FROM: Compliance & Asset Management

TO: Rental Tax Credit Portfolio

RE: Average Income Test Guidelines

DATE: April 2021

October 30, 2020, the IRS published a notice of proposed guidance on the **Average Income Test (AIT) minimum set-aside**. The proposed regulations affect owners of low-income housing projects, tenants in those projects, and Virginia Housing, as the agency which administers the low-income housing tax credit.

*The IRS proposed regulations for the Average Income Test conflicts with Virginia Housing guidance allowing unit designation changes ("floating units"), and the AIT threshold for the minimum set-aside noncompliance and project failure. Virginia Housing is working with the National Council of State Housing Agencies by submitting written and verbal comments requesting that the final rule allow unit designation changes, and a safe harbor for existing projects following our guidance. Until the final rule is released, Virginia Housing will continue to monitor properties under our current guidance. Once the IRS releases the Final Average Income Test guidelines, our teams will review and revise our guidance as needed to ensure existing Average Income projects can comply with the final rule as seamlessly as possible.

Please Note:

For the purposes of this document, **Site** includes all physical residential buildings and all units in the development (allocation). **Project** is defined on line 8b in Part II on the 8609 form. Compliance monitoring will review the unit designations according to the **Site**, and the Applicable Fraction, Average Income Test, and Next Available Unit according to the **Project**.

Federal Requirements Minimum Set-Aside

The minimum set-aside establishes the qualified project, as well as the applicable income and rent limits for all designated low-income units in the project.

The "Consolidated Appropriations Act of 2018", effective March 23, 2018 established a third minimum set-aside election for Housing Credit allocations to include income and rent limits at 20%, 30%, 40%, 50%, 60%, 70% and 80% AMI for low-income households.

In order to qualify for a Tax Credit Allocation, a development must meet one of three minimum threshold occupancy tests:

1. At least 20% of the units must be rent restricted and occupied by persons with income at 50% or less of the area median income adjusted for family size. Known as the **20/50 Minimum Set-Aside**.
2. At least 40% of the units must be rent restricted and occupied by persons with income at 60% or less of the area median income adjusted for family size. Known as the **40/60 Minimum Set-Aside**.
3. At least 40% of the low-income **units** in the ***project*** are income qualified, rent restricted, and occupied by individuals whose income does not exceed the imputed income limitation designated by the taxpayer at an average of 60% AMI or less. Known as the **Average Income Minimum Set-Aside (AIT)**

Taxpayer Responsibilities

The taxpayer (owner) is responsible for confirming that the development has qualified low-income buildings under IRC §42(g)(1), and must carefully consider the risks in implementing Average Income. It is strongly recommended that taxpayer work with their lender(s), investor partners, management agents, and industry Compliance professionals to understand and limit compliance risks with Average Income.

Average Income Requirements

The taxpayer agrees:

1. *60% Average AMI for all designated low-income units in the project
2. "Yes" on Line 8b in Part II of the IRS 8609 for a multiple building project to include **all** physical buildings on the required attachment
3. All income limitations from 20% to 80% AMI can be designated to units
4. *Unit designations **must** float within the site
5. At least 40% of all low-income units in the site must be designated at or below 60% AMI for 4% Tax Exempt Bond developments.
6. 100% low-income site-wide (when possible)

The Average Income Test Minimum Set-Aside

The actual income of the households is not tracked and averaged on an annual basis to calculate project's Average Income percentage.

*The Average Income Test is calculated based on the average of all designated units at 60% AMI or less in the site throughout the Extended Use Period.

Projects Ineligible for Average Income

Projects with an executed Part II of the 8609 as of March 23, 2018 for **any** BINs in the project are **not eligible** to elect Average Income

Existing Projects - Waiver Request for AIT

Projects approved for a Tax Credit Allocation prior to March 2018 must submit a waiver request to the Tax Credit Allocation department to change their proposed minimum set-aside to Average Income.

Tax Exempt Bonds 4% Tax Credit Allocations

At the time of this guidance, the AIT Minimum Set-Aside does not apply to Tax Exempt Bond 4% developments. Therefore, if elected, projects in the site must meet both the AIT requirements **and** the federal Tax Exempt Bond minimum set-aside requirements throughout the Extended Use Period. For 4% allocations, Virginia Housing requires at least 40% of all low income units in the site designated at or below 60% AMI and maintained throughout the Extended Use Period.

Designated Units Confirmation

The proposed unit designations are reviewed at the time of the Reservation Application, using the Unit Details form in the LIHTC Application Workbook~~,~~ and confirmed in the review of Tenant Income Certifications executed in the initial Credit (Lease-up) Year.

Unit Designation Non-Compliance

Units lost to non-compliance and discovered by Virginia Housing will be reported to the IRS as required in all applicable categories on the 8823 form.

Unit Distribution (Parity)

The units must be reasonably distributed across all AMI levels **and** bedroom sizes in the proposed project.

*Floating Units - Changes to the Unit Designation

The taxpayer may change the AMI designated on a unit as needed to maintain the Applicable Fraction. This change may occur at any time at the discretion of the management agent, or as requested by the tenant for income increases or decreases, or need to fill a vacant unit throughout the Compliance and Extended Use Period. Approval is not required before a unit designation change

Floating units allow each project to adapt to the needs of existing or potential tenants, to maintain the Applicable Fraction, required set-asides, or changes in tenant demand throughout the Extended Use Period.

QAP Points for lower limitations at 30%, 40%, and 50% AMI

The Minimum Set-Aside election falls under the QAP Threshold, however point incentives may be awarded for maintaining a fixed number of 30%, 40% and 50% units throughout the Extended Use Period. Although the unit designation may change, the number of units with eligible households at 30%, 40%, and 50% must be maintained throughout the Extended Use Period.

These units are counted towards meeting the overall Average Income Test as long as the household is income eligible and pays the unit designated AMI gross rent throughout the Extended Use Period.

Extended Use Agreement (EUA)

The recorded Extended Use Agreement (EUA) will include language for the required number of units for which points incentives were awarded along with the requirement to maintain an average of 60% AMI for at least 40% of the total low income units in the site **and** the Applicable Fraction.

Extended Use Agreement (EUA) & 2nd Allocation of Tax Credits or Additional Credit Allocation

A new set-aside election on IRS form 8609 for a 2nd allocation of Tax Credits does not terminate the obligations under the original EUA. The EUA will include the requirements under both Agreements and the project will be monitored according to the most restrictive occupancy requirements.

Applicable Fraction

The project **must** maintain the Applicable Fraction included in the Extended Use Agreement throughout the Extended Use Period.

Average Income HUD Published Limits

HUD is mandated to publish income limits for the Tax Credit program annually, including the Average Income limits. The limits can be found using the link below.
https://www.huduser.gov/portal/datasets/mtsp.html

AIT Program Income & Rent Limits

Virginia Housing assembles and posts MTSP, HERA Special, and Average Income income and rent limits on our website.

Average Income Test Rent Limits Calculation Calculation Factors

The AIT rent limits are calculated using the HUD published AIT Income Limits and the calculation factors above for each limitation at 20% up to 80% AMI.

20% AMI = 50% AMI x **0.4**
30% AMI = 50% AMI x **0.6**
40% AMI = 50% AMI x **0.8**
70% AMI = 50% AMI x **1.4**
80% AMI = 50% AMI x **1.6**

Extremely Low Income Limits (ELI)

The 30% AMI level calculated for the Average Income Test is not the same as the Extremely Low Income (ELI) restriction under the National Housing Trust Fund. Taxpayer (owner) of project with both programs must be mindful of the difference and follow the most restrictive program requirements for designated units.

Next Available Unit Rule (NAU)

The taxpayer (project owner) may choose to rent the Next Available Unit at any unit designation as needed to meet and maintain the AIT in the project.

Annual Certifications

By statute, annual certifications for income eligibility are not required for 100% low income Tax Credit projects. Projects with market units must complete annual recertifications with 3rd party verification of income and assets.

Student Status – Full-time student status must be verified annually for all designated low-income households throughout the Compliance Period.

Online Tenant Activity Monitoring – Virginia Housing requires an annual update of household occupancy, full-time student status, rent and utility allowances in the online tenant monitoring system and in the property records.

Any non-compliance discovered and corrected before receiving notice of HFA tenant file audit or physical inspection is not reportable to the IRS, and shows due diligence in managing the program requirements.

Important Project Information

Qualified Allocation Plan (QAP)

The Qualified Allocation Plan (QAP) identifies the selection criteria for determining housing priorities in Virginia, and gives preference to projects serving the lowest income tenants, for the longest periods, with the highest number of low-income units. The QAP also guides compliance with the project rules based upon the year the project was awarded federal housing credits.

Tax Credit Manual

The Tax Credit Manual supports the QAP, and provides guidance and instruction for policies and qualifications related to the federal housing credit program. The Average Income Minimum Set-Aside requirements can be found in the Appendix section of this document.

LIHTC Application Workbook used for Tax Credit Allocations

The taxpayer (owner) submits the LIHTC Application Workbook (Workbook) before the project is built and on-site staff is hired. The Workbook includes the unit mix, point categories, and other project requirements to maximize approval of a Tax Credit allocation.

The unit mix for the Minimum Set-Aside, including Average Income is identified on the **Unit Details form** in the Excel Workbook.

Extended Use Agreement (EUA)

The EUA identifies the specific requirements the taxpayer (owner) project must meet and aligns with the QAP, the Workbook, and the IRS form 8609. The EUA also lists the project's Applicable Fraction, which is the required total percentage of qualified low-income units required at all times in the project.

Section 5 of the EUA contains the required occupancy, income and rent restrictions, and other requirements for the project for 30+ years.

8609 Form Part I – Issued by Virginia Housing

Virginia Housing issues Part I of the IRS 8609 form to the taxpayer (owner) with the Housing Credit allocation amount, the project allocation date and Placed in Service Date for each building.

8609 Part II Executed by the Taxpayer (Owner)

The taxpayer (owner) must complete and sign Part II of the IRS 8609 form to define the project in line 8b, identify the beginning of the Credit Period in line 10a, and select the Minimum Set-Aside election in line 10c.

Once Part II is complete, the taxpayer (owner) sends the completed form to the IRS with the required attachment that identifies all BINs in the project (line 8b) by the end of the first year of the Credit Period. A copy of the executed 8609 Part II and attachments must also be sent to the Virginia Housing Compliance Officer assigned to the project.

Year End Annual Owner's Certification

It is the taxpayer's (owner) responsibility to acknowledge and certify the project's continuing compliance and identify non-compliance with the requirements of Section 42 of the Internal Revenue Code on an annual basis in a report to Virginia Housing.