NOVOGRADAC
TAX CREDIT TUESDAY
PODCAST

Summary: Sept. 10, 2019

In this week's Tax Credit Tuesday Podcast, Michael J. Novogradac, CPA, talks about a plan by House Democrats to consider a continuing resolution to avoid a government shutdown at the end of this month. After that, he'll discuss Treasury and HUD's housing finance reform plans for Fannie Mae and Freddie Mac. Then, he'll share details about a long-awaited notice from HUD that revises and expands its Rental Assistance Demonstration program, followed by news on the opening of the 2019 new markets tax credit allocation round. He'll also talk about updated opportunity zones frequently asked questions and some analysis on fiscal year 2020 fair market rents. That's followed by some brief news on Cross Refined Coal LLC and USA Refined Coal LLC vs. the Commissioner of Internal Revenue, a recent tax court ruling that may have implications for tax credit incentive investments. And, he'll close with the status of California A.B. 10, a proposal to authorize an additional $500 million in state low-income housing tax credits annually for five years.

Summaries of each topic:

GENERAL NEWS

House Stopgap Bill

- Let's start with the House of Representatives.
- Politico reported last week that the House is planning to vote on a stopgap bill that would prevent a government shutdown.
- The government is currently funded until the end of the 2019 fiscal year, which ends Sept. 30.
- That's 20 days from the time of this recording.
- House Majority Leader Steny Hoyer wrote a letter to the caucus on Thursday, announcing that he expects the House to consider a continuing resolution next week.
- It's unclear how long the continuing resolution would keep the government funded.
    - However, most insiders are predicting the continuing resolution will last until mid-November.
- What *is* known is that Congress will almost certainly need to pass a stopgap measure and not wait for individual spending bills to pass.
- House Democrats passed a majority of fiscal year 2020 spending bills before the August recess.
    - However, those bills were written assuming a larger fiscal year 2020 discretionary budget, larger than was ultimately enacted by the Bipartisan Budget Act of 2019.
- However, the Republican-led Senate has yet to consider a single appropriations bill.
    - The Senate Appropriations Committee will begin considering fiscal year 2020 spending bills on Thursday.
- What a House stopgap bill would look like and whether the legislation will be a vehicle for tax extenders remains to be seen.
- I'll keep you updated in future podcasts.

Housing Finance Reform

- Now, onto the topic of housing finance reform in Fannie and Freddie.
- The Trump administration this past Thursday released its highly anticipated housing finance reform plans.
- President Donald Trump directed Treasury Secretary Steven Mnuchin back in March to end the conservatorship of Fannie Mae and Freddie Mac.
    - As noted earlier, Fannie and Freddie have been in conservatorship under the Federal Housing Finance Agency, or FHFA, for over 11 years.
- Since the president's directive in March, Treasury, the Department of Housing and Urban Development, or HUD, and FHFA have worked together on housing finance reform.
- Both Treasury and HUD have released plans.
- The Treasury plan has 49 legislative and administrative recommendations, with the headline recommendation being for FHFA to begin the process of ending its conservatorship of Fannie and Freddie.
    - Treasury outlined several preconditions that FHFA should consider before ending conservatorship, such as making sure Fannie and Freddie have enough capital or capacity to operate safely.

- Treasury said the government-sponsored entities, Fannie and Freddie or GSEs, should also be recapitalized so that private capital takes a first-loss position on the GSEs' exposure to risk and loss.
  - By putting the private capital in a first-loss position, Treasury's ongoing commitment under each senior preferred stock purchase agreement would only be triggered in exigent circumstances.
- Now, the Treasury plan also recommends replacing Fannie and Freddie's statutory affordable housing goals, replacing them with what the report calls a more efficient, transparent and accountable mechanism.
- That said, no surprise, not everyone agrees with that approach.
- For instance, House Financial Services Committee Chairwoman Maxine Waters of California said the Treasury proposal to replace affordable housing goals with a fee would not adequately support affordable housing.
- Now turning to the HUD plan.
- The HUD plan has 67 recommendations.
- Under the HUD plan, FHFA would be restructured as an autonomous corporation within HUD.
- HUD also recommends that Congress eliminate the 455,000-unit cap for the Rental Assistance Demonstration program.
- By eliminating the cap, it would expand RAD's reach and impact.
- RAD is the HUD program that allows public housing authorities to convert public housing funding to Section 8 funding with private ownership.
  - RAD also applies to HUD's other non-public housing legacy rental assistance programs.
- Now, the report called on Congress to eliminate the current 455,000-unit cap, which would allow any public housing authority with public housing to convert to the Section 8 program.
- Of course, it does require an act of Congress to change the cap on RAD, but that has already been done three times.
  - First, when the program launched in 2012, the cap was 60,000 units.
  - In 2015, Congress increased the cap to 185,000 units.
  - Then, two years later, the cap was raised to 225,000 units.
  - Last year, the cap was increased again, this time to 455,000 units.
- For perspective, there were an estimated 1.2 million public housing units in America when RAD launched.
- If Congress follows HUD's recommendation, *all* public housing authorities could consider converting their public housing to private ownership with Section 8 funding
- The HUD plan also calls for moving some of FHA's activities to a new division.
- Specifically, the rental subsidy and asset management would be separated from mortgage insurance administration from FHA and moved out of FHA.
- Rental subsidy and asset management would be combined with public housing and housing voucher administration into a new office of rental subsidy and asset management division.
- I expect we'll learn more about the plan after a scheduled housing finance reform hearing today in the Senate Banking Committee.
  - Scheduled to be speaking are Treasury Secretary Steven Mnuchin, HUD Secretary Ben Carson and FHFA Director Mark Calabria.

- I'll share highlights of the hearing in next week's podcast.

RAD Notice Update

- Staying on the topic of housing, HUD published a revised notice last week about its Rental Assistance Demonstration program, or RAD, which we've been talking about.
- This was the fourth revised notice on RAD.
    - The notice included a series of changes, including eligibility and selection criteria.
- Of note, last week's notice officially added HUD's Section 202 elderly housing program to RAD.
    - About 120,000 of the nearly 350,000 Section 202 units have project rental assistance contracts that are eligible for conversion to RAD.
- The notice allows those Section 202 contracts to be converted to Section 8 project-based rental assistance or project-based voucher contracts.
- The notice also allows limited rent increases for public housing conversions to PBRA contracts in certain situations.
    - Among those situations, by the way, is public housing in opportunity zones.
- The notice also proposes that HUD review RAD applications on a first-come, first-serve basis.
    - If a waiting list forms, HUD proposes creating a priority selection of applications for properties in opportunity zones.
- The HUD notice is effective immediately except for changes in project eligibility and selection criteria.
    - All recommended changes in those two areas are subject to a 30-day comment period.
- This is the latest step in the continuing evolution of RAD.
    - As I said, this is the fourth revision of the notice.
- There's a link to the notice in today's show notes, and I'll tweet it out as well.
- The October issue of the Novogradac Journal of Tax Credits will also feature an article on the RAD notice by our advisory member Monica Sussman of Nixon Peabody.

2019 NMTC Allocation Round

- Switching gears now to community development, as you've heard, the CDFI Fund last week opened the 2019 allocation round of the new markets tax credit.
    - $3.5 billion in allocation authority is available in this round.
    - As you know, this is the last approved and funded round.
- First, I want to talk about some of the key dates of the 2019 allocation round.
- Then, I want to talk about some application considerations applicants should keep in mind for the 2019 round.
- Now, let's start with the key dates.
    - Community development entity, or CDE, certification applications are due Monday, Sept. 23.
    - Then, certification of qualified equity investment issuance and qualified low-income community investment requirements have a deadline of Monday, Oct. 7.
    - The CDFI Fund will answer application questions until Thursday, Oct. 24.
        - On that note, the CDFI Fund is hosting two one-hour conference calls to answer application questions.

        - The conference calls will be this Thursday, Sept. 12, as well as next Monday, Sept. 16.
    - And, the big date to circle on your calendar: Allocation applications are due Monday, Oct. 28—that's seven weeks from yesterday.
    - After that, prior allocatees must meet their qualified equity investment issuance and qualified low-income community investment requirements by Friday, Jan. 31, 2020.
    - The CDFI Fund expects to announce 2019 awards in summer 2020.
- Those are a lot of dates to remember.
- You can visit the New Markets Tax Credit Resource Center to find those dates, as well as the application and supplementary information.
- I'll include a link in today's show notes.
- Now, let's turn to the application itself.
- In all recent rounds except the last, prior allocatees had to have a percentage of their prior awards issued in the form of qualified equity investments.
    - As noted, last year the CDFI Fund removed the equity investment issuance requirement altogether.
    - This year the CDFI Fund has reinstituted the requirement and they've added an additional requirement.
    - CDEs will now be measured by both the amount of QEIs issued and the amount of qualified low-income community investments closed, as a percentage of those QEIs.
    - This means that community development entities can no longer merely raise and close a minimum amount of equity in order to satisfy application requirements.
    - Instead, community development entities will have to raise close the qualified equity investment, as well as make qualified low-income community investments.
- Another change is that the number of Phase 1 reviewers reading each application will be reduced from three to two.
    - It's a bit early to tell what effect, if any, this could have on applicants.
    - But for now, no change in application approach is needed.
- Another reminder: Applications and all required documents must be submitted through the Awards Management Information System, or AMIS.
    - I say that it's a reminder because it's not a new requirement for this year.
    - I will note though that the CDFI Fund did specify in its updated application FAQs that the CDFI Fund would <u>not</u> review any materials that are accessible only through hyperlinks in submitted materials.
    - That means you want to make sure that all the material you intend to submit is uploaded directly to AMIS.
    - Do <u>not</u> rely on hyperlinked material.
- Another important tip to keep in mind relates to new markets tax credit investments in opportunity zones.
    - Question 24 of the new allocation application asks applicants to identify areas where they propose to target qualified low-income community investments, including areas such as opportunity zones.
    - The CDFI Fund does caution applicants to note that not all opportunity zones are low-income communities that are also eligible for the new markets tax credit.
    - As such, applicants should check whether a census tract is eligible for the new markets tax credit.

- You can do that in the CDFI Fund's mapping system.
- These are just a couple of application tips.
- I could obviously share a lot more.
- My partner Brad Elphick wrote a detailed article for the Novogradac Journal of Tax Credits on what applicants need to know about the 2019 allocation round.
- I encourage you to review Brad's article when it comes out in the October issue of the Journal.
- For listeners who are not subscribers to the Journal yet, I'll include a subscription link in today's show notes.
- In the meantime, I encourage new markets tax credit allocation applicants to reach out to my partner Brad Elphick or another Novogradac partner for application assistance.
- With less than seven weeks before applications are due, I recommend consulting a professional as soon as possible.

Opportunity Zones FAQ

- Let's turn now to opportunity zones and updated guidance.
- The IRS last Wednesday updated its Opportunity Zones Frequently Asked Questions page.
- One of the questions that was added to the page was on adjusting basis to fair market value.
    - If an investment in a qualified opportunity fund is held for at least 10 years, then the investor can generally adjust the basis to fair market value when they sell or exchange their interest.
    - The FAQ notes that that's only if the investment was made in connection with the proper deferral election.
    - The election must also have remained in effect until the post year-10 sale or exchange.
- Another question added has to do with the 50-percent-of-gross income test.
    - Qualified opportunity zone businesses must earn at least 50 percent of their gross income from business activities within a qualified opportunity zone every taxable year.
    - The proposed regulations provide three safe harbors that a business may use to measure and satisfy this test:
        - First is the number of service hours worked in and out of the opportunity zone.
        - Second is the amounts paid for services in and out of the opportunity zone.
        - And the third safe harbor is the necessary-tangible-property-and-business-functions test.
- These are now in the FAQ and, no surprise, they were in the proposed regulations.
- The next logical question is whether a qualified opportunity zone business needs to meet all three of those safe harbors to meet the 50 percent of gross income test or not.
    - I think it was clear from the regulations and now the FAQ makes it even clearer that the answer is no.
    - You do not need to satisfy all three tests.
    - You just have to satisfy one safe harbor.
    - Or the general facts and circumstances is the fourth test.

- If you have any other questions about opportunity zones, I encourage you to contact my partner John Sciarretti.
- As you likely know, John heads the Novogradac Opportunity Zones Working Group.
- He's also the chairman of our upcoming Novogradac Opportunity Zones Fall Conference in Chicago, Oct. 24-25.
- I'll include John's email and a conference registration link in today's show notes.

Department of Commerce on OZs

- On a related opportunity zones note, the Department of Commerce published a Federal Register notice last week inviting public comment on opportunity zones.
- Specifically, public comments are invited on Department of Commerce policy in opportunity zones.
- Questions for public comment include:
  - How can the federal government target and streamline infrastructure programs in qualified opportunity zones to create long-term economic growth?
  - Also: How can federal, state and local capital investment be coordinated to maximize economic development benefits in opportunity zones?
  - Another one: How should the federal government evaluate the economic development impact of investments that are designed to assist qualified opportunity zones?
- Those are just some of the questions.
- Comments are due Oct. 18.
- I'll include in today's show notes a link to the notice and the email address for submitting comments.
- If you have suggestions, please email them to cpas@novoco.com.
- The Novogradac-led Opportunity Zones Working Group will be submitting a comment letter.

FY 2020 FMRs

- In last week's podcast, I mentioned that HUD had released fiscal year 2020 fair market rents, or FMRs.
- As promised, I have more details for you today about 2020 FMR trends.
- In general, FMRs for 2020 continued an upward trend over the past few years.
- FMRs increased by about 1 percent or about $11 on average.
- Now, this 1 percent increase is notably less than the increase in 2019.
- The 2019 increase was about 2.5 percent or $23.
- Metro areas tended to have larger increases in 2020 than non-metro areas.
- The average increase for metro areas was about 1.75 percent compared to the average increase of 0.40 percent in non-metro areas.
- Now, to look at major areas with the greatest increases and decreases:
  - For areas with a population of more than 100,000, the Grand Junction, Colorado, MSA saw the largest increase in FMRs at nearly 23 percent.
  - Similarly, of areas with a population greater than 100,000, the area that saw the greatest <u>decrease</u> was the Reading, Pennsylvania, MSA at a decrease of 10 percent compared to 2019.

- I'll also note that public housing authorities may ask HUD to reevaluate FMRs for a particular area if the public housing authority thinks that the FMRs do no accurately reflect the rents in the area.
- So, how do these FMRs affect low-income housing tax credit properties' income and rent limits?
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- Well, when determining low-income housing tax credit income and rent limits, HUD applies a high housing cost adjustment.
  - This high-housing-cost adjustment increases the income limits for areas where housing costs are abnormally high as compared to the median income for the area.
  - This high-housing-cost adjustment is based on HUD's FMR for a two-bedroom unit.
- Now that we know the FY 2020 FMRs, we can calculate a preliminary income limit based on the high housing cost areas.
  - There are 235 areas out of a total of nearly 4,800 total areas where the income limit based on the high-housing-cost adjustment is greater than the FY 2019 income limits.
  - The average adjustment is an 8.95 percent increase, a nearly 9 percent increase, over the FY 2019 income limits.
  - There are two items that may further affect the final FY 2020 limits for these 235 areas.
  - First, HUD caps any increase at twice the change in national median income.
  - We are estimating the cap for 2020 will be about 7.9 percent, which means that if the average increase is 8.95 percent, the increase to any individual area is going to be capped at 7.9 percent.
  - In addition, for areas that are increasing by less than the cap at 7.9 percent, HUD has other adjustments that it applies to income limits that might result in a larger increase than the high-housing-cost adjustment.
  - However, the high-housing-cost adjustment does give a floor for what the income limit will be for these areas.
  - If the high-housing-cost adjustment is showing a 5 percent increase, then the FY 2020 limits will have an increase of no less than 5 percent.
  - Said another way, if the high-housing-cost adjustment shows a 5 percent increase, HUD could have another adjustment that increases the income limit for the area to say a 6 percent increase, but HUD would not have any adjustments that would lower the increase below 5 percent.
  - If you would like to purchase a 2020 income limit estimate for a particular area or areas, please visit the estimator page on at www.novoco.com.
  - Or email cpas@novoco.com.
  - I'll tweet out a link as well.
- I also encourage you to reach out to my partner Thomas Stagg with any specific questions.

Other news

- Turning now to news from the Tax Court, a U.S. Tax Court bench opinion was released last week on a case that has been watched by many in the affordable housing, community development and renewable energy communities.
    - The case involved whether the owner of a refined coal production facility was a bona fide partnership and whether the tax credit investors in the owner were bona fide partners.
    - The IRS had disallowed millions of dollars in tax credits, asserting that the partnership was formed purely to facilitate the monetizing of refined coal tax credits.
    - The partnership, to no surprise, appealed the decision and the bench opinion sided with the partnership and partners, granting the tax credits and granting the allocation of tax credits to the investors.
    - This opinion highlighted that the partnership faced risks of ownership and pointed out that the credits were energy *production* tax credits, claimed over time, and not energy *investment* tax credits, claimed on a placed-in-service date.
    - The fact that it was claimed over time implied there was more risk.
    - It's important to know that a bench opinion technically cannot be relied on for another case under tax court rules, but this does give an idea of where the U.S. Tax Court is on this issue, which could affect other partnerships.
    - The case was Cross Refined Coal LLC and USA Refined Coal LLC vs. the Commissioner of Internal Revenue.
    - I will post a link to the bench opinion in today's show notes and tweet it out as well.
    - Also, look for an article in a future Novogradac Journal of Tax Credits edition about the implications for other tax credit partnerships.
- I now want to turn to state news.
- A bill to authorize a $500 million increase in allocation for California state low-income housing tax credits for five years, $500 million a year for five years, was held under submission in committee.
    - That means the bill will not advance in this year's Legislature.
    - California, you may remember from a prior podcast, recently increased its annual allocation of state credits by $500 million.
        - However, that's only guaranteed for next year, 2020.
    - There can be an extra $500 million every year, but only with approval from the state Legislature.
    - The bill that was sidelined last week would have authorized or provided approval for the $500 million boost for each year through 2024.
    - The bottom line for California is that the state still has the big jump in tax credits next year.
    - However, any future allocation of the extra $500 million annually will require the Legislature to budget for it.

RELATED RESOURCES

Housing Finance Reform

Treasury Housing Reform Plan

HUD Housing Finance Reform Plan

RAD Revisions Notice

Rental Assistance Demonstration, Final Implementation, Revision 4: H-2019-09. PIH-2019-23 (HA)

2019 NMTC Application Round

Key dates
Read-only application
Notice of allocation availability
Introduction to the NMTC program
AMIS navigation guide
Updated FAQs
Application roadmap presentation
Subscribe to the Novogradac Journal of Tax Credits
Email Brad Elphick

Opportunity Zones FAQ

OZ FAQ Page
Email John Sciarretti
Register for the Novogradac 2019 Opportunity Zones Fall Conference

Commerce Department Request for Comment

Review of DOC Policy in Opportunity Zones
Email comments to regulations@eda.gov; include “Comments on RFI” in the subject line.

FY 2020 FMRs

FY 2020 Fair Market Rents
Email Thomas Stagg

Tax Court Ruling

Cross Refined Coal, LLC, USA Refined Coal, LLC, Tax Matters Partner v. Commissioner of Internal Revenue

California Bill

California A.B. 10

HTC Conference

Register for the Novogradac 2019 Historic Tax Credit Conference