Introduction

This Low-Income Housing Tax Credit Compliance Manual (the "Manual") is intended to provide a basic description and explanation of the rules and regulations to maintain compliance for properties which have received an allocation of affordable housing tax credits pursuant to Section 42 of the Internal Revenue Code (the "Code"). Please note that the Commission's website includes the most up-to-date versions of our compliance manuals, as well as copies of the most recent income and rent schedules used for tax credit units, samples of the most current forms used to collect resident income information, FAQs, and copies of applicable federal regulations issued by the IRS and other authorities.

The Owner is responsible for being aware of all applicable rules and regulations.

The Commission has modified its tax credit policies over the life of the program. This Manual contains a description of the most recent set of rules. Older properties may have slightly different requirements. An Owner is responsible for knowing the requirements that apply to their properties. Each property is assigned a Portfolio Analyst from the Commission's Asset Management & Compliance Division. Questions regarding tax credit compliance for a particular property should be directed to the Portfolio Analyst assigned to the specific property via email or phone. Refer to the list of Portfolio Analysts and Property Assignments on our website at ***wshfc.org/managers*.**

This Manual does not address how to obtain an allocation of tax credits. Persons interested in developing tax credit properties should first consult with their attorney, CPA, or other tax credit advisor, and should contact the Commission's Multifamily Housing & Community Facilities Division (access their website at ***wshfc.org/mhcf***.)

Note: *Virtually every tax credit rule has a variation or exception for specific circumstances. The following overview by necessity oversimplifies some aspects; otherwise, no overview would be possible.* ***It is the responsibility of the property Owner and management company to be aware of applicable rules and regulations affecting the property and to ensure compliance with tax credit regulations and any additional contractual agreements with the Commission.***

Capitalized terms used in this Manual are defined in ***Appendix A, Glossary*** *at the end of this Manual.*

Tax Credit Program Overview

The Low-Income Housing Tax Credit ("LIHTC") was created in 1986 under Section 42 of the Internal Revenue Code to foster the development of affordable multifamily rental housing. The credit is generally referred to as Section 42 credit, low-income housing tax credits, or LIHTC. LIHTC provides equity from the sale of tax credits. The equity funds are used to pay for part of the property development costs. The equity comes into the property from investors as a contribution to the legal entity that owns the property. This entity is typically a limited partnership or a limited liability company, which are legal entities that allow the benefit of the tax credits to flow through to investors. Investors, in turn, use the credit to offset their income tax liability.

Credits are received annually over a 10-year period, while the equity funds are usually contributed during construction or soon after the completion of the property. The price paid for the credit is determined by the timing of the payments to the ownership entity as agreed upon between the Owner or general partner and the investors. The balance of the property costs are paid with conventional mortgage financing and other sources of funds. The trade-off for receiving tax credits is that the Owner must agree that the housing units receiving credit will be restricted to income-qualified Households for a specific period of time and that the rents for these units be capped, following a fixed formula. However, because a large portion of the property costs have been paid from equity, a property is designed so that the restricted rents are sufficient to pay the operational costs and mortgage debt on the property.

The minimum election of 60% or 50% AMGI affects all low-income units within a property.

In return for the tax credits, an Owner must, at a minimum, commit to serve Households earning at or below 60% of the Area Median Gross Income (AMGI) for the county in which the property is located. A minimum of 40% of the units in a property must serve the 60% AMGI residents for the property to be eligible for tax credits. Alternatively, 20% of the units must service Households earning at or below 50% AMGI. These Owner elections are commonly referred to as the 40/60 or 20/50 test. Once the minimum election is made, it is irrevocable and cannot be switched. **The minimum election of 60% or 50% AMGI affects all low-income units within a property.** If the property falls below the minimum threshold limit, it is no longer considered a qualified property and is no longer eligible for credit. In addition, there is a possibility of recapture of credit claimed in earlier years, as well as other penalties.

Since tax credits are only available for property costs associated with the affordable units and not for market-rate units, the economics generally promote properties that are 100% or nearly 100% "*low-income*." Although this is called the "Low-Income" Housing Tax Credit Program, the Commission prefers to use the term "affordable" in place of "low-income."

The term "*affordable*" is used throughout this Manual to describe units with rent and income limits below 60% of AMGI.

Compliance Basics

Tax credits are available for each Qualified Low-Income Housing Unit, which is usually an apartment unit. However, a unit may be part of a duplex, triplex, apartment building or may be a single-room occupancy (SRO) unit, a rented manufactured home or a rented single-family house. Additionally, the term "*property*" includes both multifamily housing complexes and scattered site properties, and the rules apply to affordable units in any configuration that make up a Project.

The fundamental requirement for units to qualify for tax credits is that they must be rented only to income-qualified households and that the rents must be restricted. Generally, a resident's rent plus the utilities s/he pays for his or her unit must not exceed approximately 30% of Household income. In the tax credit program, certain assumptions about Household size are made in calculating the maximum rent level — as a result of these assumptions, a Household may in fact pay more than 30% of their actual income for rent and utilities. A property may have both tax credit units ("affordable units") and market-rate units. The income and restricted rent requirements explained in this Manual only apply to the affordable units. Household income is determined at the beginning of the lease term and is based on the actual number of persons in the Household at the time of initial occupancy and the median gross income for the county in which the property is located. This is known as the "Area Median Gross Income" or AMGI. The rent level is also tied to the AMGI. A more detailed discussion of Household income and rent and how they are determined is discussed in Chapter 4, *Rents & Tenancy Issues* and Chapter 5, *Income and Asset Certification.*

Minimum Low-Income Housing Set-Aside

A property receiving tax credits must meet one of these two basic federal standards:

1. At least 40% of the units in a property must be rented to Households earning 60% or less of the AMGI,

   OR

2. At least 20% of the units in a property must be rented to Households earning 50% or less of the AMGI.

Applicable Fraction

These elections are typically called the 40/60 or 20/50 election or test.

The fraction of low-income use is the lesser of the ratio of affordable units to total housing units (the "Unit Fraction") or the ratio of the floor area of the affordable units to the floor area of all housing units (the "Floor Space Fraction").

Example: *Yurt Apartments consist of a single building with 20 units, as follows: 10 one-bedroom units that are 600 square feet and 10 two-bedroom units that are 1,000 square feet, for a total of 16,000 square feet of housing. The Owner has selected the 20/50 test. To earn more tax credits, the Owner elects to increase the number of affordable units from 20% of all units to 45%.* ***Either*** *of the following results in a 45% affordable use (the* ***lesser*** *of the Unit Fraction or Floor Space Fraction):*

	600 sq. ft 1-Bdrm	*1,000 sq. ft 2-Bdrm*	*Total Units*	*Total Area*	*Unit Fraction*	*Floor Space Fraction*
Affordable:	*7 units*	*3 units*	*10*	*7,200*	*50%*	***45%***
Market:	*3 units*	*7 units*	*10*	*8,800*	*50%*	*55%*
Total	*10 units*	*10 units*	*20*	*16,000*	*100%*	*100%*

	600 sq. ft 1-Bdrm	*1,000 sq. ft 2-Bdrm*	*Total Units*	*Total Area*	*Unit Fraction*	*Floor Space Fraction*
Affordable:	*4 units*	*5 units*	*9*	*7,400*	***45%***	*46.25%*
Market:	*6 units*	*5 units*	*11*	*8,600*	*55%*	*53.75%*
Total	*10 units*	*10 units*	*20*	*16,000*	*100%*	*100%*

Once an Owner makes an election of one of these options, it cannot be changed. The election applies to ***all*** affordable units in the property.

Most Tax Credit Properties are 100% "affordable" units

Example: *Sunshine Apartments consists of 100 units. To maximize credits, the Owner designates all units as affordable units. The Owner has made the minimum 20/50 election. All 100 units must be set aside for Households with incomes at or below 50% of AMGI. If the Owner had elected the 40/60 minimum, all affordable units would be limited to Households with incomes at or below 60% of AMGI.*

Restricted Rents

The rents, including an estimate of resident-paid utilities for affordable units, are restricted for qualified residents living in affordable units. The rents are tied to the income level of the Households targeted, e.g., 50% AMGI or 60% AMGI. Rents are based upon the number of bedrooms in the unit, regardless of the number of persons renting the unit. The Commission provides schedules of the maximum rents by county and income set-asides on our website.

Note that the income and rent limit sets applicable to a property in any given year may not be the most current limits. Make sure to review the Commission's website every year to find the limits which apply to your specific property. Also remember that when there are multiple funders attached to a property, the most restrictive funder's limits are generally required to be used. If your property is eligible to use tax credit limits that are higher than those required by another funder, the Owner must coordinate with the more restrictive funder in order to apply a higher set of limits at a property.

Additional State Rules

An Owner must meet all federal requirements to maintain the tax credits, as set out in the Code and IRS regulations and rulings ***and must also maintain*** commitments and requirements of the initial tax credit application and the Commission's *Program Guidelines* and *Policies*. The commitments applicable to a particular property are identified in the Regulatory Agreement and/or Reservation and Carryover Allocation Contract for the property. **The Exhibit "B" to the Regulatory Agreement provides a Project summary of the various income set-asides and Special-Needs Commitments, and other property specifics.** Check your entire Regulatory Agreement to verify the requirements that apply to your property.

Importance of Regulatory Agreement

Compliance Process Overview

This manual is designed to assist Owners and managers in keeping their properties in compliance with federal and state requirements. Federal requirements are described in Chapter 2. State requirements are described in Chapter 3. A brief outline of the compliance process follows.

Tax Credit Only Properties

- Compliance begins prior to initial lease-up activity. The Owner or property management company representative must attend a compliance training sponsored by the Commission at least 120 days prior to the Placed-In-Service (PIS) date of the first building completed in the property. The Commission encourages property management personnel to attend a compliance training prior to any marketing and pre-leasing activities if these begin earlier than 120 days before the first building is placed in service.

- For new construction, property managers begin qualifying Households within 120 days of building PIS date or temporary occupancy date. Households are then re-certified annually.

- For acquisition/rehabilitation, property managers may begin initially qualifying Households within 120 days of acquisition. Households must be re-certified annually during the rehabilitation period and throughout the term of the Regulatory Agreement.

- Owner receives an allocation of credit on IRS Form 8609 from the Commission for each building in the property. Buildings in the property may PIS in two different years.
- A copy of the first credit year Form 8609, filed with the IRS, must also be sent to the Commission.
- Owner makes election for first year of credit on each building (PIS year or following year).
- Owner must meet minimum set-aside selected (40/60 or 20/50) in the first credit year to claim any credit for the property. The minimum set-aside may be met by building *or* by property at the Owner's election on line 8B of Form 8609.
- Owner must also meet selected "applicable fraction" for affordable units vs. market-rate units (often properties are 100% affordable) during the first credit year to claim credit on additionally set-aside units.
- Owner income-qualifies Households to meet lowest selected federal or state set-aside. Owner may select 50% or 60% level to meet federal requirement and also elect units at 30%, 35%, 40%, 45% or 50% of median income for state requirements.
- Owner may have selected Special-Needs Housing Commitments which are also monitored by Compliance staff. These include commitments for Elderly, Large Households, Disabled, Homeless/Transitional, or Farmworker Households.
- Special-Needs Housing Commitments must be met by the end of the first year that credits are taken for the property.
- Owner must use Commission-approved forms to qualify Households.
- Annually, Owner completes the *Owners Annual Certification (formerly called the CCPC Part A)*, Table 1, and Table 4, all of which provide summary data on all units in the property. Tables 1 and 4 must be submitted using the Web-Based Annual Reporting System (WBARS).
- Owner provides copies of Household certification packets (which include all verification forms) as requested by the Commission.
- Within the first year or following year after buildings PIS, and at least every three years thereafter, the Commission conducts on-site visits of the property. Portfolio Analysts will visit with the on-site/property

manager; randomly inspect 20% of all units; and inspect all vacant units, common areas and building exteriors.

- Portfolio Analysts will request copies of certification packets for all units inspected during the on-site visit to complete the file review.
- Portfolio Analysts send letters to Owners to gain clarification of issues noted during on-site inspections and during reviews of annual reports and Household certification packets.
- Owners are given time to correct issues during a provided "correction period" noted in correction letters which are issued by the property's Portfolio Analyst.
- Non-compliance issues are reported to IRS by the Commission on Form 8823. Most issues can be corrected but still must be reported to the IRS. IRS determines penalties, if any, on a case-by-case basis, and notifies the Owner directly.
- Any transfers of ownership that occur during the Compliance Period must be approved by the Commission.
- Owners are required to notify the Commission of any other significant changes to the property such as health, building or safety code violations, Fair Housing violations, or notices and changes in management or on-site personnel.

Tax Credit Properties with Tax-Exempt Bonds

Properties may receive an allocation of credits (without going through the competitive process) by financing at least 50% of the property with tax-exempt bonds. These properties receive a proportionally smaller allocation of credits than tax credit-only properties and generally have higher rent and income limits (50% to 60% of median versus 30-60% on tax credit-only properties). Properties with tax-exempt bonds are described further in ***Chapter 8, Tax-Exempt Bonds***.

In addition to above-mentioned Compliance requirements, properties with tax-exempt bond financing must also:

- Meet the selected federal set-aside (20/50 or 40/60) within one year of bond closing and every year thereafter on acquisition/rehabilitation properties.
- Owner must meet all selected set-asides and Commitments. Bond set-asides are income-restricted only; if tax credits subsequently are

obtained, the units must be rent- and income-restricted. The Owner may have selected different federal minimum set-asides for bonds and tax credits, and may have different state set-asides selected. The most restrictive requirements should always be used. Property managers should have copies of both Regulatory Agreements.

- Issues of non-compliance for bond requirements are reported to the bond trustee rather than the IRS until tax credits are taken.
- Properties with Commission-financed tax-exempt bonds combined with tax credits will have two Regulatory Agreements. Generally, the tax credit requirements will be more restrictive than tax-exempt bond requirements. For more information on bonds, review the Bond Compliance Procedures Manual online at ***wshfc.org/managers/ManualBondIndex.htm*****,** and check your bond Regulatory Agreement. Also review the primary differences between the two programs by consulting Appendix L***, Differences between Bonds and Tax Credits*** at the end of this Manual.