ILLINOIS HOUSING DEVELOPMENT AUTHORITY

LOW INCOME HOUSING TAX CREDIT/ TCAP/1602 COMPLIANCE REFERENCE GUIDE

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INTRODUCTION

This document is a reference guide for compliance with the Low Income Housing Tax Credit (LIHTC) Program under Section 42 of the Internal Revenue Code of 1986, as amended (*the Code*), for developments allocated Credits by Illinois Housing Development Authority (IHDA). It is intended for the use of owners, developers, management companies, and on-site management personnel. It is a supplement to existing federal law and regulations regarding LIHTC compliance. Questions regarding the content of this document should be directed to:

Illinois Housing Development Authority
401 N. Michigan Avenue, Suite 700
Chicago, Illinois 60611
(312) 836-5200

ATTN: Asset Management Services Department

DISCLAIMER

This Compliance Reference Guide (The Guide) is intended as a general guide to some of the requirements of the federal LIHTC Program under the Code, which are monitored by (IHDA). It is intended to assist developers, owners, and managers of LIHTC properties which were allocated Credits by IHDA, in understanding their obligations under the LIHTC Program. However, this information is presented as guidance regarding compliance with the Code and is not a substitute for legal and accounting advice as to compliance with Section 42 and applicable Treasury regulations, rulings and issuances. The U.S. Internal Revenue Service (IRS) is responsible for interpreting and applying the Code. IHDA makes no representation as to the, accuracy or completeness of the information contained herein, or in the interpretations provided, and advises all of the LIHTC Program participants to consult with their own tax professionals to assure that they and their projects are in compliance with all applicable federal requirements.

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I. TAX CREDIT/TCAP/1602 REQUIREMENTS

A. General Comments

In 1986, Congress enacted the Tax Reform Act creating the Low Income Housing Tax Credit Program. The Program is authorized and governed by the 1986 Tax Reform Act as amended and Section 42 of the Code. The purpose of the Act is to encourage the construction and rehabilitation of housing for low and moderate-income individuals and families.

The Tax Credit 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 the Credit allocated is based directly upon the number or size of qualified low-income units that meet federal rent and income targeting requirements.

The IRS is responsible for program oversight nationwide. State and local government issuers of Tax Credits are responsible for the actual administration. Under the law, each state is required to designate a housing credit agency to allocate and monitor the Credits. In Illinois, the agencies designated are IHDA and the City of Chicago, which has authority within the corporate limits of Chicago.

IHDA is required under Section 42(*m*)(1)(*B*)(*iii*) of the Code, to monitor projects for compliance with the requirements of Section 42 of the Code and report instances of non-compliance to the IRS. This requirement applies to all buildings placed in service for which the LIHTC is, or has been claimed at any time.

Compliance with the Code is the responsibility of the owner of the building for which the Credit is allowable. IHDA′s obligation to monitor for compliance with these requirements does not make IHDA liable for the owner′s non-compliance.

B. Placed In Service

The owner′s responsibilities for Tax Credit compliance begin when a building is placed in service. Placement in service is defined as:

- *New Construction* - when a certificate of occupancy is issued for the first unit in a building;

- *Acquisition* - for an occupied or habitable building, the date of title transfer; and,

- *Rehabilitation* - a date selected by the owner as the last day of a 24-month period within which rehabilitation expenditures are aggregated.

Subsequent to a building being placed in service, IRS Form 8609 for that building is issued to the owner by IHDA.

C. Set-Aside Requirements

Each project that participates in the LIHTC must set-aside a minimum portion of the project units for low or very low-income tenants. The minimum set-asides are as follows:

- 20% of the units must be set-aside for households earning 50% or less of the area median income (very low); or,

- 40% of the units must be set-aside for households earning 60% or less of the area median income (low).

The choice as to which minimum set-aside to satisfy (e.g., 20/50 or 40/60), is made by the project owner and is determined on a project basis. In addition, the owner may elect to set aside additional units, up to 100% of the total units in the project, for low-income tenants, in which event Tax Credits will be based upon the larger proportion of low-income units. An actual percentage of low-income units must be established for each building in a project no later than the time of issuance of IRS Forms 8609. Thereafter, recapture of Tax Credits and other compliance issues are normally determined on a building basis. The project must satisfy both the minimum set-aside requirement and the actual percentage of low-income units selected throughout the compliance period.

D. First Year Requirements

For a property to qualify to claim Credits the owner must have a minimum number of units set aside for low-income tenants and which are rent-restricted. These units are defined as low-income units under the Code. If the project does not meet the minimum set aside at the end of year the building/project was placed in service, the owner must wait until the next year to claim the credits. Once the minimum set aside has been selected, it is **irrevocable.**

The first year's compliance is the most critical. Failure to meet the minimum set aside within the initial compliance period disqualifies the project as an LIHTC. Initial compliance with the minimum set aside must be met no later than December 31 of the second year in which the building(s) was placed in service.

II. MANAGEMENT ACTIVITIES

Management Agent

If the owner uses the services of a management agent, the management agent is responsible to the owner for compliance with the LIHTC Program requirements, but this does not relieve the owner from its obligation to assure that all program requirements are met. Persons authorized to lease apartment units to tenants should be familiar with all federal laws and IHDA requirements governing tenant certification, recertification and leasing procedures.

A. Renting Vacant Qualified Units

If an owner elects any set-aside other than 100% of the units, thereby creating market rate units, they are required to adhere to a specific policy concerning the renting of vacant qualified units. When a qualified unit is vacated, the owner must rent the unit or any available unit of comparable or smaller size, whether qualified or not, to tenants having a qualifying income, and may not rent any units in the project to tenants not having a qualifying income (market rate tenant) until a unit has actually been rented to low-income tenants. When both market rate and low-income apartments are vacant, low-income units (of comparable or smaller size) should be rented first until the project has the correct proportion of low-income units. Managing agents should delay leasing available market rent units until demonstrating reasonable attempts to fill vacant qualified units. This policy is designed to insure that ownership maintains the chosen set-aside throughout the compliance period. (Note that under the current law and Treasury Regulations, the rule governing vacant units applies on a *project* basis, while the rule governing over-income units, discussed below, apply *building-by-building).*

B. Certification of Applicants

Owners are required, by the Code regulations, to certify and verify that the income listed on all prospective tenant applications, does not exceed maximum income limitations. Prior to occupancy, the owner must verify the tenant's income and assets (to accurately determine income derived from such assets) by obtaining a written verification of income and assets <u>and</u> require the tenant to sign a certification. The maximum income limitations, based on HUD median income data, are published yearly by IHDA.

IHDA requires owners to use IHDA Form TST-3 Annual Income Certification/Recertification to certify tenant income.

C. Leases

The lease should include an addendum that indicates the tenant must provide income certifications at least once annually and that explains the occupancy requirements of Section 42. All Tax Credit developments must have annual lease renewals.

D. Recertification of Tenants

Owners are required annually to recertify the eligibility of the household for the low-income unit. The owner must verify the income of all occupants of the unit and the household size. The recertification must be completed within 12 months of the most recent certification.

IHDA requires owners to use the IHDA Form TST-3,"Annual Income Certification/ Recertification", in completing tenant certification/ recertification. Effective January 1, 2009, HERA (Housing and Economic Recovery Act of 2008) waived the annual recertification requirement for properties with 100% of their units occupied by income eligible tax credit tenants. However, owners are required to submit annually to IHDA TST-3 forms plus all supporting documentation (i.e. income and asset verifications) on all new move-ins and 2nd year recertification only. Plus, all other residents must submit a Self-Certification of total income and assets to management at lease renewal.

Tax credit properties with other types of affordable programs, i.e. HOME, Trust Fund Bond, RHS, etc., must continue to recertify all of their tax credit tenants in addition to tenants of other affordable programs.

E. Household's Income Increase Above Income Limit

When any low-income tenant's income rises above 140% of the allowable level, the property agent must lease the next available (comparable or smaller) unit in the building to a qualified person.

1) If a building has fewer than 100% low-income units, a unit in which the tenant exceeded the income limit by more than 140% can cease to be treated as a low-income unit once another unit has been rented to a qualifying tenant and the building has returned to the proper percentage of low-income units. In that case, the over-income tenant can remain in occupancy, but may not be counted in the calculation of low-income units and, subject to lease terms, may be charged market-rate rents. A unit with a tenant whose income does not rise above 140% of the income limit shall continue to be treated as a low-income unit if the income of the occupants initially met such income limit and the unit continues to be rent- restricted.

2) For buildings that are 100% low-income and qualify for Credits on all units, the next available unit must always be rented to an income eligible tenant and all units must be rent-restricted. If a tenant's income rises above 140% of the allowable level, that unit remains rent-restricted also.

F. Change In Household Size

A unit in which tenant incomes exceed the applicable income limit because of a change in household size is treated the same as one in which the tenant exceeds the income limit because of an increase in income. The unit may continue to be counted toward satisfaction of the low-income requirement as long as the unit continues to be rent-restricted and the next unit in the building of comparable or smaller size is rented to a qualified low-income tenant.

If a tenant has occupied a unit for a length of time and decides to add a roommate, prior to move-in of a new person, management must determine whether the unit may continue to qualify as low-income using the income limits in effect at the time the roommate is to be added. Increases in a lower-income household's aggregate income to greater than 140% of the applicable limit (adjusted for family size) will not result in disqualification as long as the unit continues to be rent-restricted and the next unit in the building of comparable or smaller size is rented to a qualified lower-income tenant.

G. Students

Households where all of the members are full-time students are not eligible tenants and units occupied by these households may not be counted as low-income units. A full-time student is defined by Section 151(c)(4) of the Code as an individual who during at least five calendar months of the year is a full time student at a regular educational institution.

There are five exceptions to the full-time student restrictions; however only one must be met for the household to qualify for the tax credit program.

1. At least one member receiving assistance under Title IV of the Social Security Act (AFDC or its successor under welfare reform).

2. The household consists of single parents and their children and such parents and children are not dependents of another individual.

3. All members of the household are married and file a joint tax return.

4. At least one person of the household is a participant in a job-training program receiving assistance under the Job Training Partnership Act or similar federal, state or local laws.

5. A full-time student previously in a Foster Care Program.

H. Unit Transfers

If a low-income tenant (including an over-income tenant) moves to a new unit within the same building, the new unit assumes the low-income status of the moving tenant. Thus, no recertification or requalification of low-income tenants is required for moves within a building. Should an existing tenant wish to transfer to a unit in a different building, the tenant(s) must be treated as a new move-in, following all application, verification and certification procedures unless the owner elected to treat the building as part of a multi-building project on the 8609 (see Part II, section 8b). Income limits (adjusted for family size) at the time of the move will determine if the new unit will be counted as lower-income according to federal regulations.

I. Maximum Rental Charges

1) Developments participating exclusively in the LIHTC Program

In order to be claimed as a *qualified unit*, the gross rent (the rent plus a utility allowance determined as described below) must not exceed the applicable income limitation. Failure to restrict the rent of a unit will result in ineligibility for the Section 42 Credit, reduction in the amount of the Credit, and/or recapture of previously allocated Credits. Maximum rent limitations, based on HUD median income data, are published yearly by IHDA.

The maximum gross rent for a unit is based on the bedroom size. It is calculated by using the maximum household income limit, which would apply to a typical family occupying the unit, and assuming the number of individuals occupying the unit are as follows:

- In the case of a unit which does not have a separate bedroom, e.g. studio or efficiency, = 1 individual;

- In the case of a unit which has 1 or more separate bedrooms, = 1.5 individuals for each separate bedroom.

When the applicable family size is not a whole number, i.e. 1 bedroom = 1.5 or 3 bedroom = 4.5, the maximum annual income limit is determined by adding the two limits for the smaller and larger families (1 bedroom = 1 person limit plus 2 person limit) and dividing by

2. Finally, the applicable maximum annual income limit is divided by 12 and then multiplied by 30%. The resulting answer is the maximum gross rent for all qualified units of that size.

2) Projects participating in the LIHTC Program and other federal housing programs

A) Project Based Section 8 and Section 8 Certificate and/or Voucher holders: The rental payment, calculated using the Section 8 Program formula, is always to be considered the proper and applicable rental payment. This is true even if the household's rental payment exceeds the maximum permissible rent published for the Tax Credit Program. A unit, occupied by a Section 8 tenant, whose rental payment has exceeded the maximum permissible under the Tax Credit program, is still considered a qualified unit.

B) Rural Development or Farmers Home Administration (FmHA) 515: For properties issued Housing Credits in 1991 or later, the owner may charge the higher of the maximum permissible tax credit rent and the FmHA 515 >basic rent. When the higher figure is the FmHA basic rent, it is considered an overcharge and the difference must be refunded to the FmHA. For properties issued Housing Credits in 1990 and before, only the lower tax credit maximum rent may be charged.

C) HOME Funded Developments: For Low HOME units, the maximum rent cannot exceed the greater of the Low HOME rent limit or the LIHTC rent limit or the rent limit established by the rental assistance program. For High HOME units, rents are established by the most restrictive of all the programs within the development.

J. Cost Of Services Included In Rent

The cost of any services, that are required to be paid by a tenant as a condition of occupancy, generally must be included in the gross rent for purposes of applying the gross rent limitation of Section 42(*g*)(*2*) of the Code. A service is generally considered to be optional if payment for the service is not required as a condition of occupancy. Payments to owners by persons other than the tenant for certain supportive tenant services in special needs housing will not be considered as part of gross rent or counted against the maximum rents under the tax credit program.

Where multiple services are provided, the owner must decide which services are mandatory and included in the gross rent. All other services must be provided on an optional basis.

K. Utility Allowance Computation

Per Treasury Regulations section 1.42-10, gross rent for tax credit units must include an allowance for the cost of any utilities, other than telephone and cable TV, which are paid directly by the tenant. When a property is participating exclusively in the LIHTC Program, one of the following methodologies must be used:

- utility allowance schedule from either the local Public Housing Authority or the local utility company.
- State agency estimates
- HUD utility schedule model
- Energy consumption model

For projects participating in the LIHTC Program **and** other Federal Programs, which require a utility allowance, Section 42 requires the owner to use the methodology required by the other Federal Program. For example:

- In a HUD regulated building, use the HUD approved utility allowance.
- In an RD (FmHA) regulated building, use the RD approved allowance.
- In a building with both HUD and RD tenants use RD approved allowance.
- In a conventional building with Section 8 Certificates or Vouchers, use PHA approved allowances.

In the case where either the building or any tenant in the building receives FmHA housing assistance, the owner must apply Farmers Home Administration (FmHA) utility allowances to any rent-restricted unit in a building.

Per IRS Notice 89-6, utility allowances should be updated at the time rents are revised and must be put into effect within 90 days of receipts.

L. Fair Housing Act

Under current IRS interpretations, owners are required under the general use requirement to comply with the Fair Housing Act. The Act prohibits discrimination in the sale, rental and financing based on race, color, religion, sex, national origin, familial status, and disability***.*** It also mandates specific design and construction requirements for multifamily housing built for first occupancy after March 13, 1991. The failure of low-income housing credit properties to comply with the requirement of the Fair Housing Act will result in the denial of the tax credits on a per-unit basis.

III. OWNER'S ACTIVITIES

A. Record Keeping

The owner of a low-income housing project must keep records for each qualified low income building in the project that shows for each calendar year in the compliance period:

- The total number of residential rental units in the building (including the number of bedrooms and the size in square feet of each residential rental unit);
- The percentage of residential rental units in the building that are low income units;
- The rent charged on each residential rental unit in the building (including any utility allowances);
- The number of occupants in each low income unit, but only if rent is determined by the number of occupants rather than on the basis of unit size;
- The low income unit vacancies in the building and information that shows when, and to whom the next available units were rented;
- The annual income certification of each low income tenant, per unit;
- Documentation to support each low-income tenant's income certification (*for example, a copy of the tenant's federal tax return, Forms W-2, or verifications of income from third parties such as employees or state agencies paying unemployment compensation*). As shown above, tenant income is calculated in a manner consistent with the determination of annual income under the HUD Section 8 program, not in accordance with the determination of gross income for federal income tax liability. If a tenant receives housing assistance payments under Section 8, the documentation requirement is satisfied if the public housing authority provides a statement to the building owner declaring that the tenant's income does not exceed the applicable income limit under Section 42(*g*) of the Code;
- The eligible basis and qualified basis of the building at the end of the first year of the credit period; and'

- 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., tenant facilities that are available on a comparable basis to all tenants and for which no separate fee is charged for use of the facilities, or facilities reasonably required by the project*).

B. Record Retention

The owner is required to retain the records described above for each building in the project for at least six (6) years after the due date (with extensions) for filing the federal income tax return for that year. The records for the first year of the credit period, however, must be retained for at least six (6) years beyond the due date (with extensions) for filing the federal income tax return for the last year of the compliance period of the building.

C. Certifications

The owner of a low income housing project must certify, at least annually, to IHDA for the preceding twelve (12) month period, that the project meets and has met the requirements of Section 42 of the Code, and provide such additional information as may be required by Treasury Regulations or IHDA procedures. This certification must be in the format prescribed by IHDA, Forms TST-1 & TST-1A.

IV. ANNUAL INCOME AND ASSETS

Annual income is 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 household, including all net income derived from assets for the 12-month period following the effective date of certification of income.

Please refer to the HUD Handbook 4350.3 Chapter 5 and Appendix 3 for more detailed information concerning annual income and assets inclusions, exclusions and income calculations.

V. IHDA'S CERTIFICATION & REVIEW PROCESSES

A. General Reporting Requirements

Compliance monitoring is administered by IHDA's Technical Services Department. Tax Credit projects are typically subject to an annual review of their management activities. Owners will be notified annually as to the extent of their reporting requirements, which will include, at minimum, furnishing of one or more of the documents described below. Projects, which also received mortgage financing from IHDA, may be subject to additional or different reporting requirements. Owners will be informed of these requirements through other communications from IHDA.

- *Certification of Continuing Low Income Housing Tax Credit Compliance (IHDA Form TST-1 & TST-1A)*.

- *Low Income Housing Tax Credit Compliance Report (IHDA Form TST-2)*.

- *Annual Income Certification (IHDA Form TST-3)*. Documentation to support each low-income tenant's income certification must also be submitted with the TST-3.

- *Development Information for Low Income Housing Tax Credit Projects (IHDA Form TST-4)*. This form only needs to be completed and submitted once.

- *Tenant Rent Record Information for Low Income Housing Tax Credit Projects (IHDA Form TST-5).*

- *Certification of Student Eligibility (IHDA Form TST-6)*

NOTE: IRS has proposed modifications to the Treasury Regulations governing compliance monitoring. IHDA will implement any changes required by such Regulations, upon their effective date, which may result in changes in the procedures described in this Manual.

B. Tenant Certification & Recertification Reviews

IHDA will perform an in-house desk review of a minimum of 20% of the low-income tenant's files submitted by the owner or his agent. For properties of less than 10 qualified units, 100% of the files will be reviewed. If through the sampling review, significant or sufficient errors are found, a review of 100% of the files will be conducted. For new properties, IHDA will conduct on-site tenant file reviews within one year of buildings being placed in service.

C. Property Inspections

IHDA will perform on-site physical inspections to monitor for habitability standards of at least 33% of the low-income housing tax credit projects annually. Such inspections will include 20% of the low-income units, examination of the grounds, the exterior of the building(s), common areas, and photographs of the project. IHDA will also conduct physical inspections within one year of new buildings being placed in service.

For tax credit projects receiving mortgage financing from IHDA, the inspections may be more frequent and more detailed due to other monitoring requirements.

D. Fees

IHDA may charge an annual compliance-monitoring fee to the owner for undertaking the tax credit compliance monitoring review. Currently, IHDA has established the following fee schedule:

- 1 - 10 units — $75.00
- 11 - 19 units — $150.00
- 20 or more units — $25.00 per tax credit unit

The fee must be paid at the time that compliance monitoring information is supplied to IHDA. Fees should be sent to the lock box address below.

Illinois Housing Development Authority
P.O. Box 93397
Chicago, Il 60673

VI. REPORTING OF NON-COMPLIANCE

A. General Reporting Requirements

IHDA will report all findings of non-compliance, whether corrected or not, to the Internal Revenue Service within 30 days of the end of any correction period. The current IRS Form 8823 allows for IHDA to make a notation concerning the correction of some non-compliance findings.

B. Examples Of Non-Compliance

- Failure to maintain the selected low-income set-aside for the project;
- Charging low income tenants rents in excess of the restricted rents, including improper calculations of utility allowances;
- Failure to maintain and/or provide adequate documentation of low-income occupancy;
  - failure to certify or recertify tenants;
  - improper or incorrect tenant certifications;
  - inadequate, incorrect or improper supporting documentation of tenant certification;
  - failure to meet the next available unit rule; and
  - failure by the owner to submit required documentation to IHDA;
- Changes in the qualified basis of the building;
- Failure to maintain building in safe and habitable condition;
- Failure to permit or provide IHDA access to any low income housing project for the purpose of performing physical inspections;
- Housing ineligibles in qualified units, i.e. over income or certain students;

- Failure to meet selected minimum set-aside (20/50, 40/60) by the end of the first year of the credit period;

- Failure to perform and/or prepare tenant's certification and/or recertification; and

- Failure to comply with any other requirement set out in Code Section 42, Treasury Regulations, IHDA procedures or the extended use agreement.

- State and Local reports of Building Code violations not corrected to filing the annual recertifications.

- Violations of the Fair Housing Amendments Act of 1988 or the 1968 Civil Rights Act

C. Notice to Owner

IHDA will promptly notify the owner, in writing (the *Notice*), as to the nature of the non-compliance and specify a period for correction.

D. Correction Period

The owner will, generally, be given an opportunity to correct most incidents of non-compliance within a *90-day* correction period. This correction period commences on the date of the Notice. During this *90-day* correction period, the owner may be required to submit a detailed report of the actions to be taken to correct the issues of non-compliance. IHDA, in its sole discretion, may extend the correction period for up to 6 months but only if it determines that good cause exists for granting such extension. IHDA will determine whether a particular instance of non-compliance has been satisfactorily corrected within the applicable time period.

VII. RESYNDICATION

When an owner takes a project through resyndication, either with rehab credits only or as an acquisition/rehab, the existing LIHTC residents are grandfathered in under the new credit/compliance/extended use period. The owner must demonstrate that each resident qualified for the LIHTC program during the original credit/compliance/extended use period. That means they must show the TIC and its backup documentation that show the resident was LIHTC-qualified.

When the development go through resyndication, the income limits are based on the placed in service date for their **new** credits. Since it is post-2008, they no longer qualify to use the HERA-special income limits.