

Chapter 14
Category 11i
Violations of the Available Unit Rule
Under Section 42(g)(2)(D)(ii)

Note

Effective July 31, 2008, owners of 100% low-income project are no longer required to complete the annual tenant income recertifications referenced in Treas. Reg. 1.42-5(b)(1)(vi). Until further guidance is provided through administrative ruling or regulation, the IRS will evaluate an owner's compliance with the Available Unit Rule as explained here.

Definition

This category is used to report violations of the Available Unit Rule (AUR)¹; i.e., situations where an *initially* qualified household's income subsequently rises above 140 percent (170 percent in deep rent skewed developments) of the current income limit and a household that is not income qualified moves into a unit of comparable or smaller size *in the low-income building.*

The Available Unit Rule under IRC §42(g)(2)(D) states that if the income of the occupants of a low-income unit increases above 140 percent of the income limit (or 170 percent in deep rent skewed developments), the unit will continue to be treated as a low-income unit if the occupants initially met the income limitation and the unit continues to be rent restricted. If the income of the occupants of the unit increases above 140 percent of the applicable income limitation, the unit will cease to qualify as a low-income unit if any residential rental unit in the building (of a size comparable to, or small than, such unit) is occupied by a *new* resident whose income exceeds the income limitation.

*Under IRC §142(d)(3)(A), as amended by the Housing Assistance Tax Act of 2008, owners are not required to complete annual income recertifications if the building is part of a 100% low-income project. For purposes of applying the Available Unit Rule *only*, all households documented as initially income-qualified households are treated as initially income-qualified as long as the owner *demonstrates due diligence*² when completing the initial income certification.*

**Compliance
on a
Continuing
Basis**

The determination of whether a tenant qualifies for purposes of the low-income set-aside is made on a continuing basis, both with respect to the tenant's income and the qualifying income for the location, rather than only on the date the tenant initially occupies the unit.³

¹ The terms Next Available Unit Rule (NAUR) and Available Unit Rule (AUR) are synonymous and can be used interchangeably.

² *Due diligence is discussed in chapter 3.*

³ H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-89 (1986), 1986-3 (Vol. 4) C.B. 89.

Changes in Area Median Gross Income	The determination of an over-income <i>*unit*</i> is not limited to instances where the household's income increases. A unit may also become over-income if, subsequent to the initial income qualification, there is a decrease in the Area Median Gross Income (AMGI). Likewise, an increase in AMGI increases the income limitation used to calculate whether an owner must rent any available residential unit of comparable or smaller size to a new low-income tenant. See Rev. Rul. 94-57 for additional information.
Treatment of Vacated Over-Income Units	If an over-income <i>*unit*</i> is vacated, <i>*</i> it will be treated as an over-income unit subject to the Available Unit Rule until the effective date of the tenant income certification for the new income-qualified household that moves into the unit or the unit is rented to a nonqualifying tenant.
Next Available Unit Defined	The "next available unit" is any vacant unit, or any unit that is subsequently vacated in the same building, of a comparable or smaller size. Treas. Reg. §1.42-15(c) states that a unit is not available when the unit is no longer available for rent due to contractual arrangements that are binding under local law.
Comparable or Smaller Unit	A comparable or smaller unit is defined in §1.42-15 as "a residential unit in a low-income building that is comparably sized or smaller than an over-income unit or, for deep rent skewed projects described in IRC §142(d)(4)(B), any low-income unit. For purposes of determining whether a residential unit is comparably sized, a comparable unit must be measured by the same method used to determine qualified basis for the credit year in which the comparable unit became available." Since a comparable unit may need to be identified before the end of the year when the qualified basis is determined, an owner may consider a residential unit with <i>*the same number of bedrooms (or fewer)*and *comparable* amenities</i> to be a comparable unit.
Summary	Key concepts of the Available Unit Rule include: <ol style="list-style-type: none"> 1. The Available Unit Rule is used to replace over-income <i>*units*</i> with new <i>*low-income units*</i> as available units are rented. Alternatively, over-income units may be returned to low-income status if the household's income decreases or the AMGI increases. 2. In a project containing more than one low-income building, the Available Unit Rule applies separately to each building. 3. Low-income units containing households whose income rises above 140% (or 170% for deep rent skewed projects) of the <i>current</i> income limit are still considered low-income units as long as the rent remains restricted and available units of comparable or smaller size are rented to qualified low-income households <i>*with restricted rents.*</i> 4. For purposes of determining whether a residential unit is comparably sized, a comparable unit must be measured by the same method used to determine qualified basis for the credit year in which the comparable unit became available. <i>*For example,*</i> an owner may consider a residential unit with <i>*the same number of bedrooms (or fewer)* and *comparable* amenities</i> to be a comparable unit. 5. The owner of a low-income building must rent all comparable units that are available or that subsequently become available in the same building <i>*as low-income units*</i> in order to continue treating the over-income unit as a low-income unit. Once the

percentage of low-income units in a building (excluding the over-income units) equals the percentage of low-income units on which the credit is based, failure to maintain the over-income units as low-income units has no immediate significance; *i.e., the over-income units can be converted to market-rate units.*

6. If any comparable or smaller unit that is available or that subsequently becomes available is rented to a nonqualified resident, all over-income units within the same building for which the available unit is comparable or *larger* lose their status as low-income units. See Treas. Reg. 1.42-15(f).
7. The Available Unit Rule should not be confused with the Vacant Unit Rule, which applies without regard to the income of existing tenants.

In Compliance

A building is in compliance when the current applicable fraction is at the applicable fraction on which credit is based. Units containing households whose incomes originally qualified, but currently exceed 140 percent (170 percent for deep rent skewed projects) of the current income limit are included in the applicable fraction as long as the rents for the units continue to be restricted.

Example 1: Change in Over-Income Units

A project consists of one building with 10 units of equal size. Units 1 through 8 are low-income units. Unit 9 is a market rate unit. Unit 10 is a vacant market rate unit. The applicable fraction for the credit is 80%. The current percentage of income-qualified tenants is 80% and the building is in compliance.

On July 1, 2000, the income of the tenants in units 6, 7 and 8 were determined to be over 140 percent of the income limit. The rents for these 3 units remained restricted. The current applicable fraction remains at 80% and the building continues to be in compliance.

To determine whether a noncompliance event could potentially occur, the owner calculated the applicable fraction without the over-income *units* as part of the numerator. This fraction is 50 percent (5/10). To remain in compliance, Unit 10 must be rented *as a low-income unit* to replace one of the over-income *units*. In addition, if the tenant in Unit 9 (the other market rate unit) vacates, that unit must also be rented *as a low-income unit*.

An income-qualified household moved into Unit 10, *at a restricted rent,* on August 1, 2000. At the time of the move in, the current applicable fraction (excluding all of the over-income units) has increased to 60 percent.

On August 31, 2000, Unit 9 *a market-rate unit, was* vacated and *an income-qualified* household moved into Unit 9 *at a rent restricted rate* on January 1, 2001. The applicable fraction (excluding all of the over-income units) increased to 70 percent.

On December 31, 2000, Unit 6, *an over-income unit, was* vacated and *an income-qualified* household moved on February 1, 2001, *at a rent-restricted rate*. The current fraction (excluding all of the over-income units) increased to 80%.

Because the current fraction excluding the over-income units meets the 80% applicable fraction for the building, the remaining over-income units, Units 7 and 8, may be rented at market rate (depending on the terms of the leases). Once the percentage of low-income units in the building (excluding the over-income units) equals the percentage of low-income units on which the credit is based, failure to maintain the over-income units as low-income units has no immediate significance.

Example 2: Lease Reservation Signed Prior to the Effective Date of a Unit Becoming an Over-Income Unit

A project consists of one building with 10 units of equal size. The project is currently "in compliance" with respect to the qualified basis. Unit 10 is a vacant market rate unit. A household *with income exceeding the limit* signs a lease on June 25, 2000, for unit 10 and intends to move in on July 5, 2000. The lease term is from July 5, 2000 to June 30, 2001. Unit 6 was an over-income *unit on* July 1, 2000. *Under local law, no other person may rent Unit 10 between June 25, 2000 and July 5, 2000.*

The building remains "in compliance" even though the *next* available unit was *occupied* after the *effective* date of the over-income unit because a unit is not available for purposes of the Available Unit Rule if the unit is unavailable due to contractual arrangements that are binding under local law. See Treas. Reg. §1.42-15(c).

Out of Compliance

Under Treas. Reg. §1.42-15(c), noncompliance occurs when a comparable or smaller unit than the over-income unit is rented to a nonqualified household when the current applicable fraction (excluding all over-income units from the numerator, but not the denominator) is less than the applicable fraction for which the credit is based. The date of a noncompliance event is the date the market *rate unit is occupied* or the reservation, if earlier.

Example 1: Moving In Nonqualified Household When Over-Income *Units* Have Not Been Replaced

A project consists of one building with ten units of equal size. Units 1 through 8 are low-income units. Unit 9 is a market rate unit. Unit 10 is a vacant market rate unit. The applicable fraction for the credit is 80 percent. The current applicable fraction is 80 percent and the building is presently in compliance.

Units 6 and 7 were determined to be over-income. The rents for these two units remain rent restricted. The current applicable fraction remains at 80%.

To determine whether a noncompliance event could potentially occur, the owner calculated the applicable fraction without the over-income *units* as part of the numerator. The applicable fraction is now 60 percent (6/10). To remain in compliance, Unit 10 must be rented to *an income-qualified* household *and the rents restricted* to replace one of the over-income *units*.

An income-qualified household moved into Unit 10 on August 1, 2000 *and paid market rate rents*. At the time of the move in, the current applicable fraction (excluding all of the over-income units) was 60 percent. The event triggered a *violation of the* Available Unit Rule. All the over-income units cease to be treated as low-income units. The date of noncompliance is August 1, 2000.

Example 2: Comparable Units

A mixed-use building, with an applicable fraction of 85 percent, contains 85 *low-income* units and 15 market rate units. Eleven of the low-income units are occupied by households with incomes that have increased above 140 percent of the income limit. The eleven over-income units consist of 4 three-bedroom, 5 two-bedroom, and 2 one-bedroom units. The next unit to be vacated is #99, a two-bedroom unit (not one of the eleven over-income units). The vacated unit is leased to a *nonqualified household at market rate rent.*

The building is out of compliance. To comply with the Available Unit Rule, the unit should have been leased to an *income-qualified* household *and the rents should have been restricted*. Because the unit was leased to a *nonqualifying* tenant, all over-income units, for which #99 was a comparable or *larger*-sized unit, lose their status as low-income units. Thus, all 4 of the three-bedroom and all 5 of the two-bedroom units of the over-income units are out of compliance. The 2 one-bedroom units (which are smaller than the rented unit) are not out of compliance (See Treas. Reg. §1.42-15(f).)

100% LIHC Projects: Owner Fails to Demonstrate Due Diligence

The Available Unit Rule is also violated when an owner of a 100% LIHC project fails to rent a unit to an income-qualified household *and* cannot demonstrate due diligence when completing the initial income certification. The rule is also violated if the owner deliberately rents a unit as a market-rate unit.⁴

Example 1: Owner of 100% LIHC Project Fails to Demonstrate Due Diligence

A state agency conducts a tenant file review for a 100% low-income project and determines that numerous errors were made when identifying source of income and completing third party verification as part of the initial income certifications after July 30, 2008. In some cases, certifications were not completed for months after the households moved in. The state agency reviewed the owner's due diligence and determined that the owner did not

⁴ *To avoid noncompliance, the owner must first determine which units are over-income units and apply the Available Unit Rule accordingly. Reducing the number of low-income units in a building will reduce the allowable credit and is a credit recapture event under IRC §42(j).*

provide sufficient oversight or due diligence.

Failure to provide sufficient due diligence results in disregard of the Available Unit Rule. (See Chapter 21.) The noncompliance date is the date of the earliest unacceptable initial income certification.

Other Non-Compliance Issues

Violations of the Available Unit Rule can also result in noncompliance with other IRC §42 requirements. Specifically, consideration should be given to the following:

1. Minimum Set-Aside Requirement – *as* a violation of the *Available Unit Rule* may result in multiple over-income units losing the low-income status, the minimum set-aside requirement may not be met; i.e., the number of qualifying units falls below the minimum requirement. See chapter 10.
2. Annual Income Recertifications *after July 30, 2008* - if the building is part of a 100% qualified low-income project, where the owner is not completing annual tenant income certifications under IRC §142(d)(3)(A),⁵ the IRS accepts, for purposes of the Available Unit Rule only, that households documented as initially income-qualified households are income-qualified. Failure to rent the next available unit as a rent-restricted unit reduces the low-income building's qualified basis to zero unless the owner can document which units are not over-income units. If the owner intends to convert from a 100% low-income project to a mixed-use project, the owner must first determine which units are over-income units and apply the Available Unit Rule as needed. Reducing the number of low-income units in a building is a credit recapture event under IRC §42(j).
3. Annual Income Recertification Waivers *before July 31, 2008* - if the *building* was a 100% low-income building* and the owner has a waiver of the annual income recertification under IRC §42(g)(8)(B), qualified low-income units in the building continued to be treated as qualified low-income units even if the owner was not completing annual tenant income certification or otherwise documenting that the units are not over-income. However if the building owner rented an available unit in the building to a nonqualified household, the owner was required to determine if any of the units in the building were over-income, despite having a recertification waiver in effect. Further, under Rev. Proc. 94-64 or Rev. Proc. 2004-38, renting a unit to a nonqualified household in a 100% LIHC building resulted in the revocation of the waiver. *The Annual Income Recertification Waiver was subsumed by the new exception under IRC §142(d)(3)(A) for 100% qualified low-income projects and are, therefore, no longer enforced.*
4. Annual Certification – the owner may have incorrectly reported compliance with the *Available Unit Rule* as part of the annual certification as described in Treas. Reg. §1.42-5(c). See chapter 7.

⁵ IRC §142(d)(3)(A) was amended by section 3010 of the Housing Assistance Act of 2008 and is effective for taxable years ending after July 30, 2008. IRC §142(d)(3)(A) is made applicable to IRC §42 low-income projects in IRC §42(g)(4).

Back in Compliance

Once the Available Unit Rule has been triggered, *the noncompliance can be corrected by* renting any combination of market rate units, over-income units, and out of compliance low-income units *as rent restricted units* to *income-qualified* households until the applicable fraction upon which the credit amount is based is restored. The applicable fraction can also be restored if:

1. The tenant's income decreases to an amount below 140 percent of the income limit in place, or
2. The AMGI increases to an amount, such that 140 percent of the income limit is more than the tenant's income.

The date of correction is the date the last household, which restores the applicable fraction, moves into the building or the income of an existing household falls below the current income limit.

References

1. IRC §42(g)(2)(D)(ii).
2. Treas. Reg. §1.42-5(c)(1)(x).
3. IRC §42(d)(3)(B).
4. Treas. Reg. §1.42-15.
5. Rev. Rul. 94-57, 1994-2 C.B. 5.
6. Rev. Rul. 2004-82, 2004-2 C.B. 350.