

CALIFORNIA TAX CREDIT ALLOCATION COMMITTEE

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July 30, 2010

POLICY MEMO 10-01

TO: Low Income Housing Tax Credit Property Owners and Managers

FROM: The California Tax Credit Allocation Committee (CTCAC) Compliance Section

RE: New Policies and Program Requirements for 2010

Dear Housing Credit Participant:

The purpose of this memo is to notify you of new policy changes for year 2010 affecting California Tax Credit Allocation Committee's (CTCAC) Compliance Monitoring program.

All policies stated in Policy Memo 09-01 Dated March 9, 2009 continue to be in effect and can be found on our website at: www.treasurer.ca.gov/ctcac/compliance.asp

New Policies for 2010:

IRS Guidance on Over Charging Rents and Utility Allowances: Per the revised 8823 Guide (9/2009) - IRS is taking a hard line on overages of tenant paid rent at tax credit properties. If rent is over charged for any tax credit unit during a calendar year, the credit for that unit is disallowed for the entire year and will not commence again until the next calendar year. Consideration will not be given due to intent and there is no cure for this non-compliance.

Owners are highly cautioned on use of correct, appropriate and current utility allowances for projects and need to be extra careful of charging tenants for any "non-optional fees" as this could impact tax credits for the entire project. CTCAC is required to report an incident of noncompliance with rent overages, however it's up to the IRS if a recapture of credits will occur.

CTCAC's policy to request "rebates" to overcharged tenant paid rent will remain in effect as a requirement for owner to show correction of noncompliance. Please note, CTCAC policy to request only 4-months of rent ledgers for the 20% random selection of units during a monitoring visit will change. The policy going forward from the date of this memo, is to require the entire tenant rent history via rent ledgers at the time of the monitoring visit for each unit in

the 20% random selection as well as the current year of rent roll for the project with the pre-inspection materials. In addition, CTCAC may expand the random sample of files reviewed if a high level of noncompliance with rent overages is identified.

Sub Metering of Utilities: Per IRS Regulation § 1.4-10 (a) on utility allowances and further clarified in Notice 2009-44 – IRS states, “Utility costs paid by a tenant based on actual consumption in a sub-metered rent-restricted unit are treated as paid directly by the tenant, and not by or through the owner of the building. From the date of this memo going forward CTCAC will be requesting and inspecting the following documents at tax credit projects where utilities are sub-metered in order to verify tenant usage by comparison of master meter bill and individual tenant billing statements:

- Copy of master bill (4 months worth)
- Copies of tenant billing statements (4 months worth)
- Language in lease must identify units are sub-metered for certain utility costs
- Visual check of buildings or units to verify sub-metering location

Mass Recertification's: For 100% of tax credit properties, in 2009, CTCAC began requiring one full annual recertification. Problems were observed in projects with mass recertification schedules, thus the following procedure will now be required prior to households being switched to a mass recertification schedule. For each new move-in, the owner/management agent will be required to complete a 1st recertification on their move-in anniversary date. The household can then be moved to the Mass Recertification cycle for the property after the completion of the 1st recertification. **Example:**

- Year **one:** Household in unit #5 – initial move-in is **10/1/2009**, owner is required to complete full-income and asset certification via 3rd party documentation
- Year **two:** Household in unit # 5 – TCAC requires a complete full-income and asset recertification via 3rd party documentation at the 1st anniversary of move-in – **10/1/2010**
- Year **two+:** If project is on a mass recertification schedule of **June** each year - you may now add household in unit #5 to mass recertification in June 2011, or at any time after the completed 1st recertification

ARRA Funded Projects: On 2/17/2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (ARRA) – A stimulus bill to reinvigorate the nation's economy. CTCAC received more than \$800 Million dollars of ARRA funds and implemented two major funding programs within the tax credit program known as the ARRA program to help gap the financing of certain tax credit projects that needed financial assistance. As of the date of this memo 145 projects were financed with ARRA funds. The two types of ARRA funding are known as:

1. The Tax Credit Assistance Program (TCAP) - funding administered by Department of Housing Urban Development (HUD), and

2. Section 1602 Credit Exchange Funds administered by Department of Treasury

- Projects funded via these types of financing are considered regular tax credit projects and will be monitored with exactly the same protocols as existing tax credit portfolio. There will be no change in CTCAC monitoring requirements. All ARRA funded projects will have regulatory agreements stipulating affordability restrictions for the entire compliance period
- TCAP funded projects – noncompliance will be reported to IRS via Form 8823
- Projects with 1602 Exchange Funds –Recapture of grant/loan amounts by the Department of Treasury might occur, as well as negative points assessment from CTCAC to project owner and management company for failure to correct any noncompliance issues during the correction period
- In addition to regular compliance monitoring, ARRA funded projects will be subject to asset management reviews, the project owner will pay all asset management fees

File Noncompliance – Cash Payments: CTCAC is implementing a new policy requirement on tenant files where indication of annual income from wages is via cash payment. In many instances in 2008 and 2009, CTCAC saw a pattern of high incidents of lack of due-diligence in allowing initial move-ins based on single self-certification statements by tenants with no verifiable documentation in file. Beginning as of date of this memo CTCAC requirement for files with tenants indicating wages paid in cash, tenant file must contain the following:

- File must contain the most current tax return – The IRS considers a person paid by cash as an “independent contractor” who must file a tax return.
- If no filed tax return – management to follow procedure of completing IRS form 4506-T, to verify non-filing status. Copy of 4506-T in file must be the returned and the fully completed transmittal form from the IRS indicating filing or non-filing status.
- A blank but signed copy of Form 4506-T will not suffice.
- In addition to a copy of the most current filed tax return or completed Form 4506-T, the file must also contain a 3rd party statement from employer on company letterhead stating the employee’s job title, specific job duties, hourly, weekly or monthly wage payment in cash.

File Issue – The Work Number: Beginning in June 2010, the outside employment verification company “The Work Number” will no longer offer free verifications of employment for users of their program.

At ***initial move-in*** into a tax credit unit, CTCAC policy requires all tenant files must contain 3rd party verification for all wage earners in the form of a Verification of Employment (VOE) along ***3 months of consecutive pay-stubs***. Beginning in June 2010 forward, CTCAC will require that for all initial applicants whose wage earnings can only be verified via The Work Number,

the owner of the project may **pass** on the cost of the verification to the applicant. This will ensure there is a VOE and pay-stubs for all wage earners at initial move-in, in the tenant files as requested by CTCAC. The requirement to pass the cost for the VOE is only at initial move-in year. At first year anniversary move-in date during the CTCAC mandatory 1st recertification, the owner or their management agent no longer have to supply a VOE from The Work Number, as long as 3 months of consecutive pay-stubs are included in the file.

For projects layered with HUD financing and tax credits, and where the owner is prohibited from passing on the cost of a verification to the applicant, for the cost of The Work Number, the owner **must** pay for the cost to obtain The Work Number verification for the file and include the required 3 months of pay-stubs as well. This will be a one-time expense at initial move-in only, as you may revert to using only the 3 months of pay-stubs at the required 1st anniversary move-in date during the CTCAC mandatory 1st recertification.

Please note this policy is only for those files where obtaining The Work Number verification is an issue, for all other wage earners at initial move-in the file must contain a VOE form directly from the employer plus the required 3 months of consecutive pay-stubs.

Physical Inspections-Lock Outs: Units where management has no keys to some or all units randomly selected during a State Monitoring visit:

- Please note this is an automatic fail for the unit or units and considered a Level 3 UPCS Violation
- Automatic reporting of noncompliance issue on Form 8823
- Management will have to provide a written certification (not a work order) that key to unit or units have been obtained, certify the unit has been inspected and all systems are operational including smoke detectors, ingress/egress, etc.
- Once certification has been submitted to CTCAC – the noncompliance will be deemed as corrected
- CTCAC will begin reporting noncompliance on Form 8823 on **September 1st, 2010**
- As of the date of this memo, all corrected noncompliance with major physical issues noted in units, CTCAC will require the work order(s) have to be signed and dated by both the maintenance staff and the tenant

Vacant Units not in Habitable Condition: At the time of monitoring visit any vacant unit not in habitable condition (vacant more than **2** months) will automatically be reported as out of compliance with the following IRS regulations:

- Violation of Vacant Unit Rule
- Violation of UPCS standards
- Violation of the General Public Use Rule

Extended Use Projects: CTCAC is closely monitoring projects in our extended use portfolio and will be notifying owners in writing at the time our records show the project is exiting the 15-year federal compliance period.

- Owners will be required to continue to operate these projects in accordance with recorded regulatory agreement
- Income and rent restrictions, including deeper targeting continue to be met
- Units, buildings and common areas must be kept in good physical condition standards
- A 10% random selection of files and units will be reviewed, with the option to expand the review sample if problems are noted
- Projects in the extended use will be on a 5 year monitoring rotation, unless problems are observed with high noncompliance which could result in a yearly visit from CTCAC
- CTCAC will no longer view **K-12th** grade school children as “full-time students” for purposes of the full-time student rule in extended use projects
- Close monitoring of full-time student rule will still be in effect for student household comprised of all full-time students other than K-12th
- Negative points will be assessed to the ownership and management agent if issues of noncompliance are not corrected or rectified within the correction period

On our website: www.treasurer.ca.gov/ctcac/compliance.asp

- 2010 Compliance Monitoring list – *available now*
- 2010 Annual Owner Certification (AOC) package – *available now*
- 2009 Compliance Manual – *2010 revision posted in July*
- 2010 HUD Rent and Income Limits – *posted May 28, 2010*

Changes to stated policies or procedures on this memo will be changed or revised as the subject matter changes or CTCAC receives notification from IRS or HUD on any regulation changes or updates to the program. CTCAC looks forward to another successful year in our working relationships with owners and management agents. If you have any question regarding the policies or information noted you may contact the following staff:

Rose Guerrero, Chief, Compliance Section at: rquerrero@treasurer.ca.gov

Ammer Singh, Compliance Program Manager at: asingh@treasurer.ca.gov

Shannon Nardinelli, Compliance Program Manager at: snardinelli@treasurer.ca.gov

Or by phone at: **916-654-6340**