HHT Committee

From: Stacy S. Crivello
Sent: Friday, November 17, 2017 8:58 AM
To: HHT Committee
Subject: Front Street Apartments HHT-39
Attachments: HR 3299, 98-103.rtf; FedRegi2007.pdf; SunAmericaLet.pdf; LawCenter.doc; NewYorkCommissioner letter.pdf; LoopholeInMichgan.pdf; FrontStreetChronology 10-17.rtf; NewStory10_30_17.jpg

From: Gary Kubota [mailto:garytkubota@gmail.com]
Sent: Friday, November 17, 2017 8:05 AM
To: Kelly King <Kelly.King@mauicounty.us>; Mike White <Mike.White@mauicounty.us>; Robert Carroll <Robert.Carroll@mauicounty.us>; Stacy S. Crivello <Stacy.Crivello@mauicounty.us>; Alika A. Atay <Alika.Atay@mauicounty.us>; Elle Cochran <Elle.Cochran@mauicounty.us>; Donald S. Guzman <Donald.Guzman@mauicounty.us>; Yukilei Sugimura <Yukilei.Sugimura@mauicounty.us>
Subject: Mahalo for your support!

Aloha Mike, Kelly, Stacy, Robert, Elle, Alika:

Many thanks for your support on the resolution related to keeping rents low at the Front Street Apartment. Roz send me an email saying she was elated and that the vote was "Great!"

Since there was quite a bit of curiosity about the history of the IRS change in 2012, I've taken the liberty of attaching documents related to it. I don't necessarily agree with some points of view shared by certain groups but I think it's important to know their point of view. Additionally, I don't think there has been enough conversation to know just how to value low income rental properties, especially when government benefits and tax exemptions are involved in developing the projects.

Short-term, someone needs to also look at the process of conversion from low income to market price to see if the process used by Front Street Affordable Housing Partners is flawed, based on law or common practice. Tenants who have paid rent have not been given notice in a timely fashion, enough to organize and take action.

The trigger point in all this is the argument that Front Street Affordable Housing Partners was unable to financially continue or somehow wasn't getting the return expected. There's been no proof offer by the Partners or the landowner 3900 Corp to substantiate the claim. The contract between them and their financials should be reviewed to find what, if any losses were incurred and if it was due to the lack of management and/or market conditions. Also, the Partners should turn over their appraisals for scrutiny, and the county should talk to the county appraiser to find out the source and basis of the county's appraisal of $24 million and its substantiation.

After the meeting, Mike White raised a good question about elwhat has state housing officials done to prevent similar circumstances from happening again. In some states, as I understand, tax credits are not offered unless the developers waive the IRS "Qualified Contract" provision that allows termination of the low income rental before the prescribed term.

Thanks to Stacy, we now know that according to the Maui Property Tax Office, the tax exemption enjoyed by the Partners and land owner was in excess of $2 million since its beginning.

Perhaps what's needed eventually is a change in the IRS "Qualified Contract" provision itself by Congress.

Aloha,
Gary Kubota,
Volunteer Liaison, Front Street Apartment Tenants Group
(808) 268-3918

cc. Riki Hokama, Yuki Sugimura, Don Guzman

Here are the attachments

1) House Resolution 3299, passed by the 101 Congress in 1989-90 was the legislation enabling the Secretary of the Treasury (IRS) to take action.

2) FedReg2007 Federal Register called for comments.

3) The Affordable Housing Tax Credit Coalition including developer SunAmerica submitted testimony in support of investors.

4) The National Law Housing Project provided a low-income housing point of view.

5) The New York Housing Commissioner letter expresses fear about changes.

6) News article about loophole in Michigan.

7) Law office of Nixon-Peabody provides investor point of view of 2012 IRS final rule.

8) Chronology of Events

Page 98-103, H.R.3299 - 101st Congress (1989-1990)/ Omnibus Budget Reconciliation Act of 1989 | Congress.gov | Library of Congress

SEC. 7108. EXTENSION AND MODIFICATION OF LOW-INCOME HOUSING CREDIT.
(a) EXTENSION-
(1) IN GENERAL- Subsection (n) of section 42 (relating to low-income housing credit) is amended to read as follows--
`(n) TERMINATION-
`(1) IN GENERAL- Except as provided in paragraph (2), for any calendar year after 1990--
`(A) clause (i) of subsection (h)(3)(C) shall not apply, and
`(B) subsection (h)(4) shall not apply to any building placed in service after 1990.
`(2) EXCEPTION FOR BOND-FINANCED BUILDINGS IN PROGRESS- For purposes of
paragraph (1)(B), a building shall be treated as placed in service before 1990 if--
`(A) the bonds with respect to such building are issued before 1990,
`(B) such building is constructed, reconstructed, or rehabilitated by the taxpayer,
`(C) more than 10 percent of the reasonably anticipated cost of such construction, reconstruction, or rehabilitation has been incurred as of January 1, 1990, and some of such cost is incurred on or after such date, and
`(D) such building is placed in service before January 1, 1992.'
(2) SPECIAL RULE- In the case of calendar year 1990, section 42(h)(3)(C)(i) of the Internal Revenue Code of 1986 (as amended by subsection (b)(1)) shall be applied by substituting `$.9375' for `$1.25'.
(b) 1-YEAR CARRYOVER OF UNUSED CREDIT AUTHORITY, ETC-
(1) IN GENERAL- Section 42(h)(3) (relating to housing credit dollar amount for agencies) is amended by redesignating subparagraphs (D), (E), and (F) as subparagraphs (E), (F), and (G), respectively, and by striking subparagraph (C) and inserting the following new subparagraphs:
`(C) STATE HOUSING CREDIT CEILING- The State housing credit ceiling applicable to any State for any calendar year shall be an amount equal to the sum of--
`(i) $1.25 multiplied by the State population,
`(ii) the unused State housing credit ceiling (if any) of such State for the preceding calendar year,
`(iii) the amount of State housing credit ceiling returned in the calendar year, plus
`(iv) the amount (if any) allocated under subparagraph (D) to such State by the Secretary.

For purposes of clause (ii), the unused State housing credit ceiling for any calendar year is the excess (if any) of the amount described in clause (i) over the aggregate housing credit dollar amount allocated for such year. For purposes of clause (iii), the amount of State housing credit ceiling returned in the calendar year equals the housing credit dollar amount previously

allocated within the State to any project which does not become a qualified
low-income housing project within the period required by this section or
the terms of the allocation or to any project with respect to which an
allocation is cancelled by mutual consent of the housing credit agency and
the allocation recipient.

`(D) UNUSED HOUSING CREDIT CARRYOVERS ALLOCATED AMONG CERTAIN STATES-

`(i) IN GENERAL- The unused housing credit carryover of a State for any calendar year shall be assigned to the Secretary for allocation among qualified States for the succeeding calendar year.

`(ii) UNUSED HOUSING CREDIT CARRYOVER- For purposes of this subparagraph, the unused housing credit carryover of a State for any calendar year is the excess (if any) of the unused State housing credit ceiling for such year (as defined in subparagraph (C)(ii)) over the excess (if any) of--

`(I) the aggregate housing credit dollar amount allocated for such year, over

`(II) the amount described in clause (i) of subparagraph (C).

`(iii) FORMULA FOR ALLOCATION OF UNUSED HOUSING CREDIT CARRYOVERS AMONG QUALIFIED STATES- The amount allocated under this subparagraph to a qualified State for any calendar year shall be the amount determined by the Secretary to bear the same ratio to the aggregate unused housing credit carryovers of all States for the preceding calendar year as such State's population for the calendar year bears to the population of all qualified States for the calendar year. For purposes of the preceding sentence, population shall be determined in accordance with section 146(j).

`(iv) QUALIFIED STATE- For purposes of this subparagraph, the term `qualified State' means, with respect to a calendar year, any State--

`(I) which allocated its entire State housing credit ceiling for the preceding calendar year, and

`(II) for which a request is made (not later than May 1 of the calendar year) to receive an allocation under clause (iii).'

(2) CONFORMING AMENDMENTS-

(A) Subparagraph (E) of section 42(h)(5) is amended by striking `subparagraph (E)' and inserting `subparagraph (F)'.

(B) Paragraph (6) of section 42(h) is amended by striking subparagraph (B) and by redesignating subparagraphs (C), (D), and (E) as subparagraphs (B), (C), and (D), respectively.

(c) BUILDINGS ELIGIBLE FOR CREDIT ONLY IF MINIMUM LONG-TERM COMMITMENT TO LOW-INCOME HOUSING-

(1) IN GENERAL- Section 42(h) (relating to limitation on aggregate credit allowable with respect to projects located in a State) is amended by redesignating paragraphs (6) and (7) as paragraphs (7) and (8), respectively, and by inserting after paragraph (5) the following new paragraph:

`(6) BUILDINGS ELIGIBLE FOR CREDIT ONLY IF MINIMUM LONG-TERM

COMMITMENT TO
LOW-INCOME HOUSING-
`(A) IN GENERAL- No credit shall be allowed by reason of this section with respect to any building for the taxable year unless an extended low-income housing commitment is in effect as of the end of such taxable year.
`(B) EXTENDED LOW-INCOME HOUSING COMMITMENT- For purposes of this paragraph,
the term `extended low-income housing commitment' means any agreement between the taxpayer and the housing credit agency--
`(i) which requires that the applicable fraction (as defined in subsection (c)(1)) for the building for each taxable year in the extended use period will not be less than the applicable fraction specified in such agreement,
`(ii) which allows individuals who meet the income limitation applicable to the building under subsection (g) (whether prospective, present, or former occupants of the building) the right to enforce in any State court the requirement of clause (i),
`(iii) which is binding on all successors of the taxpayer, and
`(iv) which, with respect to the property, is recorded pursuant to State law as a restrictive covenant.
`(C) ALLOCATION OF CREDIT MAY NOT EXCEED AMOUNT NECESSARY TO SUPPORT
COMMITMENT-
`(i) IN GENERAL- The housing credit dollar amount allocated to any building may not exceed the amount necessary to support the applicable fraction specified in the extended low-income housing commitment for such building, including any increase in such fraction pursuant to the application of subsection (f)(3) if such increase is reflected in an amended low-income housing commitment.
`(ii) BUILDINGS FINANCED BY TAX-EXEMPT BONDS- If paragraph (4) applies to
any building the amount of credit allowed in any taxable year may not exceed the amount necessary to support the applicable fraction specified in the extended low-income housing commitment for such building. Such commitment
may be amended to increase such fraction.
`(D) EXTENDED USE PERIOD- For purposes of this paragraph, the term `extended
use period' means the period--
`(i) beginning on the 1st day in the compliance period on which such building is part of a qualified low-income housing project, and
`(ii) ending on the later of--
`(I) the date specified by such agency in such agreement, or
`(II) the date which is 15 years after the close of the compliance period.
`(E) EXCEPTIONS IF FORECLOSURE OR IF NO BUYER WILLING TO MAINTAIN LOW-INCOME
STATUS-

`(i) IN GENERAL- The extended use period for any building shall terminate--
`(I) on the date the building is acquired by foreclosure (or instrument in lieu of foreclosure), or
`(II) on the last day of the period specified in subparagraph (I) if the housing credit agency is unable to present during such period a qualified contract for the acquisition of the low-income portion of the building by any person who will continue to operate such portion as a qualified low-income building.

Subclause (II) shall not apply to the extent more stringent requirements are provided in the agreement or in State law.

`(ii) EVICTION, ETC. OF EXISTING LOW-INCOME TENANTS NOT PERMITTED- The termination of an extended use period under clause (i) shall not be construed to permit before the close of the 3-year period following such termination--
`(I) the eviction or the termination of tenancy (other than for good cause) of an existing tenant of any low-income unit, or
`(II) any increase in the gross rent with respect to such unit.
`(F) QUALIFIED CONTRACT- For purposes of subparagraph (E), the term `qualified contract' means a bona fide contract to acquire (within a reasonable period after the contract is entered into) the low-income portion of the building for an amount not less than the applicable fraction (specified in the extended low-income housing commitment) of--
`(i) the sum of--
`(I) the outstanding indebtedness secured by, or with respect to, the building,
`(II) the adjusted investor equity in the building, plus
`(III) other capital contributions not reflected in the amounts described in subclause (I) or (II), reduced by
`(ii) cash distributions from (or available for distribution from) the project.

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this paragraph, including regulations to prevent the manipulation of the amount determined under the preceding sentence.

`(G) ADJUSTED INVESTOR EQUITY-
`(i) IN GENERAL- For purposes of subparagraph (E), the term `adjusted investor equity' means, with respect to any calendar year, the aggregate amount of cash taxpayers invested with respect to the project increased by the amount equal to--
`(I) such amount, multiplied by
`(II) the cost-of-living adjustment for such calendar year, determined under section 1(f)(3) by substituting the base calendar year for `calendar year 1987'.

An amount shall be taken into account as an investment in the project only to the extent there was an obligation to invest such amount as of the beginning of the credit period and to the extent such amount is reflected

in the adjusted basis of the project.
`(ii) COST-OF-LIVING INCREASES IN EXCESS OF 5 PERCENT NOT TAKEN INTO ACCOUNT-
Under regulations prescribed by the Secretary, if the CPI for any calendar year (as defined in section 1(f)(4)) exceeds the CPI for the preceding calendar year by more than 5 percent, the CPI for the base calendar year shall be increased such that such excess shall never be taken into account under clause (i).
`(iii) BASE CALENDAR YEAR- For purposes of this subparagraph, the term `base calendar year' means the calendar year with or within which the 1st taxable year of the credit period ends.
`(H) LOW-INCOME PORTION- For purposes of this paragraph, the low-income
portion of a building is the portion of such building equal to the applicable fraction specified in the extended low-income housing commitment for the building.
`(I) PERIOD FOR FINDING BUYER- The period referred to in this subparagraph
is the 1-year period beginning on the date (after the 14th year of the compliance period) the taxpayer submits a written request to the housing credit agency to find a person to acquire the taxpayer's interest in the low-income portion of the building.
`(J) SALES OF LESS THAN LOW-INCOME PORTION OF BUILDING- In the case of a sale
or exchange of only a portion of the low-income portion of the building, only the same portion (as the portion sold or exchanged) of the amount determined under subparagraph (F) shall be taken into account thereunder.
`(K) EFFECT OF NONCOMPLIANCE- If, during a taxable year, there is a determination that an extended low-income housing agreement was not in effect as of the beginning of such year, such determination shall not apply to any period before such year and subparagraph (A) shall be applied without regard to such determination if the failure is corrected within 1 year from the date of the determination.
`(L) PROJECTS WHICH CONSIST OF MORE THAN 1 BUILDING- The application of
this paragraph to projects which consist of more than 1 building shall be made under regulations prescribed by the Secretary.'
(2) CONFORMING AMENDMENT- Subparagraph (C) of section 42(b)(3) is amended
by striking `subsection (h)(6))' and inserting `subsection (h)(7)'.
(d) CREDIT FOR ACQUISITION OF EXISTING BUILDING TO APPLY ONLY IF BUILDING
TO BE REHABILITATED; INCREASE IN REQUIRED REHABILITATION EXPENDITURES-
(1) IN GENERAL- Subparagraph (B) of section 42(d)(2) is amended by striking

`and' at the end of clause (ii), by striking the period at the end of clause
(iii) and inserting `, and', and by adding at the end thereof the following
new clause:
`(iv) except as provided in subsection (f)(5), a credit is allowable under
subsection (a) by reason of subsection (e) with respect to the building.'
(2) CREDIT PERIOD FOR EXISTING BUILDINGS NOT TO BEGIN BEFORE
REHABILITATION
CREDIT ALLOWED- Subsection (f) of section 42 (relating to definition and
special rules relating to credit period), as amended by subtitle H, is
amended by adding at the end thereof the following new paragraph:
`(5) CREDIT PERIOD FOR EXISTING BUILDINGS NOT TO BEGIN BEFORE
REHABILITATION
CREDIT ALLOWED-
`(A) IN GENERAL- The credit period for an existing building shall not
begin before the 1st taxable year of the credit period for rehabilitation
expenditures with respect to the building.
`(B) ACQUISITION CREDIT ALLOWED FOR CERTAIN BUILDINGS NOT
ALLOWED A
REHABILITATION CREDIT-
`(i) IN GENERAL- In the case of a building described in clause (ii)--
`(I) subsection (d)(2)(B)(iv) shall not apply, and
`(II) the credit period for such building shall not begin before the
taxable year which would be the 1st taxable year of the credit period
for rehabilitation expenditures with respect to the building under the
modifications described in clause (ii)(II).
`(ii) BUILDING DESCRIBED- A building is described in this clause if--
`(I) a waiver is granted under subsection (d)(6)(C) with respect to the
acquisition of the building, and
`(II) a credit would be allowed for rehabilitation expenditures with
respect to such building if subsection (e)(3)(A)(ii)(I) did not apply and
if subsection (e)(3)(A)(ii)(II) were applied by substituting `$2,000' for
`$3,000'.'
(3) INCREASE IN REQUIRED REHABILITATION EXPENDITURES-
Paragraph (3) of
section 42(e) is amended by redesignating subparagraph (B) as
subparagraph
(C) and by striking so much of such paragraph as precedes such
subparagraph
and inserting the following:
`(3) MINIMUM EXPENDITURES TO QUALIFY-
`(A) IN GENERAL- Paragraph (1) shall apply to rehabilitation expenditures
with respect to any building only if--
`(i) the expenditures are allocable to 1 or more low-income units or
substantially benefit such units, and
`(ii) the amount of such expenditures during any 24-month period meets the
requirements of whichever of the following subclauses requires the greater

amount of such expenditures:
`(I) The requirement of this subclause is met if such amount is not less than 10 percent of the adjusted basis of the building (determined as of the 1st day of such period and without regard to paragraphs (2) and (3) of section 1016(a)).
`(II) The requirement of this subclause is met if the qualified basis attributable to such amount, when divided by the number of low-income units in the building, is $3,000 or more.
`(B) EXCEPTION FROM 10 PERCENT REHABILITATION- In the case of a building
acquired by the taxpayer from a governmental unit, at the election of the taxpayer, subparagraph (A)(ii)(I) shall not apply and the credit under this section for such rehabilitation expenditures shall be determined using the percentage applicable under subsection (b)(2)(B)(ii).'
(e) CHANGES IN RULES RELATING TO RENT RESTRICTIONS-
(1) RENT RESTRICTION DETERMINED ON BASIS OF NUMBER OF BEDROOMS-
(A) Section 42(g)(2) is amended by redesignating subparagraph (C) as subparagraph (E) and by inserting after subparagraph (B) the following new subparagraphs:
`(C) IMPUTED INCOME LIMITATION APPLICABLE TO UNIT- For purposes of this
paragraph, the imputed income limitation applicable to a unit is the income limitation which would apply under paragraph (1) to individuals occupying the unit if the number of individuals occupying the unit were as follows:
`(i) In the case of a unit which does not have a separate bedroom, 1 individual.
`(ii) In the case of a unit which has 1 or more separate bedrooms, 1.5 individuals for each separate bedroom.
In the case of a project with respect to which a credit is allowable by reason of this section and for which financing is provided by a bond described in section 142(a)(7), the imputed income limitation shall apply in lieu of the otherwise applicable income limitation for purposes of applying section 142(d)(4)(B)(ii).
`(D) TREATMENT OF UNITS OCCUPIED BY INDIVIDUALS WHOSE INCOMES RISE ABOVE
LIMIT-
`(i) IN GENERAL- Except as provided in clause (ii), notwithstanding an increase in the income of the occupants of a low-income unit above the income
limitation applicable under paragraph (1), such unit shall continue to be treated as a low-income unit if the income of such occupants initially met such income limitation.
`(ii) NEXT AVAILABLE UNIT MUST BE RENTED TO LOW-INCOME TENANT IF INCOME
RISES ABOVE 140 PERCENT OF INCOME LIMIT- If the income of the

occupants of
the unit increases above 140 percent of the income limitation applicable under paragraph (1), clause (i) shall cease to apply to such unit if any residential rental unit in the building (of a size comparable to, or smaller than, such unit) is occupied by a new resident whose income exceeds such income limitation.'

(B) Subparagraph (A) of section 42(g)(2) is amended by striking `the income limitation under paragraph (1) applicable to individuals occupying such unit' and inserting `the imputed income limitation applicable to such unit'.

(2) REDUCTION IN AREA MEDIAN GROSS INCOME NOT TO REQUIRE REDUCTION OF RENT-
Subparagraph (A) of section 42(g)(2) (relating to rent-restricted units) is amended by adding at the end thereof the following new sentence: `For purposes of the preceding sentence, the amount of the income limitation under paragraph (1) applicable for any period shall not be less than such limitation applicable for the earliest period the building (which contains the unit) was included in the determination of whether the project is a qualified low-income housing project.'

(3) EXCLUSION WITH RESPECT TO CONTINUING CARE FACILITIES NOT TO APPLY IN DETERMINING INCOME- Subparagraph (B) of section 142(d)(2) is amended by adding at the end thereof the following:

`Section 7872(g) shall not apply in determining the income of individuals under this subparagraph.'

(f) ADDITIONAL BUILDINGS ELIGIBLE FOR WAIVER OF 10-YEAR PERIOD APPLICABLE TO ACQUISITIONS OF EXISTING BUILDINGS- Paragraph (6) of section 42(d) is amended by redesignating subparagraph (C) as subparagraph (E) and by inserting after subparagraph (B) the following new subparagraphs:

`(C) LOW-INCOME BUILDINGS WHERE MORTGAGE MAY BE PREPAID- A waiver may be granted under subparagraph (A) (without regard to any clause thereof) with respect to a federally-assisted building described in clause (ii) or (iii) of subparagraph (B) if--

`(i) the mortgage on such building is eligible for prepayment under subtitle B of the Emergency Low Income Housing Preservation Act of 1987 or under section 502(c) of the Housing Act of 1949 at any time within 1 year after the date of the application for such a waiver,

`(ii) the appropriate Federal official certifies to the Secretary that it is reasonable to expect that, if the waiver is not granted, such building will cease complying with its low-income occupancy requirements, and

`(iii) the eligibility to prepay such mortgage without the approval of the appropriate Federal official is waived by all persons who are so eligible and such waiver is binding on all successors of such persons.

`(D) BUILDINGS ACQUIRED FROM INSURED DEPOSITORY INSTITUTIONS IN DEFAULT- A waiver may be granted under subparagraph (A) (without regard to any clause thereof) with respect to any building acquired from an insured depository institution in default (as defined in section 3 of the Federal Deposit Insurance Act) or from a receiver or conservator of such an institution.'

(g) INCREASE IN CREDIT FOR BUILDINGS IN HIGH COST AREAS- Paragraph (5) of section 42(d) (relating to eligible basis) is amended by adding at the end thereof the following new subparagraph:

`(D) INCREASE IN CREDIT FOR BUILDINGS IN HIGH COST AREAS-

`(i) IN GENERAL- In the case of any building located in a qualified census tract or difficult development area which is designated for purposes of this subparagraph--

`(I) in the case of a new building, the eligible basis of such building shall be 130 percent of such basis determined without regard to this subparagraph, and

`(II) in the case of an existing building, the rehabilitation expenditures taken into account under subsection (e) shall be 130 percent of such expenditures determined without regard to this subparagraph.

`(ii) QUALIFIED CENSUS TRACT-

`(I) IN GENERAL- The term `qualified census tract' means any census tract in which 50 percent or more of the households have an income which is less than 60 percent of the area median gross income.

`(II) LIMIT ON MSA's DESIGNATED- The portion of a metropolitan statistical area which may be designated for purposes of this subparagraph shall not exceed an area having 20 percent of the population of such metropolitan statistical area.

`(III) DETERMINATION OF AREAS- For purposes of this clause, each metropolitan statistical area shall be treated as a separate area and all nonmetropolitan areas in a State shall be treated as 1 area.

`(iii) DIFFICULT DEVELOPMENT AREAS-

`(I) IN GENERAL- The term `difficult development areas' means any area designated by the Secretary of Housing and Urban Development as an area which has high construction, land, and utility costs relative to area median gross income.

`(II) LIMIT ON AREAS DESIGNATED- The portions of metropolitan statistical areas which may be designated for purposes of this subparagraph shall not exceed an aggregate area having 20 percent of the population of such metropolitan statistical areas. A comparable rule shall apply to nonmetropolitan areas.

`(iv) SPECIAL RULES AND DEFINITIONS- For purposes of this subparagraph--

`(I) population shall be determined on the basis of the most recent decennial census for which data are available,

`(II) area median gross income shall be determined in accordance with subsection (g)(4),
`(III) the term `metropolitan statistical area' has the same meaning as when used in section 143(k)(2)(B), and
`(IV) the term `nonmetropolitan area' means any county (or portion thereof) which is not within a metropolitan statistical area.'
(h) CHANGES IN RULES RELATING TO BUILDINGS FOR WHICH CREDIT MAY BE ALLOWED-
(1) SINGLE-ROOM OCCUPANCY UNITS RENTED ON A MONTHLY BASIS- Subparagraph (B) of section 42(i)(3) (relating to low income unit) is amended by adding at the end thereof the following new sentence: `For purposes of the preceding sentence, a single-room occupancy unit shall not be treated as used on a transient basis merely because it is rented on a month-by-month basis.'
(2) SPECIAL NEEDS HOUSING- Subparagraph (B) of section 42(g)(2) (relating to gross rent) is amended--
(A) in clause (i), by striking `and' at the end,
(B) in clause (ii), by striking the period at the end and inserting `, and', and
(C) by adding at the end the following:
`(iii) does not include any fee for a supportive service which is paid to the owner of the unit (on the basis of the low-income status of the tenant of the unit) by any governmental program of assistance (or by an organization described in section 501(c)(3) and exempt from tax under section 501(a)) if such program (or organization) provides assistance for rent and the amount of assistance provided for rent is not separable from the amount of assistance provided for supportive services.

For purposes of clause (iii), the term `supportive service' means any service provided under a planned program of services designed to enable residents of a residential rental property to remain independent and avoid placement in a hospital, nursing home, or intermediate care facility for the mentally or physically handicapped. In the case of a single-room occupancy unit or a building described in subsection (i)(3)(B)(iii), such term includes any service provided to assist tenants in locating and retaining permanent housing.'
(3) SCATTERED SITE PROJECTS- Section 42(g) (relating to qualified low-income housing project) is amended by adding at the end thereof the following new paragraph:
`(7) SCATTERED SITE PROJECTS- Buildings which would (but for their lack of proximity) be treated as a project for purposes of this section shall be so treated if all of the dwelling units in each of the buildings are rent-restricted (within the meaning of paragraph (2)) residential rental units.'
(4) OWNER-OCCUPIED BUILDINGS HAVING 4 OR FEWER UNITS ELIGIBLE FOR CREDIT

WHERE DEVELOPMENT PLAN- Section 42(i)(3) (defining low-income unit), as amended by subtitle H, is amended by adding at the end thereof the following new subparagraph:

`(E) OWNER-OCCUPIED BUILDINGS HAVING 4 OR FEWER UNITS ELIGIBLE FOR CREDIT WHERE DEVELOPMENT PLAN-

`(i) IN GENERAL- Subparagraph (C) shall not apply to the acquisition or rehabilitation of a building pursuant to a development plan of action sponsored by a State or local government or a qualified nonprofit organization (as defined in subsection (h)(5)(C)).

`(ii) LIMITATION ON CREDIT- In the case of a building to which clause (i) applies, the applicable fraction shall not exceed 80 percent of the unit fraction.

`(iii) CERTAIN UNRENTED UNITS TREATED AS OWNER-OCCUPIED- In the case of a building to which clause (i) applies, any unit which is not rented for 90 days or more shall be treated as occupied by the owner of the building as of the 1st day it is not rented.'

(5) BUILDINGS RECEIVING SECTION 8 MODERATE REHABILITATION ASSISTANCE OR SIMILAR ASSISTANCE NOT ELIGIBLE FOR CREDIT- Section 42(b)(1) (relating to applicable percentage for buildings placed in service during 1987) is amended by adding at the end thereof the following new flush sentence:

`A building shall not be treated as described in subparagraph (B) if, at any time during the credit period, moderate rehabilitation assistance is provided with respect to such building under section 8(e)(2) of the United States Housing Act of 1937.'

(i) APPLICATION OF CREDIT TO TRANSITIONAL HOUSING FOR THE HOMELESS; DENIAL OF CREDIT FOR SUBSTANDARD HOUSING-

(1) IN GENERAL- Subparagraph (B) of section 42(i)(3) (defining low-income unit) is amended to read as follows:

`(B) EXCEPTIONS-

`(i) IN GENERAL- A unit shall not be treated as a low-income unit unless the unit is suitable for occupancy and used other than on a transient basis.

`(ii) SUITABILITY FOR OCCUPANCY- For purposes of clause (i), the suitability of a unit for occupancy shall be determined under regulations prescribed by the Secretary taking into account local health, safety, and building codes.

`(iii) TRANSITIONAL HOUSING FOR HOMELESS- For purposes of clause (i), a unit shall be considered to be used other than on a transient basis if the unit contains sleeping accommodations and kitchen and bathroom facilities and is located in a building--

`(I) which is used exclusively to facilitate the transition of homeless individuals (within the meaning of section 103 of the Stewart B. McKinney Homeless Assistance Act (42 U.S.C. 11302), as in effect on the date of the enactment of this clause) to independent living within 24 months, and

`(II) in which a governmental entity or qualified nonprofit organization (as defined in subsection (h)(5)) provides such individuals with temporary housing and supportive services designed to assist such individuals in locating and retaining permanent housing.

`(iv) SINGLE-ROOM OCCUPANCY UNITS- For purposes of clause (i), a single-room occupancy unit shall not be treated as used on a transient basis merely because it is rented on a month-by-month basis.'

(2) QUALIFIED BASIS TO INCLUDE PORTION OF BUILDING USED TO PROVIDE SUPPORTIVE SERVICES- Paragraph (1) of section 42(c) is amended by adding at the end thereof the following new subparagraph:

`(E) QUALIFIED BASIS TO INCLUDE PORTION OF BUILDING USED TO PROVIDE SUPPORTIVE SERVICES FOR HOMELESS- In the case of a qualified low-income building described in subsection (i)(3)(B)(iii), the qualified basis of such building for any taxable year shall be increased by the lesser of--

`(i) so much of the eligible basis of such building as is used throughout the year to provide supportive services designed to assist tenants in locating and retaining permanent housing, or

`(ii) 20 percent of the qualified basis of such building (determined without regard to this subparagraph).'

(j) VOLUME CAP NOT TO APPLY WHERE 50 PERCENT OR MORE OF BUILDING IS FINANCED WITH TAX-EXEMPT BONDS- Subparagraph (B) of section 42(h)(4) is amended by striking `70 percent' each place it appears and inserting `50 percent'.

(k) BUILDING NOT TREATED AS FEDERALLY SUBSIDIZED BY REASON OF COMMUNITY DEVELOPMENT BLOCK GRANT- Subparagraph (D) of section 42(i)(2) (defining below market Federal loan) is amended by adding at the end thereof the following new sentence: `Such term shall not include any loan which would be a below market Federal loan solely by reason of assistance provided under section 106, 107, or 108 of the Housing and Community Development Act of 1974 (as in effect on the date of the enactment of this sentence).'

(l) ELIGIBLE BASIS FOR NEW BUILDINGS TO INCLUDE EXPENDITURES BEFORE CLOSE OF 1ST YEAR OF CREDIT PERIOD-

(1) NEW BUILDINGS- Paragraph (1) of section 42(d) (relating to eligible basis for new buildings) is amended by inserting before the period `as of

the close of the 1st taxable year of the credit period'.
(2) EXISTING BUILDINGS- Subparagraph (A) of section 42(d)(2) (relating to eligible basis for existing buildings) is amended by striking `subparagraph (B)' and all that follows through the end of clause (i) and inserting `subparagraph (B), its adjusted basis as of the close of the 1st taxable year of the credit period, and'.
(3) CONFORMING AMENDMENTS-
(A) Subparagraph (C) of section 42(d)(2) is amended by striking `ACQUISITION
COST' in the heading and inserting `ADJUSTED BASIS' and by striking `cost' in the text and inserting `adjusted basis'.
(B) Paragraph (5) of section 42(d), as amended by subsection (g), is further amended by striking subparagraph (A), by redesignating subparagraphs (B), (C), and (D) as subparagraphs (A), (B), and (C), respectively, and by striking the paragraph heading and inserting the following:
`(5) SPECIAL RULES FOR DETERMINING ELIGIBLE BASIS- '.
(C) Paragraph (5) of section 42(e) is amended by striking `subsection (d)(2)(A)(i)(II)' and inserting `subsection (d)(2)(A)(i)'.
(m) HOUSING CREDIT MAY BE ALLOCATED ON PROJECT BASIS-
(1) IN GENERAL- Section 42(h)(1) (relating to credit may not exceed credit amount allocated to building) is amended by adding at the end thereof the following new subparagraph:
`(F) ALLOCATION OF CREDIT ON A PROJECT BASIS-
`(i) IN GENERAL- In the case of a project which includes (or will include) more than 1 building, an allocation meets the requirements of this subparagraph if--
`(I) the allocation is made to the project for a calendar year during the project period,
`(II) the allocation only applies to buildings placed in service during or after the calendar year for which the allocation is made, and
`(III) the portion of such allocation which is allocated to any building in such project is specified not later than the close of the calendar year in which the building is placed in service.
`(ii) PROJECT PERIOD- For purposes of clause (i), the term `project period' means the period--
`(I) beginning with the 1st calendar year for which an allocation may be made for the 1st building placed in service as part of such project, and
`(II) ending with the calendar year the last building is placed in service as part of such project.'
(2) CONFORMING AMENDMENT- Subparagraph (B) of section 42(h)(1) is amended
by striking `or (E)' and inserting `(E), or (F)'.
(3) PROJECTS WITH MORE THAN 1 BUILDING MUST BE IDENTIFIED- Section 42(g)(3)
(relating to date for meeting requirements) is amended by adding at the end thereof the following new subparagraph:

`(D) PROJECTS WITH MORE THAN 1 BUILDING MUST BE IDENTIFIED- For purposes of
this section, a project shall be treated as consisting of only 1 building unless, before the close of the 1st calendar year in the project period (as defined in subsection (h)(1)(F)(ii)), each building which is (or will be) part of such project is identified in such form and manner as the Secretary may provide.'

(n) CHANGES IN RULES RELATED TO DEEP RENT SKEWED PROJECTS-

(1) Clause (iii) of section 142(d)(4)(B) (relating to deep rent skewed project) is amended by striking ` 1/3 ' and inserting ` 1/2 '.

(2) Section 42(g)(4) (relating to certain rules made applicable) is amended by striking `(other than section 142(d)(4)(B)(iii))'.

(o) INCREASED RESPONSIBILITIES FOR HOUSING CREDIT AGENCIES- Section 42 is
amended by redesignating subsections (m) and (n) as subsections (n) and (o), respectively, and by inserting after subsection (l) the following new subsection:

`(m) RESPONSIBILITIES OF HOUSING CREDIT AGENCIES-

`(1) PLANS FOR ALLOCATION OF CREDIT AMONG PROJECTS-

`(A) IN GENERAL- Notwithstanding any other provision of this section, the housing credit dollar amount with respect to any building shall be zero unless--

`(i) such amount was allocated pursuant to a qualified allocation plan of the housing credit agency which is approved by the governmental unit (in accordance with rules similar to the rules of section 147(f)(2) (other than subparagraph (B)(ii) thereof)) of which such agency is a part, and

`(ii) such agency notifies the chief executive officer (or the equivalent) of the local jurisdiction within which the building is located of such project and provides such individual a reasonable opportunity to comment on the project.

`(B) QUALIFIED ALLOCATION PLAN- For purposes of this paragraph, the term
`qualified allocation plan' means any plan--

`(i) which sets forth selection criteria to be used to determine housing priorities of the housing credit agency which are appropriate to local conditions,

`(ii) which gives the highest priority to those projects as to which the highest percentage of the housing credit dollar amount is to be used for project costs other than the cost of intermediaries unless granting such priority would impede the development of projects in hard-to-develop areas,

`(iii) which also gives preference in allocating housing credit dollar amounts among selected projects to--

`(I) projects serving the lowest income tenants, and

`(II) projects obligated to serve qualified tenants for the longest periods, and

`(iv) which provides a procedure that the agency will follow in notifying

the Internal Revenue Service of noncompliance with the provisions of this section which such agency becomes aware of.
`(C) CERTAIN SELECTION CRITERIA MUST BE USED- The selection criteria set
forth in a qualified allocation plan must include--
`(i) project location,
`(ii) housing needs characteristics,
`(iii) project characteristics,
`(iv) sponsor characteristics,
`(v) participation of local tax-exempt organizations,
`(vi) tenant populations with special housing needs, and
`(vii) public housing waiting lists.
`(D) APPLICATION TO BOND FINANCED PROJECTS- Subsection (h)(4) shall not
apply to any project unless the project satisfies the requirements for allocation of a housing credit dollar amount under the qualified allocation plan applicable to the area in which the project is located.
`(2) CREDIT ALLOCATED TO BUILDING NOT TO EXCEED AMOUNT NECESSARY TO ASSURE
PROJECT FEASIBILITY-
`(A) IN GENERAL- The housing credit dollar amount allocated to a project shall
not exceed the amount the housing credit agency determines is necessary for
the financial feasibility of the project and its viability as a qualified low-income housing project throughout the credit period.
`(B) AGENCY EVALUATION- In making the determination under subparagraph (A),
the housing credit agency shall consider--
`(i) the sources and uses of funds and the total financing planned for the project, and
`(ii) any proceeds or receipts expected to be generated by reason of tax benefits.
Such a determination shall not be construed to be a representation or warranty
as to the feasibility or viability of the project.
`(C) DETERMINATION MADE WHEN CREDIT AMOUNT APPLIED FOR AND WHEN BUILDING
PLACED IN SERVICE-
`(i) IN GENERAL- A determination under subparagraph (A) shall be made as of each of the following times:
`(I) The application for the housing credit dollar amount.
`(II) The allocation of the housing credit dollar amount.
`(III) The date the building is placed in service.
`(ii) CERTIFICATION AS TO AMOUNT OF OTHER SUBSIDIES- Prior to each

determination under clause (i), the taxpayer shall certify to the housing credit agency the full extent of all Federal, State, and local subsidies which apply (or which the taxpayer expects to apply) with respect to the building.

`(D) APPLICATION TO BOND FINANCED PROJECTS- Subsection (h)(4) shall not apply to any project unless the governmental unit which issued the bonds (or on behalf of which the bonds were issued) makes a determination under rules similar to the rules of subparagraphs (A) and (B).'

(o) APPLICATION OF AT-RISK RULES WITH RESPECT TO CERTAIN FINANCING PROVIDED BY QUALIFIED NONPROFIT ORGANIZATIONS- Subparagraph (D) of section 42(k)(2) (relating to application of at-risk rules) is amended by adding at the end thereof the following new flush sentence:

`In the case of a qualified nonprofit organization which is not described in section 46(c)(8)(D)(iv)(II) with respect to a building, clause (ii) of this subparagraph shall be applied as if the date described therein were the 90th day after the earlier of the date the building ceases to be a qualified low-income building or the date which is 15 years after the close of a compliance period with respect thereto.'

(p) TIME FOR CERTIFICATION- Section 42(l)(1) (relating to certification with respect to 1st year of credit period) is amended--

(1) by striking `Not later than the 90th day following' and inserting `Following', and

(2) by inserting `at such time and' before `in such form'.

(q) IMPACT OF TENANT'S RIGHT OF 1ST REFUSAL TO ACQUIRE PROPERTY- Subsection (i) of section 42 is amended by adding at the end thereof the following new paragraph:

`(8) IMPACT OF TENANT'S RIGHT OF 1ST REFUSAL TO ACQUIRE PROPERTY-

`(A) IN GENERAL- No Federal income tax benefit shall fail to be allowable to the taxpayer with respect to any qualified low-income building merely by reason of a right of 1st refusal held by the tenants of such building to purchase the property after the close of the compliance period for a price which is not less than the minimum purchase price determined under subparagraph (B).

`(B) MINIMUM PURCHASE PRICE- For purposes of subparagraph (A), the minimum purchase price under this subparagraph is an amount equal to the sum of--

`(i) the principal amount of outstanding indebtedness secured by the building (other than indebtedness incurred within the 5-year period ending on the date of the sale to the tenants), and

`(ii) all Federal, State, and local taxes attributable to such sale.

Except in the case of Federal income taxes, there shall not be taken into account under clause (ii) any additional tax attributable to the application of clause (ii).'

(r) EFFECTIVE DATES-

(1) IN GENERAL- Except as otherwise provided in this subsection, the amendments made by this section shall apply to determinations under section 42 of the Internal Revenue Code of 1986 with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989.

(2) BUILDINGS NOT SUBJECT TO ALLOCATION LIMITS- Except as otherwise provided in this subsection, to the extent paragraph (1) of section 42(h) of such Code does not apply to any building by reason of paragraph (4) thereof, the amendments made by this section shall apply to buildings placed in service after December 31, 1989.

(3) ONE-YEAR CARRYOVER OF UNUSED CREDIT AUTHORITY, ETC- The amendments made by subsection (b) shall apply to calendar years after 1989, but clauses (ii), (iii), and (iv) of section 42(h)(3)(C) of such Code (as added by this section) shall be applied without regard to allocations for 1989 or any preceding year.

(4) ADDITIONAL BUILDINGS ELIGIBLE FOR WAIVER OF 10-YEAR RULE- The amendments made by subsection (f) shall take effect on the date of the enactment of this Act.

(5) CERTIFICATIONS WITH RESPECT TO 1ST YEAR OF CREDIT PERIOD- The amendment made by subsection (p) shall apply to taxable years ending on or after December 31, 1989.

(6) CERTAIN RULES WHICH APPLY TO BONDS- Paragraphs (1)(D) and (2)(D) of section 42(m) of such Code, as added by this section, shall apply to obligations issued December 31, 1989.

(7) CLARIFICATIONS- The amendments made by the following provisions of this section shall apply as if included in the amendments made by section 252 of the Tax Reform Act of 1986:

(A) Paragraph (1) of subsection (h) (relating to units rented on a monthly basis).

(B) Subsection (l) (relating to eligible basis for new buildings to include expenditures before close of 1st year of credit period).

(8) GUIDANCE ON DIFFICULT DEVELOPMENT AREAS AND POSTING OF BOND TO AVOID RECAPTURE- Not later than 180 days after the date of the enactment of this Act--

(A) the Secretary of Housing and Urban Development shall publish initial guidance on the designation of difficult development areas under section 42(d)(5)(C) of such Code, as added by this section, and

(B) the Secretary of the Treasury shall publish initial guidance under section 42(j)(6) of such Code (relating to no recapture on disposition of building (or interest therein) where bond posted).

SEC. 7109. LOW-INCOME HOUSING CREDIT EXEMPT FROM INCOME PHASE-OUT OF $25,000 EXEMPTION FROM PASSIVE LOSS RULES.

(a) IN GENERAL- Paragraph (3) of section 469(i) (relating to phase-out of exemption) is amended by redesignating subparagraph (D) as subparagraph (E) and by striking subparagraphs (B) and (C) and inserting the following new subparagraphs:

`(B) SPECIAL PHASE-OUT OF REHABILITATION CREDIT- In the case of any portion of the passive activity credit for any taxable year which is attributable to the rehabilitation investment credit (within the meaning of section 48(o)), subparagraph (A) shall be applied by substituting `$200,000' for `$100,000'.

`(C) EXCEPTION FOR LOW-INCOME HOUSING CREDIT- Subparagraph (A) shall not apply to any portion of the passive activity credit for any taxable year which is attributable to any credit determined under section 42.

`(D) ORDERING RULES TO REFLECT EXCEPTION AND SEPARATE PHASE-OUT- If subparagraph (B) or (C) applies for any taxable year, paragraph (1) shall be applied--

`(i) first to the passive activity loss,

`(ii) second to the portion of the passive activity credit to which subparagraph (B) or (C) does not apply,

`(iii) third to the portion of such credit to which subparagraph (B) applies, and

`(iv) then to the portion of such credit to which subparagraph (C) applies.'

(b) EFFECTIVE DATE-

(1) IN GENERAL- Except as provided in paragraph (2), the amendments made by this section shall apply to property placed in service after December 31, 1989, in taxable years ending after such date.

(2) SPECIAL RULE WHERE INTEREST HELD IN PASS-THRU ENTITY- In the case of a taxpayer who holds an indirect interest in property described in paragraph (1), the amendments made by this section shall apply only if such interest is acquired after December 31, 1989.

otherwise applicable PHA utility allowance, the lower rent must be in effect for rent due more than 90 days after the date of the local utility company estimate. This paragraph (c)(1) does not apply until the building has achieved 90 percent occupancy for a period of 90 consecutive days or by the end of the first year of the credit period, whichever is earlier.

(2) *Annual review.* A building owner must review at least annually the basis on which utility allowances have been established and must update the applicable utility allowance in accordance with paragraph (c)(1) of this section. The review must take into account any changes to the building such as any energy conservation measures that affect energy consumption and changes in utility rates.

Par. 3. Section 1.42–12 is amended by adding paragraph (a)(4) to read as follows:

§ 1.42–12 Effective dates and transitional rules.

(a) * * *

(4) *Utility allowances.* Section 1.42–10 is applicable to taxable years beginning on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

* * * * *

Kevin M. Brown,

Deputy Commissioner for Services and Enforcement.

[FR Doc. E7–11731 Filed 6–18–07; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–114084–04]

RIN 1545–BD20

Section 42 Qualified Contract Provisions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: Section 42(h)(6)(F) requires the Secretary to prescribe such regulations as may be necessary or appropriate to carry out the provisions of section 42(h)(6)(F), including regulations to prevent the manipulation of the qualified contract amount. This document contains proposed regulations that provide guidance concerning taxpayers' requests to housing credit agencies to obtain a qualified contract (as defined in section 42(h)(6)(F) of the Internal Revenue Code) for the acquisition of a low-income housing credit building. The regulations will affect taxpayers requesting a qualified contract, potential buyers, and low-income housing credit agencies responsible for the administration of the low-income housing credit program. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by September 17, 2007. Outlines of topics to be discussed at the public hearing scheduled for October 15, 2007, must be received by September 13, 2007.

ADDRESSES: Send submissions to: Internal Revenue Service, CC:PA:LPD:PR (REG–114084–04), room 5203, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–114084–04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or may be sent electronically via the Federal eRulemaking Portal at: *http://www.regulations.gov* (IRS REG–114084–04). The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Jack Malgeri (202) 622–3040; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Kelly Banks, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by August 20, 2007.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in § 1.42–18(a)(1)(ii)(B). This information is required in order for a taxpayer to provide a written request to a housing credit agency to obtain a qualified contract (as defined in section 42(h)(6)(F) of the Internal Revenue Code) for the acquisition of a low-income housing credit building. The collection of information is voluntary to obtain a benefit. The likely respondents are business or other for-profit institutions.

Estimated total annual reporting burden: 20,000 hours.

Estimated average annual burden hours per respondent: 1 hour.

Estimated number of respondents: 20,000.

Estimated annual frequency of responses: One time.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains amendments to 26 CFR part 1 under section 42 of the Internal Revenue Code (Code). Section 42 was amended by section 7108(c)(1) of the Omnibus Budget Reconciliation Act of 1989 (Pub. L. 101–239, 103 Stat. 2106) to add paragraph (h)(6). In general, section 42(h)(6)(A) provides that no credit will be allowed with respect to any building for the taxable year unless an extended low-income housing commitment (commitment) (as defined in section 42(h)(6)(B)) is in effect as of the end of the taxable year.

Section 42(h)(6)(B) provides in part that the term commitment means any agreement between the taxpayer and the low-income housing credit agency (Agency) that requires that the applicable fraction (as defined in section 42(c)(1)) for the building for each taxable year in the extended use period will not be less than the applicable fraction specified in the commitment, and that prohibits the eviction or termination of tenancy (other than for good cause) of an existing tenant of any low-income unit and any increase in the gross rent with respect to the unit not otherwise permitted under section 42.

Section 42(h)(6)(D) defines the term extended use period as the period beginning on the first day in the compliance period under section 42(i)(1) on which the building is part of a qualified low-income housing project and ending on the later of: (1) The date specified by the Agency in the commitment, or (2) the date which is 15 years after the close of the compliance period.

Section 42(h)(6)(E)(i)(II) provides for the termination of the extended use period if the Agency is unable to present within a specified period of time a qualified contract for the acquisition of the low-income portion of the building by any person who will continue to operate such portion as a low-income building.

Section 42(h)(6)(F) defines the term qualified contract as a bona fide contract to acquire (within a reasonable period of time after the contract is entered into) the non low-income portion of the building for fair market value and the low-income portion of the building for an amount not less than the applicable fraction (specified in the commitment) of the sum of: (I) The outstanding indebtedness secured by, or with respect to the building, (II) the adjusted investor equity in the building, plus (III) other capital contributions not reflected in these amounts, reduced by cash distributions from (or available for distribution from) the project.

Section 42(h)(6)(F) also provides that the Secretary shall prescribe regulations as may be necessary or appropriate to carry out that paragraph, including regulations to prevent the manipulation of the amount determined under section 42(h)(6)(F).

Section 42(h)(6)(I) provides that the Agency must present the qualified contract within the 1-year period beginning on the date (after the 14th year of the compliance period) the taxpayer submits a written request to the Agency to find a person to acquire the taxpayer's interest in the low-income portion of the building.

These proposed regulations provide guidance with respect to the application of the qualified contract provisions of section 42.

Explanation of Provisions

Qualified Contract Formula

Section 1.42–18(c)(1) of the proposed regulations defines the qualified contract formula used to compute the purchase price amount of the low-income housing building as: (1) The fair market value of the non low-income portion of the building, plus (2) the low-income portion of the building. Section 1.42–18(c)(2) of the proposed regulations defines the low-income portion of the building as an amount not less than the applicable fraction (as specified in the commitment) of the total of: (a) Outstanding indebtedness on the building, plus (b) the adjusted investor equity in the building, plus (c) other capital contributions not reflected in the amounts in described in (a) and (b), minus (d) cash distributions from (or available for distribution from) the project.

Under § 1.42–18(b)(3) of the proposed regulations, the fair market value of the non low-income portion of the building is its fair market value at the time of the Agency's offer of sale. Because 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 Treasury Department and IRS believe that fair market value must reflect the restrictions on the use of the low-income portion of the building. Therefore, the proposed regulations provide that the valuation must take into account the existing and continuing requirements under the commitment for the building.

Section 42(h)(6) does not discuss the appropriate treatment of land in the calculation of qualified contracts. Qualified contracts are defined by reference to the building, which for other purposes of section 42 generally does not include the underlying land. However, because the Treasury Department and the IRS anticipate that the sales of the building without the underlying land would be infrequent, the Treasury Department and the IRS believe that it is necessary to include the underlying land in the computation of the qualified contract formula. Therefore, the proposed regulations provide that the non low-income portion also includes the fair market value of the land underlying the entire building, both the non low-income portion and the low-income portion, regardless of whether the building is entirely low-income. Comments are requested on whether low-income buildings are ever sold without the underlying land, and if so, the appropriate treatment in those cases. In addition, comments are requested on the appropriate treatment of leased land and the prevalence of leased land in low-income housing credit transactions.

For purposes of determining the low-income portion of the building, § 1.42–18(c)(3) defines the term outstanding indebtedness as the outstanding principal balance, at the time of the 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. Qualifying building costs are generally defined in § 1.42–18(b)(4) of the proposed regulations as those costs that would have been includible in eligible basis of a low-income housing building under section 42(d)(1), provided the amounts were expended for depreciable property that conveys under the contract with the building. Thus, for example, the outstanding mortgage on the building will generally be outstanding indebtedness for purposes of section 42(h)(6)(F), even if the indebtedness is incurred after the first year of the credit period, but only up to the amount of costs included in original eligible basis established at the end of the first year of the credit period under section 42(f)(1), plus indebtedness for qualifying building costs incurred after the first year of the credit period of a type that could be includible in eligible basis under section 42(d)(1). Thus, any proceeds from refinancing indebtedness or additional mortgages in excess of such qualifying building costs are not outstanding indebtedness for purposes of section 42(h)(6)(F).

Outstanding indebtedness with an interest rate below the applicable Federal rate (as determined under section 1274(d)) at the time of issuance must be discounted using a present-value calculation to obtain an imputed principal amount. This imputed principal amount constitutes the amount of indebtedness that must be utilized in calculating the amount of outstanding indebtedness under the qualified contract formula.

Section 1.42–18(c)(4) of the proposed regulations provides that adjusted investor equity includes only those cash investments by owners of the low-income building used for qualifying building costs. Investor equity is adjusted by a cost of living adjustment not to exceed five percent. The cost-of-living adjustment is determined under section 1(f)(3), substituting the language in section 1(f)(3)(B) with ''the CPI for the base calendar year.'' The base calendar year is the calendar year with or within which the first taxable year of the credit period ends. Thus, the cost-of-living adjustment is the percent by which the Consumer Price Index (CPI) for the year preceding the written request to find a person to acquire the project exceeds the CPI for the base calendar year.

Under § 1.42–18(c)(5) of the proposed regulations, other capital contributions are defined as contributions for qualifying building costs other than amounts included in the calculation of outstanding indebtedness or adjusted investor equity as defined in this section. An example of other capital contributions includes an amount expended to replace a furnace after the first year of the credit period, provided any loan taken to finance the furnace was not secured by the furnace or the building. In this example, the loan would be outstanding indebtedness on the building.

Qualifying building costs are defined under § 1.42–18(b)(4)(i) and (ii) of the proposed regulations. Under § 1.42–18(b)(4)(i) of the proposed regulations, a qualifying building is a cost included in eligible basis under section 42(d)(1). A cost is included in eligible basis under section 42(d)(1) only if the cost is (1) included in the adjusted basis of depreciable property subject to section 168 and the property qualifies as residential rental property under section 142(d) and § 1.103–8(b)(4)(iii), or (2) included in the adjusted basis of depreciable property subject to section 168 that is used in a common area or provided as a comparable amenity to all residential rental units in the building, but only if the property conveys under the contract with the building. A qualifying building cost also includes costs incurred after the first year of the credit period (as defined in section 42(f)) of the type included in eligible basis under section 42(d)(1). See § 1.42–18(b)(4)(ii) of the proposed regulations.

Under the qualified contract formula, the sum of the outstanding indebtedness, adjusted investor equity, and other capital contributions is reduced by cash distributions from or available for distribution from the project. Section 1.42–18(c)(6) of the proposed regulations defines cash distributions as including all distributions to owners or related parties within the meaning of section 267(b) or 707(b) (for example, cash distributions to owners from the proceeds of refinancings and second mortgages in excess of existing mortgages), and all cash and cash equivalents including reserve funds (for example, replacement and operating reserves) generated by cash flow from the project. To the extent an owner contributed his or her own funds to a reserve fund for replacement and improvements, such amounts are evaluated as either adjusted investor equity or other capital contributions. The Treasury Department and the IRS request comments and examples of forms of cash distributions from or available for distribution from the project that should or should not be included in the regulatory definition. Additionally, comments are requested whether low-income housing is owned by other than a corporation or partnership, for example, a sole proprietor, estate, or trust, and if so, what rules should apply for determining the amount of cash distributions from the project.

Administrative Discretion and Responsibilities of Agency

Under § 1.42–18(d)(1) of the proposed regulations, the Agency may exercise administrative discretion in evaluating and acting upon an owner's request to find a buyer to acquire the building. For example, the Agency may determine that an owner's request to find a buyer for the project lacks essential information and it may suspend the one-year period for finding a buyer until essential information is submitted.

Actual Offer of Sale

Section 1.42–18(d)(2) of the proposed regulations provides that in order to satisfy the qualified contract requirements under section 42(h)(6), the Agency must offer the building for sale to the general public at the determined qualified contract price upon receipt of a written request by the owner to find a buyer to acquire the building.

Fair Market Value Cap

Commentators suggested the inclusion of a fair market value cap on the low-income portion of the qualified contract amount as defined in section 42(h)(6)(F) noting that the qualified contract price may exceed the fair market value of a project. Commentators noted one reason for the qualified contract price exceeding fair market value is the formula for adjusted investor equity, which includes the CPI-based cost of living adjustments. The statute defines a qualified contract, in part, as a contract to acquire the low-income portion of the building for an amount ''not less than'' the applicable fraction of the statutorily provided formula. Therefore, the proposed regulations do not adopt this comment. However, the flush language of section 42(h)(6)(E) provides that the qualified contract exception to the termination of the extended use period of a commitment shall not apply to the extent more stringent requirements are provided in the commitment or in state law. The Treasury Department and the IRS request comments on the extent of Agency and state authority in providing more stringent requirements than the provisions contained in section 42(h)(6)(F), and specifically, the authority of Agency or state regulators to require in agreements a fair market value cap that would restrict any qualified contract price to fair market value.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the collection of information described under the heading ''Paperwork Reduction Act'' imposes virtually no incremental burden in time or expense and is voluntary for the taxpayer to obtain a benefit. Therefore, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for October 15, 2007, beginning at 10 a.m. in the auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments on September 17, 2007 and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by September 13, 2007. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Jack Malgeri, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.42–18 also issued under 26 U.S.C. 42(h)(6)(F) and 42(h)(6)(K); * * *

Par. 2. Section 1.42–18 is added to read as follows:

§ 1.42–18 Qualified contracts.

(a) *Extended low-income housing commitment*—(1) *In general.* No credit under section 42(a) is allowed by reason of section 42 and this section with respect to any building for the taxable year unless an extended low-income housing commitment (commitment) (as defined in section 42(h)(6)(B)) is in effect as of the end of such taxable year. A commitment must be in effect for the extended use period (as defined in paragraph (a)(1)(i) of this section).

(i) *Extended use period.* The term *extended use period* means the period beginning on the first day in the compliance period (as defined in section 42(i)(1)) on which the building is part of a qualified low-income housing project (as defined in section 42(g)(1)) and ending on the later of—

(A) The date specified by the low-income housing credit agency (Agency) in the commitment; or

(B) The date that is 15 years after the close of the compliance period.

(ii) *Termination of extended use period.* The extended use period under paragraph (a)(1)(i) of this section for any building will terminate—

(A) On the date the building is acquired by foreclosure (or instrument in lieu of foreclosure) unless the Secretary determines that such acquisition is part of an arrangement with the taxpayer a purpose of which is to terminate such period; or

(B) On the last day of the one-year period beginning on the date (after the 14th year of the compliance period) the owner submits a written request to the Agency to find a person to acquire the owner's interest in the low-income portion of the building and the Agency is unable to present during such period a qualified contract for the acquisition of the low-income portion of the building by any person who will continue to operate such portion as a qualified low-income building (as defined in section 42(c)(2)). This paragraph (a)(1)(ii)(B) shall not apply to the extent more stringent requirements are provided in the commitment or under state law. If the Agency provides a qualified contract within the one-year period and the owner rejects or fails to act upon the contract, the building remains subject to the existing commitment.

(iii) *Eviction, gross-rent increase concerning existing low-income tenants not permitted.* During the three-year period following the termination of a commitment, no owner shall be permitted to evict or terminate the tenancy (other than for good cause) of an existing tenant of any low-income unit, or increase the gross rent for such unit in a manner or amount not otherwise permitted by section 42.

(2) [Reserved]

(b) *Special rules.* For purposes of this section, the following terms are defined:

(1) *Base calendar year* means the calendar year with or within which the first taxable year of the credit period ends.

(2) *The low-income portion* of a building is the portion of the building equal to the applicable fraction (as defined in section 42(c)(1)) specified in the commitment for the building.

(3) *The fair market value* of the non low-income portion of the building is determined at the time of the Agency's offer of sale of the project to the general public. This valuation must take into account the existing and continuing requirements contained in the commitment for the building. The non low-income portion also includes the fair market value of the land underlying the entire building, both the non low-income portion and the low-income portion regardless of whether the project is entirely low-income. The non low-income portion also includes the fair market value of items of personal property not included in eligible basis under section 42(d)(1) that convey under the contract with the building.

(4) *A qualifying building cost* is—

(i) A cost that is included in eligible basis of a low-income housing building under section 42(d)(1) which is—

(A) Included in the adjusted basis of depreciable property subject to section 168 and the property qualifies as residential rental property under section 142(d) and § 1.103–8(b)(4)(iii); or

(B) Included in the adjusted basis of depreciable property subject to section 168 that is used in a common area or provided as a comparable amenity to all residential rental units in the building; and

(ii) Of the type described in paragraph (b)(4)(i) of this section incurred after the first year of the low-income building's credit period under section 42(f).

(c) *Qualified contract purchase price formula*—(1) *In general.* For purposes of this section, the term *qualified contract* means a bona fide contract to acquire (within a reasonable period after the contract is entered into) the non low-income portion of the building for fair market value (as defined in paragraph (b)(3) of this section) and the low-income portion of the building (as defined in paragraph (b)(2) of this section) for the low-income portion amount as calculated in paragraph (c)(2) of this section. The qualified contract amount is determined at the time of the Agency's offer of sale of the project to the general public. An Agency must, however, adjust the amount of the low-income portion of the qualified contract formula to reflect changes in the components of the qualified contract formula such as mortgage payments which reduce outstanding indebtedness between the time of the seller's request to the Agency to obtain a buyer and the project's actual sale closing date. In addition, the Agency may adjust the fair market value of the building if, after a reasonable period of time within the one-year offer of sale period, no buyer has made an offer or market values have adjusted downward.

(2) *Low-income portion amount.* The low-income portion amount is an amount not less than the applicable fraction specified in the commitment, as defined in section 42(h)(6)(B)(i), multiplied by the total of—

(i) The outstanding indebtedness for the building (as defined in paragraph (c)(3) of this section); plus

(ii) The adjusted investor equity in the building (as defined in paragraph (c)(4) of this section); plus

(iii) Other capital contributions (as defined in paragraph (c)(5) of this section), not including any amounts described in paragraphs (c)(2)(i) and (ii) of this section; minus

(iv) Cash distributions from (or available for distribution from) the building (as defined in paragraph (c)(6) of this section).

(3) *Outstanding indebtedness.* (i) For purposes of paragraph (c)(2)(i) of this section, except as provided in paragraph (c)(3)(ii) of this section, the term *outstanding indebtedness* for the building means the remaining stated principal balance, at the time of the Agency's offer of sale of the project to the general public, of any indebtedness secured by, or with respect to, the building that does not exceed the amount of qualifying building costs described in paragraph (b)(4) of this section. Examples of such indebtedness include certain mortgages and developer fee notes (excluding developer service costs not included in eligible basis). Outstanding indebtedness does not include debt used to finance nondepreciable land costs, syndication costs, legal and accounting costs, and operating deficit payments. The term outstanding indebtedness for the building only includes obligations that are indebtedness under general principles of Federal income tax law.

(ii) For purposes of paragraph (c)(2)(i) of this section, if the indebtedness had a yield to maturity below the applicable Federal rate (as determined under section 1274(d)) at the time of issuance, the term outstanding indebtedness for the building is the imputed principal amount of the indebtedness, secured by, or with respect to, the building, at the time of the Agency's offer of sale of the project to the general public, that does not exceed the amount of qualifying building costs described in paragraph (b)(4) of this section. The imputed principal amount of the indebtedness is the sum of the present values, as of the Agency's offer of sale of the project to the general public, of all the remaining payments of principal and interest payable on the indebtedness after the Agency's offer of sale of the project to the general public. The present value of each payment is determined by using a discount rate equal to the applicable Federal rate (as determined under section 1274(d)) at the time of issuance of the indebtedness. In the case of a variable rate debt instrument, rules similar to those in § 1.1274–2(f) are used to determine the instrument's imputed principal amount.

(4) *Adjusted investor equity.* (i) For purposes of paragraph (c)(2)(ii) of this section, the term *adjusted investor equity* for any calendar year means the aggregate amount of cash invested by owners for qualifying building costs described in paragraph (b)(4)(i) of this section. Thus, equity paid for land, credit adjuster payments, Agency low-income housing credit application and allocation fees, operating deficit contributions, and legal, syndication, and accounting costs all are examples of cost payments that do not qualify as adjusted investor equity under this section.

(ii) The adjusted investor equity as determined under paragraph (c)(4)(i) of this section is increased by an amount equal to the adjusted investor equity multiplied by the cost-of-living adjustment for such calendar year, determined under section 1(f)(3) by substituting for the language in section 1(f)(3)(B), the Consumer Price Index for all urban consumers (CPI) (not seasonally adjusted, U.S. City Average) as specified in paragraph (c)(4)(v) of this section for the base calendar year (as defined in paragraph (b)(1) of this section).

(iii) Adjusted investor equity is taken into account under this section only to the extent there existed an obligation to invest the amount as of the beginning of the low-income building's credit period (as defined in section 42(f)(1)).

(iv) Adjusted investor equity does not include amounts included in the calculation of outstanding indebtedness as defined in paragraph (c)(3) of this section.

(v) *The cost-of-living adjustment* is based on the CPI as of the close of the 12-month period ending on August 31 of the calendar year. The *cost-of-living adjustment* is the percent by which the CPI for the year preceding the written request to find a person to acquire the taxpayer's project (CPI_p) exceeds the CPI for the base calendar year (CPI_b). If the CPI for any calendar year during this period (after the base calendar year) exceeds the CPI for the preceding calendar year by more than 5 percent, the CPI for the base calendar year shall be increased such that such excess shall never be taken into account under paragraph (c)(4) of this section. The adjusted investor equity equals the aggregate amount of cash invested by the taxpayer in the building multiplied by the ratio of CPI_p to CPI_b.

(vi) *Example.* The following example illustrates the CPI calculation:

Example. Owner contributed $600,000 in equity to a building in 1991, which was the first year of the credit period for the project. In year 2005, owner requests Agency to find a buyer to purchase the building. The CPI_b (at the close of the 12-month period ending on August 31, 1991) is 136.6. The CPI_p for the close of the 12-month period ending August 31, 2004, is 189.5. At no time during this period (after the base calendar year) did the CPI for any calendar year exceed the CPI for the preceding calendar year by more than 5 percent. The owner's adjusted investor equity is $600,000 multiplied by 189.5/136.6, or $832,357.

(5) *Other capital contributions.* For purposes of paragraph (c)(2)(iii) of this section, other capital contributions to a low-income building are qualifying building costs described in paragraph (b)(4)(ii) of this section paid or incurred by the owner of the low-income building other than amounts included in the calculation of outstanding indebtedness or adjusted investor equity as defined in this section. For example, other capital contributions may include amounts incurred to replace a furnace after the first year of a low-income housing credit building's credit period under section 42(f), provided any loan used to finance the replacement of the furnace is not secured by the furnace or the building. Other capital contributions do not include expenditures for land costs, operating deficit payments, credit adjuster payments, and payments for legal, syndication, and accounting costs.

(6) *Cash distribution*—(i) *In general.* For purposes of paragraph (c)(2)(iv) of this section, the term *cash distributions* from (or available for distribution from) the project include—

(A) All distributions from the project to the owners or to related parties within the meaning of section 267(b) or section 707(b)), including distributions under section 301 (relating to distributions by a corporation), section

731 (relating to distributions by a partnership), or section 1368 (relating to distributions by a S corporation); and

(B) All cash and cash equivalents available for distribution at the time of sale, including for example, reserve funds whether operating or replacement reserves.

(ii) *Anti-abuse rule.* The Commissioner will interpret and apply the rules in this paragraph (c)(6) as necessary and appropriate to prevent manipulation of the qualified contract amount. For example, cash distributions include payments to owners or related parties within the meaning of section 267(b) or section 707(b) for any operating expenses in excess of amounts reasonable under the circumstances.

(d) *Administrative responsibilities of the Agency*—(1) *In general.* An Agency may exercise administrative discretion in evaluating and acting upon an owner's request to find a buyer to acquire the building. Examples of administrative discretion may include but are not limited to the following:

(i) Concluding that the owner's request lacks essential information and denying the request until such information is provided.

(ii) Refusing to consider an owner's representations without substantiating documentation verified with the Agency's records.

(iii) Suspending the one-year period for finding a buyer until the owner provides requested information.

(iv) Determining how many subsequent requests to find a buyer, if any, may be submitted if the owner has previously submitted a request for a qualified contract and then rejects or fails to act upon the qualified contract furnished by the Agency.

(v) Assessing and charging the seller certain administrative fees for the performance of services in obtaining a qualified contract (for example, real estate appraiser costs).

(vi) Requiring other conditions applicable to the qualified contract consistent with this section.

(2) *Actual offer.* Upon receipt of a written request from the owner to find a person to acquire the building, the Agency must offer the building for sale at the determined qualified contract amount to the general public in order for the qualified contract to satisfy the requirements of this section unless the Agency has already identified a willing buyer who submitted a contract to purchase the building.

(e) *Effective/applicability date.* This section is applicable on the date the final regulations are published in the **Federal Register**.

Kevin M. Brown,

Deputy Commissioner for Services and Enforcement.

[FR Doc. E7–11725 Filed 6–18–07; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 165

[CGD14–07–001]

RIN 1625–AA87

Security Zones; Oahu, Maui, Hawaii, and Kauai, HI

AGENCY: Coast Guard, DHS.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Coast Guard proposes to change the permanent security zones in waters adjacent to the islands of Oahu, Maui, Hawaii, and Kauai, Hawaii. Review of the established zones indicates the need for some adjustment to better suit vessel and facility security in and around Hawaiian ports. The proposed changes are intended to enhance the protection of personnel, vessels, and facilities from acts of sabotage or other subversive acts, accidents, or other causes of a similar nature.

DATES: Comments and related material must reach the Coast Guard on or before July 19, 2007.

ADDRESSES: You may mail comments and related material to Commanding Officer, U.S. Coast Guard Sector Honolulu, Sand Island Parkway, Honolulu, Hawaii 96819–4398. Sector Honolulu maintains the public docket for this rulemaking. Comments and material received from the public, as well as documents indicated in this preamble as being available in the docket, are available for inspection and copying at Coast Guard Sector Honolulu between 7 a.m. and 3:30 p.m., Monday through Friday, except Federal holidays.

FOR FURTHER INFORMATION CONTACT: Lieutenant (Junior Grade) Jasmin Parker, U. S. Coast Guard Sector Honolulu at (808) 842–2600.

SUPPLEMENTARY INFORMATION:

Request for Comments

We encourage you to participate in this rulemaking by submitting comments and related material. If you do so, please include your name and address, identify the docket number for this rulemaking (CGD14–07–001), indicate the specific section of this document to which each comment applies, and give the reason for each comment. Please submit all comments and related material in an unbound format, no larger than 81/2 by 11 inches, suitable for copying. If you would like to know that your submission reached us, please enclose a stamped, self-addressed postcard or envelope. We will consider all comments and material received during the comment period. We may change this proposed rule in view of them.

Public Meeting

We do not now plan to hold a public meeting. But you may submit a request for a meeting by writing to Sector Honolulu at the address under **ADDRESSES** explaining why one would be beneficial. If we determine that one would aid this rulemaking, we would hold one at a time and place announced by separate notice in the **Federal Register**.

Background and Purpose

The terrorist attacks against the United States that occurred on September 11, 2001, have emphasized the need for the United States to establish heightened security measures in order to protect the public, ports and waterways, and the maritime transportation system from future acts of terrorism or other subversive acts. The terrorist organization al-Qaeda and other similar groups remain committed to conducting armed attacks against U.S. interests, including civilian targets within the United States. National security and intelligence officials warn that future terrorist attacks are likely.

In response to this threat, on December 19, 2005, the Coast Guard published a final rule establishing permanent security zones in designated waters surrounding the Hawaiian Islands (70 FR 75036, December 19, 2005). These zones replaced the temporary zones that had been established, and then extended, in the waters surrounding the Hawaiian Islands soon after the attacks (66 FR 52693, October 17, 2001). The existing permanent security zones have been in operation for over a year.

We have recently completed a periodic review of port and harbor security procedures and considered the oral feedback that local vessel operators gave to Coast Guard units enforcing the zones. In response, the Coast Guard is proposing to reduce the scope of the *Honolulu International Airport, North Section* security zone. The Coast Guard is also proposing new zones at

AFFORDABLE HOUSING • TAX CREDIT COALITION •

September 17, 2007

Internal Revenue Service
CC:PA:LPD:PR (REG-114084-04)
Room 5203
PO Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Comments on Proposed Regulations Implementing Section 42 Qualified Contract Provisions

Ladies and Gentlemen:

The Affordable Housing Tax Credit Coalition (the "Coalition") is submitting these comments in response to the above-cited notice of proposed rulemaking. The Coalition is a national trade association based in Washington, DC comprised of syndicators, investors, developers, lenders, housing credit agencies and professionals who are deeply involved in the low-income housing tax credit ("Housing Credit") industry. Our members are responsible for raising a substantial portion of the equity capital that is invested in properties which generate Housing Credits. We have a great deal of experience with respect to the financing, development and tax matters pertaining to the Housing Credit program. We appreciate your consideration of these comments.

BACKGROUND

In 1989, the Congress enacted Section 42(h)(6) of the Code. In doing so, Congress reflected a concern that the properties developed using the Housing Credit be preserved for low-income use for an extended period, generally at least thirty years. However, the Congress also recognized a concern expressed by owners, syndicators and investors, including Coalition members, that extending the low-income use period to thirty years could discourage or decrease capital investment in these properties; if investors had no opportunity to recoup their investment or benefit from the potential appreciation of the property's value as an unrestricted property for at least thirty years, then investors' would likely to be less willing to provide capital or as much capital.

Accordingly, the enactment of Section 42(h)(6) reflected a compromise recognizing the need to preserve Housing Credit properties

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for an extended period but providing a mechanism by which owners and investors could, if they chose to do so, either receive a fair return on their investment, determined by receipt of a "qualified contract" or be permitted to end the low-income use restrictions on the property (after a phase-out period). The ability to utilize a qualified contract makes it feasible to develop properties in areas where land costs are high, since it provides developers and investors with the ability to recognize a return on their investment. The mechanism to be employed permits the owner to request anytime after the fourteenth year of the compliance period that the housing credit agency present a "qualified contract" for the acquisition of the low-income portion of the building by any person who will continue to operate such portion as a qualified low-income building[1]. The housing credit agency is given a one-year period after the owner's written request to find a buyer. In the event that no qualified contract is presented, then the extended use period terminates, subject to a three year period during which existing tenants may not be evicted, except for good cause, and rents may not be raised except in conformity with Section 42.

A "qualified contract" is defined in Section 42(h)(6)(F) as a "bona fide contract to acquire (within a reasonable period after the contract is entered into) the non-low-income portion of the building for fair market value and the low-income portion of the building for an amount not less than the applicable fraction (specified in the extended low-income housing commitment) of—

(i) the sum of—

(I) the outstanding indebtedness secured by, or with respect to, the building,
(II) the adjusted investor equity in the building, plus
(III) other capital contributions not reflected in the amounts described in subclause (I) or (II), reduced by

(ii) cash distributions from (or available for distribution from the project.)"

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[1] We note that there is an inconsistency in the statutory language. Under Section 42(h)(6)(B)(iii), there is a prohibition on disposing of a building unless the entire building is disposed of to one person. Accordingly, we believe that the Congress intended the qualified contract process to relate to both the low-income and nonlow-income portion of a building despite the language in Section 42(h)(6)(E)(i)(II) that refers only to the low-income portion.

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The "adjusted investor equity" is defined in sub-clause (G) as the "aggregate amount of cash taxpayers invested with respect to the project increased by the amount equal to—

(I) such amount, multiplied by
(II) the cost-of-living adjustment for such calendar year, determined under Section 1(f)(3) by substituting the base calendar year for 'calendar year 1987'.

An amount shall be taken into account as an investment in the project only to the extent there was an obligation to invest such amount as of the beginning of the credit period and to the extent such amount is reflected in the adjusted basis of the project."

Our comments are organized as follows: Section I deals with questions as to which the Service has specifically asked for comment in the Preamble to the Proposed Regulations. Section II deals with concerns with specific provisions set forth in the Proposed Regulations. Section III deals with areas which the Coalition believes should be, but are not addressed, in the Proposed Regulations.

SECTION I—RESPONSES TO QUESTIONS RAISED BY THE SERVICE

1) Are buildings ever sold without the underlying land, and if so, what is the appropriate treatment?

Response: Our experience is that while most buildings are constructed on land owned in fee simple by the owner, a substantial number of buildings are constructed on land subject to a long term ground lease. This is particularly true in buildings owned by public housing authorities and financed under the Department of Housing and Urban Development's mixed finance programs, including the HOPE VI program. However, in such cases, in order to demonstrate ownership of the buildings in the land lessee for federal income tax purposes, the ground lease has a very long term, generally in excess of 65 years and often as long as 99 years. Accordingly, buildings that are subject to a long term ground lease will continue to be held by the purchaser for a period that is generally in excess of fifty additional years. Such buildings, however, will be sold subject to that lease and we believe that the land should be valued based upon the fair market value of the land that is subject to the ground lease, which is the same way that land owned in fee simple would be valued. We also note that in many cases, the terms of the ground lease or other regulatory restrictions imposed in connection with the building's financing will limit the use of the building

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to low-income housing and that such restrictions should be taken into account in valuing the building and the land.

2) Do housing credit agencies have authority to provide more stringent requirements than the provisions contained in Section 42(h)(6)(F) and specifically, may such agencies impose a fair market value cap that would restrict any qualified contract price to the fair market value?

Response: The Coalition believes strongly that housing credit agencies have no authority under Section 42(h)(6)(F) or otherwise to impose a different formula for computing the qualified contract price and no authority to impose a fair market value limitation on such price. As noted earlier in our comments, the Congress carefully considered how to calculate the qualified contract price. That determination was a compromise that reflected a balancing of interests between investors concerned that they be able to recoup their equity investment and tenant advocates who wished to extend the low-income use restrictions. The result of its careful deliberations on this subject is the calculation set forth in Section 42(h)(6)(F). Had the Congress desired to set or limit the price to the fair market value, it would have done so, but it chose instead to set the price as set forth in Section 42(h)(6)(F). There is absolutely no legislative history of which we are aware that would support the proposition that the Congress intended a fair market value limitation. The flush language that the Service cites in Section 42(h)(6)(E), which allows for "more stringent requirements," relates to a wholly different concept—when the extended use period will terminate. Indeed, the language is very clear—the "more stringent requirements" relate to "Subclause II" of Section 42(h)(6)(E), which deals with the date for termination of the extended use period; it has nothing to do with the qualified contract price, which is set forth in Section 42(h)(6)(F). The Coalition recognizes that housing credit agencies have the authority, which has been regularly exercised, to terminate the extended use period at a date later than contemplated in Section 42(h)(6)(E). Indeed, our experience is that it is impossible to obtain a housing credit allocation in most states unless the owner agrees, in its application, to extend the termination of the extended use period. However, housing credit agencies have no ability to change the calculation of the qualified contract price, nor does the Service have the ability through regulations to alter the statutory language on the subject.

We also note that Section 1.42-18(c)(1) of the Proposed Regulations provide that housing credit agencies would have the right to reduce the fair market value of the building (presumably meaning the non low-income portion) if, after a reasonable period, no buyer has made an offer or market values have adjusted downward during the one year period. We question the statutory authority for giving housing credit

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agencies such a right. Moreover, it is unclear as to how agencies would decide precisely when to reduce the acceptable price and by what amount. Would the agencies be required to adjust the price upward if market values were determined to have increased? Accordingly, we object to giving housing credit agencies the right to adjust the fair market value during the one-year period.

SECTION II—COMMENTS ON SPECIFIC PROVISIONS OF THE PROPOSED REGULATIONS

1) **Definition of "outstanding indebtedness".** Proposed Section 1.42-18(c)(3)(i) would define "outstanding indebtedness" for purposes of calculating that aspect of the qualified contract price as being limited to the amount of the qualified building costs as defined in paragraph (b)(4) of that Section. A qualified building cost is limited to costs includable in eligible basis and as explained in the Preamble, the proposal would exclude the proceeds of any refinancing or additional mortgages in excess of such qualifying building costs. Moreover, Proposed Section 1.42(c)(3)(ii) would require the discounting of any debt which has an interest rate below the applicable Federal rate ("AFR") under Code Section 1274. There is absolutely no statutory authority, nor legislative history, to indicate that the Congress intended that outstanding indebtedness be limited to qualified building costs or that debt with an interest rate below the applicable Federal rate be discounted as proposed. Had Congress intended either result, it would provided language to this effect. Contrast the language of Code Section 42(i)(7)(B)(i), enacted at the same time as the qualified contract provisions, which deals with the minimum purchase price under the exercise of a right of first refusal. In that situation, the Congress explicitly excluded debt that was incurred in the five year period prior to the sale to the tenants. Congress could have chosen to limit the debt to be taken into account in calculating the qualified contract price but unlike the provisions governing the minimum price for rights of first refusal, it did not do so. The Service's attempt to reduce the qualified contract price in a manner not contemplated by the Congress is not justified by the law nor the language allowing the Secretary of Treasury to issue regulations to prevent the manipulation of the qualified contract price. There is no abuse occurring here that the Proposed Regulations are preventing. Moreover, as a practical matter, it is virtually impossible to trace whether a particular cost of the development was paid for by debt or equity as these funds are fungible during the development and construction of a project.

In our experience a substantial number of projects are financed with debt which bears interest at rates below the AFR and in fact, these projects would not have been financially feasible without such favorable interest rates. In most instances, the buyer of the project would acquire the property subject to the debt and the residents of the project would

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continue to benefit from the lower debt service expense that permits the new owner to provide lower than market rental rates. Both the seller and the buyer would treat the full, undiscounted amount of the debt as part of the purchase price under general tax principles and there would generally not be any reduction to basis. Nor would there be any upward adjustment if the financing had an interest rate that was above the AFR and such financing was required to be assumed. Assuming the buyer acquired the property and did not assume or take subject to the below AFR financing, the seller would still have to pay off the full principal amount of the loan even if it received only the discounted amount as part of the purchase price. This would require that some of the purchase price that was attributable to the equity investment would have to be utilized to satisfy the below AFR financing. We see no policy justification for this result.

2) **Definition of adjusted investor equity.** Section 1.42-18(c)(4) of the Proposed Regulations also limits the adjusted investor equity to the amount of cash invested in qualifying building costs. The proposal is inconsistent with the statutory language which provides that the adjusted investor equity shall only be taken into account to the extent that such amount is reflected in the "adjusted basis of the project". We believe that the "adjusted basis of the project" should be determined in accordance with Section 1012 of the Code, i.e., the adjusted basis is the cost of the project. Accordingly, this would include land, real property, personal property, site improvements and intangible assets and not just qualifying building costs as defined in the Proposed Regulations. Moreover, in our view, tracing of capital contributions to specific uses of funds should not be required as the various sources of funds in a project, including debt and equity, are generally fungible and it will be impossible to trace, particularly for transactions that closed fifteen years ago. Finally, adjusted basis should not reflect adjustments to basis such as those required under Section 50(c) of the Code for rehabilitation or other investment credits or adjustments to eligible basis allowed for projects located in difficult development areas or qualified census tracts under Section 42(d)(5)(C) of the Code.

3) **Rejection of a contract by an owner or its failure to act.** Under Section 1.42-18(a)(ii)(B) of the Proposed Regulations, if the housing credit agency provides a qualified contract within the one-year period and the owner rejects or fails to act upon the contract, the building remains subject to the existing extended use commitment. For reasons explained in Section III below in these comments, we believe that the Service has paid insufficient attention to a number of procedural matters pertaining to the qualified contract process and that this statement does not adequately deal with this issue. If an owner rejects or fails to act on a contract presented by the housing credit agency

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because the qualified contract price is incorrect or because the presented contract contains unreasonable terms and conditions, we do not believe that the building should automatically remain subject to the extended use commitment. As explained below, a process needs to be developed as part of the Proposed Regulations to deal with disputes between the parties as to what constitutes a qualified contact or a bona fide contract.

4) **Determination of cash distributions from or available for distribution from the building.** Proposed Regulation 1.42-18(c)(6) provides that the qualified contract price is reduced by all distributions from the project to owners or to related parties to owners within the meaning of Code Sections 267(b) or 707(b) and by all reserve funds available for distribution at the time of closing.

Without legislative history, this has been perhaps the least understood concept in the qualified contract context. As a general matter, we believe that the Congress intended to look at what the owners (i.e., partners in a limited partnership, or members of limited liability companies, which are typically the owners of these projects) were distributed or could have been distributed in cash throughout the life of the partnership. We have reviewed the written policies of several of the housing credit agencies and believe that the Florida Housing Finance Corporation's approach to this point best reflects what we believe the Congress intended. For this purpose, Florida calculates all cash payments and distributions from net operating income, i.e., income remaining after payment of operating expenses, debt service and payments into reserves. The distributions to be taken into account include amounts paid to partners or affiliates as fees payable from operations (including, but not limited to, investor fees, partnership management fees, incentive management fees and guaranty fees) and amounts distributed as a return of capital, such as refinancing proceeds. However, the agency will not reduce the qualified contract price by payments of deferred development fees to the extent that the amount of such fee was within that agency's guidelines, even if paid to a related party (as is often the case). In addition, we believe that repayments of project expense loans, including interest, made by partners or affiliates of partners should not be treated as distributions that would reduce the qualified contract price. Of course, regular cash distributions to partners would serve to reduce the qualified contract price.

Florida also interprets the "available for distribution" language to include all cash held in partnership reserves and other accounts, the distribution of which to the owners is not prohibited by mortgage restrictions, regulatory agreements or similar third-party contractual provisions. We believe it is important to clarify in the Proposed Regulations that it is only the amount of reserves that are distributable to the owners which would serve to reduce the qualified contract price. To the extent that a reserve amount is required by such contractual

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provisions to remain with the property after sale, such reserve would not be computed in the qualified contract price. An amount currently held in such a restricted account that will become unrestricted and available for distribution on or before the expiration of the one-year qualified contract period is listed as available for distribution. We endorse the approach taken by the Florida housing credit agency and would urge the Service to consider adopting that approach.

5) **Administrative responsibilities of the Agency.**

While we do not object to the provisions of Proposed Regulation Section 1.42-18(d), for the reasons explained in Section III below, we believe that much more attention needs to be paid to outstanding procedural concerns and that this aspect of the Proposed Regulations does not adequately address administrative matters.

SECTION III—MATTERS NOT ADDRESSED IN THE PROPOSED REGULATIONS

1) **What constitutes a "bona fide contract"?** Although Black's Law Dictionary defines the term as "a contract in which equity may intervene to correct inequalities and to adjust matters according to the parties' intention", that definition has little relevance or meaning in the context of Section 42. A typical modern contract for the purchase and sale of real estate is often a lengthy, complicated and heavily negotiated document. In addition to negotiation on a sales price (which price is prescribed under the provisions of Section 42(h)(6)(F) in these circumstances), there are a myriad of other provisions that the parties will typically negotiate. For example, provisions often include representations and warranties on a number of topics, the scope of due diligence and the time frame for permitting due diligence review, the manner in which the purchase price will be paid, contingencies permitting the termination of the contract, provisions concerning a default by the parties, the amount of down payments, risk of loss during the contract period and so forth. Even in a particular state, there are seldom "form" purchase and sale agreements; indeed within a state, different regions may have substantially different forms and very different local business customs that guide the practice.

The Code provides that the extended use period terminates if the housing credit agency does not "present" a qualified contract (i.e., a bona fide contract) within the one-year period after a written request is made. But what if the presented contract contains terms and conditions (leaving the price aside for the moment) that are completely unreasonable, particularly given standard real estate practice in that jurisdiction? Suppose, for example, that the buyer arranged for by the state insisted that the seller guarantee for ten years that there will be a minimum of $1,000,000 of net cash flow each year even if the property is currently

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barely breaking even financially. Does that constitute a bona fide contract? If the owner does not agree to that term, can the housing credit agency argue successfully that its refusal to accept the presented contract results in the continuation of the extended use period?

Conversely, for example, it is common in most jurisdictions for the seller to certify the accuracy of the current rent roll; suppose the seller refused to take that simple step? Would the seller's refusal to accept the presented contract under these circumstances allow the seller to claim that the extended use agreement should be terminated? The examples of potentially unreasonable or bad faith dealing can go on and on but the point is that these are very complex transactions where the business practices will vary in different jurisdictions and the facts and circumstances of each transaction are likely to be very different. Defining a bona fide contract that would fit substantially different and myriad circumstances is simply not possible.

Moreover, despite the statutorily determined price to be set forth in the qualified contract, it is possible that the housing credit agency and the owner may disagree over the calculation of that price.

An essential question is whether a presented contract that fails to contain reasonable and standard terms can be considered bona fide, regardless of whether it is the buyer or the seller that is being unreasonable. Our position is that such a contract, if presented by the housing credit agency or its buyer, should not be treated as bona fide. In our view, if the state agency presented such a contract, then it would not have met the condition set forth in Section 42(h)(6)(E)(i)(I)(ii) and the extended use period should be allowed to terminate pursuant to Section 42(h)(6). The simple act of presenting a contract that is not bona fide should not result in a continuation of the extended use period.

On the other hand, if the state agency presented a reasonable contract that should be treated as bona fide, but the owner refused to act reasonably in response, then in our view, the owner should not be released from the extended use period. In other words, the Coalition believes that neither side should be able to act unreasonably in order to effectuate the extension or termination of the extended use agreement.

The most important question in this area is how to resolve fairly and efficiently disputes over what constitutes a bona fide contract where the parties are not able to agree on terms or the price to be paid under the Code. The Coalition's suggestion is to invoke binding arbitration, conducted in accordance with nationally recognized rules of arbitration such as the American Arbitration Association, if the parties are not able to agree after a certain period of time on the terms of a qualified contract. A substantial advantage of arbitration is that the opposing parties are much more likely to be reasonable in their negotiations if they face the possibility of an arbitration proceeding. A trained and experienced arbitrator will be able to determine which of the parties is acting reasonably (and if the dispute is over the price, the amount to be paid)

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and whether the contract being presented or rejected is bona fide in light of its terms and conditions.

In considering this suggestion, the Coalition thought about other alternatives. Despite our substantial experience in real estate, we were unable to devise a way of defining the term "bona fide contract" that would fit all circumstances. If the parties are able to agree, the issue resolves itself and the threat of arbitration is likely, in our view, to resolve many disputes. But in those cases, which could be numerous, where the buyer and seller are not able to agree on whether the contract is bona fide or the price, then having a conflict resolution process in place will help resolve disputes relatively quickly and efficiently.

Accordingly, we urge the Service to adopt a binding arbitration process to determine whether a presented qualified contract is a "bona fide contract" if the parties to the transaction are not able to agree.

2) **<u>What is a reasonable time to acquire the property after the qualified contract is entered into?</u>** Typically, the purchase and sale agreement will spell out the date on which the closing will occur and will permit extensions of that date under certain circumstances or if requested by one of the parties. However, facts and circumstances will dictate what is reasonable in any given situation and that may vary substantially from transaction to transaction. Like the questions posed above concerning bona fide contracts, we believe that if the parties cannot agree as to what constitutes a reasonable time to close, that this matter also be subject to binding arbitration.

Moreover, if the buyer does not acquire the project within the agreed upon timeframe due to its default, then the extended use period should be treated as terminated (unless the owner elects to allow the housing credit agency to present another contract). The Code contemplates that the extended use period terminates if the housing credit agencies does not present **"<u>a</u>"** qualified contract in response to the owner's request. (See Section 42(h)(6)(E)(i)(II)). In our view, this language must be read literally—"a" contract means one contract. If the buyer presented by the housing credit agency defaults in its obligation to acquire the project, the agency should not be given multiple chances to present additional contracts (absent the owner's election to do so); otherwise, the statutory scheme can be frustrated as one contract after another is presented and the extended use period is prolonged indefinitely.

3) **<u>How should the fair market value of the nonlow-income portion of the building be calculated?</u>** We believe that qualified real estate appraisers should determine fair market value. However, it is only fair and equitable that neither side be able to dictate the identity of the appraiser since in our experience, different appraisers, even though licensed and qualified, may differ in their conclusions. If

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the parties are able to agree on the identity of an appraiser, there will be no issue. However, if the parties each wish to engage their own appraiser, and the value determination is different, the resulting conclusion as to value should either be the average of the two appraisers or the two appraisers should jointly appoint a third appraiser whose determination of fair market value would be binding on the parties. These techniques are generally accepted in the real estate industry.

4) **What information and documentation can the housing credit agency require when an owner makes a written request of the agency to locate a buyer?** We expect that housing credit agencies will legitimately ask owners to submit certain information and documents about the project in order for the agency to seek potential buyers. However, we are also concerned that housing credit agencies may impose unreasonable and unnecessary information requirements on owners in making requests to find a buyer. If such information requests are unreasonable and burdensome, then the owner's statutory right to make a request can be effectively frustrated.

Once again, we believe that the approach established by the Florida housing credit agency with respect to information and documents to be submitted in making a written request is a good example that the Service could adopt. The documents and information required to be submitted by Florida are as follows:

(i) a calculation of the qualified contract price;
(ii) a thorough narrative description of the project, including amenities;
(iii) a description of the regulatory restrictions, if any, applicable to the project;
(iv) photographs of the exterior and representative apartment units and buildings;
(v) financial operating statements for the project for the prior 12 months;
(vi) a current rent roll;
(vii) copies of any leases if any portion of the land or improvements are leased.

In addition, Florida requires the payment of a fee. While we do not expect the Service to regulate the amount of such a fee, it should be reasonable.

We urge the Service to state in its regulations that housing credit agencies which impose substantially more burdensome information and documentation requirements on owners will forfeit their right to require owners to go through the qualified contract process. Finally, the one year period should commence when the reasonably required information is submitted by the owner.

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5) **How can the qualified contract price be calculated, particularly if the project owner does not have complete tax and financial records for the prior 15 years?** Unfortunately, we have discovered that many project owners have not maintained their financial records and tax returns for the full 15 years, making the calculation of cash distributed or available for distribution difficult to determine with complete precision. To address this situation, the Coalition would suggest that the accounting industry, working together with housing credit agencies, develop an agreed upon procedures report where the accountants would draw upon the best available documents and resources in order to make these determinations. The accounting industry has taken a similar approach in developing cost certification and "ten percent test" reports for housing credit agencies.

6) **What is meant by the phrase "only to the extent there was an obligation to invest such amount [i.e., the aggregate amount of cash taxpayers invested] as of the beginning of the credit period"?** It is very common in the housing credit industry to provide in the governing documents (generally an agreement of limited partnership or a limited liability company operating agreement) that the investor's capital contributions will be subject to adjustment, based upon the amount of or timing of delivery of Housing Credits. The amount and timing of Housing Credits are usually determined by the accountants after completion and lease up of the project. These agreements are generally executed and are in place before the beginning of the credit period, although the final adjustments to the capital contributions may not be made until after the commencement of the credit period due to the timing of the accountants' determination in relation to the beginning of the credit period. Moreover, payment of these capital contribution adjustments may be contingent on the investor having sufficient funds to make the payment. These provisions are generally referred to as "adjuster clauses". We believe it is fair and equitable and within the Congress's intent, to interpret the "obligation to invest" language as including capital which is contributed after the commencement of the credit period as a result of an adjuster clause, provided that the adjuster clause was in place prior to the start of the credit period.

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The Affordable Housing Tax Credit Coalition appreciates the opportunity to submit these comments. Under separate cover, we are submitting an outline of topics to be discussed at the public hearing on these Proposed Regulations. We stand ready to work with the Service in this or any other matter pertaining to the Housing Credit. Thank you for your consideration of our views.

Very truly yours,

Ronne L. Thielen RSG

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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 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 property is affected by legal constraints on what an owner may do with that property, 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, without specifically stating so, would be inconsistent with this pattern. Thus, the Service's 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 the Low-Income Housing Preservation and Resident Homeownership Act of 1990 (12 U.S.C. §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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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.

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)

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SHAUN DONOVAN
Commissioner

September 15, 2007

Ms. Linda E. Stiff
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue NW
Washington, DC 20044

Re: Comments in Response to Notice of Proposed Rulemaking on Section 42 Qualified Contract Provisions

Dear Commissioner Stiff:

The New York City Department of Housing Preservation and Development (HPD) appreciates the opportunity to comment in response to the Notice of Proposed Rulemaking on Section 42 Qualified Contract Provisions, as published in the Federal Register on June 19, 2007. HPD is the nation's largest municipal housing development agency. Our mission is to promote quality housing and viable neighborhoods for New Yorkers. As part of our responsibility, HPD directly allocates approximately $12.5 million in 9% tax credits each year.

We are concerned proposed section 1.42-18(b)(3), as it applies to projects built on land acquired for below market prices, will increase the cost of the qualified contract and thereby make it more difficult to maintain affordability in these properties. Such an increase would be inconsistent with the goal of the extended-long term commitment provided for by the Code to continue the use of the low income portion of the building as low-income housing.

For a building that has received an allocation of Low Income Housing Tax Credits (LIHTC), the proposed section requires the fair market value of the land underlying the building be included in the computation of a qualified contract price. However, land for LIHTC projects in the City of New York has often been provided to the development from the City at a below market price, and often at a nominal price, as a form of direct subsidy to create low-income housing.

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An increase in the qualified contract price that does not reflect the actual amount contributed by the investor is inconsistent with the goal of the extended-long term commitment. The change would make it more difficult to find an entity committed to maintaining the affordability of the property (typically a non-profit) while still being able to pay the qualified contract price, acquire the property, and continue to operate it as low-income housing. In addition, if a non-profit were unable to pay the qualified contract price, the City could be required to provide additional subsidy to the non-profit to preserve the affordability of the housing. Not recognizing the City's initial subsidy would have the effect of forcing the City to provide a land subsidy twice.

As it is the intent of the Code to ensure a fair price is arrived at in the computation of a qualified contract price, and the intent of the extended-long term commitment is to maintain the low-income housing, we are of the opinion that the regulations should only include the actual value contributed by the investor in acquiring the land, not the fair market value, in the computation of a qualified contract price.

If you have any questions or would like to discuss our comments please contact Alexandra Sewell at (212) 863-8402.

Sincerely,

Shaun Donovan
Commissioner

Copy: CC:PA:LPD:PR (REG–114084–04)
Room 5203
Internal Revenue Service
P.O. Box 7604
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Washington, DC 20044

RE: Section 42 Qualified Contract Provisions, RIN 1545-BC20

WEST MICHIGAN BUSINESS

Bill would tighten foreclosure loophole for low-income housing

Updated on March 12, 2017 at 9:01 PM
Posted on March 10, 2017 at 9:53 AM

By Jim Harger, jharger@mlive.com

GRAND RAPIDS, MI - A bill introduced in the U.S. Senate this week includes language that would tighten a loophole that a Grand Rapids-based apartment developer has used to convert seven of its properties from low income to market rate developments.

The bill, introduced by U.S. Sen. Maria Cantwell, D-Wash., and co-sponsored by Senate Finance Committee Chairman Orrin Hatch, R-Utah, is designed to expand the federal low income housing tax credit program by 50 percent over the next five years.

The program, which has been popular with investors and low income housing developers for more than 30 years, would make more funding available to address a shortage of low income housing in the U.S, according to Richard Goldstein, counsel for the Affordable Housing Tax Credit Coalition.

But the bill also has provisions that will restrict property owners from shedding their low income housing promises by foreclosing on them and converting them into market rate developments.

Eenhoorn LLC of Grand Rapids has been accused by state housing regulators and housing advocates of using foreclosures to escape its obligations to provide low income rents at four of its Michigan apartment projects, including two in the Grand Rapids area.

The properties were acquired by Eenhoorn and given loans by Eenhoorn-related entities. The properties gave their lenders "deeds in lieu of foreclosure" after they failed to keep up with the Eenhoorn mortgages.

Those foreclosures allowed Eenhoorn to prematurely charge market rate rents at 540 of their apartments, according to the housing advocates.

Introduced as Senate Bill 548 on Tuesday, March 7, Cantwell's bill would require housing developers to give state housing agencies 60 days before their obligations to provide low income housing could be waived as a result of foreclosure, according to Goldstein.

Low income housing tax credits offer their investors full tax write-offs for 10 years, but the developers are required by the IRS to offer lower rents to low-income residents for up to 30 years.

A foreclosure cancels those requirements and allows landlords to charge higher rents for the final 15 years, provided they give their low-income tenants a three-year grace period to find new housing after the foreclosure.

Cantwell's bill would allow state regulators to determine if the foreclosure was intended to terminate the low rent obligations, Goldstein said. Currently, the IRS has no rules or procedures in place to determine if a planned foreclosure has occurred and state and local housing agencies are left in the dark, he said.

Goldstein said few developments financed by low income housing tax credits have failed and gone through foreclosure compared to other real estate ventures. Goldstein said he was not familiar with the Eenhoorn foreclosures.

State housing officials said they were caught off guard by the Eenhoorn foreclosures, which occurred over the past five years. They were made aware of the foreclosures by lawyers from Legal Aid of West Michigan, which was defending a low income tenant who was being evicted.

Last fall, Michigan State Housing Development Authority asked the Internal Revenue Service to stop Eenhoorn from converting two of its developments to market rates. So far, the IRS has not responded.

Eenhoorn-related projects in Madison, Wis., in Franklin, Ind. and near Springboro, Ohio also have gone through the "deed in lieu of foreclosure" process.

Nyal Deems, Eenhoorn's lawyer, said the mortgages were intended to revive unprofitable housing developments. Eenhoorn owned the properties for between nine and 12 years before foreclosing on them, he said.

"These properties were not acquired as part of planned elimination of affordable housing," he said. "It would be an odd investment indeed to acquire a property interest, planning to foreclose on it and then hold it and invest money in it for 12 years before foreclosing."

Despite the foreclosures, Eenhoorn will continue to offer its low-income tenants subsidized rates for as long as they stay - even beyond the three years that is required by law after a foreclosure, Deems said.

But new tenants pay market rates at the apartment complexes that went through the foreclosure process.

IRS ISSUES FINAL QUALIFIED CONTRACT RULES

May 08, 2012

Tax Credit Alert

Last week, the IRS issued final qualified contract rules for the low-income housing tax credit program. This alert discusses the qualified contract process, the contract price formula components, as well as state housing agencies' administrative role in this process.

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Year-15 Low-Income Housing Tax Credit (LIHTC) exit strategy

Property owners who want to exit the LIHTC program before the end of the property's lengthy extended low-income housing commitment may consider using the qualified contract process. This process allows an owner, at any time after the 14th year of the 15-year compliance period, to request the state housing agency to find a buyer who will operate the building as an LIHTC property. If the housing agency is unable to find a qualified buyer within a year, the land use restrictions terminate. The owner is free to operate the building at market rate subject to a three year period that caps rents for exiting tenants at the LIHTC rents and prohibits eviction except for good cause.

The IRS received many comments on how to implement the qualified contract process and, in particular, how to apply the qualified contract price formula. After considering these comments, the IRS final rules explain how the qualified process works and the requirements owners and state housing agencies must follow.

What is a qualified contract?

A qualified contract is a contract to acquire the LIHTC building for a price computed under a formula described in the section 42 statute and regulations. The formula breaks out the components of the building into a low-income portion and a non low-income portion.

Under the formula, the non low-income portion of the building is valued at fair market value. The value of the low-income portion is an amount not less than the sum of the outstanding debt, adjusted investor equity, and other capital contributions. This amount is then reduced by cash distributions from the project. Adjusted investor equity is the amount of cash invested in the project increased by an annual cost-of-living adjustment. The IRS final rules provide a mathematical formula to compute the adjuster investor equity.

The IRS rules explain in more detail other components of the purchase price formula that we will discuss below.

Qualified contract price formula components

Low-income portion price

Some commentators thought that the price of the low-income portion of a building should be capped at fair market value. The adjusted investor equity amount, which could possibly increase based upon the consumer-price-index-based cost-of-living adjustment, could inflate the formula price above the fair market value of a project. As was the case under the proposed rules, the IRS did not adopt this suggestion in the final rules. The language of the section 42 statute itself requires that the low-income portion purchase price cannot be less than the formula price.

Also, the IRS made it clear in the preamble to the final rules that state housing agencies have no authority under the qualified contract rules to adopt a fair-market value cap for the low-income portion of the building.

Non low-income portion price

The proposed rules allowed state housing agencies to reduce the price of the non low-income portion of the building below the fair market value if, after a reasonable period of time within the one-year offer-of-sale period, no buyer has made an offer or market values decline. Commentators thought it unfair to grant the agencies a unilateral right to reduce the contract price. They were also concerned that such a rule might encourage potential buyers to wait out the qualified contract process until the agency lowers the price.

The IRS agreed that these were valid concerns. Consequently, the final rules allow a state housing agency to adjust the fair market value of the non low-income portion of the building only with consent of the owner. If no agreement can be reached between the parties, the fair market value determined at the time of the agency's offer of sale of the building to the general public remains unchanged.

Land

Despite some commentators' view that the land is not explicitly mentioned in the purchase price formula, the final rules include the value of the underlying land in the qualified contract formula. Thus, the fair market value of the land underlying the entire building, taking into account the existing and continuing LIHTC restrictions, is included in the value of the non low-income portion of the building. The IRS reasoned that land is inherently part of the LIHTC project. Also, this approach is consistent with industry standards for valuing land.

Any adjustments to the qualified contract price between the date the sale price is first determined and the closing date due to adjustments to outstanding debt, is the responsibility of the buyer and owner, and not the housing agency as was originally provided for under the proposed rules.

Cash distributions and outstanding debt

With respect to project reserves, the final rules clarify that cash distributions only include reserve funds not legally required by mortgage restrictions, regulatory agreements, or any third-party contractual agreements that remain with the building following the sale of the building.

Also, debt from refinancings or additional mortgages in excess of qualifying building costs does not qualify as outstanding debt. The IRS rules define qualifying building costs generally as costs that go into the eligible basis of the building plus these types of costs that may be incurred after the end of the first year of the credit period. Some commentators argued that these debt limiting rules go beyond the scope of the statutory formula. They note the right of first refusal purchase price formula provision in which Congress explicitly excluded certain debt incurred in the five year period prior to the sale to the tenants. No such limiting language exists under the qualified contract purchase price formula.

Commentators also questioned the rationale for the requirement in the proposed rules that would discount outstanding debt having an interest rate below the AFR. The final rules remove the provision altogether. Instead, outstanding debt includes only those amounts secured by the building that do not exceed qualifying building costs, are true debt under federal income tax law, and upon the sale of the building, are actually paid to the lender or are assumed by the buyer as part of the sale.

Appraiser standards

As with the proposed rules, the final rules do not adopt any specific methodology or standards for appraising the LIHTC property. However, they do prohibit appraisers currently on any list for active suspension or revocation for performing appraisals in any state or listed on the Excluded Parties Lists System (EPLS) maintained by the General Services Administration for the United

States Government. Agencies have discretion to select the appraisers involved in the qualified contract process and to require all appraisers to be state-certified general appraisers.

Actual offer of sale

The IRS seemed reluctant to place too many restrictions on the state housing agencies' ability to enter into contracts or to provide any conflict resolution process, where the parties may disagree over the terms and conditions under the contract. Citing to the variations of contract law that exists from state to state concerning the terms of a bona fide contract and methods for resolving disputes, the IRS concluded that final rules should not explicitly address these issues. Instead, the final rules allow the state housing agencies to specify other conditions applicable to the qualified contract consistent with section 42 and the final rules.

Administrative discretion and responsibilities of the state housing agencies

The final rules allow the state housing agency to establish reasonable requirements for written qualified contract requests. Failure to follow these requirements could ultimately suspend the one-year qualified contract period to find a qualified buyer.

Examples of agency administrative discretion include—

- Concluding that the owner's request lacks essential information and denying the request until such information is provided.

- Refusing to consider an owner's representations without substantiating documentation verified with the agency's records.

- Determining how many, if any, subsequent requests to find a buyer may be submitted if the owner has previously submitted a request for a qualified contract and then rejected or failed to act upon a qualified contract presented by the agency.

- Assessing and charging the owner certain administrative fees (for example, real estate appraiser costs).

Now that the qualified contract rules have been finalized, they will hopefully provide some consistency in the implementation of the qualified contract process throughout the country as between owners and the state housing agencies.

PDF

Front Street Apartments Chronology

1999: **SunAmerica Affordable Housing Partners** develops an Environmental Assessment proposing the development of the 142-unit Front Street Apartments on 8.7-acres of land bordering Kenui and Front streets. It proposes a low-income housing project on 3900 Corporation land, with links to the nonprofit Weinberg Foundation. The assessment includes a plan to convert a pre-school into a learning center/telemedicine center and provide three separate recreational areas on an acre of land — including two "tot lots."

2001: The Maui County Council places SunAmerica and other partners, including the Front Street Affordable Housing Partners, on a "fast track" to approve the project and provides millions of dollars in benefits. 1) Rezoning .8 acres of land from residential to apartment within the site 2) Waiving the donation of 1.5 acres of park land 3) Waiving requirement of requiring the utilities to be placed underground along Kenui and Front streets. 4) Effectively placing Front Street Apartments on the list of nonprofits that do not pay property, taxes 2001-2017. 5) Qualifying Front Street Affordable Housing Partners and other project investors to up to more than $1.5 million in federal and state tax credits.

The developer promises to provide low-income housing for individual and families earning up to 60 percent of the median income under a standard develop by the federal Housing and Urban Development agency. Front Street Affordable Partners assumes the role of the developer. Tenants say they received assurances that the project will continue to at least 2051.

2007: The Affordable Housing Tax Credit Coalition, which includes original developer **SunAmerica**, supports changing IRS tax laws to enable investors to sell their low-income housing projects after 14 years in service. Government agencies and groups are wary of the proposal and some question whether the proposed tax change exceeds the scope of the enabling legislation, H.R. 3299 as outlined on page 98.

2012: The IRS issues its final regulations amending the tax code, allowing investors to sell their low-income housing project after the 14th year of service. The changes are done under IRS section 42(h)(6)(F) and published in the Federal Register (72 FR 33706)

2017: Front Street Affordable Housing Partners moves to converting the 142-unit Front Street Apartments into market priced units as early as Aug. 4, 2019, raising complaints from its tenants. State Sens. Rosalyn Baker and Gil Agaran introduce a bill to condemn and buy the property, in light of the public interest. The bill is deferred in the House-Senater conference committee, pending negotiations with the owners. Negotiations break off once the legislative session is ended. The National Housing Low Income Coalition said several states are being affected by the IRS amendment. Residents continue a petition drive to ask their state Legislators and Maui County Council member to support state Senate Bill 1266 or similar legislation.

Low-income renters fear they'll be priced out of Lahaina complex

Honolulu Star-Advertiser · 30 Oct 2017 · By Gary T. Kubota Star-Advertiser staff

LAHAINA >> Disabled couple Reuben and Rhonda Pali worry they'd have no place to live and would have to close their part-time after-school music business for children if their home in a 142-unit low-income housing project is converted to market-priced rentals.

"I wouldn't know where to go," said Reuben Pali, a Native Hawaiian who can trace his roots in the region back to the early 1800s.

Some 300 low-income residents at Front Street Apartments effectively face eviction under what they call an "IRS loophole" that enables the property to be converted to market-priced units after 15 years in service.

Under the IRS amendment, tenants have until Aug. 4, 2019, before their rents are raised to marketprice levels. Building owner Front Street Affordable Housing Partners has begun raising rents at vacated units.

To prevent the rent hikes, some Hawaii legislators, including Sen. Rosalyn Baker (D, West Maui-South Maui) proposed Senate Bill 1266 in 2017 authorizing the state and county in a partnership to buy Front Street Apartments through negotiation or condemnation. The bill was held in a Senate-House

conference committee.

State Rep. Angus McKelvey (D, Lahaina-KaanapaliHonokohau) said he and other lawmaker want to see the bill or similar legislation passed in 2018.

The problem is not unique to Hawaii. Ed Gramlich, senior policy adviser to the Washington, D.C.based National Low-Income Housing Coalition, said foreclosures of low-income housing have been a problem also in Ohio, Pennsylvania, New Jersey, Michigan and Florida. He said his coalition and legal aid advocates in local communities have written to the IRS, urging the agency to issue clearer rules and guidance to states.

The Lahaina landowner, 3900 Corp., a Weinberg charitable trust affiliate, was unavailable for comment, and the building owner, Front Street Affordable Housing Partners, which has a 50-year lease on the land, declined to comment.

Reuben Pali, 50, who was disabled in a car accident, and his wife, Rhonda, 47, who has fibromyalgia, said they pay $840 a month in rent for a one-bedroom unit at Front Street Apartments. A one-bedroom apartment was recently rented to a new tenant at the marketprice rate of $1,700, so their rent will likely more than double in less than two years.

"That's before paying for electricity and water," Pali said. "It's all commercialized in Lahaina, so landowners jack up the prices. Everything is sky high."

Rhonda Pali said she and her husband have started a business teaching guitar, piano, ukulele, violin, singing and music theory to about 30 children, ages 5 to 12, although neither is able to work full time.

She said Reuben, who broke his back in the car accident, has recovered enough to walk but occasionally uses a brace and crutches.

"He has to be careful. He can't work a whole day," she said.

Tourism industry workers in resort areas like Lahaina have faced a housing dilemma for years.

In West Maui, where food service employees earn about $1,960 a month before taxes, many work at more than one job. The average monthly rent for a studio in Lahaina is

$1,375, according to rentcafe.com.

Some workers live on the edge of homelessness, sometimes staying with friends and family or wherever they can park their vehicles at night.

At Front Street Apartments, residents pay

$758 to $923 for a studio and as much as $1,161 for a two-bedroom unit.

The tenants group said 75 to 80 percent of the apartment's adult occupants work, but many of them are in low-paying positions characteristic of a tourism economy, including salon workers, landscape employees, maids, condominium cleaners, taxi drivers, waiters, busboys, store clerks, part-time construction workers and entertainers. The others are retirees and disabled, including veterans.

County exemptions

In September 1999 developer SunAmerica Affordable Housing Partners Inc. proposed building the 142unit low-income housing complex on 8.73-acres of land owned by 3900 Corp.

A 1997 market study done for SunAmerica said the cost of homeownership in West Maui was high, forcing many to rent, including the majority of the tenants who work in the visitor industry and can't amass the down payment to purchase a home.

The Front Street Apartments project was approved as a "fast track" housing project by the Maui County Council on Nov. 5, 1999.

Sunamerica asked for and received a number of exemptions from Maui County because its project was a low-income housing development. A portion of the site was rezoned from residential to apartment, and the number of required parking stalls was reduced by 25 percent.

Maui County also waived requiring the developer to provide 1.5 acres of land for public park purposes and placing off-site utility lines underground along Kenui and Front streets.

Under a government incentive program with help from the state Housing Finance and Development Corp., the project qualified to receive more than

$1.5 million.

Since it went into service in 2001, the building and land owners have been charged virtually no land and building taxes.

Federal tax

In 2012 the IRS revised its tax code to help in the resale of low-income housing before the end of its projected life.

In the case of Front Street Apartments, the projected life was 50 years.

A supporter of the revision was the Washington, D.C.-based Affordable Housing Tax Credit Coalition, a national investors-lenders associated group that includes SunAmerica Affordable Housing Partners, the original developer of the Front Street Apartments.

The coalition supported giving the investors an opportunity to offer for sale the low-income housing property under certain conditions.

In a letter to the IRS, the coalition said if investors had no opportunity to recoup their investment or benefit from the potential appreciation of the property during an extended period, then they would be less likely to provide capital or as much capital.

Hawaii appleseed attorney Victor Geminiani, representing tenants, said the developers claimed in 2015 — when they first asked for deregulation — that the property was worth

$8.6 million. But in their recent testimony opposing SB 1266, they claimed the current value — after the removal of the affordability requirements — was between $31 million and

$47 million.

Geminiani said political leaders need to act now if they want to prevent homelessness and a loss of affordable housing.

"Our political leaders in both the county and the state are going to have to develop a concrete plan to acquire this property," he said.

Front Street Apartments tenant Marialejandra Pocatera said she and her 6-year-old son could become homeless if the low-income apartment building is able to go through with its plans for a rental increase.

"There is no place for me to relocate in West Maui," said Pocatera, a survivor of domestic violence who works in a beauty salon and also as an acrobat at a hotel luau. "I appeal to the common sense and compassion of all decision-makers."