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The Credential



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■ IRS Regulation 1.42-10 Utility Allowance Regulation Change

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Many owners of Low Income Housing Tax Credit apartment communities are facing a multitude of hardships brought on by the economic downturn. In addition operating costs, including insurance premiums, deferred maintenance needs for aging portfolios and utility expenses continue to escalate. This has occurred while income and rent limits have remained stagnant or increased minimally, failing to keep pace with the rising operating expenses.

A major factor in preventing owners from increasing rents to keep up with increasing operating costs has been the limited methodologies IRS regulations allowed to compute utility allowances for tax credit properties. Previous methods used to calculate utility allowances were often based on averages obtained utilizing outdated public housing units which lacked energy efficient features. In many cases, using utility allowances that are actually higher than consumption has resulted in owners having to reduce tenant-paid rents. This results in critical budget shortages endangering the financial viability of developments.

Recognizing these issues and working with the affordable housing industry, the IRS revised IRS Regulation 1.42-10 effective July 29, 2008. The adjustments expanded options and provided owners with more flexibility in the way utility allowances are calculated. The updated regulation found in 26 CFR Part I allows new options which can be used to calculate utility allowances for buildings which are not subject to the HUD or RHS building or rental assistance rules. Note: the new 8823 Guide's Chapter 18 contains extensive information on the implementation of Regulation 1.42-10. Although we will provide highlights of the new utility allowance provisions in this article, all interested persons should read the Guide Chapter 18 for themselves.

Options which can be used to calculate utility allowances include:

- Public housing authority (PHA) utility allowance
- An estimate from the utility provider.
- Agency estimate from the agency that has jurisdiction over the building with any costs involved absorbed by the owner. This can be calculated by the agency, or by a contractor approved by the agency.
- HUD utility schedule model available on the HUD website at: <http://www.huduser.org/resources/utimodel.html>
- The final regulations also include a new option allowing building owners to retain the services of a qualified professional to calculate utility allowances based on an energy consumption model. The use of this option is subject to several special rules:
 - Use of the energy consumption model must, at a minimum, take into account specific factors including unit size, building orientation, design and materials, mechanical systems, appliances and characteristics of the building location.
 - The utility estimate must also be calculated by either a properly licensed engineer or a qualified professional approved by the Agency that has jurisdiction over the building. The qualified professional and building owner cannot be related as defined within the meaning of section IRC 267(b) or 707 (b).

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- The building owner must furnish a copy of the estimates obtained to the Agency and make copies of the estimates available to all residents in the building.
- All cost incurred in obtaining the utility estimates are incurred by the owner.

The change in regulations also addressed sub-metering. Originally the new regulation prohibited the inclusion in the utility allowance of any utility that was paid “by or through” the owner. This required owners that had properties with sub-metered utility systems to use the actual utility expense incurred by households each month and prevented the use of a standard utility allowance considering the costs to the household to be rent. Since sub metered bills vary each month, this would require that rents be based on actual consumption and recalculated each month or that owners absorb part of the costs of the households’ utility expense. This presented a problem, because sub-metering is part of an important effort to encourage conservation at multi-family projects. This reg had the unintended consequence of discouraging conservation at LIHTC properties.

On May 5, 2009 the IRS published Notice 2009-44 addressing the problem of sub-metering. It now permits the use of utility allowances for sub-metered units as long as the billing is based on actual expense to the household and is limited to utility company rates paid for the building. It is important to note that *ratio utility billing systems* (RUBS) are not based on each individual household’s actual use. Rather, costs are distributed throughout a building based on ratios. These systems are not considered “sub-metered,” and RUBS-generated utility costs would be considered part of monthly rent.

Another significant element of IRS Regulation 1.42-10 is that owners are not required to update utility allowances more than once annually. PHA-based allowances are subject to the rule requiring that new PHA allowances be implemented no more than 90 days after they are made available by the PHA. The IRS regulation also does not require that the effective date of any new utility allowance coincide with the effective date of HUD’s annual income limits. Finally, it’s notable that the adjusted regs allow for different methods to be used for different utilities, and that owners may switch between methods in future years.

According to Martha McBroom, manager of the utility allowance calculation department at Zeffert and Associates, Inc, the following states are among those who have adopted and are allowing the use of the at least one of the new estimate (“actual use”) methods or the “HUD Utility Schedule Model:” Arkansas, Arizona, Georgia, Illinois, Indiana, Louisiana, Mississippi, Nevada, North and South Carolina, Ohio, Oregon, Texas, Virginia and Washington.

Florida also allows an “actual use” method and according to Robin Grantham, Director of Asset Management and Guaranteed Program at FHFC, they will be putting out a Request for Proposal in early 2010 in order to provide a list of approved engineers which FHFC owners will be able to use to utilize the Energy Consumption Model outlined in the regulation.

With the emphasis on going green in many building industries, including the apartment industry, developers who come up with innovative ways to reduce utility costs for both the owner and the residents may be able to significantly reduce utility allowances utilizing one of the “actual use” or energy consumption models thereby increasing cash flow and viability of operating long term affordable housing communities.

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