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average income test compliance monitoring policy for housing tax credit developments

CHFA Asset Management

Effective October 1, 2025

This policy outlines Colorado Housing and Finance Authority's (CHFA's) Average Income Test Compliance Monitoring Policy (the "Policy") for Housing Tax Credit [HTC; also known as Low Income Housing Tax Credit (LIHTC)] projects that have elected the Average Income Test as the minimum set-aside test option. CHFA's policy is based on the applicable federal statute [IRC Section 42(g)(1)(C)], federal regulations (26 CFR Sections 1.42-15 and -19, as updated 09.30.2025), and various guidance published by the Internal Revenue Service. In addition to reviewing this policy, CHFA encourages owners that elect this set-aside to become familiar with the federal statute and regulations to ensure compliance with its detailed requirements.

Average Income Test (AIT) minimum set-aside election

The Consolidated Appropriations Act of 2018 signed into law on 03.23.2018, established the Average Income Test (AIT) as a third minimum set-aside election to the IRC Section 42. Under this election, the owner must identify a group of low-income units that constitutes 40 percent or more of the residential units in the project and for which the average of the income designations of all of the units in the group does not exceed 60 percent AMI.

The AIT option enables Housing Tax Credit projects to offer deeper levels of affordability and serve a broader range of low- and moderate-income households, including those earning as much as 80 percent of Area Median Income (AMI). Owners must select rent and income levels in 10 percent increments beginning at 20 percent AMI. The allowable income/rent designation levels are 20 percent, 30 percent, 40 percent, 50 percent, 60 percent, 70 percent, and 80 percent AMI.

Eligible projects

For projects in Colorado, the AIT minimum set-aside may be elected with 9 percent federal Housing Tax Credit, 4 percent federal Housing Tax Credit, and 4 percent federal/state Housing Tax Credit applications only if 100 percent of residential units in the project are designated as low-income units. Refer to CHFA's QAP for further guidance.

Multiple building election

Owners of projects with multiple buildings that elect AIT as the minimum set aside are required to do so for each building in the project.

Owners must elect to treat each building as part of a multiple-building project on line 8b of the IRS Form 8609.

Unit parity

Refer to CHFA's QAP for further guidance on CHFA's requirements regarding equitable distribution of unit and affordability mix.

Compliance monitoring timeframe

CHFA's preliminary monitoring of AIT compliance will begin with the Initial Inspection of the project.

Formal monitoring of AIT compliance will begin with the first year of the Credit Period and will continue through the end of the Extended Use Period.

Effective date and implementation date

The effective date of the IRS final average income test regulations is 09.30.2025. The final regulations at 26 CFR § 1.42-19 regarding procedures for identifying, recording, and reporting qualified groups apply to taxable years beginning on or after 09.30.2025.

CHFA is applying this policy retroactively to AIT projects with taxable years beginning prior to 09.30.2025, beginning with calendar year 2025. For all such projects, qualified groups as of 12.31.2025 must be reported to CHFA by the annual reporting deadline as explained below.

Qualified group of units: average income test and applicable fractions

For each taxable year in the Extended Use Period, the owner must identify two qualified groups of units: one for the Average Income Test set-aside and one for the applicable fraction determination. Both groups must have an average imputed income designation that does not exceed 60 percent AMI. The average is **not** based on the actual income of households occupying the units.

Below is a basic summary of the two qualified group definitions in 26 CFR § 1.42-19. Owners should ensure their identified qualified groups meet the exact definitions as specified in the regulation.

Average Income Test qualified group definition

- A group of units that constitutes 40 percent or more of the residential units in the project and for which:
    - each unit in the group meets the definition of a low-income unit at 26 CFR § 1.42-19 (b)(1)(i)-(iii), summarized below,
        - correctly rent-restricted,
        - occupied by a household that is income-qualified,
        - otherwise meets all other requirements under IRC Section 42 and in the regulations under Section 42 to qualify as a low-income unit, and
    - the average of the income designations of all of the units in the group does not exceed 60 percent AMI.

Applicable fraction qualified group definition

- Includes the same residential units counted in the Average Income Test qualified group for the project.
- The owner may include additional units in the applicable fraction qualified group for the project provided that the resulting group has an average imputed income designation that does not exceed 60 percent AMI.

- **Note:** Although the applicable fraction qualified group for a multi-building project must have an average income designation of 60 percent AMI, individual buildings are **not** required to have an average income designation that averages 60 percent or less. Each individual building must simply meet its required applicable fraction, as specified in the Land Use Restriction Agreement, using the units that are in that particular building and that are also in the applicable fraction qualified group of units for the overall project.

Unit designations

Floating designations

After each new Housing Tax Credit unit is qualified as a low-income unit and the initial AMI designation is made by the owner, CHFA permits AMI designations to float over time in certain circumstances, as explained below.

Recording designations

CHFA requires owners to record unit designations both in tenant files and online in CHFA's NextGen occupancy data reporting system as follows. Note that each unit's designations must be identical for income and rent. For example, if the income designation is 40 percent AMI, the rent designation must also be 40 percent AMI.

Designation Type	Tenant File Documentation	NextGen
Newly occupied unit	▪ Move-in or Initial Tenant Income Certification	Move-in or Initial Certification
Household transfers units	▪ Unit Transfer Tenant Income Certification	Unit Transfer Certification
Redesignated unit permitted under 26 CFR § 1.42-19(d)	▪ Interim Tenant Income Certification ▪ Clarification record explaining the specific reason for the redesignation	Interim Certification

Timing of designations

Before a unit is first occupied as a low-income unit, the owner must designate the unit's designation.

For an occupied unit that is subject to a permitted change in designation, the owner must record the unit's changed designation not later than the end of the taxable year in which the change occurs. See pg. 6 below for information on correcting failures to comply with procedural requirements, including when a unit's change in designation is not recorded by the end of the taxable year.

Changing designations

As specified under 26 CFR § 1.42-19(d), the owner may change the designation of a unit only in the following circumstances and subject to the timing of designations requirements described above and the reporting requirements described below.

Note: When moving an existing household to a vacant unit with a lower AMI designation or when changing an occupied unit to a lower AMI designation, the current household income must be verified to be at or below the applicable income limit for the new, lower AMI designation, and gross rent must be reduced to be at or below the applicable maximum rent for the new AMI designation. An interim Tenant Income Certification is required at the time of unit redesignation.

- Federally permitted changes. Permission for the change is contained in IRS forms, instructions, or guidance published in the Internal Revenue Bulletin.
- CHFA-permitted changes. As of this policy effective date, CHFA has specified the following two conditions for a permitted change not identified in the regulation. If CHFA identifies other conditions for a permitted change that apply to all projects, they will be incorporated into this policy.
    - Other federal housing programs under which the project operates require redesignation of a unit or household to comply with the rules of that program. Examples of such programs include Section 8, HOME, USDA Rural Development, National Housing Trust Fund, and CDBG.
    - An existing household now qualifies for a lower AMI designation and a unit designated at a lower AMI becomes vacant.
- Certain laws. The change in designation is required or appropriate to enhance protections contained in the following, as amended.
    - The Americans with Disabilities Act of 1990
    - The Fair Housing Amendments Act of 1988
    - The Violence Against Women Act of 1994
    - The Rehabilitation Act of 1973
    - Any other state, federal, or local law or program that protects tenants and that is identified as a federally permitted change or a CHFA-permitted change.
- Tenant movement/Unit transfers.
    - If a current income-qualified tenant moves to a different unit in the project, the unit to which the tenant moves has its income designation changed to the limitation of the unit from which the tenant is moving and the vacated unit takes on the prior limitation of the tenant's new unit.
    - In other words, the two units swap designations.
- Restoring compliance with Average Income Test requirements.
    - If one or more units lose low-income status or if there is a change in the designation of some unit **and** if either event would cause a previously qualifying group of units to have an average designation that

exceeds 60 percent AMI, then the owner may reduce the existing designation of one or more other units in the project to restore compliance with the Average Income Test requirement.

- The rule in this paragraph may be applied to vacant or low-income units.
- When changing an occupied unit to a lower AMI designation, the current household income must be verified to be at or below the applicable income limit for the new, lower AMI designation, and gross rent must be reduced to be at or below the applicable maximum rent for the new AMI designation. An interim Tenant Income Certification is required at the time of unit redesignation.

Reporting requirements

Annual Owner Certification

Owners must complete CHFA's LIHTC Owner Certification of Continuing Program Compliance, annually by February 15th for the previous calendar year, which will include a certification of the owner's compliance with the AIT minimum set-aside and CHFA's Average Income Test Policy each year.

Annual qualified group of units and unit designation reporting

CHFA's reporting requirements have been updated according to the final AIT regulations effective 09.30.2025.

Annually by February 15th, owners must submit their own AIT report with information as of December 31st of the previous calendar year. Per the final AIT regulations, if CHFA can identify a qualified group of units within the Applicable Fraction qualified group of units that also satisfies the average income set-aside test, then the owner is considered to have identified an Average Income Test qualified group of units. Therefore, the report must list the following.

- Each tax credit unit, its AMI designation, and whether the unit is included in the Applicable Fraction qualified group
- Total number of residential units in the project
- Total number of units in the Applicable Fraction qualified group
- Average income designation of the Applicable Fraction group

In addition to the report, the owner must certify whether any units were redesignated during the previous calendar year using CHFA's Unit Redesignation Certification form. If any units were redesignated, the unit number and the reason for the redesignation must be listed on the certification. See above for compliant reasons to redesignate a unit.

Monthly unit occupancy data reporting - NextGen

Occupancy and demographic data for all Housing Tax Credit projects must be submitted utilizing CHFA's online NextGen system, as soon as the project begins leasing up.

NextGen data must be maintained monthly thereafter.

Unless they occur at annual recertification, any changes in designation must be recorded in NextGen as an interim certification.

Annually by February 15, all occupancy records through December 31 of the previous calendar year must be entered and finalized in NextGen.

Correcting failures to comply with procedural requirements

If there is a failure to comply with the AIT regulation's unit and qualified group identification, recording, and agency notification requirements (i.e., the "procedural requirements"), and the processes outlined below are followed, then the failure will be treated as corrected.

Discovery by the owner

If an owner discovers a failure to comply, they must submit a correction to CHFA in the form of a revised qualified group of units. The correction must be submitted not more than 180 days after discovery of the failure.

Discovery by CHFA

If CHFA discovers a failure to comply, CHFA will provide prompt notification to the owner in a manner similar to the one described in 26 CFR § 1.42-5(e)(2). The owner must submit a correction to CHFA within 90 days of the notice as described in 26 CFR § 1.42-5(e)(4).

CHFA discretion to issue a waiver

As specified under 26 CFR § 1.42-19(c)(4)(iv), on a case-by-case basis, CHFA may waive in writing any failure to comply with the procedural requirements. This writing will be provided to the owner within the time limit described earlier in this section, depending on who discovered the failure (the owner or CHFA). If the owner wishes to request such a waiver, the owner must report the failure to CHFA within 30 days after discovery of it.

Compliance testing

Each year CHFA will use NextGen occupancy data along with the owner's certification and report to test for compliance with the AIT minimum set-aside as of December 31 of the previous year.

Testing for compliance with the AIT minimum set-aside will also be conducted as part of each Housing Tax Credit program compliance review by CHFA.

Note: AIT projects with tax-exempt bonds must meet both the minimum set-aside elected in the CHFA Bond Regulatory Agreement and the AIT minimum set-aside.

Rent and income limits

CHFA uses the Multifamily Tax Subsidy Program (MTSP) methodology to calculate rent and income limits for the 20 percent, 70 percent, and 80 percent AIT AMI designations. CHFA's calculation may not align with the IRS and/or HUD methodology until formal federal guidance is issued, which could impact household qualification and monitoring.

Annual resident recertifications

AIT projects are required to follow CHFA's existing annual recertification policy for 100 percent low-income projects. See CHFA's Multifamily Program Compliance Manual, Section 7.4.

Training

AIT-specific compliance training for all onsite and corporate staff involved in compliance and tenant file preparation as well as members of the ownership and management teams must be completed before CHFA will issue IRS Form(s) 8609. This training can be delivered by a third-party compliance consultant that is acceptable to CHFA. Training certificates must be submitted to CHFA prior to issuance of IRS Form(s) 8609. Refer to CHFA's QAP for additional guidance.

After IRS Form(s) 8609 have been issued, additional AIT compliance training will be required upon any change in the compliance staff, owner, and/or management agent, and upon the request of CHFA as necessary.

Noncompliance

Noncompliance with the AIT election will be treated in the same manner as the other minimum set-aside elections and reported on IRS Form 8823. Failure to meet the AIT election for the first year of the Credit Period will result in the permanent loss of the entire Housing Tax Credit allocation. Failure to maintain the AIT election for any year after the first year of the Credit Period will result in no allowable Housing Tax Credits for that tax year.

For developments with state Affordable Housing Tax Credits, whenever CHFA files an IRS Form 8823, CHFA will forward the 8823 filing to the Colorado Department of Revenue.

Uncorrected noncompliance with CHFA's requirements that is not reportable via IRS Form 8823 will be addressed according to CHFA's noncompliance policy as outlined in CHFA's Multifamily Program Compliance Manual, Chapter 17, and may result in a "Not in Good Standing" with CHFA Programs Designation.

Disclaimer

This policy is not intended to provide, and should not be relied on for, tax, legal, or accounting advice. Any project considering the AIT election should do so in consultation with its tax, legal, and accounting advisors.

For more information

For additional information, including CHFA's Average Income Test Policy and Frequently Asked Questions (FAQs), please visit chfainfo.com/rental-housing/housing-credit/average-income.

References

- 26 CFR §§ 1.42-15 and 1.42-19 (§ 1.42-19T removed in 2025)
    - Treasury regulations regarding available unit rule and average income test
- 87 FR 61489
    - Federal Register notice publishing and explaining final and temporary Average Income Test regulations
- 90 FR 46756
    - Federal Register notice publishing and explaining final Average Income Test regulations and removing temporary regulations
- IRC § 42(g)(1)(C)
    - Internal Revenue Code regarding average income option for minimum set-aside test