



July 9, 2010

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**RE: Income and Rent Limits Under Internal Revenue Code §42 and §142**

Dear Mr. Cross, Mr. Novey, Mr. Polfer, and Mr. Handleman:

On behalf of the members of the LIHTC Working Group, along with the National Association of Home Builders and the National Affordable Housing Management Association, we request clarification on income and rent limits relating to the Housing and Economic Recovery Act of 2008 (“HERA”). This letter is a follow up to the letter sent to Carla Young and Paul Handleman dated April 6, 2009. This letter addresses the same issues, which are more critical now that HUD has discontinued its hold harmless policy for Section 8 income limits as of May 14, 2010.

**Background**

Since 1986, low-income housing tax credit (“LIHTC”) and tax-exempt bond properties under Internal Revenue Code (“IRC”) §42 and §142 have determined their income limits from HUD Section 8 income limits. However, in 2009, to accommodate adjustments to the Section 8

income limits required by HERA, HUD published income limits for IRC §42 and §142 separately from Section 8. This separate data set for IRC §42 and §142 is called Multifamily Tax Subsidy Projects (“MTSP”); and includes both the Section 8 income limits and the HERA Special income limits. LIHTC and tax-exempt bond properties under IRC §42 and §142 still use Section 8 income limits, but HUD now publishes the MTSP income limits to accommodate the HERA adjustments. The two adjustments from HERA are as follows:

1. HERA Special adjustment for counties with no income decrease in 2007 or 2008 due to HUD’s hold harmless policy
2. HERA Hold Harmless provision to prevent income limits from decreasing

### **Project-based Approach**

The HUD 2009 and 2010 briefing material for MTSP income limits, along with informal guidance from the IRS in LIHC Newsletter #35, indicate that only projects **placed in service before January 1, 2009** qualify for HERA Special income limits.

Briefing material for MTSP income limits:

[http://www.huduser.org/portal/datasets/mtsp/mtsp10/MTSP\\_BriefingReport.PDF](http://www.huduser.org/portal/datasets/mtsp/mtsp10/MTSP_BriefingReport.PDF)

LIHC Newsletter #35:

[http://www.novoco.com/low\\_income\\_housing/resource\\_files/irs\\_rulings/irs\\_newsletter/lihc\\_newsletter35.pdf](http://www.novoco.com/low_income_housing/resource_files/irs_rulings/irs_newsletter/lihc_newsletter35.pdf)

This guidance also indicates that the income floor for the HERA Hold Harmless provision **begins when the project is placed in service.**

This project-based approach means that in 2010 there are two income limits for those counties that had a decrease in Section 8 income limits from 2009 to 2010 (over 500 counties had a decrease). For example, San Diego County, CA has two income limits in 2010 as follows:

1. 2009 MTSP for projects placed in service prior to 5/14/10 that use the HERA Hold Harmless Provision
2. 2010 MTSP for projects placed in service on or after 5/14/10

This project-based approach also means that in 2010 there are possibly three income limits for HERA Special counties (over 1,000 counties are HERA Special). For example, Durham County, NC has three income limits in 2010 as follows:

1. HERA Special for projects placed in service prior to 1/1/09
2. 2009 MTSP for projects placed in service on or after 1/1/09 but prior to 5/14/10 that use the HERA Hold Harmless Provision
3. 2010 MTSP for projects placed in service on or after 5/14/10

The project-based approach results in different income and rent limits in the same county depending on when projects place in service. We believe a county-based approach, where all projects in a county use the same income and rent limits, is the technically correct approach under HERA Section 3009(a) (now codified in IRC §42 and §142).

### **Technical Issue 1 – HERA Hold Harmless Definition of “Determined”**

Section 3009(a) of HERA established a hold harmless policy for tax credit and tax-exempt bond projects by amending IRC §142(d)(2)(E)(i) to read as follows:

“Any determination of area median gross income under **subparagraph (B)** with respect to any project for any calendar year after 2008 shall not be less than the area median gross income **determined** under such subparagraph with respect to such project for the calendar year preceding the calendar year for which such determination is made.” (emphasis added)

This implies that the hold harmless policy should apply on a county basis for all projects. IRC§142(d)(2)(E)(i) does not explicitly state that the project had to be eligible in a prior year for tax credits or tax-exempt bonds, but does explicitly state that the income shall be **determined** under **subparagraph B**. IRC§142(d)(2) **subparagraph B** states that:

“area median gross income shall be **determined** by the Secretary in a manner consistent with **determinations of lower income families and area median gross income under section 8.**” (emphasis added)

According to HUD’s 2010 Section 8 income limit briefing material:

“HUD uses the Section 8 program’s Fair Market Rent (FMR) area definitions in developing median family income estimates (MFIs), which means that income estimates are developed for each metropolitan area, parts of some metropolitan areas, and each non-metropolitan county.”

In accordance with the HUD briefing material, HUD determines Section 8 income limits on a county basis and projects in a county use the same income and rent limits; HUD does not consider a project’s placed in service date for selecting income limits. Under IRC §142(d)(2)(E)(i), the income limit shall not be less than income **determined** under **subparagraph B** with respect to such project. Determinations under **subparagraph B**, which are made in accordance with Section 8 rules, are always determined on a county basis, and therefore, IRC §142(d)(2)(B) income determinations should also be made on a county basis. To apply income limits on a project basis would not be consistent with the requirement that income

limits be calculated in a manner consistent with the Section 8 program. All that is required to determine the applicable income limit under **subparagraph B** is the county where a project is or will be located. There is no requirement to consider a project's placed in service date.

If the HERA hold harmless provision is applied on a project basis, the result is that projects in the same county have different income and rent limits depending on when they place in service.

Example 1 – HERA Hold Harmless Applied on a Project Basis

	Applicable Income Limit				
	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
HUD very low-income limit <sup>1</sup> (“VLI”)	\$30,000	\$32,000	\$29,000	\$26,000	\$27,000
Project 1 (Income determined in 2008)	\$30,000	\$32,000	\$32,000	\$32,000	\$32,000
Project 2 (Income determined in 2009)	N/A	\$32,000	\$32,000	\$32,000	\$32,000
Project 3 (Income determined in 2010)	N/A	N/A	\$29,000	\$29,000	\$29,000
Project 4 (Income determined in 2011)	N/A	N/A	N/A	\$26,000	\$27,000

If the HERA hold harmless provision is applied on a county basis, the result is that projects in the same county have the same income and rent limits no matter when they place in service.

Example 2 – HERA Hold Harmless Applied on a County Basis

	Applicable Income Limit				
	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
HUD very low-income limit <sup>2</sup>	\$30,000	\$32,000	\$29,000	\$26,000	\$27,000
Project 1 (Income determined in 2008)	\$30,000	\$32,000	\$32,000	\$32,000	\$32,000
Project 2 (Income determined in 2009)	N/A	\$32,000	\$32,000	\$32,000	\$32,000
Project 3 (Income determined in 2010)	N/A	N/A	\$32,000	\$32,000	\$32,000
Project 4 (Income determined in 2011)	N/A	N/A	N/A	\$32,000	\$32,000

Adopting a hold harmless policy that is applied on a project basis creates anomalies amongst projects located within the same area and creates uncertainty for industry stakeholders who are trying to determine the feasibility of future projects. We discuss other practical considerations at the end of our letter under Practical Issues.

<sup>1</sup> HUD has stated that because tax credits and tax-exempt bonds now have a hold harmless policy in place, they will no longer use the historical exception (hold harmless provision) for Section 8 income limits as they have done in the past, which will now result in some areas possibly having a decrease in Section 8 income limits.

<sup>2</sup> Ibid.

## **Technical Issue 2 - HERA Special Definition of “Determined”**

Section 3009(a) of HERA established a special income calculation for tax credit and tax-exempt bond projects by amending IRC§142(d)(2)(E)(ii), (iii), and (iv) to read as follows:

“(ii) Special rule for certain census changes. In the case of a HUD hold harmless impacted project, the area median gross income with respect to such project for any calendar year after 2008 (hereafter in this clause referred to as the current calendar year) shall be the greater of the amount determined without regard to this clause or the sum of—

(I) the area median gross income determined under the HUD hold harmless policy with respect to such project for calendar year 2008, plus  
(II) any increase in the area median gross income determined under subparagraph (B) (determined without regard to the HUD hold harmless policy and this subparagraph) with respect to such project for the current calendar year over the area median gross income (as so determined) with respect to such project for calendar year 2008.

(iii) HUD hold harmless policy. The term “HUD hold harmless policy” means the regulations under which a policy similar to the rules of clause (i) applied to prevent a change in the method of determining area median gross income from resulting in a reduction in the area median gross income determined with respect to certain projects in calendar years 2007 and 2008.

(iv) “The Term ‘HUD hold harmless impacted project’ means any project with respect to which area median gross income was determined under subparagraph (B) for calendar year 2007 or 2008 if such determination would have been less but for the HUD hold harmless policy.”

Similar to Issue 1, income determinations under IRC§142(d)(2)(B) should be on a county basis. IRC§142(d)(2)(E), does not explicitly state that the project needed to be eligible for the income limits in 2007 or 2008, but rather that the area median income determined under IRC§142(d)(2)(B) for 2007 or 2008 be determined under the HUD hold harmless policy.

## **Technical Issue 3 - Hold Harmless for Rural Projects**

Section 3004 of HERA created IRC §42(i)(8), which allows rural tax credit projects to use the greater of AMGI or the national non-metro median income for purposes of determining the applicable rent and income limit.

IRC §42(i)(8) reads as follows:

“For purposes of this section, in the case of any project for residential rental property located in a rural area (as defined in section 520 of the Housing Act of 1949), any income limitation measured by reference to area median gross income shall be measured by reference to the greater of area median gross income or national non-metropolitan median income.”

IRC §42(i)(8) does not specify that hold harmless treatment applies at the national non-metro amount for rural projects, however, IRC §42(g)(4) by reference to IRC §142(d)(2)(E) implies that hold harmless treatment would apply at the national non-metro amount for rural projects. The hold harmless policy should apply to the national non-metro because IRC§42(i)(8) states “any income limitation measured by reference to area median gross income shall be measured by reference to the greater of area median gross income or national non-metropolitan median income,” and therefore any income limitation determined under IRC§42(g)(4) would use the greater of AMGI or the national non-metro median income for purposes of determining the applicable rent and income limit. We believe the county-based approach is the correct method under this section as well.

### **Other Technical Issues**

If the IRS continues to recommend the project-based approach instead of a county-based approach then the issues below require more guidance. All of these issues below would not exist under the county-based approach.

1. Is the reference to calendar year in IRC §142(d)(2)(E)(i) based on a 12-month calendar year or a HUD income year?
2. When is the income limit determined for projects with buildings that are placed in service in different credit periods?
3. When is the income limit determined for projects with all or some buildings that defer the credit period?
4. When is the income limit determined for multi-building projects that elect no on Question 8b of IRS Form 8609 regarding the multiple-building election?
5. When income & rent limits have been determined by the state for financial feasibility during application and carryover, should that count as the year of income determination instead of the year the project is placed in service?
6. When is the income limit determined for acquisition rehabilitation projects that are not previously subject to a LIHTC regulatory agreement?
7. When is the income limit determined for acquisition rehabilitation projects that are subject to a previous LIHTC regulatory agreement?
8. Is there a corresponding income floor that is similar to the gross rent floor election discussed in IRS Revenue Procedure 94-57?

## **Practical Issues**

The project-based approach could make the HERA Hold Harmless provision ineffective because older projects might have to lower their rents to compete with newer projects in the same neighborhood placed in service in years where income and rent limits decreased from a prior year. In addition, in years of decreasing income and rent limits, projects placed in service in later years might be at a financial disadvantage to projects that were placed in service in earlier years in both the amount of rent they can charge and in the number of tenants that can qualify to live in the project. Defining the hold harmless policy on a county basis would solve many of these problems.

The project-based approach will make it more difficult for lenders and investors to underwrite affordable housing, potentially resulting in smaller loans, lower syndication proceeds and a reduction in affordable housing as a result of less financing proceeds. When a project is being underwritten, the developer, lender, investor, market analyst, and state agency all look at the historical and current HUD published income limits for a county to determine if income growth assumptions used in underwriting a project are reasonable. The project is underwritten on current and historical income limits, so it would be impractical to not hold a project harmless at the current and historical income limits. Under the project based approach lenders will require higher debt service ratios and higher operating reserves at initial underwriting to absorb any potential decrease in rent limits prior to placed in service, which will likely result in a project being able to support less debt. If affordable housing developers obtain less conventional debt, then other government sources will have to be used to make up the difference. Therefore, applying the hold harmless policy on a project basis may result in less affordable housing produced each year.

One selling point to investors in tax credit and tax-exempt bond projects is that rent limits do not have extreme fluctuations and are relatively predictable. The fact that income and rents can decrease from when a project is underwritten to when a project is placed in service adds a level of unpredictability that could cause some investors to shy away from tax credit and tax-exempt bond projects.

The project-based approach creates an administrative burden for state monitoring agencies, property managers, and investors because of the complicated rules and multiple data sets. Despite the best efforts of the state agencies and many professional advisors, many industry participants are still unsure which income limit is correct for their property. If property managers are unsure which income limit is correct they may move in tenants that do not qualify to live in their project, or may deny tenancy to tenants that do actually qualify to live in their project; and rents might be over-charged or under-charged.

The county-based approach is administratively easier and less prone to user error. We have included two flow charts with this letter. One is a project-based chart and one is a county-based

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chart. The project-based chart demonstrates the administrative complexity associated with determining rents and incomes on a project by project basis. The only question that needs to be asked on the county-based chart is whether or not a project is in a rural area. Note that these charts are only for tax credit projects. The tax-exempt bond charts would look similar except the national non-metro income and rent floor election do not apply.

We request that you issue guidance clarifying that the correct interpretation of the HERA income rules is the county-based approach. Thank you for your consideration of these matters. We look forward to your timely response so that industry participants can start applying income limits on a county basis. If there is any way we can be of assistance, please feel free to contact Michael Novogradac (415) 356-8000 or Jim Kroger (415) 356-8016.

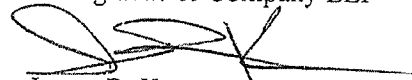
Yours very truly,

**THE LIHTC WORKING GROUP**

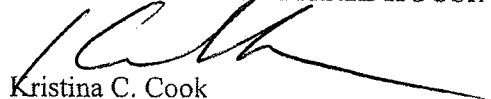
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**NATIONAL AFFORDABLE HOUSING MANAGEMENT ASSOCIATION**

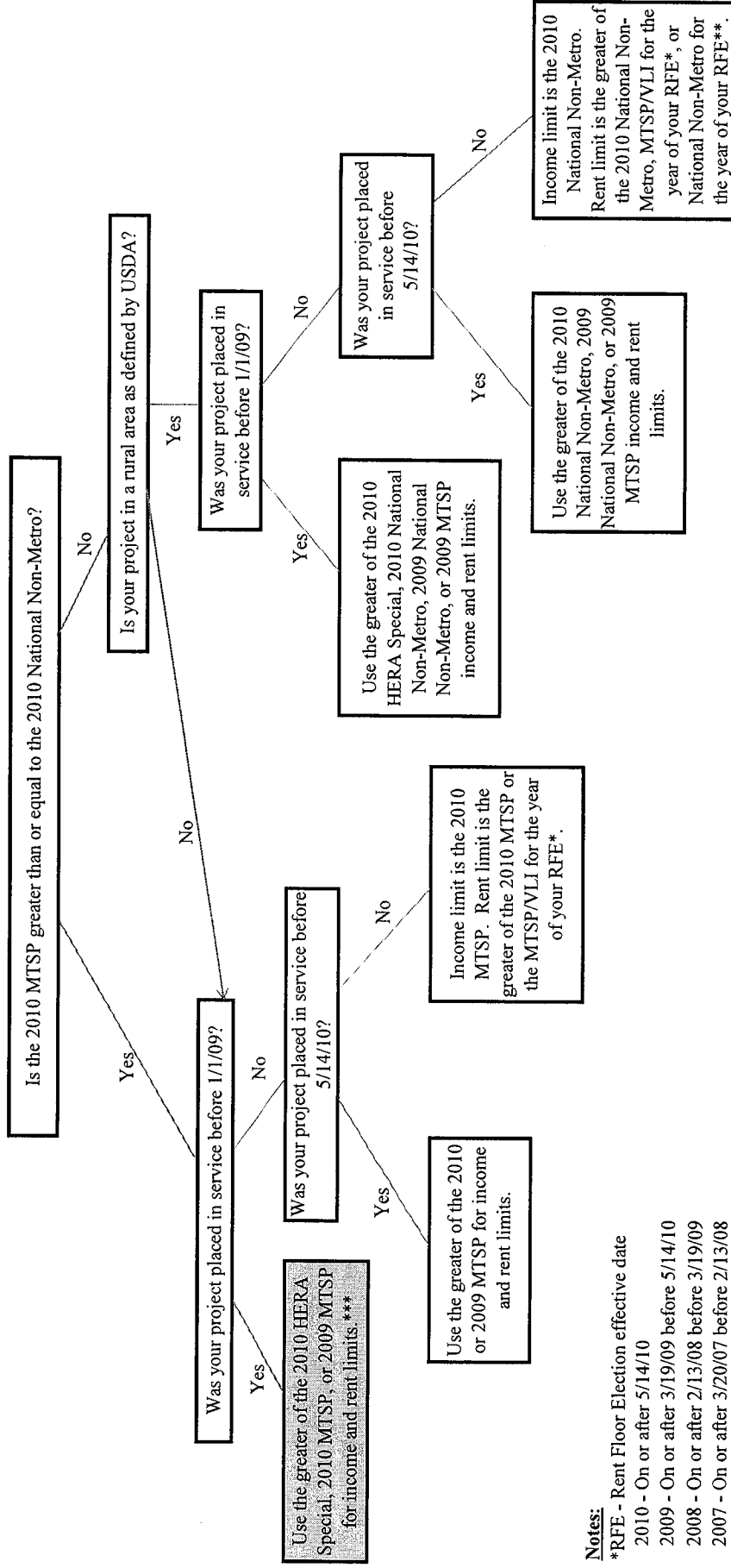
  
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# Novogradac Rent and Income Calculator © Flowchart To Determine 2010 Limits for LIHTC Projects (Project Based)



**Notes:**

- \*RFE - Rent Floor Election effective date  
2010 - On or after 5/14/10  
2009 - On or after 3/19/09 before 5/14/10  
2008 - On or after 2/13/08 before 3/19/09  
2007 - On or after 3/20/07 before 2/13/08  
2006 - On or after 3/8/06 before 3/20/07
- \*\*RFE before 7/31/08 is not eligible for the national non-metro income and rent limits.
- \*\*\*Majority of the existing LIHTC projects were placed in service prior to 1/1/09, and therefore, would be using the income and rent limits that apply from the shaded box above.

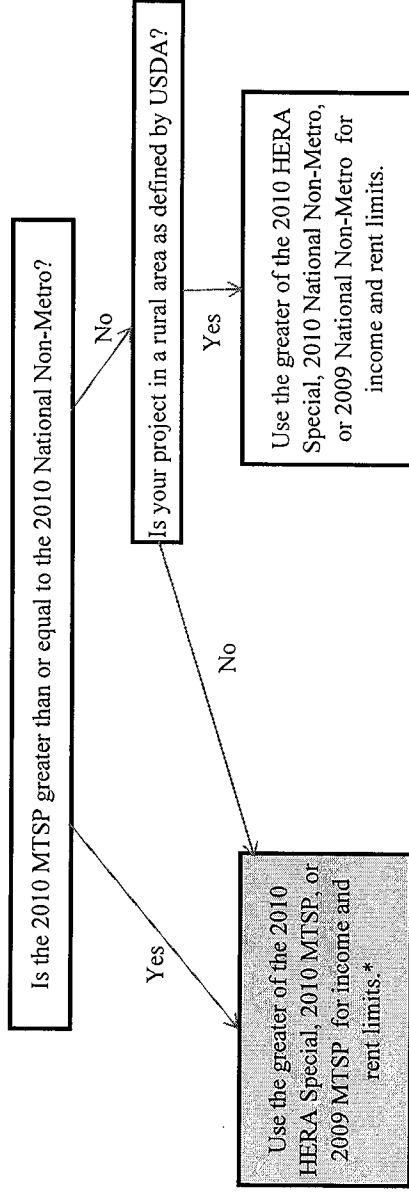
**Assumptions:**

1. Your project is in a rural area for 2010 if your project is in a rural area for 2009.
2. Your project is not in a rural area for 2010 if your project is not in a rural area for 2009.
3. The Rent and Income Limit Calculator© assumes that "calendar year" in the hold harmless rule means the HUD income limit year. For example, the 2009 calendar year means the HUD income limit year from 3/19/2009 through 5/13/2010.

This flow chart is for discussion purposes only. See 5/26/10 Novogradac Webinar for explanation. We strongly recommend that you check with the applicable state housing agency to verify that the flow chart agrees with the state agency's approach. Novogradac & Company LLP provides no assurance of the accuracy of the particular results you may obtain from the flow chart. The flow chart is designed only to be a quick reference tool and is no substitute for professional tax and accounting advice. The flow chart should not be used for any final financial decisions. Please contact a partner of Novogradac & Company LLP to calculate the rent & income limits for your specific projects. As consideration for your use of the flow chart without engaging us on a particular project, you agree to hold Novogradac & Company LLP harmless from any and all damages and claims related to use of this flow chart. If you do not agree with the terms of this paragraph, you may not use the flow chart.



# Novogradac Rent and Income Calculator © Flowchart To Determine 2010 Limits for LIHTC Projects (County Based)



**Assumptions:**

1. Your project is in a rural area for 2010 if your project is in a rural area for 2009.
2. Your project is not in a rural area for 2010 if your project is not in a rural area for 2009.
3. The Rent and Income Limit Calculator© assumes that "calendar year" in the hold harmless rule means the HUD income limit year. For example, the 2009 calendar year means the HUD income limit year from 3/19/2009 through 5/13/2010.

\*Majority of the existing LIHTC projects would be using the income and rent limits that apply from the shaded box above.

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