

**LOW INCOME HOUSING  
TAX CREDIT  
COMPLIANCE MANUAL**

**IDAHO HOUSING AND  
FINANCE ASSOCIATION**

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## PREFACE

This manual is a training and reference guide developed to assist owner/agents in administering the Low-Income Housing Tax Credit (LIHTC) Program. The manual is designed to furnish guidance pursuant to Section 42 of the Internal Revenue Service (IRS) code, 8823 guide, and HUD Handbook 4350.3 REV1 regulations and all subsequent IRS rulings, notices and announcements. Owner/agents must also be familiar with additional Idaho Housing & Finance Association (IHFA) requirements which are set forth in the Regulatory Agreement as well in the Qualified Allocation Plan (QAP).

It is important to note that this manual is to be used as a supplement to existing laws and rules. It is not intended to be an all-inclusive and comprehensive guide to the LIHTC program. Therefore, LIHTC compliance is solely the owner/agent's responsibility. Please note, however, that as the designated Compliance Monitoring Agency for the LIHTC Program in Idaho, IHFA has been provided with the regulatory authority to implement requirements that are in addition to those published by the IRS. The Association has incorporated several provisions into this version of the Manual that are in addition to current IRS guidance. However, those requirements were implemented only in those areas where existing program-related information resulted in ambiguities, or areas that appeared to be in need of clarification. Every effort has been made to keep those additional requirements at a minimum. They have been incorporated into this Compliance Manual in order to help ensure that scarce low-income housing opportunities are afforded to those households truly in need. Please refer to the "Index of Significant Changes" below for a listing of important program changes.

Owner/agents are responsible for compliance with all applicable federal and state rules and regulations that govern their particular developments. The determination of compliance is the sole responsibility of each owner/agent. IHFA will not assume liability for tax consequences as a result of noncompliance and/or IRS audits. All errors made will be the responsibility of the owner/agent.

Future IRS or HUD rulings more stringent than IHFA requirements must be adhered to based upon their effective date(s). IHFA will make every effort to provide technical assistance and appropriate interpretations where it is able to do so, but will not unilaterally defer or alter effective / implementation dates by so doing. Compliance with all applicable rules and regulations is solely the responsibility of the housing sponsor.

The manual does not ensure compliance with any or all laws and regulations governing LIHTC developments. Further, the manual does not guarantee the financial viability of any development. As a result, IHFA recommends all tax credit recipients consult with their tax accountant, attorney or other advisors regarding specific requirements of the LIHTC Program. The manual can be found in its entirety, including updates, on the IHFA website at [www.ihfa.org](http://www.ihfa.org). The manual not only contains guidelines for compliance

but source documents and forms to assist owner/agents in understanding Tax Credit Compliance.

**NOTE: Please reference the IRS 8823 Reporting Guide, issued January 2007, for detailed information and guidance in addition to the information presented in this Manual. Reference HUD Handbook 4350.3 REV-1 Chg-2 for additional information pertaining to income qualifications and verifications that is applicable to applicants/tenants seeking housing opportunities under the LIHTC program.**

## **Index of Significant Changes**

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# Part 1: Introduction

## LIHTC History

Congress enacted the Low Income Housing Tax Credit Program under the Tax Reform Act of 1986. The Treasury Department is responsible for the administration of the program nationwide. State agencies like IHFA are delegated the responsibility and authority to allocate tax credits for the purpose of providing low-income housing at the state level.

The LIHTC program is a dollar-for-dollar reduction in an owner's tax liability for those who construct or rehabilitate low-income rental housing units. The amount of credit allocated is directly linked to the number of qualified low-income units that meet federal rent and income targeting requirements.

The Omnibus Budget Reconciliation Act of 1990 amended the IRS Tax Credit Code to require state tax credit allocating agencies like IHFA to provide procedures for monitoring developments for non-compliance in accordance with Section 42(m) (1) (B) of the Code and for notifying the IRS of such non-compliance. Guidelines and rules outlined in this manual are reflective of that amendment and the associated monitoring requirements contained herein.

## Compliance Period & Extended Use Period

According to Section 42 of the Code, developments that receive allocations prior to January 1, 1990 are subject to a 15-year compliance period. However, any building that received an additional allocation of credit after December 31, 1989 must comply with eligibility requirements in effect beginning January 1, 1990.

Those projects receiving a credit allocation after December 31, 1989 must commit to an extended use period as stated in their individual Regulatory Agreement. After these developments are placed in-service, they must comply with eligibility requirements for at least an additional 15 years beyond the initial 15-year federal compliance period, for a total of at least 30 years.

Many developers have committed to even longer extended use periods. The IHFA Qualified Allocation Plan (QAP) grants preference points to those developers who are willing to expand the extended use period out to forty years. Such commitments bind owner/agents to maintain specific occupancy and affordability requirements for the development. Owner/agents, therefore, should be aware of their development's compliance commitment.

An additional factor impacting management of Tax Credit developments is the fact that these developments are often coupled with subsidy programs (both project-based and tenant-based) that involve other government housing regulations. There are times when conflicts between programs arise. **Care must be exercised to ensure that the most restrictive of these competing program requirements are met.**

## Responsibilities

For the purposes of clarification, the responsibilities of various parties involved in the LIHTC process are outlined below.

### IHFA Compliance Department Responsibilities

Once the tax credits are allocated and a development is placed in-service, the IRS code requires that IHFA monitor program compliance during the compliance and extended use periods.

IHFA's Monitoring Duties Include:

1. Providing an on-line LIHTC Compliance Manual and additional pertinent information.
2. Providing technical assistance regarding compliance as needed.
3. Reviewing Annual submissions, which include Certificates of Continuing Compliance, Annual Occupancy Reports and any additional documents required under the Regulatory Agreement.
4. Reviewing each low-income housing development at least once every three years. IHFA performs inspections by sampling 20% of household units and the associated low-income tenant files. Audits are scheduled in a manner that provides owner/agents enough advance notice to ensure arrangements are made for representatives to attend the audit, and that proper notice is given to tenants. **Note: If the development has HOME financing and units, reviews may be conducted on a more frequent basis, depending on the number of units in the development.**

The areas reviewed by IHFA's Compliance Department may include, but are not limited to the following:

- Determining, on a building-by-building basis, whether the initial minimum set-aside has been met within prescribed timeframes and assuring the minimum set-aside is maintained.
- Tenant qualifications, income calculations and appropriate supporting documentation.
- Gross rent calculations including utility allowance processes.

- Additional rental and social service requirements set forth in the IHFA Regulatory Agreement for which the IHFA compliance department must ensure owner/agents comply.
  - Physical Inspections that include a review of tenant units, all common areas, development grounds, building interiors, exteriors and maintenance facilities. IHFA will utilize standards set forth in the Real Estate Assessment Center System (REAC) Definitions of Deficiencies Guide to determine whether noncompliance has occurred.
5. Notifying owner/agents after an inspection when developments are out of compliance with IRS Code or IHFA requirements. Owner/agents are typically given 30 days to correct the noncompliance issues and to respond to IHFA with either the corrected actions or the corrective action plan. However, extensions may be granted under certain circumstances. Extensions must be requested in writing and submitted to IHFA prior to the original reporting deadline.
  6. Performing follow-up reviews of any building or development if deemed necessary. A follow-up review may include a physical inspections and/or tenant file reviews. Such reviews are subject to additional monitoring fees. (Please refer to page 65 for additional information relative to monitoring fees.)
  7. Reporting Owner/agent noncompliance and/or corrected findings to the IRS via an IRS form 8823. Per the 8823 Reporting Guide, a copy of all 8823s sent to the IRS must also be sent to the Owner listed on the 8609.

Under IRS regulations, IHFA findings of noncompliance, whether corrected or not, are not considered binding. **Note: Only the IRS can make a final determination of noncompliance; and only the IRS can determine what effect noncompliance will have on the development's owners and/or investors.**

### **Owners' Responsibilities**

Owners who have chosen to participate in the LIHTC Program have done so in order to take advantage of the tax benefits the program provides. In exchange for the tax benefits, owners must meet requirements, which will benefit low-income tenants. In accordance with Section 42 of the IRS Code, owners receiving tax credit allocations are required, by acceptance of the allocation, to perform the following:

1. Owners must meet all requirements agreed to in the Placed-in-Service Application, Regulatory Agreement and/or Extended Use Agreement. Such requirements include minimum set aside elections, appropriate income and rental rate requirements and annual certification processes.

Further, in the application rounds, if owner/agents receive preference points to provide social services or additional rental restrictions. Owner/agents must ensure that they are following through on these commitments. Non-compliance will not result in an 8823 filing. However it will be considered a finding on the IHFA audit report.

2. Owners are required to keep tenant records for each qualified low-income building in the development.
3. Throughout all phases of a development, owners are required to submit the following items:
  - Occupancy Reports at Initial Lease-up: Owner/agents are required to submit to IHFA an initial Occupancy Report after all buildings have been occupied and lease up is complete. As soon as a development is fully leased, Owner/agents have 30-days in which to provide the report listing all first-year tenants.
  - Certificate of Continuing Compliance: On the first day of the thirteenth month after the development is Placed in-Service, and on the first business day of each year thereafter through the final year of the extended use agreement, the owner must submit to IHFA a Certificate of Continuing Compliance. The IRS Code requires owners to certify that they have complied with all terms and provisions of the Section 42 agreement with the development. Owners must submit this certificate annually. The form must be fully completed and signed by the owner. **NOTE: Failure to submit a Certificate of Continuing Compliance is sufficient cause to file an 8823 with the IRS.**
  - Occupancy Reports: In conjunction with the Certificate of Continuing Compliance, the IHFA Occupancy Report must be submitted. The report is a listing of all the tenants that have occupied a development in the past year. The report allows IHFA Compliance Department staff to ensure owner/agents are following the next available unit rules and other pertinent Section 42 Code requirements.
  - IRS Forms 8609 and 8609A: Owners are responsible for providing the IHFA Multifamily Finance department with signed 8609 forms. The 8609 form must be filed for each building in a development for the first year, showing the development's owner, minimum set-aside designation and verifying the year and the amount of Tax Credits claimed. The 8609A is completed and filed by the owner annually during the 15-year compliance period. Owners' are responsible for submitting both IRS forms to the IHFA Compliance Department while filing annual tax returns with the IRS.

4. Owners are responsible to correct any incidents of non-compliance that are discovered by the owner/agent. Additionally, owners are responsible for correcting incidents of non-compliance discovered by IHFA within required time frames.
  
5. In accordance with Section 42 of the Code, the owner's record-keeping requirements for low-income buildings include, but are not limited to the following:
  - The total number of residential rental units in the building, including the number of bedrooms and the size in square feet of each residential rental unit.
  - The percentage of units in the building that are low-income units meeting the election of 20/50 or 40/60 minimum set-aside test.
  - The rent charged on each unit in the building including the basis for determining the utility allowance.
  - A record reflective of vacancies in low-income units within each building, and when the next available units were rented.
  - Low-income move-in certifications, annual certifications of each low-income tenant as well as documentation to support those certifications **must** be available during reviews.
  - The eligible basis and qualified basis of the building at the end of the first year of the credit period.
  - The character and use of the nonresidential portion of the building included in the building's eligible basis under Section 42 (d). For example, tenant facilities that are available on a comparable basis to all tenants and for which no separate fee is charged for use of the facilities, or facilities reasonably required by the development.
  - The IRS requires owner/agents to retain tenant records for at least six years after the due date (with extensions) for filing the federal income tax return for that year.

The records for the first year of the credit period, however, must be retained for the entire compliance period plus six years beyond the due date (with extensions) for filing the federal income tax return for the last year of the compliance period of the building. Therefore, the IRS mandates that first year records be maintained for twenty-one (21) years.

### **Management Responsibilities**

The owner's management agent may be responsible for implementing the LIHTC Program requirements. Although an Owner may have a Managing Agent acting on his/her behalf, the Owner is ultimately responsible for ensuring compliance with all applicable low-income housing tax credit regulations. In selecting a Managing Agent, the Owner should ensure that the Agent and all on-site personnel are knowledgeable of the provisions and requirements of the Tax Credit Program and have adequate experience in managing a tax credit development.

1. Agents / staff that are authorized to lease units to tenants should be thoroughly familiar with all federal and state regulations such as Fair Housing and Land-Tenant laws governing certifications and leasing procedures. Management agents must also provide information, as needed, to IHFA and submit all required reports and documentation in a timely manner.
2. The Managing Agent may sign documents on behalf of the Owner only with appropriate signature authority.
3. The Managing Agent must ensure that the development is in compliance with all LIHTC Program requirements.
4. Managing Agents should ensure that tenant occupancy information is secured and remains confidential, but is accessible to authorized representatives of IHFA and/or the IRS.
5. Managing Agents of developments with Tax Credit allocations granted under the 2008 QAP and future QAPs are required to attend industry sponsored compliance training or to demonstrate proficiency in the program otherwise, prior to receiving the IRS Form 8609 from IHFA. Managing Agents will have to present a certificate from an industry-sponsored training or other alternative documentation before the 8609s will be provided. If agents have previously attended compliance training, certificates from that training may suffice as proof of attendance.

## Compliance Issues

The key to the entire Tax Credit Program, as well as an owner's ability to claim the full amount of tax credits allocated to the development, is continuous compliance with federal and state LIHTC rules and regulations throughout the compliance and extended use periods.

As per IRS Section 42 Section (m), a Qualified Allocation Plan (QAP), identifies the procedures a state agency will follow in performing compliance review monitoring procedures. The section of the code gives broad authority to state housing agencies in order for them to be able to implement oversight responsibilities. The IHFA QAP lists what areas are subject to review and provides a discussion of the Compliance Manual. Please note, the Compliance Manual is part of the QAP. Therefore, state rules and regulations must be adhered to in order for owner/agents to be in compliance.

The following discussion elaborates on several Code provisions directly affecting project compliance. **NOTE: The following is not presented as a complete, all-inclusive listing of compliance regulations. Housing sponsors are responsible for overall compliance, and must be thoroughly familiar with all pertinent aspects of the LIHTC program.**

### Rent Restrictions

The two fundamental components of compliance are as follows:

- Tax Credit units must be rented to tenants that are income eligible at move-in.
- Rent must be restricted according to the maximum limits imposed by using the appropriate formula and income limits.

Units set aside as low-income must be rent restricted as required by Section 42 (g) (2) of the Code. A unit is rent restricted if the "gross rent" does not exceed 30% of the applicable income limitation.

Each year, HUD publishes the Section 8 area median gross income limits for all states. IHFA annually publishes income and rent limit tables on the IHFA website, [www.ihfa.org](http://www.ihfa.org). The IRS requires these income limits, adjusted for family size, to be used when determining eligibility of LIHTC applicants/tenants at move-in and at certification.

**NOTE: Please download the most current income and rent limits for your county or area from the IHFA website, and implement the new limits no later than 45 days after the effective date. Also be aware that any fluctuations up or down in the income limits will have a corresponding impact on maximum gross rent amounts.**

## **Gross Rents**

The Code defines “gross rent” as the sum of unit rent, utility allowances used to cover any utilities a tenant is required to pay other than telephone and any other charges routinely imposed on tenants that are not considered to be optional. (See the following utility allowance section) If low-income tenants are charged more than the allowable rent, the unit is in noncompliance and recapture of credits may result. The gross rent cannot exceed the applicable maximum rent as listed on the current applicable Income and Rent Limit Tables provided by IHFA. Certain exclusions and inclusions must be considered when determining gross rents.

Gross Rent does not include:

- Any payment under Section 8 of the United States Housing Act of 1937 or any comparable rental assistance program.
- Any fee for supportive service, paid to the owner of the unit (or the basis of the low-income status of the tenant of the unit) by any governmental program of assistance or by a tax-exempt organization if such program or organization provides assistance for rent and the amount of assistance provided for rent is not separable from the amount of assistance provided for supportive services.

“Supportive Service” is defined as any service provided under a planned program of services designed to enable tenants of a rental property to remain independent and avoid placement in a hospital, nursing home or intermediate care facility for the mentally or physically handicapped. In the case of single room occupancy or transitional housing for the homeless, such term includes any service provided to assist tenants in locating and retaining permanent housing. **NOTE: This supportive service provision is applicable only to developments receiving credit allocations after 1989.**

- Any rental payment to the owner of the unit to the extent such owner pays an equivalent amount to Rural Development (RD) under Section 515 of the Housing Act of 1949. **NOTE: This RD provision is applicable only to developments receiving credit allocations after 1990.**

Gross Rent does include:

- A Utility allowance for **any** tenant-paid utilities other than telephone.

## **Additional Fees**

Fees for facilities or services that are non-optional, and that are charged to tenants, are included within gross rent. Non-optional services such as a washer/dryer hook-up fee and built-in/on storage sheds would always be included within gross rent.

As per the 8823 Guide, Chapter 11, Page 11-1, “a service is optional when the service is not a condition of occupancy and there is a reasonable alternative.”

No separate fees should be charged for tenant facilities such as pools, parking and recreational facilities if the costs of the facilities are included in the eligible basis. For example: If an owner offers washers and dryers in the units for an additional fee, the cost of the washers and dryers must not be included in the eligible basis and an alternative such as laundry facilities in the building must be provided to the tenants.

**NOTE: Monthly fees charged in addition to gross rent for month-to-month leases are not allowed.**

### **Utility Allowances**

As stated in the previous section, the gross rent includes any utilities other than telephone that a tenant is required to pay. If any utilities are paid directly by the tenant, the Code requires these utility costs to be included with the tenant rent. The sum of both the utilities and the tenant rent must not exceed the applicable maximum rent. The type of utility allowance used depends upon the type of building the unit is in.

- HUD assisted Buildings: If a development receives assistance from HUD, the utility allowance used must be the HUD approved utility allowance.
- Section 515-RD assisted Buildings: If a development receives assistance under Section 515, the utility allowance used must be RD utility allowances.
- HUD and Section 515 Assisted Buildings: If a development receives assistance from both HUD and Section 515, the RD utility allowances must be used.
- Other Buildings: For all other buildings, the local Public Housing Authority (PHA) utility allowances are used as well as local utility company information.

If information from the local utility company is used to calculate the utility allowance, owner/agents must collect utility information this way on an annual basis. The information must include average utility usage and cost for each unit type in order to determine a utility allowance. This information should be collected from the local utility company for any utilities the tenants pay for the preceding twelve- month period. The utility costs per year should be averaged for each unit type and divided by twelve to ascertain a monthly utility allowance. Once completed, an analysis of the new utility allowance, including back-up documentation must be submitted to the IHFA Compliance Department for approval. IHFA compliance staff will review the submission and determine the acceptability of the analysis. This process will be effective January 1, 2008.

Utility allowances must be updated annually or whenever changes are made by the source (PHA, HUD, and RD). Written documentation should be obtained from the source each year of the compliance and extended use periods indicating whether or not

there has been a change in the utility allowance or rates. This documentation must be kept on file for inspection and maintained in accordance with the Record Retention Requirements of the Code.

**NOTE: If an owner/agent decides to calculate allowances through the utility company, they cannot decide the next year to obtain allowance information from their local PHA. Owner/agents must decide during the rent-up process which avenue to take to obtain annual utility allowances. If utility allowances change, owner/agents may need to adjust rents accordingly to remain in compliance with the Code's rent restriction requirement. In addition, any new allowance must be implemented within ninety (90) days of the change.**

### **Overcharging Rent**

A unit is in compliance when rents charged (as defined above) do not exceed the rent limits. However, a unit is out of compliance when tenant rent charged exceeds the maximum rent limits.

If an owner inadvertently overcharges rent during any year other than the first year during the compliance period, the units will be out of compliance until the owner correctly limits the rent for all units affected.

According to the 8823 Guide, overcharging tenants for rent in the first year of the compliance can disqualify the owner from claiming credits. For example, an owner of a 100% building overcharges rent to all units, and as a result, fails to meet the minimum set-aside for the first year of the credit period. Therefore, the building does not qualify for credits. **NOTE: It is very important for owner/agents to establish rents with the knowledge of current utility allowances and rent limits. The IRS may view overcharging tenants in the first year of compliance as an incurable offense.**

### **Household Size**

A household is defined as all occupants who reside in a unit and may or may not be directly related. All household members are considered in determining the family size in a LIHTC unit. Owner/agents must know this number in order to determine the income limit for the combined household.

There are several categories of people that are not counted as household members when determining household size.

- Live-in Attendants
- Visitors or Guests
- Foster Children

- Foster Adults

When determining family size for income limits, the owner must include the following household members even though they are not living in the unit:

- Children temporarily absent due to placement in a foster home;
- Children in joint custody arrangements who are present in the household 50% or more of the time;
- Children who are away at school but who live with the family during school recesses;
- Unborn children of pregnant women (as self-certified by the woman);
- Temporarily absent family members who are still considered family members. For example, a family member in the military deployed overseas;
- Family members in the hospital, or in a rehabilitation facility, for periods of limited or fixed duration;
- Persons permanently confined to a hospital or a nursing home. The family decides if such persons are included when determining family size for income limits. If the family chooses to include the permanently confined person as a member of the household, the owner must include income of the confined person when calculating family income.

**NOTE: Please see “Adding Additional Household Members” in the Compliance Section, page 41.**

## Qualified Basis & Low Income Occupancy

The amount of Tax Credits an owner can claim depends on the number of rent-restricted, qualified LIHTC units in each building of the development. The applicable fraction in the building multiplied by the allowable development costs (eligible basis) establishes the building's qualified basis.

The applicable fraction is the smaller of the following:

- The number of low-income units as a percentage of all residential units; or
- The total floor space of low-income units as a percentage of the total floor space of all residential units.

Qualified Basis is determined on a building-by-building basis and not at the aggregate development level. For Tax Credit developments that are not 100%, the qualified basis can change annually if there is a change in the number of market units in any given building.

Owners have until the end of the initial credit period to establish the development's original low-income occupancy or applicable fraction for each building. The low-income occupancy achieved by the end of the initial credit period establishes the development's original qualified basis. Once the basis has been initially established and credits claimed, the qualified basis is locked in, and must be maintained for the entire 15-year compliance period. Only low-income units in the original qualified basis are eligible to receive the full tax credit value during the accelerated 10-year credit period. The qualified basis of a building may be increased subsequent to the initial determination only by reason of an increase in the number of low-income units or in the floor space of the low-income units. Credits claimed on such additional qualified basis are determined using 2/3 of the value of the credit which is now "de-accelerated" through year 15.

A decrease in a development's applicable fraction reduces its qualified basis. If a development's qualified basis for a given tax year decreases from the previous year, this results in noncompliance and potential recapture by the IRS of some or all of the accelerated portion of the development's credits claimed in prior years.

**NOTE: Problems may occur in establishing or maintaining the qualified basis due to rent-up problems, admittance of non-qualified tenants into tax credit units, or misuse of common areas.**

The qualified basis multiplied by the development's particular tax credit percentage (9% or 4%) determines the amount of credit an owner can claim each year for the 10-year credit period. The allocation of credit dollars is based on a Federal Economic formula that is linked to the type of financing involved. The Federal Economic formula sets forth 9% credits and 4% credits. A nine (9) percent tax credit development is for new

buildings that are not federally subsidized for the taxable year. A four (4) percent tax credit development is for existing buildings which are federally subsidized for the taxable year.

### **Eligible Basis**

According to the LIHTC Developer's Guide, "The Eligible Basis is based upon the costs used to determine depreciable basis of Property." This includes costs such as:

- Engineering Studies
- Architectural Specifications
- Certain Relocation Expenses
- Certain Legal and Accounting Costs
- Construction Period Interest and Taxes
- Developer Fees
- General Contractor Fees

**NOTE: For more information about these potential costs and Eligible Basis in general, please defer to your accountant for guidance.**

Eligible basis includes the low-income units, facilities for use by the tenants (i.e. common areas, elevators, corridors and roofs) and facilities reasonably acquired by the development. The allowable costs of tenant facilities such as swimming pools, other recreational facilities and parking areas may be included, provided there is no separate fee for the use of these facilities and they are made available on a comparable basis to all tenants in the development. Costs of the low-income rental units in a building may be included in eligible basis only if such units are not above the average quality standard of the low-income units. Rehabilitation costs may not be included in eligible basis if such expenditures improve any unit beyond comparability with the low-income units. **NOTE: Eligible basis does not include commercial space. The cost of land is not includable in the adjusted basis either.**

Any change in the eligible basis that results in a decrease in the qualified basis of the project is noncompliance that must be reported to the IRS.

### **Minimum Set-Aside Requirements**

At the time of application, owners must choose one of two minimum set-aside (MSA) requirements. The election, once stated in the Regulatory Agreement and elected on the IRS Form 8609, is irrevocable. If managing agents are unaware of which set-aside

requirement is designated for their development, they must contact the owner of their development.

The set-aside is the minimum number of units that must be rent restricted and reserved for low-income tenants in a building to qualify a building as low income. Pursuant to the Code, the set-aside options are:

- At least 20% of the available rental units in a development must be rent restricted and occupied by tenants whose income is 50% or less of area median gross income (AMGI) as adjusted for family size; or
- At least 40% of the available rental units in a development must be rent restricted and occupied by tenants whose income is 60% or less of area median gross income (AMGI) as adjusted for family size.

These elections are the minimum requirements dictated by IRS Code. An owner must determine if the minimum set-aside (MSA) will be met building –by-building or across the development. Such determination is specified on owners IRS Form 8609. A building is eligible to receive tax credits during the 10-year accelerated credit period only if it meets the elected MSA no later than the close of the first year of the credit period. The development must maintain this set-aside to remain in federal compliance during the initial 15-year compliance period or otherwise stated in the extended use agreement.

The IRS has an additional set-aside for deep-rent skewing, which entail at least 15% of the low-income units in the development to be occupied by households with incomes at 40% or less depending on the percentage designation of the development. Gross rent must not exceed the maximum gross rent applicable for the deep-skewed percentage elected.

Once made, the minimum set-aside and deep-skewed elections are irrevocable. Therefore, the applicable minimum set-aside and deep-skewed designations are set for the duration of the initial 15-year compliance period as well as the extended use period.

**NOTE: Meeting the MSA may not qualify the owner for the full amount of annual credits allocated to a development.**

Minimum set-aside deadlines depend upon the year tax credits were allocated. For developments receiving an allocation between 1987 and 1990, the MSA had to be met within twelve (12) months of the date the building was placed in service. For developments receiving credits in 1991 and thereafter, the MSA must be met by December 31 of the year the development is placed in service, if credits are to be claimed for that year. If the credit start period is deferred until the second year, the MSA must be met by December 31 of the second year. Once the MSA is met, it must be maintained for the entire compliance period as noted above.

### **Other Set-Aside Requirements**

In addition to the required MSA election requirement discussed above, developments have additional set-asides. Owners earn extra preference points in the allocation process by establishing additional set-asides. For example, an owner may decide to house tenants at a deep skewed income rent level of 30% AMI. This set-aside not only gives owners points in the competitive allocation process, but also allows for tenants with a dire need of housing and limited resources.

Additional set-aside requirements are set forth in the IHFA Regulatory Agreement, and are a result of owner commitments or additional loan requirements. Owners must carefully review their Regulatory Agreement for requirements, which may designate units or buildings specifically for the additional set-aside. States may impose set-asides that require certain units to be rented to the elderly or to large families, or may impose lower income limits than the LIHTC code requires.

**NOTE: Owner's must first establish the MSA, and then determine the other set-aside requirements.**

IHFA has allocated credit based upon a specified number of low-income units, and in accordance with the Regulatory Agreement, and will expect compliance with the actual set-aside pledged by the owner after the first year of the credit period. IHFA suggests all owner/agents implement a tracking system for all set-asides to ensure compliance with all requirements. Follow the most restrictive set-aside so that the development will remain in compliance with all set-asides committed to.

### **Unit Status Terminology**

The following is terminology defining unit status that should be considered when leasing units in a tax credit building.

- Vacant Unit: Tax credit unit, which a qualified tenant has vacated.
- Empty Unit: Tax credit unit that has NEVER been rented.
- Market Unit: Unit without tax credit, occupied or not.
- Occupied Unit: Tax credit unit that is currently rented.

### **Vacant Unit**

Under IRS Code, owner/agents cannot count a Vacant Unit as a tax credit unit if the unit did not qualify as a tax credit unit prior to being vacated. Therefore, to be considered a tax credit unit, an eligible tenant must occupy the unit. A vacant unit cannot be counted

as a tax credit unit simply because it is being held for a qualified tenant. **NOTE: The vacant unit counts toward the set-aside and the qualified basis.**

The IRS code has established that if a low-income tenant moves out, the owner/agent may continue to count the unit as a qualified low-income unit as long as a reasonable attempt is made to rent the unit to an eligible household, and no available unit of comparable or smaller size is rented to an ineligible tenant. This provision of the IRS Code allows owner/agents to replace eligible tenants without losing qualified basis. The vacant unit also continues to be counted as part of the minimum set-aside.

“Reasonable Attempts” can be defined as owner/agents efforts toward marketing and renting a unit that is ready for occupancy. Under no circumstances can an owner claim credits on units if the rule is violated. For example, if an owner/agent has three vacant units and violates this rule by renting to a non-eligible applicant, credit on all three vacant units will be lost and the units cannot be counted toward the minimum set-aside.

According to the 8823 Guide, a development is considered in compliance when the owner/agent makes reasonable efforts to rent vacant low-income units (comparably sized or smaller than the vacated unit) to tenants having a qualifying income before units are rented to non-qualifying tenants. Reasonable effort is defined as advertising, contact with waiting list applicants, banner and signage stating vacancies on the development grounds, and other marketing practices.

If reasonable effort is made to rent to low-income tenants, but no one qualifies by way of the resident selection policy, owner/agents may rent a vacant market unit of comparable size or smaller before a low-income unit. The rule only applies as long as none of the current low-income units are over income. The owner/agent must make every possible effort to attract low-income tenants to the development before a market unit can be rented.

IHFA may assess whether owner/agents made reasonable efforts to rent to low-income tenants by reviewing the owner/agent’s advertising practices. Ensure that all advertising practices are available for review during scheduled monitoring visits.

### **Empty Unit**

Units that have never been occupied are referred to as Empty units rather than vacant units. Empty units cannot be counted as low-income units. However, they must be included in the building’s total unit count for purposes of counting the applicable fraction.

According to the definitions above, it may be a best-practice suggestion to rent empty units first before renting vacant units. Empty units are not eligible for tax credits, until an initial, income-qualified tenant rents the unit. Therefore, the initial tenant will give the unit tax credit status.

### **Next Available Unit Rule**

The Next Available Unit Rule amends the regulations under Section 42 (g) (2) (D) of the Code. It applies to all leases entered into or renewed on and after September 26, 1997. Generally, the rule allowed for previously Tax Credit eligible tenants to move to a new unit within the same building. Thus, when a current tenant moves into a different unit within a building, a newly occupied unit adopts the status of the vacated unit.

Specifically, the Next Available Unit Rule dictates that if a tenant's income increases up to 140% of the applicable income limit continues to be treated as a low-income unit if the tenant's income initially met the applicable income limitation, and the unit continues to be rent restricted.

Increases beyond 140% of the applicable income limitations in a tenant's household income are deemed to result in an "over-income unit." The unit may continue to be counted as a low-income unit as long as the following two (2) conditions are met.

- The unit must continue to be rent restricted.
- The Next Comparable Size unit or Smaller Size unit in the building must be rented to a qualified low-income tenant.

The owner of a low-income building must rent to qualified tenants all comparable units that are available or that subsequently become available in the same building until the applicable fraction (excluding the over-income units) is restored to the percentage on which the credit is based.

### **Comparable Unit Defined**

The rule defines a "comparable unit" as a unit that is comparably sized or smaller than an over-income unit (or, for deep rent skewed projects, any low-income unit). The Rule further states that a comparable unit must be measured by the same method (unit fraction or floor space fraction) the taxpayer (owner) used to determine qualified basis for the credit year in which the comparable unit became available.

### **Transfers**

IHFA follows the specific unit transfer policy in the 8823 Guide. According to the guide, when a tenant, whose income is less than 140% of the income limitations, transfers to a new unit, the vacated unit assumes the status of the newly occupied unit that is occupied by the current tenant (units swap status). This is true whether the tenant is transferring within the same building or to a new building within the same project.

A new certification is not required when a tenant moves to another unit because the tenant's current income (re) certification, as well as the lease, moves with them. When a tenant moves within a building, the (re) certification documentation moves with the tenant to the new unit's file folder.

The tenant's income status is determined from the most recent (re) certification. If a tenant's most recent (re) certification is more than 12 months prior to the transfer, then a recertification must be completed as soon as possible.

**NOTE: The potential noncompliance exists for that time period from the due date of the recertification to the date the recertification is completed.**

As indicated above, it is now permissible for those tenants whose incomes are less than 140% of the income limitations to transfer between buildings in a development. However, the IRS Code excludes tenants who earn more than 140% of the income limitations from transferring between buildings within the same development.

### **Noncompliance with the Next Available Unit Rule**

If any comparable unit that is available or that subsequently becomes available is rented to a nonqualified tenant before the original fraction is restored, all over-income units for which the available unit was a comparable unit within the same building lose their status as low-income units and are deemed to be out of compliance. Therefore, violating this rule puts owners at risk for losing credits on all 140% units. These units would no longer count toward the minimum set-aside. It is also critical in the initial credit period that owner/agents do not relocate existing tenants for purposes of qualifying more than one LIHTC unit to count toward the minimum set-aside and applicable fraction. Under NO circumstance can one household be used to initially qualify more than one tax credit unit in the development.

### **Staff Units**

Under IRS Code, owners may count a unit occupied by a full-time staff member as either a qualified low-income Tax Credit unit or part of a development's "common area."

- Counted as a Low-income Unit: If a staff unit is considered a rental unit and included in the building's Qualified Basis, then the staff member must be income-eligible, certified accordingly, and must sign a lease. The staff member must be treated the same as any low-income tenant. In this case, if a staff member receives free rent or a rental discount, the imputed value of the rent or discount must be included as income.
- Counted as Common Area: Revenue Ruling 92-61, Section 13, effective September 9, 1997 allows a unit for a staff member to be considered part of a development's "common area." Such units are not classified as residential units and thus are not included in the applicable fraction under section 42c (1) (B) for purposes of determining the building's qualified basis. If the unit is not a residential rental unit and is used as common area by full-time staff, then the staff does not have to be income-eligible, certified, leased or considered a tenant.

The owner's LIHTC application and the allocation documentation should stipulate the number of "common area" units set aside for staff members. Staff units must be a fixed unit size as dictated in the Placed-In-Service Application. The designated unit size therefore can't float.

The IRS revenue ruling regarding employee units does not apply to any building Placed-In-Service prior to September 9, 1992, or to any building receiving an allocation of credit prior to that date. However, it may apply if the owner filed a tax return that is consistent with this ruling.

The 8823 Guide clarifies the IRS Code, by stating that owners who charge rent for a staff person's "common area" unit may take away the exempt status of the unit. If owners are charging rent for manager units, the IRS has determined that the designated manager's unit is not required to be occupied as a condition of employment. If living on-site were a mandatory condition of employment, a portion of a staff person's salary would be taken out before taxes were remitted. In order for this case to occur, the Placed-In-Service Application and Regulatory Agreement must both state this employment contingency. If not, owners cannot charge for "common area" staff units.

### **Commercial Space**

Any space included in eligible basis of a development cannot be used or considered for commercial space. The IRS, however, does allow for commercial use in a LIHTC development. The Code states, "Residential rental property may qualify for the credit even though a portion of the building in which the residential rental units are located is used for commercial use."

**NOTE: Owner/agents cannot take LIHTC eligible common areas and convert them to commercial space after they have claimed tax credits. A recapture of credits may occur in this case. For Example: If garages are considered part of the eligible basis and a tenant decided to use his garage as a mechanics shop, the garage space (eligible common area) has now become commercial space. This situation may result in tax credit recapture.**

### **Non-Transient Occupancy**

A unit shall not be considered a low-income unit unless it is suitable for occupancy and used on other than on a "Transient Basis." The IRS Code defines "Suitable Occupancy" as: "occupancy determined under regulations prescribed by the IRS taking into account local health, safety and building codes." The Code defines occupancy on a Transient Basis as: "Any unit that is under a lease term less than six (6) months." Therefore, in order for units to be IRS Code compliant, all initial tenant leases must be for a term of six (6) months or greater. Thereafter, a lease term may revert to month-to-month.

**NOTE: Two exceptions to this rule apply to Housing for the Homeless (Section 103 of the Stewart B McKinney Homeless Assistance Act) and Single Room Occupancy (SRO) developments.**

### **Available to the General Public**

Additionally, rental units in a low-income housing development must be available for use by the “General Public.” If units are provided only for members of a social organization or by employers for their employees, the units will not be qualified tax credit units as the general public would not be included. Further, any rental unit that is part of a hospital, nursing home, sanitarium, life-care facility, dormitory, trailer park, retirement home providing significant services other than housing, or intermediate care facility for the mentally and physically handicapped is not for use by the general public and is not eligible for credit under Section 42. However, owners providing housing for elderly, homeless, disabled or handicapped will not violate the general use requirement.

### **Fair Housing**

LIHTC developments are subject to Title VIII of the Civil Rights Act of 1968, also known as the Fair Housing Act, prohibiting discrimination in the sale, rental, and financing of dwellings based on race, color, religion, sex, national origin, familial status and disability.

If IHFA auditors become aware of potential Fair Housing Act violations during compliance monitoring activities, they are obligated to report their concerns to the HUD Regional offices or other fair housing enforcement agencies as appropriate. IRS Form 8823 will be filed with the IRS when the civil action is completed. HUD or the Department of Justice (DOJ) will notify IHFA of the resolution of the alleged violation. Documentation that the owner/agent has complied with the court order and/or HUD’s requirements that the violation has been corrected must be submitted to IHFA as well in order to complete mandatory reporting requirements.

### **Section 8 Requirements**

Under IRS rules, LIHTC owner/agents are prohibited from refusing to lease a unit to a Section 8 certificate or voucher holder. Simply put, Section 8 certificate and voucher holders cannot be denied housing on the basis of their Section 8 status. However, Section 8 participants may not automatically meet Section 42 requirements. The following issues relative to recipients of Section 8 assistance should be considered.

- A Section 8 participant may have income that exceeds LIHTC income limits.
- Fair Market Rent (FMR) and voucher payment standards, both established by HUD, may be less than LIHTC rent preventing certificate and voucher holders from tenancy. For example, if the FMR is \$500 and the development rent, \$525, the Section 8 participant may not be able to rent the unit.

- Poor credit rating, criminal background and/or poor rental history.
- Tax Credit development may have 100% Section 8 subsidy.

Owner/agents denying tenancy to participants of the Section 8 program must document the reason that occupancy was denied. Failure to document that Section 8 certificate or voucher holders applying for LIHTC units were rejected for acceptable reasons, can result in a finding of noncompliance.

### **Students**

IRS Code Section 151 (c) (4) defines the term “student” as “an individual who during each of five (5) calendar months during the calendar year is a full-time student” at an “educational institution” described in Code Section 170(b)(1)(A)(ii). Treasury Regulation Section 1.151-3(b) provides that a full-time student is one who is enrolled for some part of five calendar months for the number of hours of courses, which is considered to be a full-time attendance. The five calendar months need not be consecutive months.

Further, Section 151(c) (4) of the IRS Code states that “in no case is a unit considered to be occupied by low-income individuals if all of the occupants are students.”

Therefore, households consisting of all full-time students are not eligible to live in units receiving tax credits. Some additional considerations relative to students follow:

- Part-time Students are NOT “Students” under LIHTC program rules.
- Recent high school and college graduates cannot rent a tax credit unit until the beginning of the next calendar year. For example, an applicant has just graduated in May from high school. The applicant is not eligible to rent a tax credit unit until the following January when the taxable year begins again.
- School attendance exclusively at a night school does not constitute full-time attendance. However, full-time attendance at an educational institution may include some attendance at night in connection to a full-time course of study.
- Full-time student status includes enrollment in grades K-12, depending on the standards of the individual educational institution.
- Individuals pursuing a full-time course in institutional farm training, under the supervision of an accredited agency, are deemed to be full-time students.
- Further, full-time students who are employed full-time are still considered full-time students regardless of their employment status.
- The student rule does not contain a grandfather clause. Therefore, a qualified tenant may become a non-qualified tenant after move-in if the tenant decides to

become a full-time student. If the household contains one non-school aged child, working adult or part-time student, the student rule does not apply. When the child starts school, however, the household would not be eligible since the program does not allow grandfathering. For this reason, student status must be re-verified at annual re-certification to confirm continuing eligibility of the household.

### **Exemptions Available Under the Student Rule**

At no time during the lease, or any extension thereof, may the unit be occupied entirely by full-time students unless the household meets one or more of the following student rule exemptions, contained in Section 42 (i) (3)(D). A unit would not be disqualified for tax credits if it were occupied as follows:

(i) By an individual(s) who is/are:

- A student receiving assistance under Title IV of the Social Security Act, i.e. ADFC / TANF; or
- Enrolled in a job training program receiving assistance under the job Training Partnership Act or under other similar Federal, State or Local laws; or
- Married and able to file a joint tax return; or
- As per the new law under IRC 42 (i)(3)(D)(ii)(I), a unit can be treated as a low-income unit if it is occupied entirely by full-time students if such students are (I) single parents and their children and such parents are not dependents (as defined in Section 152, determined without regard to subsection (b)(1)(b)(2) thereof) of another individual, and such children are not dependents (as defined) of another individual other than a parent of such children.”

The new law allows full-time students who are single parents and their children to live in LIHTC units, provided that their children are not dependents of another individual, other than a parent of such children. For example, a single mother has two full-time students living with her and the children’s father is not living in the unit. This unit **will** qualify if the children are dependents of either the mother or father. Under the old law, they would not qualify if the children were dependents of a parent not living in the unit.

**Note: According to the 8823 Guide, a married couple that is entitled to file a joint tax return but has not filed one still satisfies the exception to the full-time student rule. For example, a recently married full-time student couple is looking for housing. The couple is income qualified, but they have not yet filed their first tax return. Even if the couple does not file a joint tax return, they are still entitled to file a joint return, and thus qualify for the exemption.**

If all of the occupants of the unit are full-time students and their status does not fall within one of the above exemptions, the household may be eligible to live in the development, if the development has market units. However, if the development consists of 100% Tax Credit units, this type of household would not qualify for residency.

### **Suitability of Units**

In order for owners to claim credits, a development and its units must be suitable for occupancy in accordance with state or local codes. If a unit is not habitable, no credits can be claimed. In a related situation, the IRS has ruled that should a unit be destroyed due to casualty loss (i.e., fire, flood or any other disaster) for which credits cannot be claimed while the unit is being replaced, that should the unit be restored within a reasonable time, credits can again be claimed and no recapture would occur.

According to the 8823 guide, Casualty Loss is defined as, “the damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual.” Casualty loss ranges from car accidents, fires, government demolitions, hurricanes, mine cave-ins, sonic booms, storms, tornados, vandalism, etc. Property damage is not considered a casualty loss if the damage occurred during normal use, the owner willfully caused the damage or was willfully negligent, or a progressive deterioration, as in the case of damage caused by termites.

The physical damage due to the casualty loss must be reported as noncompliance with UPCS Code or local standards. However, as soon as the damage is fixed, the damaged area will be considered in compliance once again.

Tax credit units that are vacant during the course of unit turn must be made rent ready as soon as possible. Otherwise, they may not be considered suitable for occupancy and may be subject to an 8823 filing.

According to the 8823 guide, if an owner has a high vacancy rate with a large number of empty units not suitable for occupancy, they are considered in non-compliance. “Not Suitable for Occupancy” can be defined as not rent ready in a reasonable amount of time. For example, a vacant unit is inspected on March 1<sup>st</sup> and find the unit under rehabilitation (no carpet, appliances are not in place, painting has not been started). Management states the move-out date was July – the unit had been vacant for 9 months. Because of the long vacancy, an 8823 would be filed and the unit considered “out of compliance” until the owner/agent can return the unit to rent ready status.

## Part 2: Development Operations

### Procedures in Qualifying Tenants

Due to the scarcity of affordable housing resources, and the need to allocate those resources to truly needy households, owner/agents must ensure that they take the steps necessary to provide housing only to those who are truly low-income. Going forward, owner/agents must ensure that they adhere to appropriate steps within the application process in order to assure an effective allocation of housing resources.

#### Application Process

Owner/agents must be diligent in obtaining complete and accurate tenant information when collecting tenant applications. The application form is the first step in determining tenant eligibility. Therefore, the application should request complete and comprehensive information regarding income, assets, student status and previous rental history.

Owner/agents must also demonstrate due diligence in determining applicant eligibility by asking applicants whether they anticipate changes to their employment status or whether they intend to seek any additional or changed employment opportunities within the next twelve months. Owner/agent's due diligence in determining applicant eligibility must be verifiable. IHFA strongly suggests that owner/agents alter or add proper verbiage to yes/no questionnaires to ensure applicants are asked anticipated income questions. These types of move-in questions help ensure compliance, and may protect owner/agents against tenant misrepresentations relative to anticipated income.

IHFA also strongly suggests that owner/agents establish a resident selection policy that provides for credit/criminal background screening for every potential tenant. Screening criteria when properly and consistently employed may decrease the likelihood of problems going forward.

#### Income and Asset Determination

The IRS Code states: "Tenant income is calculated in a manner consistent with the determination of annual income under Section 8 of the United States Housing Act of 1937 (Section 8) and not in accordance with the determination of gross income for federal income tax liability." The HUD Handbook 4350.3 REV1 defines gross annual income as the *anticipated* total income from all sources to be received by members of the household (with some exceptions), including all net income to be derived from assets during the twelve (12) months following the effective date of the initial certification or recertification.

**Note: The Tax Credit program uses Gross annual income and not adjusted annual income in calculating tenant eligibility.**

The HUD Handbook 4350.3 REV1, Chapter 5, provides a discussion of how to correctly calculate gross income. Further, Exhibit 5-1 and 5-2 of the Handbook both list Income and Asset inclusions and exclusions. Since a variety of eligibility situations arise during certification processing, IHFA anticipates LIHTC development staff will be thoroughly familiar with income-qualification requirements and protocols. The list below of suggestions below, while not all-inclusive, is provided to assist in the qualification and certification process.

### **Gross Annual Income**

Considerations when determining gross annual income include:

- Gross income should always be annualized even if the period of time is less. For example, a teacher's income received for nine months should be annualized.
- Owner/agents must calculate income by both the traditional way (hours, rate of pay and weeks) and by the year-to-date earnings. The highest calculated amount must be used as the tenant's gross employment income.
- If a third-party verification states a range of hours worked, i.e. 7-10, owner/agents should use the average to calculate anticipated employment income. However, if it is owner/agent policy to use the highest number in the range, IHFA auditors will accept the calculation, with the stipulation that owner/agents are aware that they may prevent someone from qualifying for a tax credit unit by calculating the higher hours worked.
- Unless otherwise noted on the third-party verification, i.e. seasonal work, income that cannot be anticipated for a full twelve (12) months (such as unemployment compensation) should be calculated assuming current circumstances.
- Military employment- Per the 8823 Guide, unless an individual is the head of household, spouse or co-head, a temporarily absent individual on active duty must be removed from the household and his/her income must not be included in the computation of household income.
- As per the HUD Student Rule of April 10, 2006 and clarified in the 8823 Guide, "for any student under age 24 who is seeking housing without his/her parent, financial assistance in excess of amounts received for tuition from private sources or from an institution of higher education shall be considered income to that individual..." Persons over the age of 23 with dependent children are exempt from this ruling. Financial assistance does not include loan proceeds but does include grants received for the purpose of attending higher education.
- The HUD Handbook 4350.3 REV1 states that childcare expenses that are not reimbursed are not included as annual income. However, if such childcare is

paid by a *non-custodial* parent in lieu of all, or part, of child support payments, owner/agents should include this childcare income within gross income.

- As per HUD's Rental Housing Integrity Improvement Program (RHIP), irregular, nonrecurring monetary gifts or contributions to tenant are ***not*** included in gross income.
- The earned income of full-time students 18 years or older who are NOT the head, co-head or spouse is excluded to the extent that it exceeds \$480 annually.

### **Asset Income**

Special considerations relative to counting income derived from assets are:

- Assets should always be included on the Tenant Income Certification (TIC) whether or not the asset yields actual income. Owner/agents should never assume that because a household has little income, that they have no assets.
- There is no limit on the amount of assets a household may hold and they are not required to convert an asset to cash in order to live in a tax credit unit.
- If an applicant/tenant declares a combined total asset value of less than \$5,000, third-party verification is not necessary. However, any actual income the applicant/tenant receives from the asset must be added to regular income. An Under \$5,000 Certification must be used to self-certify total assets under \$5,000.

If total assets exceed \$5,000, a third-party verification must be sent to the appropriate asset holders to verify the accounts and pertinent balances. The asset income included in household gross income will be the greater of: (a) the actual asset income, or (b) the imputed income from assets, which is the net family assets multiplied by the passbook rate specified by HUD. Currently, the passbook rate is 2%.

**NOTE: Owner/agents who have HOME units must verify all assets through the third-party verification process, in accordance with HOME regulations.**

- When determining asset income, owner/agents must calculate the cash value of an asset. Cash value is defined as the market value of an asset minus any reasonable costs that would occur if the asset were converted into cash unless it is already in cash form. Costs may include brokerage/legal fees when selling an asset, penalties on an investment like an IRA for early withdrawal and costs for real estate transactions.
- At each certification and annual recertification, applicants and tenants must declare whether or not an asset has been disposed of for less than fair market value during the two years preceding the date of application or the effective date

of the recertification. An asset is considered disposed of for less than fair market value if the cash value of the asset disposed of exceeds the gross amount the tenant received by more than \$1,000.00. If it does exceed this amount, for two years owners must include in the total household assets the difference between the cash value of the asset and the amount received.

## Verifications

All regular sources of income, including asset income must be verified. In order of their acceptability under LIHTC and HUD guidelines, verifications should be accomplished: (1) Through a third-party via direct written communications; (2) Through second-party activities such as check stubs, W-2's, bank statements, and divorce decrees that are supplied by tenants/applicants; or, (3) Through tenant/applicant self-certifications. Methods other than third-party verifications should be used only when third-party verification methods have been attempted for a minimum of two weeks (efforts must be documented), and are deemed to be either impossible or impractical. Third-party verification activities must be conducted independent of tenant involvement – i.e., tenants may not be allowed access to verification documentation such as through hand-carrying forms or documents to, or returning forms from third parties.

Verifications must contain complete and detailed information and must, at a minimum, include direct written information from all sources of regular income. The required employment verification must be thoroughly completed by the employer. If any mandatory information is not provided, owner/agents must follow-up with a phone clarification to obtain the information that was omitted in the original verification. Clarifications must be documented in the tenant file. Complete verifications and/or phone clarifications are a key program requirement and thus are subject to in-depth review during compliance audits.

According to the HUD Handbook 4350.3 REV1 Change 2, Page 5-52 & 5-59, if third-party verifications are not received within two (2) weeks of the request, owner/agents may attempt to verify income and assets via second-party verification such as pay-stubs. However, before second-party verifications are pursued, owner/agents must verify their attempt at getting the original third-party verifications. Such documentation may include fax cover sheets or written notes indicating follow-up efforts to obtain the third-party verification. The follow-up evidence and documentation must be placed in the tenant file.

Owner/agents please note – **third-party verifications must never be altered.** Owner/agents must never write on the verification themselves. Writing in calculation information, or filling in incomplete areas on the verification itself will invalidate that verification. Additionally, “whiteout” must never be used, as this will call the veracity of the original information into question. If there is a need to clarify information, a phone clarification document should be used to obtain and record any additional information not appearing on the third-party verification. Any clarification document must have the name and signature of the party completing the clarification document, the date performed, and the source of the additional information.

Phone clarifications must never be used in place of a third-party verification. The phone clarifications should only be used when a third-party verification is not clear or complete and/or there is conflicting information. Clarifications will not supersede any information

originally obtained through a third-party verification. The third-party information must be used to qualify applicants/tenants.

Third-party verifications are valid for 120 days only. They are not valid if they precede the effective date of the TIC by more than 120 days.

**NOTE: Verifications must be received by owner/agent prior to the execution of the TIC and the actual move-in date. They may not be obtained after the actual move-in date.**

### **Forms of Verification**

The following briefly describe acceptable forms of verification:

- **Employment Income:** Verification form completed by the employer or a statement from the employer, which must include the anticipated income for the following 12 months, as well as current year to-date earnings. If employer verification is not possible, then current check stubs from the employer showing gross income per pay period and frequency of pay. As a last resort, a copy of the most recent income tax return signed by the applicant/tenant or copies of Form W-2 providing the amount of income, including income from tips and other gratuities, supported by current check stubs from the employer.
- **Self-Employment Income:** Self-employed applicants/tenants must provide sufficient documentation to prove they are income qualified. A tenant statement, whether notarized or not, is not sufficient documentation to verify income. In this case, when obtaining written third-party verification is impossible, owner/agents must obtain the following tenant-supplied documentation in support of tenant eligibility:
  1. For businesses that have filed taxes:
    - Form 1040 with Schedule C (business income) for the past year must be obtained. This form is only valid if the tenant was self-employed, in the same profession, throughout the previous year.
  2. For new businesses and those that have not filed taxes:
    - An audited or unaudited financial statement of the business, as well as, a notarized statement signed by the applicant/tenant stating the anticipated income for the 12 months following certification.
    - An independent accountant's statement of net income.

- Copies of applicant's/tenant's business bank statements, and covering all of the applicant's/tenant's business. This method is only applicable in cases where the applicant/tenant separates business finances from personal finances.
- *Social Security, Pensions, Supplemental Security Income (SSI) Income:* A benefit verification form completed by the agency providing the benefits, or an award letter or benefit letter, or other printout prepared by the authorizing agency. Checks or bank deposits slips often show only net amount remaining after deducting SSI, Medicare, or state health insurance, and thus should not be used. If this form of documentation is used, any withholdings must be verified and included in annual income.  
**NOTE: Since income calculations are based upon anticipated income figures during the next 12 months, owner/agents should include the published Cost of Living Adjustment (COLA) in the calculation of gross income. The COLA can be found on the Social Security Administrations web site.**
- *Unemployment Compensation:* A verification form completed by the unemployment compensation agency, or records from the unemployment office stating payment dates and amounts. **NOTE: Unemployment compensation benefits must be annualized regardless of the number of weeks noted on the third-party verification.**
- *Alimony & Child Support Payments:* A copy of a separation or settlement agreement or a divorce decree stating the amount and type of support and payment schedule, a printout or statement from the Support Enforcement Agency, a signed statement from the person paying support (i.e. a former spouse not currently residing in the household), or a signed self-certification by an applicant/tenant indicating that they are not receiving child support payments, and have taken legal steps to enforce collection.

If a signed self-certification is accepted, the statement should indicate whether the tenant will be seeking or expects to receive child support payments within the next 12 months. If the tenant has a child support agreement, but is not presently receiving any child support payments, the applicant/tenant should include an explanation of this and all supporting documentation; i.e. divorce decree or court documents. Also the self-certification, according the 8823 Guide, should indicate that the tenant will notify the owner of any changes in the status of the child support.

**NOTE: You must include the amount specified in a divorce settlement, separation agreement or other legally binding document as income unless the applicant/tenant certifies: (1) the income is not being provided, and (2) he/she has made reasonable effort to collect the amounts due, including filing with courts or agencies responsible for enforcing payments.**

- Recurring Contributions and Gifts: Self-certified statement of affidavit signed by the person providing the gift and indicating the frequency and value of the gift, a verification letter from the bank, attorney or a trustee administering the gift, or a notarized statement from the receiver of the gift stating the frequency and value of the gift and copies of the checks. **Note: Contributions and gifts that are received sporadically are not counted as income.**
- Public Housing Authority/Section 8 Voucher Holders: If an applicant/tenant is receiving a housing assistance payment under Section 8, owner/agents do not have to obtain written third-party verifications and are no longer required to obtain the 50058 from Public Housing Authorities. According to the 8823 Guide, owner/agents may accept and rely upon a statement from the Public Housing Authority (PHA) that certifies the voucher holder does not exceed the applicable LIHTC income limits. A new Statement form, found at Exhibit 1, is the mandatory document required for Section 8 voucher holder information in lieu of obtaining a 50058 from the PHA, or third-party verifications. If owner/agents are unable to obtain the new Statement from the PHA, they must then follow third-party verification procedures necessary to income-qualify the applicant/tenant. **Note: The gross income, as noted on the new PHA-supplied Statement, must be reflected on the TIC. Supporting verifications that underlie the Statement must also be current – no less than 120 days old.**
- Unemployed/Zero Income Household Members: The income of unemployed applicants/tenants with regular income from any other sources, such as Social Security, pension, recurring gifts, etc., must be verified as specified in the sections appearing immediately above.

All adult members of the household who are currently unemployed must complete a self-certification such as a Statement of No Income to verify they are not employed, nor are they anticipating any changes in that status, and/or do not intend to seek any additional or changed employment opportunities in the next twelve (12) months. Ensure that the self-certification is placed in the tenant file.

If an applicant/tenant is currently unemployed and claiming no income, but intends to live off of assets only, ensure all asset income is verified as previously stated.

- Student Status: Owner/agents must include student status questions on applications and/or questionnaires that allow them to determine if an applicant or tenant has been a student for any portions of five calendar months within the current calendar year. This question will allow owner/agents to demonstrate due diligence in determining student status prior to move-in and/or annual recertification.

Owner/agents must verify student status and financial aid, excluding K-12, by sending third-party verifications to appropriate educational institutions.

**NOTE: Students who are over the age of 23 with dependent children, or a student living with their parents are exempt from this requirement.**

## **Tenant Income Certification**

Once all sources of income and assets have been properly obtained, owner/agents must calculate and record anticipated annual gross income using a Tenant Income Certification (TIC form found in **Exhibit 1**) to document formally that the applicant/tenant qualifies for LIHTC housing.

### **TIC Effective Dates**

The effective date of an applicant/tenant's TIC is the date the tenant actually moves into the unit. All adult members of the household must sign the certification. Per the 8823 Guide, if the certification is more than 120 days old, the applicant/tenant must provide a new certification.

Further, the income recertifications performed annually must be based on the anniversary of the move-in effective date.

If for whatever reason an owner/agent is late in completing an annual recertification, the TIC effective date will be the tenant signature date. The next annual recertification, if performed in a timely manner, will again be the anniversary date of the original move-in. Also, ensure that all recertification documentation is obtained and the TIC generated first before tenants sign the late recertification paperwork. Backdating TICs is an event of non-compliance.

### **TIC Signatures**

Per the HUD Handbook 4350.3 REV1, all adult household members must sign all documents and forms, either before, or when they move-in to the unit in order to be eligible for LIHTC housing. This stipulation includes the lease and the TIC. However, there will be situations where obtaining signatures will be impractical. In these circumstances, owner/agents should document the reason for the delay in the tenant's file and secure the signature as soon as possible.

Generally, ensure that TICs are thoroughly and accurately completed, and that all required signatures have been obtained. Incomplete or inaccurate TICs could represent an event of non-compliance. Additional attention should be given to the following - effective and move-in dates, Section 8 rental assistance from a public housing authority, HOME program units and BIN numbers.

### **Adding Additional Household Members after Move-in**

According to the IRS 8823 Guide, if an income qualified person moves into a unit and "soon thereafter", a second tenant joins the household putting the household above the income limits, the unit is out of compliance as of the original tenant's move-in date. The IRS has not, to date, defined "soon thereafter." In order to remove the ambiguity this

provision created, IHFA has made the determination that a change in household composition that occurs within the first six (6) months of tenancy will be deemed to have occurred “soon thereafter.” (IHFA’s adoption of this definition is consistent with accepted industry practice in this area as it has evolved since the release of the 8823 Guide.) The new/changed household must re-qualify for the unit as of the date of original move-in. If the original move-in occurred prior to new published income limits and the new tenant moves in after the new income limits, the household must re-qualify at the old income limit rates. In other words, the new/changed household must qualify under the income limits that were in place at the date of original move-in.

If a new household member moves into a household after the original six (6) months have passed, the household will not have to re-qualify since the event did not occur “soon thereafter.” The new household member must sign a lease and owner/agents must prepare a new TIC to reflect the new household composition of the unit. Only at annual recertification will the new household member’s income be included in gross income.

### **Recertification**

Owner/agents are required to recertify each low-income household at least annually and may begin 120 days prior to the anniversary date of move-in. IHFA is required under program guidelines to review tenant recertifications and any supporting documentation. Therefore, IHFA will always be reviewing the most recent income recertification or move-in, whichever applies. The recertification process is identical to the initial certification in terms of documenting household composition, income and income from assets. The annual recertification process also assists owner/agents in identifying changes in household attributes such as student status, household composition changes, and provides for compliance with the next available unit rule, where applicable.

Owner/agents are in compliance if the recertification process is completed within 120 days before anniversary date of move-in. If an owner/agent has sent timely recertification notices to a tenant, but the household does not respond because they are vacating the unit, the vacated unit will not be considered out of compliance with the recertification requirements. Owner/agents must always document the attempts made to recertify the household by placing copies of the Annual Recertification notifications in the tenant file.

Prior to the new IRS 8823 Guide, it was common practice to accept an interim certification date as a starting date for the next annual recertification in LIHTC developments with Rural Development (RD) subsidy. As of January 2007 and the advent of the 8823 Guide, this practice is no longer deemed to be acceptable. All RD developments must recertify tenants on the anniversary date of the original move-in under the LIHTC program – regardless of when the last interim recertification in any layered program may have taken place.

**NOTE: This changed requirement is important! Owner/agents may miss anniversary dates of move-ins, resulting in late re-certifications and possible 8823 submissions.**

### **Non-Compliance at Recertification**

A LIHTC living unit is considered to be out of compliance and subject to an 8823 submission if the annual recertification is not performed, or the annual recertification was performed *late and after* an IHFA compliance review. If non-compliance is determined by the owner/agent and corrected prior to an IHFA review, the unit is not considered to be out of compliance and an 8823 will not be submitted to the IRS.

According to the 8823 Guide, there are two methods owner/agents may use to correct non-compliance. With both methods, owner/agents must submit copies of all documents that demonstrate the issue has been rectified.

1. A recertification can be performed using current income and asset sources and current income limits. If there is no resulting non-compliance such as a violation of the Next Available Unit Rule, the unit would be out of compliance on the date of the recertification was due and back in compliance on the date the tenant signed the recertification paperwork.
2. A retroactive recertification can be performed which clearly documents all sources of income and assets that were in place at the time the recertification should have been completed and applies income limits that were in effect on that date. If there is no resulting noncompliance such as a violation of the Next Available Unit Rule, the unit would be out of compliance on the date the recertification was due and back in compliance on the date the tenant signs the certification.
3. Even though the certification is performed retroactively, the recertification documents should be dated with the current date. All adult members of the household should sign the TIC and all appropriate documents with the current date. Backdated documents are not acceptable and are considered to be an event of non-compliance.

In both methods the effective date on the TIC will be the anniversary of the actual move-in date.

### **Changed Income after Move-In**

The LIHTC program exists to provide affordable housing resources to those that are truly in need of such assistance. Changes in individuals' incomes can and do occur with a fair degree of regularity; IHFA acknowledges this situation and is supportive of individuals' efforts to better their life circumstances. However, due to the potential for misrepresentation by applicants in this area, the Association has determined that a

defined timeframe is appropriate in order to address ambiguity surrounding this issue, and in order to assist owner/agents with compliance in this area. Thus, an increase in income within the first 60-days of tenancy that puts a household over the initial income limits will be considered a misrepresentation of eligibility unless the owner/agent can demonstrate through due diligence, and to a reasonable degree of certainty, that the changes were unintended and unanticipated as of the date of move-in. If this level of assurance cannot be demonstrated, the household will be deemed ineligible, and the living unit deemed to be out of compliance as of the move-in date. To reiterate, owner/agents must be able to demonstrate that the changes were unintended to a reasonable degree of certainty, in order to avoid an event of non-compliance.

In order to illustrate this changed requirement, consider the following... An applicant states on the application they are not working and don't intend to work in the next 12 months. Further, the applicant completes a Statement of No Income, wherein they state they are not working and do not intend to seek employment in the next twelve months. After move-in, if the tenant decides within the first sixty (60) days of tenancy to seek employment, the household may be considered over-income and the unit out of compliance if income from these changed circumstances places the household's income over the current income limitations. When Owner/agents discover this circumstance at the tenant's first annual recertification, they must perform due diligence and re-qualify the household at the point where income changed in order to ensure the household was not over the income limits in effect at the time of original move-in. If the household is over-income as a result of the re-qualification process, the owner/agent must either perform the necessary due diligence required to effectively demonstrate that the change was neither anticipated nor intended at the time of move-in; or the owner/agent must recognize an out-of-compliance condition, and proceed with appropriate corrective actions necessary to bring the unit back into compliance.

If misrepresentation is suspected, owner/agents must take the necessary steps to verify the accuracy of the information provided by the tenant. If necessary, owner/agents may ask the tenant to complete Form 8821, Tax Information Authorization, which will provide confirmation to the owner of the accuracy of the tenant's IRS tax return.

### **Tenant Misrepresentation or Fraud**

Owner/agents must be able to demonstrate due diligence in their efforts to prevent tenant fraud. According to the 8823 Guide: *"...fraud includes **deliberate** misrepresentation of fact in order to induce someone else to part with something of value or surrender a legal right. The outcome of deliberate misrepresentation by a tenant can result in the development's owner/agent renting a unit to an ineligible tenant at below market rate..."*

**NOTE: Consult the Chapter 25 of the 8823 Guide for additional details relative to fraud-related program requirements, and owner/agent responsibilities in this area.**

### **Annual Recertification Waiver**

An amendment of the Omnibus Budget Reconciliation Act of 1993 allows an Owner of a 100% LIHTC development to request the IRS to waive the annual tenant income recertification requirement. The Compliance Monitoring Agency must concur with the request, and must certify that the property is 100% low-income occupied. Currently, IHFA has determined it will not endorse an annual recertification waiver for any Idaho LIHTC property during its Federal Compliance Period. However, the Association will consider waivers for 100% low-income developments, on a case-by-case basis, once a development reaches the Extended Use Period and credit recapture risks no longer exist. Consideration for this waiver will be based on an owner/agent's ability to demonstrate a pattern of on-going and successful program administration and management, and their ability to maintain compliant operations. This determination will be made at the sole discretion of IHFA. Only developments with no other funding sources or program layering, such as HOME, RD, or project-based Section 8 are eligible for consideration for the recertification waiver.

## Other Issues Impacting Development Operations

### Leases

All tenants occupying tax credit units must be certified, and must have executed a lease no later than the date the tenant takes possession of the unit. All adult members of the household, including dependents that are 18, must sign the lease agreement. The lease start date and the move-in date, and must be the same date and reflected as such on the TIC.

IHFA does not specify a model lease for LIHTC developments as long as the lease contains information sufficient to satisfy the following minimum requirements:

- Legal name of the parties to the agreement and all additional occupants.
- Unit number.
- Date the lease is effective.
- Term of the lease (minimum of 6 months per IRS, regulations unless the housing is Single Room Occupancy [SRO], where 30-day lease terms are appropriate).
- The amount of rent tenant must pay for the duration of the lease.
- The rights and obligations under the lease, such as the obligation to recertify income annually.
- Signature pages including dates.

**NOTE: Owner/agents must ensure that they enter into leases under the LIHTC program with all Section 8 Voucher holders, even though the Public Housing Authority (PHA) may also have established a lease arrangement with the tenant. The lease initiated by the PHA and tenant is not an acceptable substitute for the LIHTC lease, and will not be recognized as such. The LIHTC lease must be an agreement between the owner/agent and the adult members of the household – exclusive of any PHA involvement and any additional requirements that may result from involvement of the PHA.**

### LIHTC Developments Combined with Other Assistance Programs

Properties that combine LIHTC with HOME or other federal programs have a unique set of rules that must be observed in order to maintain compliance with program regulations. It is imperative that applicants are Tax Credit eligible before any additional regulatory requirements are met. In other words, the LIHTC program is the primary program and all requirements associated with it must be satisfied before additional

requirements related to other programs are observed. The following is a list of the types of programs that may be associated with the LIHTC program:

1. HOME: If HOME funds are included in a LIHTC development, at least 20% of the total units must be reserved for households with incomes at or below 50% of the area median income and 80% of the HOME funded units be rented to households at 60% or less of area median income.

For HOME units to qualify as low-income units, rents and income cannot exceed either program limit. Low HOME rents are subject to 50% HOME income and rent limits. High HOME rents are subject to 65% of HOME income and rent limits. HOME units can be deep skewed at the 30% or 40% income and rent limits. Owner/agents must be aware that both deep skewed unit types have HOME income limits, however rent limits are not stated on the HOME rent limit charts. Therefore, owner/agents must use the Tax Credit rent charts to obtain 30% and 40% rent limits. If a unit is being counted under both programs, the stricter rent limit applies. **NOTE: Owner/agents may have to obtain both Tax Credit and HOME income and rent limits to determine household eligibility.**

When tenants receive additional subsidy through rental assistance such as Section 8 or Rural Development (RD), the rents may be raised to the rental assistance program limit only if the following HOME requirements are met:

- The tenant is paying no more than 30% of their adjusted income.
- The subsidy is project-based (affects the entire development, not just a single unit).
- The tenant's income is less than 50% of the area median income.

**NOTE: The Tax Credit rule of allowing the tenant's rent to be raised to the higher Section 8 rent limit as long as the tenant pays no more than 30% of their adjusted monthly income does not apply when a unit is combined with HOME funds. According to the 8823 Guide, the "portion of the rent paid by Section 8 tenants can exceed the LIHTC rent ceiling as long as the owner receives a Section 8 assistance payment on behalf of the tenant." This does not apply to HOME units.**

Unless the subsidy is project-based (not tenant-based), the total HOME rent is the maximum amount from all sources that the owner/agent may receive for HOME assisted units. Therefore, a tenant's rent, utility allowance and rental subsidy amount CANNOT equal more than the applicable HOME rent limit.

In addition to obtaining the HOME income and rent limits, Owner/agents must follow three HOME Program requirements.

- Owner/agents must obtain copies of Social Security cards for all tenants. This requirement dictates that all tenants are US citizens or have legal status under Homeland Security guidelines.
- Tenants, who live in HOME designated units, must sign a one-year lease. The HOME program dictates all leases must have an initial term that is a minimum of twelve (12) months.
- HOME regulation requires third-party verification of all asset income, whereas the Tax Credit program rules require verification of asset income only if the household's assets are greater than \$5,000. For units that combine both HOME and LIHTC units, the stricter HOME rules apply and all assets must be third-party verified.

For those owner/agents who must adhere to both program requirements in one development, IHFA ensures compliance through annual monitoring. Under the Tax Credit program, the affordability period is generally 30 years, unless developments agree to longer extended use periods. Developments with HOME monies may have affordability periods of 5-20 years depending upon the type of development and the amount of HOME dollars invested. As a result, developments with combined HOME and LIHTC units may be subject to two sets of affordability periods and will be monitored according to each specific program requirement.

**Note: Failure to establish and maintain compliance with HOME Program regulations could result in an event of default under the HOME Note, Deed of Trust and Regulatory Agreements, which would be noted as a Program Violation.**

2. Rural Development (RD): Rural Development subsidy may be included in LIHTC developments. Owner/agents must not only certify through the subsidy process that the tenant is receiving rental subsidy, but is also qualified to live in a LIHTC unit.
3. Deep Skewed Units: In addition to an election of the minimum set-aside, owner/agents may elect to provide housing to households with incomes of 40% or less of the area median income per regulatory agreements with IHFA. The election of the deep skewed units is a means for developers to gain additional points in the qualified allocation process. By agreeing to allocate units at a 30% or 40% area median income, owner/agents agree to rent units to those households whose income is extremely low.

For developments with 30% and 40% area median income unit restrictions, owner/agents must apply the 140% or Next Available Unit Rule at annual recertification. Based on the assumption that the tenant was a qualified 30% or 40% area median income tenant at move-in, the tenant or household continues

to be a qualified tenant provided the tenant's income does not increase above 140% of the applicable 30% or 40% gross area median income limit. If the tenant's income increases above 140% of the 30% or 40% gross area median income limit, then the next available unit of equal size or smaller (subject to the established square footage applicable fraction) must be rented to a qualified 30% or 40% area median income tenant. The rent of the "over-income" tenant will remain at the 30% or 40% level until such time as the next available unit is rented to a qualified tenant. Once the next available unit is rented to a qualified tenant, the rent of the "over-income" tenant can be converted to the next applicable area median income level, depending upon the minimum set-aside.

**NOTE: LIHTC regulations only require a minimum set-aside of 20/50 or 40/60. Owner/agents must be aware of the minimum set-aside and deep-skewed designations for their own developments. The Placed-in Service Application and Regulatory Agreement should be available to those who are responsible for adhering to these requirements.**

### **Notification of the Fair Housing Actions**

LIHTC developments are subject to Title VIII of the Civil rights Act of 1968, which makes it unlawful to discriminate in any way relating to the sale or rental of housing because of race, color, religion, sex, disability, familial status or national origin.

Due to a 2000 Memorandum of Understanding between the IRS, HUD and the Department of Justice, an agreement exists between the parties to cooperate with each other in all Fair Housing compliance issues. Such cooperation comes in the form of interagency assistance and training. Procedures exist for notifying the IRS of charges, lawsuits and other actions under the Fair Housing Act involving LIHTC developments.

According to the 8823 Guide, State agencies must report Fair Housing notifications and legal action issued by HUD or the Department of Justice to the IRS via an 8823.

If IHFA discovers potential Fair Housing Act violations during compliance reviews, the Association is obligated, pursuant to the Memorandum of Understanding, to report the potential violations to the applicable HUD FHEO office or other fair housing agencies as applicable. IHFA will submit an 8823 to the IRS based upon subsequent actions taken by those agencies. The 8823 Guide provides additional guidance relative to this issue.

### **Extended Use Agreement**

For all buildings allocated Tax Credits after 1989, IRS regulations dictate that owner/agents enter into an extended use agreement. Extended use periods are typically reflected in paragraph 6 of the IHFA LIHTC Regulatory Agreement. Building owners must agree to a long-term commitment on the first day of the 15-year compliance period and ending on the later of (1) the date specified by IHFA in the Regulatory Agreement or (2) the date, which is 15 years after the close of the 15-year

compliance period. In other words, the owner/agent commits to maintain the development as a low-income housing project for at least 30 years. Owner/agents may receive allocation points for electing for a longer extended use agreement.

### **Termination of Participation in the Program**

The IRS stipulates that there are several ways regulatory agencies can terminate tax credit participation. According to Treasury Regulation 1.42-14(d) (2) (iv), IHFA or the IRS may pull the entire amount of credits allocated to owner/agents due to the following:

- A building is not placed in service within the required time period.
- A building fails to meet set-aside requirements.
- The building does not comply with the terms of its credit allocation.
- The owner and IHFA mutually agree to cancel an allocation of credit.
- Tax credits allocated to a development are not necessary for the financial feasibility of the development.
- Egregious noncompliance.
- Voluntary withdrawal from the LIHTC program.
- Failure to respond to repeated notices of compliance reviews, annual reporting and owner certifications.

When a building is no longer participating in the LIHTC program, the Extended Use Period is terminated. Owner/agents must note that the termination of participation in the program and of the Extended Use Agreement does not mean tenant rights under the LIHTC program are forgone.

Tenant Rights must be protected subsequent to termination per the following:

- Eviction or Termination (other than for Good Cause) of a current tenant before the close of the 3-year period following the termination of the extended use period is prohibited; and
- A gross rent increase of any unit occupied by an existing tenant before the close of the 3-year period following the termination of the extended use agreement is prohibited. Therefore, income-qualified tenants continue to be rent restricted for three years or until the tenants vacate the unit, whichever comes first.

### **Disposition of LIHTC Development during the Compliance Period**

Disposition of a LIHTC development in the initial compliance period (the first 15 years) requires the owner selling the development to post a Surety Bond directly with the IRS. The IRS will approve the bond when it is determined that the amount of the bond is correct. The development must remain in compliance for the balance of the initial 15-year compliance period. The bond must remain in effect until 58 months after the end of the 15-year compliance period. Surety Bonds may be difficult and costly to obtain. Accordingly, IRS Revenue Procedure 99-11, as periodically updated, establishes an avenue for owners to pledge specific forms of collateral in order to satisfy bonding requirements associated with the sale of a development during the compliance period. Failure to post the required Surety Bond, or to pledge the necessary collateral, will result in an event of noncompliance.

**NOTE: The IRS can “call a bond” to recapture credit if it subsequently determines that the new owner has not operated the development as a qualified low-income development for the remainder of the compliance period.**

## **Part 3 – Compliance**

### **Compliance with Program Requirements**

IHFA is responsible for establishing compliance monitoring procedures based on LIHTC program requirements; utilizing the requirements contained in both the IRS code, the 8823 Reporting Guide, and HUD Handbook 4350.3 REV 1. IHFA conducts periodic inspections to assess the degree to which owner/agents are following the guidelines referenced above. Compliance with the applicable regulations is ultimately the responsibility of the Owner/Agent, who can be liable for consequences resulting from noncompliance. It is vitally important that owner/agents understand fundamental program requirements, and IHFA monitoring procedures and how on-going compliance can impact tax credits, and participation in the program.

#### **Regulatory Agreement**

Developments receiving an allocation of tax credits after December 31, 1989 must execute and are subject to a Regulatory Agreement. The agreements are signed between owner entities and IHFA, and are recorded in the county where the development is located.

A Regulatory Agreement contains covenants that govern the development throughout the compliance period. Such covenants include but are not limited to the following:

- Amount of annual credit.
- Number of low-income units.
- Area Median Gross Income Targeting- 50% or 60%.
- Extended Use Term.
- Very Low-Income Targeting.
- Additional commitments pledged during the application / allocation process.

It is not only the responsibility of the owner, but of the management agent as well, to understand the contents of the Regulatory Agreement. Both parties should acquaint themselves with all aspects of the development's commitments, and with provisions contained in the governing documents.

#### **Additional Tax Credit Commitments**

Owner entities will often make additional commitments to receive preference points during the Tax Credit application and allocation process. These additional commitments are typically recorded in paragraph 10 of the IHFA Regulatory Agreement. Owner/agents are expected to fulfill those commitments during both the compliance period, and the entire extended use period.

Such commitments often include:

- Targeting households with lower income levels than the IRS minimum set-aside requirements.
- Restricting unit rent levels.
- Providing amenities and supportive services.
- Extending affordability periods.
- Reducing developer and contractor fees.
- Developing housing that serves populations with special needs such as persons with physical or developmental disabilities, the homeless or the elderly.

IHFA will monitor compliance with any such commitments contained within the Regulatory Agreements. Owner/agents should ensure that they are meeting all agreed-upon commitments. If not, non-compliance will be noted in the IHFA audit report.

### **Tax Credit Allocation Period and Initial Credit Period**

Once a development's Tax Credit allocation has been finalized, the tax credits can be claimed annually on a building-by-building basis over a 10- year period. This 10- year period begins during either the taxable year in which the building is Placed-in-Service or at the election of the owner, the succeeding taxable year. The development's owner entity must elect the Initial Credit Period on each building's IRS Form 8609. Once made, this election is irrevocable.

It is important for management agents to know when the credits were or will be claimed for the first time because the compliance period starts the first year the credits are claimed. No credits may be taken if the building does not comply with IRS regulations for meeting initial compliance.

### **Tax Credit Compliance Period**

Section 42 regulations require an initial 15 years of continuous compliance – also known as the “federal compliance period.” However, with the advent of extended-use periods,

owner entities are required to extend the low-income housing commitment period by a minimum of an additional 15 years beyond the initial 15-year federal compliance period.

State allocating agencies have been granted the authority to impose additional requirements over and above the federal standards to better address local housing needs, including extending the period of affordability. IHFA grants preference points to developments that extend the period of affordability beyond the 30- year commitment. Therefore, owner entities are committed to a longer period of compliance than the original compliance period.

A complicating factor exists when Tax Credit developments are coupled with other subsidy programs such as HOME. There are times when conflicts between programs may arise. Care must be exercised to ensure that the most restrictive of these competing program requirements is met.

### **Placed-In-Service Date**

All monitoring and compliance is on a building-by-building basis. The date an owner can formally qualify Tax Credit units and initiate the start of the compliance period for a building is called the “Placed-in-Service Date”. The date is the day the owner/agent receives a building’s certificate of occupancy.

Each building has only one placed-in-service date. It is possible to have the same or different dates for different buildings in a Tax Credit development.

For New Construction, the Placed-in-Service date corresponds with the date of the certificate of occupancy. The occupancy date is “the date on which the building is ready and available for its specifically assigned function, i.e., the date on which the first unit in the building is certified as being suitable for occupancy in accordance with state of local law.” This is the date when the first unit in a building could be occupied, not when it was occupied.

For acquisition and rehabilitation developments, the owner entities must select a Placed-in-Service date, which may be any date within a 24-month period corresponding with the period between the date the building was acquired and the date the rehabilitation work is completed.

All projects must be Placed-in-Service by the end of the second calendar year from the date of the allocation of Tax Credits. Owners must document the date by completing an IRS form 8609 for each building in the development. (Refer to Reporting Requirements on page 11).

## **IHFA Compliance Monitoring Procedures**

The IHFA Compliance Department will begin inspection of LIHTC developments within two years of the Placed-in-Service date. As soon as 8609 documents are completed

and filed, developments will be added to IHFA's inspection regime. Owner/agent compliance responsibilities commence shortly after placed-in-service occurs. Once the lease up period is completed, owner/agents must provide IHFA with an IHFA Occupancy Report that includes all first year household information. Owner/agents have 30 days from the completion of lease-up in which to submit the required occupancy report.

Going forward, the Compliance Department will perform an on-site inspection and file review at least once every three years thereafter. If a development has HOME, Bond or ICRC funding, compliance reviews will typically be conducted on an annual basis depending on the individual Regulatory Agreement. Owner/agents will be notified of the site visit a minimum of 30-days in advance. IHFA will make every effort to accommodate emergency situations and re-scheduling requests, but audit dates are not always negotiable due to travel schedules and the added costs associated with last-minute changes to pre-arranged travel. Schedules are tight, and on-site visits must be geographically coordinated in order to mitigate travel costs.

### **IHFA Required Tax Credit Program Forms**

In an attempt to ease the burden associated with both compliance and oversight, IHFA requires the use of a very limited number of forms. The required forms are found in **Exhibit 1**. Forms used by owners / agents must replicate these forms as to both content and format. Deviations from these formats will not be considered acceptable. The following list represents the forms that are considered mandatory:

- Owner's Certificate of Continuing Program Compliance
- Annual Occupancy Report
- Tenant Income Certification (TIC) – An original certificate, signed by all adult members of the household and owner/agents, which demonstrates household members are qualified to live in the low-income unit
- Employment Verification
- PHA Statement of income-qualification of tenant/applicant

An additional array of forms is included in **Exhibit 2**. These forms are included for owner / agent use on a recommended basis only. They are not required, but we recommend that their use be strongly considered since they will facilitate the gathering of information necessary for compliance.

### **IHFA Audit/Inspection Procedures**

Following are the basic procedures IHFA will adhere to when planning and conducting LIHTC compliance monitoring reviews:

- Contact the Owner/agent via notification letter, and request pre-audit documentation such as rent rolls, etc...
- Only original tenant file documentation will be reviewed. File reviews will no longer be conducted at owner/agent offices, but will be conducted at the site where the original files are maintained.
- On-site visitations include a review of 20% of tenant files, all vacant units, and inspection of 20% of the occupied units as well as all common areas.
- If findings/issues are determined to exist, a formalized Compliance Report will be generated and sent to the owner/agent within 30-days of the on-site review. Owner/agents will have 30-days to respond. If owner/agents are late with a response without an explanation or an approved extension, they will be in non-compliance. An 8823 Form will be filed with the IRS reflecting the non-compliance.
- IHFA will approve extensions if owner/agents need the time to rectify findings and issues on-site. Owner/agents must ask for an extension in writing and must abide by the deadlines they set for themselves or those that IHFA sets for them.
- Owner/agent responses to audits will then be reviewed and appropriate notifications will be sent informing them of their compliance status. Auditors may need additional documentation for a particular finding or the owner/agent response may be sufficient to close a review.
- Auditors at this stage will send appropriate correspondence to owner/agents. If an owner has remedied an IRS Reportable Finding or remain out of compliance, an 8823 Form will be filed with the IRS reflecting the fact that issues of non-compliance have been corrected. If an owner has not adequately addressed or resolved a reportable finding, an 8823 Form will be filed with the IRS reflecting a continuing out-of-compliance condition. IHFA will also send the owner a copy of the 8823 Form(s) concurrent to filing the form(s) with the IRS.

## **IHFA Review, Inspection, and Reporting Standards**

IHFA auditors perform both file reviews and on-site inspections. Both monitoring tasks include specific documentation and condition standards that must be followed in order for developments to be successful in their compliance efforts. Association auditors will request rent rolls as a necessary first step in planning and preparing for the review. As soon as the rent roll is received from the owner/agent, auditors determine which of the units to inspect, and which files to review by selecting a judgmental sample. Auditors make every effort where possible to choose from those of the development's units that were not inspected in the previous year. Program guidelines require that a 20% sampling of files and living units be used as the foundation for the audit.

**NOTE: The rent roll is the only document the auditors have at their disposal when selecting samples of files/units prior to arriving on-site. Please note that IHFA may file 8823 forms with the IRS if owner/agents chronically fail to provide rent rolls prior to scheduled inspection.**

### **The Tenant File Review Procedures**

As indicated earlier, in each case, IHFA requires review of original documentation only. The following original documents will form the basis for a file review:

- Tenant Rental Application
- Tenant Lease and Addendums, if applicable
- Tenant Income and Asset Disclosure
- Tenant Income Certifications (TIC)
- Third-party verifications of income and unearned income
- Under \$5,000 Asset Certification \*
- Documentation supporting tenant eligibility, i.e....credit, criminal checks.
- Move-in Unit Inspection Report

**\*All assets must be verified for HOME units. The \$5,000 limitation applies only to Tax Credit files.**

Events of non-compliance may occur based on identification of the following types of issues:

- Tenants are not qualified under the LIHTC Program.

- Qualified low-income tenants are charged improper or unrestricted rents.
- Owner/agents failed to maintain properly executed certification or failed to re-certify tenants prior to move-in anniversary date.
- Owner/agents failed to document tenant income eligibility and identify full-time students.
- Tenant records such as applications, leases, third-party verifications and TICs are insufficient, inaccurate and/or incomplete; or they evidence any other deficiencies that would impair their validity.
- Owner/agent lease does not have minimum LIHTC standards such as a 6-month lease term or the lease is not properly executed.
- Owner/agents fail to perform background checks when their resident selection policy requires they perform this tenant screening criteria.
- Owner/agents fail to gather and implement utility allowance changes annually.
- Rents, including other regularly assessed charges, exceed annual published limits.
- Owner/agents failed to comply with IRS record-keeping requirements.
- Other issues that evidence a departure from LIHTC program rules or requirements.

### **Physical Inspection Procedures**

Owner/agents are not only responsible for ensuring tenant files are maintained in a compliant fashion, but that the development is structurally sound, functionally adequate, in good repair and free of health and safety hazards.

IHFA Compliance Auditors require owner/agents or their designated representatives to accompany them on all physical inspections. If the auditor is unable to gain access to a unit during a physical inspection, a replacement unit may be chosen at the discretion of the auditor.

Shortly after the physical inspection, IHFA auditors will perform an exit interview to discuss all inspection findings and/or comments. This meeting provides owner/agents with the opportunity to ask questions, confirm observations, and / or refute findings.

Pursuant to program guidelines, IHFA utilizes the Uniform Physical Condition Standards (UPCS)/REAC Standards promulgated by HUD to assess the physical condition of the

LIHTC developments. For specific physical inspection information, please refer to HUD's UPCS/REAC protocol, found at 24 CFR 5.703. That guidance, as well as additional REAC documents and guidance, can be accessed at [www.hudclips.org](http://www.hudclips.org). The UPCS/REAC standards require developments to be in "decent, safe and sanitary condition and in good repair" and require IHFA to inspect the following major areas:

- Site: Site components include, but are not limited to, fencing, retaining walls, grounds, lighting, project signs, parking lots and driveways, play areas and equipment, refuse disposal equipment, roads, storm drainage, and walkways. All items must be free of health and safety hazards and in good repair / working order, as applicable.
- Building Exterior: Each building on-site must be structurally sound, secure, habitable, and in good repair. Each building's door, fire escapes, foundations, lighting, roofs, walls and windows must be free of health and safety hazards, operable and in good repair / working order, as applicable.
- Building Systems: Each building's domestic water, electric systems, elevators, emergency power, fire protection, HVAC, and sanitary system must be free from health and safety hazards, functionally adequate, operable and in good repair / working order, as applicable.
- Dwelling Units: Each dwelling unit within a building must be structurally sound, habitable and in good repair. The unit must be free from health and safety hazards, functionally adequate, operable and in good repair / working order, as applicable. This includes all areas and aspects of the unit, i.e., bathroom call for aid and fixtures, ceilings, doors, electrical systems, floors, hot water heaters, HVAC, kitchen, lighting, outlet/switches, patio/porch/balcony, smoke detectors, stairs, walls and windows.

Each living unit also must include at least one (1) battery operated or hard-wired smoke detector in proper working condition on each level of the unit.

- Common Areas: Common areas also must be structurally sound, secure and functionally adequate for the purposes intended. The basement, garage/carport, restrooms, closets, utility, mechanical, community rooms, day care, halls and corridors, stairs, kitchens, laundry rooms, office, porch/patio/balcony and trash collection areas, if applicable, must be free from health and safety hazards, operable and in good repair / working order, as applicable.
- Health and Safety Concerns: All areas and components of the development must be free of health and safety hazards. These areas include, but are not limited to, air quality, electrical hazards, elevators, emergency/fire exits, flammable materials, garbage and debris, handrail hazards, infestation and lead based paint.

Please refer to the “Dictionary of Definitions” within the REAC program documentation for further information and examples. According to the REAC protocol, violations in each of the inspection areas listed above may be present at any of three levels, one being the least severe, and three being the most severe. According to the 8823 Guide all violation levels are considered to be IRS Reportable items. Please see Page 6-4 of the 8823 Guide for further explanation of this standard.

### **Compliance Concerns Related to Physical Condition**

A unit, building, or development may be out of compliance due to the following:

- The owner/agent incorrectly certifies that the buildings and units in the Tax Credit development were suitable for occupancy. For example, if an owner/agent certifies that a unit has been turned and is rent ready for a new tenant, but an inspection discovers the unit is still under rehabilitation, the unit is considered out of compliance and will be noted as an IRS Reportable finding on the report. Per the 8823 Guide, all vacant tax credit units that are not suitable for occupancy are out of compliance and are subject to an 8823 submission. Accordingly, move-out units are subject to inspection in order to ensure compliance.
- The development evidenced conditions that failed to meet UPCS standards. For example, the development may have findings that include parking lot potholes and exterior paint peeling problems. These issues, if noted during an inspection, will be included in the report.
- Owner/agent fails to comply with the requirements of the REAC protocol at any time. Non-compliance in this case may mean the owner/agent is not living up their agreement to maintain affordable housing in a decent, safe and sanitary state. Such non-compliance will lead to an 8823 filing.
- Casualty Loss to a unit, building or any part thereof at any time during the compliance period. A Casualty Loss is defined as the damage, destruction or loss of property resulting from an identifiable event that is sudden, unexpected or unusual. It may result from a number of different sources such as, car accidents, fires, tornados, hurricanes, storms vandalism, etc...; it is not damage that occurred during normal use, or that was caused through willful negligence, or through progressive deterioration such as damage caused by an infestation. Physical damage to LIHTC developments caused by casualties such as those mentioned will render units and buildings unsuitable for occupancy and therefore, out of compliance. An 8823 submission would be required.

### **Audit Reports / Responses**

IHFA will provide owner/agents with a written report of findings within 30 days of the date a review is conducted, and will anticipate any required response from the owner/agent will be provided back to IHFA within a similar timeframe. The

report/response phase of the examination process provides the owner/agent with an opportunity to review the issues noted, and take corrective actions as necessary and appropriate to any deficiencies noted. This period also provides owner/agents with an opportunity to question any findings that, upon further investigation, are found to be without merit. If the owner's documentation clearly refutes a report finding, it will be dropped – i.e. the noted condition will not be reported to the IRS via an IRS 8823 Form.

Once the report/response phase is completed, IHFA will file 8823 forms with the IRS as required. The 8823 forms are required to reflect the status of any reportable conditions of non-compliance noted during the review. A development is back in compliance when reportable/reported findings are corrected. Owner/agents must confirm all IRS Reportable findings have been corrected by supplying IHFA with works orders, invoices or other pertinent documentation with their response to the review. IHFA, on occasion, may determine that visual inspection is needed to determine the owner/agent is back in compliance. If so, the Association will notify the owner/agent, and will schedule a follow-up visit.

IHFA's reports may also include observation or recommendation items in the "Comment" portion of the report. These items are for owner/agent information only, and are not required to be addressed via the response process. Comment items may not need a response; however they do represent issues that IHFA believes housing sponsors should consider for possible corrective action, or for procedural change.

### **IHFA Compliance Auditing Protocols- Extended Use Period**

IHFA has established a separate monitoring protocol that will be followed for developments that have completed their federal compliance period (the first 15 years), and are entering the required extended use period. During the extended use period, audits will be conducted as follows:

- Frequency: Monitoring will occur at three (3) year intervals, or more frequently as IHFA deems necessary.
- Scope: The number of tenant files and living units will be reduced. Ten percent (10%) of the files and units will be audited.
- Monitoring Fees: Monitoring fees will be reduced to two-thirds (2/3) of the standard annual fees that are payable during the federal compliance period (the initial 15 year affordability period).
- Monitoring Protocol: All other auditing protocols such as scheduling, notice, file reviews, reporting, etc... will remain the same.

## **On-Going Compliance Activities**

### **Owner Reporting**

Owners are responsible for completing a “Certificate of Continuing Program Compliance” each year. IHFA normally sends out a notice relative to this requirement during the month of December. The Certificate is due to the IHFA Compliance office by February 28<sup>th</sup> of each year. For example, the report for 2007 is due February 28, 2008; etc...

Owners are also responsible for completing and submitting an Annual Occupancy Report. The report, which must be submitted with the “Certificate of Continuing Compliance”, must show all tenants that have lived in the development in the last year. Compliance Auditors will use the year-end report to ensure compliance with the next available unit rule and reasonable vacancy time-periods. Examples of both reports can be found at **Exhibit 1** in the Appendix of this manual.

### **Monitoring Fees**

In order to support the monitoring efforts of designated Compliance Monitoring Agencies, Tax Credit developments are required to pay a modest monitoring fee on a per-door basis each year. To account for changes in operating costs, these fees are indexed in Idaho. After the initial base monitoring fee of \$30.00 per living unit was established, IHFA utilized the annual change in the Consumer Price Index (CPI) published each January to annually adjust the monitoring fees. Thus, fees will only be increased at a rate that is consistent with the overall rise in prices in the general economy.

Additional fees may be required in specific circumstances. If non-compliance is discovered and IHFA determines that an additional or out-of-pattern follow-up review is necessary, an additional charge based on the current monitoring fee then in effect will be charged for every file and / or unit inspected. For example, if IHFA auditors have to perform a follow-up 100% file review on a 40 unit development, and the current year’s monitoring fee was \$31, the additional fees due and payable as a result of the review would be calculated as follows: 40 files x \$31.00 = \$1,240.00.

Monitoring fee invoices will be sent to housing sponsors during January each year. Monitoring fees are due February 28<sup>th</sup> of each year.

## **Conclusion**

It is vitally important owners/agents remember that the responsibility for maintaining compliance in an LIHTC development rests solely with the owner. Due to the complexity of the program, and the risks and exposures involved, IHFA encourages owner/agents to ensure that management and staff involved in both initial leasing activities, and in on-going operations are adequately trained and versed in the tax credit program so that compliance can be maintained. The Association is available to provide technical assistance wherever needed, but, as the designated Compliance Monitoring Agency, bears no responsibility for on-going compliance at LIHTC developments. To reiterate, IHFA is responsible for monitoring compliance on an on-going basis and for reporting on conditions of non-compliance – owners are responsible for maintaining compliance with all applicable program requirements.

Owner/agents are invited to contact IHFA Compliance Staff in order to discuss LIHTC questions and concerns in order to arrive at acceptable solutions.