advancing housing justice
614 Grand Avenue, Suite 320
Oakland, California 94610
Telephone: 510-251-9400
Fax: 510-451-2300
nhlp@nhlp.org
www.nhlp.org

Electronically Submitted

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Internal Revenue Service
Department of the Treasury
CC:PA:LPD:PR (REG--114084--04)
Room 5203
P.O.Box 7604
Ben Franklin Station
Washington, D.C. 20044

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
SEP 19 2007

Dear Treasury Department:

On behalf of the undersigned organizations, the National Housing Law Project submits the following comments on the Department's proposed changes to the regulations governing the qualified contract process for the Low Income Housing Tax Credit program. 72 Fed. Reg. 33706 (June 19, 2007), adopting a new 26 C.F.R. § 1.42-18.

NHLP is a national housing and legal advocacy center established to advance housing justice for low-income people by increasing and preserving the supply of decent, affordable housing; by improving existing housing conditions; by expanding and enforcing low-income tenants' and homeowners' rights; and by increasing housing opportunities for racial and ethnic minorities. The Housing Justice Network is a unique nationwide organization of more than 500 public interest housing attorneys, paralegals and tenant leaders formed in 1977 that works on issues such as affordable housing preservation.

The undersigned organizations are a diverse array of nonprofit organizations, including national, statewide, regional and local nonprofit organizations working to preserve affordable housing or to directly represent tenants facing the loss of their homes.

Our comments focus on the effectiveness of the proposed rules to implement Section 42 of the Internal Revenue Code governing the Low Income Housing Tax Credit program, in carrying out Congress' intent to preserve affordable housing.

Proposed Requirements for Fair Market Valuation Of Qualified Contract Property, Including the Restrictions on Low-Income Portions of the Building (Sec. 1.42-18)

Noting that "the intent of the extended-long term commitment is the continued use of the low-income portion of the building as low-income housing," the proposed Section 1.42-18 would calculate the fair market value of the qualified contract property by taking into account the "existing and continuing requirements contained in the commitment for the building."

This position on the valuation of the property is both logical and in furtherance of the policy that Congress intended when adopting the statute. Economically, the actual value of any

especially the amount of income potentially available. Because under the extended use agreement the low-income portions of a building reduce the income available from those units, the fair market value must take into account such requirements.

As the Service has noted, the continued use of the low-income portions of a building in that capacity should, where feasible, be encouraged. According to the Joint Center for Housing Studies, the supply of low-cost rentals in the United States is rapidly dwindling. For example, from 1993-2003, the number of units renting for less than $400 fell by 13%, or over 1.2 million units. By taking existing conditions that affect the market value of a property into account, a potential preservation purchaser is significantly more likely to gather the resources required to preserve the preserve the property as part of the nation's affordable housing supply. Thus, in order to implement Congress' intent to preserve low-income units under this program, the fair market valuation of property should properly consider the impact of any restrictions on the use of or economic gain derivable from the low-income portions of a building.

Proposed requirements to limit outstanding indebtedness in excess of the original qualified basis for the building and to discount below-market debt

Another part of the proposed qualified contract formula requires a calculation of the outstanding indebtedness, which is the "outstanding principal balance, at the time of sale, of any indebtedness or loan that is secured by, or with respect to, the building, and that does not exceed the amount of qualifying building costs." The agency's proposed rules, at Sec. 1.42-18(c)(3) exclude from outstanding indebtedness, for purposes of Section 42(h)(6)(F), any proceeds from refinancing indebtedness or additional mortgages in excess of qualifying building costs. The proposed rules also discount the outstanding indebtedness bearing an interest rate below the applicable Federal rate at the time of issuance in order to obtain an imputed principal amount. This calculation of outstanding indebtedness helps further the intent of the qualified contract process – the concept that qualified purchasers would pay a reasonable price for the property, provide the investors a fair rate of return, and keep the property in the affordable housing stock wherever possible.

Inclusion of the land value in the fair market valuation, as well as the impact of the presence of the low-income portion of a building

The proposed regulations intend to include the value of the land underlying a subject building. The agency reasons that because a building would rarely be sold without its underlying land, that "it is necessary to include the underlying land in the computation of the qualified contract formula." It further concludes that the non low-income portions of the building should include the fair market value of both the non low-income and low-income portions of the land underlying the building, even if the entire building is low-income units. This regulation is inconsistent with the Congressional statute, as well as with the other proposed regulations.

Section 42(h)(6) of the Internal Revenue Code makes no mention of the underlying land in relationship to qualified contract property. The statute consistently refers to the qualified contract property as the building in question and not the underlying land. To assume that Congress intended for the property to include the underlying land in only one instance,

authority to include land value in qualified contract valuations appears beyond the scope of the statute.

Additionally, even if including underlying land in the fair market value of a qualified contract property were not inconsistent with the statute, any value should take into account both the restrictions on the low-income portion of the building (for the remaining term of the extended use commitment), as well as the impact of the presence of a restricted portion on the value of the remaining property. At the very least, the land allocable to the low-income portion of the property (prorated by some reasonable formula taking into account the number of low-income units compared to the project as a whole) should be valued with all of its remaining restrictions. Even beyond that, there is no doubt that the value of the entire property, including the land, is reduced when a portion of the building is restricted to low-income use. During the extended use period, the buyer cannot develop the underlying land allocable to the non low-income portion to its highest economic value. That fact must be reflected in the valuation if land is included in the calculation.

Furthermore, as long as the extended commitment remains, development of any open portion of the land where no building is situated is also restricted as a practical matter. Without any extended commitment, that undeveloped land would be free of any constraints. However, during the extended use period, both the housing credit agency and the owners would have to approve any further development of the land, and that restriction further diminishes the value of the land.

The Code considers the qualified contract property to be only the building and not the underlying land, raising doubts as to the Service's authority to include the land in its valuation of the property. Thus, even if the Service could include the value of the underlying land in the qualified contract formula, the valuation should at least require consideration of both the proportion of the building that is low-income and the diminished value of the undeveloped land. If these factors are not taken into account, the regulations would be internally inconsistent with regard to how the building itself is valued, as well as inaccurate as to the true fair market value.

Standards for Appraisal Methodology and Qualification

Currently, the proposed rules do not suggest any uniform standards for appraisal methodology and qualification. Creating such standards is necessary to achieve the most efficient, uniform, and fair results. Because the valuation of restricted property is complicated, appraisers should have to meet standards established by the regulations or by the Agency. They should not have been barred by other governmental agencies, and possess licenses and training sufficient to qualify them for this complex task. The methodology must require appraisers to take into account all applicable restrictions in the title, recorded agreements or other contracts, as well as any and all restrictions imposed by other subsidy sources or land use and zoning requirements.

We recommend that the State Housing Finance Agency and owner each select an independent qualified appraiser. If the two parties disagree significantly on the valuation, the parties could agree to average the valuation between the two appraisals. (A similar system was used under

§4101 *et seq.*) to determine fair market valuations for owners seeking to refinance or sell their low-income properties at the end of their restricted use periods.) Otherwise, then the two appraisers could appoint a third appraiser, whose determination of the final fair market value (between the two figures) would be binding for both parties.

The Valuation of the Low-Income Portion of the Property Should Not Exceed Fair Market Value

The Service observes that the formula value for a qualified contract property could often exceed the fair market value of a property. However, permitting this result would be directly contrary to intent of the statute – to preserve affordable housing when feasible. In order to effectuate Congressional intent in creating this program, the rules should place a cap on the low-income portion of the property, not allowing the value to exceed the fair market value for that portion. To do so would be consistent with the intent of Congress to ensure that low-income housing would be preserved. By capping the value of the low-income portion of a building at fair market value, an owner could sell his or her property at a fair price to a purchaser that will continue the low-income use of that property and would prevent the loss of affordable units. Permitting unrealistically high and financially infeasible sale prices under the qualified contract formula would produce the anomalous result of permitting some owners to dispose of properties (thus converting them to market-rate use) for the very same fair market value that a preservation purchaser would have no right to match.

Deferred Developer Fees Should be Included in "Cash Distribution from (or available for distribution from) the project" (Section 1.42-18(c)(6))

The qualified contract formula requires that the sum of the outstanding indebtedness, adjusted investor equity, and other capital contributions be reduced by cash distributions from or available for distribution from the project. While the proposed regulations already include all distributions to owners or related parties and all cash and cash equivalents, the definition should be expanded to include deferred developers fees. At minimum, the definition of cash distributions should include the following four types of income: 1) all cash payments and distributions from net operating income; 2) amounts paid to partners or affiliates as fees from operations, including investor fees, partnership management fees, refinancing proceeds, etc.; 3) deferred developer fees and; 4) cash in partnership reserves and other accounts. The inclusion of deferred developer fees is necessary to provide a fair and accurate assessment of the amount of cash distribution from the project.

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Staff Attorney, at 510-251-9400x104 or <jgrow@nhlp.org> if you have any further questions.

For the undersigned organizations,

James R. Grow
Senior Attorney
National Housing Law Project

National Housing Law Project (Oakland, CA)
National Housing Trust (Washington, DC)
Texas RioGrande Legal Aid (Austin, TX)
Empire Justice Center (Rochester, NY)
Florida Rural Legal Services (Fort Myers, FL)
Oregon Law Center (Portland, OR)
California Housing Partnership Corporation (San Francisco)
National Law Center on Homelessness and Poverty (Washington, DC)
Sargent Shriver National Center on Poverty Law (Chicago, IL)
Community Alliance of Tenants (Portland, OR)
Legal Services of Northern California (Sacramento, CA)
Housing Preservation Project (St. Paul, MN)
California Rural Legal Assistance (San Francisco, CA)

NHT/Enterprise Preservation Corporation

1101 30TH STREET N.W., SUITE 400
WASHINGTON, D.C. 20007
(202) 333-8931
(202) 833-1031 FAX
E-Mail:mbodaken@nhtinc.org
Web: www.nhtinc.org

FAX TRANSMITTAL

TO: Kelly Banks	**202-622-4084**

DATE: 9/18/07

FROM: Scott Kline

RE: Comments

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Please call Helen at (202) 333-8931 ext. 10
if there are any problems in transmission.