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September 10, 2004

Mr. Garth Rieman
National Council of State Housing Agencies
444 North Capitol Street, NW
Suite 438
Washington, DC 20001

RE: Request for Comment on Working Group Proposals

Dear Mr. Rieman:

We appreciate the opportunity to comment on the legislative and regulatory proposals submitted by the NCSHA Working Group on Improvements to the Housing Bond and Credit Programs. The Affordable Housing Tax Credit Coalition (AHTCC) is a group of developers, syndicators, lenders, nonprofit groups, public agencies, professionals and others concerned with the low-income housing tax credit (LIHTC). With respect to the recommendations the Working Group has made, the AHTCC has focused its comments on those items pertaining to residential rental housing. There were seven recommendations with respect to residential rental housing and the AHTCC supports all seven proposed improvements, which are numbered 1 through 5, and 7 and 8.

With respect to Recommendation 3, wherein, state allocating agencies would be allowed to award Credits greater than 9% when necessary to achieve greater income targeting, we suggest that for transactions qualifying for the 9% credit that the credit agencies have discretion to increase the credits by up to 30% for projects which do not otherwise qualify for the 30% difficult development area or qualified census tract increase.

We would also like to restate our support for Representative Nancy Johnson's legislation that would statutorily treat certain costs as included in eligible basis.

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In addition to the seven residential rental housing changes that you have proposed, we would like for you to consider these additional six recommendations:

1. **Eliminate the recapture bond posting requirement.**

   Current law: If an investor in a LIHTC project decides to sell its interest during the required 15-year Credit compliance period, then generally the investor must post a bond with the Internal Revenue Service or face tax credit recapture. The bond posting amount is the amount that would have been recaptured as a result of the sale.

   Proposal: The recapture bond requirement should be eliminated in situations where, due to conditions attached to a sale, the underlying Credit property must remain in compliance with Section 42 requirements.

   Rationale: Recapture bonds are expensive, difficult to obtain, usually require full collateral and must remain with the IRS for 58 months after the completion of the compliance period. Because of this, Credit investments are less liquid, and this lack of liquidity adversely affects the value of the Credits. The prior owner should not be subject to an additional burden (the bond), which is a burden beyond that which he already had as the owner and for which he continues to be liable after the sale. States would continue to monitor properties to ensure that the Section 42 restrictions are maintained by the new owner. If the new owner fails to comply there will be a recapture of credits to both the old owner (with respect to the Credits it claimed) and the new owner. Furthermore, historically the IRS has reported that it has not made any claims on a recapture bond since the inception of the program. This change would increase the pool of potential investors, which would further increase the value of the Credit. It would eliminate a cost to the program, which cost does not provide additional protection to taxpayers. An increase in the value of the Credit would increase the tax credit equity available, resulting in more subsidy dollars available to build affordable housing. This change should have little cost to the government as there is no increase in the overall volume cap of Credit.

2. **Allow the Credits to continue for a property suffering from a casualty loss.**

   Current law: In the case of a casualty event on a property that is not located in a presidentially declared disaster area, although no recapture occurs, property owners arguably may not claim credits on units while they are not in service. The IRS reached this conclusion in Chief Counsel Advice (CCA 200134006). The CCA concluded that while previous guidance on casualty losses (Rev. Proc. 95-

28) did allow Credits to continue to be claimed during reconstruction or rehabilitation attributable to units taken out of service as a result of a casualty, that guidance only applied to casualties occurring in a presidentially declared disaster area. Units out of service as a result of a general casualty loss, outside of a presidentially declared disaster area, were not so covered.

Proposal: Section 42 should be revised to allow for the Credit to continue during the rehabilitation or reconstruction period so that a property suffering from a general casualty loss does not also suffer from a loss of Credits during the rehabilitation or reconstruction period.

Rationale: Adopting this recommendation will eliminate a major area of uncertainty facing investors, resulting in a reduced perception of risk by investors. This reduced perception of risk will accomplish two things; first, existing investors will see less risk and require lower rates of return. Second, this change will increase the pool of potential investors, which would further increase the value of the Credit. An increase in the value of the Credit would increase the tax credit equity available, resulting in more subsidy dollars available to build affordable housing. This change should have little cost to the government as there is no increase in the overall volume cap of Credit. Adopting this recommendation will improve the effectiveness of the program without diminishing protection for tenants or taxpayers.

3. Enhance the use of LIHTC with Federal grants.

Current law: Federal grants, as a general rule, reduce eligible basis.

Proposal: The Code should state that Federal grants do not reduce eligible basis if the grant is included in taxpayer's taxable income. Similarly, the Code should state that Federal grants that can directly be traced to noneligible basis items should not reduce eligible basis.

Rationale: The current provision in the Code reduces the amount of the Credit and the ability of Credit developments to serve more needy tenant populations and severely distressed areas. Changing the Code provisions pursuant to the recommendation above will serve to mitigate these effects.

4. Allow projects that were previously involved in the Section 8 Moderate Rehabilitation Program to be eligible for Credits.

Current law: Generally, the Code prohibits any project that receives assistance under the HUD Section 8 Moderate Rehabilitation Program (the "Mod Rehab

Program") from qualifying for Credits. This provision has been interpreted as preventing any project that ever in its existence had received assistance from the Mod Rehab Program from being eligible for Credits.

Proposal: The Code should be modified to allow such projects, that are no longer receiving assistance from the Mod Rehab program, to be eligible for Credits.

Rationale: The current provision in the Code reduces the ability of Credit developments to serve more needy tenant populations and severely distressed areas. Changing the Code provisions pursuant to the recommendation above will end these effects and help facilitate preservation and recapitalization of older affordable housing.

5. Make the 10% Test requirement, once met, incontestable.

Current law: The 10% Test is a highly technical calculation that is required in order to ensure that the Credit is only allocated to projects that have begun development. Once a building is actually placed in service, however, Credit investors are still faced with a technical 10% Test risk. Specifically, if the project that they invested in were determined to have failed some technical aspect the 10% Test, than its Credits would be lost, even if the project has been completed and occupied by qualified tenants.

Proposal: Once a building is actually placed in service, its allocation should not be subject to challenge on the question of whether it properly satisfied the 10% Test.

Rationale: This provision in the Code creates unnecessary risk to investors. With this higher risk, a higher return is required. By eliminating this risk, more Credit equity will be generated and unnecessary administrative costs will be avoided. The net result would be more dollars being freed to up to subsidize Credit developments. The 10% Test was intended to prevent the banking of Credits. Once the building is placed in service the intent is no longer served.

6. Repeal 10-year rule for acquisition Credits.

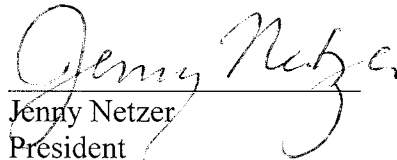
Current law: The acquisition of an existing building qualifies for Credits if at least 10 years has passed between the date the building was last placed in service and the date of the current acquisition.

Proposal: The 10-year rule should be eliminated.

Rationale: This 10-year rule is preventing many existing properties from qualifying for acquisition Credits. Each state housing agency should have the authority to determine which, if any, existing buildings should be allocated acquisition credits.. Additionally, the purpose behind the 10 year rule was to prevent the churning of property where favorable depreciation rules were used. There has not been any significant change in depreciation rules since the adoption of the 1986 Tax Reform Act. Therefore, the 10 Year Rule no longer serves its intended purpose. Repeal of this rule would help to facilitate preservation and recapitalization of older affordable housing.

We appreciate the opportunity to comment on your legislative and regulatory proposals, as well as submit additional recommendations. If you have any questions regarding this letter, please feel free to contact me at (617) 772-9500, Rick Goldstein at (202) 585-8730, or Michael Novogradac at (415) 356-8006.

Very truly yours,
Affordable Housing Tax Credit Coalition

by 

Jenny Netzer
President