TAX CREDIT
HOUSING MANAGEMENT INSIDER

Free Sample Issue

How 'Deep Rent-Skewing' Affects Tax Credit Compliance

If you manage a site in a city where market-rate rents are high, there's a good chance that your site's owner decided to make the site "deep rent-skewed." When renting low-income units at a deep rent-skewed site, an owner must meet even tougher income restrictions than the site's minimum set-aside requires. But in return for these tougher restrictions, the owner won't ever have to make market-rate units available if a low-income household goes over-income.

If your site is deep rent-skewed, there are three key compliance differences that you'll need to be aware of, notes A.J. Johnson, president of A.J. Johnson Consulting Services, Inc. Deep rent-skewing affects:

1) How you qualify your site;
2) How much rent you charge; and
3) How you comply with the next available unit (NAU) rule.

We'll tell you what you need to know about each of these differences so you can keep the owner's tax credits safe.

Find Out Whether Owner Elected Deep Rent-Skewing

When you take over management of a tax credit site, look at Line 10d of the owner's IRS Form 8609 to find out if the owner elected to make your site deep rent-skewed. If the box labeled "15-40" is checked, then the owner made this election. This label refers to the deep rent-skewing set-aside. If this box isn't checked, then your site isn't deep rent-skewed.

Take Deep Rent-Skewing into Account During Three Tax Credit Compliance Activities

Here's a rundown of the three ways deep rent-skewing affects what you must do to maintain compliance with the tax credit program.

1) Qualifying your site. To qualify a site that's not deep rent-skewed for the tax credit program, you only need to make sure that the site meets its minimum set-aside. This means you must rent a certain number of units to households earning no more than a certain percentage of area median gross income (AMGI). For example, if your minimum set-aside is "20-50," you must rent at least 20 percent of your units to households earning 50 percent or less of AMGI. These units become the site's qualified low-income units.

To qualify a deep rent-skewed site, you must do more than just meet the minimum set-aside, says Johnson. You also need to make sure you meet the deep rent-skewed set-aside. This means you must rent 15 percent of your low-income units to households earning 40 percent or less of AMGI, he explains. And you must include all your low-income units in your calculation—even the ones that you don't need to meet the minimum set-aside, he adds. For example, say your minimum set-aside is "20-50," and you've rented exactly 20 percent of your units to qualified low-income households. This means you'll have to rent 3 percent of your units (15 percent of 20 percent) to households earning 40 percent or less of AMGI.

***Insider* Says:** The deadline for meeting the deep rent-skewing set-aside is the same as the deadline for meeting the minimum set-aside, Johnson notes. It's the end of either the placed-in-service year or the following year, depending on what the owner elected on its Form 8609, he adds.

If you meet the minimum set-aside but not the deep rent-skewing set-aside, your site won't qualify as deep rent-skewed, Johnson warns. If you meet the deep rent-skewing set-aside on time, but you don't maintain the set-aside during later years of the compliance period, your site will lose its deep rent-skewed status for those years, he adds.

***Insider* Says:** It's unclear whether the IRS would in this case treat your site as not being deep rent-skewed during all earlier years of the compliance period, notes Johnson. If the IRS does this, then the owner's tax credits could be subject to recapture, he warns. Why? Because you may have followed the NAU rule in a way that doesn't comply with the tax credit law for sites that aren't deep rent-skewed, he explains.

2) Charging the correct rents to low-income households. Deep rent-skewing places additional restrictions on how much rent you can charge your low-income households. The rule that applies depends on when your building was allocated credits, Johnson explains. But both versions of the rule apply to *all* your low-income units—not just to the 15 percent that are deep rent-skewed, he notes. In most cases, either version of the rule requires you to charge less than the maximum allowable rent if your market-rate rents are low relative to other areas of the country or your county's AMGI is high, Johnson points out.

▶ *Rule for buildings allocated credits before 1990.* If your building was allocated credits before 1990, the gross rent you charge for each low-income unit can't be more than *one-third* of the average gross rent for comparable market-rate units in your building. This means that if the maximum allowable rent exceeds one-third of the average gross rent of these comparable market-rate units, you'll have to charge less than the maximum, Johnson notes.

For example, say the average gross rent of your two-bedroom market-rate units is $1,000, and the maximum allowable rent for a two-bedroom low-income unit is $650. You would have to charge your low-income households a maximum of $333 (a third of $1,000)—not $650.

▶ *Rule for buildings allocated credits after 1989.* If your building was allocated credits after 1989, the gross rent you charge for each low-income unit can't be more than *one-half* of the average gross rent of comparable market-rate units in your building. This means that if the maximum allowable rent exceeds one-half of the average gross rent of comparable market-rate units, you'll have to charge less than the maximum, Johnson notes. So in the example above, you would have to charge the household a maximum of $500 (half of $1,000)—not $650.

***Insider* Says:** Remember that you can never charge more than the maximum allowable rent—even if it's less than one-third or one-half of the average gross rent of comparable market-rate units, says Johnson.

3) Complying with the NAU rule. If a low-income household goes over-income, you must comply with the NAU rule. But if your site is deep rent-skewed, you should be aware that the NAU rule is different in four key ways. Here's what you need to know.

▶ *The next available unit you rent must be the next-available low-income unit.* At a site that's not deep rent-skewed, the next available unit you rent to a qualified, low-income household may be either low-income or market-rate. But at a deep rent-skewed site, you have to rent only the next available *low-income* unit to a qualified low-income household. As a result, you're free to continue renting your market-rate units to market-rate households—which should bring the owner more revenue, Johnson points out.

▶ *The next available unit doesn't have to be of comparable size or smaller than the over-income unit.* At a site that's not deep rent-skewed, the next available unit you rent to a qualified low-income household must be of comparable size or smaller than the unit in which the over-income household lives. But at a deep rent-skewed site, the next available unit can be larger, Johnson notes. This makes it easier to comply with the NAU rule, Johnson notes.

▶ *A household's income must exceed 170 percent of AMGI for it to be over-income.* You must start to comply with the NAU rule whenever a low-income household goes over-income. At sites that aren't deep rent-skewed, a household is considered over-income if its income exceeds 140 percent of AMGI. But at a deep rent-skewed site, a household isn't considered over-income until its income exceeds 170 percent of AMGI. So if your site is deep rent-skewed, you're less likely to have to comply with the NAU rule in the first place, Johnson notes.

***Insider* Says:** The 170 percent threshold applies to *all* your low-income households—not just the 15 percent that are deep rent-skewed, Johnson points out.

▶ *When you rent the next available unit, it must be to a household earning 40 percent or less of AMGI.* At sites that aren't deep rent-skewed, you must rent your next available unit to a qualified low-income household. But at a deep rent-skewed site, you must always rent the next available unit to a household earning no more than 40 percent of AMGI—even if the over-income household wasn't living in one of your deep rent-skewed units. This means more than 15 percent of your low-income units will likely become deep rent-skewed as the compliance period progresses, Johnson notes.

***Insider* Says:** Keep in mind that if the over-income household wasn't living in one of your deep rent-skewed units, the rent you must charge the new household will be lower than the rent you charged the over-income household, cautions Johnson. That's because now that the unit is deep rent-skewed, you'll need to use the 40 percent income limit to calculate its rent, he explains.

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