NASLEF

DEPARTMENT OF THE TREASURY December 22, 2020
Internal Revenue Service
Via Electronic Portal

RE: Comments regarding proposed Low-Income Housing Credit Average Income Test Regulations
IRS REG-104591-18

To Whom it May Concern:

On behalf of the membership of the National Association of State and Local Equity Funds (NASLEF), we appreciate having the opportunity to respond to the aforementioned proposed rule regarding the Low-Income Housing Tax Credit (LIHTC) Average Income Test (AIT).

The National Association of State and Local Equity Funds (NASLEF) is a professional, nonprofit association formed in 1994 to promote the efficient management of state and local equity funds. Collectively through 2019, member funds have raised over $16.9 billion in equity capital for rental housing developments throughout the country, creating or rehabilitating more than 201,125 units of affordable housing in 4,175 developments.

NASLEF's mission is to promote a greater understanding of tax credit and other financing programs, to advocate for community development resources and to encourage the professional development of its member organizations all in support of the communities we serve. Our work is fueled by our members' leadership in affordable housing advocacy, connection with community organizations, and knowledge of local markets. These organizational attributes enable NASLEF members to invest capital in strategic community endeavors, especially in underserved markets.

Across the United States, 13 State and Local Equity Funds are in the business of delivering to 40 states equity capital for rental housing developments that qualify under the LIHTC program.

As you will note in our comments below, we believe that the Average Income provision enacted in the Consolidated Appropriations Act of 2018, if thoughtfully administered, can have a very positive impact on the development and preservation of affordable housing. We appreciate the IRS's commitment to craft guidance governing this tool. However, we are highly concerned that the specific rules (as proposed) raise serious problems that will make it very difficult for this important tool to be utilized as Congress intended. This letter outlines some of our major concerns and recommends alternate rules that enable this provision to achieve its intended impact.

Importance of the Average Income Test Provision

Practitioners within the affordable housing industry have long advocated for 'income averaging' as an important enhancement that would improve the efficiency and effectiveness of the LIHTC program. Our organization's members, who serve harder to reach urban and rural areas, viewed this provision as especially critical for helping develop and preserve affordable housing in those communities. We have provided several examples below of the ways this tool has the potential to aid in addressing key challenges to affordable housing preservation and development.

Tool for Low-Income Housing Preservation

As you know, access to affordable housing remains a major challenge affecting communities across the country. Preservation of existing affordable housing properties is a key component of our efforts to address the affordable housing crisis. We work to ensure that affordable housing properties are well-maintained and sustainable, allowing for these assets to remain in service for the longest possible timespans.

Prior to the 2018 Average Income provision, developers of affordable housing routinely encountered barriers when attempting to use LIHTC to preserve U.S. Department of Agriculture Rural Development (RD) and HUD Section 8 housing. It was not uncommon for an existing affordable housing project in desperate need of recapitalization to have a few residents whose income levels may have been slightly higher than 60% AMI, thereby falling outside of the existing LIHTC maximum allowable income level. In order to utilize LIHTC to recapitalize and preserve these developments, it was necessary for the developer to remove the eligible basis associated with these units from the calculation of credits to be earned, effectively 'surrendering' the tax credit subsidy that might have otherwise been used for those units. In doing so, the developer received less tax credits (i.e., less cash available to the property), resulting in the developer often being required to reduce the amount of rehab work to be performed. This results in housing that is less sustainable for the long term.

The affordable housing industry advocated consistently for the Average Income provision (in part) so that under this scenario, LIHTC would not be lost allowing for a more robust rehabilitation to be performed during the time of recapitalization. Using the Average Income provision, a developer could identify a few units to serve residents whose income exceeded the previous 60% maximum limit, and still claim credits on those units. In doing so, a more robust rehabilitation would be pursued at the time of recapitalization yielding a stronger asset that will be sustainable for a longer period of time.

Meeting Demand for Affordable Housing in Rural Areas

In rural areas, affordable housing options are often very limited. The income averaging provision would help address a dynamic that our members often see in these rural communities. Management at newly developed rural properties at times will turn away applicants whose income limits were slightly above the LIHTC 60% threshold. These applicants typically do not have other housing options due to the exceedingly limited housing stock across rural communities.

For these properties, the Average Income provision can be a critically important tool as it 'widens the band' of affordability, potentially serving households from 20-80% AMI. There are some rural markets where serving those households in the 60-80% AMI range is critically important, and the Average Income provision enabled in the Consolidated Appropriations Act of 2018 addressed that need.

Improved Efficiency of the LIHTC

In certain markets, market rate rents are exceedingly high (such as Boston, San Francisco, San Diego, Chicago, etc.). If developing a building in a high rent location, a savvy developer is able to use the Average Income provision in a way to reduce the reliance of LIHTC. For example, if able to achieve 80% AMI rents for a number of units, a property is able to collect higher rental income than a typical affordable housing property and in doing so, the property should be able to service a higher debt level. This allows the property to require less housing tax credits during the allocation process by pursing higher debt. If a number of properties within a state are able to leverage additional debt (under the Average Income provision), the HFA should be able to produce additional units of affordable housing, thereby achieving improved efficiency of the program by bolstering the number of units produced per year.

Damaging Effects of Rules as Proposed

Unfortunately, the proposed rule would dramatically and unnecessarily elevate the risk to the investors creating a major and possibly insurmountable barrier for its use. *In fact, within the past several days a major national investor in the LIHTC program has provided notice to two NASLEF members indicating that they will highly scrutinize and/or likely disapprove properties in upcoming funds utilizing the Average Income provisions as result of the status of the AIT proposed rule.* It appears that the potential benefits to utilizing the program will be weighed against the drastic penalty for minor noncompliance and *will* discourage the use of income averaging.

The proposed rule's requirement that all low-income units in a project average no more than 60 percent of AMI could result in the complete loss of tax credits as a result of a single unit falling out of compliance. This is highly punitive and creates a severe disincentive for using the AIT set-aside. While the proposed rule allows an owner to 'remove' other units within a 60-day window to allow the taxpayer a short-lived remedy to maintain the minimum set-aside, the reality is that non-compliance is <u>not</u> routinely identified within 60 days of year-end. While non-compliance is rare, it is most likely to be identified long after the 60-day proposed window, and sometimes may not be identified until years after the fact. The current proposed rule may result in many properties failing to meet the minimum set-aside, yielding massive credit loss to the underlying investors. As such, if this proposed rule is adopted, it will significantly raise risks to investors that will cause developers to not use the AIT option. The benefits that the affordable housing industry and Congress sought in the Average Income provisions would be lost.

Furthermore, the aspect of the proposed rule that 'fixes' the units versus allowing units to 'float' also dramatically complicates an owner's ability to effectively manage their housing as the proposed rule appears to completely disregard key provision of the Fair Housing Act. Owners of affordable housing routinely entertain requests for reasonable accommodations and more recently, requests for special consideration resulting from the Violence Against Women Act (VAWA) legislation. In response to their Fair Housing and VAWA obligations, owners and managing agents exercise their best judgement and will routinely transfer residents to other units in response to these reasonable accommodation requests to be responsive to the evolving needs of residents who are aging in place. 'Fixing' units in the matter suggested in the proposed rule eliminates the owner's ability to do so and could place them in direct conflict with their fair housing and VAWA responsibilities. *It is critical that rule-making processes work to better align varying federally mandated programs and requirements so they to work together more seamlessly.*

We have provided case studies from our members to highlight the unworkability of the proposed rule, as drafted.

<u>Case Study 1: Identifying Non-Compliance After 60-Day Window</u>

In October 2020, a NASLEF member worked with their Housing Finance Agency (HFA) to reconsider a tenant file from 2004, a full 16 years after the original move-in where the original eligibility of the resident was in question. After careful review and re-calculation of the original documentation submitted at the time of move-in in 2004, it was confirmed (and the HFA verified) that the household did in fact qualify and the credits claimed associated with that unit were in fact appropriately earned.

If, theoretically, it was found that the original move-in *did not appropriately qualify that unit*, we acknowledge that all of the LIHTC associated with that unit would be lost, and the taxpayer would be required to repay the LIHTC with penalty and interest resulting in a significant sum (likely in excess of $150,000). Under the proposed Average Income rule (assuming this same property was operating under this propose rule), however, this project may not have maintained minimum set-aside resulting in the financial loss of $6.7M in previously claimed LIHTC plus penalties and interest. These penalties would accrue despite all other units in the project having been appropriately rent and income restricted and properly qualified for the last 16 years.

Under the proposed Average Income Test rule, the risk to the investors is dramatically increased and will suppress the usage of this new set-aside, effectively nullifying the positive impact it was meant to promote.

<u>Case Study 2: Suppressing Preservation Activities / RD and RAD Conversions</u>

There is an essential need in our industry to preserve the existing inventory of affordable housing. The creation of the Average Income policy under the tax credit program provides the often-difficult preservation work with an important new tool. Unfortunately, we believe the power of this new tool is being undercut by the proposed rule.

As proposed, the new guidelines have set forth a rigid structure that will undoubtedly have a chilling effect in the industry and severely limit the adoption of Average Income as viable tool. A NASLEF member was in recent conversations with a nonprofit developer actively working to preserve the affordability of a large Rural Development portfolio. Prior to the new proposed guidance from the IRS, the project was looking to employ the Average Income election to remove barriers within the development process. The Average Income election would enable them a solution to the problem of those long-time residents in the 60-80% income bracket while also ensuring the project received sufficient equity to rehabilitate the aging buildings and units. However, due to the restrictive nature of the new interpretation, the nonprofit has serious concerns on whether it can successfully operate the project while following the requirement to fix income designations to specific units for the life of the regulatory period. If the deal cannot be structured using Average Income, it is not clear whether units can be preserved.

In a very short period, it has become clear that the Average Income policy can be a critically important component of the preservation puzzle. However, as drafted, we believe the proposed guidelines will limit widespread adoption of the tool and ultimately have a negative impact on the industry's ability to find creative solutions to the complex challenges of preservation.

<u>Case Study 3: Rule is in Conflict with Fair Housing Rules</u>

At move-in, an elderly resident has an income meeting the 80% income standard and occupies a unit on the 2nd floor of a two-story walk-up complex. A year later, the resident's condition has deteriorated to the point of needing to use a walker, making navigating the stairs impossible. In accordance with Fair Housing law, the resident requests a reasonable accommodation to be transferred to a first-floor unit. The property has an available comparable unit on the first floor; however, the unit has been designated for households with a 30% income. Since designations are fixed under the proposed rule, the transfer cannot be accomplished and the household will have to move out.

Similarly, consider a situation where a household moves in with an income meeting the 80% income standard and occupies a two-bedroom unit. Later the household is involved in a car accident and the wife loses the use of her legs and requires a wheelchair. The household requests a transfer to an accessible unit as a reasonable accommodation under Fair Housing law. However, the accessible units have been designated for households with a 50% income. Therefore, under the proposed regulations the transfer cannot take place. However, if the project has utilized any federal funding sources in its financing or subsidy, the project will be subject to the requirements of Section 504 of the Rehabilitation Act of 1973 which will require the owner to modify the tenant's current unit to provide the necessary accessibility *at the owner's expense*. This is an expense that will fall on the project when a simple transfer would have provided the needed accessibility at very little expense.

An Alternate Proposed Approach

While NASELF organizations expend considerable resources to ensure full regulatory compliance in all of the affordable housing properties where we hold an investment, we know that compliance issues do sporadically arise. We fully understand and accept that failure to comply with regulations should result in the loss of the housing tax credits with any unit that is found to be in non-compliance (consistent with current practices). *Being at risk, however, of losing <u>ALL</u> tax credits at a property over one unit not being in compliance creates unnecessary risk to investors that threaten the use of the important AIT tool.*

A fair and reasonable approach would be to follow the well-established precedent whereby the LIHTC associated with the non-compliant unit(s) should be lost if found to be in a state of non-compliance at year-end. If more than 40% of the overall units in the property are found to not be in compliance at year-end, the property should fail its minimum set-aside test. Under no circumstances should the rule allow a single unit's non-compliance to put at risk the full tax credits for the property (unless it is only a 2-unit LIHTC property).

Additionally, unit designations should be able to 'float' thereby allowing the owner flexibility to more effectively respond to the emerging needs of residents in compliance with VAWA, reasonable accommodation requests and Fair Housing laws more generally. Many LIHTC allocating agencies have historically incentivized deeper income targeted units and have implemented this deeper income targeting by designating a specific number of units at each income level. A similar unit designation could be used with the average income test which would fix the number of units at various AMI levels yet provide flexibility needed to successfully operate a property.

Conclusion

We ask that the proposed rule surrounding the Low-Income Housing Credit Average Income Test be reconsidered and amended, as the proposed rule runs contrary to the spirit and the intent of the underlying statute and fails to meet the purpose for which it was enacted.

In place of the proposed rule, a simple provision should be adopted disallowing the taxpayer to claim tax credits for any units that are found to be in non-compliance with LIHTC provisions (consistent with existing regulations). In the instance where more than 40% of the total units in a property are found to be in non-compliance with LIHTC regulations, the property should be considered in violation of its minimum set-aside, thereby disallowing *any* credits to be earned by the taxpayer. *Under no circumstances should non-compliance in one unit potentially result in a failure to meet the minimum set-aside test.*

Additionally, units should be allowed to 'float' and not be 'fixed', allowing for compliance with other federal laws including the Fair Housing Act and VAWA.

We appreciate your thoughtful consideration of these comments.

National Association of State and Local Equity Funds (NASLEF):

CAHEC
CINNAIRE
Hawaii Housing Finance, LLC
Housing Vermont
Massachusetts Housing Investment Corporation
Merritt Community Capital Corporation
Midwest Housing Equity Group, Inc.
Mountain Plains Equity Group, Inc.
Northern New England Housing Investment Fund
Ohio Capital Corporation for Housing
St. Louis / Kansas City Equity Fund, Inc.
Virginia Community Development Corporation