NCSHA

May 1, 2015

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2015-27)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

RE: <u>Notice 2015-27, Recommendations for 2015-2016 Priority Guidance Plan</u>

To Whom It May Concern:

Thank you for the opportunity to recommend for inclusion on the Department of Treasury/Internal Revenue Service (IRS) 2015-2016 Priority Guidance Plan subjects critical to effective state administration of the Low Income Housing Tax Credit (Housing Credit) and Tax Exempt Housing Bond programs.

As the Washington representative of the agencies that administer the Housing Credit and Bond programs, including the Mortgage Credit Certificate program, in all 50 states, the District of Columbia, New York City, Puerto Rico, and the U.S. Virgin Islands, the National Council of State Housing Agencies (NCSHA) appreciates the Treasury Department's and IRS' expert oversight of these programs, your continued cooperative attitude toward NCSHA and state housing agencies, and your timely provision of program guidance.

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.

<u>Housing Credit</u>

(1) §1.42-5 compliance monitoring regulations

In February, 2012, IRS issued proposed regulations concerning HFA Housing Credit monitoring procedures, in response to which NCSHA submitted comments suggesting a number of changes to the physical inspection and tenant file review requirements. To ensure that the §1.42-5 regulations continue to provide an efficient framework for compliance with §42 and provide the information necessary for IRS oversight, while allowing more flexibility for the agencies charged with compliance monitoring, we urge IRS to issue final regulations as soon as possible, consistent with NCSHA's comments submitted in response to Notice 2012-18. Specifically, NCSHA urges IRS to modify the proposed regulations in the following ways:

- Reduce and refine the minimum 20 percent physical inspection requirement. NCSHA recommends that IRS implement a sliding scale that would allow the number of units inspected to vary according to project size. We also suggest calculating the inspection sample size based on the total units in a project, rather than in each building, and allow monitoring agencies to consider multiple buildings with a common owner and plan of financing as a single project for monitoring purposes, regardless of whether or not the owner officially elected such treatment on Form 8609.
- Decouple physical inspections and tenant file reviews so that states may conduct the two monitoring requirements independently. We also urge IRS to expressly permit monitoring agencies to utilize desk audits as a method for conducting tenant file reviews.
- Expand the inspection and file review exception currently provided to Rural Housing Service (RHS) properties that undergo an RHS inspection to other properties that undergo inspections and tenant file reviews conducted by HUD and other local, state, or federal agencies that perform similar monitoring activities. This flexibility will encourage consolidation and alignment of monitoring processes, reduce redundancy, enhance tenant quality of life, and reduce costs to property owners and monitoring agencies.

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

NCSHA urges IRS to provide guidance on the treatment of existing tenants in assisted affordable housing properties 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.

(3) 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 lose the year's Credit allotment, 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.

(4) Regulations concerning utility allowances under §42(g)(2)(B)(ii) for sub-metered buildings.

NCSHA urges IRS to issue final guidance concerning utility allowance calculations for Housing Credit developments that sub-meter. In prior comments on proposed utility allowance regulations, NCSHA has expressed its appreciation that regulations generally allow for more accurate utility allowance determinations, provide greater flexibility to make such determinations, and help HFAs promote energy efficiency in Housing Credit properties. We have also maintained that more accurate utility allowances help keep Housing Credit properties financially sustainable. We reiterate these principles and urge IRS to ensure that any final guidance concerning utility allowances for sub-metered buildings does not impose any unnecessary administrative burdens or complexity on HFAs.

<u>Housing Bonds</u>

(1) 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.

(2) Public Hearing Requirements Under §147(f) for Issuance of Tax-Exempt Bonds

On September 9, 2008, IRS issued a proposed rule simplifying the public approval requirements that apply to private activity bonds (PABs) issued by state and local government entities. The proposed regulations include a number of provisions allowing HFAs and other PAB issuers to cut unnecessary costs while still allowing for adequate public notice of new bond issues, such as permitting the use of electronic notifications if a state's open meeting laws so allow and cutting in half the public notice requirement from 14 to 7days.

The proposed rule also includes special rules for Mortgage Revenue Bond (MRB) issuances that would allow for less specific information to be included for public approval. Specifically, no information would be required on specific names of mortgage loan borrowers or specific locations of individual residences. Instead, issuers would only be required to provide the maximum stated principal amount of qualified mortgage bonds to be issued and a general description of the geographic jurisdiction in which the financed residences will be located.

NCSHA strongly recommends that IRS adopt final regulations that are consistent with the proposed rule referenced above. The final rule should also take into account issuers' increasing use of the Internet and other electronic communications to communicate with their constituents. This will allow HFAs and other issuers to save time and money and to bring the federal rules in line with current technology and state laws.

(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). Typically, these updates also prohibit HFAs from relying on those income limits established for the fiscal year two 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, the last such Revenue Procedure, released on March 16, may have technically negated the use of FY 2013 income limits retroactively back to March 6.

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 reasonable transition 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 and MCCs in high-cost housing areas, as these limits often take a substantially longer time to calculate.

(4) Yield and Valuation of Purpose Investments in §1.148-5

On September 16, 2013, IRS released a proposed rule (1545-BH38) that, amongst other provisions, amends §1.148-5 to clarify that investments allocated to a tax-exempt bond issue must be valued using the fair-market method. This standard would not apply to investments that are allocated from one bond issue to another as transferred proceeds in refundings or universal cap allocations, which could be valued at present value.

In amending §1.148, the proposed rule eliminates language that states that "purpose investments," or investments made in furtherance of the bond's stated purpose, should always be valued at present value. While we do not believe that this was IRS' intent, the proposed regulations could be interpreted as requiring that purpose investments, including mortgage loans funded through MRBs, be marked-to-market whenever they enter into or are transferred from a bond issue. Under such an interpretation, while MRB-financed loans would still be subject to the exemption for refundings and universal cap allocation, such loans would need to be marked-to-market if sold or if financed by an issuer with its general fund and brought into a bond issued pursuant to a reimbursement resolution.

MRBs are designed to fulfill a public purpose: providing affordable mortgages to low- and moderate-income borrowers who may not otherwise be able to purchase a home. As such, HFAs and other MRB issuers often accept a lower than market rate of return on their mortgages. Requiring that all MRB-financed mortgages be valued at market rate would contradict MRBs public purpose, which is established under federal statute.

NCSHA recommends that, when finalizing rule 1545-BH38, IRS include language making it clear that purpose investments can always be valued using the present value standard.

(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 2015-2016 Priority Guidance Plan. If you have any questions, please do not hesitate to contact me.

Sincerely,

Garth B Rieman

Garth Rieman
Director, Housing Advocacy and Strategic Initiatives