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

Electronically Submitted

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

**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 26 C.F.R. § 1.42-18.

NHLP is a national housing and legal advocacy center established to advance housing justice for poor people by increasing and preserving the supply of decent, affordable housing; by improving existing housing conditions, including physical conditions and management practices; 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 organization of housing advocates and clients that was formed in 1997 in response to the recognition that many client issues can be addressed more effectively through coordinated advocacy and through a regular exchange of information on matters relating to ongoing litigation and other client housing issues. The undersigned organizations are the National Housing Law Project, the National Housing Trust, Texas RioGrande Legal Aid, Empire Justice Center, Florida Rural Legal Services, Oregon Law Center, California Housing Partnership Corporation, National Law Center on Homelessness and Poverty, Sargent Shriver National Center on Poverty Law, Community Alliance of Tenants, Legal Services of Northern California, the Housing Preservation Project, and California Rural Legal Assistance.

Our comments focus on the effectiveness of the proposed rules promulgating Section 42 of the Internal Revenue Code, the LIHTC statute, in carrying out Congress' intent to preserve affordable housing.

***Proposed Requirements Including the Restrictions on Low-Income Portions of the Building for Fair Market Valuation Of Qualified Contract Property (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 of 72 Fed. Reg. 33706 computes 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 it created this statute. Economically, the actual value of any property is affected by legal constraints on what an owner may do with that property, especially the amount of income potentially available. Because the low-income portions of a building change the amount of 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 buyer is significantly more likely to gather the resources required to preserve the preserve the property and keep it in the nation's affordable housing supply. Thus, in order to implement Congress' intent to preserve low-income units available through this program, the fair market valuation of property should take into account any restrictions on the use of 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 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 with 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 notion behind offering the properties in Year 15 to qualified purchasers – the idea 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 if possible.

***Inclusion of the land value of the low-income portion of a building in the fair market valuation***

The proposed regulations intend to include the value of the land that a building referred to in a qualified contract exists upon. 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. This regulation is inconsistent with the Congressional statute, as well as with the other proposed regulations.

Part 42 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, without specifically stating so, would be erroneous. Thus, the Service's authority to include such a value in its assessment is not within the scope of the statute.

Additionally, even if including the underlying land in the fair market value of a qualified contract property is within the parameters of the Code, the value should take into account the effects of the portion of the building is restricted for the remaining term of the extended use commitment. 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 to its highest economic value and that must be reflected in the fair market value if the land is to be included in the calculation.

Furthermore, as long as the commitment remains, the buyer's development of the part of the land where the building is not located is also restricted. Without any commitment, that undeveloped land would be free of any constraints. However, during the extended use period, the housing credit agency and investors 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. Even if the Service may include the value of the underlying land in its assessment of the property, the valuation should take into account both the proportion of the building that is low-income and also 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. We recommend that the State Housing Finance Agency and owner each select an independent appraiser. If the two parties disagree significantly on the valuation, the parties can agree to one of two methods. First, they could agree to average the valuation between the two appraisals. If that is not acceptable, then the two appraisers could appoint a third appraiser whose determination of the final fair market value would be binding for both parties.

***The Valuation of the low-income portion of the qualified contract property should not exceed fair market value***

The agency observes that the qualified contract property value could often exceed the fair market value of a property. This result is directly contrary to intent of the statute – to preserve affordable housing when feasible. In order to promulgate Congressional intent in creating this

law, the agency 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 another owner who wishes to continue the low-income use of that property and would prevent the loss of affordable units due to an unrealistically high and financially infeasible sale price.

***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 form net operating income; 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.

Thank you for considering these comments. Please feel free to contact James Grow, NHLP Staff Attorney, at 510-251-9400x104 or <jgrow@nhlp.org> if you have any further questions.

[Closing]
For the undersigned organizations,

James R. Grow
Senior Attorney
National Housing Law Project

List of Organizational Sign-Ons to NHLP Comments on proposed rule re LIHTC QCs

National Housing Law Project
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)