

**Millennial Housing Commission
Tax Policy Task Force
Proposed Recommendations**

1. Credit basis tied to property cost and independent of depreciation

Recommendation. Establish a definition of Credit basis tied to property cost (independent of depreciable basis) and lets allocating agencies certify it.

The problem being addressed. Under current Credit rules, basis is derived using traditional principles applicable to depreciation, with additional restrictions that exclude costs covered through federal grants. This leads to the following problem areas:

- ***Changing boundaries.*** IRS guidance determining what costs properly go in depreciable basis changes from time to time (through Technical Advice Memoranda (TAMs) and otherwise). As a result, (1) expenditures previously approved by state allocating agencies are vulnerable to IRS disallowance, and (2) capital markets pricing Credits must include a modest inherent discount to reflect that uncertainty.
- ***Structuring costs as debt.*** Funds that would ordinarily be grants (HOME, CDBG, HOPE VI) must be provided as deferred-payment loans, saddling properties with accruing debt that creates a downstream problem and significantly limits financing options.
- ***Land.*** A significant cost in many Credit properties but ineligible in Credit basis.

How the recommendation would work. Credit basis would be established based on project cost (construction or acquisition, together with associated soft costs). A basis estimate would be provided at the time of allocation, to be certified by the property's accountants (in a manner analogous to HUD cost certification) when permanent financing was put in place.

Principles governing the recommendation.

- Simplicity.
- Devolution.
- Eliminate duplicative requirements.
- Increase efficiency by reducing complexity.
- No incremental Federal cost since total Credits are already a capped resource.

Task Force view. *For*, subject to review by the full task force.

2. Other Federal funds

Recommendation. Repeal §42(b)(1)(B)(i) that lowers allocated Credits (from 9% to 4%) on that portion of the property subsidized with 'other federal funds.' .

The problem being addressed. Properties using allocated 9% Credits are substantially penalized for using effective vehicles such as HOME and CDBG.

How the recommendation would work. As a simple repeal, implementation would be immediate. Costs that would otherwise qualify for 9% Credits would once again be able to do so.

Principles governing the recommendation.

- Devolution.
- Efficiency.

This provision, part of the original 1986 statutory language, arose out of the same apprehension, understandable in historical context, that led to the 10% expenditure test (see Recommendation 5) and §102(d) subsidy layering (see Recommendation 9). The risk it sought to address is long past, and now the provision is merely an obstacle to efficiency.

Task Force view. *For*, subject to review by the full task force. (Allocated 9% Credits should not be used for pure acquisition.)

3. Rural Housing Service properties

Recommendation. Allow RHS properties using allocated Credits to use 9% rather than 4% Credits (a special case of Recommendation 2).

The problem being addressed. RHS properties, either existing or new, using Federal resource such as §515 below-market loans. This automatically precludes them from using 9% Credits.

Principles governing the recommendation. The same as Recommendation 2. This is simply a special case of that Recommendation, listed separately for clarity.

How the recommendation would work. Costs that would otherwise qualify for 9% Credits would once again be able to do so.

Task Force view. *For*, subject to review by the full task force.

4. Conform definitions

Recommendation. Provide generally that satisfying Credit standards of income, rent cap and so on satisfy other programs (e.g. HOME, CDBG). (Specifics are being provided in a separate paper being developed for the Production and Preservation Task Forces.)

The problem being addressed. Overlapping program rules either add complexity, make programs more onerous to combine, or duplicate reporting requirements.

How the recommendation would work. Numerous technical changes (to be developed by an appropriate working group within the Production and Preservation Task Forces) would be written into the various programs, providing generally that so long as the income requirements and rent caps were generally consistent, compliance with the Credit satisfied the other program requirements.

Principles governing the recommendation.

- Hierarchy of Compliance.

Task Force view. *For*, subject to review by the full task force and deferring to the Production/Preservation Task Forces that are developing specific recommendations.

5. Ten-percent expenditure test

Recommendation. Repeal the §42(h)(1)(E) ten-percent expenditure test requiring 10% of estimated property cost to be expended within the calendar year of the allocation, but not earlier than six months after the actual allocation. .

The problem being addressed. In today's properties, developers are often under pressure artificially to accelerate their costs so as to meet the 10% test and demonstrate its achievement. The 10% test, originally placed in the 1986 statute to stimulate states not to allocate Credits to properties unlikely to be developed, has outlived whatever usefulness it might have had.

How the recommendation would work. As a repeal, effective upon impact. States would establish their own mechanisms for recapturing allocated Credits from sponsors who had not achieved performance milestones required in the original allocation.

Principles governing the recommendation.

- Simplicity.
- Devolution.

Task Force view. *For*, subject to review by the full task force.

6. Rural area rent caps

Recommendation. Allow properties in rural areas to establish rent caps based on statewide rather than county median income.

The problem being addressed. In communities with very low median income, the resulting Credit rent caps (30% of 60% of median income, or a monthly rent of 1.5% of annual median income) are so low that they support little if any debt. As a result, pockets of poverty (typically rural) can be served by Credits only if significant other resources are combined.

How the recommendation would work. Provide rent caps equal to 30% of 60% of the greater of (i) county median income or (ii) state median income.

Principles governing the recommendation.

- Improving program effectiveness.

Task Force view. *Not opposed*, subject to review by the full task force.

7. Ten-year rule

Recommendation. Repeal §42(b)(2)(B)(ii) denying Credit eligibility to any property whose ownership has changed hands in the last ten years.

The problem being addressed. Properties that would otherwise be good candidates for preservation using Credits are arbitrarily denied eligibility under any of these circumstances:

- *Internal transfers by owners* (such as occur on death or change in partner circumstances).
- *Unrelated recent transfers* where one owner of a non-Credit property sold it to another. Their exclusion serves no public purpose.
- *Repositioning transfers* where a property (such as a non-profit intermediary or portfolio buyer) acquires a property with a view to repositioning, stabilization, probably resource assembly (such as with Credits), and eventual transfer to a long-term preservation entity.

This provision was included in the original 1986 version of §42 principally because Congress was apprehensive that recently re-syndicated properties would be 'churned' (as the phrase was known) to take advantage of more favorable Credit treatment. Since the original §42 had a three-year sunset, none of the original drafters probably contemplated that it would prove as enduring as it has, and no ten-year sunset was included.

How the recommendation would work. As a repeal, implementation would be immediate and simple.

Principles governing the recommendation.

- Effectiveness.
- Preservation of at-risk affordable housing.

Task Force view. *For*, recognizing that this is principally a Preservation recommendation.

8. Resident income verification using tax returns

Recommendation. Allow renters' tax returns to serve as income verification.

The problem being addressed. Resident income certification is a fairly lengthy process requiring the owner to investigate the applicant's background and to assemble information all of which is required disclosure on a tax return.

How the recommendation would work. Applicants or residents would provide, in lieu of other verification of income, a copy of the relevant pages from their personal or family tax returns. (With multiple taxpayers filing separately living in one apartment, all tax returns would be required.)

Issues.

- Historically, tax returns have been held as private information. However, occupancy of a Credit property is not a right, it is a privilege, and waiver of this element of privacy could be made a condition of that privilege. Appropriate steps would be required to allow the income certification information to remain on file but at the same time keep the tax return itself confidential from other inquiries.
- Tax returns provide a snapshot of the resident's income from the prior year, not current income. The inaccuracy associated with this time mismatch (e.g. possible changes of income sources or level, or marital/ family status) would have to be accepted and set against the presumed increase in accuracy from the tax return filing.

Principles governing the recommendation.

- Hierarchy of Compliance.

Task Force view. *Undecided*, pending discussion by the full task force.

9. Subsidy layering

Recommendation. Either (a) repeal §102(d) of DHUDRA (which mandates a subsidy-layering review whenever HUD resources are involved) or (b) provide that an allocating agency award of Credits *shall* constitute approval under §102(d).

The problem being addressed. HUD's review process under §102(d) is designed to assure that properties do not receive excessive resources by focusing on situations where multiple resources are combined. It was predicated on the hypothesis, tenable more than a decade ago when it was enacted but out of date now, that HUD subsidy was the predominant resource in every transaction. With modern finance, virtually every property combines multiple resources, many of which (such as Credits) are allocated much more competitively than HUD resources, and with their own reviews. As a result, §102(d) review is unusually burdensome to the point where HUD resources are often bypassed.

Section 102(d) was part of a sweeping package of reforms designed to curb perceived influence in the award of HUD resources (principally Section 8 Mod Rehab). Since then (i) the Federal role has significantly waned, (ii) the finance of affordable housing has become more complex, involving many more resources, and (iii) state agency allocators have become significantly more sophisticated in their resource-allocation award procedures and intensive in their review of resources provided.

How the recommendation would work. As noted above, either by repealing §102(d) or by amending it to provide that another allocation review (specifically including LIHTC or volume-cap bond award) would constitute a §102(d) review and approval.

Principles governing the recommendation.

- Simplicity.
- Hierarchy of Compliance. Avoid duplicative reviews.

Task Force view. *For* allowing allocating agency approval to constitute §102(d) compliance, subject to review by the full task force.

10. CODI for post-compliance preservation

Recommendation. Waive cancellation of indebtedness income (CODI) on existing Credit properties that cancel the debt if (i) the property currently has only a 15-year Credit use restriction and (ii) as a condition of or simultaneous with the debt cancellation, a new use restriction is imposed that conforms to the current thirty-year statutory requirement.

The problem being addressed. Older Credit properties (typically those done in 1987-89, although some between 1990-93) that have soft government financing (CDBG and its precursors,

UDAG, HoDAG, and similar state/ local loans) may face balloon payments on maturity of those loans. Either solution now available is unappealing:

- Paying off the loans normally requires taking the property market to create the source of cash to pay the debt.
- Extending or restructuring the loans generally will constitute a material modification (under §1001 of the IR Code) triggering Original Issue Discount (OID) that creates Cancellation of Debt Income (CODI).

How the recommendation would work. A provision would be added to §108 of the Internal Revenue Code providing an exception to the general rule that the cancellation of indebtedness provides income to the debtor where the owner-debtor has agreed to a preservation extension conforming the use restriction to that required of new Credit properties under current IR Code §42.

Principles governing the recommendation.

- Preservation of at-risk affordable housing.

Task Force view. *For*, recognizing that this is principally a Preservation recommendation.

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**Millennial Housing Commission: Tax Policy Task Force
Proposed Recommendations, Summary**

<u>Num.</u>	<u>Recommendation</u>	<u>TF view</u>	<u>Status</u>
1	Establish a definition of Credit basis tied to property cost (independent of depreciable basis) and lets allocating agencies certify it.	For	Subject to full task force review
2	Repeal §42(b)(1)(B)(i) that lowers allocated Credits to 4% if 'other Federal funds' are involved.	For	Subject to full task force review
3	Allow RHS properties using allocated Credits to use 9% rather than 4% Credits. (Special case of Recommendation 2.)	For	Subject to full task force review
4	Provide generally that satisfying Credit standards of income, rent cap and so on satisfy other programs (e.g. HOME, CDBG).	For	Subject to full task force review and deferring to Production/ Preservation
5	Repeal the §42(h)(1)(E) ten-percent expenditure test requiring 10% of estimated property cost to be expended within a few months of award.	For	Subject to full task force review
6	Allow properties in rural areas to establish rent caps based on statewide rather than county median income.	Not opposed	Subject to full task force review
7	Repeal §42(b)(2)(B)(ii) denying Credit eligibility to any property whose ownership has changed hands in the last ten years.	For	Recognizing this is principally Preservation
8	Allow renters' tax returns to serve as income verification.	Undecided	Pending discussion by full task force
9	Either (a) repeal §102(d) of DHUDRA (which mandates a subsidy-layering review whenever HUD resources are involved) or (b) provide that an allocating agency award of Credits <i>shall</i> constitute approval under §102(d).	For option (b)	Subject to full task force review
10	Waive CODI for accruing government finance on existing Credit properties that cancel the debt if (i) the property currently has only a 15-year Credit use restriction and (ii) as a condition of or simultaneous with the debt cancellation, a new use restriction is imposed that conforms to the current thirty-year statutory requirement.	For	Recognizing this is principally Preservation