

Average Income Test Policy

The Consolidated Appropriations Act of 2018 (the Act) established the average income test as a third minimum set-aside election for low-income housing tax credit developments. The IRS and Treasury released final and temporary regulations on the Low-Income Housing Tax Credit average income test ([26 CFR §1.42-19](#)) on October 7, 2022. This regulation is now in effect. It allows developments to serve households with income as high as 80% of the Area Median Income (AMI) as long as the average imputed income designations of the qualified group of units is at or below 60% of AMI.

A. Federal requirements:

Under Internal Revenue Code (IRC) Section 42(g)(1)(C)(ii)(I) owners designate the imputed income and rent limitation of each unit.

1. A project meets the average income minimum set-aside when at least 40% of rental units in the project are rent restricted, occupied by individuals and part of a qualified group of units whose average imputed income limitation at initial occupancy is at or below 60% of the AMI at the end of the first year of the credit period. The minimum set-aside must be met at the end of each taxable year thereafter during the compliance and extended use period.
2. Units may be set-aside at an income and rent level of up to 80% AMI, as long as the average imputed income for the designated group is at or below 60% AMI.
3. There are 7 designated imputed income levels: 20%, 30%, 40%, 50%, 60%, 70%, and/or 80% of AMI.
4. The 30% AMI level under the Housing Credit is not the same as the Extremely Low-Income (ELI) restriction under the National Housing Trust Fund. Owners of properties with both sources should be mindful of the difference.
5. Once a particular set-aside test approach is elected for a project, the election is irrevocable and must be maintained for the duration of the 15 year compliance period and the subsequent extended use period. On the 8609 form, the owner irrevocably elects the minimum set-aside on a project wide basis.
6. The owner must identify (1) the units in the qualified group of units that satisfy the average income test (at least 40 percent of total units) and (2) the units in the qualified group for purposes of the applicable fraction (all low-income units in the property on which eligible basis is based for purposes of receiving credits).
7. Record keeping and reporting is required to be completed during Development and after Lease Up and annually thereafter. The Average Income Set-Aside Unit [Mapping Report](#) must be submitted with the annual required reporting for the LIHTC Program.
8. The following circumstances allow for changes to the designated imputed income limitations:
 - Federally permitted changes
 - VHFA permitted changes
 - Certain laws including:
 - Americans with Disabilities Act of 1990
 - Fair Housing Amendments Act of 1988
 - Violence Against Women Act of 1994
 - Rehabilitation Act of 1973
 - Any other State, Federal, or local law or program that protects tenants
 - Tenant movement
 - Restoring compliance with average income test requirements
9. A project (as defined by Form 8609 Line 8b) that has elected an “Average Income” Minimum Set-Aside Election may serve households up to 80% of area median income, as long as (1) at least 40% of the total units in the project are income and rent restricted tax credit units and (2) the average income test in the project must remain at or below 60% AMI for each year of the compliance/extended use period. Possible income and rent limit options under average income test include 20%, 30%, 40%, 50%, 60%, 70%, and 80%

AMI designations. A project is not required to have units designated at each of these various limits, so long as the average is at or below 60% AMI.

10. The owner must elect to designate a certain number of units at the various income and rent limits in order to demonstrate that the unit mix will result in a project-wide average income limit of 60% AMI or less. **The average is calculated based on the AMI level assigned to the unit, not on the actual income of the household residing in the unit.**
 - **Example:**
If a unit is designated as a 60% AMI unit and the household moving into the unit is at 54% AMI, for purposes of calculating the average this unit is considered as 60%.
11. The income and rent restriction for a unit must match. For example, a unit considered 40% AMI must be rented to a household at or below the 40% AMI income limit and gross rent must be at or below the 40% AMI rent limit.
12. A 100% tax credit project that has elected average income set-aside is exempt from annual recertifications.
13. At recertification for projects with less than 100% tax credit units, where a household's income has increased at time of recertification, VHFA will continue to use the AMI level the household initially qualified under at time of move-in to calculate the average income of the project, as long as the unit remains restricted at that rent level.
 - **Example:**
A household had income at move-in under the 40% income limit and was treated as a 40% household with a 40% rent restriction. At recertification, the household income now exceeds 40% AMI. As long as the unit continues to be rent restricted at the 40% rent limit, VHFA will continue to consider this a 40% unit for purposes of calculating the average income.
14. Average income projects may include market rate units. At least 40% of the units in the project must be tax credit units. Any market rate units are excluded from the calculation for purposes of determining the average.
 - **Example 1: A compliant 100% LIHTC project:**
A project consists of 10 units. 2 units are designated at 40% AMI, 2 at 50%, 2 at 60%, 2 at 70% and 2 at 80%. The average is calculated by taking the sum of all income/rent restrictions divided by the total number of tax credit units. $(40+40+50+50+60+60+70+70+80+80) / 10$ tax credit units = 60 average
 - **Example 2: A compliant Mixed Income LIHTC project with market rate units:**
A project consists of 10 units. 2 units are designated at 30% AMI, 2 at 40%, 2 at 60%, 2 at 80%, and 2 as market rate units. The average is calculated by taking the sum of all income/rent restrictions divided by the total number of tax credit units. $(30+30+40+40+60+60+80+80) / 8$ tax credit units = 52.5 average
 - **Example 3: Out of compliance 100% LIHTC Project due to failing the AIT:**
A project consists of 10 units. 4 units are designated at 50% AMI, 2 at 60%, and 4 at 80%. The average is calculated by taking the sum of all income/rent restrictions divided by the total number of tax credit units. $(50+50+50+50+60+60+80+80+80+80) / 10$ tax credit units = 64 average
 - **Example 4: Out of compliance Mixed Income LIHTC Project due to failing the AIT:**
A project consists of 10 units. 1 unit is designated at 40% AMI, 1 at 60% AMI, 1 at 80% AMI, and 7 as market rate units. While the average income for the tax credit units is calculated as 60%, the project still fails the Average Income Minimum Set-Aside because it fails to have at least 40% of the units in the project as tax credit qualified units.
15. Next Available Unit Rule:
A unit maintains its low-income status when a household's income increases above the AMI designation as long as the Next Available Unit Rule is followed. The Next Available Unit Rule is followed when:
 - the imputed income designations for 20%, 30%, 40%, 50%, 60% exceed 140% of the 60% AMI income designation, or
 - the imputed income designated for 70% and 80% exceed 140% of their respective imputed income designations; and
 - the next available unit of comparable or smaller size is occupied by a household whose income does not exceed the applicable imputed income designation for that unit in that qualified grouping.

Final regulations provide that if multiple units are over-income at the same time in a project and the project has a mix of low-income and market-rate units, then the units do not need to be re-rented in a specific order.

Renting any available comparable or smaller vacant units to qualified tenants maintains all over-income units' status as a low-income unit until the next comparable or smaller unit becomes available.

B. Minimum Set-Aside requirements:

1. The Minimum Set-Aside must be met on a project basis (project is defined by the election made by the owner on IRS Form 8609 Part II, Line 8b). Therefore, if each building is its own project, then the Minimum Set-Aside must be met at each building.
2. Once the election of the Minimum Set-Aside is made on IRS Form 8609, it is irrevocable. Thus, the elected Minimum Set-Aside and the corresponding rent and income restrictions apply for the duration of the Compliance Period and Extended Use Period applicable to the development.
3. Minimum Set-Aside Violations in the Initial Year; Credits cannot be claimed until the minimum set-aside has been met. Since the credit period must begin in either the year that a building is placed-in-service or the following year, the minimum set-aside must also be met by this deadline. If the minimum set-aside is not met by the deadline, no credits can ever be claimed. This is a non-correctable form of noncompliance.
4. If the minimum set-aside is violated in a subsequent year of the compliance period (not the initial year of the credit period), the project is out of compliance for that year and subject to recapture of previously claimed credits. Furthermore, no additional credits can be claimed until the minimum set-aside has been restored. The project is back in compliance for the taxable year in which the minimum set-aside is restored.
5. The minimum set-aside is violated if an insufficient number of units are qualified tax credit units. However, per the 8823 Guide (page 10-3), "noncompliance with the minimum set-aside should also be reported if systemic errors affecting all the LIHC units are identified; e.g. using incorrect income or rent limits for all the units."
6. The Applicable Fraction and the Minimum Set-Aside are not the same thing. The Applicable Fraction tells the percentage of units and floor space that must be reserved for qualified low-income households in a specific building. The Minimum Set-Aside tells the minimum percentage of units that must be set-aside as tax credit units in the entire project (as defined on Form 8609), and the federal income restriction at which these units must be set-aside (50%, 60% or Average Income). To be in compliance, a project must meet its Minimum Set-Aside, and each building within that project must meet its Applicable Fraction.

C. 8609 Part II Line 8b: Multiple Building Project Election:

1. Part II of the Form 8609 is completed by the owner with respect to the first year of the credit period. Under Part II Line 8b, the owner must answer the question "Are you treating this building as part of a multiple building project for purposes of Section 42?" If the owner elects "yes," then the building is part of a multiple building project along with other buildings in the development. The owner must attach to Form 8609 a listing of those buildings that are considered part of the multiple building project. If the owner fails to attach the listing to Form 8609 the IRS will consider the answer to Line 8b to be "no". If the owner elects "no," then each building in the development is considered its own project. This election has important compliance implications that affect the project for the duration of the compliance period.
2. The Minimum Set-Aside election must be met on a project basis. Therefore, if the owner has elected "yes" on Line 8b, then the building is part of a multiple building project and the Minimum Set-Aside must be met across the entire project. If the owner has elected "no" on Line 8b, then the building is considered its own project and the Minimum Set-Aside must be met within each building.
3. The Line 8b election also affects unit transfer rules. If the owner has elected "yes" to the multiple building project, then tenants may transfer between buildings within the project without having to recertify for the program, as long as the household is not above the 140% limit. If the owner has elected "no" to the multiple building project, then tenants may not transfer between buildings. If a household wants to move to another building it must be treated as a new move-in and re-qualified for the program based on current circumstances.
4. The Line 8b election impacts implementation of rent and income limits, specifically regarding the applicability of HERA special and hold-harmless limits (limits are project specific).
5. The Line 8b election impacts the 100% recertification exemption since this applies to a project per the 8609 definition. Because the Part II Line 8b election on Form 8609 is so important for ongoing compliance, it is

crucial that the owner and management agents have copies of the 8609s for each building and understand the elections that have been made.

D. VHFA adopted requirements of the average income set-aside election:

1. Developments awarded allocations of federal 9% credit on January 1st 2020 or later are eligible to apply for the Average Income election.
2. Existing tax credit properties that go through a resyndication, and have a recorded Housing Credit Housing Subsidy Covenant are not eligible.
3. VHFA will monitor the property for compliance annually and perform file reviews and physical inspection every three years.
4. VHFA reserves the right to charge an increased tax credit compliance monitoring fee for developments that elect to use the average income minimum set-aside.

C. 9% “Ceiling Credit” Applications:

The average income test election is available at the time of application.

D. 4% “Bond Credit” Applications:

The Act did not change IRC Section 142, which includes multifamily Housing Bonds. However, these properties may satisfy both the average income set-aside and one of the elections applicable to tax-exempt financing (20% at 50% or 40% at 60%). Units with incomes above 60% or 50%, as applicable, do not count for purposes of bond compliance.

This policy is subject to change at the discretion of the Vermont Housing Finance Agency. Compliance with Section 42 of the IRS and any policy, including future updates, implemented by the Vermont Housing Finance Agency, is the responsibility of the owner of a property.