

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 limit schedules provided by HUD, samples of the most current forms used to collect resident income information, FAQs, and other guidance.

The Commission has modified its tax credit compliance rules over the life of the program. This Manual contains a description of the most recent set of rules. 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.

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

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.

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.

In return for the tax credits, an Owner must, at a minimum, commit to one of the following elections:

1. 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. This election is known as the 40/60 test.
2. To serve Households earning at or below 50% of the AMGI for the county in which the property is located. A minimum of 20% of the units must serve Households earning at or below 50% AMGI. This election is known as the 20/50 test.
3. To serve Households at varying AMGI levels (between 20% and 80%) by ensuring at least 40% of the assigned unit AMGIs average at or below 60% AMGI. This election is known as the Average Income test.

Once the minimum election is made on the Owner’s Form 8609, it is irrevocable and cannot be switched. If the property falls below the minimum threshold, 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.

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

Compliance Basics

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% income- and rent-restricted.

The term “*affordable*” is used throughout this Manual to describe properties where 100% of units (excepting any Common Area Units) are income- and rent-restricted.

Any properties with both income- and rent-restricted units AND Market Rate units are known as “mixed-income” properties.

Tax credits are available for each Qualified Low-Income Housing Unit. Additionally, the term “*property*” includes both single site housing complexes and scattered site projects (i.e. project with more than one non-contiguous tax parcel) , 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. 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, or alternately, the “Area Median Income” (AMI). The rent level is also tied to the AMGI. A more detailed discussion of Household incomes and rents 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 commit to one of these three basic federal elections:

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

OR

Applicable Fraction

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

OR

3. At least 40% of the units in a property must have AMGIs which average at or below 60% AMGI.

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):*

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

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

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.

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.*

*Most Tax Credit
Properties are 100%
“affordable” units*

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. 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 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

Importance of Regulatory Agreement

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.

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 prior to the completion of the project (i.e., the last building placing in service). The Commission encourages property management personnel to attend a compliance training prior to any marketing and pre-leasing activities if these begin prior to the first building placing in service.

- ◆ For new construction, property managers begin qualifying Households within 120 days of building PIS date or temporary occupancy date.
- ◆ For acquisition/rehabilitation, property managers may begin initially qualifying Households within 120 days of acquisition.
- ◆ 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. Properties that have elected Average Income may qualify Households at any AMGI between 20% and 80% (increments of 10 only), as long as the property-wide (or BIN-wide, depending on the 8609 elections) average of AMGIs does not exceed 60% AMGI.
- ◆ Owner may have selected Special-Needs Housing Commitments which are also monitored by the Commission. 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*, Table 1 (Tenant Activity), Table 4 (Operational Income and Expenses) and Table 5 (Extended Vacancy and Rent Ready Report), all of which provide summary data on all units in the property. Tables 1, 4 and 5 must be submitted using the Web-Based Annual Reporting System (WBARS).
- ◆ Owner provides copies of Household certification packets (which include all required verification forms) as requested by the Commission.
- ◆ During the following year after the last building places in service, and every three years thereafter, the Commission (either Commission staff or the Commission's designee) conducts on-site visits of the property.
- ◆ The inspector will visit with the manager and other site staff; randomly inspect between 10%-20% of all units; and inspect common areas and building exteriors.
- ◆ Portfolio Analysts will request copies of certification packets for specific units after the on-site visit to complete the file review.

- ◆ Portfolio Analysts send deficiency letters to Owners to alert the owner/manager to deficiencies noted during on-site inspections and during reviews of annual reports and Household certification packets.
- ◆ Owners are given time to correct issues during a specified “correction period” noted in correction letters which are issued by the property’s Portfolio Analyst.
- ◆ During the federal compliance period, non-compliance issues are reported to IRS by the Commission on IRS Form 8823. Most issues can be corrected but may still need to 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 entire Regulatory Period (both federal and state periods) 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 4% credits by financing at least 50% of the property with tax-exempt bonds. These properties receive a proportionally smaller allocation of credits than 9% tax credit-only properties and generally have higher rent and income limits. 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 bond set-aside (20/50 or 40/60) within one year of bond closing and every year thereafter on acquisition/rehabilitation properties.
- ◆ 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. For more information on bonds, review the Bond Compliance Procedures Manual on our website 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* in this Manual.