

HUD Low Income Housing Tax Credits: Calculating Utility Allowances

By Karen Juckett

In order to keep federally assisted housing affordable, federal law requires that residents in public housing should pay no more than 30 percent of a household's adjusted monthly income in rent. HUD has interpreted 'rent' to include both the cost of shelter itself and the cost of a reasonable amount of utilities, known as the 'utility allowance'. The amount of rent received by the Public Housing Authority (PHA) is thus reduced by the amount of the utility allowance. This system also applies to affordable housing developed under Low Income Housing Tax Credit (LIHTC) program. Under Internal Revenue Service (IRS) regulations, there are two options for calculating utility allowances: either the Housing Choice Voucher (HCV or Section 8) utility allowance set by the local Public Housing Authority or the local utility company estimate. However, LIHTC property owners have identified a number of problems with these options.

- HCV utility allowance schedule does not reflect improved energy efficiency of newer LIHTC properties.
- Data from utility companies is difficult to obtain.
- Energy costs are rising while income estimates have stagnated.

First, the current system is problematic because the HCV utility allowance schedule is based on Section 8 Housing utility costs, which are much less energy and utility efficient than newer LIHTC projects. Thus in the case of individually metered utilities where the HCV utility allowance is higher than actual tenant consumption, owners receive less in rent on each unit while the tenant keeps the difference between the HCV estimate and actual consumption. While this may seem advantageous for low-income tenants, it endangers the financial viability of the property and reduces the ability of owners to provide services or invest in capital improvements.

Alternatively, HUD allows owners to use utility company estimates to calculate their own utility allowances for their properties. However, owners have found it difficult to use this option because of a lack of data, because the utility company is unwilling to provide data, and because it is difficult to update estimates annually.

While developers understand that utility costs are never totally predictable, they usually feel comfortable predicting a steady increase in income over time. However, recent volatility of utility costs and stagnant income limits in recent years have made it difficult for owners to calculate a property's cash flow.

In some cases the stagnant incomes are the result of a 2006 change in HUD methodology for calculating incomes, in which estimates of income are lower than previously thought. HUD used this information to calculate the FY 2007 median family income numbers, and when the income estimate for a particular area is lower than the previous year's estimate, the income limit is frozen at the previous year's level. This results in lower than expected income limits and stagnant rents in many areas. Thus there is a concern that the new calculation methodology endangers the financial viability of many LIHTC projects around the country. In addition, utility costs in Texas are on the rise. Average electricity

prices have increased 58% since 2002. In 2007 deregulated utilities are freed of all price restraints, which could mean further increases in the coming years.

In response to complaints regarding the method for calculating utility allowances, the Internal Revenue Service has proposed amendments to the internal revenue code to provide owners additional options in calculating their own utility allowances. Under the proposed regulations, owners could use the HUD Utility Schedule Model or obtain estimates from the Housing Finance Agency (HFA) if the HFA agreed.

Steps for Calculating Utility Allowances

HUD advertises two methodologies for calculating utility allowances, the Engineering-based Methodology and the Consumption-based Methodology. Each will be summarized briefly here. For more detailed information on these methodologies, please visit <http://www.hud.gov/offices/pih/programs/ph/phecc/allowances2.cfm>.

Engineering-based Methodology

This method uses engineering calculations and technical data to estimate a utility allowance. First, owners develop categories of dwelling units based on the factors that affect utility consumption. Next, owners determine the consumption requirements for each type of end-use to be covered by the allowance. Depending on the end-use, the consumption requirement may be estimated based on engineering formulas, standardized consumption tables, or in-house information on equipment used or the physical condition of the developments.

Advantages

- This methodology allows owners to estimate requirements of an ‘energy-conservative household in order to promote conservative behavior.
- Allowances do not need to be recalculated every year.
- There is no need to have actual consumption data.

Disadvantages

- Must have access to technical data such as heat loss calculations and weather information.
- Must make accurate assumptions regarding reasonable consumption.
- Allowances are not linked to actual consumption and may be inaccurate.

Consumption-based Methodology

Under this methodology owners use data on past consumption by residents to calculate utility allowances. Billing records or check-meter records can be used to make calculations. First owners should decide on allowable end uses, and the timeframe the consumption data will cover. Timeframe options are:

- Three-year rolling base – the owner calculates allowances based on three years of data. Every year the database is updated and the oldest year is dropped.
- Fixed database normalized for weather – the owner uses a fixed database of consumption information for one or more years, adjusted for the effects of weather. This database does not need to be updated with current information every year.

This methodology also has some advantages and disadvantages:

Advantages

- For an owner with a homogenous housing stock, this methodology might be simpler than the engineering-based methodology.
- Allowances are based on actual consumption.

Disadvantages

- Does not provide insight into what proportion of consumption is wasteful.
- Under the rolling base timeframe consumption data must be updated yearly.
- Obtaining information from the local utility can be difficult and time-consuming.

Resources

Current IRS Regulations on Utility Allowances

http://www.novoco.com/low_income_housing/resource_files/irs_rulings/treasury_regulations_1_42/TR1_42_10.pdf

IRS Notice of Proposed Rules Changes

http://www.novoco.com/low_income_housing/resource_files/irs_regulations_forms/fedreg_061907_utility.pdf

HUD Utility Schedule Model

The HUD model calculates different allowances, depending on when the project was built. Some believe that if it is adopted by PHAs, it would produce lower allowances for many newer LIHTC properties.

<http://www.huduser.org/resources/utlmodel.html>

National Low Income Housing Coalition memo on proposed changes

http://www.nlihc.org/detail/article.cfm?article_id=4295