WASHINGTON STATE
HOUSING FINANCE
COMMISSION

Opening doors to a better life

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TO: Office of Associate Chief Counsel, Internal Revenue Service
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FROM: Washington State Housing Finance Commission
Steve Walker, Executive Director

RE: Notice of Proposed Rule Making – Section 42, Low-Income Housing Credit Average Income Test Regulations

The Washington State Housing Finance Commission (the Commission) urges the Internal Revenue Service (IRS) to rescind the recently released Notice of Proposed Rule Making concerning the **Section 42, Low-Income Housing Credit Average Income Test Regulations.**

The proposed rule would impose significant operational and financial burdens on tax credit property owners and management companies. The new rule departs from current program intent concerning the minimum set-aside test and fails to deliver the flexibility that the income averaging election was intended to provide owners. It also creates a new monitoring role for housing finance agencies that is not intended under current regulations.

Permanent Unit AMI Designations Creates Operational Problems

The proposed rule indicates that once the owner provides confirmation of the AMI designation for each unit (at the end of the first credit year), that those AMI designations are irrevocable. This position creates a number of problems. Property managers routinely transfer residents between units and BINs at 100% affordable properties. This rule would make it impossible for residents to transfer when and where they needed; they could only transfer to another unit with the same AMI designation. This is problematic for residents who need a specific unit due to a reasonable accommodation or for household size changes.

This position also prevents managers from adjusting AMIs due to changes in household income. Residents would only be able to have their AMI designations changed by moving units; this is overly burdensome on the household and the management company as it forces excessive costs on both parties for no compelling reason. In Washington State, most tax credit properties operate with at least two, if not three, different AMI restrictions. One key to the successful management of multiple AMIs is to allow adjustments to be made based on resident circumstances and the needs of the property.

The inability for managers to transfer residents to the appropriate unit could have Fair Housing consequences. If the only unit at a property with the appropriate design amenities to meet a reasonable accommodation is designated at an inappropriate AMI for the transferring

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household, then the property owner risks a Fair Housing violation.

Maintaining fixed AMI designations also hinders the property's ability to successfully navigate changing market conditions. Over time, properties must respond to changing markets, something the income averaging election was designed to aid. With permanent AMI designations, owners have no flexibility to adapt AMIs to meet operational and market needs. This will result in extended and unnecessary vacancies as owners are forced to wait for households which meet the fixed AMI requirements for the vacant units. Extended vacancies will result in loss of rental revenue, adversely impacting cash flow and long-term viability of the project. Extended vacancies also result in fewer households being housed. We are at a time when affordable housing is scarce and needed more than ever, and this would be a truly devastating result.

Contradicts General Program and Specific Election Intent

The general intent of the LIHTC program has always been to associate AMI set-asides with resident households, not with units at a property. The traditional federal elections support this concept. Existing federal elections also follow the program's centering of BINs as the focus of program compliance, not units.

Most projects elect not just the federal AMI but additional AMIs as needed to meet the housing needs of their communities. The Commission prioritizes state AMI set-asides as a way to ensure that tax credit housing can meet critical housing needs throughout the state. Owners and managers in our state are used to running projects with multiple AMI set-asides and have done so successfully for more than 20 years. Management companies are also adept at calibrating the AMI mixes at their properties to address rising incomes of current residents to ensure that vacant units can target the lowest income households in the community.

Another departure from general program intent in the proposed rule is the changing of the minimum set-aside test for income averaging. In contrast, the other elections require only that a portion of a project's units be income-qualified by the end of the first credit year in order for the project to be a qualified LIHTC property. The proposed rule requires that 100% of the project's units must meet the minimum set-aside test. This means that if one unit is out of compliance, the entire project could fail the minimum set-aside at the end of the first credit year. This would have catastrophic consequences for owners and could render the property operationally untenable. The proposed rule's interpretation of the minimum set-aside test is not consistent with the treatment of the other federal elections and creates an unnecessarily harsh burden for the project and its stakeholders to carry.

The intent of the income averaging election was to give owners the flexibility to respond to specific market conditions and project operational needs. This flexibility is erased by the proposed rule. This will make investors wary of embracing income averaging as an election since it undermines operational flexibility and carries such significant noncompliance consequences. To accommodate income averaging as an election, investors are more likely to require that owners build in a "buffer" so that the project averages below 60% AMI (especially if the minimum set-aside test will apply to all units). Forecasting this level of AMI set-aside precision at the onset of a 40 year regulatory period dooms the property to operational difficulties over time, difficulties which are not present when choosing either of the other federal elections.

The other inconsistency in the proposed rule is its treatment of the correction period for out of compliance units. The Commission annually audits each tax credit property, reviewing documentation for the previous calendar year. We review data for over 100,000 units across the state – as such, it takes our team of eight staff an entire year to review annual reports for all properties and units. When we discover noncompliance, we notify the owner immediately and provide a cure period consistent with guidance provided by the IRS in the 8823 Guide. The Guide does not require noncompliance cures to take place within a certain time frame after the close of a tax year.

Under the proposed rule, at the time noncompliance is discovered, a unit could be in a state of noncompliance for over a year. Given our workload and business processes, the Commission is unable to provide notice to an owner in time for them to cure a unit which violates the income averaging election. The owner would have to discover the noncompliance on their own and fix it before the end of February each year. Again, this puts a significant burden on the owner and prevents housing finance agencies from exercising their current discretion on how and when noncompliance is resolved.

Creates Role for HFAs Which Supersedes Their Authority

The concept of unit removal for purposes of curing income averaging-related noncompliance is an entirely new concept which nothing else in Code supports. This concept creates an option for "disallowed" credits, instead of credit recapture. More significantly, the concept of disallowed credits places housing finance agencies in the position of deciding on which units the owner can claim credits. The historic and programmatic role of housing finance agencies is to simply report noncompliance as it is found. The role of determining credit recapture, or anything else to do with credits, is accorded to the IRS. Requiring housing finance agencies to track removed units essentially requires housing finance agencies to confirm a tax-related

transaction. This is an inappropriate interpretation of housing finance agency scope in the LIHTC program.

Conflicts with Other Housing Programs

Finally, the proposed rule creates potential conflict with other housing programs. HOME, Rural Development rental assistance, project- and voucher-based Section 8 are all routinely layered with credits at affordable properties across the country. All these programs have their own rules that may be unnecessarily triggered by the permanent designation of AMIs on tax credit units. Tax credit AMI designations could conflict with HOME unit-based set-asides, and Section 8 voucher holders may have greater difficulty using their vouchers if AMI designations cannot be adjusted on vacant units. The restrictions posed by permanent AMI designations could also make it difficult to transfer a domestic violence victim to a new unit, which would violate federal VAWA regulations.

The Commission has long-standing relationships with most of the other public funder agencies in our state, including agencies which distribute State and National Housing Trust Funds, HOME funds and municipal and county-level housing levy dollars. These relationships have allowed us to share compliance monitoring and inspection tasks on jointly-funded multifamily properties. The proposed rule on income averaging introduces complications that may make it difficult for us to collaborate with our funder partners and may make it more difficult for developers to align different funding streams to optimally position properties for credit allocation.

In light of the significant negative consequences of the proposed rule, the Commission urges the Service to rescind the proposed rule and work with housing finance agencies to provide clarification of the income averaging election that is consistent with broader LIHTC program intentions and goals.