

**HAWAII HOUSING FINANCE
AND
DEVELOPMENT CORPORATION**

**Low Income Housing Tax Credit
Compliance Manual**

Effective March, 2009

HAWAII COMPLIANCE MANUAL

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Low-Income Housing Tax Credit Disclaimer

These materials are intended to assist owners in meeting the requirements for complying with Internal Revenue Code Section 42 and Section 1.42-5 of the Regulations thereunder. However, it is important to note that compliance with IRC 42 and the Regulations is solely the responsibility of the owner of the building for which Low-Income Housing Tax Credit is allowable, and the owner is solely responsible for the consequences of any non-compliance. The information contained in this Manual is presented without any representation or warranty whatsoever regarding the accuracy, completeness or currency of the information. The information contained in this Manual is subject to change without notice. HHFDC shall not be liable for any loss or damage caused by any inaccuracies in the information contained herein, and suggest you review such information for accuracy prior to implementation.

HAWAII TAX CREDIT DOCUMENTS

The following items should be inserted here.

- a. **Tax Credit Application / Consolidated Application**
- b. **Notice of Low-Income Housing Tax Credit Reservation (if applicable)**
- c. **HHFDC Carryover Allocation (if applicable)**
- d. **Tax Credit Declaration**
- e. **Copies of Original, Completed, Signed Forms 8609**
- f. **Utility Allowance Source Documentation (updated annually)**
- g. **Limited Partnership Documents**
- h. **Certificates of Occupancy**
- i. **Income limits**

Tax Credit Overview

*Credits at
9% or 4%*

*Qualified
Allocation Plan*

INTRODUCTION

1.1 The Low-Income Housing Tax Credit (LIHTC)

The Tax Reform Act of 1986 established a tax credit for low-income rental housing that was directly based on the number of low-income tenants residing in the complex. Section 252 of the Act and Section 42 of the Internal Revenue Code (IRC) govern the Low-Income Housing Tax Credit (LIHTC) program that began in 1987 and received permanent authorization with the Omnibus Budget Reconciliation Act of 1993. The LIHTC program provides incentives for investment of equity capital in the development of affordable single family or multifamily rental housing. The credit is a dollar-for-dollar reduction in tax liability to investors in exchange for equity participation in the construction or acquisition and rehabilitation of rental housing units that will remain income and rent restricted for an extended period of time.

Credits are allocated based on a federal economic formula of approximately 9% for non-federally subsidized projects or below market rate interest deals, i.e., “conventional” developments, or approximately 4% if the project is federally subsidized or given an interest subsidy, such as tax-exempt bonds or Rural Development. The acquisition credit for existing buildings is approximately 4%. Developers may be for-profit or nonprofit. Investors, often represented by limited partnerships, apply the tax credits to reduce their income tax liabilities. Individuals can claim Credits up to the equivalent of a \$25,000 deduction. Corporate and bank investors have no limit on credit amount.

Hawaii’s Qualified Allocation Plan (QAP) includes guidelines for the competitive ranking of applications. The amount of credits given to each state is based on population, indexed for inflation, with a minimum of \$2 million. Hawaii may also have credits from previously unallocated or returned credits or by using the credits originally allocated to other states that failed to use them. The latter are referred to as credits from the “National Pool.”

Many recognize the tax credit’s influence on development, but its effect on management must also not be minimized. In order

Purpose of the Manual

Reference for owners and managers

for properties to qualify initially for the LIHTC and to continue to receive the credit without risk of recapture, management must at minimum, follow all tax credit regulations throughout a 15-year compliance period. From a management perspective, a thorough understanding of the tax regulations governing this program is imperative.

1.2 Purpose of the Tax Credit Compliance Manual

This manual is intended to help owners and managers of LIHTC projects in the State of Hawaii fulfill their obligations in maintaining compliance pursuant to Section 42 of the IRC. The *General Explanation of the Tax Reform Act of 1986* (the “Blue Book”) [Section 8], IRC Section 42 regulations [Section 9], and excerpts from HUD Handbook 4350.3 REV-1 [Sections 22-24] are included in this manual for reference. Additional Hawaii requirements for owners of a tax credit property are delineated in the Declaration of Restrictive Covenants for Low-Income Tax Credits.

Owners are responsible for being aware of all applicable federal and state rules and regulations that govern their properties.

This manual focuses on the responsibilities of owners and managers of LIHTC projects from the beginning of the lease up period through the end of the compliance period. Subjects discussed include:

- Owner’s recordkeeping requirements
- Occupancy regulations
- Properly evaluating tenant income, assets and eligibility at move-in and at re-certification
- Determining the maximum gross rent for units
- Regulatory considerations when leasing vacant units

Sample forms, including those required for tenant certification procedures, are provided in Section 6 of this manual.

“Required” forms are specified in the instructions for that section. *Upon approval, other income or asset verification*

Credit Period

Credits given over a 10-year period

Compliance Period

Compliance required for 15 years.

forms may be substituted for those provided in this manual.

In the State of Hawaii, The Hawaii Housing Finance and Development Corporation (HHFDC) is the housing credit agency administering LIHTC allocations. HHFDC is dedicated to providing quality affordable housing and is committed to helping owners of LIHTC properties understand and fulfill their obligations under the program. This manual is intended as a reference to promote a better understanding of the LIHTC program.

1.3 Credit Period

Once an LIHTC allocation has been finalized for a property, the tax credits can be claimed annually on a building-by-building basis over a 10-year period, beginning either with

- (a) the taxable year in which the building is placed in service, or
- (b) at the election of the taxpayer (owner), the succeeding taxable year.

The election under subparagraph (b), once made, is irrevocable. No credits are given if the building does not comply with IRS regulations for meeting initial compliance. This means that eligible households must occupy the required number of units throughout the ten-year credit period plus an additional five (5) year term (*see "Compliance Period"*). The housing units designated for the LIHTC must also be rent-restricted for a specific period of time.

1.4 Compliance Period

The tax credit program requires fifteen (15) years of continuous compliance, but allows the credit to be taken over a ten (10) year period. Beginning with 1990 allocations (and no later than 1991) state housing credit agencies began the requirement of extended low-income housing commitments that are recorded in local land records. Owners of these developments must agree to commit to an additional 15-year low-income use of the project beyond the initial 15-year compliance period. It is important for management to understand that such projects are committed to a minimum 30-year time frame of compliance with tax credit eligibility requirements.

*Extended
low-income
use period*

If a building is not initially qualified by the end of the first year of the credit period, tax credits associated with unqualified units will earn two thirds credit over the compliance period.

The Declaration of Restrictive Covenants binds the owner and any successors to maintain specific occupancy and affordability requirements for the projects. The agreement may list the exact number and size of units that must be low-income at designated income levels (including state deep skew set-asides), provisions for allowing staff units, and special needs groups to be served.

The extended use period may terminate for any building if:

- (a) acquired by foreclosure, or
- (b) the housing credit agency is unable to find a buyer in the 1-year period following the current owner's request in the last year of the compliance period to acquire the owner's interest in the low-income portion of the building.

Section 42 also provides that each individual state has the power to impose additional requirements over and above the federal standards to better address local housing needs inclusive of extending the period for which the property is kept as affordable housing, and HHFDC has used this authority to provide for an extended use period of more than thirty (30) years that is not subject to prior termination in certain cases, for example, if owners have obtained a higher ranking for their project in the application process by committing to extended affordability.

An additional factor complicating management of tax credit projects is that LIHTC properties are often coupled with subsidy programs (both project-based and tenant-based) that have 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 is met.*

Five
Regulation
Periods

1.5 Five Tax Credit Regulation Periods

Since the 1986 enactment of the LIHTC, Congress has changed or amended the laws governing the program, yet many changes have not been retroactive. In some cases, the change in regulations brought forth by a technical correction is minor; in others, the effect is substantial. Management must not only be aware of the

*The years
referenced
pertain to the
allocation year.*

differences in regulations, but must have full knowledge of what tax credit law applies to each particular building and/or project. The relevant law for management/compliance purposes is that applicable to the year in which tax credits were allocated by the state housing credit agency. Currently, there are five specific tax credit regulation periods as follows:

I. January 1, 1987 – December 31, 1989

Properties receiving credit allocations during this period based rent on the number of people living in the unit. Rents were subject to change whenever the household composition changed. The Omnibus Reconciliation Act of 1993 allowed owners of these projects a one-time opportunity to either maintain the per person rent formula or elect to change to the formula based on apartment bedroom size used for 1990 and later allocations. The owner had to write to the IRS no later than February 6, 1994 to request this election. Once made, the decision to switch formulas or not was irrevocable. The new rent formula only affected new move-ins on or after the election date. A copy of the election letter must have been provided to HHFDC or its Authorized Delegate and must be available during any compliance review. *Please note that all properties allocated credit during this time period have now completed their compliance periods.*

II. 1990

- Rent is calculated by number of bedrooms in a unit (not retroactive).
- Gross Rent Floor adopted (not retroactive).
- Extended Low-Income Housing Commitment required.

III. 1991

- AFDC Student Rule exception (retroactive).
- FmHA Overage Rule (not retroactive).
- Extension on Initial Compliance with Set-Aside (not retroactive).

IV. August 10, 1993

- Married Students Rule (retroactive).
- Single Parent Student Rule (not retroactive).
- 1987-89 Rent Change Option (special rule).

Additional Ruling

- Section 8 requirement (retroactive) where projects cannot refuse to lease to Section 8 tenants.

V. - Single Parent Student Rule revised, December 2007 (retroactive) [Section 27]

1.6 Additional Rule Change

Another important revenue ruling was later issued that was not retroactive.

I. September 9, 1992

- IRS Revenue Ruling 92-61 deals with treatment of staff units as part of the eligible basis [Section 13].

Important Compliance Factors

*Income eligible
and rent restricted*

COMPLIANCE ISSUES

2.1 General Compliance

Unlike any other federal housing program, the LIHTC program is administered by the IRS. 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 project, is *continuous compliance* with federal and state LIHTC regulations throughout the compliance period.

The two fundamental components of compliance are as follows:

- Tax credit units must be rented to households 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.

An LIHTC project may have both tax credit units (low-income units) and market (unrestricted rent) units, or it may have 100% tax credit units. The project may also have nonresidential units specified in the LIHTC application and designated in the Declaration of Restrictive Covenants for Low-Income Housing Credits. The income eligibility and restricted rent requirements apply only to the low-income units. These issues will be discussed in more detail later in this manual.

Each Allocating Agency or their Authorized Delegate must monitor owners to ensure properties are in compliance. The IRS requires that all findings of noncompliance, whether corrected or not, must be reported. A leading cause of noncompliance stems from the owner's failure to inform management of the specific regulatory commitments that have been made. Once credits have been allocated for a property, it is imperative that management be given copies of all regulatory and extended use documents to keep on file, including the Tax Credit Application, IRS Form(s) 8609 [Section 10], and Certificates of Occupancy.

HHFDC requires that these documents be inserted into Section ii (immediately before Section 1) of this manual and always be readily available for review by your monitoring agency. The

Allocation year

*Recordkeeping
by building*

*Monitoring begins
when building
places in services*

following make up HHFDCs regulatory documents:

- Declaration of Restrictive Covenants for Low-Income Housing Credits
- Copies of the original completed, signed 8609s
- Utility Allowance Documentation, updated annually
- Tax Credit Application

Additional key issues are as follows:

- A. **Allocation year** – As previously stated in Section 1, different compliance regulations are in force depending on the year the tax credit allocation was awarded. The most important compliance issue is that all monitoring/compliance is based on the year of **allocation**. *The first two numbers of the Building Identification Number is the allocation year.* Maintain a record of this date.
- B. **Compliance by building** – All monitoring/compliance is a **building** issue. Records must be kept by building and by unit number, not by project or alphabetical order by tenant. Every LIHTC building receives a separate IRS Form 8609 and is assigned its own BIN (Building Identification Number). Required annual reports must be submitted by BIN.
- C. **Placed-in-service date (PIS)**– For the LIHTC, a building’s **placed-in-service date** initiates the start of compliance monitoring for that building. Each building has only one placed-in-service date for new construction or rehabilitation credits. It is possible to have the same or different dates for different buildings. For new construction, this date is the certificate of occupancy date—“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 or local law.” [Section 19] It is the date when the first unit in a building *could* be occupied, not when it *was* occupied. For rehabilitation of an existing building, the owner selects any date within a 24-month period over which rehab expenditures are aggregated. The placed-in-service (PIS) date is recorded on the 8609 form for each building. Be sure you have documentation to back up the PIS date for

Eligible basis equals allowable development costs

every building in your project. *It is important to note: If you have Section 8 tenants, as in a HUD project based property, you must certify your tenants income eligible before you can claim the unit as a tax credit unit. You cannot rely on old certifications (previous year) for this purpose. If you will have both acquisition credits and rehab credits, and you have performed a Tenant Certification for the Acquisition PIS date, you may rely on that certification and are not required to complete another certification for the rehabilitation PIS date.*

D. Eligible basis – “Eligible basis consists of

- (1) the cost of new construction,
- (2) the cost of rehabilitation, or

(3) the cost of acquisition of existing buildings acquired by purchase... . Only the adjusted basis of the depreciable property may be included in the eligible basis. The cost of land is not included in adjusted basis.” [General Explanation of the Tax Reform Act]

Eligible basis includes the cost of low-income units, facilities for use by the tenants (e.g., common areas, elevators, corridors, roofs) and other facilities reasonably required by the project. The allocable 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 project. Costs of the residential rental units in a building which are not low-income units 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. **Eligible basis does not include commercial space.**

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. See Section 2.4.

Compliance period begins when credits are claimed

Minimum number of LIHTC units required

Criteria for tax credit unit

Keep first year records for 21 years

E. **Initial credit period** – Owners may initially claim credits for the year that the building is placed in service or may defer claiming credits until the close of the following year. It is important for management to know when the credits were or will be claimed for the first time because the compliance period runs fifteen (15) years starting with the first year credits are claimed. The owner makes the election for the initial credit period on each building's Form 8609. Once made, the election is irrevocable. Credits may not be claimed until the minimum set-aside is met.

F. **Minimum set-aside (MSA)** – Also an irrevocable election, the minimum set-aside establishes both the minimum number of low-income units to be maintained in a project and the applicable income limit for households to qualify for all tax credit units. See discussion in Section 2.2.

G. **Qualified LIHTC unit** – A low-income unit qualifies for the tax credit when the following conditions are met:

- Tenant eligibility verified and certified
- Restricted rent
- Nontransient residency
- Unit suitable for occupancy
- Unit recorded as LIHTC unit
- Tenant eligibility re-certified annually
- Available to the public on a non-discriminatory basis

Units meeting these requirements may be counted in the **qualified basis** for tax credit purposes (See Section 2.4).

H. **Record keeping requirements** – IRS regulations list the LIHTC record keeping and record retention requirements for owners to follow to maintain compliance. Project owners and managers should be familiar with this list and understand that required records could be subject to monitoring at any time. In addition, the first year records must be kept for 21 years. It is strongly recommended that these original documents be stored in a secure fireproof and waterproof location.

Minimum Set-Aside

*20/50 or 40/60
to qualify for credit*

*Multiple building vs.
building-by-building*

2.2 Minimum Set-Aside Election

The most critical compliance issue for a low-income housing tax credit project is the minimum set-aside (MSA) requirement. In order for an owner to claim tax credits, a project must have a minimum number of qualified tax credit units. The owner must select one of two minimum set-asides, which establishes both the minimum percentage of tax credit units at the project and the income limit used to determine tenant eligibility. The IRS requires the selection and adherence to a minimum set-aside as follows:

“A residential rental project providing low-income housing qualifies for the credit only if

- (1) 20 percent or more of the aggregate residential rental units in the project are occupied by individuals with incomes of 50 percent or less of the area median gross income, as adjusted for family size, or
- (2) 40 percent or more of the aggregate residential rental units in the project are occupied by individuals with incomes of 60 percent or less of the area median gross income, as adjusted for family size.”

The owner specifies the MSA when applying for a tax credit allocation and makes the MSA election on the Form 8609 for each building. This election is irrevocable and sets the applicable income limit for *all* LIHTC units in the project. The minimum set-aside must be met within the initial credit period or the property will not be eligible for tax credits. In addition, the MSA must be maintained for the entire 15-year compliance period or recapture of the credit for all units will result.

If a building is identified as part of a **multiple building project** on Line 8b of the Form 8609, the minimum set-aside may be met across all so noted buildings in the project. If the building is not identified as part of a multiple building project, the MSA must be met **within that building**. Properties with several buildings may have buildings noted differently on the form 8609, so management must be aware of the status of **each building**.

Example 2-1: The owner of a 10-building, 100-unit tax credit project has elected the 40/60 minimum set-aside to be met as a “multiple-building” project, meaning that 40% of 100, or **40 units project-wide**, must be rented by the end of the initial

credit period to tenants who are eligible at the 60% area median gross income limit or no tax credits are available.

Example 2-2: In this case, the owner of the same 10-building, 100-unit tax credit project has elected the 40/60 MSA to be met on a *building-by-building* basis. If the project were comprised of 6 buildings with 12 units each and 4 buildings with 7 units each, 40% of a 12 unit building = 4.8 or 5 units and 40% of a 7 unit building = 2.8 or 3 units. Thus the MSA = (6 buildings x 5) plus (4 buildings x 3) = 30 plus 12 = 42 units. In this example, the MSA must be met by the end of the initial credit period for each building or the building will not be eligible for tax credits. *Management must be aware of the distinction between per building and project-wide MSA .*

Allocation year affects MSA

Depending on the year of allocation, different requirements regarding the MSA apply. For 1987-1990 projects, the MSA had to be met within 12 months of the Placed-in-Service date. For 1991 and later years, the MSA must be met no later than the close of the first year of the credit period for such building. The MSA must be met prior to any credits being claimed, thus if an owner wanted to claim credits at the end of year one, the MSA would have to be met as needed, by building or project, by 12/31 of the first year. If the owner has deferred the first credit year to the year after placing in service, the MSA must be met by 12/31 of the second year after placing in service.

MSA not to be confused with state set-asides

The tax credit MSA should not be confused with other set-asides such as state set-asides that earned extra points in the allocation process and are recorded in the project's Land Use Restriction Agreement (LURA). States may impose set-asides that require certain properties to be rented to the elderly or to large families, or may impose lower income limits than the LIHTC would require. In addition, the MSA should not be confused with HOME fund requirements or subsidy programs such as HUD Section 8 or Rural Development. Always determine the tax credit MSA first and review allocation documents to identify any additional set-asides. Implement a tracking system for all set-asides to ensure compliance with these requirements. Follow the most restrictive set-asides so that the project will remain in compliance with all set-asides.

Income Limits

VLI=50% limits

50% x 1.2 = 60%

Use new income limits within 45 days

Qualified Basis

Determines the amount of tax credits the owner can claim each year

2.3 Income Limits

Each year, the Department of Housing and Urban Development (HUD) publishes the Section 8 area median gross income limits for all states. The IRS requires these income limits, as adjusted for family size, to be used when determining eligibility of LIHTC tenants at move-in. The minimum set-aside election establishes whether the 50% or 60% area median gross income (AMGI) limit applies to the project's tax credit units.

HUD's **50 Very Low Income** amounts equal the **50% AMGI** limits for households of one to eight persons. The **60% AMGI** limit equals 120% of the HUD Very Low Income amount for the corresponding family size. Calculate the 60% limits by multiplying the 50% AMGI figures by 1.2

Example 2-3: If the 50% income limit for a 2-person household equaled \$25,100, the 60% income limit for a 2-person household would be \$25,100 x 1.2 = \$30,120. (While HUD rounds figures to the nearest \$50 or \$100, there is no provision in the code for rounding the 120% calculation up or down.)

Where State set-asides at lower income percentages are in place, these limits would also need to be calculated. Most Allocating Agencies provide the income limits for any additional set-asides. *When HUD publishes new income limits, owners are required to implement the new income limits no later than 45 days after the effective date.* Be aware that any fluctuations up or down in the income limits may have a corresponding impact on maximum gross rent amounts.

2.4 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 project. The percentage of TC units (applicable fraction) in the building multiplied against the allowable development costs (eligible basis) establishes the amount for the building's qualified basis. The qualified basis multiplied by the project'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.

Applicable fraction is lesser of unit fraction and floor space fraction

The **applicable fraction** is calculated for each building and is the lesser of:

- (a) the unit fraction—the proportion of low income units to all residential rental units in the building, or
- (b) the floor space fraction—the proportion of floor space of the low-income units to the floor space of all residential rental units in the building.

Owners have until the end of the initial credit period to establish the project's original low-income occupancy—the applicable fraction for each building. The low-income occupancy achieved by the end of the initial credit period establishes the project's original qualified basis (QB). Once the QB has been initially established and credits are claimed, the QB is locked in and must be maintained for the entire 15-year compliance period or recapture will result. 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 project's applicable fraction reduces its qualified basis. If a project's qualified basis for a given tax year decreases from the previous year, this results in noncompliance and recapture by the IRS of some or all of the accelerated portion of the project's credits claimed in prior years.

Maximum Gross Rent

2.5 Maximum Gross Rent

Units qualifying for tax credits are subject to a rent restriction formula that sets the maximum gross rent that may be charged. The maximum gross rent may not exceed 30% of the applicable qualifying income limit. Gross rent equals the tenant portion of rent plus the cost of tenant-paid utilities (except telephone and cable) and any other non-optional charges. If low-income tenants are charged more than the allowable rent, the unit is in noncompliance and recapture of credits may result. Whenever utility costs are paid directly by the tenant, gross rent must include an allowance for utilities. Section 2.6 provides more information regarding utility allowances.

Restricted Rents

The maximum gross monthly rent is calculated by this formula:

$$\text{Maximum Gross Rent (including Utilities)} = (\text{Applicable Income Limit divided by 12}) \times 30\%$$

If the rent calculation ends with a decimal point, always round the amount down since you may never charge more than the maximum. Rounding up would charge more than the maximum allowable rent, resulting in noncompliance.

Example 2-4: If the applicable income limit = \$17,500, then divide by 12 to get **\$1458.33** then multiply by .30 , to get **\$437.49**. Round down to **\$437** so as not to exceed the maximum. The maximum gross rent including utilities cannot exceed this figure.

# Persons		1	2	3	4
Income Limit	50%	13,600	15,550	17,500	19,450
	60%	16,320	18,660	21,000	23,340

# Persons		1	2	3	4
Rents	50%	340	388	437	486
	60%	408	466	525	583

A. 1987-89 Projects

For projects with 1987, 1988, or 1989 tax credit allocations, the unit rent was calculated using the income limit for the actual number of people in the household. Therefore, the maximum rent could increase or decrease based on respective changes in the household composition. The 1987-89 projects have all completed their compliance periods, therefore no property still regulated by Section 42 has rents based on family size.

B. 1990+ Projects

For 1990 and later allocations, rent is based on unit size, not the number of people in the household. The rent formula uses an imputed family size of 1.5 persons per

bedroom to determine the applicable income limit upon which to base rent calculations. For efficiency or studio units which do not have separate bedrooms, the 1 person income limit is used.

# Bedrooms	0	1	2
Income Limit	1 person	1.5 person`	3 person

Example 2-5: To determine which income limit amount to use for the bedroom size rent formula, use the imputed household size of 1.5 persons x the actual number of bedrooms, with an efficiency/studio using the one person income limit.

	# Persons	1	1.5	3
Income Limit	50%	13,600	14,575	17,500
	60%	16,320	17,490	21,000

For the 1.5 person income limit, take the 1 person limit, add to the 2 person limit and divide the answer by 2. Using the limits provided in Example 2-5 above, the income limits and resultant maximum gross rents for the bedroom size formula would be:

	# Bedrooms	0	1	2
Income Limit	50%	340	364	437
	60%	408	437	525

C. Option to Change Pre-1990 Rent Formula

Owners of pre-1990 projects were given an option to make a one-time irrevocable election by February 6, 1994 to convert to the bedroom size rent formula. If election to the bedroom size formula was made, it could only apply to new move-ins following the date of election while prior tenants remained on the household size rent formula. *The owner was required to provide documentation to their State Monitoring Agency or the Authorized Agent that this election to the IRS was made.*

As noted above, all pre-1990 projects have now completed their compliance periods.

D. Rent Subsidies

Gross rent does not include any housing assistance payments made to an owner to subsidize a tenant's rent, such as from Section 8 or any comparable federal or state rental assistance program to a unit or its occupants. Only the actual rent paid by the tenant, including tenant-paid utilities, is counted toward the maximum gross rent allowable. For example, if the LIHTC maximum gross rent was \$350 and the total tenant payment was \$250 with Rental Assistance paying an additional \$150 subsidy to reach the Basic or Contract Rent of \$400, there is no problem. The rent meets tax credit guidelines because the total tenant payment inclusive of utilities does not exceed \$350.

E. Section 8 Rent

The HUD Section 8 program protects subsidized tenants from ever paying more than 30% of their adjusted gross income for rent. For this reason, in 1989 the IRS ruled that if the tenant portion of rent increases above the LIHTC maximum gross rent, thereby reducing the Section 8 subsidy, the higher rent may be charged.

F. Rural Development Overage

In RD 515 projects, overage rents may result when 30% of the tenant income minus the utility allowance exceeds the RD program's Basic Rent. If this overage rent exceeds the maximum LIHTC rent, then the overage cannot always be charged. For 1991 and later year projects, the overage can be charged for amounts that are turned over to RD. In 1987-1990 projects, the overage cannot be charged to the tenant since this provision is not retroactive.

Utility Allowances

Mandatory amenities or services in gross rent

2.6 Utility Allowances

The maximum gross rent includes the amount of tenant paid utilities inclusive of costs for heat, lights, air conditioning, water, sewer, oil, and gas, where applicable. Utilities do not include telephone or cable television. Whenever the tenant pays utility costs directly (not by or through the owner of the building), the gross rent for that unit includes the applicable utility allowance. The utility allowance must be subtracted from the maximum gross rent to calculate the maximum tenant portion of rent.

In addition, any *mandatory* supportive service or amenity charge must be counted as part of the gross rent for these units. Such costs may include parking fees, a telephone if required to open the door or project gate as part of a security system, housekeeping, trash removal, meal service, or other required costs. Charges for *optional* services other than housing do not have to be included in gross rent, but such services must truly be optional. *NOTE: Fees may not be charged for any item that is part of the eligible basis (See Section 2-1).*

Example 2-6: If the maximum gross rent on a unit is \$525 and the tenant pays utilities with a utility allowance of \$75, the maximum tenant portion of rent allowable is \$450 (\$525 – \$75).

Example 2-7: If the same tenant pays an additional mandatory parking fee of \$25 per month, the maximum tenant portion of rent allowable is \$425 (\$525 – \$75 – \$25).

Internal Revenue Bulletin 2008-39 was published on 9/29/08. It contains final regulations for 42-10, utility allowances. Utility allowances should be calculated as follows:

(1) Rural Housing Services (RHS) - If a building receives assistance from RHS the applicable utility allowance in the building is the RHS approved UA. Additionally, if any tenant in the building receives RHS rental assistance the applicable US for ALL units in the building (including those occupied by tenants receiving HUD assistance) is the applicable RHS allowance.

(2) HUD regulated buildings - If neither a building nor any tenant receives RHS assistance and the rents and utility allowances are reviewed by HUD on an annual basis, the applicable UA for all units in the building is the HUD utility allowance.

(3) Other buildings - If a building is not subject to either 1 or 2 above, the applicable utility allowance for rent-restricted units in the building is determined under the following methods:

(i) For tenants receiving HUD rental assistance, use the

applicable PHA utility allowance.

(ii) For other tenants, (A) the general rule is to use the PHA utility allowance. However, if a local utility company estimate is obtained in accordance with (B) below, that estimate becomes the appropriate utility allowance.

(B) Utility company estimate. The estimate is obtained when an interested party receives, in writing, information from a local utility company providing the estimated cost of that utility.

(C) HUD Utility Schedule Model. May be found at www.huduser.org/datasets/lihtc.html.

(D) Energy consumption model. A building owner may calculate utility estimates using an energy and water and sewage consumption and analysis mode.

Update utility allowances annually and submit with annual reports

Utility allowances must be updated at least annually since they are included in the maximum allowable rent calculations. Copies of utility allowance documentation must be submitted with HHFDC's required annual year-end reports. Realize that any changes in utility allowances have a direct impact on the net chargeable rent to the tenant. *Any new allowance must be implemented within 90 days of the change.*

Additional LIHTC Regulations

2.7 Additional LIHTC Regulations

The following is a list of additional LIHTC regulations.

A. Vacant unit rule

If a low-income unit becomes vacant during the year, the unit remains LIHTC compliant and eligible for the tax credit for purposes of the set-aside requirement and determining the qualified basis provided reasonable attempts are made to rent the unit or the next available comparable or smaller size unit to an eligible household and no other comparable or smaller size units in the project are rented to non-qualifying individuals. See Section 25 for IRS explanation of this rule.

Recapture may result from renting comparable size units in the BIN to ineligibles while a TC unit is vacant

“Reasonable attempts” indicates that efforts toward marketing and renting a unit that is suitable for occupancy must be made. *Under no circumstances can you claim*

Available Unit/140% Rule

credit on the unit if you violate this rule. Concurrently, if an owner of three vacant units 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.

Units that have never been occupied are termed “empty” rather than vacant, and cannot be counted as low-income units. However, they must be included in the building’s total unit count for purposes of calculating the applicable fraction.

Owners are required to keep records for each qualified low-income building in the project showing for each year of the compliance period the low-income unit vacancies and data for when, and to whom, the next available units were rented.

B. Available unit rule / 140% rule

If the household income for residents in a qualified unit increases to more than 140% of the current applicable income limit, the unit is considered an “over-income unit” but may continue to be counted as a low-income unit as long as two conditions are met. The unit must continue to be rent restricted and the next comparable 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 residents *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.

IRS Regulation 1.42-15, effective September 26, 1997, allows over-income tenants who were previously LIHTC eligible to move to a new unit within the same building, because when a current resident moves to a different unit within the building, the newly occupied unit adopts the status of the vacated unit [Section 21].

Violating this rule means losing the credits on all 140% units. These units would no longer count toward the MSA.

Relocating tenants

C. Relocating existing tenants

When an existing tenant moves to another unit within the same building, the status of the two units swaps. Thus, if a

*Units occupied
by staff*

qualified tenant moves to an ‘empty’ unit, the new unit ceases to be ‘empty’ and becomes a qualified unit. The original unit will then be deemed ‘empty’.

When the transfer occurs between different buildings in the same project, a similar rule applies as long as the tenant’s income did not exceed 140% of AMI at the most recent certification. Please note that for purposes of this test, if on the 8609 the owner elected to say ‘No’ to line 8b, then the owner has chosen to treat each BIN as a separate project. In this case, a transfer would require a new certification and the tenant would have to be qualified at the time of move-in.

During the initial credit period, existing tenants cannot be relocated for purposes of qualifying more than one LIHTC unit to count toward the minimum set-aside or applicable fraction. *Under no circumstances can one household be used to initially qualify more than one tax credit unit in the project.*

D. Staff units

Revenue Ruling 92-61 [Section 13], effective September 9, 1997 allows a unit for a *full-time* staff member to be considered part of a project’s “common area.” Such units are not classified as residential rental units and thus are not included in either the numerator or denominator of the applicable fraction under section 42(c)(1)(B) for purposes of determining the building’s qualified basis.

Revenue Ruling 2004-82 [Section 25] further expanded staff units to include a unit occupied by a full-time security officer for the building if the building owner requires the security officer to live in the unit.

Two options apply:

(1) If the staff unit is a rental unit and is to be counted as part of the qualified basis, then the staff must be income eligible, be certified, and sign a lease the same as any low-income tenant. In this case, if the staff member receives free rent or a rental discount, the imputed value of the rent or discount must be included as income.

(2) If the unit is not a residential rental unit but used as common area by full-time staff, then the staff does not

*6-month
minimum initial
lease term required
except for SROs or
transitional housing
for the homeless*

*LIHTC
ineligible facilities*

have to be income eligible, certified, leased, or considered a tenant.

The owner's LIHTC application and the allocation documents should stipulate the number of common area units set-aside for staff. If not, the owner should work with the HHFDC Finance Branch on amending or clarifying the language in the Declaration. This revenue ruling 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 unless the owner filed a tax return that is consistent with this ruling.

E. Nontransient occupancy

“Residential rental units must be for use by the general public and all of the units in a project must be used on a nontransient basis....Generally, a unit is considered to be used on a nontransient basis if the initial lease term is six months or greater.”

[General Explanation of the Tax Reform Act of 1986]

“In General—A unit shall not be treated as a low-income unit unless the unit is suitable for occupancy and used other than on a transient basis.”

[Section 42(i)(3)(B)(i)]

To be in compliance, a six-month minimum lease term is required at initial occupancy of low-income units. A six-month lease addendum should be signed with in-place tenants who do not have six months left on an existing lease when the building is placed in service. The only exceptions to this requirement would be SRO housing rented on a month-by-month (30-day lease) basis or transitional housing for the homeless as specified below.

F. General public / fair housing

All residential rental units in the project must be available for use by the general public. LIHTC properties 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. State of Hawaii Code also prohibits discrimination against marital status and age.

Know accessibility requirements

Discrimination prohibited

Student status determined on a tax-year basis

Tax credit units may not be provided only for members of a social organization or provided by an employer for its employees. In addition, any residential 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.

The Fair Housing Act also mandates specific design and construction requirements for multifamily housing built after March 13, 1991, to provide accessible housing for individuals with disabilities. Owners are expected to be familiar with accessibility requirements applicable to their projects.

The IRS 8823 Report of Noncompliance form states:

“The failure of low-income housing credit properties to comply with the requirements of the Fair Housing Act will result in the denial of the low-income housing tax credit on a per-unit basis.”

“Available to the general public” applies to all residential rental units, market and tax credit.

G. Students

Many students are considered to be transient and thus are not LIHTC eligible. The issue with students is only a concern when *everyone* in the household is a full-time student, defined by the IRS as taking 12 credit hours a semester or attending school full-time 5 months per year at an educational institution with regular facilities, other than a correspondence or night school. The IRS has made it clear that student status is to be monitored on a tax-year basis, thus an applicant would not be eligible if the person had been a full-time student for 5 months of the tax year, even if they had graduated prior to applying for an LIHTC unit. Owners and managers should adjust tenant certification procedures to consider student status according to this interpretation. In addition, there is no grandfathering of eligibility because the tenant was not a student when they moved in and later became one. For this reason, tenant student status must be re-verified at

No grandfathering due to student status

household. Failure to verify student status is noncompliance.

Exceptions: A unit would not be disqualified for tax credits if it is occupied as specified in Section 42(i)(3)(D)—

(i) by an individual who is—

- I. a student and receiving assistance under title IV of the Social Security Act,
- II. A student who was previously under the care and placement responsibility of the State agency responsible for administering a plan under part B or Part E of title IV of the Social Security Act (foster care), or
- III. A student enrolled in a job training program receiving assistance under the Job Training Partnership Act or under other similar Federal, State, or local laws, or

(ii) 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) and the children are not dependents of another individual other than the parents, or
- II. married and file a joint return.

The single parent exception was changed as noted above in December, 2007.

Section (i)(II) was established with the Housing Assistance Tax Act of 2008.

H. Section 8 certificates / vouchers

Section 42 states that LIHTC properties may not refuse Section 8 certificate or voucher holders simply on the basis of their Section 8 status. However, this does not assure tenant selection, because applicants eligible for Section 8 may have incomes exceeding LIHTC income limits, may have negative references, may not be able to afford the rent with vouchers in some situations, or the unit rent may exclude certificate holders due to a conflict with the local Fair Market Rent.

I. Suitability of unit

A unit must be suitable for occupancy in accordance with state or local codes in order for credits to be claimed. If the 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, if the unit is restored within a reasonable time within a taxable year, credits can again be claimed and no recapture would occur. Tax credit units that are vacant must be made ready to rent as soon as possible. Otherwise, they would not be considered suitable for occupancy and would not be eligible for credit.

**Tenant
Eligibility for
LIHTC**

*Income and student
status must be
considered*

Household Size

DETERMINING TENANT ELIGIBILITY

3.1 Overview

Owners must determine and document the eligibility of potential low-income tenants in accordance with LIHTC requirements. A tenant's income eligibility is determined by comparing the household's gross annual anticipated income per HUD Section 8 guidelines to the LIHTC 50% or 60% area gross median income limits that apply to the project. As previously mentioned in Section 2.7(G) of this manual, student status may also affect the eligibility of a household. Owners must verify the household's income and the student status of all household members and the tenant and owner must certify the accuracy of the verified information. Since household composition, income, and student status may change over time, owners must re-certify the eligibility of tenants in tax credit units annually, on or before the anniversary date of the previous certification.

3.2 Household Size and Income Limits

Section 42 mandates that HUD Section 8 income limits as adjusted for household size be used in determining income eligibility for the LIHTC. A household can consist of one or more persons. Members do not need to be related to be considered a household. Count all household members and compare to the per person 50% or 60% income limits currently in effect. Full-time students residing together in a unit do not constitute a household under LIHTC requirements unless one of the exceptions listed in Section 2.7(G) applies.

Certain individuals are not considered members of the household in determining the income limits.

Do NOT count the following in determining income limits:

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

*Unborn children
and children being
adopted counted
for income limits*

Temporarily absent members who *would* be included in the household size determination include:

- Children temporarily absent due to placement in a foster home
- Children away at school, but who live with the family during school recesses
- A person confined to a hospital or nursing home per family decision
- A son or daughter on active military duty *only* if this person leaves dependents or a spouse in the unit

Households may choose whether or not to count permanently absent family members. When HUD issued Change-27 on September 29, 1995, the following determination on household size appeared for the first time:

“Unborn children and children who are in the process of being adopted (who do not live in the unit) are considered household members for purposes of determining unit size and income limits....”

HUD 4350.3 CHG-27, Figure 3-6
Currently found in HUD Handbook 4350.3 REV-1, 3-7

HHFDC recognizes unborn children and children in the process of being adopted as household members in determining income limits.

Definition of Income

3.3 Gross Annual Income

The 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”), not in accordance with the determination of gross income for federal income tax liability.” In the HUD Handbook 4350.3 REV-1, 5-3 annual income is defined as the anticipated total income from all sources received by the family head and spouse (even if temporarily absent) and by each additional member of the family, including all net income derived from assets for the 12-month period following the effective date of certification of income, exclusive of certain types of income.

Total Income from all Sources		=	Annual Income	
Gross Earned/ Unearned Income	+	Net Income from Assets	=	Annual Income

For information regarding what annual income includes/excludes and how to calculate annual income, see Section 23 for excerpts from HUD Handbook 4350.3 REV-1, 5-6. Note that LIHTC total income is gross annual income, *not* “adjusted” annual income. Allowances used in some government programs, such as childcare allowance and medical expense allowance, are not deducted from the household’s annual gross income to determine income eligibility for LIHTC units.

Net Asset Income

*Cash value of assets
and asset income
must be verified
for entire household*

*If net assets >\$5,000
use the greater of
actual income
of imputed income*

*Assets disposed of
for less than fair
market value
must be considered*

3.4 Assets

The net income from assets must be considered when determining the tax credit eligibility of a household. Asset information for all household members (including minors) should be obtained at the time of application. Information regarding what net family assets include/exclude is provided in Section 23 excerpts from HUD Handbook 4350.3 REV-1, 5-83, Exhibit 5-2.

The cash value for all assets and asset income must be verified by the owner obtaining third party documentation as specified by HUD verification procedures. Owners may use the sworn statement for assets referenced under IRS Revenue Procedure 94-65 [Section 17]. Assets must be verified for the initial certification of the household and for each recertification.

If utilizing the procedure 94-65, please be aware that the income from the asset must always be identified and included as income on the certification.

If net family assets exceed \$5,000, the asset income to be included in household income will be the greater of: (a) the actual asset income, or (b) an imputed income from assets, which is the net family assets multiplied by the passbook rate specified by HUD. Until further notice, owners must use a rate of 2 percent (.02).

At each certification and annual certification, 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 to be disposed of for less than fair market value if the cash value of the disposed asset exceeds the gross amount the family received by more than \$1,000. If it does, for a period of two years owners must include in the total household assets the difference between the cash value of the asset and the amount received. See Section 23 HUD Handbook excerpts 5-33 for examples of assets disposed of for less than fair market value.

Application Procedure

3.5 Tenant Application Procedure

Because the LIHTC program uses special definitions for income, assets, and household composition, standard property management application forms may not collect sufficient information to determine tenant eligibility. A comprehensive housing application is critical to the accurate identification of full-time student status, all assets, and anticipated income sources to be verified in the determination of tenant eligibility for the LIHTC. *The application must be sufficiently detailed with regard to income, assets, and student status enabling an owner to effectively make a determination of eligibility for this program.*

The **Application for Housing**, included in Section 6 of this manual, is recommended for use by all tax credit properties in Hawaii. The information furnished on the fully completed application is reviewed along with supplementary historical documents (i.e., most recent 1040 form, divorce decree, etc.) submitted with the application.

The application procedure *must* include an interview with all adult household members to review the application and historical documents and clarify any discrepancies or missing information. (For example, if the recent 1040 form and W-2s show 2 employers, but the application only lists one, question what happened to the second job and confirm its termination.) This interview is documented with the **recommended Interview Checklist**, also included in Section 6 which is signed and dated by management and all adult applicants.

One application and interview checklist signed by all co-applicants should be submitted per household.

Interview Checklist

3.6 Tenant Income Verification

Determination of annual income of individuals and area median gross income adjusted for family size must be made in a manner consistent with HUD Section 8 income definitions and guidelines. HUD Handbook 4350.3 REV-1 is the reference guide to be used for identifying the income/assets to be included or excluded when determining household income and appropriate excerpts from the HUD Handbook 4350.3 REV-1 are included in Section 23 of this manual.

The anticipated earned income of every prospective household member 18 years of age or older must be verified. Unearned income, assets and asset income of all household members, including minors, must be verified. Verifications must be received by the owner/ management agent prior to the execution of the certification of tenant eligibility and lease. Information concerning acceptable forms of verification, the effective term of verifications, proper verification methods to follow, and how to calculate total income is provided in HUD Handbook 4350.3 REV-1 included in Section 23. To summarize:

Verifying Income

A. **Effective Term of Verifications**

Third-party verifications are valid for 120 days following receipt. Owners may not rely on verifications that are more than 120 days old. After this time, a new written verification must be obtained.

B. **Verification Methods**

Written third party verifications are preferred. An authorization to release information must be signed by the applicant/tenant and must accompany verification requests. Owners must send verifications directly to the source and the source must return them directly to the owner.

Verifications must not be hand-carried by the applicant/tenant to or from the source. If written verification is not possible, direct contact with the source, in person or by phone, is acceptable. The owner must document this verbal verification in the tenant file and must obtain all information as requested on the written verification [See Section 23 HUD Handbook 4350.3 REV-1, 5-49].

C. **Differences in Reported Income**

Significant differences between the income/asset amounts reported on the application and amounts reported from third

Certification of Income

party verifications should be explained by the applicant/tenant and documented in the tenant file utilizing a form such as the Telephone Verification.

Sample recommended verification forms are included in Section 6. If forms currently in use at your property are comparable to the forms in this section, you may continue to use your current forms. However, since these forms are being provided only as examples, noncompliance will occur if forms in use do not adequately meet LIHTC and HUD certification or verification requirements.

3.7 Tenant Income Certification

Once all the income and asset information has been obtained, data should be recorded and computations done on a form similar to the **Certification Worksheet** found in Section 6. If the total 12-month projected household income is less than or equal to the maximum allowable qualifying income in effect at the time of tenant certification, the household is income eligible for a tax credit unit. If the total household income exceeds the maximum allowable qualifying income, the household can not be certified eligible for a tax credit unit.

Upon receipt of all verifications, owners/managers should review all documentation and calculations. If it is determined that all requirements for eligibility are met, the **Certification of Tenant Eligibility** found in Section 6 must be filled out and executed along with the lease prior to move-in. All adult members of the household must sign the Certification form. It is preferred that the Certification be executed by tenants and owner/manager no earlier than 5 calendar days prior to move-in and in no event after the execution of the lease.

Lease

3.8 Lease

All tenants occupying tax credit units must be certified and under lease (as specified in the Code) no later than the date the tenant takes possession of the unit. The lease must be signed by all parties to the agreement by the beginning lease term date to be properly in effect and the unit in compliance.

HHFDC does not specify a model dwelling lease to be used by owners however, some leasing guidelines are listed below.

- A. The lease should include, but is not limited to:
- The legal name of all parties to the agreement and all additional occupants
 - Identification of the unit to be rented (number, street address, etc.)
 - The date the lease becomes effective
 - The term of the lease
 - The amount for rent—If this reflects a contract rent amount which may include a subsidy payment, rather than just the tenant portion of the rent, a lease addendum listing only the tenant share of rent is recommended.
 - The rights and obligations of the parties, including the obligation of the tenant to recertify income annually (or more frequently as required)
 - Language addressing changes in income, utility allowance, income limits, basic rent (RD or HUD 236 projects), family composition or any other change and its impact on the tenant's rent
 - Signature dates
- B. The tenant portion of rent plus utility allowance and other mandatory fees must not exceed the maximum gross rent allowed by Section 42 of the Code.
- C. The initial lease term must be at least 6 months on all tax credit units, except for SRO housing which may have a 30-day lease or transitional housing for the homeless (as specified in Section 2.7(E) of this manual) which provides “temporary housing” and has no lease requirement. Succeeding leases are not subject to a minimum lease term.

The beginning term of the lease and effective date of the certification should be concurrent. Signatures should be no greater than 5 days prior to these dates.

Additionally, the lease should not contain any clauses that would allow termination prior to the six month tax credit requirement.

Recertification

3.9 Recertification

Recent changes in IRS regulations no longer require annual certifications for properties that are 100% tax credit. Allocating agencies can still require them and the HHFDC is no exception.

FOR 100% TAX CREDIT PROPERTIES:

HHFDC requires that recertification of residents be completed on at least an annual basis (though failure to recertify tenants on an annual basis is no longer cause for the issuance of IRS Form 8823). What is required has changed significantly. *Every* LIHTC household is expected to undergo a complete annual recertification *the year following move in*. Subsequent years, require a self-certification. The self-certification forms for both income and student status may be found online at www.spectrumlihtc.com.

The HHFDC can require properties that have rented to ineligible households or demonstrated inadequate certification/documentation procedures to revert to full annual recertification procedures as with properties containing market units.

FOR PROPERTIES WITH MARKET UNITS:

Section 42 states: “The determination of whether the income of a resident exceeds the applicable income limit shall be made at least annually on the basis of the current income of the resident.” While the recert does not determine continued eligibility, it does identify the 140% rule situation, student status, and possible household composition changes. Properties with market units must complete a full annual recertification every year. **Self certifications cannot be used.**

FOR ALL PROPERTIES:

The timing of the recertification is critical. Recertification must be completed within 12 months from the initial certification date, or 12 months from the most recent certification.

Recertification Waiver

3.10 Annual Recertification Waiver

HHFDC has chosen to continue requiring a first annual recertification of tenant income in 100% low-income projects. The Annual Recertification Waiver is not an option at

Section 8 Qualification

this time.

3.11 Qualifying Section 8 Tenants

Additional forms of income verification may be used for tenants who receive housing assistance through the HUD Section 8 program. For these tenants only, acceptable forms of income verification include a signed copy of the appropriate HUD form 50058 or 50059, a letter from the HUD Contract Administrator (e.g., local PHA) stating that the tenant's annual gross income is less than the applicable LIHTC income limit, **OR** a Section 8 verification form as found in Section 6. These forms may be used as income verification documentation to support the **Tenant Income Certification** which must be executed for every LIHTC household.

Proof of tax credit eligibility must be on file for all Section 8 tenants. Section 8 eligibility does not guarantee tax credit eligibility. Student requirements will never be identified or verified by the local PHA. Proof of income eligibility and tax credit eligibility is the responsibility of the owner.

Recordkeeping and Retention

RECORDKEEPING & RECORD RETENTION

4.1 LIHTC Recordkeeping

The LIHTC program requires owners to maintain project records in accordance with program requirements and to provide annual reports to their State Monitoring Agency documenting project occupancy. IRS regulations set forth in 26 CFR Part I - 1.42-5(b) [Section 26-1] specify the tax credit recordkeeping and record retention provisions that owners must follow to maintain compliance. Recordkeeping responsibilities include three types of project records:

- Tenant files
- Monthly unit data tracking
- Project files, including records regarding the use of facilities included in the project's eligible basis

An owner must keep records for each qualified low-income resident by building and unit number throughout the Compliance Period.

Owners must also provide three documents regarding a project's status:

- LIHTC Owner's Compliance Certification; *annually*
- LIHTC Status Report; *annually*
- Qualified Basis Tracking Sheet; *each year until original qualified basis is established*

In addition, Unit History information must be gathered and submitted electronically. Owners and managers will be updated on changing technology.

Failure of the owner to provide reports in a timely manner when requested is regarded as noncompliance.

4.2 LIHTC Record Retention

The owner must retain the above-described records for the first year of the credit period for at least **6 years** beyond the due date (with extensions) for filing the federal income tax return

for the last year of the Compliance Period, meaning original files must be retained for **21 years**. All other records are required to be retained for at least **6 years after the due date** (with extensions) for filing the federal income tax return for that year.

NONCOMPLIANCE

5.1 Types of Noncompliance

LIHTC noncompliance may be defined as a period of time the development, specific building, or unit has failed to follow proper procedures. These procedures may be IRS Section 42 requirements or HUD certification procedures. Noncompliance can lead to recapture of tax credits for a given period of time.

Most noncompliance issues as identified by IRS definitions may be found on the IRS Form 8823 Low-Income Housing Agencies Report of Noncompliance [Section 20]. In general, noncompliance issues can occur for:

A compliance checklist

- Inadequate certification documents
- Failure to obtain and retain proper income verifications
- Missing signatures
- Late certifications or certification signature dates
- Lease issues, i.e., not signed, late, or no 6 month term
- Failure to re-certify by the certification anniversary date
- Violations of UPCS or local inspection standards
- Failure to submit year-end documentation on time
- Failure to respond to requests for additional information
- Incomplete record-keeping
- Failure to properly identify full time students
- Failure to maintain and update utility allowance documentation
- Charging unrestricted rents
- Failure to maintain the minimum set-aside
- Any change in the applicable fraction or eligible basis that results in a decrease in the qualified basis
- Housing a non-eligible tenant

Recapture

- Failure to use the HHFDC designated documentation and forms
- Disposal of ownership interest.

This list is representative and not meant to be all-inclusive.

5.2 Recapture of Tax Credits

The most serious action the IRS can take against an ownership is the recapture of credits previously claimed. Only the IRS determines this course of action. Consequences to issues of reported noncompliance are not governed by the monitoring agency. If the owner discovers at any time that credits were claimed in error, miscalculated, or the basis was incorrectly listed, IRS Form 8611 may be submitted to voluntarily recapture credits.

Owner Liability

5.3 Liability

Compliance with the regulatory requirements of Section 42 is the responsibility of the owner(s) of the building for which credit is allowable. HHFDC's obligation to monitor for compliance and report any issues of noncompliance with Section 42 regulations to the IRS does not make HHFDC liable for an owner's noncompliance.

FORMS

This section contains copies of **required** and recommended forms. You will note that the Section A forms are now **required** in addition to the annual year end forms in Section B. The combination of these forms sufficiently meets the Section 42 code requirements for record-keeping and, in striving to reach a consistent standard of accurate tenant file documentation, their use is **mandatory** for all Hawaii LIHTC properties.

In filling out each form, see that every line item is addressed. Make certain that all forms are filled out completely, including returned verification forms. Do not assume that a blank line means “Not Applicable.” *Third party verifications should be mailed or faxed to the source, never hand-carried.* Pursue phone verification to clarify any missing or ambiguous information.

Never use correction tape or liquid to revise information on any document. If revision or correction is required, draw a line through the change, then write the correct information above it. All parties must initial each change or correction.

A. Required Forms For Tenant Certification

1. Application for Housing
2. Interview Checklist
3. HI Tenant Income Certification
4. Certification of Zero Income
5. Re-certification Update

All required forms can be downloaded from the SPECTRUM website at www.spectrumlihtc.com.

B. Annual Year End Forms

These forms are **required to be submitted by February 1st** following the close of every calendar year of the compliance

period for each building. They can be downloaded from the SPECTRUM website at www.spectrumlihtc.com.

1. HHFDC Annual Report/Owner's Certification
2. Original Qualified Basis Tracking Sheet – to be submitted each year until original qualified basis is achieved
3. Utility Allowance Information
4. Software Download / Status Report database

C. Recommended Forms for Tenant Certification

Note: If the corresponding forms currently in use at your property are comparable to the forms in this section, you may continue to use your current forms. However, since these forms are being provided at no additional expense as examples of tenant information to request/verify and document for tenant files, noncompliance will occur if the form in use does not adequately meet LIHTC and HUD certification or verification requirements. Should there be any question regarding comprehensiveness of your forms, please submit your forms to SPECTRUM for approval.

1. Annuity Verification (Third Party)
2. Asset Income Verification (Third Party)
3. Certification Worksheet
4. Child Support or Alimony Certification (Third Party & Self Affidavit)
5. Employment Income Verification (Third Party)
6. Financial Aid Affidavit
7. Household Student Status Verification (Retroactive, Self-Affidavit)
8. Investment Verification (Third Party)
9. Life Insurance Verification (Third Party)
10. LIHTC Self Certification of Income
11. No Change in Income Statement (Self-Affidavit)
12. Pension Verification (Third Party)
13. Public Assistance/TANF Verification (Third Party)
14. Real Estate Asset Worksheet
15. Real Estate Verification (Third Party)

16. Section 8 Income Verification (Third Party)
17. Self-Employment Affidavit
18. Social Security/SSI Verification (Third Party)
19. Student Household Status Verification - Additional
Use
20. Student verification (Third Party)
21. Telephone Verification/Clarification (Third Party)
22. Unable to Obtain Third Party Verification
23. Under \$5,000 Asset Certification
24. Unemployed Status Affidavit
25. Unemployment Verification (Third Party)
26. Verification of Terminated Employment (Third Party)
27. Veteran's Pension/Benefits Verification (Third Party)

All recommended forms can be downloaded from the
SPECTRUM website at www.spectrumlihtc.com.

COMPLIANCE MONITORING

7.1 Fulfilling Compliance Obligations

Your compliance monitoring *begins when you place in service*. The IRS requires specific recordkeeping requirements that may be found in Recordkeeping Requirements of Section 42 in Section 4 of this manual. **In order to maintain compliance with Section 42 and Hawaii Requirements, you should immediately notify HHFDC when you place in service.** HHFDC will help you identify specific submission requirements for your property.

A file review of 20% of the files for 1/3 of the LIHTC properties annually is required by the IRS. Currently, SPECTRUM Enterprises performs compliance monitoring under contract as the Authorized Delegate for the State of Hawaii. On the SPECTRUM Web site, www.spectrumlihtc.com, you will find information regarding yearly submission requirements. You will need to contact SPECTRUM to receive specific details for the yearly submission requirements and to notify SPECTRUM & HHFDC of your placed in service dates. You will be placed on the SPECTRUM mailing list as soon as it is determined you have placed in service, and you will be notified when any required yearly submissions are due. However, if you place in service earlier than targeted and do not contact SPECTRUM & HHFDC, you may miss submission deadlines required by the IRS. Information and updates will be posted on the SPECTRUM Web site. This information will include but not be limited to forms, industry Web links, and industry information. Additionally, we will be sending notices via email, in an attempt to reduce paper communications.

Yearly submission requirements

What are the yearly submission requirements? In short, an owner is required to submit an annual report and certification [Section 6] and unit history for all tax credits units. Unit history information is collected electronically for the previous year. You may download software and instructions from the SPECTRUM Web site at www.spectrumlihtc.com. In Hawaii, the deadline for these submissions is February 1 each year.

This information is required by law, so it is very important that information submitted is timely and accurate. Failure to

Site visit within two years of PIS date

submit on time, incomplete submissions, or inaccurate submissions may be determined noncompliant.

An Owner must realize that the *Owner* is required to maintain and submit the records. Managers must realize that the Owner is financially responsible for late submissions or inaccurate submissions.

When will SPECTRUM visit the site? By 12/31 of the second year after the last building places in service and at least once every three years thereafter SPECTRUM will audit 20% of your files, inspect 20% of your units, and inspect all of common area in all buildings. You will be notified at least 30 days in advance of the site visit. While we can accommodate emergency situations, audit dates are not negotiable. Our schedules are tight and geographically coordinated. Normal procedures are as follows:

1. A SPECTRUM Monitor will contact Management by phone to inform them of an upcoming on-site review. The monitor will answer any questions or concerns about the review.
2. A Confirmation Letter (see sample below) will be sent verifying the date, time, and requirements for the review.
3. We visit the site, auditing 20% of the tenant files, inspecting 20% of the units and all common areas
4. An Owner's Report is then written and forwarded to the Owner, with management copied. There is a forty-five (45) day period in which to respond. Late submissions will be considered noncompliance. Submissions after an IRS Form 8823 is generated will not be reviewed without HHFDC authorization.
5. The Owners' responses to the Owner's Report will be reviewed and a notification to the Owner will be sent out informing the Owner of his compliance status. Management is again copied. If non-compliance is being reported, an unsigned copy of the generated Form 8823 will be included as an attachment.

Sample confirmation letter

The following is a sample confirmation letter:

[date]

[name]

[address]

[address]

Re: LIHTC Compliance Monitoring For **[property name]**

Dear [name] :

This letter is to confirm our scheduled inspection and review of the referenced property on **[day, date, and time, e.g. Tuesday, June 26, at 10:30AM]**. We will review (#) LIHTC files and inspect (#) LIHTC units and all common areas. The files and units will be chosen at random upon our arrival. To help prepare for our inspection and review, please comply with all of the following:

1. Ensure that all LIHTC residents are notified of the upcoming site inspection. Additionally, it is **required** that an Owner's representative be present at all times during the site inspection, preferably a maintenance staff person familiar with the building systems and also an administrative person familiar to the residents. SPECTRUM Monitors *will not* enter a unit or a room in any building unaccompanied. The Owner's representative must be able to keep pace with the Monitor to facilitate the review. If the Owner is unable to provide such a representative, the building/unit will be failed and it will be reported to the Internal Revenue Service (IRS) as non-compliance.
2. All interior common area emergency lighting will be tested during the inspection by throwing the circuit breakers and walking the hallways. Circuit breakers for emergency lighting *must* be identified, labeled, and accessible at the time of inspection. This system test is the most accurate portrayal of an emergency situation. This type of system test will be conducted unless loss of power to the building would automatically bring the fire department or unless the building has a generator back up system. In this instance we will require a copy of the results of the last test of the system
3. The following documents are **required** for the review. Those documents identified as items **b-g** will be taken back to the SPECTRUM office for our records. An Owner's representative familiar with the resident files **must** be present during the file review.

- a. LIHTC resident files including certifications, verifications, applications and lease agreements;
- b. A current Rent Roll showing rents charged to LIHTC residents (*please provide this immediately*);
- c. Copies of original 8609's, signed by the owner (*first year only*), and also Schedule(s) A and form(s) 8586.
- d. Copy of the Tenant Selection Criteria in use for the property;
- e. Copies of Utility Allowance documentation for *all* years under review;
- f. Copy of a listing of all LIHTC units, *organized by BIN* (Building Identification Number);
- g. A management forms package including: tenant application, income certification, interview/questionnaire, worksheet, employment verification, certification of child support, and other applicable third party verifications.

Please Note: Failure to comply with any of these monitoring requirements will hinder the review and will be reported to the IRS as noncompliance.

SPECTRUM utilizes Uniform Physical Condition Standards (UPCS) and State, City, or County Building Codes when conducting physical inspections. Should you have any questions or concerns, please contact our office directly.

As stated in the Code, Section 1.42-5(g), Compliance with requirements of Section 42 is the responsibility of the owner of the building for which the credit is allowable. The Agency's obligation to monitor for compliance with the requirements of Section 42 does not make the Agency liable for an owner's non-compliance.

Thank you for your assistance.

Respectfully,
LIHTC Monitoring Specialist

*What we expect
regarding a file
review*

Please review the requirements listed in sections two and three of the sample letter. It is essential that these documents are available for the review. No excuses will be accepted.

Failure to comply with these requests will be considered noncompliance and would be reported to the Internal Revenue Service as such.

What expectations does SPECTRUM have regarding the file review?

- * Uniformly organized files
- * Move-in certifications effective for the LIHTC move-in date and signed not more than 5 days prior to the effective date
- * Supporting verifications for all certifications
- * Annual certification effective on or before the anniversary date
- * Student Status identified and/or verified for every certification
- * Worksheets showing calculations used on the certification
- * A documented tenant interview at move-in
- * An application sufficient to determine eligibility for a LIHTC property
- * A re-certification update or questionnaire for the annual certifications
- * Phone clarifications for any ambiguities or missing information on verifications (NO BLANKS)
- * Child support and zero income affidavits addressing historical and anticipated income
- * Zero employment affidavits
- * Third-party verification of gross pension benefits, including verification of changes
- * Verification of termination of employment where applicable
- * All HUD criteria for acceptable forms of verification satisfied
- * At minimum, a six-month lease in effect for the LIHTC move-in date without an early termination clause prior to six-months
- * Utility allowance verification for each year of the credit

Will SPECTRUM look at anything else? SPECTRUM will audit your submissions on an annual basis. This review is separate from the on-site reviews. Additionally, SPECTRUM will monitor compliance with the Land Use Restriction

Agreement, the original qualified basis, deep income targeting, next available unit rules, 140% rules, Fair Housing, ADA, and utility allowance requirements.

7.2 Physical Inspection of Units

SPECTRUM uses Uniform Physical Conditions Standards (UPCS) and State, County, or City Building Codes. A physical inspection of all buildings in a project and 20% of the units in a project is a requirement of the Tax Credit Program. Physical inspections will generally be performed at the same time as file reviews. State physical inspection guidelines are strictly adhered to. The IRS requires reporting of violations. As all properties have knowledge of our arrival there is no excuse for common area violations such as smoke detectors, emergency lights, and fire alarm panel system faults. All violations must be reported to the IRS as non-compliance unless repaired prior to our leaving the property.

Examples of health and safety findings include:

- Structural and roof problems
- Blockage of fire exits
- Elevators functioning improperly
- Smoke detectors or sprinklers not functioning
- Pest infestation
- Serious electrical, heating, or plumbing problems
- Common area safety lighting problems

Routine violations are those that require correction but do not impair essential services and tenant safeguards.

What expectations we have regarding the physical inspection

What expectation does SPECTRUM have regarding the physical inspections?

- * All LIHTC residents must be notified, in writing, of the upcoming site inspection.
 - * An Owner's representative *must* be present at all times during the site inspection, preferably a maintenance staff person familiar with the building systems and an administrative person familiar to the residents
- SPECTRUM Monitors *will not* enter a unit or a room in any building unaccompanied.

- * Circuit breakers for emergency lighting *must* be identified, labeled, and accessible at the time of inspection.
- * All interior common area emergency lighting will be tested during the inspection by throwing the circuit breakers and walking the hallways. This system test is the most accurate portrayal of an emergency situation. This type of system test will be conducted unless loss of power to the building would automatically bring the fire department or unless the building has a generator back up. In that instance we will require a copy of the last test of the system by a qualified contractor.
- * Since smoke detectors, emergency lighting, fire alarm panel system faults, and blocked egress issues in common areas are automatic non-compliance, be sure to inspect all of these systems before our arrival.
- * The IRS requires that unit inspections be performed on the same units that are selected for file review. Units where admittance is not possible for any reason may be failed and/or subject to re-inspection at the owner's expense.

7.3 Additional Use Period

After the initial fifteen year compliance period, the HHFDC is no longer required to report instances of noncompliance to the IRS. Compliance monitoring during the Additional Use (AU) Period will concentrate on enforcing the requirements of the LIHTC Program through the term of the Declaration of Restrictive Covenants recorded on the property. Unless noted below, the policy and procedure for compliance during the initial compliance period shall continue to apply to the additional use period.

Effective date

Generally, the AU compliance period will begin on January 1 of the year after the expiration of the initial 15 year compliance period of the last building placed in service and be in effect until the end of the additional use period.

Income and Rent Set Aside

Owners are subject to the Section 42 occupancy and rent restrictions required in the LURC.

Student Households

A modified student eligibility requirement will be enforced. During the AU compliance period, a household comprised entirely of full time students will qualify as long as at least one member of the household is an independent student or is a student in grades Kindergarten through 12 (including home schooled minors studying course material within these grades). An independent student is defined as one who is not claimed as a dependent on his/her parent's tax return (proof required).

Available Unit Rule / 140% Rule

For projects which include market rate units, the Available Unit Rule and the 140% Rule do not apply during the AU period. The percentage of tax credit units as specified in the LURC must be maintained throughout the additional use period.

Unit Transfers

During the additional use period, unit transfers are allowed without a new income qualification. Documentation of all unit transfers that occur shall be submitted as part of annual Reporting Requirements.

Site Audits

Commencing within three years after the expiration of the Compliance Period, site audits for projects may be conducted at least once every five years. Projects that have substantial outstanding noncompliance beyond the correction period based on the findings of the most recent site audit may be subject to more frequent site audits.

Owner Inspection

Owners shall conduct an annual physical inspection of each unit and common areas in the project.

Correction Period and Noncompliance Penalties

Upon determination by the HHFDC of noncompliance with the LIHTC Program during the AU period, the owner shall be notified and given at least thirty (30) days to correct any discovered violations. The HHFDC may extend the correction period on a case-by-case basis, up to a total of six (6) months, if it is determined by the HHFDC that good cause exists for granting such an extension. Owners may request the HHFDC review all outstanding noncompliance issues for a property once per calendar year after the initial correction period.

Any owner and constituent entities involved in management and ownership of a project with an unresolved finding of noncompliance beyond the initial correction period may be deemed to be Not in Good Standing by the HHFDC Finance Branch. Owners must clear all outstanding noncompliance issues to be deemed in Good Standing with the HHFDC Finance Branch.