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LEGAL PROCESSING DIVISION
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Internal Revenue Service
Department of the Treasury
CC:PA:LPD:PR (REG--128274 – 03)
Room 5203
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Washington, D.C. 20044

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 calculation of statutorily required utility allowances under the Low Income Housing Tax Credit program. 72 Fed. Reg. 33703 (June 19, 2007), revising 26 C.F.R. § 1.42-10.

The National Housing Law Project (NHLP) is a charitable nonprofit national housing law and advocacy center, working with attorneys, paralegals and tenant leaders nationwide to advance housing justice for low-income people. NHLP provides legal assistance, advocacy advice and housing expertise to legal services and other attorneys, low-income housing tenant and advocacy groups, and other intermediaries, as well as policymakers. Since 1968 NHLP has worked extensively with tenants on innumerable issues under all of the major federal affordable housing programs, including the subject of these rules, utility allowances.

The Housing Justice Network (HJN) is an association of more than 500 public interest attorneys from all around the country representing low-income clients on housing matters. In developing these comments, HJN draws upon its members' many years of experience addressing problems arising in the day-to-day operation of the many federal housing programs regulated by HUD, USDA RD, and the Treasury Department.

As explained in greater detail below, without additional safeguards, the proposed rules could cause significant financial harm to the low and very low-income tenants residing in LIHTC properties, contrary to the intent of Congress when establishing affordable rents that include utility costs.

Under the LIHTC statute (26 USC § 42(g)(2)(B)(ii)), the gross rents for the units must not exceed 30% of the applicable income limitation selected by the owner and the credit allocation agency. If any utilities are tenant-paid, tenants must receive a utility allowance as a deduction from the gross rent, determined in accordance with the regulations.

The current regulatory methodology (§ 1.42-10(b)) provides methods for calculating allowances, which essentially require those for LIHTC buildings with RD or HUD assistance

or for tenants with HUD Vouchers to use the methods required by those other programs. All other LIHTC units must use the "PHA allowance" (presumably the Voucher allowance), unless a qualifying local utility company estimate is obtained by the owner, a tenant, or the credit agency), in which case that estimate is used. § 1.42-10(b)(4). This system may indeed be flawed, delivering allowances that are inaccurately excessive (if based on "older buildings with higher utility costs" when the specific property is newer *and* is more thermally efficient), or inadequate (if the base allowance is too low or illegally unadjusted). The current regulations include no procedural safeguards to permit correction of these inaccuracies, nor any duty to adjust the allowance for rate changes to ensure continued accuracy. A revised system should address these basic deficiencies.

Goal of the Utility Allowance system. The objective of an allowance system should be to permit reasonable consumption of tenant-paid utilities – sufficient to cover the actual utility consumption of most tenants in the building, with appropriate safeguards to account for special needs and avoid wasteful consumption. Estimates provided by utility companies, state or local credit agencies, or HUD's Utility Schedule Model should *all* be subject to the same standard. Each method should have to specifically take into account the factors specified in the proposed regulations (b)(4)(ii)(C) for the agency estimates, as augmented per the recommendation below. Without further revisions, the rule could produce results inconsistent with the program's statutory design to deduct reasonable allowances for tenant-paid utilities from the restricted formula gross rents.

The regulations must carefully establish a balanced system for determining allowances. Allowances must be determined by objective factors, preferably by responsible regulators pursuant to clear rules and transparent processes. Generally, the system should avoid determinations by owners with a direct financial interest in the outcome. Under the rent scheme, changes in allowances affect an owner's rental income on a dollar-for-dollar basis. Unless far greater specificity is provided concerning standards, and strong procedural safeguards are included, owners should be a participant in the process, not its adjudicator.

Even if the decision is entrusted to credit agencies, both consistency with Congressional intent underlying the requirement and basic fairness require the Department to establish specific regulatory standards for reasonable allowances, along with procedural safeguards to challenge allowances and adjustments.

Specific Issues Raised by the Proposed Rule

- **Alternative Sources for Estimates.** Proposed § 1.42-10(b)(4)(ii)(A) would broaden the allowable sources for establishing allowances by permitting owners of other (non-RD or HUD-assisted) LIHTC units to establish allowances based on either: (1) a utility company's estimated cost of utilities for similar size and construction in the area (pursuant to subpara (B), largely unchanged), (2) a state or local credit agency's estimated cost of utilities for similar size and construction in the area (pursuant to new subpara (C)) , or (3) an estimate calculated using the HUD Utility Schedule Model (new subpara (D)).

  The proposed regulation states that if one of these methods yields an estimate, that that estimate is used. It is therefore unclear whether the owner chooses which method to

use, or what happens if more than one of these methods is used (*e.g.*, when a tenant or other interested party requests a utility company estimate, and that estimate yields an allowance that is higher than one of the other methods chosen by the owner.) In the absence of a definitive standard for determining a reasonable allowance, the rule would effectively create an economic incentive for owners to seek the cheapest estimate, since higher allowances reduce their rental income dollar-for-dollar, and their capital tax credit subsidy has already been determined.

Review and adjustment of estimates for project characteristics. Because they are necessarily unrelated to the specific building, estimates alone cannot provide accurate base allowances. Because consumption is not just a function of tenant decisions and is subject to other factors that tenants cannot control (e.g., thermal characteristics, unit location, construction defects, etc.), the methodology for establishing and adjusting allowances for specific buildings must account for these factors. Owners should have to evaluate any proposed estimates in light of the specific thermal characteristics and location of units in the building (e.g., end units typically have markedly different consumption than interior units, and top floor units may also have different consumption than lower units, depending on thermal quality and climate).

After rent-up, this could be easily done by comparing the estimates by unit size to actual consumption data for the building. Actual consumption could be obtained by having tenants sign releases (at certification or recertification) authorizing owners to obtain the utility consumption and billing data from the utility company (at least for a sufficient sample of units). Allowances should be sufficient to cover the bills of most tenants (e.g., 70% of users), so that higher users have an incentive to conserve further. Estimates should have to be reevaluated if they would yield allowances more than 5% different from the results actually experienced.

Use actual prevailing retail utility rates. Actual prevailing retail utility rates paid in the locality must be used for base allowances and, as explained *infra*, any adjustments. Where utility companies provide special lower rates for specific populations (*e.g.*, people who are elderly, with disabilities, or with very low-incomes), those rates should be used in setting the allowances, provided that tenants actually qualify and receive these lower rates. Owners have an incentive to ensure that tenants actually receive these rates, as they can increase their effective net rental income by doing so.

Seasonal allowances where warranted. In climates with substantial variations in utility consumption in different seasons, the regulations should require seasonal allowance amounts to more closely correlate tenant utility bills with allowances, reducing payment problems for both rents and utilities.

Notice and comment rights for significant changes. The entity responsible for setting allowances should have to provide 30 days' notice of the initial allowance (for new properties), or any change in a proposed allowance that exceeds 10%, and provide tenants access to supporting information and an opportunity to comment, with a duty to fairly consider those comments, prior to its becoming effective.

Special needs tenants. In order to account for any special needs of tenants in occupancy (elderly families or people with disabilities requiring special energy-

consumptive equipment or more daytime hours in the unit), higher allowances should be available by a request that documents these needs.

- **HUD Utility Model.** Proposed § 1.42-10 (b)(4)(ii)(D) would permit owners to use the "HUD Utility Schedule Model" to calculate allowances.

  The concept of using a model where an owner can insert certain data about zip code (to derive degree days), building age and type, and utility rates is obviously attractive. However, without a more complete explanation concerning the model's assumptions about consumption, one cannot tell whether this is fair to tenants or owners. All typical end uses of tenant-paid energy or other utilities (e.g. water and sewer) should be covered, including heating and cooling, lighting, hot water, small household (kitchen and bathroom) appliances and computers, etc. At the very least, the model should be tested in a wide variety of climates, housing ages and types, heating and cooling systems, and tenant characteristics (family vs. elderly), and its results compared both to existing allowances and to actual bills of tenants. A model producing estimates that cover the actual bills of most tenants in these various circumstances, e.g., at least 70% of the property's units would have more validity as a fair and accurate estimation method.

- **Credit Agency Estimates.** Proposed § 1.42-10(b)(4)(ii)(C) would allow credit agencies (or agents or contractors) to provide written estimates to owners for the allowance, so long as they take into account local utility rates, property type, climate and degree-day variables by sub-state region, taxes and fees on utility charges, building materials and mechanical systems. Agencies have discretion to use actual utility company usage data and rates for the building, but apparently need not do so.

  Allowing credit agencies to provide estimates also has merit, as long as those estimates are based on (not just "take into account") a complete list of significant factors affecting utility usage, *and* actual current utility rates charged to tenants of the property. The proposed list of significant factors should be augmented by adding others, including: date of property's construction or any rehabilitation related to energy consumption; tenant characteristics (family vs. elderly), unit size (square or cubic footage), insulation and weatherization status, etc. Residential energy consumption experts should be consulted about what additional factors have a significant bearing on consumption.

- **Review and Adjustments.** Proposed § 1.42-10(c)(2) would require owners to review the "basis" for utility allowances at least once annually, and update it in accordance with proposed (c)(1). The rule would require that the review "take into account" changes such as energy conservation measures and changes in utility rates.

  The nature of the annual review and its consequences should be further clarified, to specify how the energy conservation and rate changes affect the calculation. At the very least, rate changes should produce commensurate allowance adjustments, subject to any other changes in the base allowances to reflect energy conservation measures taken by the owner that enable reduced consumption.

  In addition to an annual review, to protect tenants from prolonged inadequate allowances from rate spikes between annual review periods (which could be up to

11 months), owners should be obligated to quickly adjust to maintain a fair utility allowance when rates suddenly increase by a stated percentage (*e.g.*, HUD programs use the trigger of a rate increase of 10% of more). The regulations should require credit agencies to review, or have owners review, local utility rates quarterly to determine if rates have increased sufficiently to require an adjustment. This is not a significant burden, as most utilities make this information readily available on the internet.

- **Effective Date for New Allowances.** Proposed § 1.42-10(c)(1) would continue the requirement that any new utility allowances become effective 90 days later, except for units in the rent-up phase, where the allowance would not take effect until the earlier of the date when the building has achieved 90 percent of occupancy for 90 consecutive days or the end of the first year of the credit period.

  Where any new method would justify a decreased allowance, the rules would apparently require 90 days before any rent increase could become effective, but there is there is no requirement for advance notice (beyond state law) of these rent increases, or any phase-ins of larger rent increases. When combined with formula rent increases due to AMI increases, additional rent burdens could be significant. The rule should require advance written notice of the same 90-day period before rent increases can become effective, so that owners give notice to tenants at the same time they decide to decrease allowances, as well as a transition period for rent increases more than 5% (e.g., 5% for each 90-day period).

  Where an allowance increases and tenant rents should decrease (offset by any legal annual increase for increases in AMI), new rents should be effective within 30 days, not 90.

  Since the proposed rule fails to clearly specify whether there is *any* utility allowance in effect during the rent-up period, the rules should nevertheless require an interim allowance based upon some easily available source, such as the PHA's properly updated allowance for its voucher program, as adjusted for unit size. Anything less would violate the statutory mandate to establish rents that include utility allowances.

- **Applicability of New Regulations.** Proposed § 1.42-12(a)(4) provides that the new regulations would not apply until the tax year beginning on or after final adoption of the regulations. Unless there is some statutory requirement that agency rules cannot become effective earlier, waiting until perhaps 2009 at the earliest to make all of these changes effective would seem unfair to tenants of those LIHTC properties with currently inadequate allowances.

- **Excluding Cable TV.** Proposed § 1.42-10(a) would exclude cable television from the list of utilities covered by the allowance. This is certainly fair, since cable is generally not considered a necessary utility. However, there may be occasions where a tenant has no option to reject cable service because of a contractual arrangement made by the owner. In these circumstances, where cable service is mandatory, the rule should require the charge to be factored into the allowance.

- **Need for Procedural Safeguards and Enforcement Mechanisms:** The rules should specify how the regulatory requirements will be enforced. In

addition to establishing clear standards for fair allowances, it is vital for the rules to specify enforcement mechanisms available to tenants to obtain review, require adjustments, or remedy violations. Tenants should have explicit rights to request a review from the credit agency and adjustment of allowances that fail to meet the regulatory standards. The credit agency should consult with the owner and the tenant, and review the relevant supporting information. Upon finding a violation that the owner fails to promptly remedy (both establishing a proper allowance and reimbursing for rent overcharges), the credit agency should be required to submit a Form 8823 to the IRS, detailing the housing provider's noncompliance as per 26 CFR § 1.42-5(e).

To encourage compliance by owners, the regulations should explicitly require owners to reimburse tenants whose rent was not calculated correctly under the gross rent and allowance rules, retroactive to the date the violation commenced. Currently no such remedy is specified.

To make regulatory requirements enforceable, the regulations should require owners to explicitly specify the duty to review and update allowances in the lease. If owners breach the duty and the credit agency fails or is unsuccessful in obtaining compliance, tenants must be able to hold violators accountable for breach of contract. Without any structural enforcement scheme, whatever provisions that may be adopted to protect tenants' interests will remain toothless in the face of possible agency inaction.

Adopting the revisions described above will substantially improve these rules, and the promise of affordable shelter established by Congress in the LIHTC program.

Thank you for considering these comments. If you have any questions, please do not hesitate to contact James Grow at NHLP, (510) 251-9400 x104.

For the undersigned organizations,

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