

PROPERTY COMPLIANCE REPORT

A MONTHLY PUBLICATION ON LOW-INCOME HOUSING TAX CREDIT COMPLIANCE

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Energy Crisis Sparks Interest in Utility Allowances

By James R. Kroger, CPA

The current energy crisis has generated an increased interest in utility allowances among low-income housing tax credit (LIHC) property owners. Owners who have master-metered properties and do not require the tenants to pay any utilities are bearing the brunt of skyrocketing utility costs. As a result, such owners are considering separately metering their properties and requiring tenants to pay certain utilities, even though tenants' rents must then be reduced by a corresponding utility allowance.

The Internal Revenue Service (IRS) requires that the maximum rent charged on a LIHC unit must be reduced if any utilities are paid directly by the tenant. IRS guidance is found in IRS Notice 89-6 and in Treasury Regulation Section 1.42-10. For example, assume that a LIHC property owner can charge a maximum of \$400 per month for a one-bedroom unit, based on the income limits published by the U.S. Department of Housing and Urban Development Department (HUD) for the appropriate location. If a tenant is required to pay electric and water utilities, then the owner must reduce the \$400 maximum rent limit by the appropriate utility allowances for electric and water utilities. If the utility allowance is \$40 for a one-bedroom unit and the average utility cost is \$50, then the owner would lose \$40 for rent for each unit, but would save an average of \$50 for utilities for each unit.

The utility allowance is an estimate, and a specific tenant may pay more or less for utilities than the estimate, depending on the month. However, if a utility allowance is in place, the actual utility costs to the tenant do not alter the amount of rent the owner collects.

Utility Definition

The IRS offers no definition of a "utility," aside from stating that telephone service is not considered as a utility. However, because the IRS states that it takes into account "the procedures under Section 8 of the U.S. Housing Act of 1937," one should look to the HUD Handbook 4350.3 for further guidance.

According to the HUD Handbook: "A utility allowance is an amount equal to the estimate made or approved by HUD of the monthly cost of a reasonable consumption of utilities (except telephone) for the unit by an energy conservative

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CA Implements Negative Points

By Tracy A. Fine, Editor

An owner's compliance and management track record has become more important in the staunch competition for low-income housing tax credits (LIHCs) in the Golden State.

The California Tax Credit Allocation Committee's (TCAC) 2001 draft qualified allocation plan (QAP) grants positive

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household of modest circumstances consistent with the requirements of a safe, sanitary and healthful living environment." Therefore, utilities generally do not include telephone or cable television services, which may be considered luxury items, but do include the services necessary for heating, air conditioning, cooking, hot water, electricity for basic appliances, water, sewer and trash.

Determining Utility Allowances

The applicable utility allowance depends on whether or not a property has HUD or Rural Housing Service (RHS) financing and subsidies. This article focuses on determining the applicable utility allowances for buildings that are not HUD- or RHS-regulated and do not have tenants who receive HUD or RHS tenant assistance.

The applicable utility allowance for all tenants is usually the public housing authority (PHA) utility allowance established for the Section 8 Existing Housing Program. However, for housing tenants who do not receive HUD or RHS rental assistance payments, property managers should consider obtaining the local utility company allowance if it is lower than the PHA utility allowance.

The Local Utility Allowance

Using a lower utility allowance may allow owners to charge higher rents and increase their monthly cash flow. If a local utility estimate is obtained in writing for any unit in a building, that estimate becomes the appropriate utility allowance for all low-income units of similar size and construction in the building. The local utility allowance does not apply to units occupied by tenants receiving HUD or RHS rental assistance; the only applicable utility allowance for these tenants is the PHA allowance.

Local Utility Estimate

A low-income tenant, owner, tax credit allocating agency or any other party may obtain a local utility estimate for the unit, according to Treasury Regulation Section 1.42-10. An estimate constitutes written information from a local utility company providing the estimated utility cost for a unit of similar size and construction for the geographic area where the building containing the unit is located.

The local utility estimate can be acquired at any time during the building's extended use or compliance period. The cost of obtaining the local utility estimate is borne by the initiating party. The initiating party must retain the original local utility company estimate and provide a copy to the owner and the tax credit allocating agency. In addition, the building owner must make copies of the estimate available to tenants.

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Separate Estimates

Separate estimates may have to be obtained if utilities are provided by separate utility companies. For example, in some parts of Los Angeles County, Southern California Gas Co. provides natural gas, and Southern California Edison provides electricity. It is not clear from Treasury Regulation Section 1.42-10 whether or not a local utility estimate can be used for one utility (e.g. gas for cooking and heating) and the PHA allowance can be used for another utility (e.g. electricity for basic appliances).

According to the IRS, if at any time during the property's 30-year extended use period, the applicable utility allowance for a unit changes, the new utility allowance must be used to compute gross rents of rent-restricted units 90 days after the change. These utility allowances shall also be updated when rents are revised.

Despite the increased administrative burden and cost of using utility allowances, owners should consider implementing utility allowances to provide better and more predictable cash flow. This is particularly true for LIHC property owners in California and other high-cost energy locations. ❖

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