Average Income Compliance Policy

Effective: 01/01/2023

Overview:

The Consolidated Appropriations Act of 2018 (the Act) permanently established income averaging as a third set-aside election for new Low-Income Housing Tax Credit (LIHTC) developments. This new income averaging set-aside allows Credit-qualified units to serve households earning as much as 80% of the Area Median Income (AMI), if the average imputed income limit of the property is 60% or less of AMI. Higher rents paid by households with incomes above 60% AMI will have the potential to offset the lower rents for households living in units designated at lower income levels. Income Averaging preserves rigorous targeting to low-income households, while providing greater income mixing potential.

The requirements listed below are subject to change in KHC's sole discretion.

KHC Compliance Monitoring Requirements: (Updated October 7, 2022-IRS)

1. Income and rent designations are required to float to maintain compliance with minimum set-asides specified in the application. **The average income for the property cannot exceed 60%.**
2. Owners electing Income Averaging must commit to having at least 40% of the units in the property affordable to eligible tenants.
3. Income Averaging applies to the designated income/rent levels of the units, not the incomes of individual tenant households.
4. Income Averaging applies to both income and rent limits. If a unit has a designated limit of 80% of AMI, the maximum rent level that may be charged to a household in that unit is 30% of 80% AMI. Similarly, if a unit has a designated a limit of 30% AMI, the maximum rent level that may be charged to a household in that unit is 30% of 30% AMI.
5. Owners must distribute 20%, 30%, 40%, 50%, 60%, 70%, and 80% units across the various unit types and sizes in a manner that does not violate the Fair Housing Act. AMI designations are allowed to float between units within the project, but the total unit mix must be maintained as agreed upon in the Application and as recorded in the Extended Use Agreement. The number of units agreed upon for each AMI level must be maintained, with the exception that KHC may allow and approve changes if needed to resolve noncompliance. Per KHC's 2023-2024 Multifamily Program Guidelines, no more than four (4) AMI selections per project are allowed. For example: 30%, 50%, 60%, and 80%.

An owner may change the imputed income designation of a previously designated LIHTC unit in any of the following circumstances:

- To enhance protections outlined in the Americans with Disabilities Act of 1990 (ADA), the Fair Housing Amendments Act of 1988, the Violence Against Women Act of 1994, the Rehabilitation Act of 1973, or any other Kentucky, Federal, or local law or program that protects tenants and that is identified by the IRS or an Agency.
- A household's unit designation may be changed to a higher designation only if household income at annual recertification exceeds 140% of the current income limit for the original designation.
- To restore the required AI income limitation for identifying a qualified group of units to satisfy the AI set-aside or determine the units to be used in computing applicable fraction(s). The rule is limited to newly designated or redesignated, vacant units or occupied by a tenant that would satisfy the new, lower imputed income limitation.

6. KHC will consider the owner to have "designated" a unit based on the AMI level being (1) recorded on the Tenant Income Certification form in the file and (2) reported through KHC's online TDCS reporting system as part of the Annual Owner Certification of Compliance. It is important to note that to change a designation, it must be understood when the unit's designation takes effect and the process through which the designation could be changed. For projects that have elected AIT and units are occupied as of Dec. 31, 2022, the initial unit's designation is determined on Jan. 1, 2023. For vacant units, the unit must be designated before move-in of a low-income tenant. In some cases, owners may wish to change the designation of occupied units to help mitigate credit loss or recapture, which also appears to be allowed by the guidance. These designations are reported to the Agency annually. If a unit's designation is changed, the taxpayer effects a change by recording the new designation in its books and records, communicating the new designation to the Agency, and retaining records of the prior and new designation retained for a period not shorter than the record retention requirement under §1.42-5(b)(2).
7. If a current qualified tenant transfers to another vacant unit in the project, the units swap AMI designations.
8. The 30% AMI income and rent level under the Housing Credit program, for purposes of Income Averaging, is not the same as the Extremely Low-Income and rent restrictions under the National Housing Trust Fund (NHTF) statutes and regulations. Whereas NHTF statutes and regulations define "Extremely Low-Income" as the greater of 30% of AMI or the federal poverty line for applicable household size, the Income Averaging unit designation under the Housing Credit program is based solely on AMI. Properties that have layered National Housing Trust Fund with Credits should be mindful of this difference.
9. The next available unit rule provides that a unit is over income if the occupant's income exceeds 140% of the greater of 60% AMI or the designated limit applicable to

the unit. This requires that the next available unit of comparable or smaller size be rented (A) to a tenant whose income does not exceed the designated limit applicable to a vacant, previously designated unit, or (B) to a tenant at an income level that would not cause a violation of the minimum set aside requirements for all other units.

10. KHC does not impose any special rules on recertification requirements based on an Average Income election. A 100% tax credit project that has elected Average Income is now exempt from full recertifications.
11. Lower set-asides must follow the Multifamily Tax Subsidy Program (MTSP) income and rent limits as published by HUD annually. These limits can be accessed through the Novogradac website or the KHC website. Any units where income or rent exceeds the limit for the set-aside specified on the low-income certification will be reported to the IRS as non-compliant.
12. As part of the annual review of the Annual Owner Certification, KHC will test compliance with the Income Averaging requirements. Units out of compliance at year end, regardless of whether attributable to a low-income certification issue or a physical inspection issue, will be removed from the applicable fraction to determine whether the Average Income is acceptable and meets program requirements. If the minimum number of compliant units falls below 40%, or if the average income designation of compliant units is above 60% AMI, the entire project will fail to meet the required minimum set-aside and will be reported to the IRS as non-compliant.
13. Monitoring Fees will be charged at a rate of $50.00 per unit should an owner elect Income Averaging as the minimum set aside.
14. Additional education requirements for property management staff may be required for developments electing Income Averaging.
15. Basic noncompliance will be handled in the same manner as other minimum set-asides. If a development elects Income Averaging and fails to meet the income averaging standard at the end of a year, it will not be considered a qualified low-income housing development for the year under IRC Section 42(g)(1)(C). This noncompliance will be reported on IRS Form 8823 and the owner could be subject to a loss of Credits.
16. If a project requires recertification and the household's income has increased at time of recertification, KHC will continue to use the AMI level the household initially qualified under at time of move-in to calculate the Average Income Test, as long as the unit remains restricted at that rent level. The unit is not "redesignated" due to income increases at recertification.
    - Example: A household had income at move-in under the 40% income limit and was treated as a 40% household with a 40% rent restriction. At recertification, the household income now exceeds 40% AMI. As long as the unit continues to be rent restricted at the 40% rent limit, KHC will continue to consider this a 40% unit for purposes of calculating the Average Income Test.
17. KHC does not allow Average Income projects to include market rate units.

<u>8609 Part II Line 8b: Multiple Building Election</u>

1. On Form 8609 Part II Line 8b, the owner must answer the question "Are you treating this building as part of a multiple building project for purposes of Section 42?" If "YES" is selected, the minimum set-aside must be met across the entire project.
2. The Line 8b election affects unit transfer rules: Tenants may transfer between buildings within the project without having to recertify for the program, as long as the household is not above the 140% limit.

<u>Qualified Group of Units:</u>

Per Treasury Regulation 1.42-19, a project (as defined by Form 8609 Line 8b) with an Average Income Minimum Set-Aside Election meets the Minimum Set-Aside test if at least 40% of the total units in the project constitute a "qualified group of units." To be considered a "qualified group of units:"

1. Each unit in the group must be a low-income unit and must be occupied by an eligible household, must be properly rent-restricted, and must be suitable for occupancy; and
2. The average of the imputed income limitations for all units in the group must not exceed 60% AMI. Possible imputed income and rent limit designations under the Average Income Test are 20%, 30%, 40%, 50%, 60%, 70%, or 80% AMI. Other designations are not allowed.
3. The owner must designate units at the various imputed income and rent limits in order to demonstrate that the unit mix will result in a qualifying group of units that meets the Minimum Set-Aside test. The average is calculated based on the AMI designation of the unit, not on the actual income of the household residing in the unit.
4. To be included in a building's Applicable Fraction, a unit must (1) be in that particular building and (2) be part of the qualified group of units for the project. The average income must be met at the project level, not at the building-by-building level.
5. KHC Compliance will pull Quarterly AI Reports from Tenant Data Certification System in order to ensure project is maintaining the AI compliance per the AI Regulations. Should non-compliance be found, notification will be promptly sent to Owner and Management of the project.
6. KHC will work with owners to allow reasonable corrections to restore compliance with average income requirements. Such corrections may include redesignating units or adding or removing units from the **qualifying group of units**.
    - If an issue is discovered and corrected within the taxable year that the problem occurs, the owner will be allowed to correct the issue to ensure that there is a qualifying group of units, and that the Minimum Set-aside test is met by the end of the taxable year.
    - If an issue is not discovered and corrected within the taxable year that the problem occurs, any retroactive correction to designations must be made **within 180 days** of discovery of an issue by the owner or KHC. If discovered by the owner, the issue and suggested correction must be promptly communicated to KHC to benefit from this correction period.

For complete Average Income guidance, please see [Section 42, Low-Income Housing Credit Average Income Test Regulations].

Please note: The IRS makes the ultimate determination if a development is in compliance with Income Averaging or any other elections made by the owner. Acceptance by KHC does not guarantee acceptance by the IRS. Owners should consult with their legal counsel. This policy is subject to change in KHC's sole discretion. Any updates can be found at KHC's Inspections and Compliance page.