LIHTC WORKING GROUP

August 11, 2017

Jennifer Schwartz
Assistant Director for Tax Policy and Advocacy
National Council of State Housing Agencies
444 North Capitol Street NW, Suite 438
Washington, DC 20001

Re: NCSHA's Draft Recommended Practices for Housing Credit Administration ("Recommended Practices")

Dear Ms. Schwartz:

The LIHTC Working Group was established by Novogradac & Company LLP to provide low-income housing tax credit (LIHTC) industry participants a platform to work together to resolve technical and administrative LIHTC program issues. On behalf of the members of the LIHTC Working Group, we respectfully submit our comments on the Recommended Practices.

The members of the LIHTC Working Group strive to make the LIHTC program even more efficient in delivering benefits to help build affordable rental housing throughout the nation in a wide variety of different housing markets. Our group includes nonprofit and for-profit developers, property managers, lenders, syndicators, investors, accountants, lawyers and other LIHTC professionals.

Enclosed please find the LIHTC Working Group's comments on the Recommended Practices. The document contains specific track-changed language and explanations.

We appreciate efforts to improve the LIHTC program and look forward to working with the NCSHA as it finalizes the recommendations.

Please do not hesitate to contact me at Dirk.Wallace@novoco.com or (330) 365-5400 if you have any questions regarding our comments or if we can be of further assistance.

THE LIHTC WORKING GROUP

Very truly yours,
NOVOGRADAC & COMPANY LLP

by
Dirk A. Wallace

NOVOGRADAC & COMPANY LLP

by
Peter Lawrence

Novogradac LIHTC Working Group
Comments on NCSHA's Draft Recommended Practices
August 11, 2017

The LIHTC Working Group's (LWG) suggested revisions and explanations are below. The revisions are indicated as track-changed, and the explanations are indented text boxes.

6. Application Procedures

> *Explanation*: To different degrees each Agency has the opportunity to both streamline the application process for its own resources and collaborate with other funders in the state. The next suggested addition is to make explicit what arguably is implied: assessing viability for housing is crucial, but worthwhile only if the Agency is able to act on its determination.

Recommendation

Allocating Agencies should combine the application for Housing Credits and any other subsidy administered and used for affordable rental housing (e.g., also a HOME Participating Jurisdiction). Agencies also should endeavor, to the extent useful and practical, to streamline the application process for Housing Credit developments involving multiple other subsidies by taking into account other sources of funding subject to different application and allocation schedules.

In addition, Agencies should visit proposed development sites (or hire a third party analyst to conduct a site visit) whenever possible at the application stage to assess the viability of the site and to check for nearby incompatible uses, physical barriers to development, or other important shortcomings. The qualified allocation plan should allow the Agency to exercise appropriate responses to such shortcomings.

8. Market Analysis

> *Explanation*: Some agencies outsource the review of studies. Such an approach can be more efficient and effective considering the specialized level of knowledge required and importance of understanding what goes into the analysis.

Recommendation

Allocating Agencies (or contracted third parties) should review each study to determine its implications for the financial viability of the property and whether it justifies the need for the number, size, and type (such as family, elderly, or other special needs housing) of rental housing proposed.

11. Encouraging Native American Housing Development with the Credit

> *Explanation*: A LWG member has been working with Allocating Agencies to create policy initiatives to ensure Native American housing needs are adequately addressed. One such initiative Agencies have considered is to create a Native American housing set aside.

Recommendation

Agencies should analyze recent state experience in using the Housing Credit for Native American housing development and consider QAP incentives or other policy initiatives (for example, the creation of a Native American housing set aside) to ensure Native American housing needs are adequately addressed. Agencies should work with relevant stakeholders and program investors to study current impediments to Native

American housing development and make appropriate changes to underwriting criteria or other policies to maximize investor interest in these developments.

14. Per Unit Cost Limits

Explanation: There are two suggested changes in this section; the first recognizes the distinction between creating new housing and rehabilitating existing units. Policies on costs should reflect the two activities being fundamentally different. For example, one development spending substantially more per unit to rehabilitate than another often is responsible, even necessary.

The other suggestion is to strengthen the statement on not allocating to overly-expensive developments. What may be valid explanations, or even compelling reasons, often do not matter when high costs are considered by those outside the Housing Credit industry. No single development, regardless of how worthy, is important enough to risk the program as a whole.

Recommendation

This process will produce a standard that either prescribes a single cost limit applicable to the entire state or multiple limits that take into account disparities in costs due to project location, type of construction, population served, and potentially other project characteristics. In developing cost limits, Agencies should balance the efficient use of scarce resources with the need to develop affordable rental housing that is durable, attractive, safe, energy efficient, and healthy. Agencies also should take into account how the limits apply to new construction versus acquisition/rehabilitation.

Each Allocating Agency's cost limit standard and/or policies should ~~acknowledge that the total cost of a development may sometimes be higher than good public policy and prudent resource allocation should allow, even if individual cost components may be justified and considered reasonable in other contexts. It should~~ recognize that some markets, property characteristics, and circumstances individually or together may be cost-prohibitive for Housing Credit development. However, if an application's total cost is higher than good public policy and prudent resource allocation should allow, it must not receive an allocation.

15. Developer Fee and Builder Fee Limits

Explanation: There are three substantive suggestions in this section; the first expresses a long-standing requirement for determining the amount of fee. Unfortunately some practitioners express rationales which do not reflect the federal expectation, such as larger fees making developments more financially feasible.

The next discusses the difference between the developer fee limit in the QAP and allocation of the fee on the cost certification. While the QAP should limit the overall fee, the owner and CPA should establish a basis for the allocation between the acquisition and rehabilitation cost of the property based on the services performed by the developer.

Finally, the third suggestion is to delete the last paragraph in the "Discussion" section. Timing of developer fee payments is best determined in the partnership negotiation.

Recommendation

Each Allocating Agency should include in its QAP or other Housing Credit allocation guidelines a general developer fee limit, including overhead. The limit should not exceed the lesser of ~~1)~~ an appropriate defined 1) per unit ~~or~~ 2) per project ~~dollar cap on developer fee~~, or ~~2~~3) ~~15~~ percentage of ~~total~~ development costs. Agencies may allow exceptions to the developer fee limit for developments meeting specified criteria based upon the following factors, but only in extremely limited circumstances with documentation of the reasons justifying the exception:

a. Development size - The smaller the development size, the higher the fee may be as a percentage of development costs.
b. Development characteristics - Higher developer fees may be allowed as an incentive to produce hard-to-develop or socially desirable developments, such as homeless housing, single-room occupancy housing, and scattered-site developments.
c. Development location - Higher developer fees may be allowed for developments produced in difficult-to-develop areas.

The amount of developer fee must relate to the amount of development work. Agencies should not base limits on other rationales, including for tax-exempt bond transactions.

Allocating Agencies should encourage lower developer fees for the acquisition portion of acquisition/rehabilitation developments. The developer fee allocation between acquisition and rehabilitation portions of developments on the tax credit application and final cost certification ("FCC") should be determined in accordance with Internal Revenue Code Section 42 and related Internal Revenue Service ("IRS") guidance, as determined by a certified public accountant ("CPA").

The total developer fee shall be in accordance with an Allocating Agency's limit, but the allocation may not be the same. The allocation of the fee in the FCC between the acquisition and rehabilitation portions of a development is a separate calculation determined by a development's owner and CPA, based on the division in the developer's efforts between acquisition and rehabilitation-related activities in accordance with IRS guidance, which should be based on the services provided in the development fee agreement.

Discussion

~~While the NCSHA recommended practice does not dictate developer fee payout standards, Allocating Agencies should consider the payout schedule in evaluating the reasonableness of developer fees. Developers undertake significant risk in developing Housing Credit properties and have an interest in earning the developer fee as quickly as possible and limiting the amount of any deferred fees. In the current equity environment, Housing Credit investors strongly prefer holding back as much of the paid development fee as possible to mitigate risk and motivate the developer to reach certain important milestones (cost certification, stabilization, etc.)~~

17. Verification of Expenditures and Issuance of IRS Form 8609

Explanation: There are three substantive suggestions in this section; the first is to recommend that all developments be subject to additional cost certification due diligence requirements, as opposed to a random sample. The next change suggests five additional procedures CPAs could perform, as part of their cost certification procedures, to certify the cost of the development. Finally, the last paragraph in the "Discussion" section corrects the statement regarding IRS guidance (requires independent verification of uses, not sources).

Status: existing recommended practice - proposed amendment to suggest Agencies require additional cost certification due diligence, such as audits of general contractors and/or sampling of subcontractor invoices, for ~~a random sampling of~~all developments~~, as determined by the Agency, and always for developments with related parties at the developer, general contractor, or subcontractor level and other developments that the Agency judges to be high risk~~.

Recommendation

~~Each Allocating Agency should establish a process for requiring and analyzing cost certifications for all developments as part of the final feasibility evaluation, prior to issuing an IRS Form 8609. As part of the analysis, the Agency should judge the reasonableness of the cost components. Agencies should issue Form 8609 in a timely manner after receiving all required documentation.~~
Prior to issuing one or more IRS Forms 8609 for a development, Allocating Agencies must review an independent third-party Certified Public Accountant (CPA) audit report and judge the reasonableness of the cost components. Agencies should issue Forms 8609 in a timely manner after receiving all required documentation.

For developments of 11 or more units, the Agency must require the sponsor to submit for the Agency's review an independent third-party Certified Public Accountant (CPA) audit report as a part of the final feasibility evaluation.

Agencies should require additional cost certification due diligence for ~~a random sampling of~~all developments~~, and always for developments with related parties at the developer, general contractor, or subcontractor level, or for other developments that the Agency judges to be high risk. This additional due diligence may include audits of general contractors and/or sampling of subcontractor invoices to verify consistency with the developer cost certification~~.

Additional FCC audit steps for developments with related party general contractors may include the following:

a. Select material subcontracts for thorough testing, and a sampling of other subcontracts should be selected based on risk assessment (e.g., highest likelihood of errors, irregularities, or fraud). For example, review all subcontractor contracts and bids that are more than 5% of the general contract.
b. Every subcontract is part of the sample, regardless of size, and qualitative factors are evaluated to select subcontracts for further testing.
c. Use a risk-based approach to detect irregularities at general contractor and subcontract levels. For example, vouch 80% (percentage will vary depending on CPA judgment) of the total subcontractor costs.
d. The vouching of subcontractor costs includes examining source documents (e.g., invoices, fee agreements, contracts, deeds) and disbursements (e.g., cancelled checks, bank statements, check stubs).
e. Explain any material differences and document results.

Each Allocating Agency should establish a process for receiving and analyzing copies of federal cost certifications for RHS and FHA developments receiving Housing Credits.

Agencies should adopt the model 10 Percent Test and final cost certification letters developed by NCSHA.

Discussion

In January 2000, the IRS issued regulations requiring independent verification of ~~sources and~~ uses of funds in the form of a CPA audit report, based on an accountant's audit or examination of financial documents and certifications the development owner provides. IRS regulations exempt developments with 10 or fewer units from the requirement to obtain a CPA audit report.

18. Sponsor Certification of Project Sources and Uses of Funds

> *Explanation*: The final cost certification report templates issued by Allocating Agencies typically lack specific certifications made by the development sponsor. The LWG recommends Agencies add the certifications below to their cost certification templates.

Discussion

For Allocating Agencies to meet their underwriting responsibilities, development sponsors must, in turn, be required by Agencies to divulge fully to them all sources and uses of funds, as well as the development's total financing, at each stage of Agency review. To help ensure the completeness and accuracy of this disclosure, we suggest Agencies require sponsors to certify all of a development's sources and uses of funds and total financing at each point of Agency evaluation and in the event of any other change in sources and uses of funds. This is especially important due to periodic changes in equity pricing.

Allocating Agencies should consider incorporating language in the body of their FCC report templates similar to the following:

"As owner(s) of the above referenced low-income housing project, I certify under penalty of perjury, that the project costs contained herein are to the best of my knowledge, accurate and actual costs associated with the construction, acquisition and/or rehabilitation of this project and that the sources of funds shown here are the only funds received by the Partnership for the development of the project. I authorize the [Allocating Agency Name] to utilize this information to calculate the low-income housing tax credit."

"The Partnership has no plans or intentions that may materially affect the carrying value or classification of the eligible basis costs and no transactions have taken place that would increase or decrease the eligible basis costs stated on the Final Cost Certification. We have disclosed any refunds or reimbursements that would affect eligible basis. "

"We acknowledge that we are familiar with IRS Technical Advice Memoranda 200043015, 200043016, 200043017, 200044004, 200044005 and 200203013 (the "TAMs"), along with IRS Revenue Ruling 2002-9, IRS Private Letter Ruling 200916007, and the IRS Section 42 Audit Technique Guide ("ATG"). Further, we acknowledge that we have previously sought professional advice where needed to understand the impact this IRS guidance might have on this Partnership. With respect to the TAMs and ATG, we represent that we understand the potential risks of including certain land preparation costs, local impact fees, developer fees and construction financing costs in the eligible basis of the project. We understand and acknowledge that the IRS has issued guidance that may conflict with our position concerning these items, and under audit, the IRS may disallow some or all of the eligible basis related to the cost of these items."

"We confirm that we are responsible for the fair presentation of the Final Cost Certification and we are also responsible for adopting sound accounting policies, establishing and maintaining internal control, and preventing and detecting fraud."

Whatever policies and approaches Allocating Agencies adopt, they must ensure that they satisfy the statutory requirement to allocate only as much Credit as necessary for a development's feasibility and viability and obtain the information necessary to carry out this responsibility.

25. Extended Use Agreements

Explanation: There are two suggested changes in this section, the first being simply a clarification of the Internal Revenue Code expectation. The other is guidance in the Discussion regarding when the agreement should be recorded.

Recommendation

Allocating Agencies should require extended low-income housing commitments to:

a. Specify whether a development was allocated Credit under the nonprofit set-aside, to make clear that the current owner (and any new owner) during the compliance period must continue to qualify under that set-aside;
b. Identify all requirements imposed on the development material to the award of Credit—including, for example, income restrictions, rent skewing, affordability period, reserve levels, amenities and services, and accessibility; and
c. Require all permanent mortgage liens on the property be subordinate to the low-income use restrictions, except in the event of a valid foreclosure (the Section 42 protections for existing tenants must remain in effect for three years).

Discussion

To assure the Allocating Agency's qualified allocation plan requirements and the conditions of its Housing Credit award are met, the Agency should record in an extended use agreement any development characteristic that materially affected its allocation of Credit, so the Agency has a means of enforcing it on the sponsor. Allocating Agencies should also require that all mortgage liens on a property be subordinate to the extended use agreement to ensure provisions of the agreement apply throughout the extended use period.

The extended use agreement should be executed and recorded soon after the date on which the ownership entity acquires the development (or the land on which the development will exist). Recording in a timely fashion ensures the property is subject to the requirements. However before doing so the Agency should take into account any changes which may have occurred after the initial award affecting the development's ability to succeed long-term or comply with the terms.

This practice will ensure a property's extended use agreement complies with the statutory requirement that it be enforceable on all parties, including the lender, except in the event of foreclosure. A foreclosing bank should, however, have the right to elect to maintain affordability under the extended use agreement.

26. Housing Credit Developments at Year 15

Explanation: Many, if not most Agencies already follow this suggestion.

Recommendation

Allocating Agencies should evaluate current Housing Credit qualified allocation plan incentives and other policy initiatives to determine any impact on developments reaching the end of their initial 15-year compliance period. While Agencies should approach Year 15 projects with a goal of preserving the housing stock as a long-term affordable housing resource, the best course of action for each development is a project-specific determination that includes consideration of the project's current financial viability, its physical condition, and its relative competitiveness in the local market. As part of this determination, Agencies should consider whether additional Housing Credits and recapitalization are necessary for each development as part of an overall preservation strategy.

Agencies monitoring developments that have completed the 15-year compliance period in a manner that varies from Treasury Regulation §1.42-5 should detail those variances.

31. Foreclosure Prevention

> *Explanation*: The primary substantive suggestion in this section is to clarify the likely intent. Under IRC Section 42(h)(6)(E)(i)(I), a valid foreclosure automatically terminates the extended use period. The ability of Agency policies to reach a different result is in doubt. Regardless, essentially all lenders require the ability to remove the restrictions upon foreclosure (other than the three year tenant protections).
>
> The revision after the list of information is largely for phrasing, although it also removes the word "unwarranted" since its application to particular fact patterns may not be clear.

Recommendation

In addition to monitoring continued compliance in the extended use period, Agencies should monitor Housing Credit developments to identify properties in danger of foreclosure. If a property faces financial challenges, Agencies should examine and consider restructuring strategies to prevent foreclosure.

~~Agencies should adopt policies requiring that restrictive covenants and other long-term use restriction instruments are not automatically terminated upon the execution of a foreclosure or deed in lieu of foreclosure.~~

~~Moreover, Agencies should establish procedures attendant to a foreclosure (or deed in lieu of foreclosure) of a Housing Credit property requiring all entities initiating foreclosure to provide the Agency with the following information at least 60 days prior to requesting the Agency release the extended use agreement:~~ Agencies should establish procedures requiring all entities initiating foreclosure (or deed in lieu of foreclosure) to provide the following information at least 60 days prior to requesting a release of the extended use agreement:

a. The name of the lender on the note triggering the foreclosure activity;
b. The original amount and date of the note, the existing balance, and the annual debt ~~cost~~service;
c. The position of the note relative to other liabilities on the property;
d. The names of all other holders of notes on the property;
e. A detailed description of the circumstances that have prevented a timely payment of ~~interest~~ debt service on the note;
f. A detailed description of efforts between the owner and the holder of the note to reach an agreement to modify the terms of the note to prevent foreclosure; and

g. Any relationship between the holder of the note and the owner of the property or its general partners by familial relationship, common ~~principals~~ownership, owners or employees (collectively, "affiliates" of the note holder).

Agencies should use this information to thoroughly examine the situation and inform the entity initiating foreclosure (or deed in lieu) that it will report any arrangement with the taxpayer and request that Treasury prevent the termination of the extended use agreement.
~~Agencies should inform the entity initiating foreclosure that should the Agency determine, based on the information provided that the foreclosure activity is unwarranted, the Agency will report its findings to the IRS and Treasury. Using this information, Agencies should thoroughly examine the situation to ensure that the foreclosure (or instrument in lieu) is not part of an arrangement with the taxpayer the purpose of which is to terminate the extended use period on the development and, should they deem it to be such an arrangement, report their findings to IRS and Treasury and request that Treasury prevent the termination of the extended use agreement.~~

34. Coordination of Monitoring Activities

Explanation: As a general matter, Agencies have several opportunities to coordinate compliance monitoring beyond the federal Alignment Initiatives. The result is more efficient use of resources and less disruption for residents.

Recommendation

To the extent practical, Agencies should coordinate compliance reviews for Housing Credit developments financed with multiple subsidies from local, state, and/or federal agencies. Specifically, Agencies may consider participation in the federal Interagency Physical Inspection Alignment Initiative to improve coordination and communication with the U.S. Departments of the Treasury, Housing and Urban Development, and Agriculture on developments financed with multiple subsidies.

38. Calculating Anticipated Tenant Income

Explanation: HUD's 2013 update to its Handbook 4350.3 relaxed the stance on pay check stubs and other tenant provided documents. Under Section 5-13 (B)(1)(b)(1) these documents are actually placed at a higher preference than "written documentation sent directly by the third-party source by mail or electronically by fax, email or internet."

Recommendation

Agencies should instruct property managers qualifying tenants for Housing Credit apartments to calculate household income using the gross income the household anticipates it will receive in the 12- month period following the effective date of the income certification or recertification. For purposes of this recommendation, anticipated income should be documented in the tenant file by third party verification or documents generated by a third party source whenever possible or by an acceptable alternate method of verification with documentation as to why third party sourced verification was not possible. States and property managers should use current circumstances to project income, unless verification forms or other verifiable documentation indicate that an imminent change will occur. Agencies should refer managers to HUD Handbook 4350.3 for guidance on the proper calculation of income and assets.

39. Encouraging Fair Housing Compliance

> *Explanation*: Recent federal decisions and guidance have emphasized the importance avoiding not only intentional violations of fair housing, but also those arising from disparate impact.

Recommendation

To further encourage fair housing compliance, Agencies should require owners and property managers to attend fair housing training prior to property lease up and on a regular basis throughout the compliance and extended use periods. Agencies should develop guidance related to developments' written policies and procedures that provide for methods to mitigate unforeseen fair housing issues. For example, consider how the criteria for occupancy may inadvertently impact a protected class.

41. Compliance Issues in Resyndication

> *Explanation*: The proposals in this section are meant to help Agencies avoid potential problems.

Recommendation

Agencies should develop policies on compliance issues encountered in resyndication of existing Housing Credit developments. At minimum, these policies should:

- Consider an existing household income-qualified under resyndication, as long as the household was initially income-qualified ~~during~~ under the original ~~15-year compliance period~~extended use agreement; ~~and~~
- Contemplate variances in the Agency's compliance monitoring between the initial 15-year period and afterwards to ensure that an existing household certified in/after year 16, is eligible under the original extended use agreement;
- Provide guidance on which income limits apply after placed in service uses versus the original extended use agreement;
- Ensure all households have a gross rent under the limits in effect by the beginning of the first year of the credit period, as calculated using the income limits in effect for the new allocation;
- If a single allocation covers multiple developments located in different counties, provide guidance that income and rent limits are determined by county, and also consider variances in utility allowances in these cases; and
- Specify any Agency policies on amendment of the original extended use agreement.

44. Utility Allowances

> *Explanation*: In recent years both the technology and federal policies regarding utility allowances have evolved more rapidly than most other areas of compliance. Therefore NCSHA should consider including a new Recommend Practice. The following is the LWG's suggested text.

Recommendation

- Agencies should permit developments to use all utility allowance methodologies available under Treasury Regulation §1.42-10.
- Agencies should adopt a process under which an alternative utility allowance (e.g. Utility

Company Estimate or HUD Utility Schedule Model) will be considered. Such processes should detail what owners need to do at the commencement of leasing activities, when they choose to change the method, or when undergoing the annual review of an already implemented alternative utility allowance.

- The Agency should provide guidance on the difference between actual-consumption submetering and utilities billed through an allocation method or Ratio Utility Billing System (RUBS).
- The Agency should be specific with the type(s) of HUD Funding result in a building being considered HUD-Regulated under Treasury Regulation §1.42-10(b)(3).

Discussion

The release of Treasury Regulation §1.42-10 on March 2016 amended the regulation to incorporate IRS Notice 2009-44 and address public comment.

Subsection 1.42-10(b)(3) changed from a building where the rent and utility allowances are reviewed by HUD on an annual basis to a building where the rent and utility allowances are regulated by HUD. This revised wording creates the possibility for other HUD programs, traditionally not considered to have triggered this provision, as meeting this requirement (e.g. HOME).

The updated regulation also made a practical change to the Energy Consumption Model that now allows for available historical data as one the factors to be taken into consideration to better meet the intent of the method. The regulation also contemplates how to consider energy obtained directly from renewable sources as it relates to actual-consumption sub metering.