

Average Income Test

AHAIN Webinar 11/15/22

REFRESHER ON MINIMUM SET-ASIDES

Establishes two critical items:

1. The minimum % of units in a project that must be income/rent-restricted and in compliance to claim any credits; and
2. The federal definition of low-income that applies to the project

In reality, a project likely:

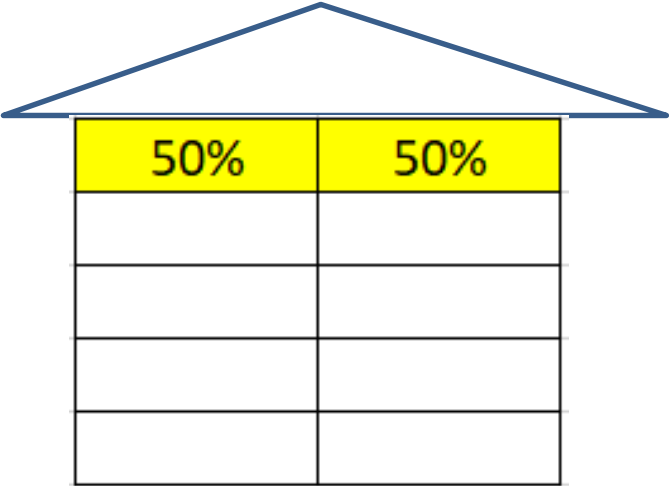
1. Has a higher % of units committed as income/rent-restricted
WHY? = In order to maximize credits by increasing the Applicable Fraction
2. Has additional (lower) income and rent restrictions on some of the units
WHY? = In order to obtain points under the QAP

REFRESHER ON MINIMUM SET-ASIDES

20/50

20/50 Minimum Set-Aside means

- 1. At least 20% of the units in the project must be income/rent restricted and in compliance to claim any credits; and
- 2. The federal definition of low-income applicable to the project is 50% AMI with 50% tax credit rents

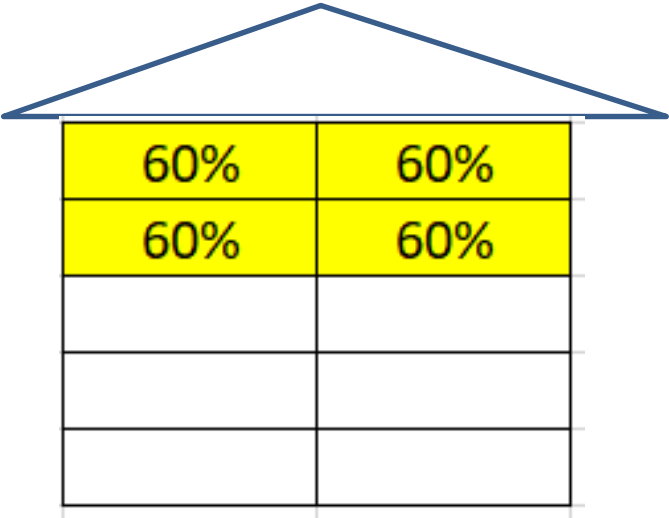


REFRESHER ON MINIMUM SET-ASIDES

40/60

40/60 Minimum Set-Aside means:

- 1. At least 40% of the units in the project must be income/rent restricted and in compliance to claim any credits; and
- 2. The federal definition of low-income applicable to the project is 60% AMI with 60% tax credit rents



REFRESHER ON MINIMUM SET-ASIDES PROJECT RULE

Minimum Set-Aside election must be met on a “project” basis

Project is defined by the owner’s irrevocable election on Form 8609 Line 8b

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)?	<input type="checkbox"/> Yes <input type="checkbox"/> No



REFRESHER ON MINIMUM SET-ASIDES NONCOMPLIANCE- INITIAL YEAR

Credits cannot be claimed until the Minimum Set-Aside has been met

Credit period must begin in either the year that a building is placed-in-service or the following year (if owner elects to defer)

Therefore, MSA must be met by this same deadline

If MSA is not met by the deadline, **no credits can ever be claimed**. This is a non-correctable form of noncompliance.



REFRESHER ON MINIMUM SET-ASIDES NONCOMPLIANCE- SUBSEQUENT YEARS

If MSA is violated for a particular year of the compliance period (not the initial year of the credit period), the project is out of compliance for that taxable year

- Subject to recapture of previously claimed credits
- Loss of credits & no additional credits claimed until MSA restored
- The project is back in compliance for the taxable year in which MSA fixed

MSA is violated if an insufficient number of units are qualified tax credit units

Per the 8823 Guide (page 10-3), “noncompliance with the minimum set-aside should also be reported if systemic errors affecting all the LHC units are identified; e.g., using incorrect income or rent limits for all the units.”

REFRESHER ON APPLICABLE FRACTION

- The percentage of a building designated for occupancy by low-income households
- Defined as the lesser of:
 - The % of residential floor space in a building comprised of LIHTC qualified units (“floor space fraction”); or
 - The % of units in a building that are LIHTC qualified units (“unit fraction”)

Tax Credit calculation for a building:

Eligible Basis x **Applicable Fraction** = Qualified Basis

Qualified Basis x Applicable Percentage = Annual Credit

If Applicable Fraction decreases, Qualified Basis decreases = loss of credits and recapture

MSA VS. AF

Minimum Set-Aside

Minimum % to get any credits
If not hit, cannot claim any credits
Project rule

Applicable Fraction

% to maximize credits
If not hit, cannot claim all credits
Building rule

AVERAGE INCOME TEST BACKGROUND

Consolidated Appropriations Act of 2018 enacted 3/23/18 (“Omnibus Bill”)

Permanently created a 3rd minimum set-aside for the LIHTC program

Form 8609 updated May 2018 to allow owners to elect this new MSA on Line 10c

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)

↑

Minimum Set-asides are irrevocable! Existing projects cannot retroactively implement AIT.



AVERAGE INCOME TEST

WHAT'S THE PURPOSE?

Expands LIHTC definition of income eligibility to include households earning up to 80% AMI at an 80% rent limit

In exchange, these higher income/rent limits are offset by lower income/rent limits to maintain an overall average of 60% AMI income and rent

Is there a benefit?

- Allows a broader range of low-income households to be served by the program
 - Income >60% AMI but <80% AMI
 - Extremely low-incomes at 20%, 30%, & 40% AMI
- May help with preservation activities by minimizing displacement of existing residents (e.g., using LIHTC to preserve HUD or RD housing)
- Impact on cash flow? Potentially- depends on rent limits and the market

BREAKING NEWS- AIT REGULATIONS

IRS issued “final and temporary regulations” on October 7, 2022. Effective starting with 2023 taxable year.

- Response to significant public feedback against the October 30, 2020 proposed rule
- Revises Treasury Regulations 1.42-15 (Available Unit Rule) and 1.42-19 (AIT)
- New regulations
 - Better align AIT MSA test with the existing 20/50 or 40/60 tests
 - Define the concepts of a “low-income unit” and “qualified group of units”
 - Differentiate meeting the minimum set-aside test vs. applicable fraction test
 - Provide instructions for designating and redesignating units
 - Eliminate proposed regulation rules about mitigating actions and removing units
- Result = eliminates issue created by the 2020 proposed regulations and “generally avoid the outsized impact that one unit’s loss of low-income status could have under the proposed regulations”

ANTICIPATED BENEFIT (PER IRS)

IRS estimates an additional 1000 LIHTC buildings a year will now elect AIT MSA

AIT projects provide mixed-income projects and may enhance financial stability

Certain markets may not support 20/50 or 40/60 projects but would demonstrate the market to serve a broader range of households

DEFINITION OF IMPUTED INCOME LIMITATION

Each unit must be designated at 20, 30, 40, 50, 60, 70, or 80% AMI

The imputed income limitation designated for the unit applies to both the income and rent restriction

For purposes of calculating the average income, use the unit's designation, not the actual income level of the household residing in the unit.

- Example: Unit is designated at 50% AMI and uses the 50% rent limit. Household living in the unit is actually below 40% AMI. Count the unit as 50%.

DEFINITION OF LOW-INCOME UNIT FOR AIT

1. Must be rent-restricted
2. Household occupying the unit must meet the imputed income limitation designated for that unit
3. The household/unit must meet all other Section 42 compliance requirements
4. The unit must be part of a “qualified group of units”

DEFINITION OF QUALIFIED GROUP OF UNITS

A group of residential units is considered a “qualified group of units” for a taxable year if:

1. Each unit in the group is considered a low-income unit
2. The average of the imputed income limitations for all units in the group does not exceed 60% AMI

AIT: MEETING THE MINIMUM SET-ASIDE

MSA is met for a taxable year if at least 40% of the residential units in the **project** constitute a “qualified group of units”

At least 40% of the units

- Are qualified low-income units
- Collectively have an average imputed income limitation that does not exceed 60% AMI

No longer required to consider all low-income units in the project!

AIT: MEETING THE APPLICABLE FRACTION

For each taxable year, the taxpayer must identify a “qualified group of units” to be used in determining the applicable fraction

All units counted towards the applicable fraction must collectively have an average imputed income limitation that does not exceed 60% AMI

“The applicable fraction of a building in a project is computed using the units that are in the particular building and that are also in the qualified group of units for the project...The units included in the applicable fraction of a building do not have to be a qualified group of units on their own”

- Applicable fraction is still calculated on a building basis
- HOWEVER, the average on a building-by-building basis does not have to have to below 60% AMI

KNOWLEDGE CHECK! SCENARIO 1

Per 8609 election, the “project” consists of 1 building with 10 units. All 10 units are 2BR of equal size. The owner elected the AIT MSA. The owner intends to claim credits on all 10 units (100% Applicable Fraction). All households have been income and student-status qualified, and all units are appropriately rent-restricted based on the designated income limitations.

SAMPLE PROJECT #1	
40%	40%
60%	60%
60%	60%
60%	60%
80%	80%

Does this building meet the AIT minimum set-aside test?

YES! At least 40% of the units are low-income units. At least 40% of units can be considered a qualifying group with an average at or below 60% AMI.

Can the owner claim tax credits on all 10 units?

YES! All units collectively have an average of 60% AMI.

KNOWLEDGE CHECK! SCENARIO 2

Per 8609 election, the “project” consists of 1 building with 10 units. All 10 units are 2BR of equal size. The owner elected the AIT MSA. The owner intends to claim credits on all 10 units (100% Applicable Fraction). All households have been income and student-status qualified, and all units are appropriately rent-restricted based on the designated income limitations.

SAMPLE PROJECT	
#2	
40%	40%
60%	60%
60%	60%
80%	80%
80%	80%

Does this building meet the AIT minimum set-aside test?

YES! At least 40% of the units are low-income units. At least 40% of units can be considered a qualifying group with an average at or below 60% AMI.

Can the owner claim tax credits on all 10 units?

NO! All 10 units collectively have an average of 64% AMI. 8 units (drop two 80% units) could be included in the Applicable Fraction. Max AF = 80%

DESIGNATING UNITS

“Taxpayer designates a unit’s imputed income limitation by recording the limitation in its books and records”

Regulation does not specify, but this could include:

- On the Tenant Income Certification form
- On a rent roll
- In property management/compliance software system

Record of designation must be maintained for LIHTC record retention period

- 21 years initial qualifying file, 6 years all other files

Must also be “communicated annually to the applicable Agency”

- For IHCDA = report on the Annual Owner Certification of Compliance



DESIGNATING UNITS- IHCD A REQUIREMENT



The tax credit application submitted to IHCD A will note the project's unit mix- i.e., the number of units at each imputed income level (20, 30, 40, 50, 60, 70, and 80% AMI)

The extended use agreement recorded against the project by IHCD A will codify this unit mix

The owner must maintain the overall unit mix, but designations can float between units

The Annual Owner Certification of Compliance review will ensure the right unit mix is maintained



REDESIGNATING UNITS

The income limitation assigned to a unit can be redesignated for various reasons:

- Based on guidance from IRS forms, instructions, or guidance
- Based on HFA “public written guidance that provides conditions for a permitted change”
 - IHCD will allow units to float as long as overall agreed upon unit mix is maintained
- If redesignation is needed to allow protections under Fair Housing, VAWA, Section 504, other laws that protect tenants
- If a current qualified tenant transfers to another unit, the units swap statuses
- To restore noncompliance, the owner may change unit designations



HFA POLICY VARIATIONS



When working in other states, key questions include:

- Does the HFA allow an AIT election? **IHCDA = yes**
- How are units designated and such designations communicated to the HFA? **IHCDA = via TIC & AOC**
- In what circumstances, and in what manner, can units be redesignated? **IHCDA = units can float**
- If the project is 100% tax credit but AIT, are full recertifications required? **IHCDA = no**
- Must units be redesignated if household income changes? **IHCDA = no**
- Can AIT projects include market-rate units? **IHCDA = yes**
- Is the HFA imposing a “unit parity” rule? **IHCDA = no**
- Does the HFA require a “buffer”? (Also check with investor) **IHCDA = no**



WAIT...I CHANGED MY MIND!

Once an MSA election is made via Form 8609, the decision is irrevocable

- 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)

However, if 8609s have not been issued, owner can contact IHCD to request a modification to the MSA

- Modification fees will apply
- Decision subject to re-underwriting
- May require updated market study

QUESTIONS?

CONTACT INFO

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