



Understanding the New Income Limits

By Thomas Stagg, CPA, Novogradac & Company LLP

When the Housing and Economic Recovery Act of 2008 (HERA) was signed into law in July of last year, many people were excited about the changes to the way income was to be determined for tax-exempt bond and low-income housing tax credit (LIHTC) projects. Last month, the U.S. Department of Housing and Urban Development (HUD) released its first HERA income limits. The new published limits raise many questions such as: which projects qualify for the different limits; what will happen next year when the limits decouple further from HUD; and how will this affect mixed financing projects. This article will examine some of these questions.

On March 19, 2009, HUD published for the first time a set of income limits for multifamily tax subsidy projects (MTSP) as well as a separate set of income limits for its assisted housing programs. To make matters even more confusing under the new MTSP plan, HUD published an income limit for projects that qualify for HERA's special income limit and for projects that do not qualify for the HERA special limit.

MTSP

Projects that receive tax-exempt bonds or LIHTCs are eligible to use the MTSP. For HUD fiscal year (FY) 2009 the MTSP 50 percent limit is equal to the traditional HUD very low-income (VLI) limit. HUD has indicated that starting in FY 2010 it will no longer hold VLI harmless for non-MTSP limits, meaning a county's VLI could potentially be set less than the year before. However, HERA established a general hold harmless rule for MTSP limits that states, "Any determination of area median gross income under subparagraph (B) with respect to any project for any calendar year after 2008 shall not be less than the area median gross income determined under such subparagraph with respect to such project for the calendar year preceding the calendar year for which such determination is made."

It is unclear how the general MTSP hold harmless policy will work going forward. There is a push in the affordable housing community to have the general MTSP hold harmless rule function in the same way that the HUD hold harmless rule has worked in the past. In other words, a county is held harmless and the income limit for the county will not be less than the year before. However, based on the HUD MTSP briefing material it appears that HUD is interpreting the hold harmless to apply on a project basis, and the project must be in service in the prior year in order to be held harmless at that prior year level.

Project v. County (HERA General)

If the provision applies on a project basis, an unintended consequence of HERA is that different projects located in the same county could have different rent and income limits. The examples below illustrate the difference between the hold harmless provision on a project basis and on a county basis.

Example 1 – Hold Harmless Applied on a Project Basis

	Applicable Income Limit				
	2008	2009	2010	2011	2012
HUD very low-income limit (VLI)	\$30,000	\$32,000	\$29,000	\$26,000	\$27,000
Project 1 (Income determined in 2008)	\$30,000	\$32,000	\$32,000	\$32,000	\$32,000
Project 2 (Income determined in 2009)	N/A	\$32,000	\$32,000	\$32,000	\$32,000
Project 3 (Income determined in 2010)	N/A	N/A	\$29,000	\$29,000	\$29,000
Project 4 (Income determined in 2011)	N/A	N/A	N/A	\$26,000	\$27,000

In periods of decreasing VLI, projects placed in service in later years will be at a financial disadvantage to projects that were placed in service in earlier years, in both the amount of rent they can charge and in the number of tenants that can qualify to live in the project. Furthermore,

(continued on page 2)

New Income Limits

(continued from page 1)

this will create an administrative burden on tax credit participants such as the Internal Revenue Service (IRS), LIHTC allocating agencies, developers, investors and property management companies that are responsible for tracking the rent and income limits. In addition, HUD will have the burden of publishing these various limits. Defining the hold harmless policy on a county basis would solve many of these problems.

Example 2 – Hold Harmless Applied on a County

Basis

	Applicable Income Limit				
	2008	2009	2010	2011	2012
HUD very low-income limit (VLI)	\$30,000	\$32,000	\$29,000	\$26,000	\$27,000
Project 1 (Income determined in 2008)	\$30,000	\$32,000	\$32,000	\$32,000	\$32,000
Project 2 (Income determined in 2009)	N/A	\$32,000	\$32,000	\$32,000	\$32,000
Project 3 (Income determined in 2010)	N/A	N/A	\$32,000	\$32,000	\$32,000
Project 4 (Income determined in 2011)	N/A	N/A	N/A	\$32,000	\$32,000

Adopting a hold harmless policy that applies on a project basis creates anomalies among projects located within the same area and creates uncertainty for industry stakeholders who are trying to determine the feasibility of future projects.

HERA Special

Certain projects that receive tax-exempt bonds and/or LIHTCs are eligible to use the HERA special income limit. Under HERA, projects whose income for 2007 or 2008 was determined under the HUD hold harmless policy are eligible for the HERA special income limit. Please see Project v. County (HERA Special) section on the following page for more discussion on who qualifies to use the HERA special limit.

HUD is calculating the HERA special income limit by determining a growth rate from the base year (2008) to the current in median family income (MFI) and by taking the current year MFI and dividing it by 2008's MFI.

(continued on page 3)

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New Income Limits

(continued from page 2)

Example 1 - Multiplication Method

Etowah County, Ala.

2008 MFI 44,300

2009 MFI 46,100

Growth rate $1.0406 = (46,100/44,300)$

2008 VLI 23,700

2009 VLI $24,650 = (23,700 * 1.0406, \text{rounded to the nearest } \$50)$

2008 VLI 23,700

2009 VLI $24,600 = (23,700 + (1,800 * .5 \text{ (for 50\%)} \text{ rounded to the nearest } 50)$

Percentage Increase v. Dollar Increase

The language below, used in HERA, indicates that the amounts should be added and not multiplied (emphasis added):

(I) the area median gross income determined under the HUD hold harmless policy with respect to such project for calendar year 2008,

plus

(II) any increase in the area median gross income determined under subparagraph (B) (determined without regard to the HUD hold harmless policy and this subparagraph) with respect to such project for the current calendar year over the area median gross income (as so determined) with respect to such project for calendar year 2008

HERA clearly states that the two should be added; however, the language in the second part appears to indicate taking the 2009 figure OVER the 2008 figure, which would result in a growth rate. So adding these two together would result in an incorrect answer. Many people in the industry are under the impression that the increase would be calculated by taking the 2009 MFI MINUS 2008 MFI and adding that to the 2008 VLI. Using HUD's method of multiplying, the end result is a slightly higher amount than would be reached under the addition method. Let's look at Etowah County again, as an example:

Example 2 - Addition Method

Etowah County, Ala.

2008 MFI 44,300

2009 MFI 46,100

Dollar growth $1,800 = (46,100 - 44,300)$

Why 2007 or 2008?

One of the nuances of the HERA special income limit is that projects that were affected in 2007 or 2008 qualify. This is an important nuance since some of the counties that are qualifying for the HERA special income limit were held harmless in 2007 but no longer held harmless in 2008. There appear to be 331 HERA special counties spread across 24 states that were held harmless in 2007 but not in 2008.

Project v. County (HERA Special)

According to HERA, projects whose income for 2007 or 2008 was determined under the HUD hold harmless policy are eligible for the HERA special income limit. In deciding who gets to use this income limit we must examine what the word "determined" means. The IRS has yet to issue formal guidance on how this should be applied, and many states are waiting to release their income limits until that guidance is available. There is some discussion in the industry that determined simply means a project is located in a county that was held harmless in 2007 or 2008. However, according to HUD, a project must be in service as of December 31, 2008 to be eligible for the HERA special income limit. However, HUD does not have jurisdiction over the IRS in setting policy for when tax credit income limits are effective.

There is another view that determined means receipt of a tax credit allocation (or bond reservation). If the IRS rules that the HERA special income limit is a project-by-project rule and not a county rule, this option makes the most sense. According to Internal Revenue Code (IRC) §42(g)(2)(A), a project locks in its rent floor at allocation. This would appear to indicate that a project's income limit is determined as early as allocation.

National Non-Metro

Section 3004 of HERA added language to IRC Section 42 that requires LIHTC projects located in a rural area—as defined in Section 520 of the Housing Act of 1949—to use the greater of area median gross income

(continued on page 4)

New Income Limits

(continued from page 3)

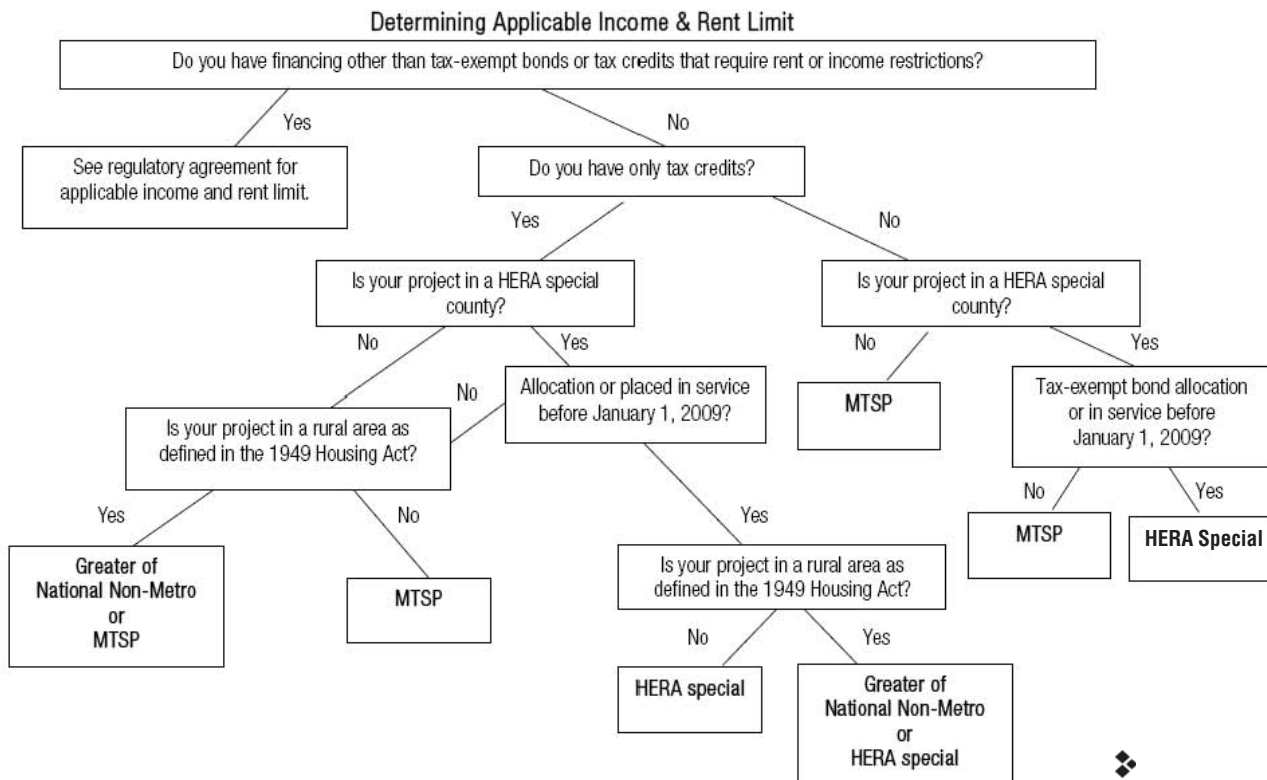
(AMGI) or national non-metro median income for rent and income limit determinations. Projects financed with tax-exempt bonds under IRC Section 142 are generally not eligible to use this provision. The national non-metro four-person median income is \$51,300. The one to eight person 50 percent national non-metro income limits are as follows:

1 Person	2 Person	3 Person	4 Person	5 Person	6 Person	7 Person	8 Person
\$17,950	\$20,500	\$23,100	\$25,650	\$27,700	\$29,750	\$31,800	\$33,850

Layered Financing

Because HUD will no longer hold VLI income limits harmless in FY 2010, a gap will start to appear between the MTSP income limits and HUD income limits for programs such as Section 8 and HOME funds. The MTSP income limit will always be greater than or equal to the HUD limits. Properties with layered financing will have to track both sets of income limits and be sure they are following both requirements. Also, projects that have project-based Section 8 will want to make sure that the contract rent is not lower than the increased rent limits under the MTSP program.

The decision tree illustrated below can assist in determining which income limit a project should use.



(continued on page 5)

New Income Limits

(continued from page 4)

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