidance provides that tenants that were income eligible upon move in, but whose income has since increased, continue to be treated as eligible tenants, even if they would otherwise be "over-income" at the time of the resyndication; thus, their units may be included in eligible basis for purposes of the resyndication. However, that guidance does not extend to affordable housing originally financed with HUD or other affordable housing programs. That means that if the owner of a HUD-financed property seeks a syndication of Credits to undergo rehabilitation, all existing tenants must be income eligible at the time of the syndication. In some instances, tenants in these properties were eligible when they moved in, but their income has since risen. Thus, the owner must either encourage them to move or the eligible basis for the rehabilitation associated is reduced because the unit may not be considered a low-income unit for purposes of the Housing Credit. This can jeopardize the entire rehabilitation.

NCSHA recommends that IRS clarify that over-income tenants in properties initially financed by a means-tested affordable housing program should be treated as income qualified for purposes of rehabilitation with the Housing Credit so long as they were income qualified upon move in, consistent with IRS policy for resyndications of Housing Credit developments.

(8) Include Relocation Expenses in Rehabilitation Expenditures

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 publication of the *IRS Section 42 Low-Income Housing Credit Audit Technique Guide*, such costs were typically included in rehabilitation costs, and thus capitalized. However, in the Guide published 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.

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

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]

(9) Provide Greater Flexibility for Properties Suffering Casualty Loss Not Attributed to a Presidentially Declared Disaster

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 requires owners of properties that suffer a casualty loss to restore the property and have it back in service by the end of the calendar year in which the casualty occurred or suffer loss of Credits, regardless of the date of the casualty event and the extent of the damage. This means that if a property suffers a fire in December that causes 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.

The IRS makes an exception in Revenue Procedures 2014-49 and 2014-50 for owners of properties that suffer a casualty loss due to a presidentially declared disaster. In these cases, IRS delegates authority to state Agencies to determine a reasonable time period for restoration within 25 months of the disaster.

NCSHA recommends that IRS extend its existing policy for casualty loss caused by presidentially declared disasters to all casualties by delegating authority to state Agencies to determine a reasonable restoration period within 25 months on a case-by-case basis.

(10) Further Clarify Housing Credit Disaster Relief and Adjust Policy for Casualty Loss Attributed to a Presidentially Declared Disaster

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 2024-2025 Priority Guidance Plan. In particular, we encourage IRS to:

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

- 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.
- Provide guidance on the issue of destroyed records following a natural disaster.

In the six years since NCSHA submitted these comments to IRS, the nation has experienced several catastrophic disasters that exceed the severity of many presidentially declared disasters of the past. In some instances, infrastructure surrounding Housing Credit properties has been so damaged that even 25 months has proven to be insufficient for property restoration. For this reason, we urge IRS to further amend Revenue Procedures 2014-49 and 2014-50 to allow for up to 37 months for restoration without penalty of recapture so long as the owner agrees to amend the property's restricted covenant to extend the affordability period by the time allotted for restoration in excess of 25 months.

Housing Bonds

(1) Update Guidance for Verifying First-Time Homebuyer Status to Reflect Tax Changes

IRS Reg. § 6a.103A-2(c)ii lays out what steps MRB issuers can take to make a good faith effort to ensure that each loan funded by an MRB issuance goes to a first-time homebuyer (those who have not owned a home in the previous three years). Specifically, the subparagraph says that, in addition to securing an affidavit from the homebuyer attesting that they have not owned a home in the past three years, issuers may also review a borrower's certified federal tax returns for the past three years to check if they have claimed a deduction for taxes and/or interest for a principal residence. The examples subsequently laid out in Reg. § 6a.103A-2(c)iv appear to emphasize that collecting and examining homebuyers' tax returns is valuable toward demonstrating good faith compliance efforts.

While examining tax returns was an effective method for enforcing the first-time homebuyer requirement in the past, the enactment of P.L. 115–97, which increased the standard deduction, has significantly reduced the amount of homebuyers who claim itemized deductions, even for mortgage interest. This is particularly the case for the low- and moderate-income households HFAs serve, for whom it is nearly always better to take the standard deduction.

Consequently, while HFAs continue to collect and examine borrower tax returns to ensure they are demonstrating good faith compliance, they find it of little value in verifying a borrower's first-time homebuyer status. Many HFAs have adopted additional means of checking a homebuyers' status, such as reviewing their credit reports to check for mortgage payments.

Given that reviewing tax returns is now of limited utility for the purposes of enforcing the first-time homebuyer requirement, and the administrative burden requesting and procuring such documents places on HFAs, homebuyers, and the IRS, NCSHA requests IRS adjust the guidance to explicitly allow for other methods of verification, including the use of credit reports.

(2) 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.

(3) 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 six 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.

(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 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.

(6) 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 2024-2025 Priority Guidance Plan. If you have any questions, please do not hesitate to contact me.

Sincerely,

Jennifer Schwartz
Director of Tax and Housing Advocacy