

THE HFA INSTITUTE 2025

Mastering Average Income Test Compliance



National Council of
State Housing Agencies



**MRBs and
Other Federal
Homeownership
Programs**
JANUARY 15 – 17



Housing Credit
JANUARY 14 – 16



**Section 8 and
Other Federally
Assisted
Multifamily
Housing**
JANUARY 15 – 17



**HOME and
Housing Trust
Fund**
JANUARY 12 – 14



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Average Income Set-Aside

- Minimum Set-Aside as of 2018
- **40% or more of the units in a project** must have a designated income limit, where the **average of the income limits** for the LIHTC units does not exceed 60%
- Allows projects to have **higher income limits** as long as the average of the income limits for all the low-income units does not exceed the 60% limit
- Units may be restricted to:



Qualified Unit Group – “Average Income Test”

The Average Income Test is met if:

- Taxpayer identifies a “qualified group” of 40% of the project’s units having income levels averaging 60% or less
- Qualified Average Income Test (AIT) Group is identified timely each taxable year of the extended use period
 - Maintains records in accordance with retention requirements in Treas. Reg. § 1.42-5(b)(2)
- Units in Qualified AIT Group are rent-restricted
- Units in Qualified AIT Group are occupied by qualified households

Qualified Unit Group – “Average Income Test”

The Average Income Test is met if:

- Not required to include all low-income units in the project when determining AIT compliance

Piney Flats

**Average
Income Group** ←

101
80%

106
40%

102
80%

107
40%

103
80%

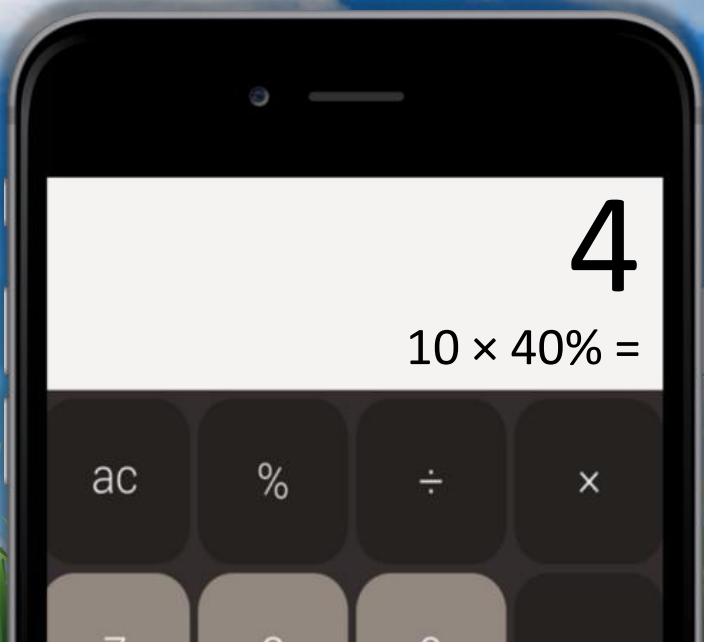
108
40%

104
80%

109
40%

105
80%

110
40%



Piney Flats

Average ←
Income Group

101
80%

106
40%

102
80%

107
40%

103
80%

108
40%

104
80%

109
40%

105
80%

110
40%

240

$80 + 80 + 40 + 40 =$

✓ 60

$240 \div 4 =$

Woodland Hills

8a Original qualified basis of the building at close of first year of credit period 8a

b Are you treating this building as part of a multiple building project for purposes of section 42 (see instructions)? Yes No

A1
80%

B1
40%

A2
80%

B2
40%

A3
40%

B3
80%

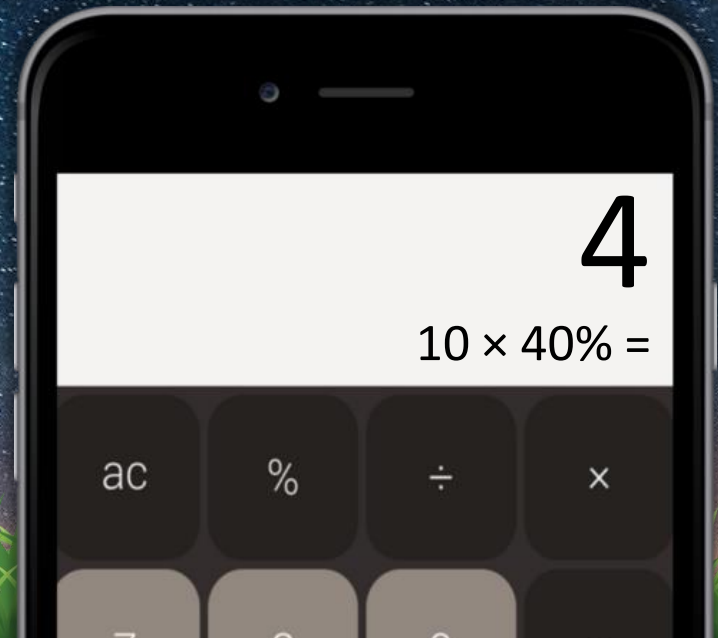
A4
40%

B4
80%

A5
40%

B5
80%

Average Income Group

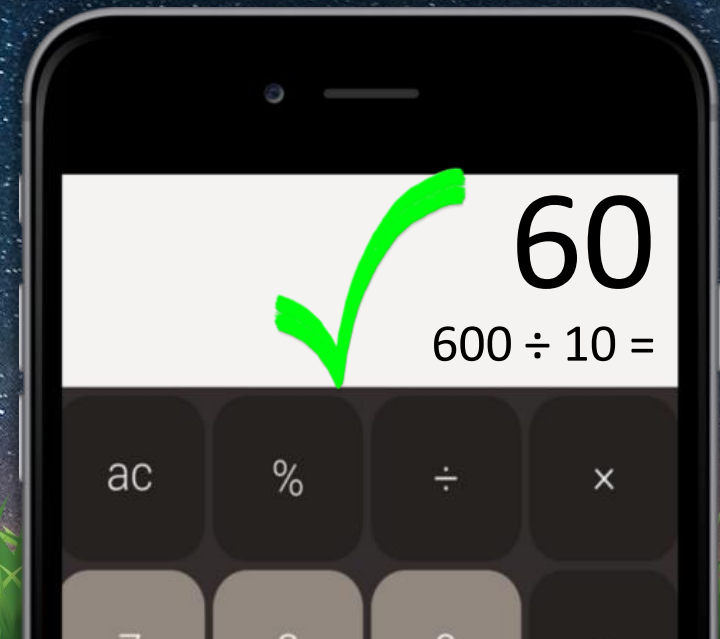


Woodland Hills

8a Original qualified basis of the building at close of first year of credit period 8a ✓
b Are you treating this building as part of a multiple building project for purposes of section 42 (see instructions)? Yes No

A1 80%	B1 40%
A2 80%	B2 40%
A3 40%	B3 80%
A4 40%	B4 80%
A5 40%	B5 80%

Average Income Group



Qualified Unit Group – “Average Income Test”

If the Average Income Test is met, the owner can claim credits.



Qualified Unit Group – “Applicable Fraction”

- Defines low-income units used to calculate annual credits
- Taxpayer identifies a “group of qualified units” for purposes of determining the Applicable Fraction (AF)
 - Each taxable year throughout the extended use period, the taxpayer will need to identify the units to be included in the group
- Same definition for the Qualified AIT Group
- Can include, but not limited to, the same units in the Qualified AIT Group
 - IRS Form 8609, line 8b – If Yes, units in the Qualified AF Group are not limited to one BIN and **can span** across multiple BINs.

8a Original qualified basis of the building at close of first year of credit period	8a _____
b Are you treating this building as part of a multiple building project for purposes of section 42 (see instructions)?	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No

Piney Flats

**Average
Income Group** ←

101
80%

106
40%

102
80%

107
40%

103
80%

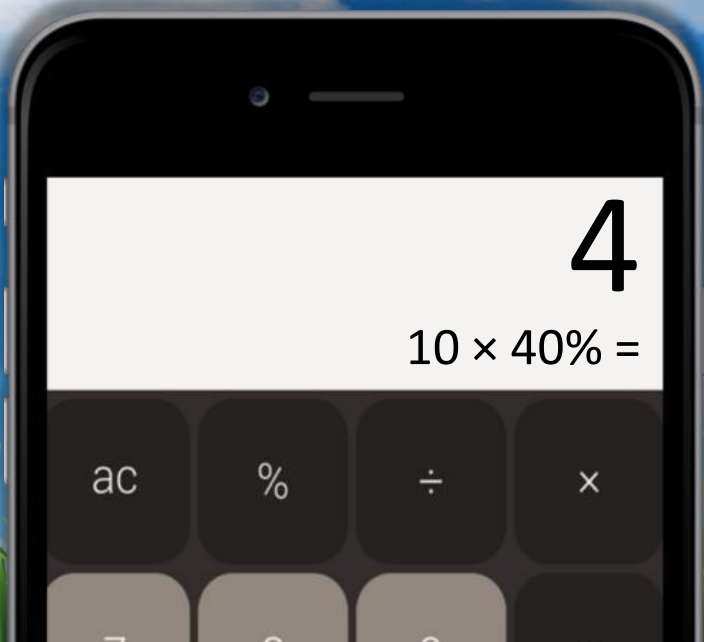
108
40%

104
80%

109
40%

105
80%

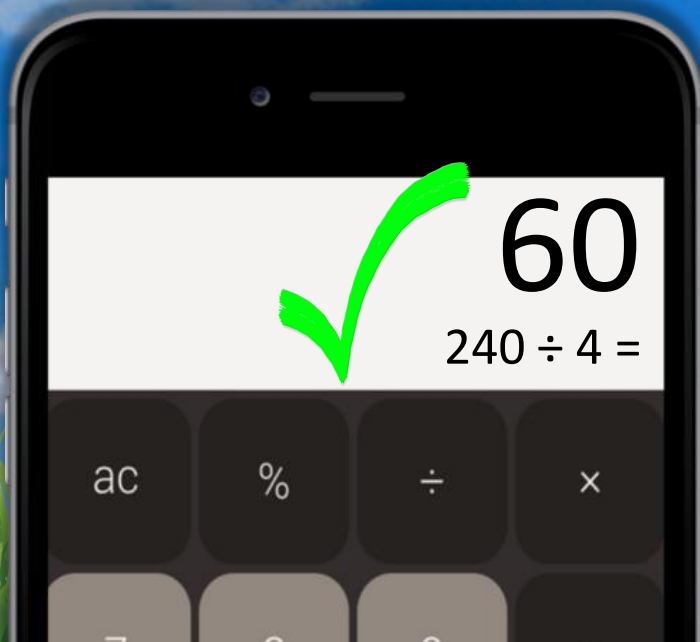
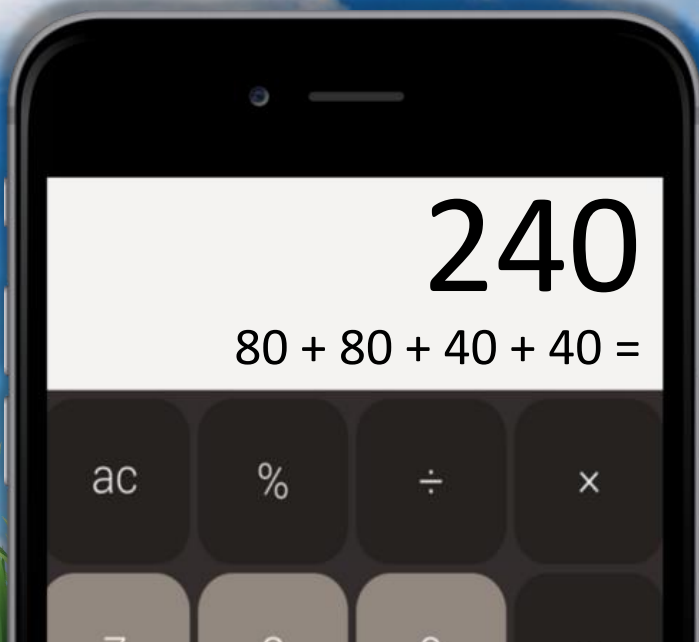
110
40%



Piney Flats

**Average
Income Group** ←

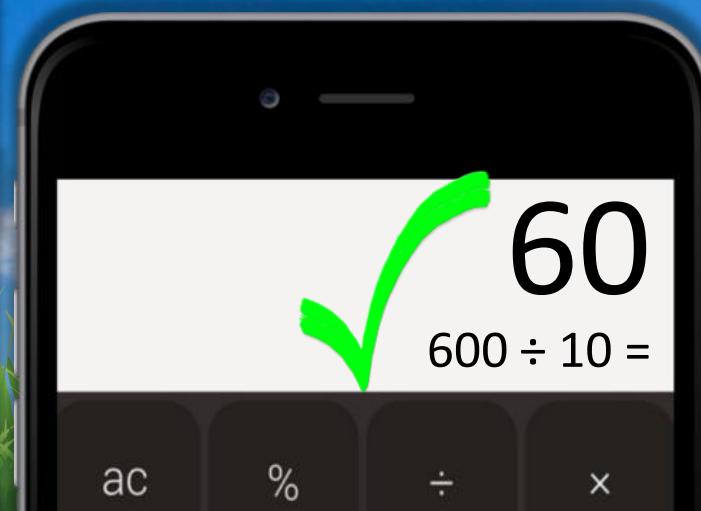
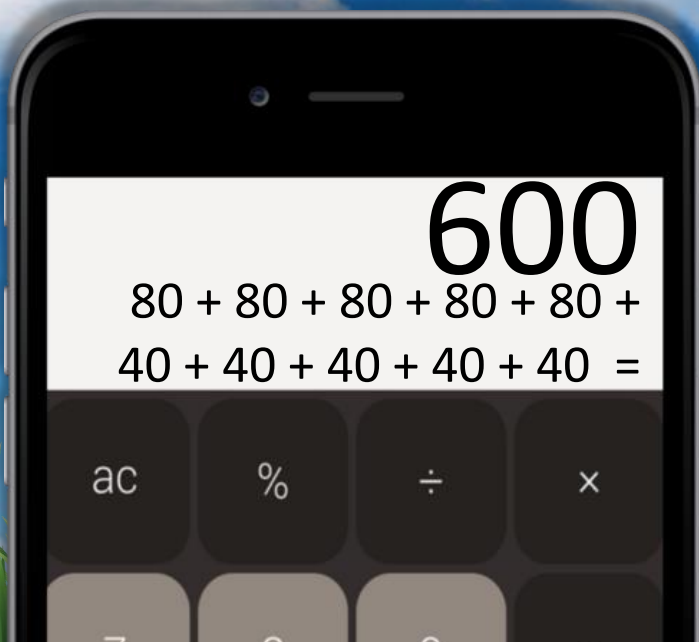
101 80%	106 40%
102 80%	107 40%
103 80%	108 40%
104 80%	109 40%
105 80%	110 40%



Piney Flats

Applicable
Fraction
Group

101 80%	106 40%
102 80%	107 40%
103 80%	108 40%
104 80%	109 40%
105 80%	110 40%



City View

8a Original qualified basis of the building at close of first year of credit period 8a

b Are you treating this building as part of a multiple building project for purposes of section 42 (see instructions)? Yes No

A1 - 900
80%

B1 - 900
40%

A2 - 900
40%

B2 - 900
40%

A3 - 900
40%

B3 - 900
80%

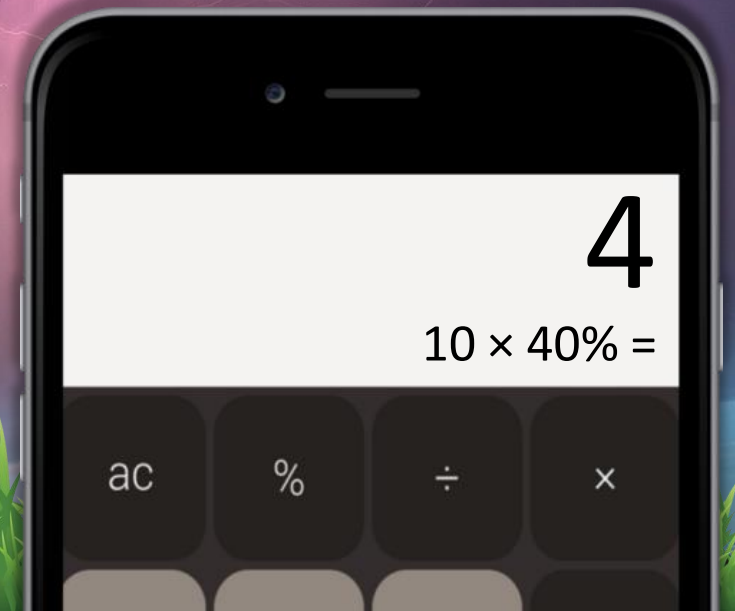
A4 - 650
40%

B4 - 650
80%

A5 - 650
MKT

B5 - 650
80%

Average Income Group



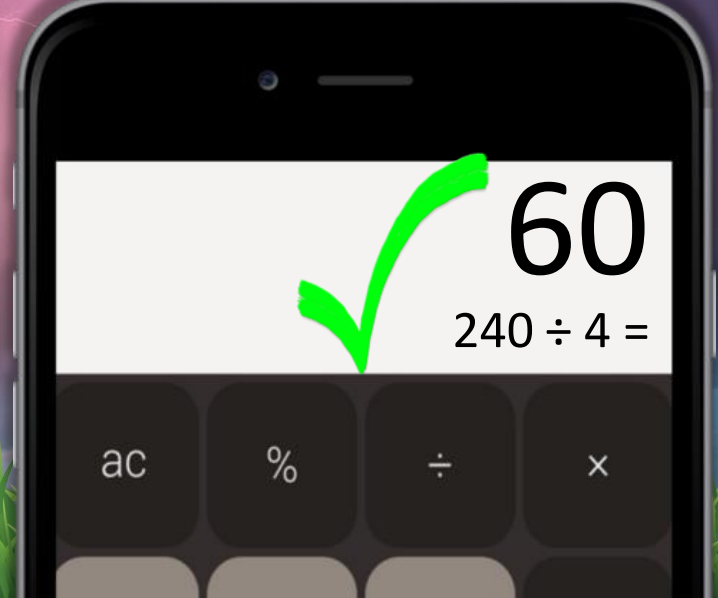
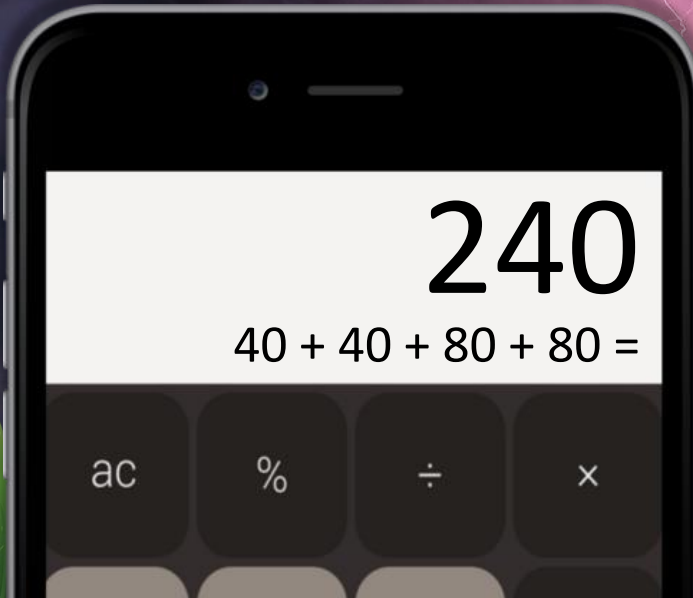
City View

8a Original qualified basis of the building at close of first year of credit period 8a

b Are you treating this building as part of a multiple building project for purposes of section 42 (see instructions)? Yes No

A1 - 900 80%	B1 - 900 40%
A2 - 900 40%	B2 - 900 40%
A3 - 900 40%	B3 - 900 80%
A4 - 650 40%	B4 - 650 80%
A5 - 650 MKT	B5 - 650 80%

Average Income Group



City View

A1 - 900
80%

B1 - 900
40%

A2 - 900
40%

B2 - 900
40%

A3 - 900
40%

B3 - 900
80%

A4 - 650
40%

B4 - 650
80%

A5 - 650
MKT

B5 - 650
80%

Applicable
Fraction
Group

520

$80 + 40 + 40 + 40 + 40 +$
 $40 + 80 + 80 + 80 =$

ac % ÷ ×

✓ 57.78

$520 \div 9 =$

ac % ÷ ×

Floating of Unit Designations

- Unit designations **can** change:
 - Federally permitted changes
 - In accordance with Housing Finance Agency (HFA) policy
 - When the designation change is needed:
 - Violence Against Women Act (VAWA)
 - Fair Housing Act
 - Section 504 of the Rehabilitation Act of 1973
 - Other federal, state or local law affording tenant protections
 - When an income-qualified household tenant transfers to a different unit in the project
 - Units swap income level designations
 - Restore compliance with AIT requirements (discussed later with Correcting Noncompliance)

Floating of Unit Designations

- Timings for Unit Designation Changes:
 - **Vacant Units** – Unit designations must be changed before being occupied
 - **Occupied Units** – Unit designations must be changed prior to the last day of the taxable year

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Next Available Unit Rule in Average Income

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Rule Summary:

If upon annual recertification, the income of an LIHTC household rises above 140% of the limit, that unit will remain LIHTC qualified as long as all subsequent available units within that building of comparable or smaller size are rented to low-income households.

- Explained in Treasury Regulation §1.42-15
- Applicable when tenant income goes over 140% of the federal income limit on recertification (20/50 or 40/60)
- Over-140-percent unit had to have been initially income qualified
- **Building-based rule**

Next Available Unit Rule

Under AIT, the 140% threshold at recertification is the greater of:

- 60% of AMI, or
- the applicable designated income limit for the unit

Unit Type	140% Threshold
20%-60% AMI	140% x 60% AMI
70% AMI	140% x 70% AMI
80% AMI	140% x 80% AMI

Next Available Unit Rule

In the case of a project with respect to which the taxpayer elects the requirements of subparagraph (A) or (B) of paragraph (1), if the income of the occupants of the unit increases above 140 percent of the income limitation applicable under paragraph (1), clause (i) shall cease

(iii) Rental of next available unit in case of average income test

subparagraph (C) of paragraph (1), if the income of the occupants of the unit increases above 140 percent of the greater of-

- (I) 60 percent of area median gross income, or
- (II) the imputed income limitation designated with respect to the unit under paragraph (1)(C)(ii)(I).

clause (i) shall cease to apply to any such unit if any residential rental unit in the building (of a size comparable to, or smaller than, such unit) is occupied by a new resident whose income exceeds the limitation described in clause (v).

(iv) Deep rent skewed projects

In the case of a project described in section 142(d)(4)(B), clause (ii) or (iii), whichever is applicable, shall be applied by substituting "170 percent" for "140 percent" and

(v) Limitation described

For purposes of clause (iii), the limitation described in this clause with respect to any unit is-

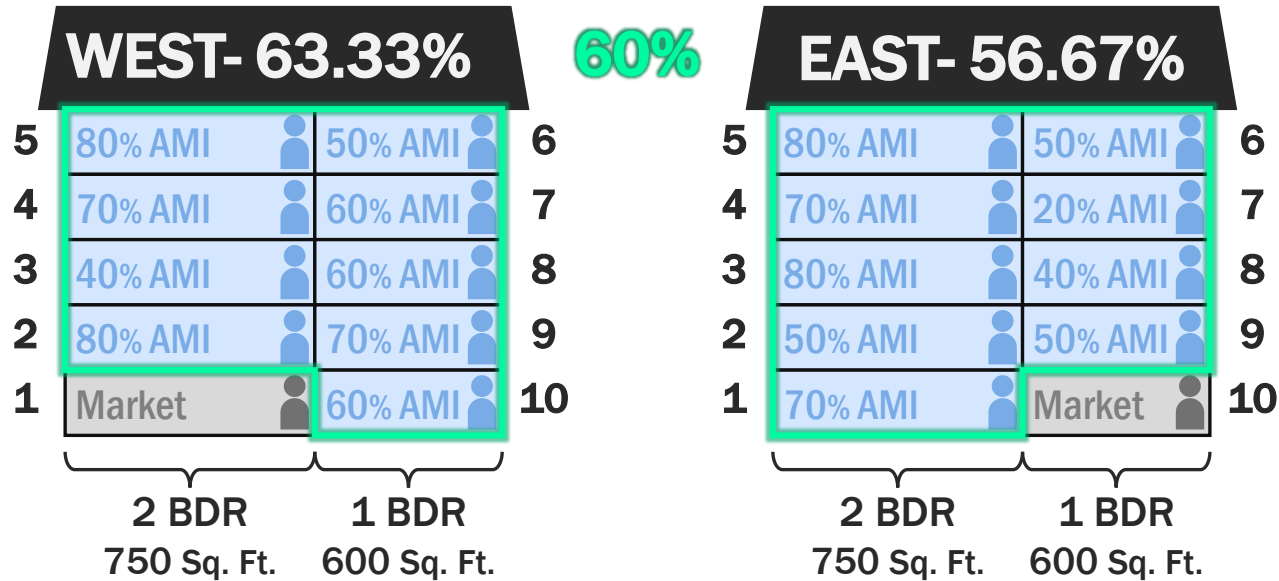
(I) the imputed income limitation designated with respect to such unit under paragraph (1)(C)(ii)(I), in the case of a unit which was taken into account as a **low-income unit prior to becoming vacant**, and

(II) the imputed income limitation which would have to be designated with respect to such unit under such paragraph in order for the project to continue to meet the requirements of paragraph (1)(C)(ii)(II), **in the case of any other unit. (market-rate unit)**

IRC § 42(g)(2)(D)

The Next Available Unit Rule (NAUR)

- **Objective #1**: Maintain each building's applicable fraction
- **Objective #2**: Maintain the qualified group of units' average to at or below 60% of AMI



Floor Space Fraction

$$\frac{6,000 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 88.89\%$$

Unit Fraction

$$\frac{9}{10} = 90.00\%$$

Floor Space Fraction

$$\frac{6,150 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 91.11\%$$

Unit Fraction

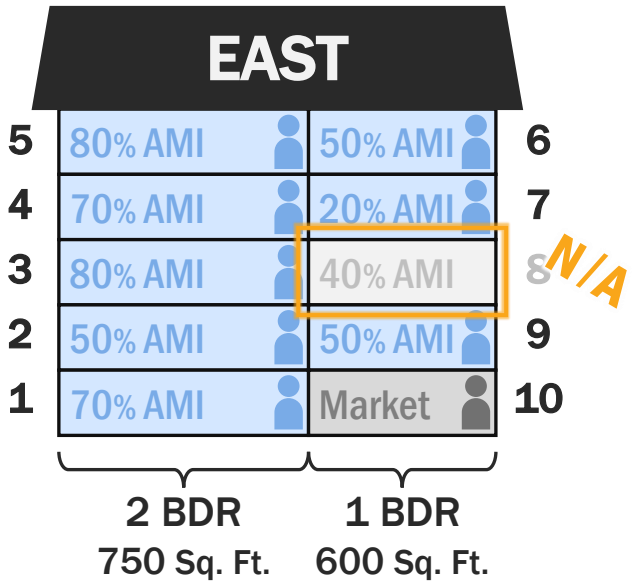
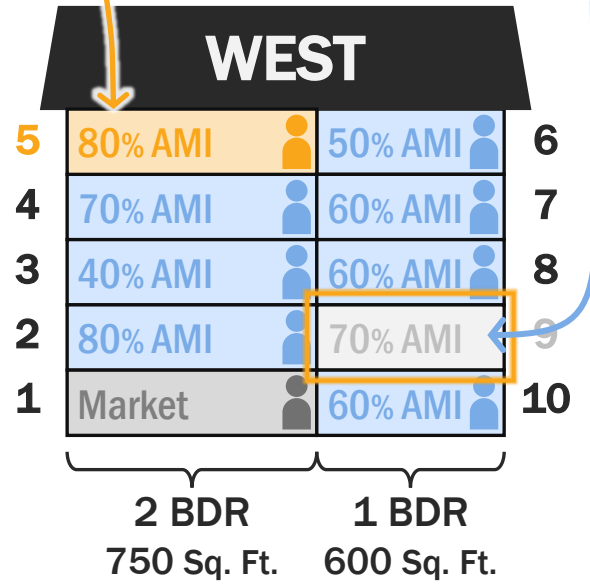
$$\frac{9}{10} = 90.00\%$$

Case Study #1

- A mixed-income, multibuilding LIHTC project is comprised of two 10-unit buildings of equal size—the East Building and the West Building. Each building has 5 one-bedroom units and 5 two-bedroom units
- The project is operating under the Average Income minimum set-aside.
- The average of imputed income limits of the designated units between the two buildings is 60% of Area Median Income (AMI), which means all restricted units are part of the **qualified group of units** to claim credits.
- The **applicable fraction** for the West Building is **88.89%** (lower floor space fraction) and the applicable fraction for East Building is **90.00%** (lower unit fraction).

>140% x 80% AMI

● Replace w/ another
70% AMI household



Scenario #1

- Assume Unit 9 of the West Building and Unit 8 of the East Building are vacant when the 80% AMI household in Unit 5 of the West Building is recertified as being Over Income.
- Unit 9 of the West Building can be replaced with a 70% AMI household to satisfy the NAUR for the West Building; continue to occupy all next available units of smaller/comparable size to households whose income satisfies their respective designations.
- The vacancy in Unit 8 of the East Building is not applicable to the NAUR in the West Building.

Floor Space Fraction

$$\frac{6,000 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 88.89\%$$

Unit Fraction

$$\frac{9}{10} = 90.00\%$$

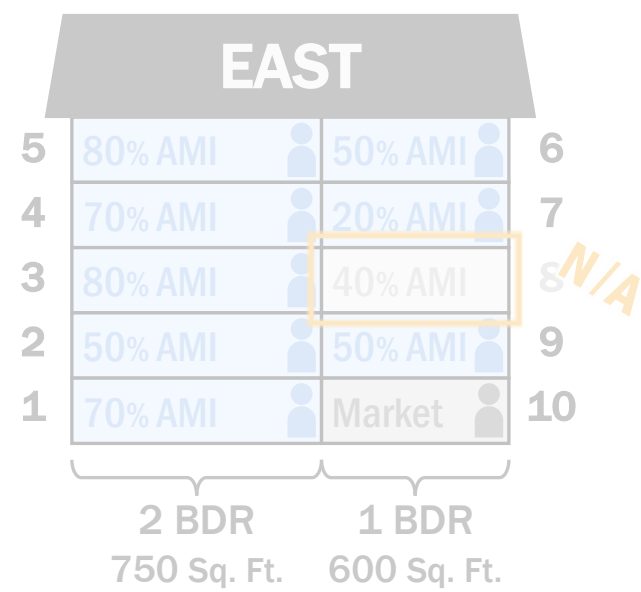
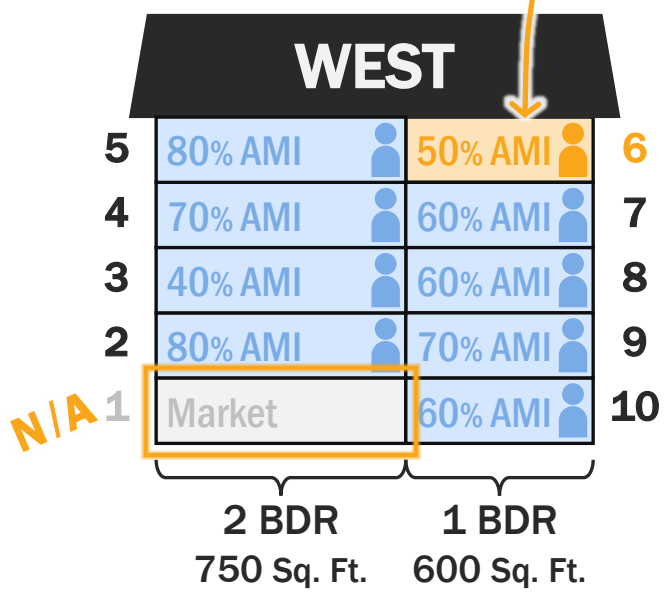
Floor Space Fraction

$$\frac{6,150 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 91.11\%$$

Unit Fraction

$$\frac{9}{10} = 90.00\%$$

>140% x 60% AMI



Scenario #2

- Assume market-rate Unit 1 of the West Building is vacant when the 50% AMI household in Unit 6 of the West Building is recertified as being Over Income.
- Since **Unit 1 is LARGER than Unit 6**, it can be leased again to a non-LIHTC-qualified household without violating the NAUR for the West Building.

Floor Space Fraction

$$\frac{6,000 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 88.89\%$$

Unit Fraction

$$\frac{9}{10} = 90.00\%$$

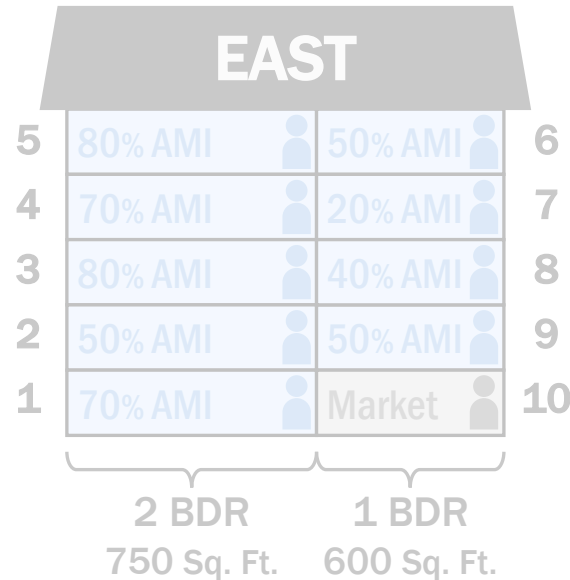
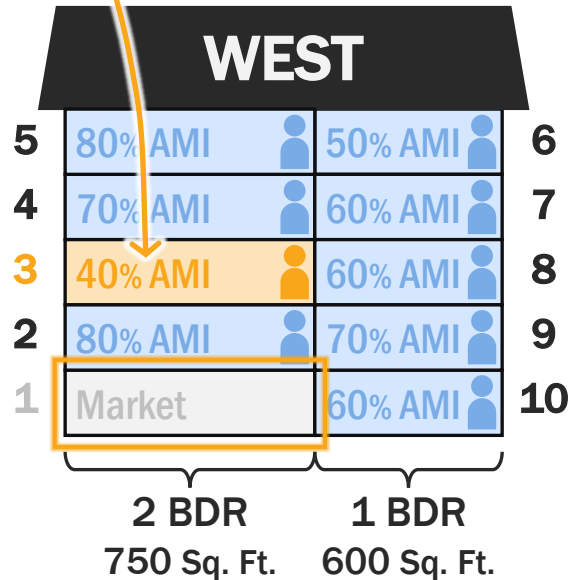
Floor Space Fraction

$$\frac{6,150 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 91.11\%$$

Unit Fraction

$$\frac{9}{10} = 90.00\%$$

>140% x 60% AMI



Scenario #3

- Unit 3 is recertified as being Over Income and Unit 1 is vacated by the Market household

Floor Space Fraction

$$\frac{6,000 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 88.89\%$$

Unit Fraction

$$\frac{9}{10} = 90.00\%$$

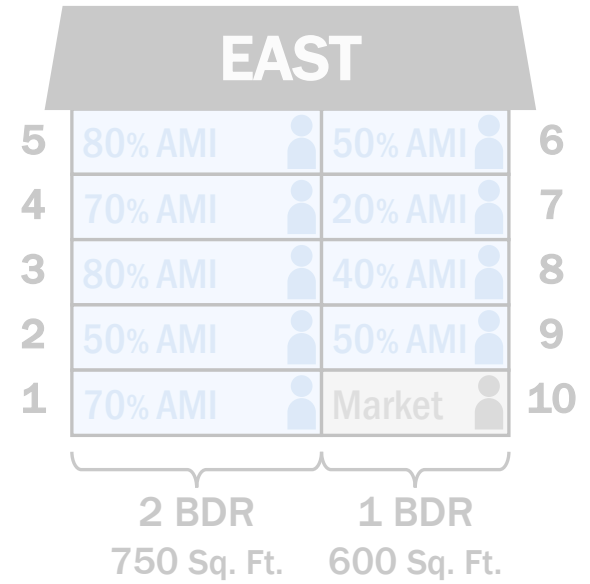
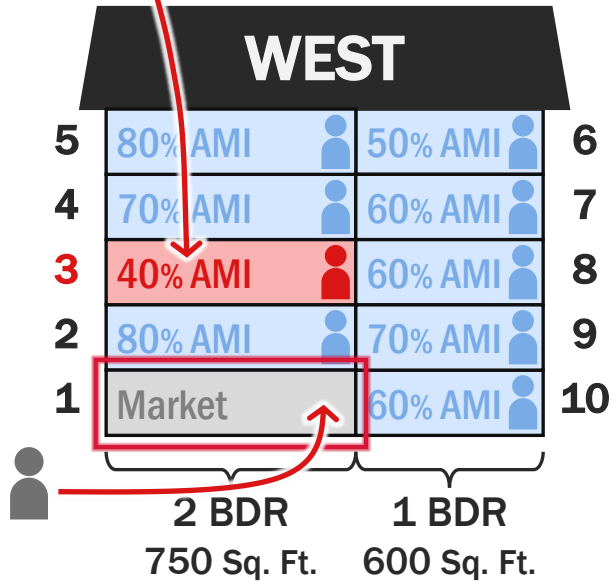
Floor Space Fraction

$$\frac{6,150 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 91.11\%$$

Unit Fraction

$$\frac{9}{10} = 90.00\%$$

>140% x 60% AMI



Scenario #3

- Unit 3 is recertified as being Over Income and Unit 1 is vacated by the Market household
- Assume Unit 1 is then leased to a non-LIHTC-qualified household, which is a violation of the NAUR causing Over-Income Unit 3 to no longer be LIHTC qualified.
- The loss of Unit 3 causes the West Building to have an **applicable fraction of 77.78%**.

Floor Space Fraction

$$\frac{5,250 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 77.78\%$$

Unit Fraction

$$\frac{9}{10} = 90.00\%$$

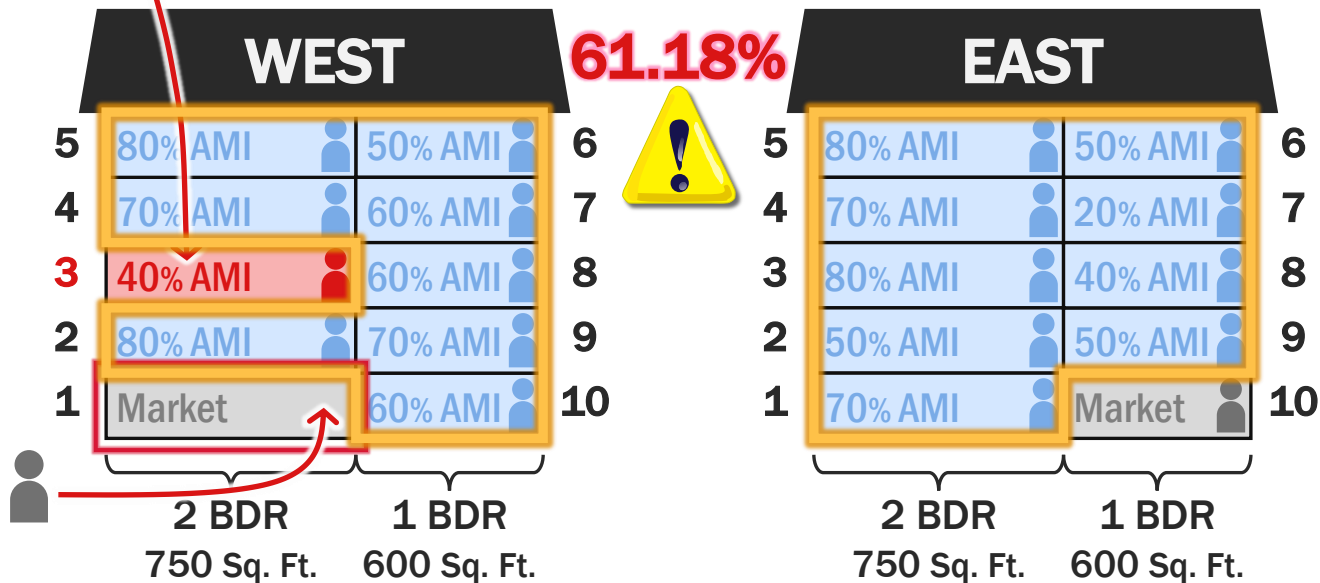
Floor Space Fraction

$$\frac{6,150 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 91.11\%$$

Unit Fraction

$$\frac{9}{10} = 90.00\%$$

>140% x 60% AMI



Scenario #3

- Assume Unit 1 of the West Building is vacant when the 40% AMI household in Unit 3 is recertified as being Over Income...
- Assume Unit 1 is then leased to a non-LIHTC-qualified household, which is a violation of the NAUR causing Over-Income Unit 3 to no longer be LIHTC qualified.
- The loss of Unit 3 causes the West Building to have an applicable fraction of 77.78%.
- **The average designation of the remaining 17 qualified LIHTC units in the project now EXCEEDS 60%.**

Floor Space Fraction

$$\frac{5,250 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 77.78\%$$

Unit Fraction

$$\frac{9}{10} = 90.00\%$$

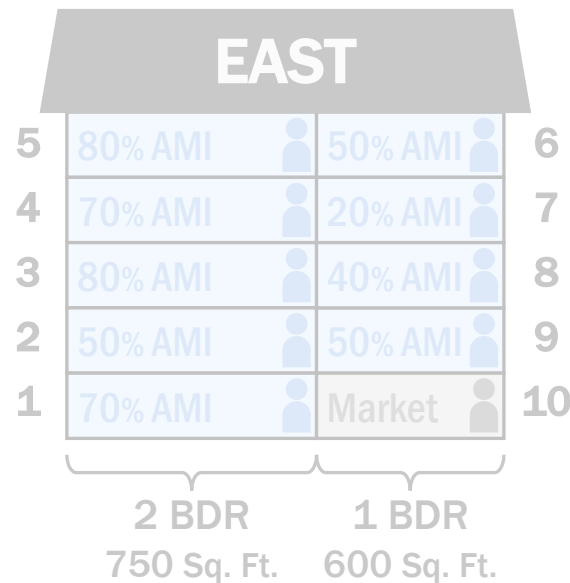
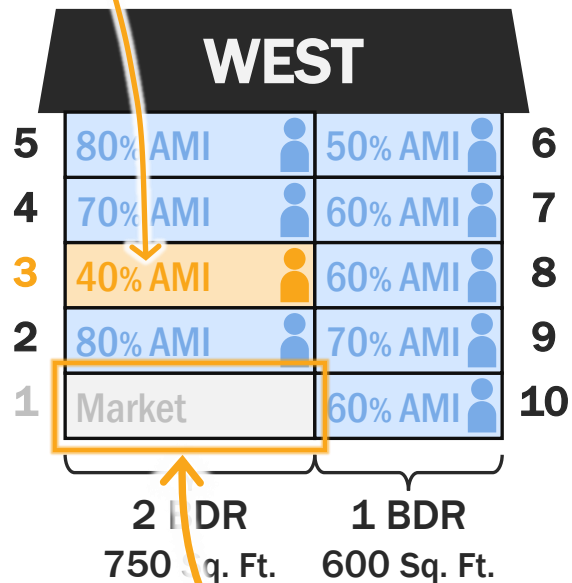
Floor Space Fraction

$$\frac{6,150 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 91.11\%$$

Unit Fraction

$$\frac{9}{10} = 90.00\%$$

>140% x 60% AMI



Floor Space Fraction

$$\frac{6,000 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 88.89\%$$

Unit Fraction

$$\frac{9}{10} = 90.00\%$$

Floor Space Fraction

$$\frac{6,150 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 91.11\%$$

Unit Fraction

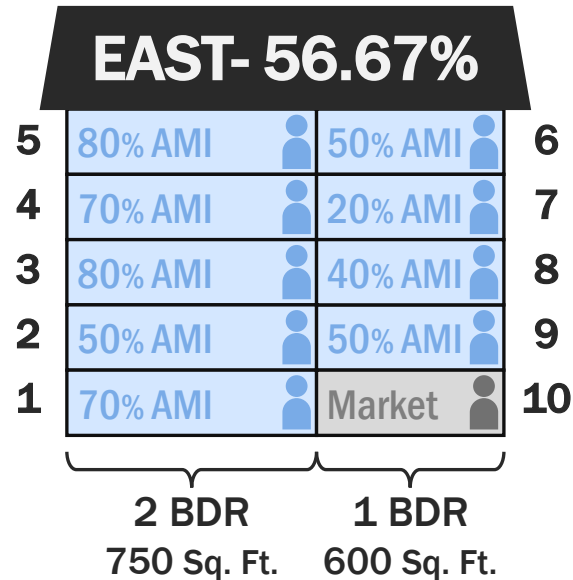
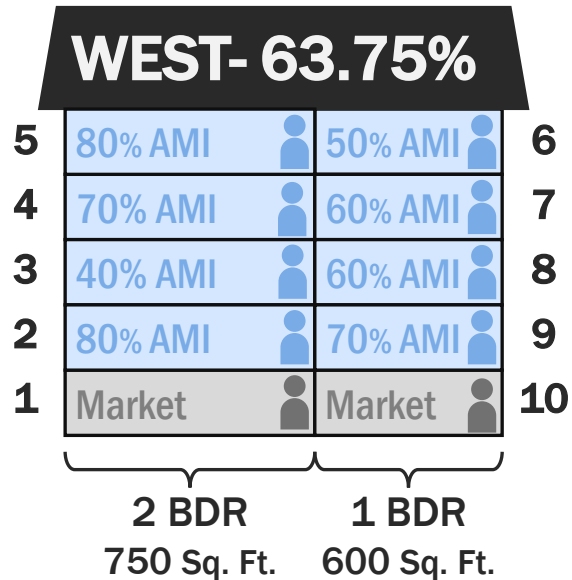
$$\frac{9}{10} = 90.00\%$$

Scenario #3

- Assume Unit 1 of the West Building is vacant when the 40% AMI household in Unit 3 is recertified as being Over Income...
- Assume Unit 1 is then leased to a non-LIHTC-qualified household, which is a violation of the NAUR causing Over-Income Unit 3 to no longer be LIHTC qualified.
- The loss of Unit 3 causes the West Building to have an applicable fraction of 77.78%.
- The average designation of the remaining 17 qualified LIHTC units in the project now EXCEEDS 60%.

Options for Unit 1 designation:

Designation	Project Avg. (w/ #3)	Project Avg. (w/o #3)
40% AMI	58.95%	60.00%
50% AMI	59.47%	60.56%
60% AMI	60.00%	61.11%



Floor Space Fraction

$$\frac{5,400 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 80.00\%$$

Unit Fraction

$$\frac{8}{10} = 80.00\%$$

Floor Space Fraction

$$\frac{6,150 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 91.11\%$$

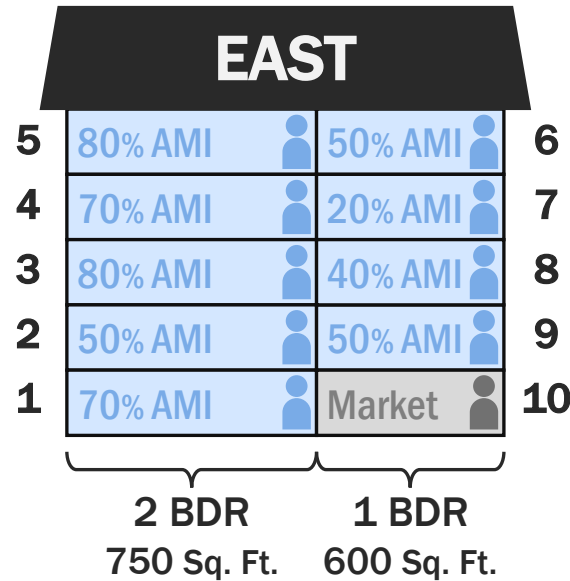
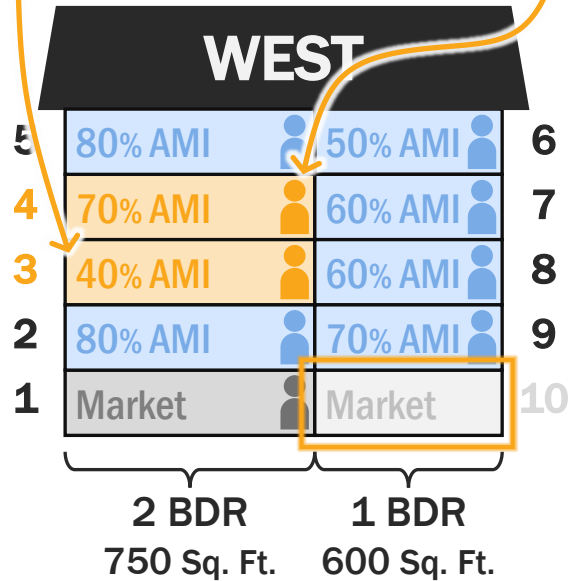
Unit Fraction

$$\frac{9}{10} = 90.00\%$$

Case Study #2

- A mixed-income, multibuilding LIHTC project is comprised of two 10-unit buildings of equal size—the East Building and the West Building. Each building has 5 one-bedroom units and 5 two-bedroom units
- The project is operating under the Average Income minimum set-aside.
- The average of imputed income limits of the designated units between the two buildings is 60% of Area Median Income (AMI), which means all restricted units are part of the **qualified group of units** to claim credits.
- The **applicable fraction** for the West Building is **80.00%** (both fractions are equal) and the applicable fraction for East Building is **90.00%** (lower unit fraction).

>140% x 60% AMI >140% x 70% AMI



Floor Space Fraction

$$\frac{5,400 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 80.00\%$$

Unit Fraction

$$\frac{8}{10} = 80.00\%$$

Floor Space Fraction

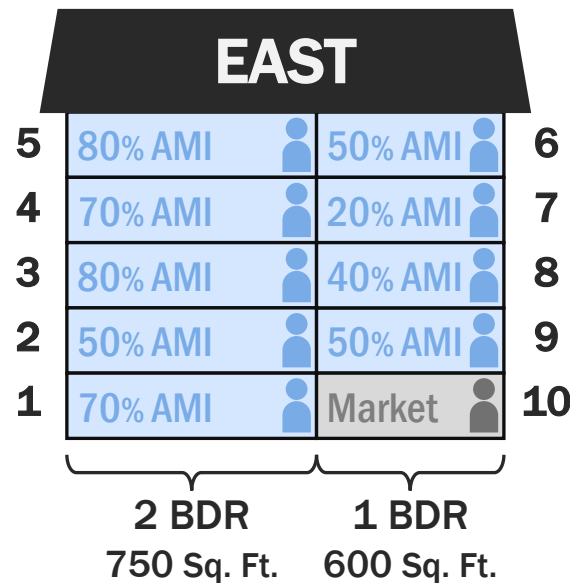
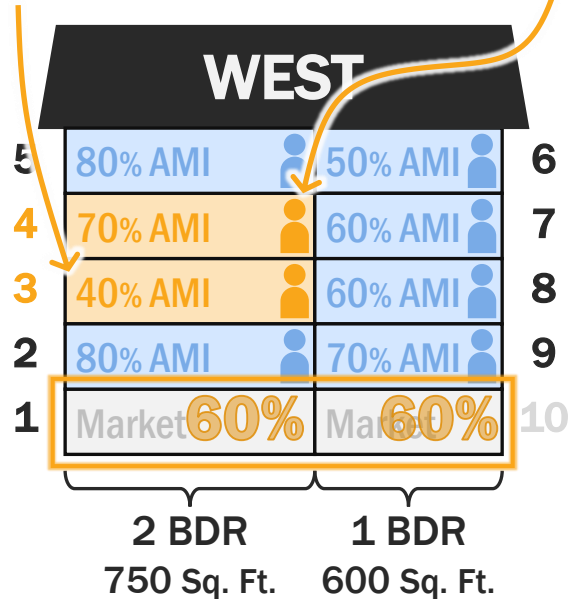
$$\frac{6,150 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 91.11\%$$

Unit Fraction

$$\frac{9}{10} = 90.00\%$$

- Assume the designations of all LIHTC units in the project average 60% of AMI.
- The 70% AMI household in Unit 4 is recertified as being Over Income and then the 40% AMI household in Unit 3 is recertified as being Over Income a after Unit 4.
- Assume that market-rate Unit 10 then becomes vacant.
- According to Treas. Reg. 1.42-19 and IRC §42(g)(1)(C), Unit 10 cannot have an imputed income designation that would cause the average of the income limit designations to exceed 60% of AMI at any time.

>140% x 60% AMI >140% x 70% AMI



Floor Space Fraction

$$\frac{5,400 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 88.89\%$$

Unit Fraction

$$\frac{8}{10} = 90.00\%$$

Floor Space Fraction

$$\frac{6,150 \text{ sq. ft.}}{6,750 \text{ sq. ft.}} = 91.11\%$$

Unit Fraction

$$\frac{9}{10} = 90.00\%$$

How do we comply with the NAUR?

- Designate Unit 10 at 60%; keep Units 3 and 4 as low-income at their respective designations
- When Unit 1 becomes vacant, designate at 60%; keep Units 3 and 4 as low-income at their respective designations
- Once Units 1 and 10 are occupied, **cannot** convert Units 3 or 4 to Market because would not have enough low-income square footage to meet the buildings applicable fraction excluding ALL over-income units

Once Units 3 or 4 are occupied by income eligible households at the original unit's designation could...

- Can convert Unit 7, 8, 9 or 10 to Market
- Can convert Units 1, 2, 4 or 5 to Market

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Stephanie Naquin is a principal and director of multifamily property compliance with Novogradac, based in the Austin, Texas, office. Her work includes consulting with state agencies, equity providers, lenders, attorneys, developers and on-site staff on topics related to multifamily compliance of Internal Revenue Code (IRC) Section 42, IRC Section 142, the HOME program, National Housing Trust Fund, U.S. Department of Housing and Urban Development multifamily programs and other locally administrated affordable housing programs, with a focus on holistic compliance. Her team is responsible for reviewing thousands of tenant files annually for compliance across the country. Naquin frequently presents to statewide and national audiences. She also presents the Novogradac Property Compliance Workshop, develops educational/training material and writes for various publications, including a regular compliance article in the Novogradac Journal of Tax Credits. Naquin was previously the director of multifamily compliance with the Texas Department of Housing and Community Affairs, where her team oversaw all aspects of compliance monitoring, physical inspection and compliance administration. Naquin began her career as a leasing agent with an owner-managed affordable housing organization, where she held various positions. Her experience in both the private and regulatory sectors of the industry allows her to synthesize complicated federal and state regulations and present that information in a concise and easily digestible manner. Naquin serves on the Texas Affiliation of Affordable Housing Providers Governing Board and is the co-chair of their compliance committee. Her certifications include the National Center for Housing Management Certified Occupancy Specialist, the National Association of Home Builders Housing Credit Certified Professional and the Novogradac Property Compliance Certification.

Re Designating Units

- Units are *designated* prior to initial occupancy
 - Recorded in owner's books and records
 - Communicated to state Agency [NOT "approved"]
- Units are *redesignated* prior to re-occupancy (or sometimes during occupancy)
 - Recorded in owner's books and records
 - Communicated to state Agency [also NOT "approved"]

Reasons

1. IRS Bulletin
2. State policies [**STRONG suggestion: for other programs**]
3. To enhance protection of other laws (FHA, VAWA, 504, etc)
4. As households transfer
5. To address noncompliance

Re Designating Units

Treas. Reg. 1.42-19T

If a problem is discovered in a later year with the designations, the regulation allows for correction and communication of the corrected designations to the state Agency if the correction is done within 180 days of the discovery of the issue by the owner or the state Agency.

Note: This is on a case-by-case basis, so state Agency policy will be important here.

This inconsistently leaves the burden of approving crucial retroactive adjustments up to state agencies, while leaving it with the owners during and shortly after a taxable year.

Re Designating Units

Example: How the Hoosiers handle it [\[RHTC Compliance Manual 2024 p 31\]](#)

IHCDA will work with owners to allow reasonable corrections to restore compliance with average income requirements. Such corrections may include redesignating units or adding or removing units from the qualifying group of units.

- If an issue is discovered and corrected within the taxable year that the problem occurs, the owner will be allowed to correct the issue to ensure that there is a qualifying group of units and that the Minimum Set-aside test is met by the end of the taxable year.
- If an issue is not discovered and corrected within the taxable year that the problem occurs, any retroactive correction to designations must be made within 180 days of discovery of an issue by the owner agent or IHCDA. If discovered by the owner, the issue and suggested correction must be promptly communicated to IHCDA to benefit from this correction period.

Supplemental Information

To address this more completely, suggested adjustments to the temporary regulations have been made:

[As per letters to the IRS from the Novogradac LIHTC Working Group, NCSHA, Costello Compliance, and Dominion]

Item 1 would allow retroactive redesignation without requiring burdensome case-by-case analysis by the state agency. This would apply the same process to retroactive recertifications as is applied to a taxable year.

Item 2 would make reporting one group of qualified units sufficient.

1.

(c)(4) **Waiver for failure to comply with procedural requirements.** Any failure to comply with the requirements of paragraph (c)(1) or (2) or (c)(3)(iv) of this section is treated as having been satisfied if up to 180 days after discovery of the failure, whether by taxpayer or Agency, a taxpayer submits a corrected qualified group of units, or the Agency waives in writing any failure to comply. If a taxpayer submits a corrected qualified group of units or an Agency exercises the discretion to waive, then the relevant requirements are treated as having been satisfied. In such a case, the tax consequences under this section correspond to that deemed satisfaction. In all cases, the 180-day period does not commence until the close of the correction period described in Treas. Reg 1.42-5 (e)(4).

2.

(c)(1)(ii)

(C) The requirement of paragraph (c)(1)(i)(A) will be considered met if the qualified group of units under (c)(1)(i)(B) is at least 40% of the units in the project.