

Novogradac Journal of Tax Credits

News, Analysis and Commentary On Affordable Housing, Community Development and Renewable Energy Tax Credits

May 2012, Volume III, Issue V

Published by Novogradac & Company LLP

The Complexities of LIHTC Unit Qualification and Credit Delivery in an Acq/Rehab Deal - Part One

By Kimberly Taylor, HCCP, Housing Development Center

Many affordable housing properties will require some form of rehabilitation as they age. As is widely known, an effective way to acquire funds for a rehab is through the low-income housing tax credit (LIHTC). But with an acquisition/rehabilitation (acq/rehab) deal comes multiple compliance complexities involving resident relocation, unit qualification and tax credit delivery. Part one of this two-part series will discuss those complexities; part two will use case studies as examples of those complexities in the real world.

Understanding Relocation

At the time of application for LIHTCs, the first question to ask is whether an existing project has federal funds. If it doesn't, or has only Tax Credit Assistance Program (TCAP) or Section 1602 cash grant exchange funds, the owner/developer is not required to follow the Uniform Relocation Act (URA). If there are federal funds, like HOME or Community Development Block Grant (CDBG) monies, the owner/developer will need to understand the complexities of URA, such as the difference between temporary and permanent relocation—and most importantly, the costs associated with both. It's all about planning ahead and budgeting appropriately.

Part of this planning consists of completing tenant surveys/self-certifications prior to acquiring the property in order to find out if there are any over-income residents at the property. Knowing this ahead of time will ensure that tenants are served the correct notices and will also enable staff to anticipate the time and money it will require to prepare for permanent displacement. A full income certification is not necessary prior to acquiring the property but doing a full

certification would give the new owner a better gauge of the risk of tenants' income increasing going into closing.

For income-qualifying residents, it is also necessary to plan for whether they will be moving temporarily to another unit on site while their unit is being rehabbed or if the temporary relocation will be off site. In either of these scenarios, having a clear plan, an appropriate budget and an organized team are essential. Never underestimate the complexities of relocation.

The Team

Typically, there are four staffing groups involved in an acq/rehab deal: development/finance, asset/property management, construction and relocation. One of the biggest mistakes made during the rehab and lease up of an LIHTC property is lack of staff communication. It is imperative to have regular team meetings to review where all groups are in their own process. Each group has its own objective but the project's development will be much more successful and will have fewer unpleasant surprises if all groups work together.

An example of this kind of surprise is an inadequate predevelopment relocation budget that can require the reallocation of funds from other project line items. This can be avoided if there is a clear understanding and plan for providing the funds and staffing it will take to relocate residents. Another example is inadequate planning and coordination among relocation, construction and property management staff. This can result in poor tenant relations, unit rehab delays and increased staff time needed to sort through the miscommunication and to correct mistakes.

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Additionally, inadequate planning and coordination among finance, property management and relocation staff can result in a negative credit adjustor and reduced occupancy. The take-away here is to ensure that each staffing group is aligning objectives with the other group(s); that the relocation staff is working with the construction team on the timing of vacating and reoccupying units, or relocation staff is sharing with development/finance staff an accurate relocation budget to ensure accurate costs are built into the pro forma. Communication through the predevelopment and rehab phases is the key to success.

Unit Qualification, Tenant Income Certifications and the Safe Harbor Rule

Once the relocation budget and plan have been implemented, all teams are in place and the rehab has begun, it's time to think about qualifying the units. There are two elements to unit qualification: 1) the unit is available for occupancy and 2) the household has completed an LIHTC file and is income-qualified.

Available for occupancy means just that—the unit is available and suitable for a household to occupy, which could be before and/or after the rehab of the unit. It is imperative to know the construction schedule and scope of work for each unit and building—both can dictate when units will be available to occupy.

A very important rule to consider in regard to income qualification of households during a rehab is the safe harbor rule under IRS Revenue Procedure 2003-82. This rule applies to tax credit units in situations where household incomes were at or below the applicable income limits prior to the first taxable year of the credit period, but when the household incomes are later tested or recertified they are over the limits at the beginning of the credit period (effective for taxable years ending on or after November 24, 2003).

A unit in an existing building acquired by a new owner or in a rehabilitated building will be treated as a low-income unit even though the occupants' incomes exceed the income limit at the beginning of the building's 10-year credit period. In order to qualify, the household must have been income-qualified at the time the owner acquired the building or the date the household started occupying the unit, whichever is later. The unit would continue to be considered low income if the unit has been rent restricted since the initial qualification date of the household and if the household income is tested for purposes of the available unit rule at the beginning of the first credit period.

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ISSN 2152-646X

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If the household income has increased to 140 percent or more of the income limit, the available unit rule is to be applied. See the IRS' "Guide for Completing Form 8823" (January 2011 revision) page 4-26 "Income Certifications Where Owner Acquires or Rehabilitates Existing Building" for further explanation. The IRS 8823 Guide says that if the new owner has access to the property before the acquisition date, tenant income certifications may be completed using the current income limits. The effective date is the date of acquisition. However, if new income limits are issued before the date of acquisition, the new income limits must be used. The safe harbor rule would apply in the following scenario:

- ♦ the owner acquired the project (closing date) on September 1, 2012.
- ♦ the first credit year for the project is planned for 2013.
- ♦ a household completes tax credit paperwork and is income-qualified in May 2012 (total household income is below the applicable income limit).
- ♦ that same household's income is tested in January 2013 and its income exceeds the applicable income limit.
- ♦ the household is still considered qualified because it was below the income limit at acquisition, which was prior to the first taxable year.
- ♦ if the household's income has exceeded 140 percent or more of the income limit, the available unit rule applies.

Even if the file is completed in December, the effective date on the file would be the acquisition date—September 1, 2012 as long as the file is completed in the 120-day timeframe from acquisition date. The 120-day window on either side of the acquisition date allows the owner to determine eligibility so that the safe harbor rule will apply if any household's income increases above the income limit during the first credit year.

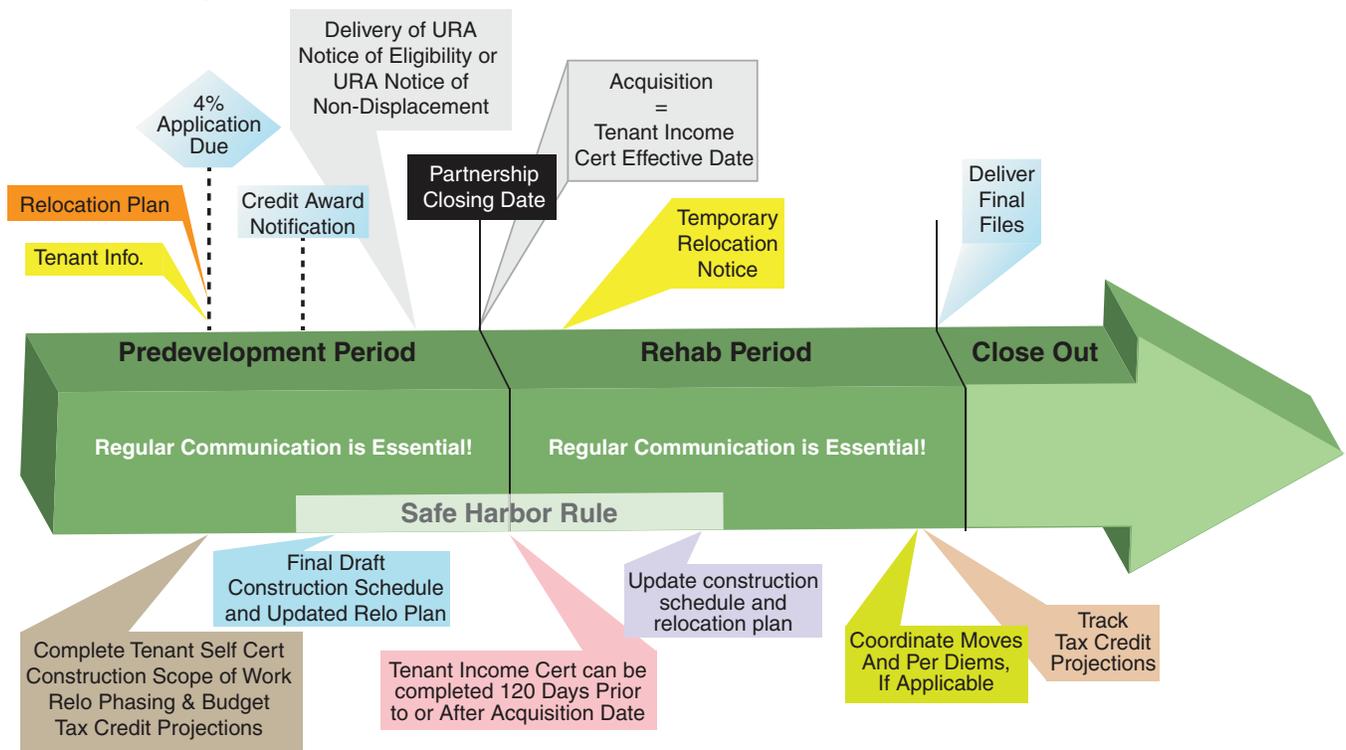
The most important thing to remember here is to ensure that all existing residents complete tax credit qualification paperwork within 120 days on either side of the acquisition date. Be careful not to start the paperwork process too early—the closing date could be delayed and all the paperwork done outside the 120-day window would be invalid. And be careful not to start the paperwork process too late—files can take a lot longer to complete than many owners think and the deadline could be missed.

Tax Credit Delivery: Qualified Units vs. Guaranteed Credits

The development team needs to know up front what its investor has determined as the first LIHTC year. In other words, what is the timeline for tax credit delivery? A reasonable credit delivery schedule must be established, one that can be met realistically by property management and relocation staff. Once that schedule is known, and it works along with the construction schedule,

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(Source: Housing Development Center; Novogradac & Company LLP)

the two issues, unit availability and qualification of households need to be taken into consideration in order to guarantee credits will flow.

The initial qualification paperwork should be completed for each household to determine its eligibility adhering to the safe harbor rule. If households are being transferred to on-site units during the rehab (versus temporarily relocated off site), it is imperative that unit qualification is tracked to ensure there is no “double-counting.” This can occur when a household while in its temporary unit is income qualified and that unit is deemed tax credit qualified but then the household is also considered qualified in its permanent unit once the members have transferred. One household can’t be used to initially qualify two units.

For example, the Smith family temporarily transfers to unit 101 so their permanent unit, unit 401, can be rehabbed. Property management staff income qualifies the household while it is in unit 101 and declares unit 101 tax credit qualified. Unit 101 was not previously qualified before the Smith family moved in. The Smith family then transfers back to its permanent unit, unit 401, and management deems unit 401 tax credit qualified as well. The Smith family is being considered the qualifying household for two units on the property,

which is double-counting and not permitted.

Conclusion

Whether a project owner is planning for a full permanent relocation of some residents, temporary location off site or temporary transfers on site, the story is the same: if acq/rehab teams have not been communicating, there is a risk the credits will not be delivered as scheduled. It could be because the certification paperwork is not being completed in a timely fashion or unit rehabs are not coinciding with the lease-up schedule. Whatever the reason, the lesson here is to ensure there is a knowledgeable and organized team prepared to meet regularly and communicate any schedule changes.

Next month, part two of this article will feature examples of two complex LIHTC acq/rehab deals and the issues encountered during predevelopment, relocation, rehab and lease up. ❖

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This article first appeared in the May 2012 issue of the *Novogradac Journal of Tax Credits*.

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