COLORADO HOUSING AND FINANCE AUTHORITY

LOW-INCOME HOUSING TAX CREDIT PROGRAM

COMPLIANCE MANUAL

CHFA

Last Revision Date 5/1/98

PREFACE

This manual is a training and reference guide for the administration of the Low-Income Housing Tax Credit Program (LIHTC or the Program). It is designed to provide guidance for compliance with the Land Use Restriction Agreement (LURA) and Section 42 of the Internal Revenue Code (the Code) and generally, to help answer questions regarding the procedures, rules, and regulations that govern LIHTC developments. It should be a useful resource for owners and developers, management companies, and on-site management personnel.

It is important to note this manual is to be used as a supplement to existing laws and rules. It is by no means a comprehensive guide to the LIHTC program and all of its requirements. This manual was produced for utilization by LIHTC participants in Colorado and should be used in conjunction with the Code and the LURA, if applicable. Owners and managers should consider retaining the services of an attorney and/or accountant that specializes in the LIHTC program to counsel them on the complex problems that may arise.

Compliance monitoring by the Colorado Housing and Finance Authority (CHFA), will be administered through the Asset Management Division. The CHFA contact for the LIHTC Compliance Monitoring Program is Tasha Weaver. She can be reached directly at (303) 297-7429 or toll-free at 1-800-877-2432, ext. 429.

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1. INTRODUCTION

1.1 THE COLORADO HOUSING AND FINANCE AUTHORITY

The Colorado Housing and Finance Authority (CHFA) is a public enterprise working to create housing, business and economic growth opportunities for the State of Colorado. In 1973, CHFA was established by the General Assembly, and given the authority to raise funds through the sale of bonds and notes and to lend the proceeds to eligible borrowers. Since its inception, CHFA has issued more than $2.8 billion in bonds and notes, providing financing for more than 50,000 families and individuals of low and moderate income, including over 30,000 first time home buyers. In addition, over 25,000 rental housing units have been provided through this financing and the Low Income Housing Tax Credit Program (the Program), the subject of this manual.

1.2 BACKGROUND

Congress enacted the Low-Income Housing Tax Credit Program under the Tax Reform Act of 1986. The Treasury Department is responsible for the administration of the Program nationwide. The Program is governed by Section 42 of the Internal Revenue Code as amended and the regulations thereunder (the Code). Under the provisions of the Code, each state is required to designate a "housing credit agency" to allocate the credits. The State of Colorado has designated CHFA to allocate tax credits within the State of Colorado.

The Low-Income Housing Tax Credit (LIHTC) is a dollar-for-dollar reduction in tax liability to the owner of a qualified low-income housing development for the acquisition, rehabilitation, or construction of low-income rental housing units. The amount of credit allocated is directly based on the number of qualified low-income units that meet federal rent and income targeting requirements.

The Omnibus Budget Reconciliation Act of 1990 amended the Code to require that state tax credit allocating agencies provide a procedure for monitoring developments for non-compliance with the requirements of the Program under Section 42(m)(1)(B) of the Code and for notifying the Internal Revenue Service of such noncompliance. To offset the costs of compliance monitoring, CHFA charges a reasonable monitoring fee as allowed by the Code.

1.3 COMPLIANCE PERIOD/EXTENDED USE PERIOD

All developments must comply with Program requirements for a period of 15 taxable years (the compliance period) beginning with the taxable year in which the development was placed in service or, at the election of the taxpayer, the succeeding taxable year. This election, if made, must be noted on the IRS Form 8609. Developments receiving credit allocations on or after January 1, 1990, must comply with Program requirements during the period of the extended low-income housing commitment (the extended use period), which is a minimum of an additional 15 years, pursuant to a LURA between the owner and CHFA which is recorded in the real estate records of the County in which the development is located. Subject to the provisions of the LURA, Section 42 of the Code provides for earlier termination of the extended use period under certain circumstances.

2. RESPONSIBILITIES

2.1 CHFA RESPONSIBILITIES

CHFA allocates tax credits through the LIHTC Program for the construction, substantial rehabilitation, and/or acquisition and substantial rehabilitation of low-income housing within the State of Colorado. CHFA also monitors compliance with Program requirements during the compliance and extended use periods. Once a final allocation is awarded to a development, CHFA will:

1. Provide a Compliance Manual;

2. Provide technical assistance and training as needed regarding compliance;

3. Review Annual Submissions;

4. Perform management reviews of resident files and on-site inspections of the development; and,

5. Notify the Internal Revenue Service of non-compliance.

A. CHFA TAX CREDIT ALLOCATION OFFICER

The Rental Housing Division's Tax Credit Allocation Officer reviews each development for LIHTC eligibility and economic feasibility prior to the issuance of a tax credit allocation. On the basis of the analysis, the Tax Credit Allocation Officer recommends to CHFA's Board of Directors the amount of tax credits to be allocated and terms and conditions for the issuance of the tax credit allocation, all in accordance with the Code and current CHFA Qualified Allocation Plan.

B. CHFA ASSET MANAGEMENT OFFICER

The Asset Management Officer (AMO) assigned to a development receives all documentation which is to be submitted to CHFA for compliance monitoring purposes. The AMO also serves as a contact for information and questions about compliance monitoring. Management reviews and necessary follow-up reviews shall be conducted by the AMO in order to verify compliance. The AMO may provide ongoing training for owners/developers, the management company personnel, and on-site management as needed.

2.2 OWNER RESPONSIBILITIES

The owner has chosen to utilize the LIHTC Program to take advantage of the tax benefits provided. In exchange for these tax benefits, certain requirements must be met that will ultimately benefit low-income residents. A description of these responsibilities follows:

A. General

The owner has provided comprehensive development information with evidence of overall economic feasibility. Prior to issuance of a final tax credit allocation, the owner and the owner's accountant must certify to the total development costs. The owner must also certify that all requirements of the LIHTC Program have been met. Any violation of the requirements of the LIHTC Program could result in the loss of the tax credits issued to the owner.

B. Administration

The owner is responsible for insuring that the development remain in compliance with Program requirements, including the requirement that at all times the development is suitable for occupancy, taking into account local health, safety and building codes. The owner must make certain that the on-site management team complies with all applicable rules, regulations and policies that govern the development.

C. Ongoing Notification and Reports

Throughout all phases of development, rent-up and operation, it is the responsibility of the owner to keep CHFA informed of the following: the actual placed in service date, the first year of the credit period, the date at which the development has achieved full occupancy, as well as any material changes, such as ownership or management that are made at any time. Monthly occupancy reports must be submitted to CHFA for <u>all</u> developments during the first year after the placed in service date. For further information, please see section 3.3, Required Submissions.

D. Compliance Training

Owners of developments that are placed in service in 1996 and thereafter are required to attend compliance training that is either approved or conducted by CHFA prior to receiving the IRS FORM 8609 from CHFA. CHFA will provide owners with a schedule of available training sessions for the year. Owners and managers may also contact their AMO or Tasha Weaver at (303) 297-7429 or (800) 877-2432 for information on available sessions.

2.3 MANAGEMENT RESPONSIBILITIES

A. General

The owner, managing agents and representatives are responsible for implementing the LIHTC Program requirements correctly. Anyone who is authorized to lease apartment units to residents should be thoroughly familiar with all federal laws, rules and regulations governing certification and leasing procedures. It is also important that the management company provide information, as needed, to CHFA and submit all required reports and documentation in a timely manner.

B. Noncompliance

If the management company determines that the development is not in compliance with LIHTC Program requirements, the assigned CHFA Asset Management Officer must be notified immediately and steps must be taken with CHFA's guidance to correct the noncompliance whenever possible.

C. Compliance Training

Management agents of developments placed in service in 1996 and thereafter are required to attend some form of compliance training that is either approved or conducted by CHFA prior to the issuance of the IRS Form 8609 from CHFA.

3. COMPLIANCE PROCEDURES

3.1 GENERAL

This section of the manual outlines procedures for projects receiving credits under the LIHTC Program to ensure each owner's compliance with the Code, the LURA, and CHFA regulations and policies.

3.2 RECORD RETENTION REQUIREMENTS

Owners are required to retain records for each qualified low-income building in the development showing the following information:

1. The total number of residential rental units in the building (including the number of bedrooms and the size in square feet of each residential rental unit);

2. The percentage of residential rental units in the building that are low-income units;

3. The rent charged on each residential rental unit in the building (including utility allowances);

4. The amount of the utility allowance for each unit and supporting documentation;

5. The number of occupants in each low-income unit;

6. The low-income unit vacancies in the building and information that shows when and to whom, the next available units were rented;

7. The annual income certification of each low-income resident;

8. Documentation to support each low-income resident's income certification;

9. The eligible basis and qualified basis of the building at the end of the first year of the credit period; and

10. The character and use of the nonresidential portion of the building included in the building's eligible basis under Section 42(d) of the Code (e.g., resident facilities that are available on a comparable basis to all residents and for which no separate fee is charged for use of the facilities, or facilities reasonably required by the development).

Owners are required to retain all records for each building for a minimum of six years after the due date (with extensions) for filing the federal income tax return for that year. The records for the first year of the credit period (see glossary) must be retained for a minimum of six years after the due date (with extensions) for filing the federal income tax return for the last year of the compliance period of the building.

3.3 REQUIRED SUBMISSIONS

Owners or Agents must submit certain documents and fees (if applicable) throughout the compliance and extended use periods. There are different submission requirements for 100% low-income developments and mixed income developments (developments with both low-income and market units). The requirements are as follows:

<u>100% Low-Income Developments</u>

1. Submit for first year of credit period only:

- Copies of IRS Form 8609 and Schedule A for each building that were completed, signed and filed with the IRS by the owner

2. Submit monthly (15th of each month) for first year after *placement in service:

- Occupancy Report covering the previous month (Exhibit G-1, Short Form)

3. Submit annually on anniversary of *placement in service:

- Occupancy and Demographics Report covering the last month of the reporting period (Exhibit G-1, Long Form)
- Certificate of Continuing Program Compliance covering the last 12 months of the reporting period (Exhibit F)
- Annual Monitoring Fees (pre-1995 developments only, see Section 3.15, CHFA Monitoring Fee)

<u>Mixed Income Developments</u>

1. Submit for first year of credit period only:

- Copies of IRS Form 8609 and Schedule A for each building that were completed, signed and filed with the IRS by the owner

2. Submit monthly (15th of each month for the previous month):

- Mixed Income Occupancy Report (Exhibit G-2, Short Form)

3. Submit annually on anniversary of *placement in service:

- Mixed Income Occupancy and Demographics Report covering last month of reporting period (Exhibit G-2, Long Form)
- Certificate of Continuing Program Compliance covering last year of reporting period (Exhibit F)
- Annual Monitoring Fees (pre-1995 developments only, see Section 3.15, CHFA Monitoring Fee)

* Note: If the development has more than one placement in service date, use the last date.

3.4 LIHTC ELIGIBILITY FORMS

One or more of the following forms, (or similar forms acceptable to CHFA) must be used in determining eligibility prior to move-in and at each annual recertification for low-income residents and in meeting part of the record retention requirements in Section 3.2:

1. Certification of Resident Eligibility (Exhibit A)

2. Income Verifications (Exhibits B, C, D, I, & J)

3. Resident Statement of Assets (Exhibit E)

4. Asset Verifications (Exhibit E-1) if total value of all assets is greater than $5,000

5. Public Housing Authority Statement (Exhibit K) and Public Housing Authority Statement, Release For Information (Exhibit K-1) for residents who receive Section 8 housing assistance payments

6. LIHTC Lease Addendum (Exhibit M). The provisions of this addendum may be incorporated in the lease in lieu of the execution of an addendum to the lease.

3.5 CERTIFICATION OF RESIDENTS

Applicants for low-income units should be advised early in their initial visit to the development that there are income limits which apply to these units. Management should explain to the applicants that the anticipated income of all persons expecting to occupy the low-income unit must be verified by third party and certified using the CRE prior to occupancy.

After move-in, anticipated incomes must be re-verified and a new CRE must be completed at least every 12 months for residents of all low-income units.

*Please note that for HUD Section 8 developments and Section 515, Rural Development (formerly Farmers Home) developments, the HUD and the Section 515 annual certification/recertification forms may be used instead of the CRE to satisfy this requirement.

Important! No applicant may be denied housing at an LIHTC development solely for the reason that said applicant is the holder of a Section 8 certificate or voucher.

A. Effective Term of Income Verification

Written verifications of income and assets are valid for ninety (90) days from the date the source provides the information. After ninety (90) days, the information may be verbally updated from the source for an additional thirty (30) days. After this time a new written verification must be obtained.

B. Acceptable Forms of Verification

All attempts at obtaining verification should be documented (i.e., copies of third party verification letters sent to the source). Acceptable forms of verification for specific types of income situations include:

1. Employment Income

The Income Verification form (Exhibit B) completed by the employer.

2. Self-Employment Income

The Income Verification form (Exhibit C) completed by the individual submitted along with the prior year's income tax return.

3. Social Security, Pensions, Supplemental Security Income (SSI), Disability Income

a. A Benefit Verification form (Exhibit I) completed by the agency providing the benefits

or,

b. An award or benefit notification letter prepared and signed by the authorizing agency. Note: Since checks or bank deposit slips show only net amount remaining after deducting SSI, Medicare, or state health insurance, they should not be used. Any withholdings must be verified and included in annual income.

4. Public Housing Authority

If a resident is receiving a housing assistance payment under Section 8, the verification requirements may be fulfilled by obtaining a Public Housing Authority Statement (Exhibit K) from the public housing authority. Exhibit K-1 is a release of information that must be signed by the resident prior to the initial certification and is effective throughout the resident's occupancy at the development.

5. Unemployment Compensation

a. A verification form completed by the unemployment compensation agency; or,

b. Records from the unemployment office stating payment dates and amounts.

6. Alimony or Child Support Payments

a. A copy of a separation or settlement agreement or a divorce decree stating the amount and type of support and payment schedule; or,

b. A notarized letter from the person paying support; or,

c. As a last resort, a notarized statement or affidavit from the receiver of the support stating the frequency and value of the support and copies of checks.

7. Recurring Contributions and Gifts

a. Notarized statement or affidavit signed by the person providing the gift stating the frequency and value of the gift; or,

b. A verification letter from a bank, attorney or a trustee administering the gift; or,

c. As a last resort, a notarized statement from the receiver of the gift stating the frequency and value of the gift and copies of checks.

8. Unemployed Individuals

a. The income of unemployed residents and applicants with regular income from any source, such as Social Security, pension, recurring gifts, etc., must be verified as covered previously.

b. If a resident is currently unemployed and claiming no income or intends to live off assets only, evidence of anticipated income for the certification year should be determined using the Unemployed Resident Affidavit (Exhibit D), obtaining a signed copy of the previous year's tax return and verifying and certifying assets as described in paragraph C, Verifying and Certifying Assets.

9. Pay Stubs

If formal written third party verification is unobtainable, pay stubs may be used. Pay stubs that cover a minimum of three pay periods must be collected and averaged to calculate an annual amount.

10. Verbal Verification

Verbal verification should only be used to update a written verification after 90 days. Verbal verifications are valid for 30 days and should be documented in the resident file.

11. Assets

The Asset Verification Form (Exhibit E-1)

C. Verifying and Certifying Assets

All assets and income from assets must be reported on the Resident Statement of Assets form (Exhibit E). Applicants and residents who claim to have no assets must also complete this form.

Household assets totaling more than $5,000 must be verified by third party using the Asset Verification Form (Exhibit E-1) or other acceptable form.

D. Annual Income

The LIHTC Program uses the Section 8 Program guidelines (HUD Handbook 4350.3) for income and asset determinations. A copy of the sections from Handbook 4350.3, that should be used in determining income and assets is located in the back of this manual.

E. Completion Of The Certification Of Resident Eligibility (CRE, Exhibit A)

After all of the income and asset information has been obtained, verified and computed, management personnel must prepare a CRE. The form is a document which, when fully executed, certifies that the applicant is eligible to live in a low-income unit in the development. The CRE (or for Section 8 or Section 515 developments, the certification forms used for those programs), must be executed along with the lease prior to move-in and at each annual recertification. The following guidelines apply:

1. Management should instruct the prospective low-income resident to sign the CRE exactly as the name appears on the form.

2. All occupants of a low-income unit must be certified and on the lease with one exception. A live-in attendant (who is not the spouse or a minor child) is not considered a household member and therefore not required to be certified or on the lease.

3. In the event the resident in a low-income unit later wishes to have an additional person move into the unit, the following steps must be taken:

   a. A new CRE must be completed adding the prospective resident.

   b. The prospective resident must provide verification of income and assets information as required of the original residents;

   c. A determination must be made as to whether the Available Unit Rule (see Section 3.13, Available Unit Rule) must be implemented by adding an additional occupant.

4. In the event that a roommate or household member vacates the unit or a new household member moves in, the unit will remain a qualified unit as long as an original qualified household member remains in the unit and the Full Time Student Rule (Section 3.10, Full Time Student Exceptions) and the Available Unit Rule (Section 3.13, Available Unit Rule) are not violated. The resident file should be documented when any household member vacates or moves in the unit.

5. Should existing resident(s) wish to transfer to a new low-income unit, the transfer provision of the Available Unit Rule should be applied (see Section 3.13, paragraph 4, Available Unit Rule)

F. Certifying Existing Residents of Acquisition and Rehabilitated Buildings

If an owner has acquired and/or rehabilitated an existing building occupied by residents who moved in prior to the acquisition or rehabilitation (rehab) date, existing residents must be certified as follows:

1. If the building is habitable at the time of acquisition: Certify and verify income of existing residents as of the acquisition placed in service date (date owner acquired the building) indicated on the IRS Form, 8609.

2. If the building is not habitable at the time of acquisition: Certify and verify income of existing residents as of the rehab placed in service date (date the rehab was complete) indicated on the IRS Form, 8609.

G. Special Waiver of Annual Recertification for 100% Low-Income Developments

Revenue Ruling 94-64 allows owners of 100% low-income developments to request a waiver of the annual income recertification requirement. However, due to the new Available Unit Rule (see Section 3.13), compliance problems may arise for 100% developments that do not recertify each year. It is also necessary to determine each year if any units are occupied by full time students that do not qualify under the Full Time Student Rule (Section 3.10, Full Time Student Exceptions). Therefore, CHFA will not process any requests for waivers of this requirement.

3.6 RENT RESTRICTION

Units set aside as low-income units must be rent restricted as required by Section 42(g)(2) of the Code. A unit is rent restricted if the "gross rent" does not exceed 30% of the applicable income limitation. CHFA will release Income and Rent Tables on an annual basis after receiving current median incomes from HUD.

A. Income and Rent Tables

Please note that there are two Income and Rent Tables: one for projects that received allocations prior to 1990 (pre-90 developments) and one for projects that received allocations after 1989 (post-89 developments). For pre-90 developments, the rents are determined by the number of people. For post-89 developments, the rents are determined by the number of bedrooms.

From January 1, 1994, through February 4, 1994, owners of pre-90 developments were allowed, per Revenue Ruling 94-9 to make a one-time election to determine rents based on the new bedroom method. This election, once made, was irrevocable, had to be filed with CHFA by February 4, 1994, and applied to residents who moved in after the election date.

B. Gross Rent Defined

The Code defines “gross rent” as the unit rent plus any utility allowance determined by the Secretary to cover any utilities a resident is required to pay other than telephone (see the following Utility Allowance section). Gross rent does not include any rental assistance payments under Section 8 of the United States Housing Act of 1937 or any comparable rental assistance program, or any fees for supportive services (any service provided under a planned program of services designed to enable residents of a residential rental property to remain independent) which are paid to the owner of the unit by any governmental program of assistance. The gross rent for developments receiving rental assistance under Section 515 does not include any rental payment to the owner of a unit to the extent such owner pays an equivalent to Rural Development under Section 515 of the Housing Act of 1949. The gross rent cannot exceed the applicable maximum rent as listed on the current applicable Income and Rent Table that is based on HUD-published income limits and provided by CHFA.

C. Additional Fees

Fees for facilities or services may be charged to residents in addition to gross rent only if:

1. The cost of the facilities are not included in eligible basis (see Eligible Basis in glossary);
2. The facilities or services are truly optional;
3. A reasonable alternative is provided.

For example if an owner offers washers and dryers in the apartments for an additional fee, the cost of the washers and dryers must not be included in eligible basis and an alternative such as laundry facilities at the building must be provided to the residents.

***Note: Monthly fees in addition to gross rent for pets or for month-to-month leases are not allowed.**

3.7 UTILITY ALLOWANCE

As stated in the previous section, the gross rent includes any utilities other than telephone that a resident is required to pay. If any utilities are paid directly by the resident, the Code requires inclusion in gross rent of a utility allowance determined by the Secretary, after taking into account such determinations under Section 8 of the United States Housing Act of 1937. In other words, the sum of resident paid rent and resident paid utilities must not exceed the applicable maximum rent. The type of utility allowance to be used depends upon the type of building.

A. <u>HUD Assisted Buildings:</u> If a development receives assistance from HUD, the utility allowance used must be the HUD-approved utility allowance.

B. <u>Section 515 Assisted Buildings:</u> If a development receives assistance from Section 515, the utility allowance used must be the Rural Development utility allowance.

C. HUD and Section 515 Assisted Buildings: If a development receives assistance from both HUD and Section 515, the Rural Development utility allowance must be used.

D. Other Buildings: For all other buildings, the local applicable Public Housing Authority (PHA) utility allowance must be used unless information from the local utility company is obtained. If both the PHA utility allowance and utility information from the utility company are obtained, use the higher amount.

If information from the local utility company is used to calculate the utility allowance, this information must be collected each year. The information must include average utility usage and cost for each unit type, so that a utility allowance can be determined. This information should be collected from the local utility company for any utilities the residents pay for the preceding twelve (12) month period. If the development has one to fifty (1-50) units total, information must be collected for each unit in the development. If the development has over fifty units total, information must be collected for a minimum of fifty percent (50%) of each unit type. The utility costs per year should be averaged for each unit type and divided by twelve (12) to ascertain a monthly utility allowance.

The utility allowances must be updated annually or whenever changes are made by the source (PHA, HUD, Rural Development or the utility company). Written documentation should be obtained from the source each year of the compliance and extended use periods indicating whether or not there has been a change in utility allowance or rates. This documentation must be kept on file for inspection and maintained in accordance with the Record Retention Requirements of the Code. See Section 3.2, Record Retention Requirements, for additional information.

3.8 RESIDENT MANAGER'S UNIT
Revenue Ruling 92-61

A unit occupied by a Resident Manager is not required to be treated as a low-income unit if the resident manager is a full time manager for the development in which he/she is living. In other words, a resident manager living and working full time at the development does not need to be income eligible and the unit does not need to be rent restricted even if the development is 100% low-income. In this case the Resident Manager’s unit would be excluded from the applicable fraction (see 3.12, Applicable Fraction). This rule applies only to developments that placed in service or received an allocation of credits on September 9, 1992, or thereafter. For all developments that placed in service or received allocations prior to September 9, 1992, this ruling will not apply unless the owner files or has filed a tax return that is consistent with this ruling.

3.9 OWNER-OCCUPIED BUILDINGS
IRC, Sec. 42(i)(3)(C) and (E)

If a building of four or fewer units is occupied by any individual who owns the building or any person related to an owner of the building, all of the units in the building will be ineligible for the tax credits. However, owner-occupied buildings are eligible for credits if the building is an acquisition or rehab at the time of allocation and the acquisition or rehab follows a development plan sponsored by a qualified nonprofit organization (as described in Section 42(h)(5)(c) of the Code) or by a state or local government.

3.10 FULL TIME STUDENT EXCEPTIONS
IRC, Sec. 42(i)(3)(D)

Residents who are full time students may disqualify a unit for tax credits. A unit entirely occupied by full time students will qualify only if one or more of the following criteria are met:

A. The students receive assistance under Title IV of the Social Security Act (Temporary Assistance to Needy Families or TANF, formerly AFDC);

B. The students are enrolled in a job training program receiving assistance under the Job Training Partnership Act or under other similar Federal, State, or local laws;

C. The students are single parents with child(ren) and such parents and the child(ren) are not dependents of another individual.

D. The students are married and file a joint tax return.

If all of the occupants of a unit are full-time students and their status does not fall within one of the above exceptions, the household may be eligible to live on the property, if the property is not 100% low-income, but the unit may not be treated as a low-income unit. Remember, this rule only applies to units occupied entirely by full time students. The status of a unit occupied by a household that originally qualified at move-in will change to non-qualifying (and thus will not be eligible for tax credits) if all members of the household become full time students who do not qualify under any of the full time student exceptions.

3.11 NONTRANSIENT OCCUPANCY
IRC, Sec. 42(i)(3)(B)(i) and (iii)

A unit will not be considered a qualifying unit if it is occupied on a transient basis. Occupancy on a transient basis is generally defined as having an initial lease of less than six months. Therefore, all initial resident leases must be for a term of at least six months. Thereafter, the lease term can be month-to-month. There are two exceptions to this rule which apply to Single Room Occupancy (SRO) developments and housing for the homeless, (within the meaning of Section 103 of the Stewart B. McKinney Homeless Assistance Act). In these two cases initial lease terms may be month-to-month.

3.12 APPLICABLE FRACTION
IRC, Sec. 42(c)(B), (C) and (D)

Developments that have both market rate units and low-income units (mixed income developments) create a special set of challenges for managers. It is particularly important that managers as well as owners understand the concept of the applicable fraction which is used to calculate the amount of tax credits an owner can receive each year.

The applicable fraction is the lesser of:

The unit fraction (percentage of low-income units)

or

The floor space fraction (percentage of low-income square footage).

The applicable fraction is calculated for each building. An owner agrees to maintain a certain applicable fraction for each building prior to the allocation of credits. If the fraction becomes lower for any reason, this could result in a loss of tax credits. **Therefore, it is extremely important that owners share applicable fraction information (i.e., copies of Form C for each building from the Final Allocation Application) with managers and work closely with managers to monitor the fraction.** The occupancy report (Exhibits G, G-1 and G-2) has been revised to help managers easily calculate the fraction. Exhibit G provides instructions for completing the reports. Copies of completed reports should be sent to the owners at least annually for the month of December so they can properly report the fraction to the IRS when claiming tax credits. If a development is 100% set aside, the fraction does not need to be calculated as it would remain at 1 or 100% so long as all units in the building qualify as low-income units.

3.13 AVAILABLE UNIT RULE
26 CFR Part 1, Federal Register Vol. 62, No. 187, Friday, September 26, 1997, Page 50503

The Available Unit Rule amends the regulations under Section 42(g)(2)(D) of the Code. It applies to all leases entered into or renewed on and after September 26, 1997. This new rule covers five major issues which are discussed below.

1. General Rule

A low-income unit occupied by a household whose income increases up to 140% of the applicable income limitation (or 170% of the applicable income limitation for deep rent skewed projects) continues to be treated as a low-income unit if the household income initially met the applicable income limitation, and the unit continues to be rent restricted.

Any units occupied by a household whose income increases beyond 140% of the applicable income limitation (or 170% for deep rent skewed projects) are considered “over-income units” and cease to be treated as low-income units if <u>any</u> other comparable unit that is available or subsequently becomes available within the ***building is rented to a non-qualifying household. All available units must be rented to qualifying households until the original applicable fraction of the building (not including the over-income units) is restored. Once the original applicable fraction of the building has been restored, the over-income units may remain rent restricted or may become market units if the building is a mixed income building.

2. Comparable Unit Defined

The Rule defines a "comparable unit" as a unit that is comparably sized or smaller than an over-income unit (or, for deep rent skewed projects, any low-income unit). The Rule further states that a comparable unit must be measured by the same method (unit fraction or floor space fraction, see Glossary) the taxpayer (owner) used to determine qualified basis for the credit year in which the comparable unit became available. However, since qualified basis is determined at the end of the year, it would be impossible in most cases to measure a comparable unit that becomes available prior to the end of the year in accordance with this Rule. A more reasonable interpretation may be to measure a comparable unit by the method used to determine qualified basis in the prior credit year. CHFA recommends that owners and managers seek the advice of a tax attorney or accountant to interpret this portion of the Rule.

3. Available Unit Defined

A comparable unit is not deemed to be available for purposes of the Rule if it is subject to a preliminary reservation (preleased) that is binding on the owner under local law prior to the date a lease is signed or the unit is occupied. This is important to understand if you are preleasing units as market (unrestricted) units. Such units are still considered "available" and must be rented to low-income households to satisfy the Available Unit Rule unless there is a previous binding contract that compels the owner to reserve the unit for an applicant.

4. Transfers

When a current household transfers to another unit within the same building, the newly occupied unit adopts the status of the vacated unit. In other words, the household simply transfers and is not required to be certified as a new move-in. Thus, if a current household, whose income exceeds the applicable income limitation, moves to a vacant unit in the same building, the newly occupied unit is treated as an over-income unit. Remember, this rule only applies to transfers within the same building. Transfers from one building to another must be treated as new move-ins.

5. Result of Noncompliance with the Available Unit Rule

If any comparable unit that is available or that subsequently becomes available is rented to a nonqualified household before the original fraction is restored, <u>all</u> over-income units for which the available unit was a comparable unit within the same building lose their status as low-income units and are therefore out of compliance.

***The Available Unit Rule is applied on a building by building basis, not by project.**

3.14 BUILDING DISPOSITION (CHANGES IN OWNERSHIP)
IRC, Section 42(j)(6) and Revenue Ruling 90-60

If an owner, who plans to dispose of (sell) a building or an interest in the building, wishes to avoid loss or recapture of tax credits, the current owner (seller) must post a disposition bond satisfactory to the IRS and for a period required by the IRS and the building must be reasonably expected to continue to be operated as a qualified low-income building for the remaining compliance period. An IRS Form 8693, Low-Income Housing Credit Disposition Bond, must be filed with the IRS. A copy of this form, along with the instructions for filing and posting a bond, is located in the forms section in the back of this manual. Owners who are considering disposing of their buildings or an interest in the buildings should consult a tax accountant regarding this requirement.

Although a building disposition is not necessarily a noncompliance event, State Agencies are required to issue an 8823, Report of Noncompliance for all building dispositions to advise the IRS of a change in ownership. Owners must advise CHFA in writing of a building disposition and provide CHFA with a copy of the sales contract and the name, tax identification number, address and phone number of the new owner within 2 weeks of the sale.

3.15 CHFA MONITORING FEE

In order to offset the cost of monitoring the developments during the compliance and extended use periods, CHFA has determined that a fee will be charged to each of the developments. This fee will be reviewed on an annual basis to reassess both its reasonableness and its ability to cover CHFA's costs of monitoring. Hence, this fee is subject to change as there are changes in costs.

For all developments that have received final tax credit allocations prior to 1995, fees are to be paid annually. Owners/agents will be notified by CHFA each year of the current fee amount. This annual fee will be due and payable on the anniversary of the development's last placed-in-service date.

For all developments that have received or will receive final tax credit allocations in 1995 and thereafter, the fee is collected up front to cover the first 15 years of the compliance period. This up front fee will be due and payable at the time the application for final allocation of credits is submitted and prior to receiving the IRS Form 8609 from CHFA. The fee amount will be listed in the Application Packet provided by CHFA's Rental Housing Division as part of the allocation process. Compliance monitoring costs will be reevaluated at the end of the first 15 years to determine what monitoring fee amounts will be assessed for the remaining period under the LURA (the extended use period).

3.16 NONCOMPLIANCE

CHFA must report any instance or evidence of noncompliance to the IRS. The IRS Form 8823, Report of Noncompliance, describing the nature of noncompliance, will be used and a copy of the completed form will be sent to the owner and investor as well. The cure date, if applicable, will be noted on the 8823. A building disposition, although not necessarily considered noncompliance, will also be reported on an 8823. Instances of noncompliance that will be reported to the IRS include but are not limited to:

1. Any violation of the Code;
2. Any violation of the LURA;
3. Any violation of Federal or local building health and safety codes.

CHFA will notify the owner and management of the noncompliance event and will allow a period of time (cure period) to correct the noncompliance prior to issuing the 8823. If an 8823 is issued to the IRS and the noncompliance is later corrected, an amended 8823 will be issued indicating that the noncompliance has been cured.

4. THE MANAGEMENT REVIEW

The AMO or other representative of CHFA shall perform management reviews once every three years or more often as warranted throughout the compliance and extended use periods. The review will be performed at the development site and will consist of an inspection of the general physical condition of the development and an audit of randomly selected resident files and utility allowance documentation. In addition to the management review, the AMO or CHFA representative shall conduct an initial physical inspection for developments placed in service in 1996 and thereafter, prior to the issuance of the IRS Form 8609.

5. GLOSSARY OF LIHTC TERMS

4% ANNUAL CREDIT
The approximate applicable percentage used to calculate the annual amount of tax credits given for the cost of a new building or substantial rehabilitation built with a federal subsidy or the cost of buying an existing building for which substantial rehabilitation expenditures also are incurred with a federal subsidy. The actual applicable percentage is set each month by the Department of Treasury based on current interest rates. This percentage is then multiplied by the qualified basis to determine the actual annual tax credits. In this case, the aggregate amount of tax credits would have a present value of 30% of the qualified basis.

9% ANNUAL CREDIT
The approximate applicable percentage used to calculate the annual amount of tax credits given for the cost of a new building or substantial rehabilitation built without federal subsidy. The actual applicable percentage is set each month by the Department of Treasury based on current interest rates. This percentage is then multiplied by the qualified basis to determine the actual annual tax credits. In this case, the aggregate amount of tax credits would have a present value of 70% of the qualified basis.

20/50 TEST
Minimum set-aside requirement in which at least 20% of a development's units must be set aside for households whose incomes are less than or equal to 50% of applicable area median income.

40/60 TEST
Minimum set-aside requirement in which at least 40% of a development's units must be set aside for households whose incomes are less than or equal to 60% of applicable area median income.

APPLICABLE FRACTION
A fraction that is used in calculating the amount of tax credit an owner can claim for a building, determined by the number of units or square footage occupied by qualifying low-income residents. The applicable fraction is the lesser of:

1. The number of low-income residential units divided by the total number of all residential rental units in the building (the unit fraction),

or

2. The total square footage of the low-income residential units divided by the total square footage of all the residential rental units in the building (the floor space fraction).

APPLICABLE PERCENTAGE
The type of annual credit (4% or 9%) that was allocated.

COMPLIANCE PERIOD
The credit period plus 5 additional years in which the owner must comply with the LIHTC Program requirements. During these additional 5 years, the owner does not receive tax credits; however, the Program requirements must be followed. (Please also see Extended Use Period.)

CREDIT PERIOD
The consecutive 10 taxable years in which the credits are received, beginning with the placed in service date or, at the election of the tax payer, the following year.

DEEP RENT SKEWED PROJECT (IRC 142(d)(4)(B)
If an owner elects to have a project treated as a deep rent skewed project the following requirements must be met:

1. 15% of the low-income units in the project must be rent restricted and occupied by households whose income does not exceed 40% of the area median gross income.

2. The gross rent of each low-income unit in the project must not exceed 1/2 of the average gross rent of the comparable unrestricted units if there are any.

3. The Available Unit Rule defines an over-income unit in a Deep Rent Skewed project as a low-income unit in which the aggregate income of the occupants of the unit increases above 170% of the applicable income limitation.

ELIGIBLE BASIS
Eligible basis of a new project is its adjusted basis, generally the eligible development costs minus the cost of land. Eligible basis for acquisition credit is the eligible costs of acquiring a building. Eligible basis for rehab credit is the eligible rehab expenditures aggregated over 24 months which are chargeable to the development's capital account.

EXTENDED USE PERIOD
Owners of developments that received an allocation of credits after 1989 are subject to a Land Use Restriction Agreement (LURA) between the owner and CHFA that requires the development to comply with the Program requirements for an extended period of a specified number of years beyond the initial 15 year Compliance Period.

FLOOR SPACE FRACTION
The total square footage of the residential low-income units divided by the total square footage of all the residential rental units in the building.

GROSS RENT FLOOR (Revenue Procedure 94-57)
This ruling allows the owner to establish floor rent amounts that will not be affected by fluctuations in the income limits and maximum rent ceilings. In other words, developments will never have to charge gross rents (rent plus utilities) below their gross rent floor amounts. For developments that received an allocation of credits or determination letters on or after October 6, 1994, the owner may elect to establish the gross rent floor as the maximum rents in effect either on the date the development was placed in service or on the date the development received an

allocation. This irrevocable election must be made by the owner and submitted in writing to CHFA no later than the development's placed in service date. For developments that received an allocation of credits prior to October 6, 1994, the Owner and CHFA may use a date based on a reasonable interpretation of the Code.

MIXED INCOME DEVELOPMENT
A development that in accordance with its occupancy requirements has set aside less than 100% of the units for low-income households. As a result, mixed income developments have low-income units and unrestricted or market units.

PLACED IN SERVICE DATE
The date a building is considered for tax purposes to be ready for occupancy, usually when a building receives its certificate of occupancy.

QUALIFIED BASIS
An amount related to the development's costs that is used in calculating the amount of tax credits a development is allocated. A development's qualified basis is determined by multiplying the building's eligible basis by its applicable fraction. The qualified basis is determined each year as fluctuations may occur with the applicable fraction.

SECTION 42
The section of the Internal Revenue Code that applies to the LIHTC Program.

UNIT FRACTION
The number of residential low-income units divided by the total number of all residential rental units in the building.