ARKANSAS DEVELOPMENT FINANCE AUTHORITY

COMPLIANCE MONITORING POLICIES AND PROCEDURES MANUAL FOR THE LOW INCOME HOUSING TAX CREDIT PROGRAM

Adopted by the Board of Directors
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EQUAL HOUSING OPPORTUNITY

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SECTION I – GENERAL INFORMATION

I.A INTRODUCTION

The Arkansas Development Finance Authority ("ADFA" or the "Authority"), a public body politic and corporate, with corporate succession, was created May 1, 1985 by Act 1062. This act abolished the former Arkansas Housing Development Agency that had existed since 1977. The former agency had as its sole purpose to sell tax-exempt bonds and use the proceeds to develop safe, decent, sanitary and affordable housing for low and moderate income Arkansans. All records, funds, properties, obligations, debts, functions, powers and duties were transferred to ADFA, which sells both taxable and non-taxable bonds and supports programs not only for housing but also for economic development, agriculture, aquaculture, export finance, government finance, and tourism development.

This Policies and Procedures Manual presents an overview of ADFA's policies as they pertain to compliance monitoring for the Low Income Housing Tax Credit ("LIHTC") Program. The procedures are designed to assist owners and managers of developments that have received an allocation pursuant to the LIHTC Program to ensure that the developments remain in compliance with Section 42 of the Internal Revenue Code ("the Code"). The procedures are not intended to be all-inclusive. In the event of a conflict or inaccuracy, the Code will control. If the development has received a combination of funds from other government entities, owners must follow the most restrictive regulations. For instance, an owner may have received funds under a governmental program in which he agreed to rent a certain number of units to persons earning 40% or less of the area median income. The owner must be sure to satisfy this restriction in addition to the applicable LIHTC area median income limit. Employees and officers of ADFA are not liable for any adverse consequences that affect the taxpayer or investor relative to compliance with the federal tax code. ADFA reserves the right to implement additional policies as needed. Also, new rulings or other changes may be made periodically. Owners are responsible for compliance with any amendments or updates to the federal regulations.

Any questions regarding this Manual should be directed to:

Compliance Monitoring Department
Arkansas Development Finance Authority
P. O. Box 8023
Little Rock, AR 72203-8023
Telephone: (501) 682-5900
Telecopy: (501) 682-5859

I.B BACKGROUND

Congress created the LIHTC Program under the Tax Reform Act of 1986. The LIHTC Program, governed by Section 42 of the Internal Revenue Code, began in 1987. The tax credit is a dollar-for-dollar reduction in tax liability to investors in exchange for equity participation in the construction or acquisition and rehabilitation of rental housing that will remain income and rent restricted for an extended period of time. Tax credits are allocated by ADFA for properties located in Arkansas.

ADFA is also designated as Arkansas' LIHTC compliance monitoring agency. Crucial elements of compliance are ensuring that the appropriate number of tax credit units is occupied by eligible households, following income eligibility guidelines and restricting rents over a specified time period. ADFA is available to provide guidance to owners in maintaining continuous compliance with federal and state LIHTC guidelines throughout the compliance period.

I.C CREDIT PERIOD AND COMPLIANCE PERIOD

Once a development is placed in service, it is generally eligible for the tax credit every year for ten (10) years. To continue generating the credit and avoid recapture, an LIHTC building must satisfy specific tax credit compliance rules for fifteen (15) years. In cases where 100% low-income occupancy is not achieved during the first tax credit year, (for example, either due to unqualified tenants or inability to find qualified tenants to qualify units) there will be possible increases in qualified basis in subsequent years. In such cases, excess qualified basis shall have the percentage equal to 2/3 of the applicable fraction applied, thus extending the tax credits claimed over the 15-year compliance period. The tax credits may be generated annually on a building-by-building basis beginning either with the taxable year in which the building is placed in service or, at the election of the taxpayer (owner), the succeeding taxable year.

The compliance period for any building is the period beginning on the first day of the first taxable year of the credit period of such building and ending fifteen (15) years from such date. Beginning in 1990 and no later than 1991, ADFA implemented the Land Use restriction Agreement ("LURA"), which extended the compliance period for an additional fifteen-year period. The LURA, recorded in the real estate records of the county in which the development is located, is a binding agreement of the owner and any successors to maintain specific occupancy and affordability requirements for the development.

Projects placed in service before the use of the LURA (1987, 1988, 1989, and some in 1990) must comply with the initial 15-year compliance period only. In reference to those projects, ADFA will review the IRS form 8609 to determine the year the owner claimed the tax credits. If there is no completed copy of the IRS form 8609 available, ADFA staff shall ask the project owner to confirm the credit year. Upon determining that the 15-year compliance period has expired, ADFA will notify the owner that the compliance period has ended and that ADFA will no longer conduct physical or tenant file audits. Developments with extension agreements will continue to be monitored.

I.D FOUR TAX CREDIT REGULATION PERIODS

Since the 1986 enactment of the LIHTC, Congress has changed or amended the laws governing the program, yet many changes have not been retroactive. In some cases, the change in regulations brought forth by a technical correction is minor; in others, the effect is substantial. Owners must be aware of the differences in regulations and which credit period applies to each building or development. The period considered for management/compliance purposes is the year in which tax credits were allocated by ADFA. Currently, there are four (4) specific credit regulation periods as follows:

1. January 1, 1987 – December 31, 1989

   Properties receiving credit allocations during this period based rent on the number of people living in the unit. Rents were subject to change whenever the household composition changed. The Omnibus Reconciliation Act of 1993 allowed owners of these developments a one-time opportunity to either maintain the per-person formula or elect to change to the formula based on apartment bedroom size used for 1990 and later allocations. The owner had to write to the IRS no later than February 6, 1994, to request this election. Once made, the decision to switch formulas or retain the per-person formula was irrevocable. The new rent formula only affected any new move-ins on or after the election date. A copy of the election letter must be provided to ADFA or available during the on-site inspection.

2. 1990

   Rent is calculated by number of bedrooms in a unit. This rule was not retroactive.
   Gross Rent Floor was adopted. This rule was not retroactive. See definition herein.
   Extended Low-income Housing Commitment required. See Section I.C for further discussion.

3. 1991

   AFDC Student Rule exception was retroactive. See Section III.P
   FmHA Overage Rule (not retroactive) is discussed in Section III.F.
   Extension on Initial Compliance with Set-Aside (not retroactive).
   Minimum Set-Aside requirements are discussed in Section III.A.

4. August 10, 1993

Married Students Rule (retroactive). We discuss students in Section III.P.
Single Parent Student Rule (not retroactive).
1987-1989 Rent Change Option (special rule)
Section 8 requirement (retroactive) that states owners cannot refuse to lease to Section 8 tenants.

References: Blue Book, Section 42 of the Code, Congressional Laws

I.E ADDITIONAL REVENUE RULINGS

Two important revenue rulings were later issued that were not retroactive.

September 9, 1992	IRS Revenue Ruling 92-61 deals with treatment of staff units as part of the eligible basis.
September 26, 1997	Section1.42-15 Available Unit Rule was adopted as an amendment to the regulations. This rule allows over-income persons in LIHTC units to relocate to another unit in the same building.

I.F RESPONSIBILITIES OF OWNERS

Compliance with the requirements of the Code is the development owner's responsibility. ADFA's obligation to monitor the development for compliance does not make ADFA liable for an owner's non-compliance, nor does it alleviate an owner's duty to comply with applicable Code requirements. In compliance with Section 42 of the Code, the owner's acceptance of the allocation of low-income housing tax credits obligates him/her to:

(1) Manage the development in accordance with the Code, and all other applicable regulations and agreements;

(2) Ensure that, once the development is placed in service, it is suitable for occupancy by meeting Housing Quality Standards ("HQS") requirements;

(3) Ensure that the development is continually managed in accordance with all applicable federal, state, local and fair housing laws;

(4) Ensure that the complete records for the first year of the credit period are maintained for a minimum of twenty-one (21) years[1];

(5) Ensure that the records for subsequent years are maintained for a minimum of six (6) years after the due date for filing the federal income tax return for that year;

(6) Keep ADFA informed of the placed in service date, completion of the development, as well as any material changes such as ownership or management that is made at any time during all phases of development;

(7) Furnish to ADFA a signed copy of the completed IRS form 8609, and make available all such 8609 forms to ADFA's staff during any on-site review;

(8) Cooperate with ADFA's staff during compliance reviews;

(9) Furnish a copy of the election request to the IRS, showing change from family size to unit size in determining maximum allowable rents;

(10) Furnish the Annual Owner's Certification and Compliance Monitoring Status Report current as of December 31st of each year. ADFA mails the Owner's Certification and Compliance Monitoring Status Report forms to owners annually in November. The Annual Owner's Certifications are due in ADFA's office by January 15th. Annual Compliance Monitoring Status Reports are due in ADFA's office by February 1st. ADFA may accept company rent rolls if they are consistent with our Compliance Monitoring Status Report format and provide essential information. The Annual Owner's Certification, attached hereto as Exhibit B, and the ADFA Compliance Monitoring Status Report, attached hereto as Exhibit C, are annual requirements for the duration of the compliance period; and

(11) Assume liability for any instance of non-compliance and to correct such deficiencies as required.

SECTION II – COMPLIANCE REQUIREMENTS

II.A ON-SITE REVIEWS

After a qualified development has been placed in service, ADFA will initiate compliance monitoring reviews. ADFA's staff will visit each development by the second year that the last building of the development is placed-in-service and once every three

[1] Refer to the IRS Compliance Monitoring Requirements – Page A-72(b)(2) Record Retention Provision, a copy of which is attached hereto as Exhibit A.

years throughout the compliance period. ADFA's staff will randomly select 20% of tax credit units and tenant files for review.

ADFA's staff will contact the owner or manager to schedule the on-site visits, which will include the following reviews:

A. Record Keeping
B. Fair Housing
C. Tenant Files
D. Housing Quality Standards for Buildings, Units and Common Areas

II.B MONITORING FEE

Beginning with 2001 reservations, ADFA will assess and collect a compliance monitoring fee of 6 % of the total amount of annual credits. ADFA will submit an invoice for the fee upon issuance of IRS Form 8609. Owner's failure to pay the monitoring fee will result in the issuance of IRS Form 8823-Report of Non-Compliance or Building Disposition.

II.C RECORD KEEPING

ADFA recommends that each development owner or manager maintain an "Administrative File for ADFA LIHTC Record Keeping Procedures." Since the information will be reviewed by ADFA during each visit, the Administrative File must include, but is not limited to the following items:

- Completed 8609 forms on each building (signed by ADFA and the development owner, with building identification numbers);
- Records that indicate the character and use of any nonresidential portion of the development included in eligible basis as defined under Section 42(d). For example, tenant facilities that are available on a comparable basis to all tenants for which no separate fee is charged for the use of the facilities or facilities reasonably required by the development;
- Certificates of Occupancy or Approval;
- The eligible basis and qualified basis of the building at the end of the first year of the credit period;
- Copy of Land Use Restriction Agreement ("LURA");
- The vacancy history of the low income units and when and to whom the next available unit was rented;

- Total number of units in the property (this information must be retained on a building-by-building basis including the number of bedrooms and the square footage of each unit);
- HUD income tables for all years the development has been placed in service;
- Household size;
- Rents charged on each type of unit, including applicable utility allowances for all years the development has been placed in service;
- Non-residential use fee (i.e. additional fees charged for parking, etc.);
- 20/50 Test, Section 42 of the Code, OR 40/60 Test, Section 42 of the Code (also known as the minimum set-aside);
- Partnership Agreement;
- Evidence of Fair Housing Compliance;
- Copies of reports submitted to ADFA (if applicable, such as annual occupancy status reports); and
- Change in Ownership documentation, if applicable

First year records (including the tenant file for each tenant that initially occupied the LIHTC units, rent rolls, etc.) provide evidence that the property met its minimum set-aside, targeted applicable fraction, and other elected set-asides. Such first year records must be kept for twenty-one (21) years and subsequent records must be kept for a minimum of six (6) years, as mandated under the Code.

II.D FAIR HOUSING

During the on-site visit, ADFA's staff, in addition to interviewing tenants, will check the following:

- Posting of Equal Housing Opportunity symbol on all advertising and exterior property sign;
- Display of the Equal Housing Opportunity sign in office where tenant applications are taken;
- Existence of acceptable number and location of accessible parking spaces and their proximity to units, ramps, etc.
- Maintenance of waiting lists and sign-in sheets;
- Diverse placement of accessible units for the disabled;

- Safe and sanitary condition of accessible units for the disabled (if units are chosen as part of random selection); and

- Utilization of a current Affirmative Fair Housing Marketing Plan (ADFA can provide necessary forms if owner needs assistance in developing and implementing a Plan).

Requirements for New Buildings: In buildings that were ready for first occupancy after March 13, 1991, and have an elevator and four (4) or more units:

- Public and common areas must be accessible to persons with disabilities;

- Doors and hallways must be wide enough for wheelchairs;

- The main entrance for the building must be at least 32 inches wide, measured between the face of the door and opposite doorjamb;

- All units must have (1) an accessible route into and through the unit; (2) accessible light switches, electrical outlets, thermostats and other environmental controls; (3) reinforced bathroom walls to allow later installation of grab bars; and (4) kitchens and bathrooms that can be used by people in wheelchairs.

II.E TENANT FILES

ADFA requires files to be maintained in a consistent order. ADFA's staff will randomly select and review at least 20% of current tenant files, as required by IRS. First year tenant files must also be available on site for review. ADFA staff's review will encompass but is not limited to the following:

- Ensure that all documents are completed, signed and dated by all appropriate parties;

- Review initial tenant income certifications;

- Review executed leases for the initial lease term of six (6) months or longer and for rents charged for each LIHTC unit;

- Review signed authorization for release of income, employment and asset information;

- Review and document annual income, subsidized rent, tenant contribution, utility allowance, and gross rent for compliance with LIHTC program limits;

- Ensure that third party income verifications are completed, signed and dated by all parties;

- Ensure that appropriate asset income verifications are used;

- Ensure that income recertifications are completed within the 12-month period;
- Review original tenant applications;
- Review student eligibility guidelines;
- Review unit inspection forms (unit inspections are recommended quarterly) and maintenance records; and
- Review tenant complaint forms, responses, and other correspondence

ADFA recommends the use of files divided into sections as follows with the latest information on top:

Section I

- Original Signed Tenant Application
- Signed Leases
- Signed Tenant Agreement

Section II

- Move-in Certification plus accompanying copies of birth certificates, Social Security cards, etc.
- Affidavit of alimony or child support
- Authorization of release of information
- Real estate verification
- Worksheet and calculator tape supporting determination of resident eligibility
- Statement of student status, if applicable
- Third-party verifications of income
- Self-employment verification, if applicable
- Social Security payment letters
- Zero income statement, if applicable
- Bank statements
- Asset statements and verifications
- Telephone conversation reports clarifying third party verifications or other similar circumstances (if applicable)
- Annual signed Recertifications

Section III

- Current rent and Income limits
- List of utility allowances
- Amount of rental assistance payments
- Amount of rent paid by tenant
- Copies of tenant's checks or receipts, if applicable

Section IV

- Correspondence between tenant and manager

Section V

- Proof of move-in inspection signed by tenant and manager
- Proof of quarterly unit inspections and maintenance requests
- Proof of repairs needed or requested (must be made within 30 days)
- Copies of work orders
- Copies of receipts or proof of completion
- Proof of move-out inspection

The above-mentioned documents under Section V may also be maintained in a separate "Unit Maintenance" folder.

II.F HOUSING QUALITY STANDARDS ("HQS")

ADFA's staff will conduct inspections of the units that are randomly selected for file audit and will utilize HUD Form 52580 (Inspection Checklist), a copy of which is attached hereto as Exhibit D. Owners may utilize Form 52580 for quarterly unit inspections or a similar form that substantially incorporates the information of Form 52580.

During compliance monitoring visits, ADFA's staff will inspect the following:

- Smoke detectors (must be functioning);
- Conditions related to health, safety and sanitary issues (i.e. housekeeping, trash disposal, evidence of infestation, fire hazards, etc.)
- Condition of grounds and exterior buildings;
- Accessibility of breezeways and walkways;
- Condition of interior stairs and common halls;
- Light fixtures, switch plates, etc.;
- Existence of electrical hazards;
- Condition of kitchen sinks, faucets, stoves, exhaust fans, refrigerators, etc.
- Bathroom sinks, toilets, tubs and showers;
- Exterior locks and door frames;
- Condition of carpet, flooring, windows, screens, walls and ceilings in all rooms;
- General condition of heating and cooling units; and
- Overall condition of unit.

SECTION III – COMPLIANCE ISSUES

III.A MINIMUM SET-ASIDE

In order for an owner to claim tax credits, a development must have a minimum number of qualified tax credit units. The owner must select one of two minimum set-asides, which establishes both the minimum percentage of tax credit units at the development and the maximum income limit used to determine tenant eligibility.

The choices are 20/50 and 40/60. Under the 20/50 selection, 20% or more of the aggregate residential rental units in the development must be occupied by persons with incomes of 50% or less of the area median gross income adjusted for family size. Under the 40/60 selection, 40% or more of the aggregate residential units in the development must be occupied by individuals with incomes of 60% or less of the area median gross income adjusted for family size.

The owner selects the minimum set-aside when applying for the tax credit allocation and makes the election on Form 8609. Once selected, the minimum set-aside is irrevocable. The year tax credits are "claimed" determines when the minimum set-aside test must be met. The minimum set-aside test must be maintained for the entire compliance period. If the property is identified as a multiple building project on Line 8b of Form 8609, the minimum set-aside may be met across the development. If the property is not identified as such, the minimum set-aside must be met building-by-building. For 1987-1990 developments, the minimum set-aside had to be met within twelve (12) months of the placed-in-service date. For 1991 and later years, the minimum set-aside must be met no later than December 31 of the second year of the initial credit period. The minimum set-aside must be met before any credits may be claimed.

The federal minimum set-aside election must not be confused with other set-aside elections that may have earned extra points in the allocation process and are recorded in the development's Regulatory Agreement. Additionally, the tax credit set-aside must not be confused with HOME fund requirements or subsidy programs such as Section 8 or Rural Development. Owners must always determine the tax credit minimum set-aside first and review allocation documents to identify any additional set-asides. If the development has layers of funding, the owner must follow the most restrictive set-aside requirements.

III.B INCOME LIMITS

The Department of Housing and Urban Development (HUD) publishes the Section 8 area median gross income (AMGI) limits annually. The IRS requires these income limits, adjusted for family size, to be used when determining eligibility of LIHTC tenants at move-in. The minimum set-aside election establishes whether the 50% or 60% AMGI limit applies to the development 's tax credit units.

HUD's L50 Very Low Income amounts equal the 50% AMGI limits for households of one to eight persons. The 60% AMGI limit must be calculated from the 50% limits. The 60% AMGI limit equals 120% of the HUD Very Low-Income amount for the corresponding family size. Owners must calculate the 60% limits by multiplying the 50% AMGI figures by 1.2.

When HUD publishes new income limits, owners are required to implement the new income limits no later than 45 days after the effective date. Any fluctuations in the income limits will have a corresponding impact on maximum gross rent amounts. When

determining income levels for qualifying tenants, the correct family size must be determined. A family includes all occupants of the unit. Owners should closely monitor family size.

Note: Owners and managers must review development files to determine if HUD or Rural Development restrictions also apply or if owner agreed to other income restrictions.

III.C MAXIMUM GROSS RENTS

Units qualifying for tax credits are subject to a rent restriction formula that sets the maximum gross rent that may be charged. The maximum gross rent (including utilities) may not exceed 30% of the imputed income limitation. If low-income tenants are charged more than the allowable rent, the unit is in non-compliance and recapture of credits may result. Whenever utility costs are paid directly by the tenant, gross rent must include an allowance for utilities. Telephone and cable are not considered to be essential utilities and are not included in the allowance for utilities.

Maximum Gross Rent = (Applicable Income Limit x 30%) divided by 12. Remember that the tenant's rent plus the utility allowance cannot exceed the maximum gross rent.

If the rent calculation ends with an amount beyond the decimal point, you must not round the amount up. Rounding up would charge more than the maximum allowable rent, thus resulting in non-compliance.

Example: If the applicable income limit is $21,750, multiply by .30 to get $$6,525.00, and then divide by 12 to get $543.75. You may round this amount down to $543.00 but you cannot round up to $544.00. The maximum gross rent including the utility allowance cannot exceed $543.75.

1987-1989 Developments

For developments with 1987, 1988, or 1989 tax credit allocations, the unit rent is calculated using the income limit for the actual number of people in the household. Thus, the maximum rent can increase or decrease based on respective changes in the household composition.

# Persons		1	2	3	4	5	6
Income Limits	50%	12,150	13,900	15,600	17,350	18,750	20,150
	60%	14,580	16,680	18,720	20,820	22,500	24,180

The resulting maximum allowable rents (including utility allowance) based on household size equals (limit x 30%) ÷ 12:

# Persons		1	2	3	4	5	6
Rents	50%	303	347	390	433	468	503
	60%	364	417	468	520	562	604

The rent decreases based on a reduction in household composition or a decrease in the income limits.

1990+ Developments

For developments with 1990 and subsequent allocations, the rent formula uses an imputed family size of 1.5 persons per bedroom to determine the applicable income limit to be used for rent calculations. For efficiency or studio units, the 1-person income limit is used.

To determine which income limit is used for the bedroom size rent formula, use the imputed household size of 1.5 persons times actual number of bedrooms.

Studio – 1 person
1 BR – 1.5 persons
2 BR – 3 persons
3 BR - 4.5 persons

For the 1.5 person income limit, take the 1-person limit, add to the 2-person limit and divide by 2. Multiply your answer by 30% and divide by 12 to arrive at maximum rent.

2 bedrooms: 1.5 x 2 = 3. Use the income for 3 persons x 30% divided by 12 = maximum rent.

3 bedrooms: 1.5 x 3 = 4.50, which means that you take the income limit for 4 persons and add to the income limit for 5 persons, divide by 2. Multiply by 30% and divide by 12 = maximum rent.

4 bedrooms: 1.5 x 4 = 6. Use the income limit for 6 persons x 30% divided by 12 = maximum rent.

Income Limits

# Persons		1	2	3	4	5	6
Income Limits	50%	12,150	13,900	15,600	17,350	18,750	20,150
	60%	14,580	16,680	18,720	20,820	22,500	24,180

Maximum Rents

# Bedrooms		0	1	2	3	4
Income Limits	50%	303	325	390	451	503
	60%	364	390	468	541	604

III.D RENT SUBSIDIES

Gross rent does not include any housing assistance payments made to an owner to subsidize a tenant's rent (i.e. Section 8). Only the actual rent paid by the tenant, including tenant-paid utilities, is counted toward the maximum allowable rent. For example, if the LIHTC maximum gross rent is $350.00 and the total tenant payment is $250.00 with Rental Assistance paying an additional $150.00 subsidy to equal the Contract Rent of $400.00, there is no problem. The amount paid by the tenant, including utilities, does not exceed $350.00.

III.E SECTION 8 RENTAL ASSISTANCE

Under the HUD Section 8 Program, a tenant cannot pay more than 30% of his adjusted gross income for rent. For this reason, in 1989 the IRS ruled that if the tenant portion of rent increases above the LIHTC maximum allowable rent, thereby reducing the Section 8 subsidy, the higher rent may be charged. Owners must make sure the total tenant payment does not exceed the maximum LIHTC rent at time of move-in.

III.F RURAL DEVELOPMENT OVERAGE

In RD 515 Projects, overage rents may result when 30% of the tenant income minus the utility allowance exceeds the RD Program's Basic Rent. If this overage rent exceeds the LIHTC rent, then the overage cannot always be charged. For 1991 and later year developments, the overage can be charged for amounts that are turned over to RD. In 1987-1990 developments, the overage cannot be charged to the tenant since the provision is not retroactive.

III.G UTILITY ALLOWANCES

Utilities include the costs for heat, lights, air conditioning, water, sewer, and trash removal. Neither telephone nor cable television is included in utilities. Whenever a tenant directly pays utility costs, a utility allowance must be used to determine the maximum unit rent that may be charged. The utility allowance must be subtracted from the maximum gross rent to determine the maximum tenant portion of rent.

Owners must calculate utility allowances based on one of the following:

1. HUD-regulated buildings – use HUD-approved utility allowances;
2. Rural Development-assisted building – use RD-approved utility allowances on all rent restricted units in the building;
3. Conventional building – use local Public Housing Authority utility allowances unless utility company data can support alternate amounts;
4. Conventional building with Section 8 subsidy through certificates or vouchers – owners must use the local Public Housing Authority Section 8 Existing utility allowances for those Section 8 units.
5. Utility Companies – Owners may obtain written estimates by private utility companies pertaining to comparable property of similar size, construction, and geographical area and to specific types of units (e.g. by number of bedrooms). Once obtained, a private utility estimate must be used for a building. Owners must average the utility costs for each unit type and divide by 12 to determine monthly utility allowance.

Utility allowances must be updated annually. Any changes in utility allowances have a direct impact on the net chargeable rent to the tenant. Any new allowance must be implemented within 90 days of the change. Owners must be sure that the lease indicates when and under what circumstances the rent and utilities may change.

III.H VACANT UNIT RULE

If a low-income unit becomes vacant during the year, the unit remains in compliance with LIHTC regulations and eligible for the tax credit. The unit may be counted in the set-aside requirement and in determining the qualified basis provided the owner has made reasonable attempts to rent the unit or the next available comparable or smaller size unit to an eligible household and no other comparable or smaller size units in the building are rented to non-qualifying individuals.

Units that have never been occupied are termed “empty”, rather than vacant, and cannot be counted as low-income units. Empty units must be included in the building’s total unit count for purposes of counting the applicable fraction.

Throughout the compliance period, owners are required to keep records for each qualified low-income development showing the low-income unit vacancies and data for when, and to whom the next available units were rented. The vacant unit rule applies to both 100% LIHTC developments and mixed income developments.

III.I NEXT AVAILABLE UNIT RULE

If the household income for residents in a qualified unit increases to more than 140% of the current applicable income limit, the unit is considered an "over-income-unit" but may continue to be counted as an LIHTC unit as long as two conditions are met. The unit must continue to be rent restricted and the next comparable size unit in the building must be rented to a qualified low-income tenant. The owner of an LIHTC building must rent to qualified residents all comparable units that are available or that subsequently become available in the same building until the applicable fraction (excluding the over-income units) is restored to the percentage on which the credit is based. Once the original applicable fraction of the building has been restored, the "over-income" unit may remain rent restricted or may become a market-rate unit if the building is a mixed income building.

III.J RELOCATING EXISTING TENANTS

If existing LIHTC tenants wish to transfer to a different LIHTC unit in the same building (as identified by the building identification number), they do not need to be recertified. A new lease must be executed to be effective on the move-in date to the new unit. If existing LIHTC tenants wish to transfer to a unit in another building (as identified by the building identification number) the tenants must be treated exactly as prospective tenants moving in for the first time and all application, certification, and verification procedures must be completed for the household. A previously qualified tenant whose income now exceeds the applicable income limit may relocate to another low-income unit within the same building. A tenant whose income now exceeds the applicable limit would not be eligible to move to a tax credit unit in another building. Any LIHTC tenant who moves to another building must be re-qualified and certified as an eligible tenant.

During the initial credit period, existing tenants cannot be relocated for the purpose of qualifying more than one LIHTC unit to count toward the minimum set-aside or applicable fraction.

III.K STAFF UNITS

Revenue Ruling 92-61 [Section A], effective 9/9/92, allows a unit for a **full-time** staff member to be considered part of a development's "common area". Such units are not classified as residential rental units and thus are not included in either the numerator or denominator of the applicable fraction under section 42(c)(1)(B) for purposes of determining the building's qualified basis.

Two options apply:

1. If the staff unit is a rental unit and is to be counted as part of the qualified basis, then the staff must be income-eligible, be certified, and sign a lease the same as any LIHTC tenant. In this case, if the staff member receives free rent or a rental discount, the imputed value of the rent or discount must be included as income.
2. If the unit is not a residential unit but used as common area by full-time staff, then the staff does not have to be income eligible, certified, leased or considered a tenant.

The bottom line is that the staff person must be full-time for the unit to be common area. The owner's application and allocation documents should specify the number of common area units set aside for staff. The Revenue Ruling does not apply to any building placed in service prior to September 9, 1992, or to any building receiving an allocation of tax credits prior to that date, unless the owner filed a tax return that is consistent with this ruling.

III.L NON-TRANSIENT OCCUPANCY

According to the Code, residential units must be for use by the general public and all of the units in a development must be used on a non-transient basis. For LIHTC units to be in compliance, a six-month minimum lease term is required at initial occupancy of such low-income units. A six-month lease addendum should be signed with in-place tenants who do not have six months left on an existing lease when the building is placed-in-service. The only exceptions to this requirement would be for Single Room Occupancy (SRO) housing rented on a month-by-month (30-day lease) basis or transitional housing for the homeless.

III.M GENERAL PUBLIC / FAIR HOUSING / SECTION 504 / ADA

All residential rental units in the development must be available for use by the general public. LIHTC properties are subject to Title VIII of the Civil Rights Act of 1968, also known as the Fair Housing Act. This Act prohibits discrimination in the sale, rental, and financing of dwellings based on race or color, religion, sex, national origin, familial status (including children under the age of 18 living with parents or legal custodians, pregnant women and people securing custody of children under 18) and disability. However, all households must be eligible in the areas of income, occupancy, selection criteria by management, and type of property.

Tax credit units may not be provided only for members of a social organization or provided by an employer for its employees. Also, a residential unit is not for use of the general public, and therefore, does not qualify under the Code as part of a hospital, nursing home, sanitarium, lifecare facility, dormitory, trailer park, retirement home that provides significant services other than housing, or intermediate care facility for the disabled.

The Fair Housing Act also mandates specific design and construction requirements for multi-family housing built after March 13, 1991, to provide accessible housing for individuals with disabilities. Owners are expected to be familiar with accessibility requirements for their developments in compliance with the Fair Housing Act, Section 504 of the Rehabilitation Act of 1973, as amended, and Americans with Disabilities Act ("ADA"). Some of those pertinent facts are:

- New Construction Requirements: Since March 13, 1991, Fair Housing has required that downstairs units in non-elevator buildings and all units in elevator buildings be accessible.

- Reasonable Accommodation: The law requires that reasonable accommodations in rules, regulations, policies and procedures may have to be made for disabled applicants or residents.

- Reasonable Modification: The law requires that reasonable physical alterations cannot be refused to an applicant or tenant.

- Section 504: Section 504 of the Rehabilitation Ace of 1973 covers all federal programs, including Community Development Block Grant ("CDBG"), HOME funds, RD, PHA and HUD properties. New construction and substantial rehabilitation require that a minimum of 5% of units or a minimum of one and additional 2% of units or a minimum of one be adapted for wheelchair and visual/hearing impaired respectively. All common areas must be accessible to and useable by the physically mobility impaired. While Fair Housing states that reasonable modification costs may be charged to tenants, Section 504 states it is a project expense unless it poses a financial or administrative burden. It is the owner's responsibility to provide documentation to prove financial or administrative burden.

- Fair Housing applies to all LIHTC developments. Section 504 does not apply to conventional 9% deals without other federal funds. This ruling may be subject to change. The ADA provision in regard to public accommodations would require offices and other common areas to be accessible.

The current Annual Owner's Certification being used by ADFA asks the owner to indicate if a finding of discrimination under the Fair Housing Act, 42 U.S.C. 3601-3619 has occurred for the development. A finding of discrimination includes an adverse final decision by the Secretary of Housing and Urban Development (HUD), 24 CFR 180.680, an adverse final finding by a substantially equivalent state or local fair housing agency, 42 U.S.C. 3616a(a)(1), or an adverse judgment by a federal court.

III.N SECTION 8 HOUSING CHOICE VOUCHERS

Owners may not refuse to rent to Section 8 housing choice voucher holders simply because they have Section 8. On the other hand, owners must not assume a Section 8 certificate or voucher holder automatically qualifies. Applicants eligible for Section 8 may have incomes exceeding LIHTC income limits, may have negative references, or otherwise may not qualify. Proof of income eligibility must be in the tenant file.

III.O SUITABILITY OF UNIT

A unit must be suitable for occupancy in accordance with state or local codes in order for credits to be claimed. If the unit is not habitable, no credits can be claimed. The IRS has ruled that if a unit is destroyed due to a casualty loss (i.e. fire, flood, or other disaster), credits cannot be claimed while the unit is being replaced. If the unit is restored within a reasonable time, credits can again be claimed and no recapture would occur. What is a reasonable replacement time? The reasonableness of the time period to repair damaged property depends on the extent of the damage. ADFA will consider other factors such as the location of the property and the time of the year. Generally, however, two years should be sufficient for the replacement of property completely destroyed by a casualty loss. In the event the owner is not able to replace the property within two years, ADFA may extend the time period if the owner demonstrates that there is a reasonable cause for delay.

III.P STUDENTS

The Code specifies that LIHTC housing must be for the use of the general public on a non-transient basis. Further, the regulations state, "no dormitory…may be a qualified low income project". An LIHTC development cannot be entirely occupied by full time students. Student status becomes an issue when <u>everyone in the household is a full-time student</u>.

The tenant, in order to be considered a full-time student, must be (a) taking at least twelve (12) credit hours per semester; (b) taking the school's full-time requirement (as defined by the institution); or (c) enrolled five (5) months out of 12 months in an institution of higher learning. The 5 months need not be consecutive. The Code clearly indicates that student status is to be monitored on a tax-year basis. Thus, an applicant would not be eligible if the person had been a full-time student for 5 months of the tax year even if he/she graduated prior to applying for the LIHTC unit. Owners must adjust tenant certification procedures to consider student status according to this interpretation. Student status must be re-verified at annual recertifications to confirm continuing eligibility of the household. Student status must be verified through the registrar's office of the educational institution. Generally, school refers to elementary through college.

Single full-time students who are not entitled to file a joint tax return are not eligible for the tax credit unit. There is no grandfathering of eligibility because the tenant was not a student when he/she moved in and later became one.

Exceptions: A unit would not be disqualified for tax credits if it is occupied as specified in Section 42(i)(3)(D)—

(i) by an individual who is

- A student and receiving assistance under Title IV of the Social Security Act, or

- enrolled in a job training program receiving assistance under the Job Training Partnership Act ("JTPA") or under other similar federal, state, or local laws, or

(ii) entirely by full-time students if such students are –

- single parents and the children and parents are not dependents (as defined in section 152) of another individual outside the household, or
- married and file a joint tax return.

ADFA considers a household eligible if it contains at least one part-time student. Children in grades kindergarten through twelve are considered to be full-time students. Temporary Assistance for Needy Families ("TANF") is an acceptable Title IV program exception. The Arkansas welfare-to-work program known as Transitional Employment Assistance ("TEA") qualifies as a job training program. See Exhibit E for definitions of child, student, and educational institution.

SECTION IV—DETERMINING TENANT ELIGIBILITY

Owners must determine and provide documentation that proves the eligibility of potential low-income tenants in accordance with LIHTC requirements. A tenant's income eligibility is determined by comparing the household's gross annual anticipated income, calculated in accordance with HUD Section 8 guidelines, to the LIHTC 50% or 60% area gross median income limits that apply to the development. Owners must verify the household's income and the student status of all household members. The tenant and owner must certify the accuracy of the verified information. Since household composition, income, and student status may change over time, owners must re-certify the eligibility of tenants in tax credit units annually.

IV.A HOUSEHOLD SIZE AND INCOME LIMITS

Section 42 of the Code mandates that HUD Section 8 income limits adjusted for household size be used in determining income eligibility for the LIHTC program. A household can consist of one or more persons. Members need not be related to be considered a household. Count all household members and compare to the per person 50% or 60% income limits currently in effect. Please do not confuse the 140% Rule which allows an existing tenant's income to exceed the allowable limit. Owners or managers must never allow over-income applicants to move into an LIHTC unit. Full-time students residing together in a unit must qualify under one of the exceptions previously listed on page 22 hereof.

Certain individuals are not considered members of the household in determining the income limits. Do NOT count the following in determining income limits:

1. Live-in attendants
2. Visitors or Guests
3. Foster children
4. Foster adults

Temporarily absent members of the household should be counted when determining household size. Count the following:

1. Children temporarily absent due to placement in a foster home
2. Children away at school but who live with the family during school recesses
3. Temporarily absent family members who are still family members (i.e. a tenant, co-tenant, or spouse is always considered to be a family member)
4. A person confined to a hospital or nursing home per family decision
5. A son or daughter on active military duty only if this person leaves dependents or a spouse in the unit.

ADFA counts unborn children and children who are in the process of being adopted (who do not live in the unit) as household members for the purposes of determining unit size and income limits.

IV.B GROSS ANNUAL INCOME

Total income is gross income, not adjusted annual income. Tenant income is 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 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 family, including all net income derived from assets for the 12-month period following the effective date of certification of income. Certain types of income are excluded. For information regarding

what annual income includes and excludes and how to calculate annual income, see excerpts from HUD Handbook 4350.3 included as Exhibit F. Allowances used in some government programs, such as childcare, elderly status, medical expense, etc., are not deducted from the household's gross annual income to determine income eligibility for LIHTC units.

IV.C ASSETS

The net income from assets must be considered when determining the tax credit eligibility of a household. Asset information for all household members (including minors) should be obtained at the time of application. Information regarding what net family assets to include or exclude is provided in the excerpts from HUD Handbook 4350.3 included as Exhibit F.

The owner must verify the cash value for all assets and asset income by obtaining third party documentation. Owners may not use sworn statements of the potential tenants. Assets must be verified for the initial certification of the household and for each re-certification.

If net family assets total $5,000 or less, owners must count the actual income derived from net family assets.

If net family assets exceed $5,000, owners must impute the asset income by multiplying the net family assets amount by the passbook rate specified by HUD, which is currently 2 percent (.02). The income to be included in household income will be the greater of (a) actual asset income, or (b) the imputed income from assets.

At each certification and re-certification, applicants and tenants must declare whether or not an asset has been disposed of for less than fair market value during the two years preceding the date of application or the effective date of the re-certification. An asset is considered to be disposed of for less than fair market value if the cash value of the disposed asset exceeds the gross amount the family received by more than $1,000.00. If it does, for a period of two years owners must include in the total household assets the difference between the cash value of the asset and the amount received. For examples of assets disposed of for less than fair market value, see excerpts of HUD Handbook 4350.3 (Exhibit F).

IV.D TENANT APPLICATION PROCESS

Because the LIHTC program uses special definitions for income, assets, and household composition, standard property management application forms may not collect sufficient information to determine tenant eligibility. A comprehensive housing application is critical to the accurate identification of full-time students, all assets, and anticipated income sources. An updated sample application form is included in this manual as Exhibit G.

Owners must review all information furnished on the fully completed Application for Housing, including any supplementary historical documents (i.e. most recent 1040 form, divorce decree, etc.) The application procedure must include an interview with all adult household members to review the application and historical documents and clarify any discrepancies or missing information. For example, if the 1040 form and W-2 forms show two employers but the application only lists one, owners must ask about the second job and confirm its termination. One application signed by all co-applicants should be submitted per household. Non-related roommates should submit separate applications.

IV.E TENANT INCOME VERIFICATION

Owners/site managers must remember that the HUD Handbook 4350.3 is the reference guide to be used for identifying income to be included or excluded when determining household income. Determination of annual income of individuals and area median gross income must be made in a manner consistent with HUD Section 8 income definitions and guidelines.

The earned income of every prospective household member aged 18 or older must be verified. Unearned income, assets and asset income of all household members, including minors, must be verified. Verifications must be received by the owner or site manager prior to the execution of the certification of tenant eligibility and lease.

Third party verifications are valid for ninety (90) days from date completed by employer. If the information is orally updated from the source, owners may use these verifications for an additional thirty (30) days. Owners may not rely on verifications that are more than 120 days old. After this time, a new written verification must be obtained

Written third party verifications are preferred. An authorization to release information must be signed by the applicant and must accompany verification requests. Owners must send verifications directly to the source and the source must return them directly to the owner. **Verifications must not be hand-carried by the applicant to or from the source.** If written verification is not possible, direct contact with the source, in person or by telephone, is acceptable. The owner must document this verbal verification in the tenant file and must obtain all information as requested on the written verification form.

IV.F TENANT INCOME CERTIFICATION (TIC)

When all the income and asset verifications have been received, the owner/manager must record and compute the 12-month anticipated income and income from assets of adult occupants and reconcile to amounts on the verifications. If the total 12-month projected income is less than or equal to the maximum allowable qualifying income in effect at the time of tenant certification, the household is income-eligible for a tax credit unit. If the household income exceeds the maximum allowable qualifying income, the

household cannot be certified eligible for a tax credit unit. If it is determined that all requirements for eligibility are met, the Certification of Tenant Eligibility must be completed and executed along with the lease prior to move-in. All adults (age 18 or older at time of move-in) must sign the lease and TIC prior to move-in. ADFA prefers that the tenants and owner/manager execute the TIC and lease on the same date. The TIC should not be executed more than 5 days before the lease date.

We have received many questions from site managers about the effective date of the Tenant Income Certification (TIC) used in connection with both Rural Development ("RD") and tax credit properties. For example, if a tenant signs the TIC on the 15th day of January, the effective date may be the first day of February for billing purposes to RD or other entities. However, the tax credit regulations (Section 42 of the Code) specify that the TIC is effective on the date the unit is designated as a low-income unit, i.e., the date a qualified tenant occupies the unit. The effective date of the initial certification is the move-in date. For annual recertifications, the effective date must be no later than twelve months from the effective (move-in) date of the previous (re) certification.

Example: Move-in date January 15, 2003
LIHTC Effective date: January 15, 2003

Recertification: Effective date may be January 1, 2004 but no later than January 15, 2004.

Managers must be aware of the tax credit effective date and be sure to re-certify within twelve months of the initial tax credit certification date or twelve months of the last tax credit recertification. Please refer to Section IV.I on Recertifications for additional information.

IV.G WAITING LISTS

No one should be placed on the waiting list unless he has submitted a completed application. All applications should be logged by date and time received. The waiting list should have columns for bedroom size, need for subsidy (if available), any other program priorities, need for accommodations for disabled persons, gross income, etc. If the owner has more than one income level in the LIHTC property, the owner should keep lists or columns by 50%, 60%, HOME limit, etc.

IV.H THE LEASE

All tenants occupying tax credit units must be certified and under lease no later than the date the tenant takes possession of the unit. All parties must sign the lease by the beginning of the lease term date to be properly in effect and the unit in compliance.

Some leasing guidelines are as follows:

A. The lease should include, but is not limited to:

1. The legal name of all parties to the agreement and all additional occupants
2. Identification of the unit to be rented (number, street address, etc.)
3. The date the lease becomes effective
4. The term of the lease
5. The amount for rent—if this reflects a contract rent amount that may include a subsidy payment rather than just the tenant portion of the rent, a lease addendum listing only the tenant share of rent is recommended.
6. The rights and obligations of the parties, including the obligation of the tenant to recertify income annually (or more frequently as required)
7. Language addressing changes in income, utility allowance, income limits, basic rent (RD or HUD 236 projects), family composition or any other change and its impact on the tenant's rent
8. The consequences of fraudulent reporting of income, asset, or household composition
9. The prohibition of Subletting
10. The prohibition of commercial business in a unit
11. Signature dates

B. The tenant portion of rent plus utility allowance and other mandatory fees must <u>not</u> exceed the maximum gross rent allowed by Section 42 of the Code.

C. The initial lease term must be at least six (6) months on all tax credit units, except for SRO housing, which may have a 30-day lease, or transitional housing for the homeless. Succeeding leases are not subject to a minimum lease term.

In addition to the lease, ADFA recommends that owners or managers get the tenants to sign a Tenant Agreement. The Tenant Agreement specifies the development's rules with which the tenant is expected to comply. For example, the Tenant Agreement may include, but is not limited to the following:

- Tenants must cooperate with management during the re-certification process
- Smoke alarms must not be disconnected
- Tenants must keep their units clean and sanitary and must permit inspections by management and ADFA
- Use of illegal substances on the premises will not be tolerated and will be grounds for eviction
- Tenants must comply with rules and regulations of the LIHTC Program
- Any other legitimate reasons for eviction

IV.I RECERTIFICATION

Section 42 of the Code requires that recertification of residents be completed on at least an annual basis. Annual recertification is crucial in identifying the 140% rule situation, student status, and household composition changes. The 140% Rule is discussed in Section III.I. Failure to recertify tenants on an annual basis is cause for ADFA to issue IRS Form 8823 Report of Non-Compliance or Building Disposition. The timing of the recertification is critical to maintain compliance with the tax credit program. Recertifications must be completed within 12 months from the initial tax credit certification date or 12 months from the last tax credit recertification. A project may have Rural Development funding and tax credits. If Rural Development requires an interim recertification, a tax credit certification can be completed at the same time. The same income verifications may be used if they are not more than 90 days old. The required LIHTC Tenant Income Certification form must be completed for each tax credit recertification. ADFA will track the recertifications to ensure that no more than 12 months elapsed since the last tax credit recertification was completed.

IV.J QUALIFYING SECTION 8 TENANTS

Additional forms of income verifications may be used for tenants who receive housing assistance through HUD Section 8 program. For these tenants only, acceptable forms of income verification include a signed copy of the appropriate HUD Form 50058 or 50059 or a letter from the HUD Contract Administrator (e.g., local PHA) stating that the tenant's annual gross income is less than the applicable LIHTC income limit. These forms may be used as income verification documentation to support the Certification of Tenant Eligibility, which must be executed for every LIHTC household.

IV.K DEFINING ELDERLY HOUSING

The Fair Housing Law states that there are three types of Elderly housing:

1. Federal or State programs that the Secretary of HUD has recognized as being Elderly so long as the definition of the program is followed. FmHA (RD), HUD and PHA Elderly housing programs fall under this category. In these programs, the definition of "Elderly" is the tenant or co-tenant must be 62 or older or disabled if the disabled tenant is of legal age. In these programs, children are allowed if they are members of the Elderly household. In such "Elderly" properties, many disabled applicants with or without children have been housed based on this definition. If a Federal Agency or a State government program wishes to create another elderly program that does not follow one of the two remaining choices in the Law, then that definition must receive a waiver from the Secretary of HUD.

2. 62 and older housing—This is the most restrictive type of Elderly housing since every resident must be 62 or older. In other words, if an applicant who was 63 applied with a spouse or household member who was 61, they would be ineligible for this type of

housing. Children are not allowed nor are disabled persons or other applicants who are under 62.

3. 55 and older housing—In this type of property, it is recognized as Elderly if one household member is 55 or older in at least 80% of the units at all times. This could occur where an applicant household consisting of a 57- and a 52-year-old applied, the 57-year-old later leaves or dies, with the remaining member under 55 certainly allowed to stay. This could also occur if no more than 20% of the units were rented to households other than 55 plus. There are two important things to recognize under Fair Housing. The first is that age is not a Fair Housing protection, so an owner may limit the age of other household members to, for example, 50 or require that everyone be 55 or that all 100% of the units have at least one 55-year-old tenant. In fact, if an owner wished to turn 55- plus housing into 60, 62, 65 or another age plus housing, it would still meet the requirements of the Law since these ages are obviously over 55. The second item to note is that in 55- plus housing there must be at least one service or amenity that would benefit the elderly. This could be a van for transportation to shopping or doctors, meals programs, specific seniors' activities on a regular basis or other services that would distinguish this property as Elderly housing.

SECTION V— LIHTC RECORD RETENTION

The owner must retain tenant files, monthly unit data tracking and development files for the first year of the credit period for **21 years**. All other records must be retained for at least 6 years after the due date (with extensions) for filing the federal tax return for that year. Owners must keep records throughout the Compliance Period, which is usually 15 years. However, those owners who have executed a Land Use Restriction Agreement ("LURA") must maintain records throughout the extended Compliance Period, which is usually an additional 15 years, for a total of **30** years.

SECTION VI –NON-COMPLIANCE

Any determinations of non-compliance, including owner's failure to certify, will be communicated to the owner in writing. The non-compliant conditions must be corrected within the period specified by ADFA. Generally, there is a maximum of sixty (60) days to correct items of non-compliance. Violations of general health, safety and sanitary conditions may require immediate corrective measures. ADFA will notify the Internal Revenue Service of any non-compliant conditions no later than forty-five (45) days after the end of the allowed correction period, whether or not those conditions are corrected. ADFA will utilize IRS Form 8823, attached hereto as Exhibit H, when reporting non-compliance or corrections. ADFA reserves the right to request additional information, if necessary. ADFA, in its sole discretion, may schedule additional follow-up visits.

Non-compliance may be described as a period of time during which the owner failed to follow proper procedures for the development, specific building, or unit. Non-compliance may lead to recapture of tax credits by the IRS for a given period of time.

Most non-compliance issues as identified by IRS may be found on the IRS Form 8823. Generally, non-compliance issues can occur for:

- Inadequate certification documents
- Failure to obtain and retain proper income verifications
- Missing signatures
- Late certifications or certification signature dates
- Lease issues, i.e., not signed, late or no 6-month term
- Failure to recertify by the LIHTC-required anniversary date
- Failure to furnish year-end documentation on time
- Failure to respond to requests for additional information
- Incomplete recordkeeping
- Failure to identify full-time students
- Failure to maintain and update utility allowance documentation
- Charging unrestricted rents
- Failure to maintain the minimum set-aside
- Any change in the applicable fraction or eligible basis that results in a decrease in the qualified basis
- Housing an ineligible tenant
- Failure to satisfy Special Needs or Additional Low-Income Housing Set-Asides
- Failure to use appropriate forms
- Failure to notify ADFA of disposition of ownership interest.

This list is not meant to be all-inclusive.

VI.A RECAPTURE OF TAX CREDITS

The most serious action the IRS can take against an ownership is the recapture of credits previously claimed. Only the IRS determines this course of action. ADFA does not determine the consequences of reported non-compliance. If the owner discovers at any time that credits have been claimed in error, miscalculated, or the basis was incorrectly listed, owner must complete IRS Form 8611 included herein as Exhibit I.

SECTION VII –CHANGE OF OWNERSHIP

Subject to the requirements of Section 42 of the Code and the LURA, the owner must notify ADFA in writing thirty (30) calendar days prior to the contemplation of any sale, transfer, or exchange. The notification must include a copy of the letter of intent of any buyer, successor or other person intending to acquire the development or any interest therein. In addition, the notification should address the requirements of the LURA and provisions allowing the transfer under Section 42 of the Code and the regulations therein. This information must be presented to ADFA for approval. Approval is not guaranteed. The owner agrees that ADFA may void any sale, transfer or exchange of the development

if the buyer or successor or other person fails to assume in writing the requirements of the Code and the LURA and for other valid reasons. It is understood and agreed that any changes to the original application must be submitted to ADFA in writing for review and approval. Any changes made without prior approval could jeopardize the issuance of tax credits for the project.

ADFA is required to issue IRS form 8823, Report of Non-Compliance or Building Disposition, for all building dispositions to advise the IRS of a change in ownership. Owners must advise ADFA in writing the name, tax identification number, address and telephone number of the new owner. New owner must obtain first year records and all other pertinent records from the previous owner.

Owners who are considering disposing of their buildings or an interest therein should consult a tax adviser about posting a disposition bond or other requirements related thereto.

SECTION VIII – FORMS

ADFA has adopted certain standardized forms for its compliance monitoring. You may access the website for samples or call the Compliance Department. If no sample is provided for a specific form, ADFA will accept the owner's forms or forms utilized by HUD or Rural Development, provided such forms substantially comply with LIHTC rules for data collecting. Use of the LIHTC Tenant Income Certification is required.

Adopted by the Board of Directors of the Arkansas Development Finance Authority this _____ day of _____, 2001.

By:_____
Karen E. Flake, Chair

ATTEST:

By:_____
Rush B. Deacon, President/Secretary

GLOSSARY OF TERMS

20/50 TEST: Requirement whereby 20 percent or more of the residential rental units are rent-restricted and occupied by households with incomes of 50 percent or less of the area median gross income, adjusted for family size. This test is referred to as one of the "minimum set-aside" requirements. Compliance with the minimum set-aside requirements must be maintained at all times during the compliance period. Failure to meet the elected test will disqualify a development from being eligible for the credit.

40/60 TEST: Requirement whereby 40 percent or more of the residential rental units are rent-restricted and occupied by households with incomes of 60 percent or less of the area median gross income, adjusted for family size. This test is referred to as one of the "minimum set-aside" requirements. Compliance with the minimum set-aside requirements must be maintained at all times during the compliance period. Failure to meet the elected test will disqualify a development from being eligible for the credit.

APPLICABLE FRACTION: The applicable fraction, which is calculated for each building, is the lesser of (a) the number of LIHTC units divided by the total number of units in the building, or (b) the total rentable square footage of LIHTC units in the building divided by the total rentable square footage in the building. The Applicable Fraction is established during rent-up. Once established, the Applicable Fraction for a building must never fall below this initial fraction. Failure to maintain applicable fraction could result in recapture of tax credits.

BEDROOM ELECTION: This election allows owners of low-income buildings with allocations before 1990 or on financed buildings placed in service before 1990 to determine the gross rent limitation for rent-restricted units under the number of bedrooms method. In this method, a set occupancy is assigned based on the number of bedrooms contained in the low-income unit. Previously, the actual number of occupants was used to determine the rent restriction.

BUILDING IDENTIFICATION NUMBER: This is the nine-digit alpha numeric designation assigned by the state housing credit agency to a low-income building. Essential to the monitoring process for IRC section 42, IRS Notice 88-91 provides information regarding building identification number requirements.

COMPLIANCE PERIOD: This is the fifteen (15) year period over which a development must maintain compliance with IRC section 42. This period begins with the first taxable year of the credit period. The compliance period may be extended another 15 years by terms of extended use provisions.

CREDIT PERIOD: The 10-year period over which an owner may claim tax credits annually on a building-by-building basis. The tax credit period begins either with (a) the taxable year in which the building is placed in service or (b) the succeeding taxable year (if elected by the owner).

ELIGIBLE BASIS: That portion of the development allocated credits and for which credits are allowable. Eligible basis consists of (1) the cost of new construction, (2) the cost of rehabilitation, or (3) the cost of acquisition of existing buildings acquired by purchase (including the cost of rehabilitation, if any, to such buildings incurred before the close of the first taxable year of the credit period which do not exceed a prescribed minimum amount). Only the adjusted basis of the depreciable property may be included in eligible basis. The cost of land is not included in adjusted basis.

EMPTY UNIT: An LIHTC unit that has never been rented.

EXTENDED LOW-INCOME HOUSING COMMITMENT: A binding agreement between the owner and the housing credit agency that obligates the owner and any successors to maintain specific occupancy and affordability requirements for the development.

GROSS RENT FLOOR: This ruling allowed the owner to establish floor rent amounts that will not be affected by fluctuations in the income limits and maximum rent ceilings. For developments that received an allocation of credits or determination letter on or after October 6, 1994, the owner may elect to establish the gross rent floor as the maximum rent in effect either on the date the development was placed in service or on the date the development received an allocation. This irrevocable election must be made by the owner and submitted in writing to ADFA no later than the placed-in-service date of the development.

GROSS RENT LIMITATION: Gross rent may not exceed 30 percent of the applicable qualifying income as adjusted for household size. Gross rent includes the cost of utilities, except telephone and cable. If utilities are paid directly by the tenant, the maximum rent must be reduced by the amount of the utility allowance. The gross rent limitation applies only to payments made directly by the tenant. Any rental assistance payment (such as HUD Section 8) is not included in the gross rent limitation.

HOUSEHOLD INCOME LIMITATIONS: One of the requirements of the minimum set-aside test, household income limitation of a qualifying unit is a set percentage of the area median gross income figure. In accordance with the minimum set-aside elections, the income level may be no greater than 50 percent or 60 percent of the respective area median gross income. A household can consist of one or more persons. Count all household members and compare to the per person income limits. You may count unborn children or children in the process of being adopted as members of the household for income limit purposes.

INCOME CERTIFICATION: All qualifying units must have adequate documentation to support the household income limitation at initial lease-up as well as annually throughout the compliance period.

LOW INCOME UNIT: A low-income unit includes any unit in a qualified low-income building if the individuals occupying such unit meet the income limitations and if the unit meets the gross rent restrictions.

MARKET UNIT: Any non-LIHTC unit whether occupied or not.

MINIMUM SET-ASIDE TEST: This is a requirement that must be met at all times during the development's compliance period. This test restricts rent and dictates which households qualify as low income and how many units must be occupied by the qualifying households. The two general minimum set aside tests are the 20/50 and the 40/60 tests, which are defined in the glossary.

MOVE-IN CERTIFICATION: The form, signed by both the resident and owner's representative, summarizes household composition, projected household income and assets.

NEXT AVAILABLE UNIT RULE: The rule states that if an existing tenant's income in a LIHTC unit increases above 140 percent of the applicable income limitations (over- income unit), the next available unit of comparable or smaller size must be rented to a low income tenant to continue treating the over- income unit as a low income unit within that building. In fact, all comparable units that subsequently become available in the same building must be rented to qualified residents until the applicable fraction is restored to the percentage on which the credit is based.

OCCUPIED UNIT: An LIHTC unit that has been rented.

OWNER'S CERTIFICATION: A building owner must provide certification to ADFA every year that the low-income units in a development are occupied by qualifying households. Failure to provide such certification in a timely manner will result in the filing of IRS Form 8823 (Report of Non-Compliance or Building Disposition (Non-compliance Report) by ADFA.

PLACED IN SERVICE: "Placed in service" is defined in IRS Notice 88-116, 1988-2 C.B. 449, as being the date on which the first unit in the building is first certified as being suitable for occupancy under state or local law. For rehabilitations which qualify for treatment as a separate new building, the placed in service date would occur at the end of the 24-month period over which such expenditures are aggregated. The Placed in Service date triggers compliance monitoring.

QUALIFIED BASIS: The "Qualified Basis" is the formula used to calculate how much tax credit will be provided. Qualified Basis amounts are determined as the proportion of eligible basis in a qualified LIHTC building attributable to the LIHTC rental units. This proportion is the lesser of (1) the proportion of low-income units to all residential rental units, or (2) the proportion of floor space of the low-income units to the floor space of all residential rental units.

RECERTIFICATION: The annual re-determination of household income and composition for continuing eligibility.

STUDENT TENANTS: Units occupied entirely by full time students will not be eligible. Exceptions apply for students who are single parents of children who are also full-time students, provided no one is claimed as a dependent of a third party. Married students who file a joint tax return are also exceptions, as are students enrolled in certain job training programs or those receiving assistance under Title IV of the Social Security Act.

UNIT FRACTION: The percentage of low-income units in a building expressed as a fraction—the numerator of which is the number of low-income units in the building and the denominator of which is the number of residential units (whether occupied or not) in such building.

UTILITY ALLOWANCE: A calculated average of expenses for utilities (other than telephone and cable) for units comparable in size or the utility allowances used by the local Public Housing Authority or Section 8 office. Utility allowances are calculated annually.

VACANT UNIT: An LIHTC unit from which someone has moved.

EXHIBITS (follow the manual)