

# COMPLIANCE & MONITORING AFTER YEAR 15

## Background

IRC Section 1.42-5 contains the regulations for agencies' compliance monitoring during the Compliance Period, however, the regulations do not require agencies to monitor according to these regulations in the Extended Use Period. IRS officials and other experts have indicated verbally that agencies may not report noncompliance to IRS after the Compliance Period is over. The tax benefit to the owner is exhausted and IRS can no longer recapture or disallow credits. Therefore, MFA must establish policy regarding how properties are to be monitored and consequences for noncompliance during the Extended Use Period.

In addition, based on the requirements of the Extended Use Period specified in IRC Section 42 regulations and in Land Use Restriction Agreement referenced below, the agency has the authority to establish different criteria for eligible/ineligible student households, available unit rule, unit transfers, and the process for performing annual recertifications during the Extended Use Period, as long as income and rent restrictions, general use requirements (fair housing), Section 8 acceptance, minimum set-aside, applicable fraction, other commitments made to obtain the tax credit allocation, and initial and annual recertifications are required.

## A. Compliance Period

Under Internal Revenue Code (IRC) Section 42(j)(1) the Compliance Period means, with respect to any building the period of 15 taxable years, beginning with the first taxable year of the credit period.

The first year of the Compliance Period is the first year in which the owner claimed credits. The first year must be either the year the building(s) are placed in service, or at the owner's election the year following placed in service. All requirements of IRC Section 42 including the 1.42-5 monitoring regulations are in effect during the 15-year Compliance Period.

## B. Extended Use Period

IRC Section 42(h)(6) establishes that buildings are eligible for the credit only if there is a minimum long-term commitment to low-income housing. Specifically, in order to receive a credit allocation in 1990 and later, the owner must record an extended low-income housing commitment. The document that evidences this commitment is called the Land Use Restriction Agreement for Housing Tax Credits. The LURA is recorded with the respective County Recorder, Registrar of Titles, Tribal Government, and/or Bureau of Indian Affairs and "runs with the land," regardless of subsequent changes in ownership.

1. For purposes of this section, the term “Extended Use Period” means the period:
  - a) beginning on the last day in the Compliance Period on which such building is part of a qualified low-income housing project, and
  - b) ending on the later of—
    - i. the date specified by the agency in the LURA, or
    - ii. the date which is 15 years after the close of the Compliance Period

IRC Section 42(h)(6)(E) provides exceptions to the Extended Use Period in the case of a legitimate foreclosure or deed in lieu or, for projects that have not waived this right, if the agency is unable to present a qualified contract pursuant to IRC Section 42(h)(6)(F). This document does not contain guidance for the provisions of IRC 42(h)(6)(F) regarding the qualified contract referenced in IRC Section 42(h)(6)(E)(i)(II).

2. Under IRC Section 42(h)(6)(E)(ii) the termination of an Extended Use Period due to foreclosure or deed in lieu, or for failure to present a qualified contract shall not be construed to permit before the close of the 3-year period following such termination:
  - a) the eviction or the termination of tenancy (other than for good cause) of an existing tenant of any low-income unit, or
  - b) any increase in the gross rent with respect to such unit not otherwise permitted by the applicable rent limits.
3. Under the MFA Land Use Restriction Agreement for Housing Tax Credits the owner agrees to comply with the following for the term of the agreement:
  - a) it will maintain the applicable fraction by leasing units to individuals or families whose incomes are those as prescribed by the LURA, as irrevocably elected by the owner at the time of allocation, or less of the area median gross income (including adjustments for family size) as determined in accordance with IRC Section 42;
  - b) it will maintain the Section 42 rent and income restrictions;
  - c) all units subject to the credit shall be leased and rented or made available to members of the general public who qualify as low-income tenants (or otherwise qualify for occupancy of the low-income units) under the applicable election specified in IRC Section 42(g) (Section 42(g) pertains to the minimum set-aside election);
  - d) the owner agrees to comply fully with the requirements of the Fair Housing Act as it may from time to time be amended;
  - e) the owner will not refuse to lease a unit to the holder of a Section 8 voucher because of the status of the prospective tenant as such a holder;
  - f) each low income unit will remain suitable for occupancy;
  - g) the determination of whether a tenant meets the low-income requirement shall be made by the owner at least annually on the basis of the current income of such low-income tenant ; and
  - h) other restrictions as required under the specific year’s Qualified Allocation Plan (QAP) and related points the owner received in order to obtain a credit allocation. These restrictions are property-specific within the respective LURA and to the extent

they are not otherwise time-limited, the additional restrictions remain in force and effect during the Extended Use Period.

Note that the LURA may have changed from year-to-year according to the respective Qualified Allocation Plans. However, the basic language pertaining to the Extended Use Period required by IRC has not materially changed.

### **C. Tenant Eligibility Criteria during the Extended Use Period**

During the Extended Use Period, MFA requires tenant eligibility and certification of income, as follows:

1. **Tenant Income Certification.** The initial income certification is required (calculated in a manner consistent with the determination of annual income under section 8 of the United States Housing Act of 1937 ("Section 8"), not in accordance with the determination of gross income for federal income tax liability). However, owners are no longer required to verify income and income from assets at annual recertification. Mixed-income tax credit properties, to the extent there is not some other financing or rental subsidy program such as Section 8 or Rural Development, are not required to verify income and income from assets at recertification. An annual self-certification by the tenant household is required in order to satisfy the annual certification requirement. MFA waives the recertification requirement altogether for 100% Tax Credit properties since even an annual statement of income, assets and household composition no longer serves a meaningful purpose
2. **Student Status.** Since student status is not one of the defined requirements of the LURA, the student rules under IRC Section 42 are no longer applicable.
3. **Unit Transfers.** Unit transfers from building to building are allowed without triggering noncompliance regardless of whether a household's income is over the applicable limit at the time of transfer.
4. **Available Unit Rule.** The available unit rule is revised to provide that if a household's income goes over 140% of the applicable income limit, a currently vacant unit or the next unit in the same building must be rented to a qualifying household (the "comparable or smaller" requirement no longer applies). This is essentially a one-for-one unit replacement.
5. **Applicable Fraction.** Only the unit fraction will be examined to determine a building's applicable fraction.
6. **Rent Limits.** Rent limits as elected by the owner at the time of allocation continue to be in force during the Extended Use Period. Owners of properties that were awarded selection points for additional rent restrictions should refer to the respective Qualified Allocation Plan or LURA to determine whether those additional rent restrictions are time-limited or if they are in effect for the full term of the Extended Use Period.
7. **Utility Allowances.** Utility Allowances must continue to be updated annually. Revised utility allowances must be implemented within 90 days of their published effective date.

MFA will continue to update the Housing Tax Credit Program income and rent limits based on the Section 8 income limits published by HUD annually.

#### **D. Monitoring Compliance during the Extended Use Period**

The following is the monitoring procedure MFA will follow during the Extended Use Period:

1. **Annual Certification.** By February 15, or the next business day, MFA will require all owners to submit an annual certification of compliance. The Owner's Certification of Compliance during the Extended Use Period, contains agency-defined certification language pursuant to the terms of the LURA.
2. **Annual Reporting.** The Tax Credit Summary Report must be submitted to MFA annually along with the tenant certifications on MFA's online system. Financials must also be sent. Owners are not required to report on student status.
3. **Inspections.** Every five years, MFA will perform a physical inspection of the property and review of tenant files and other pertinent documentation. The first review in the Extended Use Period will be five years from the last inspection conducted during the Compliance Period. A minimum of 3 low-income units chosen at random, or maximum of 10% of the low-income units not to exceed 15 units in any development will be inspected. If the first 3 units pass inspection, then no additional units need to be inspected. Different units may be chosen for the file review as those receiving a physical inspection. MFA Tax Credit compliance staff will continue to work with other inspection entities such as local inspection officials, other government agencies, MFA staff etc., to share inspection information. Also, we will accept HRA HQS inspections done in the same year as our review. If inspected by MFA Tax Credit Compliance staff, inspection will be pursuant to Uniform Physical Conditions Standards. MFA reserves the right to conduct a review of any building after serving appropriate notice and to examine all records pertaining to rental of tax credit units. MFA may perform a review at least through the end of the Extended Use Period of the buildings in the project.
4. **Annual Monitoring Fees.** The amount of annual compliance monitoring fees is \$15 per unit since inspections are less frequent and are done on a smaller number of units. The agency reserves the right to adjust the fee due to changing circumstances. Fees are due at the same time as the Annual Certification and Summary Report.
5. **Properties with HUD or Rural Development.** No Housing Tax Credit inspections or fees will be required for properties with project-based Section 8, Rural Development or other HUD programs since these properties are already subject to inspections and consequences under those programs are in place. Owners will be required to submit the Owner's Certification of Compliance During the Extended Use Period, and an Owner's Certification of Continued Monitoring of Federal Program, indicating whether or not the property is subject to monitoring for such federal programs and identifying the date of the most recent inspection review. These certifications and report are due on January 31<sup>st</sup> or the next business day. If a property is no longer subject to monitoring for HUD and/or Rural Development programs, then the property must be placed back on the Housing Tax Credit monitoring schedule. If the development is placed back on the Housing Tax Credit monitoring schedule, MFA will resume all compliance monitoring activities, including charging a fee for

monitoring. The timing of the next review will be based on the last inspection conducted by Rural Development, HUD or its Contract Administrator.

6. Transfer of Ownership or Ownership Interest. A transfer agreement is required in the event of a transfer of ownership or ownership interest. Such transfer agreement will put the new owner or partner on notice that it is subject to the terms of the LURA including all compliance restrictions and annual compliance monitoring. Documentation of signatory authorization for the new owner or partner may be requested. Owners contemplating transfers of ownership or ownership interest should notify MFA and request a copy of the appropriate transfer agreement.
7. Expiration or Termination of Extended Use Period. During the 3-year period after the LURA has expired or terminated pursuant to IRC Section 42(h)(6)(E)(ii), owners are required to annually submit the Owners report listing all low-income households that occupied a unit at the end of the term of the LURA the respective tenant-paid rent, utility allowance, and move-out date, if applicable, along with a certification that no low-income residents have been evicted or displaced for other than good cause. This report and certification will be due on January 31 or the next business day. No monitoring fees will be due during this 3-year period and MFA is not required to perform inspections.

#### **E. Consequences of Noncompliance during the Extended Use Period**

The following are the procedures for and consequence(s) of noncompliance:

1. All properties whose Compliance Period has expired and are subject to the requirements of the Extended Use Period will be listed on MFA's web site categorized in either "Good Standing" or "Not in Good Standing".
2. If an owner fails to comply with the monitoring requirements and/or terms of the LURA, MFA will issue a Notice of Noncompliance and recommendations for correction similar to what is issued during the Compliance Period. All owners will be given a period of time not to exceed 90 days with which to clarify or correct noncompliance and report to MFA that all corrections have been made. An extension of an additional 90 days may be granted, with good cause. If a property has one or more compliance violations, but the owner is making a good faith effort to correct within a reasonable time then the property can be considered in Good Standing. If the violation(s) cannot be corrected within the 90-day correction period (or within the 90-day extension, if granted) MFA may request that the owner and/or management agent formulate a plan and reasonable timeline to bring the violation(s) back into compliance and advise MFA in writing of such a plan. Owners will have demonstrated good faith efforts by carrying out the plan within the referenced timeline and the property will remain in Good Standing.
3. If an owner repeatedly delays requests for monitoring reviews, fails to submit annual certifications, reports and compliance monitoring fees, does not correct violations timely or according to the agreed-upon plan, where applicable, or otherwise chooses to ignore the compliance and monitoring requirements (serious and/or flagrant noncompliance) the following are consequences:

- a. The owner & management company are considered to be Not in Good Standing and MFA's web site will be updated to reflect the change in status.
- b. A Report of Development Not in Good Standing, will be issued for such serious and/or flagrant noncompliance. This report will be sent to the owner and filed with the MFA Development team. MFA may withhold providing or awarding any funds or tax credits awards to the owner, its partners and/or proposed developments to be managed by the management company until the property is back in Good Standing. Once good faith efforts are demonstrated to the agency's satisfaction, the agency will reinstate the property, owner and management company in Good Standing and update the web site to reflect the change in status.
- c. The agency and any interested party have the right to enforce specific performance of the LURA through the court system.  
Important: Owners and management agents must keep careful track of when a development, and in some cases certain buildings within a development, transition from the Compliance Period into the Extended Use Period. Premature implementation of the Extended Use Period compliance and monitoring guidelines may result in noncompliance with IRC Section 42 for which MFA would be required to file IRS form 8823.

MFA reserves the right to modify this "Year 15 Plan" including but not limited to the foregoing policy and procedure for compliance and monitoring during the Extended Use Period, as needed.