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Sent Via Mail and E-mail

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Dear Rosa:

The New Markets Tax Credit Working Group would like to thank you and the CDFI Fund for continuing to provide guidance for the New Markets Tax Credit ("NMTC") Program. Your efforts are a credit to why this program has been so successful. Members of the New Markets Tax Credit Working Group have again joined together to respectfully submit comments and recommendations for your consideration on the recently issued update of the Compliance and Monitoring Frequently Asked Questions document dated May 2009 ("FAQ"). We have organized our comments in the order of the questions within the FAQ for your convenience. We appreciate the time and effort that the CDFI Fund has taken to provide guidance on many of the issues surrounding the compliance requirements of the NMTC Program. It is a very substantial document and is providing much benefit to participants in the NMTC industry.

Question 16 – How does the Fund define "Affordable Housing" for the purpose of meeting Section 3.2(k) of the allocation agreement?

We request further clarification on the recently issued guidance for satisfying the affordability requirement for both rental housing and for-sale housing addressed in the FAQ. We specifically request guidance as to how the 20% affordability requirement calculation is defined. It is not clear if the calculation is on an allocation-wide basis or a QLICI-by-QLICI basis. For example, an allocatee makes two QLICIs into two projects that will develop housing units. The first QLICI is to a project with 20 units, all of which meet the affordability requirements. The second QLICI is to a project with 80 units, all of which do not meet the affordability requirements. If measured on an allocation-wide basis, the allocatee would meet the 20% requirement (20 affordable units divided by 100 total units developed). However, if the test is measured on a QLICI-by-QLICI basis, the second QLICI would fail to meet the 20% affordability requirements because none of the units would be deemed affordable. We recommend calculating the 20% requirement based on total units developed per allocation. This approach allows more flexibility in structuring transactions than if the calculation was based on each individual QLICI.

In order to incorporate these recommended changes, we have provided suggested wording for the guidance currently available:

> **An allocatee will meet the requirements of Section 3.2(k) if at least 20% of the total housing units developed or rehabilitated as a result of its QLICIs are rental housing units or for-sale housing units that meet the following criteria:**
>
> 1. ~~A QLICI that finances~~ Rental housing units ~~shall~~ **will** meet the requirements of Section 3.2(k) if it meets the following criteria:
>   a) …
>   b) …
> 2. ~~A QLICI that finances~~ For-sale housing units ~~shall~~ **will** meet the requirements of Section 3.2(k) if 20 percent or more of the total for-sale housing units…

Part 1 - Rental housing units

The FAQ states that "20 percent or more of total rental units financed with QLICIs are both **rent restricted** and occupied by **individuals whose income** is 80 percent or less than the area **medium** family income as determined and adjusted annually by HUD." However, there is no guidance or definition as to what "rent restricted" means. How do you calculate the appropriate rent restricted amount for each unit that will be used to satisfy the 20% affordability requirement? Also, should each individual occupying the unit have income that is 80 percent or less than area median family income? Or should the units be affordable to Low-Income Persons, which is defined in the allocation agreement as "having an income, adjusted for family size"?

Area median gross income ("AMGI") is a significant concept in the Low-Income Housing Tax Credit ("LIHTC") industry, and there is widespread experience and history with the use of this term. It is used as a starting point for calculating both the income and rent limits. We assume that the guidance in the FAQ contains a typographical error when it used the term medium. We recommend that "medium family income" be replaced with "median family income."

The LIHTC rules use a definition of AMGI found in the HUD methodology used for Section 8 of the United States Housing Act of 1937. Under Section 8, median family income estimates are based on decennial census data updated with Bureau of the Census P-60 income data and Department of Commerce County Business Patterns employment and earnings data.

Maximum income amounts are issued in tables produced by HUD. The amounts in the tables vary by geographic location and are presented for separate metropolitan areas and the remaining nonmetropolitan regions of each state, Puerto Rico, U.S. Virgin Islands, Guam and the District of Columbia.

Typically, HUD releases its calculations of AMGI close to the beginning of each year. At this release, HUD will present three income calculations labeled "low income" (80 percent AMGI), "very low income" (50 percent AMGI) and "30 percent of median" (30 percent AMGI). The income levels for each calculation are presented by family size, from one to eight people.

In the LIHTC industry, when determining income levels for qualifying tenants, an accurate family size must be determined. The IRS does not give guidance on determining family size for purposes of income limits and defers to the guidance in HUD Handbook 4350.3 REV-1, Glossary. A family generally includes all occupants of a unit, however there are exceptions. Household size is critical in calculating the maximum allowable income for LIHTC properties.

We recommend that similar guidance be provided to the NMTC industry for the calculation of household income. The allocation agreement states in Section 3.2(k) that "...the Allocatee shall ensure that at least 20% of the housing units developed or rehabilitated as a result of its QLICIs shall be affordable to Low-Income Persons." In Section 2.10 of the allocation agreement, Low-Income Persons are defined as "...having an income, adjusted for family size..." We believe this is the proper measurement of income and recommend the guidance be revised to match the terminology in the allocation agreement by replacing the term "individual" with "Low-Income Persons".

We further recommend using the definition of rent restricted unit in IRC Section 42(g)(2). Rather than determining the amount of rent based upon actual household size as is used to determine income limits described above, LIHTC uses imputed income levels based on the number of bedrooms in a rented unit. A studio apartment is considered occupied by one individual, while apartments with one or more separate bedrooms are deemed occupied by 1.5 individuals per bedroom.[1] These calculations do not require that the rental rate be limited by predetermined percentages of the actual household income which can be quite variable. This imputed family size rule limits overcrowding, as property owners do not get a benefit by renting to larger families and charging correspondingly higher rent. It also aids in lender underwriting, as lenders do not need to underwrite expected family size in order to underwrite expected rents.

In order to calculate these rents, it is first necessary to multiply the appropriate very low 50 percent income number (adjusted by the number of persons deemed to occupy the unit) by two to get the 100 percent income number. This number can then be multiplied by any income percentage required (in this case 80 percent). Allowable monthly rent is then calculated by multiplying 30 percent times the imputed annual family income limitation, divided by 12 months, and then deducting any utility allowance.

> ***Example:*** To demonstrate the correct method of calculating rent limits, we will calculate the maximum rent limit for a two-bedroom unit in San Francisco (Calif.) County for 2009 at the 80 percent AMGI limit. Since each bedroom is deemed to be occupied by 1.5 people, a two-bedroom unit would be deemed to be occupied by three people (2 bedrooms x 1.5). The 50 percent AMGI limit for a three-person household in San Francisco County is $50,900. Multiply the AMGI limit by two in order to get the 100 percent limit of $101,800. Then multiply the 100 percent limit by the applicable AMGI percentage, which in this case is 80 percent, to get $81,440 ($101,800 x 80 percent). Allowable monthly rent is calculated by multiplying this limit by 30 percent and then dividing by 12 to get $2,036 ($81,440 x 30 percent / 12 = $2,036). This is the 80 percent AMGI rent limit for a two bedroom unit regardless of whether two people or four are occupying the unit.

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[1] IRC Section 42(g)(2)(C)

Additionally, the FAQ states that the rent restricted units must maintain their rent restrictions throughout the 7-year NMTC compliance period. Clarification is needed as to how continued compliance with the rent restriction must be demonstrated. Does this require annual recertification of household income or only initial certification and new move in certification? We recommend that household income certifications only be required for initial tenants and any subsequent new move-ins, using the definition of income and assets under HUD Handbook 4350.3 REV-1, Chapter 5 as a guide. Pursuant to the guide, once a household has been certified, it is not required to be certified every year thereafter. The rent calculation would need to be updated each year based upon the imputed family size calculation recommended above in order to maintain the appropriate rent restriction over the compliance period. We believe that these changes will leverage the experience and history of the LIHTC Program, which is well-understood and documented. We further recommend that once a unit has been certified as affordable it will remain affordable, so long as the qualifying family continues to occupy the unit, for purposes of determining whether the 20 percent affordability requirement has been met.

In order to incorporate these recommended changes, we have provided suggested wording for the guidance currently available:

1. ~~A QLICI that finances~~ Rental housing units shall meet the requirements of Section 3.2(k) if they meet the following criteria:

   a) 20 percent or more of total rental units financed with QLICIs are both rent restricted, **as defined in Internal Revenue Code Section 42(g)(2),** and occupied by individuals whose **household** income, **as determined by HUD Handbook 4350.3 REV-1,** is less than or equal to 80 percent of area **median** family income as determined and adjusted annually by HUD; **and**

   b) **20 percent or more of total rental units financed with QLICIs maintain their rent restrictions throughout the 7-year NMTC compliance period. Maintenance of the rent restrictions for the 7-year NMTC compliance period shall be documented by certifying the initial household income of any tenants. Tenants should be certified as of the later of the date the QLICI is made or move-in. Once certified, tenants are not required to be certified again. The maximum amount of rent allowed, as determined in paragraph (a) above, is calculated annually. Once a unit has met the requirements of paragraph (a) above, it will be considered to continue to meet the requirements of paragraph (a) regardless of actual physical occupancy, until the unit is occupied by a new tenant that does not meet the requirements of paragraph (a).**

Part 2 – For-sale housing units

The FAQ states that the requirement is met for for-sale housing units if "…20 percent or more of the total for-sale housing units financed with QLICIs are purchased and occupied by individuals with a 38 percent Debt-To-Income Ratio…" We request clarification that a Debt-to-Income ratio of 38 percent **or less** is acceptable. Further, we request clarification to determine what debt service is included in the calculation of the Debt-To-Income Ratio. We recommend

that the 38 percent limit be the purchaser's percentage of income that goes toward mortgage costs, which includes mortgage principal and interest, mortgage insurance premium (when applicable), hazard insurance premium, property taxes, and homeowners' association dues (when applicable). We have provided the language below for your convenience to incorporate these suggested changes:

2. ~~A QLICI that finances~~ For-sale housing units shall meet the requirements of Section 3.2(k) if 20 percent or more of the total for-sale housing units financed with QLICIs are purchased and occupied by individuals with a **household Debt Service-To-Income Ratio that does not exceed 38 percent (debt service only includes monthly mortgage costs such as mortgage principal and interest, mortgage insurance premium (when applicable), hazard insurance premium, property taxes, and homeowners' association dues (when applicable)** and are owner-occupied by individuals with **a household income** less than 80 percent of the area **median** family income as determined and adjusted annually by HUD at the time the units are sold to the initial homebuyer.

Question 17 – What is the "Substantial Rehabilitation" threshold for purposes of meeting Section 3.3(h) of the allocation agreement?

The FAQ states in order to meet the substantial rehabilitation threshold, a CDE must show that the cost basis of any improvement incurred during the 24-month period **following** the QLICI meets a stated minimum percentage of the project's adjusted basis. However, in the case of a QLICI being used to provide "take-out" financing, improvements must have occurred within the 24 months **prior** to the QLICI being made, with the "substantial rehabilitation" threshold being tested as of the date the QLICI is made. This requirement will be overly burdensome for many CDEs as written because it creates two different 24-month periods depending on whether the QLICI is financing the cost directly or as take-out financing. If the QLICI is funding the costs directly, the measurement period is the 24 months following the QLICI. If the QLICI is being used as take-out financing, the measurement period is the 24 months prior to the making of the QLICI. In many transactions, a CDE will want to make a QLICI that will cover rehabilitation costs incurred before and after the QLICI is made.

We recommend using a provision similar to the provisions set forth in IRC Sections 47(c)(1)(C) and 42(e)(3)(A)(ii), which states that the threshold for Substantial Rehabilitation may be met during **any** 24-month period. This provision is common practice in the rehabilitation tax credit and low-income housing tax credit programs and allows the CDE to capture all the rehabilitation costs in order to meet these requirements. In order to limit the time period for which costs can be included in determining if the substantial rehabilitation requirement is met, we recommend that costs be limited to those incurred during the taxable year in which the QLICI is made and any 24 month period that begins in, ends within, or straddles the taxable year in which the QLICI is made.

> In order to meet the substantial rehabilitation threshold, **a building will be considered substantially rehabilitated in a taxable year** if the cost basis (as defined in 26 USC § 1012) of any improvements incurred during the **taxable year the QLICI is made and during any** 24-month period **that begins in , ends**

> **within, or straddles the taxable year in which the QLICI is made,** equals or exceeds 25 percent of the adjusted basis (as defined in 26 USC-§ 1011(a)) of the building ~~upon~~ **with respect to** which the improvements are made **as of the beginning of the applicable 24 month period. Once the substantial rehabilitation threshold has been met for a building, it will be deemed met for any subsequent QLICIs made with respect to the same rehabilitation.** ~~This ratio will be assessed as of the first day of the 24-month period. In the case of a QLICI being used to provide "take-out" financing (as permitted under Section 3.3(h) of the allocation agreement), improvements equaling or exceeding 25 percent of the adjusted basis of the building upon which the improvements are located must have occurred within the 24 months prior to the QLICI being made~~.

Conclusion

We look forward to continue working with the CDFI Fund as it strives to ensure the success of the NMTC Program. It is with that shared goal in mind that we thank you in advance for your time and efforts when consider our comments above regarding the FAQ. As participants in the industry, we have seen the tremendous benefits NMTCs can provide to distressed communities nationwide and the low-income residents that reside in them. If you have any questions regarding any of the recommendations or comments made above, please feel free to contact us.

Yours very truly,
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