NOVOGRADAC
TAX CREDIT TUESDAY
PODCAST

Summary: February 4, 2020

In this week's Tax Credit Tuesday podcast, Michael J. Novogradac CPA, discusses an infrastructure plan that was released by House Ways and Means Democrats called Moving Forward. Next, he discusses an emergency supplemental appropriations bill that would provide additional appropriations to Puerto Rico to help rebuild after recent earthquakes. He then shares an update on CRA reform and discusses key details from a hearing held by the House Financial Services Committee on proposed CRA regulations released by the OCC and FDIC. He also talks about guidance released by the IRS that clarifies how to determine income limits in the average income test for low-income housing tax credit properties. Then, he shares some highlights from the Novogradac 2020 New Markets Tax Credits Conference, and finally, talks about draft opportunity zone regulations that were released by the Puerto Rico Department of Economic Development and Commerce.

Summaries of each topic:

GENERAL NEWS

Infrastructure Reform

- House Ways and Means Democrats released their infrastructure plan last week.
- The framework is called Moving Forward.
- The Moving Forward framework is a five-year, $760 billion infrastructure plan that would expand in part existing infrastructure tax credits as well as create new ones.
- The framework says it would expand and build upon the new markets tax credit, historic rehabilitation tax credits and the low-income housing tax credit.
- If those tax incentives are expanded as part of an infrastructure package, it would provide substantial opportunity for the affordable housing and community development communities to build on their existing success.
- That said, the plan did not include any specific details on how it would strengthen these tools or how it would expand them.
- That's why I referenced the cost being $760 billion plus.
- Nor did the framework suggest how the plan would be paid for and that's a critical piece of this—it's a crucial element that has held up action on infrastructure legislation in the past.
- The release of the infrastructure framework last week did coincide with a House Ways and Means Committee hearing on funding and financing infrastructure investments.
- Ways and Means Committee Chairman Richard Neal of Massachusetts in his opening statement called for continued investment through the low-income housing tax credit, new markets tax credit and historic tax credit.
  - We are very fortunate in the tax credit incentive community to have Chairman Neal as a longtime supporter and champion of those initiatives serving as chairman.
- Laura Canter of the Massachusetts Development Finance Agency was a witness at the hearing.
- She also spoke highly of the low-income housing tax credit, historic tax credit and the new markets tax credit as infrastructure tools.
- A few Ways and Means Democrats asked Canter about how to enhance or improve the low-income housing tax credit.
  - I should note that those Ways and Means members who posed the questions are cosponsors of the Affordable Housing Credit Improvement Act, or AHCIA.
  - That's the bipartisan bill that would expand and improve the low-income housing tax credit.
- In response, Canter urged Congress to establish a 4 percent floor for the so-called 4% low-income housing tax credit, increase the 9 percent allocation amount and expand bond recycling.
  - All of these are key provisions of the AHCIA that would provide more resources for affordable rental housing development.
- This testimony is significant because it helps elevate the visibility of these incentives and increases the chances of them being included in a final infrastructure solution.

Puerto Rico Emergency Supplemental Appropriations

- Continuing with infrastructure, I have some details on an emergency supplemental appropriations bill that would help rebuild Puerto Rico's infrastructure after the recent earthquakes.
- House Appropriations Committee Chairwoman Nita Lowey of New York is the lead sponsor.
  - The bill is H.R. 5687 and would provide three emergency supplemental appropriations for Puerto Rico:
    - It would provide an additional $500 million in new markets tax credit allocation authority for the years 2020 and 2021,
    - increase the low-income housing tax credit ceiling for Puerto Rico by $50 million for calendar year 2020—that's $500 million over the 10-year credit period—and
    - it would provide $3.26 billion through the Community Development Block Grant-Disaster Recovery program.
  - If passed, these funds would represent a significant investment opportunity in rebuilding the area.
  - Puerto Rico would also have $1.53 billion set aside for mitigation in areas that experienced major disasters in 2018 and 2019.
  - A link to the bill is included in today's show notes.

CRA Reform Hearing

- Now let's switch gears to banking regulation.
- I want to follow up on a topic I discussed in last week's podcast: Community Reinvestment Act, or CRA, reform.
- The House Financial Services Committee on Wednesday held a hearing on whether the Office of the Comptroller of the Currency is undermining the CRA's purpose and intent with proposed regulations that the OCC released in conjunction with the FDIC—notably without participation from the Federal Reserve.
- This hearing is of particular interest to Tax Credit Tuesday listeners because of concerns that the proposed regulations, if finalized, could have a detrimental effect on low-income housing tax credit, new markets tax credit and historic tax credit equity investing.
- The hearing last week had one witness: Comptroller of the Currency Joseph Otting.
- During the hearing, Financial Services Committee Chairwoman Maxine Waters raised concerns about the OCC and FDIC's proposed regulations, saying that the regulations run contrary to the purpose of the CRA.
- She said that under the proposal, the Community Reinvestment Act would turn into the "Community <u>Dis</u>investment Act."
  - Chairwoman Waters said the proposed rule would lead to widespread bank disinvestment in the low- and moderate-income communities that the CRA was created to protect.
- The chairwoman's objections are similar to concerns previously expressed by the Federal Reserve and other community development advocates.
- One specific concern is about the proposed elimination of the CRA investment test.
- The Federal Reserve and others are concerned that replacing the investment test would remove an important incentive for banks to invest in affordable housing and community

development—think, low-income housing tax credit and new markets tax credit investment.
- A majority of low-income housing tax credit and new markets tax credit equity investment comes from banks that are overseen by the OCC.
- And so, as noted earlier, there are concerns that these proposed regulations, if finalized, could have a detrimental effect on low-income housing tax credit and new markets tax credit activity.
- In his testimony, Comptroller Otting defended the proposed regulations, saying that many of the criticisms against it are misperceptions.
- Comptroller Otting said that one misperception is that the proposal would rely on a single metric to determine a bank's CRA rating.
    - He said that the proposal requires CRA examiners to consider a retail lending test that is virtually identical to a test proposed by Federal Reserve Governor Lael Brainard.
    - I should note that I don't believe most CRA experts would consider the OCC-FDIC retail lending test to be "virtually identical" to what the Fed outlined in Brainard's speech.
    - Furthermore, Otting said examiners would also evaluate the impact of a bank's CRA activity by measuring the dollar value of the activity in each assessment area and at the overall bank level.
    - Then, examiners would apply their judgment to assign a final rating.
    - The issue with this approach is that there are few specifics in the proposed rule that indicate what it really means for an examiner to "apply his or her judgment to assign a final rating"
    - That ambiguity can lead to confusion for banks trying to figure out how to get positive CRA consideration.
- You can read more about how the proposed regulations could affect affordable housing and community development investment in this month's issue of the Novogradac Journal of Tax Credits.
- We also have a Notes from Novogradac blog post on the topic.

Clarification on LIHTC Income Limits for Average Income Test

- Let's move from bank regulation to IRS tax guidance.
- The IRS on Wednesday issued long-awaited guidance on how to determine income limits in the average income test for the low-income housing tax credit.
- This guidance provided welcome clarification and reassurance for developers and property owners who have been implementing the average income provision without certainty regarding how to set limits for the 20, 30, 40, 70 and 80 percent designation levels.
- Now that this guidance is available, I expect to see even more properties elect to use this third set-aside option.
- Specifically, Revenue Ruling 2020-4 affirms that HUD's calculation for very low-income limits should be used as the basis to determine the full range of income limits under the average income set-aside.
    - The limit should be calculated in a linear manner.
    - For example, a 30 percent income limit would be 60 percent or less of the very-low-income limit of the same size.

- Before this guidance, the only income limits that HUD published for Section 42 and Section 142 were 50 percent and 60 percent income limits.
- Why only those two?
- That's because the average income set-aside option was created in 2018, at the time there were only two minimum set-asides under which to qualify for the low-income housing tax credit: known as the 20-50 test and the 40-60 test.
    - Under the 20-50 test, at least 20 percent of the housing units in a property must be rent-restricted and occupied by tenants with a gross income of 50 percent or less of the area median gross income, or AMI.
    - Similarly, the 40-60 test is 40 percent of units at 60 percent AMI.
    - Hence, both of those tests needed a definition of the 50 and 60 percent income limit, and that's why HUD published those two limits.
- Then, the average income set-aside was added as a third option to qualify for the low-income housing tax credit, which created these additional income limits that were undefined.
- The average income set-aside was an option that many affordable housing providers have been advocating for for years as a way to provide deeper income targeting and serve a wider range of household incomes.
- In essence, the average income set-aside allows a property to serve a range of tenant incomes from 20 percent to 80 percent of the area median income, as long as the average designation of the affordable units is 60 percent of AMI or less.
- What was the challenge with this new set-aside option?
- We had a new range of incomes possible under the average income test—20 percent to 80 percent area median income—<u>but</u> HUD had only published incomes for the two original set-aside options: 50 percent and 60 percent.
- State housing agencies, and affordable housing developers and property owners didn't have guidance on how HUD should calculate the 20, 30, 40, 70 and 80 percent income limits for the average income test.
- HUD publishes several data sets for income limits, so it was unclear which set to use.
- In the Section 8 world, HUD publishes an extremely low income limit.
    - That's often referred to <u>incorrectly</u> or misleadingly as the 30 percent limit.
    - And HUD publishes a Section 8 low-income limit, often <u>incorrectly</u> or misleadingly referred to as 80 percent income limits.
- Why is it incorrect to call them the 30 percent and 80 percent limits? Or at least misleading?
- If the industry had to adopt extremely low-income limits for 30 percent and low-income limits for 80 percent, then that would have been a morass.
- That's because the extremely low and low income limits have statutory, mandated adjustments that HUD applies—adjustments that don't apply to the 50 percent and 60 percent calculations.
- These adjustments result in the limits not being mathematically pegged to each other.
- One of these adjustments for example is that the extremely low limit for any household size cannot be below the national poverty level.
- So what does this do? What does this mean?
- Well, it means that a very large adjustment can occur.
    - For example: In Calhoun, Alabama, the very low-income limit for a four-person household is $28,100.

- Mathematically, if I just extended that calculation, the 30 percent limit should be $15,570.
- However, the HUD-published extremely low-income limit is $25,750, more than $10,000 higher than the mathematically calculated 30 percent limit.
- The HUD published limit is actually a 46 percent income limit.
- That's just one example of how the 30 percent and 80 percent limits would produce inconsistent income limits.

- Fortunately, we now have this recently released guidance that tells HUD how to calculate income limits for the full range of income levels available under the average income set-aside.
- I mentioned that the average income set-aside was created in 2018 and this guidance is coming out two years later.
- In that gap of two years before guidance was available, the affordable housing community had to speculate how the income limits would be implemented under the average income test.
- Thankfully, the IRS guidance does provide limited relief language for developers and owners who proceeded differently in the absence of guidance.
- I'll include a link to a Notes from Novogradac blog post that has more information on the safe harbor in today's show notes.
  - The blog post is titled, "IRS Guidance on Average Income AMI Calculations."
- Overall, the affordable housing community is pleased to have this clarity from the IRS.
- That said, you may have questions about how to implement the average income set-aside for your property, and if you do, please contact my partner Thomas Stagg.
- I'll also include his email address in today's show notes.

NMTC Conference

- I'd like to talk about our conference we held in San Diego last week.
- It's our Novogradac 2020 New Markets Tax Credit Conference.
  - More than 500 people attended and we had two great days of learning and networking.
  - Actually, we had three days because we had a basics day and a bit of an advanced session on Wednesday as optional workshops.
  - There was, as always, important information for stakeholders in the tax incentive.
- One highlight was hearing from the CDFI Fund's new markets tax credit program manager, Christopher Allison, in a Q&A with my colleague Bob Ibanez.
- Allison provided insight during our first session of the conference.
  - He said the 2019 round of allocations is still on track to be announced this summer.
  - It's always said "this summer," but that narrows the announcement date to between June 20th and September 22nd.
  - He couldn't narrow it down more than that.
  - As you know, the 2019 round will be for $3.5 billion in new markets tax credit allocation authority.
- Allison did confirm that he expects there to be about the same number of allocatees this year as in recent rounds.
  - That would be about 70 to 75 community development entities that will get allocations.

   - He also said that the 2020 round, which is for $5 billion rather than $3.5 billion, if the past is a guide, would have more allocatees.
   - Allison said, once again if the past is a guide, we could expect about 100 CDEs to get allocations in the next round.
- Allison touched on a few other significant issues.
- He talked about the CDFI Fund's switch from three to two reviewers for new markets tax credit applications.
   - Allison pointed out that two reviewers is how many are required for other CDFI Fund programs.
   - He also clarified that a third reviewer is brought in when there is variation between the two reviewers.
   - He reminded attendees that all reviewers are trained and overseen by the CDFI Fund.
- Another issue Allison addressed was the use of third-party metrics in the community outcomes section of the new markets tax credit application.
   - And they already do get a lot of questions on this last application cycle.
   - A third-party metric isn't required, but it will provide a scoring advantage, according to the CDFI Fund.
   - He pointed out that the CDFI Fund has asked for metrics before.
   - The CDFI Fund sees a third-party metric analysis as a good way to validate the reasonableness of metrics provided by qualified low-income community businesses.
   - He said that people appear to be taking that change seriously, I can attest to that, and that he presumes this provision is here to stay.
   - If you're looking for help with third-party metrics, please contact a Novogradac office near you or reach out directly to my colleague Bob Ibanez.
   - We have experience providing that service for your new markets tax credit application and transactions.
- My conference panel in San Diego discussed the state of the new markets tax credit and its future in Washington, D.C.
- Paul Anderson of Rapoza Associates, one of my co-panelists, discussed the best legislative vehicles for possible new markets tax credit extender legislation.
   - As you know, the credit got a one-year extension at the $5 billion level in year-end budget legislation.
   - But, it expires at the end of this year.
   - Paul pointed out that one possible legislative vehicle for an extension of the credit is infrastructure legislation.
   - Another possible vehicle is the bill providing relief for Puerto Rico earthquake victims.
   - All that said, the most likely vehicle is a bill funding the federal government, which means this September.
   - Or if a continuing resolution is passed to go past Sept. 30 into the lame duck session of Congress, then that would be the time.
- Jeff McMillen of Akin Gump added an important point when having this discussion.
   - McMillen said the best vehicle for the new markets tax credit extension may be something that we don't even know about yet.
   - He reminded us that unexpected things happen every year that can provide a chance for tax legislation.
   - His point was to be alert for new opportunities.

- One takeaway from that and the rest of our session was for new markets tax credit stakeholders to continue to advocate.
- One way is to be sure to inform legislators and their staff about new markets tax credit-financed developments in their states and districts.
- There was plenty more at our conference and I do want to thank all of our presenters, attendees, co-hosts and sponsors—all of you made it possible.
    - If you couldn't make it to San Diego, I'd like to remind you that our next new markets tax credit conference is this June in Washington, D.C.
    - I'll include a link to register for that conference and I'll tweet it out as well.

Other News

- Turning to other news, the Puerto Rico Department of Economic Development and Commerce has announced the release of draft opportunity zones regulations.
- Puerto Rico is unique in the opportunity zones space because virtually all of Puerto Rico is made up of opportunity zones.
- You may recall, states could designated up to 25 percent of their low-income census tracts as opportunity zones, whereas Puerto Rico was able to include all of them.
- Which means almost any investment in Puerto Rico is eligible for the opportunity zones incentive.
- The draft regulations I'm referencing include some Puerto Rico-specific incentives, including extra tax exemptions and investment tax credits for holders of OZ decrees, that's a special standing that will be issued by the government of Puerto Rico.
- Combined with other many other federal tax incentives in Puerto Rico for recovery, there are an unusual number of ways to help finance developments, and there is a great need based upon not-so-distant hurricanes and earthquakes.
- These new regulations add an extra layer.
- Comments on the proposed regulations are due Feb. 29.
    - I'll include a link to the proposed regulations, as well as where to send comments in today's show notes.
    - If you want to learn more about investing in Puerto Rico, we will be discussing community development incentives at our Novogradac Investing in Puerto Rico Conference May 7-8 in San Juan, Puerto Rico.
    - I'll include a link to register in today's show notes.

Related Resources

Moving Forward Framework

Infrastructure Framework

Paving the Way for Funding and Financing Infrastructure Investments Hearing

Hearing Testimonies

Written comments can be sent to: WMdem.submission@mail.house.gov.

California LIHTC Allocation

Proposed Emergency Regulation Changes with Initial Statement of Reasons (Jan. 22, 2020)

Notes from Novogradac: TCAC Considers How to Distribute California's Additional $980 Million in LIHTC Allocation

Puerto Rico Supplemental Appropriations

H.R. 5687

Legislation Summary

CRA Hearing

Memorandum: Jan. 29, 2020 Hearing, "The Community Reinvestment Act: Is the OCC Undermining the Law's Purpose and Intent?"

Statement of Joseph M. Otting, Comptroller of the Currency, Before the Committee on Financial Services, Jan. 29, 2020

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Notes from Novogradac: Understanding OCC, FDIC Proposed Rule Reforming CRA Regulations

Summary: February 4, 2020

Income Limits in Average Income Test

Revenue Ruling 2020-4

Contact Thomas Stagg

Notes from Novogradac: IRS Guidance on Average Income AMI Calculations

NMTC Conference

Register for the Novogradac 2020 New Markets Tax Credit Spring Conference

Puerto Rico Draft OZ Regulations

Draft Regulations Press Release (In Spanish)
Opportunity Zones Draft Regulations (In Spanish)

Comments can be sent by mail to Gabriel Maldonado-González at the Puerto Rico Department of Economic Development and Commerce or by email to Gabriel.maldonado@ddec.pr.gov.

Novogradac 2020 Investing in Puerto Rico

Register for the Novogradac 2020 Investing in Puerto Rico Conference

Podcast Topic Suggestions

Email CPAs@novoco.com