ISSUES RELATING TO THE ACQUISITION & REHABILITATION OF LIHTC PROPERTIES

PHFA Housing Conference

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__Issues Relating to the Acquisition/Rehab of Tax Credit Properties__

Agenda

I. Placed in Service Issues

- *A. Existing Building*
- *B. Rehabilitation Expenditures*

II. Acquisition Credits & the Minimum Expenditure Test

III. Timeframe for Tenant Qualification

- *A. 120- day rule*
- *B. Rehab completion in year of acquisition*
- *C. Deferral of credits to year after acquisition*
- *D. Safe-Harbor rule*
- *E. Transferring Residents*
- *F. Tenant Relocation*
- *G. Primary Owner Issues Regarding Form 8609 Elections*

IV. Setting the Rents

V. Determining the Income Limits

Placed in Service Issues

IRS Revenue Notice 88-116

"For purposes of Section 42, the term 'placed in service' has two definitions – one for buildings and one for rehabilitation expenditures that are treated as a separate new building [Section 42(e)(1) and (e)(4)(A)]."

- New or existing building: the date on which the first unit in the building is certified as being suitable for occupancy in accordance with state or local law.
    - New construction will normally be Certificate of Occupancy (CO) or Temporary Certificate of Occupancy (TCO);
    - A transfer of a building to a new owner results in a new placed in service date if, on the date of the transfer, the building is occupied or ready for occupancy; and
    - Acquisition costs may only use the 4 percent credit, regardless of type of financing.

- Rehabilitation expenditures: Placed in service at the close of any 24-month period, over which such expenditures are aggregated.
    - This applies even if the building is occupied during the rehabilitation period.
    - Guidance from the IRS has made clear that the rehab expenditures may be placed in service in less than 24 months.
    - This provision is intended to dictate the tax credit percentage applicable to the rehab costs as the credit percentage from the final month of the 24-month period (or in the case of a shorter period, the placed in service month).
        - If the rehab expenditures are placed in service other than at the end of the taxable year, rehab expenditures incurred after that date, but before the end of the year, can be included in eligible basis **if the costs are incidental**. If substantial costs remain, the 24-month period probably has not ended.
    - Rehab costs may use 9 percent credits unless tax-exempt bonds are used.

Acquisition Credits & The Minimum Expenditure Test

*No credits may be claimed on an acquisition/rehab project unless the rehab minimum expenditure test is met.

This test is:

--The *greater* of 20% of the depreciable cost of the building, or more than $6,700 per low-income unit.

- The $6,700 is reduced to $4,000 for buildings that are HUD Section 8, 221(d)(3), 236, or Section 515 when the property is at risk of foreclosure.

*The applicable fraction may be established based on the acquisition placed in service date. (**There is no need to do a separate resident qualification when rehab is completed**).

States often impose higher minimum expenditure requirements. In VA, this is $10,000 per unit with tax-exempt bonds and $15,000 per unit for all other projects.

Qualifying Tenants in an Acquisition/Rehab Deal – The "120-Day" Rule

- Under Rev. Proc. 2003-82, units may be qualified before the beginning of the credit period. The unit remains qualified, even if the household's income exceeds the income limit at the beginning of the first year of the credit period, if the unit is rent restricted and the following specific conditions are met:

  - If household occupies unit at time of acquisition, and the initial tenant certification is completed within 120 days after the date of acquisition (using income limits in place at acquisition), the TIC is effective on the acquisition date. (*E.g., property acquired March 14, 2019; initial tenant certification is completed by July 12, 2019 – effective date of TIC is March 14, 2019. If TIC is signed July 13, 2019 – TIC effective date is July 13*). In this case, the move-in date is not the effective date, since the tenant was already in the unit when the project was acquired.

    - This is critical if credits will be claimed in the year of acquisition, i.e., rehab will be completed in the acquisition year.

    - If credits will be claimed the year after acquisition, as many tenants as possible should be qualified by the end of January of the first year of the credit period (assuming January is the first month of the tax year).

      - *Be aware of the month in which the investors enter the partnership.*

  - If household occupies unit at time of acquisition, and the initial tenant certification is completed more than 120 days after acquisition, the effective date of the TIC is the last adult in the unit signs it. Use income limits in effect at time of certification.

- For new households to a project moving in before the beginning of the first credit year, the TIC is completed using the income limits in effect at the time of move-in.

The Safe Harbor Rule

- Households qualified prior to the beginning of the first credit year must be tested for purposes of the Available Unit Rule at the beginning of the first year of the building's credit period (this is an IRS *"Safe Harbor Test," and may not be necessary for 100% low-income properties.)*

  - Test must be completed within 120 days before the beginning of the first year, *so, qualifications occurring after September 3 in the year before claiming credits will meet this requirement*;

  - The "test" consists of confirming with the household that certified income is still current. If there is additional income, the TIC must be updated. In PA, third party verifications are required.

  - If income exceeds the 140% level, the AUR applies.

- If the effective date of the initial TIC is 120 days or less before January 1 of the first year of the credit period, testing is not required. The recert will be due on the anniversary of the original TIC effective date.

- If the effective date of the TIC is more than 120 days before January 1 of the first year of the credit period, the income must be tested within 120 days before the beginning of the first year of the credit period.

See Revenue Procedure 2003-82 and IRS 8823 Guide.

Section 42(e)(4)(B) makes clear that the acquisition placed in service date may be used as the in service date for establishing the applicable fraction. The IRS, in PLR 200044020, confirmed this position.

***Important Note for Section 8 properties**: Tenants may not be displaced involuntarily in order to put credits on a Section 8 property. Incentives may be offered.*

<u>Households Qualified Under a Prior Allocation</u>

With regard to the qualification of existing residents, per IRS Guidance in the 8823 Guide, any household determined to be income qualified at the time of move in for purposes of the EUA remains a qualified low-income household for any subsequent allocation of tax credits.

- In one of the examples on how this works for a new owner receiving both Acquisition & Rehab credits, it is indicated that the property is continuously subject to an EUA.
- The new owner may rely on the previous qualification but should test the income of the household at the beginning of the credit period in accordance with Rev. Proc. 2003-82 (*if the most recent certification in the file is more than 120-days prior to the beginning of the first year of the credit period*).
- This means you should obtain a fully completed certification, on which the resident states their income, student status and household membership.

If, at the time of acquisition, the tenant's income exceeds 140% of the current income limits, the AUR applies.

Guidance relating to qualifying tenants in place at the time of acquisition requires that such qualification occur within 120 days after the acquisition date in order to use the acquisition date as the effective date, since there is no move-in date. While there is no specific requirement by the IRS to complete a new certification at acquisition for tenants qualified under a prior EUA, the guidance indicates that the income of the household be tested at the beginning of the first year of the credit period in order to determine the applicability of the Available Unit Rule. The effective date of the TIC remains the same as the effective date under the prior allocation.

Note: student status rules do not change. If a household does not meet the Section 42 student requirements, it is not a qualified low-income household.

<u>Transferring Residents Between Units</u>

Keep in mind that when moving residents between units, the owner must pay attention to whether they are moving within the same BIN, different BIN's in the same tax project, or a different tax project. *Also, when transferring a household, be sure there is no change in household composition from one unit to the next.*

1. <u>Moving within the same BIN</u>: The units simply swap status and there is no requirement to perform a new certification or qualification. The resident takes their move-in date to the new unit with them and the unit they vacate takes on the status of the unit they move into.

    a. Care should be taken in a mixed-income building relative to the applicable fraction.

2. <u>Moving to a different BIN within the same project</u>: Such a move can be very complex, especially during lease up. While a household takes their qualifying status with them in such a move, one household cannot qualify two units in the same project; so, some special rules apply.

    a. The unit occupied in the first BIN may claim credits during the months the family is in that unit. E.g., resident moves into a unit in BIN #1 on February 15, 2019, becoming the first occupant of the unit. The BIN was placed in service in January 2019 and 2019 credits will be claimed;

    b. The household moves to BIN #2 (same tax project) on September 1, 2019, becoming the first qualified household to occupy that unit. The household does not have to requalify, and while they take their status with them, credits may not be claimed on both units for the same months;

    c. The unit in BIN#1 claims credits for February – August 2019; The unit in BIN#2 begins claiming credits in September 2019;

    d. Beginning in September 2019, the unit in BIN #1 is no longer considered a low income unit and will have to be requalified before the end of 2019 in order to avoid becoming a "2/3" unit. Assuming a new tenant occupies that unit in December 2019, the unit will be entitled to credits in December. The unit will not be in the applicable fraction for September – November.

3. Moving to a different BIN in a separate tax project: In this case, the household will have to qualify as a new move-in but could be the initial qualifying resident for both units, since they are in separate projects.

Remember that a resident may never move from one BIN to another if the income of the household exceeds 140% of the allowable income limit, but, with one exception, this would generally only occur after stabilized occupancy since they would have had to recertify at least once.

- The exception to this would be a property with a prior allocation of credits. In this case, it would be possible to have an existing resident with income in excess of the 140% level.
    - They could not move to a different BIN.
- Households residing in 100% LIHTC projects, where a household's current income is not known due to not recertifying the low-income households can also transfer between buildings within the project. This is the case because the household's income is not known.

Tenant Relocation

- Issue: are relocation costs includable in eligible basis?
    - The answer is unclear.
        - If current residents have to be relocated – and compensated in some way for the relocation – in order for rehab to proceed, the costs should be part of the rehab and capitalized to the rehab expense (i.e., included in eligible basis).
        - However, IRS Audit Technique Guide indicates that tenant relocation costs should be expenses, rather than capitalized (i.e., not included in eligible basis).
        - Owners should work with the HFA on whether such costs will be permitted in eligible basis.
    - *Note – one of the possible changes in any future tax bill will be to clarify that such costs are includable in eligible basis.*

Setting the Rents

- Gross Rent Floor: §42(g)(2)(A) gives authority to establish the lowest gross rent a LIHTC property will ever have to charge. IRS Revenue Procedure 94-57 states that the gross rent floor for a property takes effect on the date of credit allocation to the building or on the placed in service date for the building.
    - Owner normally makes this election at the time of allocation, but no later than the PISD.
    - For bond properties, the choice is either when the Agency reserves bonds for the building (issuance of initial determination letter) or the PISD.
    - Due to HERA Hold Harmless Income Rule, it is recommended that the allocation date always be used for Gross Rent Floor purposes.

Determining the Income Limits

Section 42(g)(4) refers to Section 142 (d) (1) relative to the methodology for calculation of income for tax credit properties, i.e., the same methodology as the Tax Exempt Bond Program.

Section 142(d)(2)(B) provides that the income of individuals and Areawide Median Gross Income is determined in a manner consistent with determinations of lower income families and AMGI under HUD Section 8. Therefore, the HUD Section 8 rules relative to determination of income and income limits is used for Section 42. (IRS Revenue Ruling 94-57 affirms this).

IRS Revenue Notice 88-80

- HUD rules in income calculation must be used;
- Section 42 income is not the same as taxable income.

The income limit in rural areas (as defined in Section 520 of the Housing Act of 1949) for LIHTC properties that **do not** use tax-exempt bonds shall be the greater of the area median gross income or the national nonmetropolitan gross income.

Income determinations for LIHTC (and Bond) projects may not decrease for any year after 2008.

Projects placed in service prior to 2009 will use the HUD HERA Special Income limits if available to an area; projects placed in service after December 31, 2008 will use the regular HUD Multifamily Tax Subsidy Project (MTSP) income limits.

- *Note – properties with a prior allocation of credits must use income limits based on the new placed in service date.*

Note: *IRS Revenue Ruling 94-57 states "taxpayers may rely on a list of income limits released by HUD until 45 days after HUD releases a new list of income limits, or until HUD's effective date for this new list, whichever is later."*

Form 8609 (Revised May 2018, the form only has to be submitted to the IRS in the first year of the credit period.)

- Major issues relating to Acq/Rehab:
    - Line 8b – multiple building project
    - Line 10a – deferral of credits
        - There will be a separate 8609 for acquisition credits and rehab credits;
        - Acquisition credits and rehab credits must be taken on the same schedule
        - If property is acquired in a year prior to the claiming of credits, line 8b may show that all buildings are part of a multiple building project, but line 10a may show some buildings claiming credits in the placed in service year (rehab 8609) and other buildings deferring credits into the year after the placed in service year (acquisition 8609).