



## Compliance and Monitoring After Year 15

Updated February 1, 2014

### Background

After the 15-year Compliance Period has expired, there may be no tax impact in the event of non-compliance. Therefore, filing IRS for 8823 to report non-compliance is no longer an effective consequence. By establishing policy which reflects the terms of the Declaration rather than all Internal Revenue Code (IRC) Section 42 regulations, by creating reasonable and less frequent inspection criteria, and redefining some of the reporting and eligibility criteria as identified below, it is hoped that it will be administratively easier and less costly for owners and managers to operate tax credit properties and maintain compliance at a time when the tax benefit is no longer available. Therefore, after year 15, compliance can be achieved much easier, but the spirit of the program is not compromised and the housing will continue to serve the people for whom the program was intended.

IRC Section 1.42-5 contains the regulations for agencies' compliance monitoring during the Compliance Period; however, the regulations do not require agencies to monitor according to these regulations in the Extended Use Period. IRS officials and other experts have indicated that agencies may not report non-compliance to IRS after the Compliance Period is over. The tax benefit to the owner is exhausted and IRS can no longer recapture or disallow credits. Therefore, the New Mexico Mortgage Finance Authority (MFA) must establish policy regarding how properties are to be monitored and consequences for non-compliance during the Extended Use Period.

In addition, based on requirements of the Extended Use Period specified in IRC Section 42 regulations and in the Land Use Restrictive Agreement referenced below, the agency has the authority to establish different criteria for eligible/ineligible student households, available unit rule, unit transfers, and the process for performing annual recertifications during the Extended Use Period, as long as income and rent restrictions, general use requirements (fair housing), Section 8 acceptance, minimum set-aside, applicable fraction, and initial and annual recertifications are required. However, should an owner wish to apply for a new allocation of credits, households determined to be income-qualified for purposes of the IRC §42 credit during the 15-year compliance period may be concurrently income-qualified households for purposes of the extended use period as long as all §42 requirements are met in the extended use period, including annually certifying student status and not renting to ineligible full time student households, verifying income and assets for annual recertification for mixed-income properties, and following rules regarding unit transfers between buildings that are not part of the same project as defined by section 42. Management companies should consult with their owners before implementing any changes noted in this plan.

## **Compliance Period**

Under Internal Revenue Code (IRC) Section 42(j)(1) the Compliance period means, with respect to any building the period of 15 taxable years, beginning with the first taxable year of the credit period.

The first year of the Compliance Period is the first year in which the owner claimed credits. The first year must be either the year the building(s) are placed in service or at the owner's election the year following placed in service. All requirements of IRC Section 42 including the 1.42-5 monitoring regulations are in effect during the 15-year Compliance Period.

## **Extended Use Period**

IRS Section 42(h)(6) establishes that buildings are eligible for the credit only if there is a minimum long-term commitment to low-income housing. Specifically, in order to receive a credit allocation in 1990 and later, the owner must record an extended low-income housing commitment. The document that evidences this commitment is called the Land Use Restrictive Agreement for Housing Tax Credits (LURA). The LURA is recorded with the respective County Recorder and/or Registrar of Titles and "runs with the land", regardless of subsequent changes in ownership.

For purposes of this section, the term "Extended Use Period" means the period:

- Beginning on the 1<sup>st</sup> day in the compliance period on which such building is part of a qualified low-income housing project, and
- Ending on the later of:
  - The date specified by such MFA in such agreement or LURA, or
  - The date which is 15 years after the close of the Compliance Period

IRC Section 42(h)(6)(E) provides exceptions to the Extended Use Period in the case of a legitimate foreclosure, deed in lieu, or for projects that have not waived this right, if the agency is unable to present a qualified contract pursuant to IRC Section 42(h)(6)(F). This Compliance Plan does not contain guidance for the provisions of IRC 42(h)(6)(F) regarding the qualified contract as referenced in IRC Section 42(h)(6)(E)(i)(II).

Under IRC Section 42(h)(6)(E)(ii) the termination of an Extended Use Period due to foreclosure or deed in lieu, or for failure to present a qualified contract shall not be construed to permit before the close of the 3-year period following such termination:

- The eviction or the termination of tenancy (other than for good cause) of an existing tenant of any low-income unit, or
- Any increase in the gross rent with respect to such unit not otherwise permitted by the applicable rent limits.



Under the NMMFA Land Use Restrictive Agreement for Housing Tax Credits the owner agrees to comply with the following for the term of the agreement:

- It will maintain the applicable fraction by leasing units to individuals or families whose incomes are those as prescribed by the LURA, as irrevocably elected by the owner at the time of allocation, or less of the area median gross income (including adjustments for family size) as determined in accordance with IRC Section 42;
- It will maintain the Section 42 rent and income restrictions;
- All units subject to the credit shall be leased and rented or made available to members of the general public who qualify as low-income tenants (or otherwise qualify for occupancy of the low-income units) under the applicable election specified in IRC Section 42(g), which pertains to the minimum set-aside election;
- The owner agrees to comply fully with the requirements of the Fair Housing Act as it may from time to time be amended;
- The owner will not refuse to lease a unit to the holder of a Section 8 voucher because of the status of the prospective tenant as such a holder;
- Each low income unit will remain suitable for occupancy;
- The determination of whether a tenant meets the low-income requirement shall be made by the owner at least annually on the basis of the current income of such low-income tenant; and
- Other restrictions as required under the specific year's Qualified Allocation Plan (QAP) and related points the owner received in order to obtain a credit allocation. These restrictions are property-specific within the respective LURAs and to the extent they are not otherwise time-limited, the additional restrictions remain in force and effect during the Extended Use Period.

Note that the LURAs have changed from year-to-year according to the respective Qualified Allocation Plans. However, the basic language pertaining to the Extended Use Period required by IRC has not materially changed.

### **Tenant Eligibility Criteria During the Extended Use Period**

During the Extended Use Period, MFA requires tenant eligibility and certification of income as follows:

- **Tenant Income Certification.** At initial occupancy, an initial income certification is required and calculated in a manner consistent with the determination of annual income under section 8 of the United States Housing Act of 1937 ("Section 8"), not



in accordance with the determination of gross income for federal income tax liability. Annual recertification is as follows:

- Mixed-income tax credit properties must recertify annually but owners are not required to verify income and income from assets (unless there is other financing or rental subsidy program that requires verification). Households must complete a self-certification or similar form. From information provided by the tenant household, owners must calculate gross annual income, complete the Tenant Income Certification (TIC) and enter the information into the WCMS system.
- 100% tax credit properties have no recertification requirements; however, on the anniversary date of move-in or the last certification effective date, owners must have the household complete a self-certification or similar form in order to gather the household demographics and to be entered into the WCMS Online System. This information or tenant data must be provided to HUD on an annual basis by MFA.
- Student status. Since student status is not one of the defined requirements of the LURA, the student rules under IRC Section 42 are no longer applicable.
- Unit Transfers. Unit transfers from building to building are allowed without triggering non-compliance regardless of the multiple-building election or whether a household's income is over the applicable limit at the time of transfer.
- Available Unit Rule. The available unit rule is revised to provide that if a household's income goes over 140% of the applicable income limit, a currently vacant unit or the next unit in the same building must be rented to a qualifying household (the "comparable or smaller" requirement no longer applies). This is essentially a one-for-one unit replacement.
- Applicable Fraction. Only the unit fraction will be examined to determine a building's applicable fraction.
- Rent Limits. Rent limits as elected by the owner at the time of allocation continue to be in force during the Extended Use Period. Owners of properties that were awarded selection points for additional rent restrictions should refer to the respective QAP or LURA to determine whether those additional rent restrictions are time-limited or if they are in effect for the full term of the Extended Use Period.
- Utility Allowances. Utility allowances must continue to be updated annually. Revised utility allowances must be implemented within 90 days of their published effective date.

MFA will continue to update the Housing Tax Credit Program income and rent limits published by HUD annually.



## Monitoring Compliance During the Extended Use Period

The following is the monitoring procedure MFA will follow during the Extended Use Period:

- **Annual Certification:** By March 31, or the next business day, MFA requires all owners to submit an annual certification of compliance. The Owner's Certification of Compliance during the Extended Use Period contains agency-defined certification language pursuant to the terms of the LURA. Only a person authorized to sign for the respective property's ownership entity may sign the Owner's Certification. MFA may ask for signatory authorization if not on file.
- **Annual Reporting:** The Tax Credit Summary Report must be submitted to MFA annually along with the tenant certifications on MFA's online system (WCMS) by March 31<sup>st</sup>. Also the owner must submit and enter annually into the WCMS system the property's audited financials.
- **Inspections:** At least every 5 years, MFA will perform a physical inspection of the property and review of tenant files and other pertinent documentation. The first review in the Extended Use Period will be no more than five years from the last inspection conducted during the Compliance Period. A minimum of 5 low-income units chosen at random or 10% of the low-income units in any development will be inspected. If problems are discovered MFA at their discretion may choose more files and units above the minimum requirements. Different units may be chosen for the file review as those receiving a physical inspection. MFA compliance staff will continue to work with other inspection entities such as local inspection officials, other government agencies, MFA staff, etc., to share inspection information. MFA tax credit inspections will be pursuant to the Uniform Physical Conditions Standards. MFA reserves the right to conduct a review of any building after serving appropriate notice and to examine all records pertaining to rental of tax credit units. MFA may perform a review at least through the end of the Extended Use Period of the buildings in the project.
- **Annual Monitoring Fees:** The amount of annual compliance monitoring fees is \$15 per unit since inspections are less frequent and are done on a smaller number of units. The agency reserves the right to adjust the fee due to changing circumstances. Fees are due at the same time, March 31, as the Annual Certification and Summary Report.
- **Transfer of Ownership or Ownership:** A transfer agreement is required in the event of a transfer of ownership or ownership interest. Such transfer agreement will put the new owner or partner on notice that it is subject to the terms of the LURA, including all compliance restrictions and annual compliance monitoring. Documentation of signatory authorization for the new owner or partner may be requested. Owners contemplating transfers of ownership or ownership interest must notify MFA and request a copy of the appropriate transfer agreement.



- Expiration or Termination of Extended Use Period: During the 3-year period after the LURA has expired or terminated pursuant to IRC Section 42(h)(6)(E)(ii), owners are required to annually submit the Owners report listing all low-income households that occupied a unit at the end of the term of the LURA, the respective tenant-paid rent, utility allowance, and move-out date, if applicable. The owner must also submit a certification that no low-income residents have been evicted or displaced for other than good cause. This report and certification will be due on January 31 or the next business day. No monitoring fees will be due during this 3-year period and MFA is not required to perform inspections.

### **Consequences of Non-compliance during the Extended Use Period**

The following are the procedures for and consequences(s) of non-compliance:

- All properties whose Compliance Period has expired and are subject to the requirements of the Extended Use Period will be listed on MFA's website categorized in either "Good Standing" or "Not in Good Standing".
- If an owner fails to comply with the monitoring requirements and/or terms of the LURA, MFA will issue a Notice of Non-compliance and recommendations for correction similar to what is issued during the Compliance Period. All owners will be given a period of time not to exceed 90 days with which to clarify or correct non-compliance and report to MFA that all corrections have been made. An extension of an additional 90 days may be granted, with good cause. If a property has one or more compliance violations, but the owner is making a good faith effort to correct within a reasonable time then the property can be considered in Good Standing. If the violation(s) cannot be corrected within the 90-day correction period (or within the 90-day extension, if granted) MFA may request that the owner and/or management agent formulate a plan and reasonable timeline to bring the violation(s) back into compliance and advise MFA in writing of such a plan. Owners will have demonstrated good faith efforts by carrying out the plan within the referenced timeline and the property will remain in Good Standing.
- If an owner repeatedly delays requests for monitoring reviews, fails to submit annual certifications, reports and compliance monitoring fees, does not correct violations timely or according to the agreed-upon plan, where applicable, or otherwise chooses to ignore the compliance and monitoring requirements (serious and/or flagrant non-compliance) the following are consequences:
  - The owner and management company are considered to be Not in Good Standing and MFA's website will be updated to reflect the change in status.
  - A Report of Development Not in Good Standing will be issued for such serious and/or flagrant non-compliance. This report will be sent to the owner and filed with the MFA Development team. MFA may withhold providing or awarding any funds or tax credits awards to the owner, its partners and/or proposed developments to be managed by the management company until



the property is back in Good Standing. Once good faith efforts are demonstrated to the agency's satisfaction, the agency will reinstate the property, owner, and the management company in Good Standing and MFA will update their website to reflect the change in status.

- The agency and any interested party have the right to enforce specific performance of the LURA through the court system.

**Important:** Owners and management agents must keep careful track of when a development, and in some cases certain buildings within a development, transition from the Compliance Period into the Extended Use Period. Premature implementation of the Extended Use Period compliance and monitoring guidelines may result in non-compliance with IRC Section 42 for which MFA would be required to file IRS form 8823.

MFA reserves the right to modify the Housing Tax Credit Compliance Manual including, but not limited to the foregoing policy and procedure for compliance and monitoring during the Extended Use Period, as needed.

