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Room 5203
Internal Revenue Service
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Washington, DC 20044

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

OCT 4 2007

RE: Section 42 Qualified Contract Provisions, RIN 1545-BC20

To Whom It May Concern:

Thank you for the opportunity to comment on the proposed qualified contract process regulations. The National Council of State Housing Agencies (NCSHA) represents the Housing Finance Agencies (HFAs) of the 50 states, the Commonwealth of Puerto Rico, the U.S. Virgin Islands, and the District of Columbia. HFAs allocate Low Income Housing Tax Credit authority (Housing Credit) for the construction and rehabilitation of affordable apartments for low-income families. Over the past two decades, the Housing Credit has been responsible for about 2 million affordable apartments, and each year the Housing Credit induces several billion dollars of private investment to produce about 130,000 units for low-income families, the elderly, and other special needs populations.

NCSHA strongly supports the administrative discretion the proposed regulations give state HFAs to administer the qualified contract process. Such flexibility is key to the success of the program. Specific comments about particular aspects of the regulations follow.

Response to Request for Comments

The following points respond to the Service's request for comments on several particular issues.

Whether low-income buildings are ever sold without the underlying land.

We are not aware of any such transactions. However, there have been relatively few Credit property sales as a percent of the total number of Housing Credit developments.

The appropriate treatment of leased land and the prevalence of leased land in low-income housing credit transactions.

With the exception of Housing Credit-assisted properties in tribal areas, ground leases are used infrequently in Housing Credit transactions. Other examples include land owned by churches or public housing authorities. In these circumstances there is a very low probability of, and little or no incentive for, owners to request a qualified contract.

Examples of forms of cash distributions from or available for distribution from the project that should or should not be included in the regulatory definition.

NCSHA agrees with how the proposed regulations define cash distributions to help determine qualified contract price. Providing exclusions from what counts as cash distributions may inappropriately increase the qualified contract price, create unnecessary complexity, and make such exclusions subject to arbitrary or inconsistent interpretations.

Whether low-income housing is owned by other than a corporation or partnership.

Such forms of ownership are extremely rare and mostly limited to very small properties (less than five units).

The extent of HFA and state authority in providing more stringent requirements than the provisions contained in section 42(h)(6)(F).

Owners in many states have voluntarily waived their right to request a qualified contract. HFAs have also used their general program administration authority to encourage owners to lengthen extended use periods and delay the date for submitting a qualified contract request. The regulations should acknowledge that HFAs have authority to encourage owners to enter into such agreements.

Specifically, the authority of HFA or state regulators to require in agreements a fair market value cap that would restrict any qualified contract price to fair market value.

No HFAs report having such a policy. Several HFAs would like the Service to establish such a cap in the final regulations or explicitly allow HFAs to do so. It does not appear that HFAs have clear authority to establish such a cap on their own.

We encourage the Service to consider whether owners should be entitled to a sales price greater than fair market value. Without a regulatory fair market value cap, qualified contract prices often will be well in excess of fair market value. In such cases, the property either will lose its affordability restrictions or preservation-oriented buyers will have to offer more than market value, giving owners windfall profits. It is not clear Congress intended such a result.

Additional Comments

NCSHA's additional comments are separated into two main categories, price calculation and processing requests.

Calculation of the Qualified Contract Price

Land

NCSHA does not believe including land valuation in the qualified contract price determination process is necessary. Land value is already incorporated in the total of debt, equity, and other capital contributions. If land is valued and added to the qualified contract price, a reasonable portion of that value should be deducted from debt and equity. Otherwise, land would be counted twice.

NCSHA strongly agrees with the proposed regulations' position that fair market value must reflect the restrictions on the use of the low-income portion of Credit buildings. NCSHA also supports similarly requiring that low-income use restrictions be taken into account when valuing land.

Refinancing

We understand some interested parties argue that the proposed regulations should include all refinancing debt in the valuation of outstanding indebtedness for purposes of establishing the contract sales price. We support limiting such debt to the amount of costs included in original eligible basis established at the end of the first year of the Credit period, as the regulations propose.

However, NCSHA believes that, in some cases, some additional refinancing debt should be included in the contract sales price. NCSHA would support allowing HFAs to include such amounts in outstanding indebtedness or not count these proceeds as cash distributions if the HFA determines that the owner's actions were not taken to increase the qualified contract price and otherwise were for the benefit of the property. An example would be paying off a loan with debt that carried a lower interest rate or longer amortization period, and using any proceeds to make repairs.

Closing Date

The proposed regulations state the HFA must adjust the qualified contract amount between the time the qualified contract is determined and the project's actual closing date to reflect mortgage payments that reduce outstanding indebtedness and changes in market value "after a reasonable period of time" within the one-year offer of sale period. NCSHA is concerned that these additional steps are unnecessary and would pose an unreasonable burden on HFAs. NCSHA recommends the final regulations direct buyers and sellers to handle such modifications during final transaction negotiations.

If the final regulations permit modifications to the original qualified contract price after it is determined, they should clarify that HFAs do not have to participate. Under section 42(h)(6)(E)(i)(II), an HFA's statutorily mandated role ends with the presentation of a qualified

contract. Any subsequent negotiations are between the buyer and seller.

Processing Qualified Contract Requests

The proposed regulations properly reflect the fact that HFA administrative discretion will be essential in handling qualified contract requests.

Eligible Projects

NCSHA recommends the final regulations authorize HFAs to prohibit owners who are not in compliance with applicable program requirements from requesting a qualified contract. NCSHA also recommends the final regulations authorize HFAs to require owners to secure a waiver of an existing right of first refusal under section 42(i)(7). Otherwise, the effort devoted to calculating the qualified contract price may be undone. While NCSHA believes the authority for both of these limitations is included in section 1.42-81(d)(1)(vi), an explicit statement would preclude questions of interpretation.

Required Submissions and Inadequate Documentation

NCSHA supports the authority the proposed regulations give HFAs in different states to establish different submission requirements for owners requesting qualified contracts. Such variation makes sense based on differences across the country in state laws, documents, administrative procedures, and real estate markets.

We understand some owners may object to providing full documentation to justify the qualified contract price on the grounds they have not retained sufficient records to meet HFA submission requirements. However, if owners know they will not be required to provide full documentation, a small number of them may decide to be advantageously selective. For example, if owners only need to submit 10 of 15 years' worth of financial records, they might hold back the five years with the greatest cash distributions. HFAs have no ability to investigate such behavior.

The proposed regulations resolve this potential concern, by allowing HFAs the ability to deny a request, require substantiation, and suspend the one year period. NCSHA strongly supports this authority and urges the Service to include it in the final regulations. Owners expecting to take advantage of the qualified contract option had a corresponding duty to keep adequate documentation.

HFAs Presenting a Qualified Contract

NCSHA believes the proposed regulations are correct to insist that presenting a qualified contract prevents termination of the extended use restrictions. The Housing Credit statute is clear on this point. Owners do not have to accept the offer, but refusing to accept does not allow termination of the extended use restrictions. The Credit statute also provides no relief if the transaction does not close, even if that outcome is due to the buyer's default.

NCSHA understands this is a harsh result. There is also the theoretical possibility of attempts to offer contracts simply to preserve affordability. In such a hypothetical situation, either the offer itself may be unreasonable or the buyer may back out.

Owners' protection against the first is the requirement of a "bona fide" contract. Some commenters may claim that it cannot be defined at all. While the term may have varying definitions in different contexts, its use in the Code requires those involved in a qualified contract request to give it meaning. If the regulation itself will define what constitutes a bona fide offer, the following are suggestions for what could be the components:

1. Offer is made in good faith;
2. Offer is legally binding on buyer;
3. Buyer has full capacity to close, financially, legally, and otherwise;
4. Other reasonable terms and conditions, including:
 - a. Due diligence documentation,
 - b. Time period to review,
 - c. Date of closing,
 - d. Manner of payment,
 - e. Earnest money, and
 - f. Nothing else outside the ordinary course of business for such real estate transactions (e.g., seller financing or guarantees of certain financial outcomes).

Determining what constitutes reasonable terms and conditions will vary for at least two reasons. First is the wide variety of properties. Buyers will ask for less time and documentation for a 16 year-old, 48-unit property in a residential setting than a 40 year-old, 200-unit property next to industrial uses. A buyer should not be able to demand a standard of due diligence for the latter when considering the former. Another reason is that buyers paying a qualified contract price that is above fair market value will want to correspondingly reduce risk. In such cases, expecting the seller to guarantee aspects of the cash flow may be reasonable. Because of these considerations and other unknown variables, NCSHA believes the best alternative is to leave the question of what is a bona fide offer up to the administrative and legal process of the state where the property is located.

Another question is what happens in circumstances where an owner accepts the presented qualified contract but the transaction does not close. If a buyer backs out of a bona fide contract in a manner that amounts to a breach, the seller will have remedies as a matter of contract. The compensation may include the financial consequences of the inability to terminate the extended use restrictions. However, such disputes would occur after the HFA has met its statutory expectation of presenting a qualified contract, and thus should not allow an owner to terminate the use restrictions or seek relief from the HFA.

One option may be to recognize in the final regulations that owners have not lost the ability to submit another request for a qualified contract if there is an administrative or legal ruling that there was never a bona fide offer. The owner should not be allowed, in the case of such a ruling, to waive the extended use restrictions without submitting another qualified contract request.

Offer of Sale

NCSHA supports the proposed regulations' allowing HFAs to identify willing buyers as an alternative to soliciting offers from the general public. Many HFAs may need to do so based on state administrative procedure requirements and laws regarding real estate brokerage. Furthermore, we recommend the final regulations clarify that this allowance also applies to all other references to an offer of sale.

Dispute Resolution

We understand that HFAs and program participants will have disagreements over price and process, possibly leading to requests for binding arbitration. NCSHA does not think it is appropriate to require binding arbitration in the final regulations. We believe the Code only addresses outcomes of the qualified contract process, not how the participants arrived at them. The possibilities of negotiation, arbitration, or litigation will need to be determined based on state law.

Thank you for the opportunity to share our comments.

Sincerely,

Barbara J. Thompson
Executive Director