Establishing and Maintaining Compliance in the LIHTC Program

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Part One

Year 1
Establishing Compliance at an LIHTC Project
Placed in Service Dates
Placed in Service Dates

Once a unit is placed in service (PIS), it has the potential to produce an LIHTC.

Once a unit is in service a full calendar month, it can begin producing an LIHTC when occupied by an LIHTC-qualified resident.
Example

A unit can begin to produce an LIHTC in:

- **April**, if it was PIS on March 31st and occupied by a qualified resident by April 30th

- **April**, if it was PIS on April 1st and occupied by a qualified resident by April 30th

- **May**, if it was PIS on April 2nd and occupied by a qualified resident by May 31st
PIS Dates cont’d

☐ All units in the same building usually have the same PIS date

☐ Each building has its own PIS date

☐ State begins monitoring a building for compliance as of its PIS date

☐ Owner’s record keeping requirements begin on the PIS date
The Minimum Set Aside
Minimum Set Aside Options

- **20% at 50%**: 20% of the units in a project reserved for residents with income at or below 50% of the AMI

- **40% at 60%**: 40% of the units in a project reserved for residents with income at or below 60% of the AMI (25% @ 60% in NYC)
The minimum set aside establishes the minimum number of LIHTC units an owner needs for a project to produce the minimum possible tax credit.

It also establishes the income limit the owner uses to qualify households for the LIHTC program.
Minimum Set Aside cont’d

- Once an owner commits to a minimum set aside, it is irrevocable

- An owner must meet the requirements of the minimum set aside by the end of the first year of the credit period and remain in compliance with it throughout the compliance period
The Credit, Compliance, and Extended Use Periods
Credit Period vs Compliance Period

- An owner must meet the requirements of the minimum set aside by the end of the first year of the credit period and remain in compliance throughout the compliance period.

- An owner cannot begin a building’s credit period unless the project it is a part of is in compliance with its minimum set aside.
The Credit Period

- A building’s credit period lasts for **10 years**
- It typically begins the same year as the building’s PIS date
- An owner may elect to begin the credit period the year following the PIS date
The Compliance Period

- An owner must comply with all federal requirements of the LIHTC program for **15 years**

- Year 1 of the credit period is year 1 of the compliance period

- An owner may take their tax credits during the 10 year credit period but it takes 15 years for them to actually earn the tax credits each building produces
The Extended Use Period

☐ An owner must sign a regulatory agreement with their HFA agreeing to continue to operate their project as an affordable property for at least **15 additional years after the end of the 15 year compliance period**

☐ An HFA’s compliance requirements may be less restrictive for an LIHTC project once it enters year 16
The Credit Allocation and the Applicable Fraction
The Credit Allocation

- In most LIHTC projects, tax credits are allocated by building.
- That is, tax credits are allocated, calculated and taken on their federal tax returns by the investors by building.
- Each building has its own building identification number (BIN) assigned by the HFA.
A manager must know the size of each building’s credit allocation to plan its lease-up.

It is the managers goal that the percentage of each building occupied by LIHTC residents be at least equal to the size of its credit allocation.

At a 100% LIHTC project, the credit allocation covers all the units in all the buildings included in the project.
Applicable Fraction

- The applicable fraction (A/F) is that portion of a building occupied by LIHTC qualified residents

- An owner calculates the A/F separately for each individual building – BY BIN

- It is an owner’s objective is to maximize a building’s tax credit potential
Applicable Fraction Calculation

☐ Applicable Fraction is always **the lesser of**:

- **Unit Fraction**: % of units occupied by tax credit eligible residents

- **Floor Space Fraction**: % of square feet occupied by tax credit eligible residents
A/F Example - 1

- Single Building 100 Unit Project
- 20% @ 50% Set Aside
- 70% Tax Credit Allocation
- Owner needs 20 LIHTC units to meet the minimum set aside
- Owner wants 70 LIHTC units by the end of the first year of the credit period
A/F Example – 1 cont’d

- The owner needs 70% of the units and 70% of the floor space occupied by LIHTC residents by the end of the first year of the credit period.

- If the building’s units cover 80,000 square feet, and the owner needs a 70% applicable fraction, 70 units covering 56,000 (80,000 x 70%) square feet must be rented to LIHTC residents by the end of year one of the credit period.
Applicable Fraction cont’d

☐ The owner must calculate a building’s applicable fraction at the end of each year of the compliance period

☐ When making their leasing and occupancy decisions during the 15-year period, an owner must maintain a building’s applicable fraction at the level necessary to produce the anticipated annual tax credit
Year One of the Credit Period
Importance of Year 1 of the Credit Period

- A manager must know when their owner plans to start the credit period for each individual building in an LIHTC project.

- When an owner leases each unit the first time to an LIHTC-qualified resident sets:
  - The value of the credits for year 1 of the credit period; and
  - The potential value of the credits for the entire credit and compliance periods.
First Year Averaging Convention

- The building produces a tax credit for the first year of its credit period based on its applicable fraction as of 12/31 of year one.

- Additionally, during the first year of its credit period, the owner must calculate a building’s applicable fraction on a monthly basis.
First Year Averaging Convention cont’d

- The owner must split the tax credit the building produces for year one between their tax return for year one and their tax return for year eleven.

- The portion of the first year’s tax credit the owner may take on the first year’s return is calculated using the average applicable fraction for the months in year one.
First Year Averaging Convention cont’d

- The portion of the first year’s tax credit the owner is unable to take on their tax return for year one they take on their tax return for year eleven
First Year Averaging Example

50 unit, 100% LIHTC building, PIS date of July 15, 2011

A/F = 0% for Jan – July 2011
A/F = 20% on August 31, 2011
A/F = 40% on September 30, 2011
A/F = 80% on October 31, 2011
A/F = 100% on November 30, 2011
A/F = 100% on December 31, 2011

Average A/F = 28.33% \( \frac{(20\% + 40\% + 80\% + 100\% + 100\%)}{12 \text{ months}} \)
First Year Averaging Example cont’d

Estimated annual tax credit = $450,000

Estimated tax credit taken on the first year’s tax return = $127,485 ($450,000 x 28.33%)

Estimated tax credit left for the 11th year’s tax return = $322,515 ($450,000 - $127,485)
The Two-Thirds Rule

- If an owner does not meet the targeted A/F by the end of 1st year of the credit period, s/he should continue to try to rent maximum number of tax credit units to LIHTC-qualified residents.

- However, units first rented to LIHTC-qualified residents after the first year of the credit period generate 2/3 the annual credit they would have produced if first rented to an LIHTC resident during year one.
Two-Thirds Rule Example

Building allocated 9 tax credit units.
Each unit will generate a $6,000 credit
if rented during year 1

9 units x $6,000 = $54,000 = projected annual tax credit

The owner is expecting a total tax credit of $540,000
($54,000 x 10 yrs)

The owner rents 6 units during year 1
but doesn’t rent 3 units until year 2
Two-Thirds Rule Example cont’d

6 units x $6,000 = $36,000 = tax credit for year 1

(6 units x $6,000) + (3 units x $4,000) =
$36,000 + $12,000 = $48,000 = tax credit for year 2

Building produces an annual credit of $48K years 2 – 10

Building produces an annual credit of $12K years 11 - 15

Owner’s total tax credit will be $528,000 ($36,000 + $432,000 ($48,000 x 9 yrs) + $60,000 ($12,000 x 5 yrs))
Importance of Partnership Agreement

- Governs the relationship between the developer and their investor(s)

- The investor is often represented by a syndicator whose job it is to find and protect the interests of the investors

- Investor establishes conditions under which they will forward equity contributions to the developer
Details how much less the investors will contribute if it fails to produce the LIHTC they expected for year one of the credit period.

Describes how the developer is required to compensate the investors if an incidence of noncompliance during the 15-year compliance period causes the loss or recapture of LIHTC

Management company may be required to compensate developer for loss
Importance of the HFA

☐ A state HFA must inspect an LIHTC project within 2 years of an owner placing a project’s last building in service and then every 3 years

☐ The HFA must inspect 20% of the units and resident files

☐ They notify the owner if they find an incident of noncompliance
Importance of the HFA cont’d

- The HFA must review the initial tenant income certification, its supporting documentation, and recent recertification activity in the resident files.

- An HFA may use local codes or HUD’s Uniform Physical Condition Standards (UPCS) as their protocol for completing physical inspections for LIHTC projects.
Importance of the HFA cont’d

- They allow an owner a correction period, typically 30 to 90 days, to correct the noncompliance.

- At the end of the correction period, the HFA must submit a 8823 form notifying the IRS of the noncompliance, even if the owner corrected the noncompliance.
Part Two

Qualifying an Applicant for the LIHTC Program
Two Applicant Eligibility Factors

☐ An applicant must meet **two eligibility tests** to qualify for the LIHTC program

- Household’s annual income must not exceed the applicable income limit

- The household must meet the requirements of the LIHTC full-time student rule
LIHTC Income Limits
A household’s gross annual income must be at or below the income limit established for the project.

A project’s income limit is established in its minimum set aside.
LIHTC Income Limits cont’d

- If an owner commits to the:
  - **20% @ 50%** minimum set aside, the income limit for the low income units at the project is 50% of the AMI
  - **40% @ 60%** minimum set aside, the income limit for the low income units at the project is 60% of the AMI

- When an owner elects to deep rent skew, 15% of their LIHTC units must be rented to households with income below 40% of the AMI
HERA’s Impact on LIHTC Projects

- The Housing and Economic Recovery Act (HERA) of 2008 made statutory changes to how income limits are calculated for LIHTC and bond-financed projects.

- HERA protected owners from rent decreases in 2009 and established a new system for owners to hold their income limits and rents harmless beginning in 2010.
What Is An MTSP?

- A multifamily tax subsidy project (MTSP) is a project financed through the LIHTC and/or tax-exempt bond programs.

- Per HERA, HUD began issuing income limits calculated specifically for MTSPs in 2009.
Full Time Student Rule
Households comprised entirely of full-time students are generally ineligible for LIHTC program.

- Full time student attends school with full-time status for 5 months out of a calendar year and the 5 months need not be consecutive.

- Full time status verified with the learning institution the student attends.
An unborn child is included when qualifying a household under the student rule.

School age children are considered full time students without verification.

Document that a school age child is not a full time student if claimed by the family and their eligibility is dependent on the child not attending school on a full time basis.
Full Time Student Rule cont’d

- Must use the student verification form required by your state housing finance agency

- If everyone in a household is a full-time student, they are ineligible unless the manager documents in writing, in the file, why they should be considered LIHTC eligible
Eligible Student Households

☐ The following 100% full-time student households may be eligible

- All household members are married and file a joint tax return or are eligible to file a joint tax return

- Single parent with at least one child, none of whom are dependents on another person’s most recent tax return except for the return of a child’s other parent
Student Exemptions cont’d

- At least **one** household member:
  - Is a welfare recipient
  - Participates in a federal, state or local job training program
  - Was a foster child during their life time
Calculating Annual Income
Income Overview

- Tax credit managers must use the rules HUD writes for the project-based Section 8 program in the **HUD Handbook 4350.3, Revision 1, Change 3**

- HUD rules list both income inclusions and exclusions

- Knowledge of current HUD income rules is critical to success of tax credit managers
Verification Methods

☐ Direct third party

■ Written

■ Oral

■ Document file if third party verification not possible
Verifications cont’d

☐ Review of documents

☐ Tenant certification

☒ Check HFA acceptance of certifications

☐ May not use information obtained through EIV for the LIHTC program
Verification Timing

☐ Verified information is valid for **120 days**

☐ Once information is over 120 days old, it is no longer usable as part of a tenant income certification

☐ Even if another program providing assistance to a resident requires another timeline, **info cannot be more than 120 days old on the effective date of an LIHTC TIC**
The IRS does not require a specific form to be used as a TIC, or forms to be used to verify a household’s annual income, student status, etc.

The forms an owner is required to use are those issued by their state or city housing finance agency.
Part Three

Qualifying a Unit for the LIHTC Program
Unit Eligibility

☐ Is the unit suitable for occupancy?

☐ Is the unit open for rental by the general public?

☐ Is the rent charged at or below the maximum allowable rent?

☐ Is utility allowance calculated in compliance with tax credit rules?
Maximum Allowable Rent
Maximum Allowable Rent

- Maximum allowable rent is a gross rent
- Maximum allowable rent includes a utility allowance representing the average monthly cost for utilities paid directly by the residents
- Residents keep the utility allowance and pay the remaining portion of the gross rent as the tenant rent
Maximum Allowable Rent cont’d

- Tenant Rent: Actual rent paid to owner by tenant

- Tenant rent equals Gross Rent minus Utility Allowance:

  Gross Rent = $850
  Utility Allowance = -$50
  Tenant Rent = $800
Rent Calculations

- Calculations based on unit size

- Owner assumes family size of 1.5 household members per bedroom & 1 person for a studio or an efficiency

- Maximum allowable rent equals 30% of income limit for imputed family size
Imputed Household Sizes

- Efficiency Maximum Allowable Rent = 30% of the 1 person income limit

- 1 bedroom x 1.5 persons = Maximum Allowable Rent is 30% of the 1.5 person income limit
  - Average the 1 person & 2 person income limits to create income limit for 1.5 people
  - \((1 \text{ person limit} + 2 \text{ person limit})/2 = 1.5 \text{ limit}\)
2 bedroom Maximum Allowable Rent = 2 x 1.5 persons = 3 person income limit x 30%

3 bedroom Maximum Allowable Rent = 3 x 1.5 persons = 4.5 person income limit x 30%

Average the 4 person and 5 person limits to create the income limit for 4.5 people

(4 person limit + 5 person limit)/2 = 4.5 limit
Imputed Household Sizes cont’d

☐ 4 bedroom Maximum Allowable Rent = 4 x 1.5 persons = 6 person income limit x 30%

☐ 5 bedroom Maximum Allowable Rent = 5 x 1.5 persons = 7.5 person income limit x 30% (average the 7 and 8 person income limit)
Example - 1

40% @ 60% minimum set aside
1 bedroom unit with $65 UA

1-person 60% income limit = $22,500
2-person 60% income limit = $24,300

\[
\frac{($22,500 + $24,300)}{2} = \frac{46,800}{2} = $23,400
\]
Example – 1 cont’d

$23,400 = 60% income limit for 1.5 Persons

$23,400 \times 30\% = \$7,020

\$7,020/12\text{ months} = \$585 \text{ (rounded down)}

\$585 - \$65 = \$520 = \text{max tenant rent}
Example - 2

☐ 20% @ 50% minimum set aside
☐ 2 bedroom unit in an Impacted project
☐ Utility allowance = $87
☐ 3-person HERA-special 50% limit = $34,300
☐ $34,300 x 30% = $10,290
☐ $10,290/12 months = $857 (rounded down)
☐ $857 - $87 = $770 = max tenant rent
Housing Choice Vouchers

- Participants are subject to tax credit income limits/eligibility criteria

- Residents on the Section 8 program, or any comparable program pay rent according to the rules of the subsidy program

- Owner may collect total revenue exceeding the tax credit maximum
Part Four

Maintaining Compliance Through the Compliance Period
Maximizing the Value of the Credits

☐ It is always an owner’s goal to maximize the value of their LIHTC allocation. To do so, an owner must:

- Reach a building’s targeted applicable fraction by the end of the first year of its credit period; and,

- Maintain that applicable fraction through the building’s 15-year compliance period
Protecting the Applicable Fraction

☐ To protect a building’s A/F, an owner must:

■ Meet their current requirements for completing annual recertifications;

■ Implement the available unit rule;

■ Properly lease vacant units under the vacant unit rule; and

■ Analyze the impact of a unit transfer under the LIHTC transfer rule
Cost of Non-Compliance

☐ When a unit falls out of compliance:

- During years two through ten, the owner must give back one-third of the LIHTC they have taken for the unit, plus pay penalties and interest

- During years eleven through fifteen, the owner must give back less than one-third (exact calculation depends on the year of noncompliance) of the LIHTC they have taken for the unit, plus pay penalties and interest
Annual Recertifications
Annual Recerts at 100% LIHTC Projects

- Under HERA 2008, owners of 100% LIHTC projects not required to complete annual recerts
- Remember that a project is defined on Line 8b of a building’s 8609 Form
- Every building included in a project must have reached 100% LIHTC occupancy for the owner to be exempt from doing recertifications
Owners must require every household sign the full-time student certification form annually on the anniversary of their initial cert effective date.

Some HFAs have additional annual requirements.

Owners may still need to do annual recerts to meet the requirements for other programs providing assistance to the project or the residents.
Annual Recerts at Mixed Income Projects

- Owners must recertify LIHTC residents annually
- The rules for calculating and verifying annual income are the same for a recertification as for an initial certification
- The difference between an initial certification and an annual recertification is the income limit used
140 Percent Rule

- Owner must compare current family income to 140% of current income limits.

- If family income is at or below 140% of current income limits, family remains eligible for tax credit program.

- Referred to as 140% Rule.
Recertification Schedule

☐ The effective date of the initial certification is the date the tenant occupies the unit

☐ Owner must complete a recertification annually based on the anniversary of the effective date

☐ The recertifications must be completed within 120 days before the effective date for each year of the compliance period
The Available Unit Rule
Available Unit Rule for Mixed Income Projects

☐ It is a Building Rule

☐ If resident is over income at recert., unit remains in Applicable Fraction if:
  
  ■ Owner charges over income family no more than the tax credit rent

  ■ Owner rents available unit of comp/smaller size to credit eligible tenant

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Available Unit Rule cont’d

- Owner must rent all smaller or comparable sized units to eligible families until applicable fraction restored.

- Owner may have to rent multiple smaller units to replace larger unit in Applicable Fraction, including previously market rate units.
Vacant Unit and Transfer Rules
Vacant Unit Rule

- A unit cannot count toward the minimum set aside or applicable fraction until leased at least once to an eligible low income family.

- If unit is vacated after being occupied by an eligible low income family, the owner can implement Vacant Unit Rule and the unit continues to generate a tax credit.
Vacant Unit Rule

Vacant unit remains eligible if a:

- Unit is suitable for occupancy; and

- Owner takes reasonable marketing steps to fill the unit with an eligible, low income family
Transfers at 100% LIHTC Projects

- Residents of 100% LIHTC projects, where a household’s current income is not known, can transfer between buildings within the same project.

- Remember a project is defined on Line 8b of a building’s 8609 form.
Transfers at Mixed Income Projects

- Residents may transfer within the same building without requalifying for the LIHTC program.
- 2 units involved in the transfer swap their status.
- Must check the impact on the A/F before approving the transfer.
Transfers at Mixed Income Projects cont’d

- Residents may transfer *between buildings in the same project if their income is not more than 140% of their income limit*

- 2 units involved in the transfer swap their status

- Must check impact on both building’s A/F before approving the transfer
Questions

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