Housing Credit Income Averaging Frequently Asked Questions

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1. What is income averaging?

The Consolidated Appropriations Act of 2018 (the Act) permanently establishes income averaging as a third minimum set-aside election for new Housing Credit developments which owners could choose in lieu of the two previously existing minimum set-aside elections (the 40 at 60 and 20 at 50 standards). Income averaging allows Credit-qualified units to serve households earning as much as 80 percent of Area Median Income (AMI), so long as the average income/rent limit in the property is 60 percent or less of AMI. Owners electing income averaging must commit to having at least 40 percent of the units in the property affordable to eligible households.

The 80 percent of AMI standard is consistent with long-standing federal affordable housing policies, which define "low income" as households earning no more than 80 percent of AMI. Under the income averaging option, the higher rents that households with incomes in the above 60 percent of AMI range could pay would have the potential to offset the lower rents for extremely low- and very low-income households living in units designated at lower income levels, thereby allowing developments to maintain financial feasibility while providing a deeper level of affordability than may be possible otherwise. Income averaging thus preserves rigorous targeting to low-income households, while providing more flexibility to the program and greater income-mixing potential.

Income averaging applies to the designated income/rent levels of the units, not the incomes of individual tenant households. Under income averaging, designated income/rent levels may only be set at 10 percent increments beginning at 20 percent of AMI; thus, the allowable income/rent designation levels are 20 percent of AMI, 30 percent of AMI, 40 percent of AMI, 50 percent of AMI, 60 percent of AMI, 70 percent of AMI, and 80 percent of AMI.

2. Must a state allow income averaging for developments applying for Credits (or seeking bond-financed Credits) in 2018 and subsequent years?

While the Internal Revenue Code (IRC) allows for income averaging, there does not appear to be a legal obligation for a state to allow income averaging as part of its Housing Credit program.

3. Must a state modify its Qualified Allocation Plan (QAP) or related regulatory document(s) before allowing income averaging?

Given the complexity of the income averaging option, NCSHA encourages states that intend to allow income averaging to provide guidance to applicants regarding this election. That guidance can be part of the state's QAP or provided in other documents.

States should keep in mind that the QAP preferences required by the IRC, including the preference for serving the lowest income tenants, continue to apply. States will need to determine how best to balance the flexibility provided by income averaging to serve households up to 80 percent of AMI with the preference for serving the lowest income tenants.

If a state determines it will charge higher compliance monitoring fees for developments that elect income averaging due to the added complexity of income averaging, it may do so. However, it should specify the fee level in its QAP or related documents wherever compliance monitoring fees are covered.

4. Must the Internal Revenue Service (IRS) issue guidance before states can allow income averaging?

No. Income averaging is allowable for new developments making their minimum set-aside/income election after the date of enactment of the Act (March 23, 2018), and is not dependent on the issuance of IRS guidance. However, IRS guidance, as outlined in the answers to several of the questions in this FAQ document, could help facilitate the implementation of income averaging.

5. Must the IRS revise Form 8609 before states can allow income averaging?

The IRC has been changed to make the income averaging election available. If the state chooses to allow income averaging, the absence of a revised Form 8609 should not be a barrier to its use. Until IRS revises Form 8609, the state can provide owners an attachment to Form 8609 setting forth the election. NCSHA has reached out to IRS to discuss the importance of revising Form 8609 to reflect the new option.

6. Are existing Housing Credit developments already placed in service eligible to change their minimum set-aside election to income averaging?

No. The minimum set-aside election is irrevocable once made on Form 8609. Therefore, existing developments already placed in service are not eligible to change their minimum set-aside/income election to income averaging. Income averaging is available, at the state's discretion, to new developments making their minimum set-aside election after March 23, 2018.

Theoretically, the IRS could issue guidance allowing income averaging to apply to existing developments on the premise that the change in the IRC implicitly permits changing an otherwise irrevocable election. However, unless and until IRS issues such guidance, existing Housing Credit developments are not able to take advantage of income averaging.

7. If an owner has a development in the pipeline for which it has indicated that it will elect either the 40-60 or 20-50 minimum set-aside, but for which it has not yet received a carryover allocation, can the owner change to income averaging? Can the owner seek to change either such election to include income averaging after it has received a carryover allocation, but before it has made the actual election on Part II of Form 8609?

In this circumstance, there is no specific federal prohibition against selecting income averaging as the minimum set-aside election after previously indicating the intent to choose one of the other minimum set-aside options. Therefore, states may allow this change. However, NCSHA recommends states ensure the following criteria are met first: (i) the state's QAP or other authorizing document should permit a change, (ii) the change would not be inconsistent with the basis upon which the project was selected, and (iii) the development's underwriting would not be adversely affected.

8. Can states modify the Housing Credit extended-use agreement for developments in the period following the tax credit compliance period (post Year 15) to allow for income averaging rather than the minimum set-aside they elected at the time of Form 8609 issuance?

No. IRC Section 42(h)(6)(B)(i) provides that the "applicable fraction," the basis upon which "low income" is determined, throughout the extended use period be that originally specified in the extended use agreement.

9. Can states allow developments seeking a resyndication of Credits to elect income averaging? How would such election affect the existing low-income units?

A new election would not free the continuing low-income units of their obligations under the prior extended use agreement, so the owner would, in effect, have to comply with the more stringent rules applicable to each particular unit if it were to change its election upon resyndication. Given the complexity of complying with two separate minimum set-aside rules, income averaging is not likely to be a helpful tool for resyndications. However, to the extent that the resyndication includes additional low-income units, the owner technically could elect income averaging as a new minimum set-aside.

10. Is income averaging an option when acquiring and/or rehabilitating developments participating in other affordable housing programs?

If a subsidized development was not previously a Housing Credit development and an owner intends to use Housing Credit equity to acquire and/or rehabilitate the development, the owner may (at the discretion of the state) elect income averaging. However, the development must also adhere to all income and rent restrictions of the other applicable affordable housing program(s).

States and owners should keep in mind that income limits may be calculated differently for various federal programs. Housing Credit income and rent limits have various adjustments, such as Housing and Economic Recovery Act (HERA) special income limits, that other affordable housing programs may not use. Therefore, extra care should be taken when underwriting projects, leasing units, and calculating rent changes to make sure a project is complying with all restrictions for all programs. Income averaging will add to this complexity.

11. How does income averaging apply to tax-exempt bond-financed 4 percent Credit deals?

The Act modifies IRC Section 42 to allow for income averaging but does not make a similar change in IRC Section 142, which covers exempt facility bonds, including multifamily Housing Bonds. However, income averaging still may be used in bond-financed Housing Credit developments so long as the development satisfies both the income averaging minimum set-aside election and one of the minimum set-aside elections applicable to tax-exempt bond financing (20 at 50 or 40 at 60). Thus, units with income limits above 60 percent or 50 percent, as applicable, do not count for purposes of bond compliance.

12. Does income averaging apply to rent limits as well as income limits?

Yes. Income averaging applies to both income and rent limits. Therefore, if a unit has a designated limit of 80 percent of AMI, the maximum rent level that may be charged to a household in that unit is 30 percent of 80 percent of AMI. Similarly, if a unit has a designated limit of 30 percent of AMI, the maximum rent level that may be charged to a household in that unit is 30 percent of 30 percent of AMI.

13. What is the process for designating units at specific income levels under income averaging?

The IRC does not specify the process by which owners may designate units at specific income levels under income averaging. Absent contrary guidance from the IRS, states have the authority to determine a process for unit designation. NCSHA encourages states to indicate unit designations in the extended use agreement and the carryover allocation.

14. Can an owner shift designated units from one income level to another so long as they maintain a 60 percent income level on average? How will this impact waiting list management? How should compliance monitoring staff monitor for this in practice?

The language in IRC section 42(g)(1)(C)(ii)(I) is not clear as to whether a unit's designated income limit may be changed. In mixed-income projects, the next available unit rule and vacant unit rule will inevitably force some shifting of income limit designations.

- Example—Income averaging in a development that has some market-rate units: a qualified low-income tenant living in a two-bedroom 70 percent unit goes over income (140 percent of the greater of 60 percent of AMI or the designated limit applicable to the unit; in this case 140 percent of 70 percent of AMI). A two-bedroom market rate unit of comparable or smaller size becomes available. Another qualifying low-income tenant wants to rent the now-vacant market rate unit at the 70 percent rent. The previously market-rate unit must be rented to the qualifying low-income tenant at the 70 percent rent rather than a market rate tenant.

If the owner of a 100 percent low-income development would like the flexibility to change designations of units in order to limit vacancies, absent contrary guidance from the IRS, states may determine whether to permit the shifting of designations. States should have a formal notice and documentation procedure for the change in designation so that the state's records for monitoring purpose would be consistent with the owner's documentation and practices.

States should also consider the fact that such shifting may increase the complexity of compliance monitoring.

15. How would shifting designated units work in developments that have units of various bedroom sizes? Is there any requirement for maintaining unit size parity among various designated income levels?

There is no requirement within income averaging for bedroom or other unit feature parity among Housing Credit units. States may adopt policies along these lines.

16. Are there additional issues states must consider in monitoring the income averaging option for 100 percent low-income developments that are not subject to annual income recertification?

The Act makes no changes to IRC Section 142(d)(3)(A)—applicable to Housing Credit projects in Section 42(G)(4)—which does not require current income determinations for units in 100 percent low-income developments. If a state has an accurate listing of units and income limit designations, it may be able to evaluate compliance solely by evaluating the incomes of new occupants to vacant units for consistency with the designated limit. However, a state may conclude that, in order to assess compliance of a development with the income averaging rule, it needs regular monitoring and reporting.

17. How will the next available unit rule work in developments that elect the income averaging option? Will the rule apply differently in developments with some market-rate units?

The next available unit rule, as modified by the new language, (i) provides that a unit is over income if the occupant's income exceeds 140 percent of the greater of 60 percent of AMI or the designated limit applicable to the unit and (ii) effectively requires that the next available unit of comparable or smaller size be rented (A) to a tenant whose income does not exceed the designated limit applicable to the new unit, if it was previously a low-income unit or (B) to a tenant at an income level that would not cause a violation of the 60 percent average, if the new unit had not previously been a low-income unit.

As is the case when using either of the original two minimum set-asides, following the next available unit rule should be straightforward for 100 percent Housing Credit properties. Developers should consult with compliance experts in evaluating how income averaging will work in developments with market rate units.

18. How can a state ensure that the 60 percent of AMI average is achieved for a project, under the IRS' definition of a project, without knowing whether the owner will treat buildings as separate projects or make a multi-building election (line 8b election on Part II of Form 8609)?

The state should require the owner to address this question in its application. The state may choose to require the owner to state in advance what unit distribution by income designation it intends to apply to each building and show that the income averaging is achieved for the defined project(s) within the property.

19. Does the 30 percent of AMI income and rent level under the Housing Credit for purposes of income averaging conform to the extremely low-income and rent restriction under the Housing Trust Fund?

No. The Housing Trust Fund statute and regulation define "Extremely Low-Income" as the greater of 30 percent of AMI or the federal poverty line for applicable household size. Income averaging unit designation is based solely on AMI.

20. Will noncompliance with the income averaging option be reportable on IRS Form 8823?

Yes. Basic noncompliance will work the same as it does with the other minimum set-asides. If a development elects income averaging and fails to meet the income averaging standard at the end of a year, it is not a qualified low-income housing development for the year under IRC Section 42(g)(1)(C), and this noncompliance must be reported to IRS Form 8823 and the owner could be subject to loss of Credits. Presumably, IRS will revise the Form 8823 and its instructions accordingly.

Theoretically, IRS could provide guidance allowing such developments to be considered in compliance so long as the development complies with one of the other two minimum set-aside elections; however, until such time as the IRS issues guidance allowing this flexibility, states should consider noncompliance with the income averaging option to be reportable on IRS Form 8823.

Note that targeting under income averaging differs from deeper targeting under the 20 at 50 or 40 at 60 minimum set-aside elections. For example, if an owner elects the 40 at 60 minimum set-aside, but commits to deeper income targeting at 30 percent of AMI for a portion of the units in the development for scoring purposes, noncompliance with the deeper income targeting commitment

is not reportable on Form 8823 because it is not a federal requirement. Conversely, maintaining the average level of 60 percent of AMI in an income averaging property is a federal requirement, and thus, noncompliance could trigger loss of Credits.

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