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IRS Proposes Update to LIHTC Utility Allowance Regulations

By Alex Ruiz, Managing Editor, Novogradac & Company LLP

On June 19, the Internal Revenue Service (IRS) proposed regulations that amend the utility allowances regulations concerning the low-income housing tax credit (LIHTC). The proposed regulations update the utility allowances regulations to provide new options for estimating tenant utility costs. The proposed regulations affect owners of low-income housing projects who claim the credit, the tenants in those low-income housing projects, and the state and local housing credit agencies that administer the credit. This document also provides notice of a public hearing on these proposed regulations.

The IRS says it has received comments from organizations representing tenants, not-for-profit housing organizations, LIHTC agencies, building owners, building management companies, developers, and others noting that the existing rules in Treasury Regulation 1.42-10 that provide for calculating utility expenses often result in flawed information being used for calculating rent adjustments and need updating. These organizations assert that PHA utility schedules required by Treasury Regulation 1.42-10 do not represent the proper usage of utilities for low-income housing tax credit units. The IRS says this is due primarily to the fact that PHA utility schedules are designed for Section 8 properties, which generally are older buildings with higher utility costs, whereas low-income housing tax credit projects are generally newer buildings with lower utility costs.

Further, the notice says, a number of project developers, owners and building managers indicated to the IRS that they are unable to obtain local utility estimates due to a lack of data or an unwillingness on the part of utility companies to provide the information. Even if a utility company is willing to provide an initial estimate, annual updates are often difficult to obtain. Therefore, these commentators recommended that Treasury Regulation 1.42-10 be amended to provide more viable and accurate options for estimating tenant utility costs.

In response to these concerns, the IRS proposes amending Treasury Regulation 1.42-10(b)(4)(ii) to provide additional options for accurately calculating utility allowances. Section 1.42-10(b)(4)(ii)(B), which permits any interested party to obtain a local utility company estimate for a unit, would be revised to accommodate multiple utility services to a property. When charges for electricity transmission and distribution are paid to more than one company, cost estimates must be obtained from each of the utilities when computing the utility allowance.

The proposed rule would amend Treasury Regulation 1.42-10(b)(4)(ii) to permit a building owner to obtain a utility estimate for each unit in a building from the agency that has jurisdiction over the building. The agency's estimate must take into account the local utility rate data, property type, climate variables by region in the state, taxes and fees on utility charges, and property building materials and mechanical systems. The IRS says an agency may also use actual utility company usage data and rates for the building.

Further, the IRS proposes amending the regulations to permit a building owner to calculate utility allowances using the HUD Utility Schedule Model that can be found on the low-income housing tax credits page at <http://www.huduser.org/datasets/lihtc.html>.

The model is based on data from the Residential Energy Consumption Survey (RECS) conducted by the Department of Energy. RECS data provides energy consumption by structure for heating, air conditioning, cooking, water heating and other electric (lighting and refrigeration). The model incorporates building location and climate. The IRS says a building owner who chooses to use the HUD Utility Schedule Model must furnish the agency that has jurisdiction over the building with a copy of the calculations using the model. A building owner also must make available copies of the calculations to the ten-

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ants in the building.

Currently, Treasury Regulation 1.42-10(c) provides that if the applicable utility allowance for a unit in a building changes, the new utility allowance must be used to compute gross rent of rent-restricted units due 90 days after the change. Commentators requested that this rule be modified to restrict changes to the building's utility allowance until after the building has achieved 90 percent occupancy for a period of 90 consecutive days, or by the end of the first year of the credit period, whichever is earlier. The IRS's proposed regulations adopt this proposal and modify Treasury Regulation 1.42-10(c) to require that a building owner must review at least annually the basis on which utility allowances have been established and must update the applicable utility allowance. The proposed rule requires that the review must take into account any changes to the building such as any energy conservation measures that affect energy consumption and changes in utility rates.

The IRS specifically requests comments on whether other methods should be used for calculating utility allowances such as energy or water and sewer services using a software model run by a state-certified engineer who is approved by the agency that has jurisdiction over the building.

Industry Reaction

The National Multi Housing Council and National Apartment Association (NMHC/NAA) released a statement commending the IRS for issuing the long-awaited regulation changes. NMHC/NAA have since 2004 led an industry effort to encourage the IRS to expand the methods owners can use to calculate LIHTC utility allowances. They call the proposed update "a significant victory for apartment firms."

"As the only remaining federal program to support the construction of new affordable housing, the LIHTC is a critical tool in addressing the nation's worsening affordable housing shortage," said Jim Arbury, NMHC/NAA senior vice president of government affairs. "In recent years, however, the IRS-approved methods to calculate utility allowances have become outdated. This has threatened the financial viability of many existing properties and has discouraged investors from undertaking new projects. We commend the IRS for stepping forward to correct this problem."

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments or electronic comments that are submitted by September 17, 2007. Comments are requested on all aspects of the proposed regulations. In addition, the IRS

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and Treasury Department specifically request comments on the clarity of the proposed rules and how they can be made easier to understand. A public hearing has been scheduled for October 9, 2007. ❖

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