Fundamentals of LIHTC

Average Income
Minimum Set-aside

ZEFFERT & ASSOCIATES

Our Goal

This manual was prepared by Zeffert & Associates for our participants to develop a better understanding of the key components of the Section 42 Low Income Housing Tax Credit "LIHTC" program when managing the minimum set-aside including average income. In this class we will focus on understanding the LIHTC program's Minimum Set-Aside requirements.

Where We Get Direction

	Abbreviation (and format) used in the references
Legal Authority	
○ Section 42, Internal Revenue Code (IRC)	**§ 42**
○ Treasury Regulations	**Reg. 1.42 (- 1 to 1 – 17)**
○ Revenue Rulings	**Rev. Rul. (yr - #)**
○ Revenue Procedures	**Rev. Proc. (yr - #)**
○ IRS Notices	**IRS Notice (yr - #)**

Tax Credit Program Overview

What are tax credits?

Congress enacted Section 42 of the Internal Revenue Code as part of the Tax Credit Reform Act of 1986 to encourage the investment of private equity in the development of affordable rental housing for low-income households. Owners receive a reduction in tax liability in exchange for providing affordable housing. Unlike a tax deduction, which only reduces taxable income, the LIHTC credits offset dollar for dollar a party's tax liability. Tax credits are not a federal subsidy program, such as HUD or Rural Development (RD), but can be coupled with those programs to provide residents with rental assistance.

IRS Form 8609

Low Income Housing Credit Allocation and Certification – IRS Form 8609
IRS Form 8609 represents the official allocation of credits from the state HFA for each building. The state HFA completes the top portion (Part I) that documents the state agency's allocation of credit and sends it to the owner. The owner completes the bottom portion (Part II) that provides the taxpayer's certification for the first year of the credit period and submits it with the first year tax returns. Form 8609 provides basic info about the low income building, the terms of the credit allocation, and the taxpayer's elections.

Lines on the form of interest:

- Line 7 – Eligible basis
- Line 8a – Qualified basis
- Line 8b – Indicated if the building is part of a multi-building project
- Line 10c – Minimum set-aside
- Line 10d – Deep rent skewed

Minimum Set-aside "MSA"

§42(g)(1) 8823 Guide Chapter 10

In order to qualify for LIHTC, a minimum portion of a building must be rent restricted and occupied by low-income tenants at all times. This federal requirement is the minimum set-aside. The minimum set-aside or "MSA", must be met before owners can begin to claim credits. Once the initial set-aside is met, the minimum set-aside must be maintained each year thereafter.

In the event that non-compliance results in the failure to meet the minimum set-aside for the first year of the credit period, the taxpayer is prohibited from ever claiming the LIHC. The date of non-compliance is the last day of the taxable year in the first year of the credit period.

If the project meets the minimum set-aside by the end of the first year but fails to meet the minimum set-aside at the close of a subsequent taxable year in the compliance period, the entire credit is lost for that year. The date of non-compliance is the last day of the taxable year for which the minimum set-aside was not met.

Every LIHTC property has a federal minimum set-aside. There are four minimum set-aside elections in which the owner can select on the 8609.

Minimum Set-aside "MSA"

8823 Guide Chapter 10

Every LIHTC property has a minimum set-aside. There are four options the owner can select:

1. 20-50
2. 40-60
3. Average Income
4. 25-60, (NYC only)

The minimum set-aside establishes two vital, federal components relative to compliance.

1. The percentage of the units, at a minimum, that must be LIHTC at all times (20% or 40%). This is always figured on the number of units, regardless of the size of each unit. The test for this is on the last day of each year.
2. The definition of "low income" at a property (50% or 60% MTSP). All units that will be counted as LIHTC in the property must be rent restricted and occupied by individuals whose income is at or below this limit.

The minimum set-aside is **irrevocably selected** and identified on IRS Form 8609 line 10c by the owner.

10c. Elect minimum set-aside requirement (Section 42(g)) (See instructions)			
☐ 20-50	☐ 40-60	☐ Average Income	☐ 25-60 (NYC only)

Tax credits are awarded in a single allocation and each project will receive its own IRS Form 8609. It's on this form that the owner can choose to group the buildings into one project or divide them into separate projects. There are several important compliance factors related to this important election; including the minimum set-aside. The owner may make this decision on the IRS Form 8609 line 8b.

8b. Are you treating this building as part of a multiple building project for purpose of section 42?		
(see instructions)	☐ Yes	☐ No

If the owner selects YES to question 8b on the IRS Form 8609, the owner has elected to treat the building as part of a **multiple building project**. The minimum set-aside is satisfied by being spread out among all of the buildings included within the project.

If the owner selects NO to question 8b on the IRS Form 8609, the owner has is notifying the IRS that the building will be treated as a **separate building**, even though it was part of a single allocation with multiple buildings. The building will be required to meet the minimum set-aside as a stand-alone project.

Average Income MSA

§42(g)(1)(C)

The Consolidated Appropriations Act of 2018 enacted into law on March 23, 2018, permanently added a new optional minimum set-aside. The average income MSA was added to the 20-50 and 40-60 minimum set-aside, line 10c, for a qualified low-income housing project, and is effective for Form 8609 elections made after March 23, 2018. Income averaging is not available to owners who have already filed their 8609's with the IRS, as the minimum set-aside is an irrevocable election.

10c. Elect minimum set-aside requirement (Section 42(g)) (See instructions)
☐ 20-50 ☐ 40-60 ☒ Average Income ☐ 25-60 (NYC only)

The average income set-aside requires the following:

The Average Income minimum set-aside requires the following:	
At least 40% of the units have to be both rent restricted and occupied by households whose income does not exceed the imputed income limit designated by the owner of the project for a respective unit. (25% or more in a case of a project located in a high cost housing area). The average of the imputed income limitations designated cannot exceed 60% of the area median gross income. The designated imputed income limitation cannot be less than 20% or more than 80%, and must be in 10% increments of the area median income.	**20%** **30%** **40%** **50%** **60%** **70%** **80%**

The test must be met for each building (BIN), unless the owner makes the multiple building election on form 8609, Line 8b.

The intent of this provision is to allow properties to target very low-income households while still maintaining financial feasibility via the higher rents received from households above 60% of the area median gross income.

The requirements of the average income test must meet the following:

- The project must contain a qualified group of units that constitutes 40% or more of the residential units in the project
- The average of the designated imputed income limitations of the units in the group must not exceed 60% of the area median gross income

The average is 60% and all units are LIHTC eligible. 600 ÷ 10 units = 60%
Unit 6 is designated as a 40% unit and must be occupied by a household who at initial occupancy has an income equal or less than 40% AMI. If a 50% household moves into unit 6, the average of the imputed income limit is 61% and the Average Income Test has been violated.

Example One

Minimum Set-aside Example: Average Income Election			
The average is 60% and all units are LIHTC eligible. 600 ÷ 10 units = 60%			
Unit 1	60%	**Unit 6**	40%
Unit 2	60%	**Unit 7**	40%
Unit 3	60%	**Unit 8**	80%
Unit 4	60%	**Unit 9**	80%
Unit 5	60%	**Unit 10**	60%

The average is 60% and all units are LIHTC eligible. 600 ÷ 10 units = 60%

Example Two

Minimum Set-aside Example: Average Income Election							
4 BINS 20 units (5 units x 4 buildings)							
Unit 1	80%	**Unit 6**	70%	**Unit 11**	60%	**Unit 16**	40%
Unit 2	80%	**Unit 7**	70%	**Unit 12**	60%	**Unit 17**	40%
Unit 3	80%	**Unit 8**	70%	**Unit 13**	50%	**Unit 18**	30%
Unit 4	80%	**Unit 9**	60%	**Unit 14**	50%	**Unit 19**	20%
Unit 5	70%	**Unit 10**	60%	**Unit 15**	50%	**Unit 20**	20%

Total: 1,140% ÷ 20 units = 57%

Workshop: Minimum Set-aside

A project consists of two buildings, with an MSA of Average Income selected and all are part of a multiple building project. Both buildings have five units each. The owner has identified the group of units as three units at 80%, four units at 60%, two units at 40%, and one unit at 20%.

At a minimum, how many units must be affordable? __________

Has this project met the MSA elected by the owner on Form 8609? **Yes or No?**

If yes or no, please explain:

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A project consists of three buildings, with a MSA of Average Income select and all are part of a multiple building project. Two buildings have 3 units each and one building has 4 units. The owner has identified the group of units as 3 units at 80%, 3 units at 70%, 1 unit at 60%; 1 unit at 30%, 1 unit at 50%, and 1 unit at 20%.

At a minimum, how many units must be affordable? __________

Has this project met the MSA elected by the owner on Form 8609? **Yes or No?**

If yes or no, please explain:

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State Housing Finance Agency "HFA"

The HFA is often called state agency or state allocating agency because they are utilized by the IRS to carry out certain responsibilities which includes monitoring for compliance.

States differ on requirements for Average Income Minimum Set-aside.
The HFA may have additional requirements or restrictions. The following are just a few examples and should be investigated by the owner.

- Are the units fixed or floating?
- Restricting the AI MSA election to only 100% LIHTC projects
- Requiring AI project owner to elect to treat multiple buildings as a single project (Yes on line 8b)
- Not permitting the AI MSA for Re-syndication

Income Limits

The income limit is the amount the total household's income must not exceed in order to qualify for affordable housing. The income limits are based on the Area Median Income or AMI, and differ from one county and/or Metropolitan Statistical Area or MSA, to another.

New income limits must be implemented within 45 days of release.

Starting with the limits released on 3/19/2009, LIHTC projects have their own limits. These limits are referred to by HUD as the Multi-family Tax Subsidy Project (MTSP).

Calculating State Set-aside Income Limits

Rev. Rul. 89-24 & 94-57 8823 Guide Chapter 4

Every new move-in at a LIHTC property must be **at or below** the applicable income limit, as established by the minimum set-aside. HUD published its very-low (50% of area income for a county) income limit annually.

Rents

Average income also applies to rent limits. The maximum rent level that may be charged to a household is 30% of that unit's designated AMI limitation. IE: an 80% unit would have a max rent limit of 30% of 80% AMI.

Available Unit Rule "AUR"

§42(g)(2)(D) & IRS Reg. 1.42-15

This rule is also called the 140% or next available unit "NAUR" rule.

8823 Guide 14-1 & 5

If a household's income increases to over 140% of the current qualifying income limit when they are recertified, they become over-income.

For 100% LIHTC projects: Owners must demonstrate due diligence when moving in new households to make sure all units that become available are rented to qualified households. If they move in an ineligible household and cannot demonstrate due diligence, they violate the available unit rule.

For mixed income projects: If a household's income increases to over 140% of the current qualifying income limit when they are recertified, they become over-income. Credits can continue to be claimed on the unit as long as the next available unit of equal or smaller size **in the same BIN** is rented to a qualified applicant.

Available Unit Rule "AUR" and Average Income

For Average Income, the over-income limit is driven by the unit's designation. If the designated income for an over-income unit (140%) is 60% or less, the AUR is triggered when the income of the household exceeds 140% of the 60% income limit.

If the designated income for an over-income unit exceeds 60% (IE: either a 70% or 80% unit), the AUR is triggered when the income of the household exceeds 140% of the designated income limit.

As units become vacant, in the case of multiple over-income units, while the order in which the next available units are occupied makes no difference, the order in which income designations are assigned to units **does** make a difference.

- For vacant units that were previously qualified as low-income units, the unit retains its previous imputed income limit
- If redesignating any other unit (such as a market-rate unit), the imputed income limit for that unit may not cause the average imputed income of the qualified group to exceed 60 percent of AMGI.

Final Reflections…

The LIHTC program is constantly changing and learning the compliance complexities can be steep. While this new election will provide the LIHTC to widen the low-income market by reaching more populations and communities, implementation of the Average Income Test will be challenging. Owners will be required to carefully track the status of each low-income unit as it will be necessary to ensure that the required 60% average is met at all times. Your awareness, knowledge, and effort are important keys to compliance.