Table Read of LIHTC's Average Income Set-Aside

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Background

- The Average Income Test created a new Minimum Set- Aside option for owners to choose on Question 10c under Part II of Form IRS 8609
- Included in Obama Administration budget proposals for FY2012 – FY2016
- Enacted under the Consolidated Appropriations Act of 2018, effective March 23, 2018

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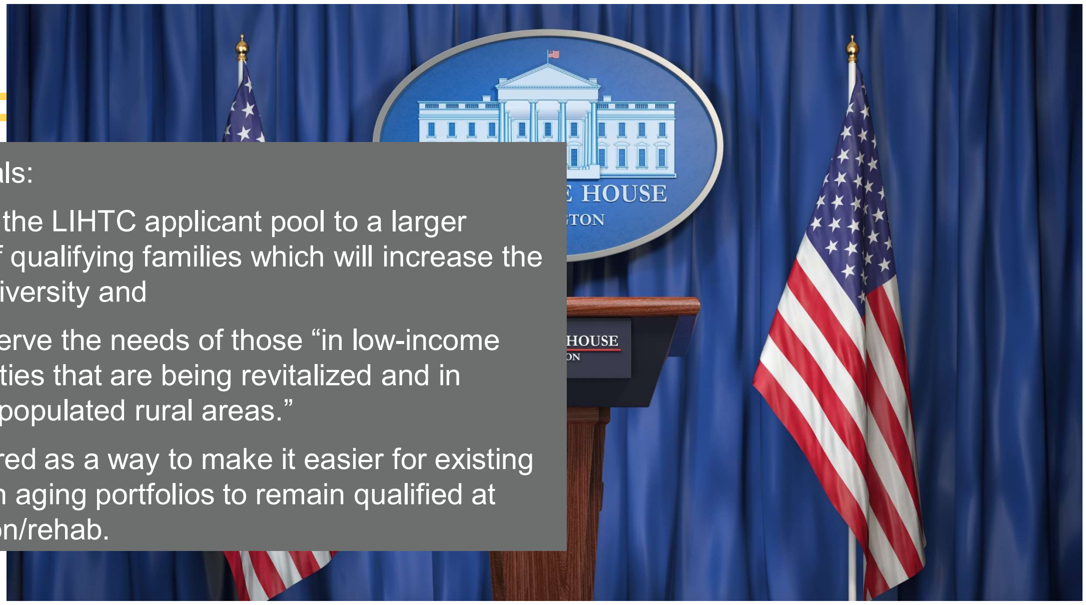
Background



Stated Goals:

- Open-up the LIHTC applicant pool to a larger portion of qualifying families which will increase the income diversity and
- Help to serve the needs of those “in low-income communities that are being revitalized and in sparsely populated rural areas.”
- Also offered as a way to make it easier for existing tenants in aging portfolios to remain qualified at acquisition/rehab.

Minimum Set Asides

Minimum Set Asides *before Average Income*

20/50	20% of the units tax credit qualified by households at or below 50% AMI
40/60	40% of the units tax credit qualified by households at or below 60% AMI
25/60	NYC only

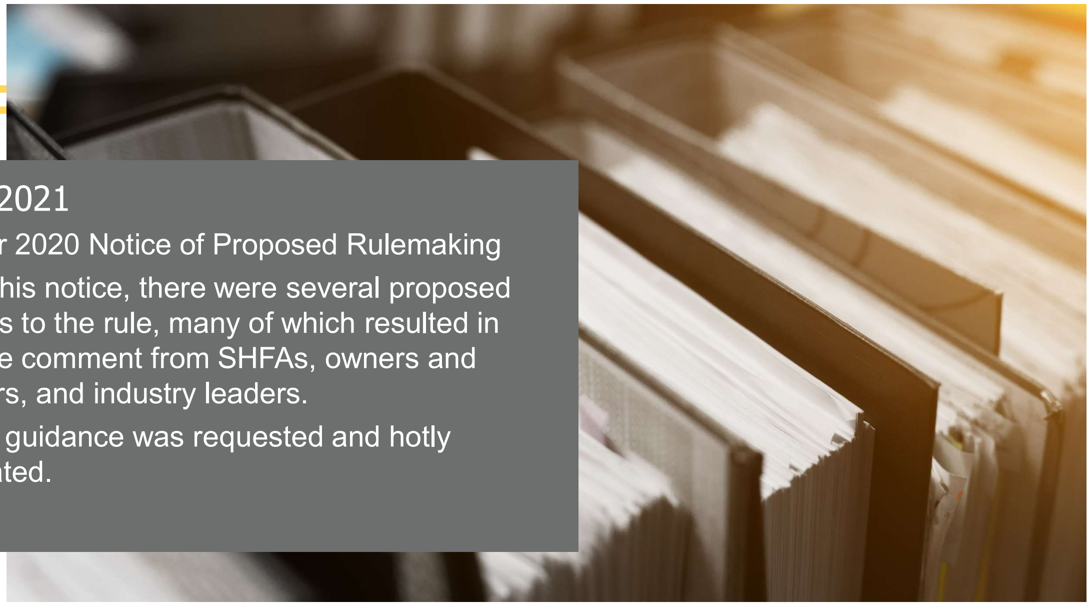
Average Income Test *Introduced in 2018*

40% of the units tax credit qualified by households with income targeting ranging from 20% to 80% AMI* and

The average unit designation is at or below 60% AMI*

*many SHFAs have further restrictions and requirements

Background



2019 – 2021

- October 2020 Notice of Proposed Rulemaking
- Under this notice, there were several proposed changes to the rule, many of which resulted in negative comment from SHFAs, owners and investors, and industry leaders.
- Further guidance was requested and hotly anticipated.

Background

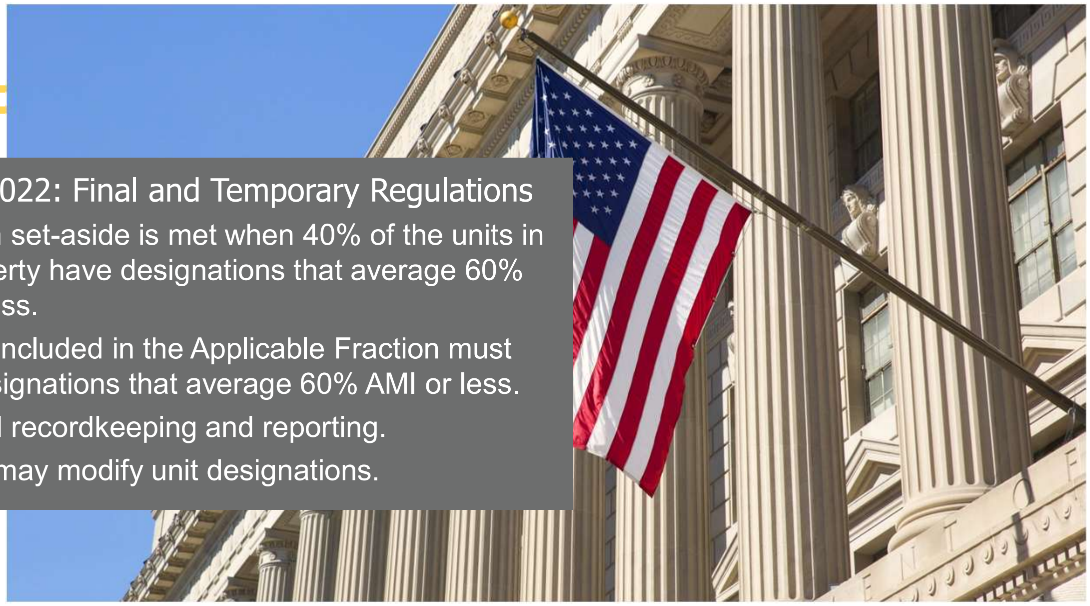
2022

- May 2022: the White House issued a statement that required finalized regulations and needed guidance be issued by the end of September 2022.
- October 2022: Final and Temporary Regulations released.
  - Updates the October 2020 Notice of Proposed Rulemaking.

Background

October 2022: Final and Temporary Regulations

- Minimum set-aside is met when 40% of the units in the property have designations that average 60% AMI or less.
- All units included in the Applicable Fraction must have designations that average 60% AMI or less.
- Required recordkeeping and reporting.
- Owners may modify unit designations.



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Unit Designations

A taxpayer must identify:

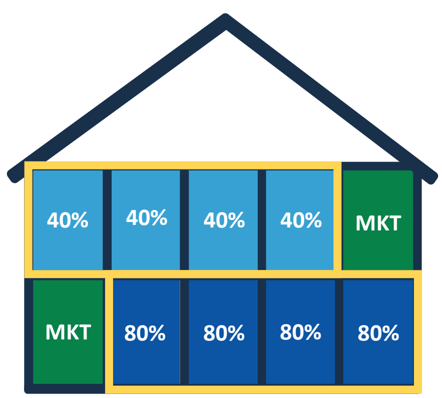
(1) The units in the qualified group of units that satisfy the **Average Income minimum set-aside** (at least 40 percent of total units) and

(2) The units in the qualified group for purposes of the **Applicable Fraction**.

Temporary regulations require that this be done by recording identifications in the taxpayer's **"books and records and communicating that information annually to the state Housing Credit agency."**

- The annual reporting requirements are similar to other annual certifications required and will be determined by the state agency.

EXAMPLE



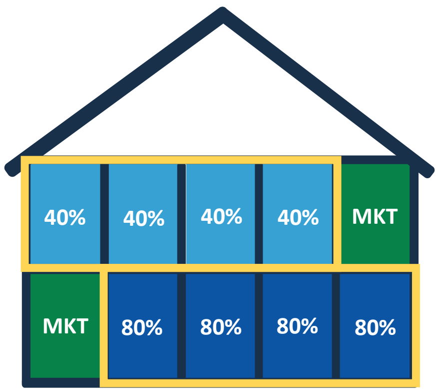
A single-building project has 10 identical units and has elected the Average Income option.

- The unit designations are 40% and 80% AMI.
- The first-year Applicable Fraction is 80%.
- Two units are market rate.
- Eight units are LIHTC
  - Four at 40% AMI
  - Four at 80% AMI

Since 8 out of 10 units are LIHTC qualified. The Applicable Fraction is met.

Does this unit mix meet the minimum set-aside requirement?

EXAMPLE



4 units @ 40% AMI (4 × 40 = 160)

4 units @ 80% AMI (4 × 80 = 320)

160 + 320 = 480

480 / 8 = 60% Average Income

These units need to be recorded to show the average unit designation is at or below 60% AMI and the applicable fraction is met.

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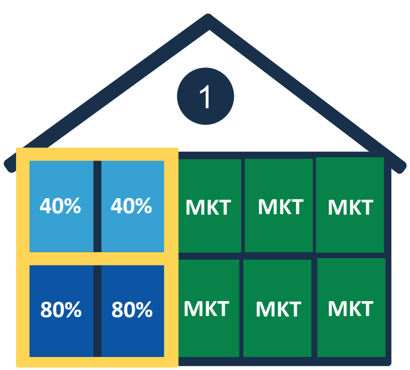
EXAMPLE: TWO DESIGNATIONS



40% averaging @ or below 60% AMI

$$\frac{\text{4 tax credit units}}{\text{10 total units}} = 40\%$$

2 units @ 40% AMI (2 x 40 = 80)

2 units @ 80% AMI (2 x 80 = 160)

80 + 160 = 240

240 / 4 = 60% Average

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EXAMPLE: THREE DESIGNATIONS

$$\frac{\text{10 tax credit units}}{\text{10 total units}} = 100\%$$

6 units @ 30% AMI (6 x 30 = 180)

1 unit @ 50% AMI (1 x 50 = 50)

3 units @ 80% AMI (3 x 80 = 240)

50 + 240 + 180 = 470

470 / 10 = 47 Average 47% < 60%

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Unit Designations

- State Housing Finance Agencies determine a process for unit designations and inclusion of such in carryover allocations and the Extended Use Agreement.
- Designation of imputed income limitations--(i) Timing of designation.
  - Before a unit is first occupied as a low-income unit, or is first occupied under a changed income limit, the taxpayer must designate the unit's imputed income limitation.
  - For an occupied unit that is subject to a change, the taxpayer must designate the unit's changed income limitation not later than the end of the taxable year in which the change occurs.

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MULTIPLE BUILDING ELECTION

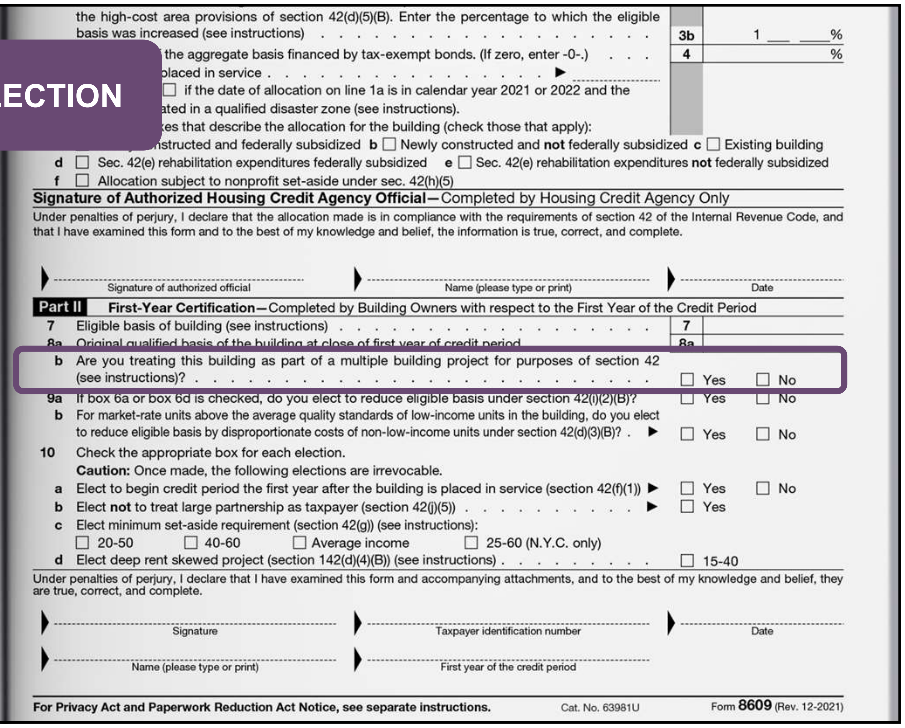
Indicated by owner on Form 8609-Part II, 8b

YES Set-aside measured among multiple buildings

NO Set-aside measured for each building

This election is non-revocable.

Some states require “Yes” on 8b with Average Income option.



the high-cost area provisions of section 42(d)(5)(B). Enter the percentage to which the eligible basis was increased (see instructions) . . . 3b 1____ ____%
the aggregate basis financed by tax-exempt bonds. (If zero, enter -0-.) . . . 4 %
placed in service . . . ▶
if the date of allocation on line 1a is in calendar year 2021 or 2022 and the ...ated in a qualified disaster zone (see instructions).
...es that describe the allocation for the building (check those that apply):
...nstructed and federally subsidized **b** ☐ Newly constructed and **not** federally subsidized **c** ☐ Existing building
d ☐ Sec. 42(e) rehabilitation expenditures federally subsidized **e** ☐ Sec. 42(e) rehabilitation expenditures **not** federally subsidized
f ☐ Allocation subject to nonprofit set-aside under sec. 42(h)(5)

Signature of Authorized Housing Credit Agency Official—Completed by Housing Credit Agency Only

Under penalties of perjury, I declare that the allocation made is in compliance with the requirements of section 42 of the Internal Revenue Code, and that I have examined this form and to the best of my knowledge and belief, the information is true, correct, and complete.

▶ Signature of authorized official ▶ Name (please type or print) ▶ Date

Part II First-Year Certification—Completed by Building Owners with respect to the First Year of the Credit Period

7 Eligible basis of building (see instructions) . . . 7
8a Original qualified basis of the building at close of first year of credit period 8a
b Are you treating this building as part of a multiple building project for purposes of section 42 (see instructions)? . . . ☐ Yes ☐ No
9a If box 6a or box 6d is checked, do you elect to reduce eligible basis under section 42(i)(2)(B)? ☐ Yes ☐ No
b For market-rate units above the average quality standards of low-income units in the building, do you elect to reduce eligible basis by disproportionate costs of non-low-income units under section 42(d)(3)(B)? . ▶ ☐ Yes ☐ No
10 Check the appropriate box for each election.
Caution: Once made, the following elections are irrevocable.
a Elect to begin credit period the first year after the building is placed in service (section 42(f)(1)) ▶ ☐ Yes ☐ No
b Elect **not** to treat large partnership as taxpayer (section 42(j)(5)) . . . ▶ ☐ Yes
c Elect minimum set-aside requirement (section 42(g)) (see instructions):
☐ 20-50 ☐ 40-60 ☐ Average income ☐ 25-60 (N.Y.C. only)
d Elect deep rent skewed project (section 142(d)(4)(B)) (see instructions) . . . ☐ 15-40

Under penalties of perjury, I declare that I have examined this form and accompanying attachments, and to the best of my knowledge and belief, they are true, correct, and complete.

▶ Signature ▶ Taxpayer identification number ▶ Date

▶ Name (please type or print) ▶ First year of the credit period

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 63981U Form **8609** (Rev. 12-2021)

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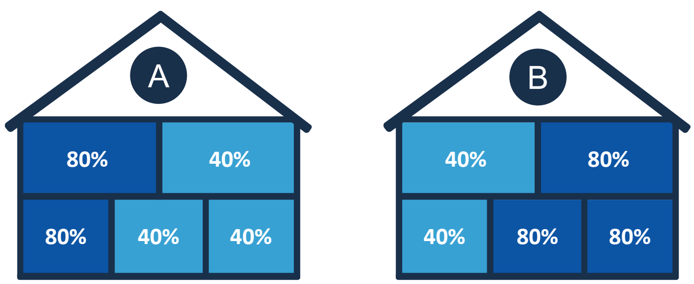
Multiple Building Election

EXAMPLE



A multiple-building housing project consisting of two buildings received an allocation and the taxpayer who owns the project elects the average income test. The taxpayer intends for the buildings (each containing 5 units) to have 100% low-income occupancy.

8b checked YES

Does this unit mix meet the minimum set-aside requirement?

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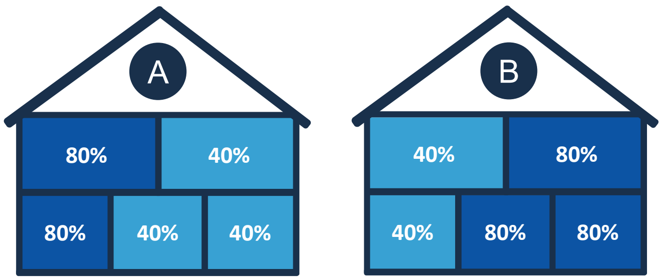
Multiple Building Election

EXAMPLE



The fact that the average of the income limitations of the units in Building B exceeds 60% AMI does not impact this result because this is a multiple building project.

40% averaging @ or below 60% AMI

$$\frac{\text{10 tax credit units}}{\text{10 total units}} = 100\%$$

5 units @ 40% AMI (5 × 40 = 200)

5 units @ 80% AMI (5 × 80 = 400)

200 + 400 = 600

600 / 10 = 60% Average Income

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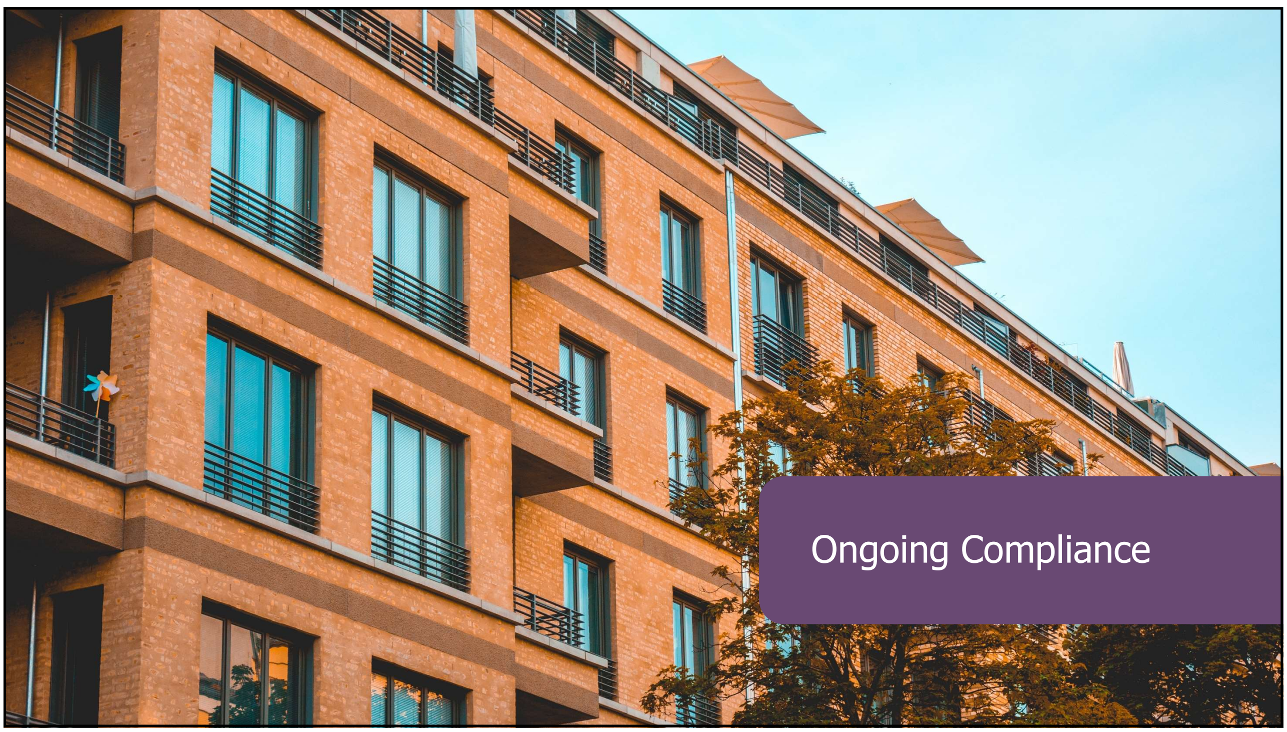

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Ongoing Compliance

- As with the other options, the Average Income minimum set-aside must be maintained throughout the life of a LIHTC project.
- Maintaining compliance will require additional care on behalf of the owner.
- Monitoring for compliance will require additional attention on behalf of the SHFAs.

The final rule provides flexibility so that O/A may modify unit designations as follows:

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Ongoing Compliance

EXAMPLE

A single building project, in Year 2, Unit #6 (designated income limitation of 40% AMI) becomes uninhabitable.

Repair work on Unit #6 is completed in Year 3.

Unit #6 cannot be included as a qualified unit in Year 2.

How does this single-building project maintain the average income minimum set-aside?

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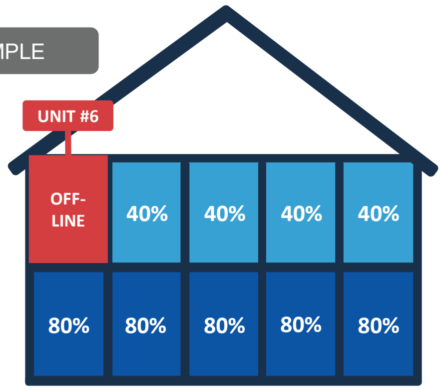
Ongoing Compliance

EXAMPLE



By removing Unit #6, we maintain at least 40% of the units, but the average is above 60% AMI.

560 / 9 = 62.22% Average Income

40% averaging @ or below 60% AMI

$$\frac{\text{9 tax credit units}}{\text{10 total units}} = 90\%$$

4 units @ 40% AMI (4 × 40 = 160)

5 units @ 80% AMI (5 × 80 = 400)

160 + 400 = 560

Another adjustment must be made

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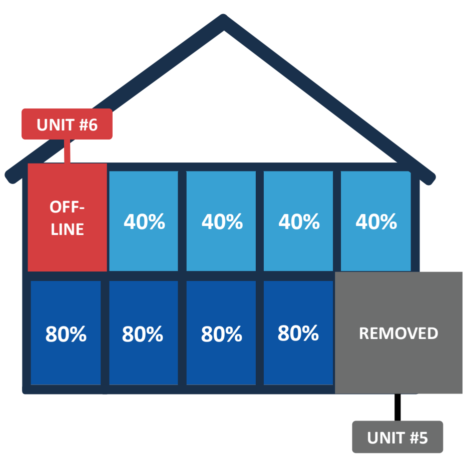
Ongoing Compliance

EXAMPLE 1

For Year 2, Taxpayer identifies the following as a qualified group of units that are to be used for both the set-aside requirement and the applicable fraction determination: Units # 1 - 4 and 7 - 10. Unit #5, which was at 80% designation, has also been removed to achieve the average.



40% averaging @ or below 60% AMI

$$\frac{\text{8 tax credit units}}{\text{10 total units}} = 80\%$$

4 units @ 40% AMI (4 × 40 = 160)

4 units @ 80% AMI (4 × 80 = 320)

160 + 320 = 480

480 / 8 = 60% Average Income

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Ongoing Compliance

EXAMPLE 1

CONSEQUENCE:

- Unit # 6's unsuitability for occupancy prevents it from being in a qualified group for purposes of computing the applicable fraction.
- Additionally, Unit # 5 is not a low-income unit because the taxpayer did not include it in the qualified group of units identified for determining the building's applicable fraction.
- The decline in the applicable fraction yields a decline in qualified basis, which results in credit recapture under section 42(j) for Year 2.

RESTORATION:

- In Year 3, after repair work is complete, the formerly uninhabitable Unit # 6 is again occupied by a qualified tenant at the same imputed income limitation (40%), and the Taxpayer identifies all 10 units as the qualified group of units that are to be used for the set-aside requirement and the applicable fraction determination.

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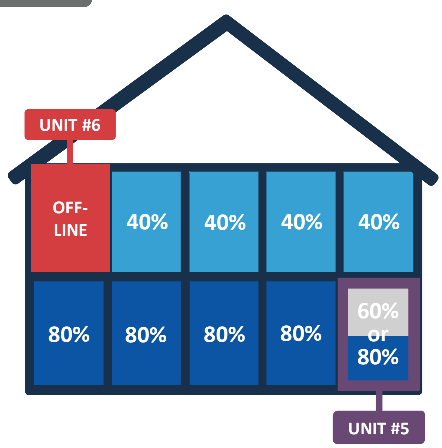
Ongoing Compliance

EXAMPLE 2



Assume the same facts as the previous example, except that the income for the tenant residing in Unit # 5 has declined so that tenant's income does not exceed 60% AMI.

Can this single-building project maintain the average income minimum set-aside by changing the designation of Unit #5 from 80% to 60%?

Let's try it!

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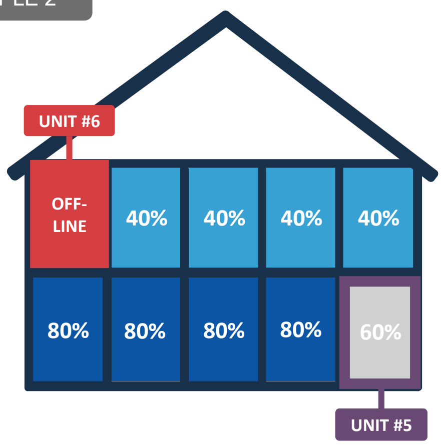
Ongoing Compliance

EXAMPLE 2



40% averaging @ or below 60% AMI

$$\frac{\text{9 tax credit units}}{\text{10 total units}} = 90\%$$

4 units @ 40% AMI (4 × 40 = 160)

1 units @ 60% AMI (1 × 60 = 60)

4 units @ 80% AMI (4 × 80 = 320)

160 + 60 + 320 = 540

540 / 9 = 60% Average Income

Ongoing Compliance

EXAMPLE 2

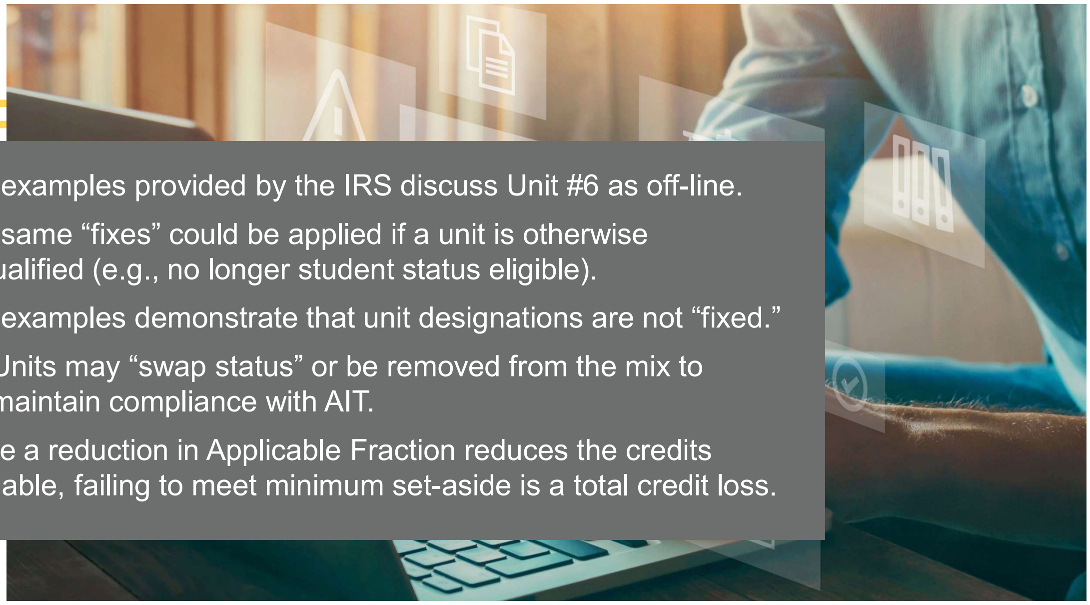
CONSEQUENCE:

- Unit # 6's unsuitability for occupancy prevents it from being in a qualified group for purposes of computing the applicable fraction.
- Thus, Units # 1, 2, 3, 4, 5, 7, 8, 9, and 10 are taken into account in the applicable fraction determination.
- The decline in the applicable fraction yields a decline in qualified basis, which results in credit recapture under section 42(j) for Year 2.

RESTORATION:

- In Year 3, after repair work is complete, the formerly uninhabitable Unit # 6 is again occupied by a qualified tenant.
- The example given by the IRS does not address whether Unit #6 needs to be rented at 40% (its previous designation).

Ongoing Compliance



- The examples provided by the IRS discuss Unit #6 as off-line.
- The same "fixes" could be applied if a unit is otherwise unqualified (e.g., no longer student status eligible).
- The examples demonstrate that unit designations are not "fixed."
  - Units may "swap status" or be removed from the mix to maintain compliance with AIT.
- While a reduction in Applicable Fraction reduces the credits available, failing to meet minimum set-aside is a total credit loss.

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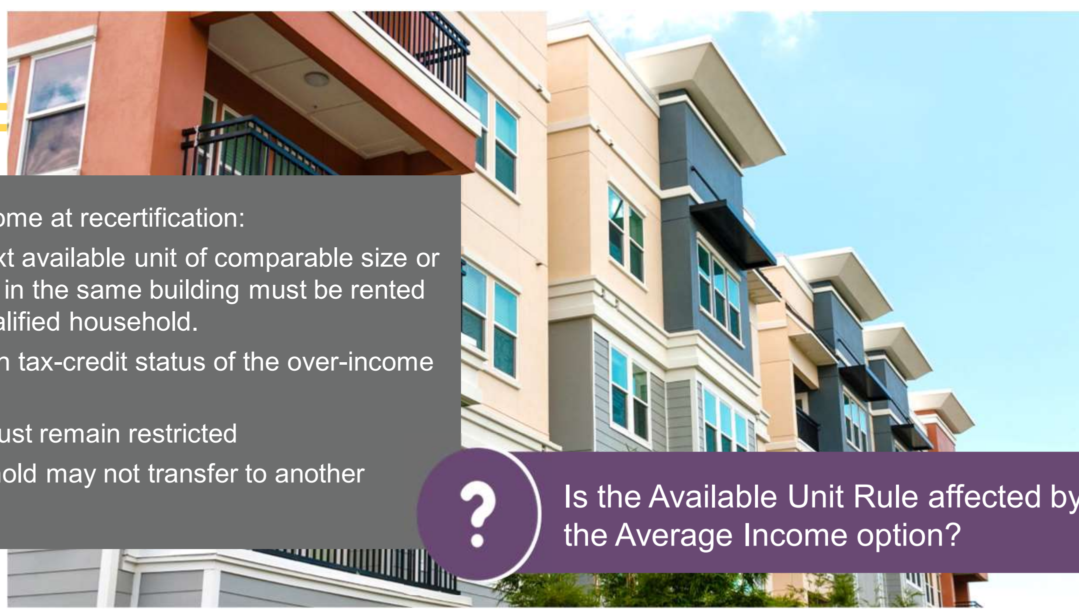
Available Unit Rule



If over-income at recertification:

- The next available unit of comparable size or smaller in the same building must be rented to a qualified household.

To maintain tax-credit status of the over-income unit:

- Rent must remain restricted
- Household may not transfer to another building

? Is the Available Unit Rule affected by the Average Income option?

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Available Unit Rule

A unit ceases to be a low-income unit if two conditions are met:

1. The income increases above 140% of the greater of 60% of AMI or the unit designation

AND

2. Any other residential rental unit in the building of comparable or smaller size is occupied by a new tenant whose income exceeds the applicable imputed income limitation.
   - In the case of a unit that was qualified prior to becoming vacant, the income designation of the available unit; and
   - In the case of any other unit, the highest income limitation that could be designated such that the average does not exceed 60% AMI.

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Available Unit Rule

"Immediately after each designation, the average of the designations in the project does not exceed 60% AMI. When there are multiple over-income units, the Taxpayer is not required to rent the next available units in a specific order, even though they may have different imputed income limitations."

- No requirement under AIT to comply with the next available unit rule in a specific order.
- As market rate units become available to rent, the taxpayer designates imputed income limitations for them, respectively, to replace the units that are now over-income.

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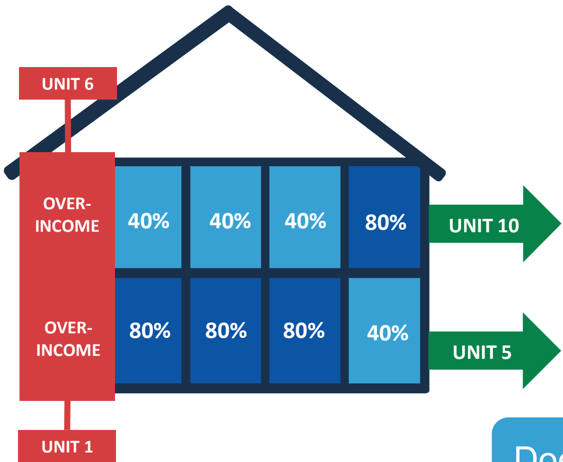
Available Unit Rule

EXAMPLE



Unit #1 and Unit #6 become over-income.

The tenant in Unit #5 vacated, and the taxpayer then designated the unit at 40% AMI.

Shortly thereafter, the tenant residing in Unit #10 vacated, and the taxpayer designated the unit at 80% AMI.

Does it matter which unit is filled first?

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Average Income: Available Unit Rule

No. When there are multiple over-income units, the Taxpayer is not required to rent the next- available units in a specific order, even though they may have different imputed income limitations.

- In this example, the taxpayer sought to maintain the status of the over-income units (Units # 1 and 6).
- As the then-market rate units (Units # 5 and 10) became available, the units were designated at 40% and 80% AMI, respectively.
- Immediately after each designation, the average of the designations in the project does not exceed 60% AMI.

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Things to Consider

Possible SHFA and Investor Policies:

- Requiring 8b, multiple building election, to be answered “yes” on Form 8609.
- Limiting the number of different unit designations in a property.
- Setting the possible project designations but allowing for unit designations to “float.”
- Disallowing certain unit designations.
  - Some will not allow for 20% or 30% without rental assistance.
- Requiring the average be below 60% AMI.
- Use of state-specific required forms and systems of reporting.

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Things to Consider

- Consult with state housing agencies regarding their plans for implementing income averaging including new policies and procedures.
- Work closely with property management software providers regarding with their plans for implementing income averaging with their products.
- Plan ahead for new AIT allocations.
- Consider the impact/benefit it could have for existing tenants under Acq/Rehab.
- Some AIT projects do not utilize all designations at first, allowing for flexibility in the future.

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