

DATE: July 27, 2020

TO: Daniel Bauman, Chairman, ARHA Board of Commissioners

FROM: Keith Pettigrew, Secretary/Treasurer

SUBJECT: **RESOLUTION No. 694-2020 Amended**
VOTE TO APPROVE APPOINTMENT OF OFFICERS TO VHD LLC AND THE
FORMATION OF AN AFFILIATE OF VHD LLC

ISSUE:

At a duly constituted meeting on or about June 22, 2020, the ARHA Board of Commissioners unanimously approved Resolution number 694-2020, authorizing ARHA to form an affiliate. In addition, the Resolution authorized the CEO to constitute Virginia Housing Development LLC (“VHD LLC”), a Virginia limited liability company, the instrumentality of ARHA. The Resolution, unfortunately, authorized the appointment of “Board members to VHD LLC”. The Resolution should have left ARHA as the sole member of VHD (and therefore controlled by the ARHA Board of Commissioners) and appointed Officers to VHD. The other sections of the approved Resolution will remain as approved.

Since 2010, ARHA has carried out its development activities through VHD LLC, a Virginia limited liability company, which has operated as an instrumentality of ARHA. For ARHA’s upcoming development activities, ARHA plans to continue to use VHD LLC, and the ARHA Board of Commissioners has authorized the formation of an affiliated entity in order to optimize ARHA’s participation and expand its flexibility in these development activities within the anticipated financing structures.

DISCUSSION:

An instrumentality and an affiliate offer different benefits to ARHA. An instrumentality is an entity wholly controlled by ARHA. The benefit of using an instrumentality relates to the control over the entity exercised by ARHA; the instrumentality can take only actions specifically authorized by ARHA and the ARHA staff who control the entity by virtue of the composition of the entity’s board. At the same time, for HUD purposes, HUD will treat an instrumentality like the housing authority itself, meaning that the instrumentality must follow the same HUD requirements ARHA must follow when using HUD funds. These restrictions, including procurement requirements, are most significant when the instrumentality is using public housing funds. As ARHA transitions its public housing stock to Section 8, the administrative requirements associated with utilizing an instrumentality may lessen.

With respect to VHD LLC, as it has been in existence since 2010 and has been operating as an instrumentality, external counsel has recommended that VHD LLC continue in its current structure as

an instrumentality. Prior discussions have argued for changing the structure of VHD LLC or its exempt status. Counsel has recommended that from a corporate formality perspective it would be structurally cleaner to retain the structure and characterization of VHD LLC and, instead, authorize VHD LLC to form an affiliate to participate in situations or transactions in which using an instrumentality may not be optimal given the financing structures. Moreover, as more fully discussed below, since the ARHA Board or staff would not fully control the new entity, a new board of affordable housing professionals can be named for this new entity and in turn provide ARHA with their input and independent judgment.

The additional benefit of using an affiliate relates to its ability to participate in potentially meaningful cash flow and sale/refinance proceeds in a LIHTC project, while allowing for the shorter depreciation recovery periods that generally LIHTC investors require in order to optimize LIHTC pricing. In order to accomplish both objectives, an affiliate that receives separate tax-exempt status under Section 501(c)(3) of the tax code can form a special purpose entity (“SPE”) that it would wholly own, such as a limited liability company, and that SPE would serve as the general partner or managing member, as applicable, of the project owner.

The SPE (not the affiliate) would make an election under Section 168(h)(6)(F) of the tax code to be taxed as a for-profit and make a corresponding filing of IRS Form 8832 to be taxed as a corporation rather than as a disregarded entity. Because of the current election requirements, an instrumentality is not able to make such an election. Therefore, if a LIHTC project is anticipated to generate enough cash flow so that there would be meaningful cash flow remaining after payment of investor fees, any tax credit adjusters, development fee, operating reserve replenishment, partner loans, and any soft debt repayment, then it would likely be beneficial for the SPE to make the election.

While any income the SPE receives from the project would no longer be tax-exempt, its share of potential income would likely be much higher than the alternative, which would require fitting within the limitations of qualified allocations (under Section 168(h)(6)(B) of the tax code). With qualified allocations, the tax-exempt organization does not make the 168(h) election, and typically receives only up to 0.01% of the residual cash flow and sale/refinance proceeds (not including reasonable fees).

A major distinction between an affiliate and an instrumentality is with regard to control over the entity. ARHA and its Board control an instrumentality financially and with respect to all decisions that the instrumentality may make. In contrast, under an affiliate structure, ARHA would participate in its governance, but would not fully control it. Therefore, a majority of the affiliate’s board cannot be comprised of a majority of ARHA’s Board or staff; instead, a majority of the board must be independent. For example, if the affiliate has five board members, three or more board seats can be held by members of the affordable housing development community who are not members of the ARHA Board or staff. ARHA, however, can retain certain involvement and levels of control based on the nature of the relationship between ARHA, the instrumentality and the affiliate. For example, since an ARHA instrumentality will establish the affiliate, the corporate formation documents for the affiliate can establish a mission for the affiliate that is intended to support and further ARHA’s own mission. Further, since ARHA and/or its instrumentality may provide financial support to the affiliate, additional controls can be realized through restrictions that may be placed on the use of the funds.

An affiliate would need to apply to the IRS for separate tax-exempt status under Section 501(c)(3) of the tax code and meet related state law requirements in order to exempt its income flowing from charitable activities from income tax. In order to qualify for tax-exempt status, the affiliate's primary activities must be charitable in nature, which can include in the creation and operation of low-income housing (and acting as a general partner or managing member of a limited partnership or limited liability company, respectively, that owns low-income housing). To the extent that the affiliate participates in a limited amount of non-qualifying activities, it would still be classified as a tax-exempt organization, but receipts from these non-qualifying activities would be treated as unrelated business taxable income ("UBTI"), and the corporate income tax rate would apply to this UBTI.

In order to obtain tax-exempt status, the affiliate must file a Form 1023 with the IRS seeking a determination of its tax-exempt status under Section 501(c)(3) of the tax code. Once approved, Form 1023 and the required annual filing (Form 990) are public documents.

With regard to VHD LLC, the ARHA Board would continue to control the sole member of VHD LLC and must appoint the officers of VHD LLC. Based on our discussion with counsel, since the ARHA Board controls the activities of VHD LLC, the officers could be ARHA senior staff or others so designated by the ARHA Board.

We note that the state law requires Alexandria City Council (the "City Council") (or its designee's) approval when a housing authority forms a related entity. Because ARHA wholly controls VHD LLC, it appears that requests for VHD LLC to form an affiliate would similarly require approval. As such, our counsel has recommended we seek City Council authorization to form the affiliate. Requests to be included on the City Council's agenda are made through the Alexandria City Manager's Office and typically are requested via a City Council member. The City Council has a specific ARHA Redevelopment Work Group which includes both Mayor Justin Wilson and Councilman John Taylor Chapman. Accordingly, unless ARHA has an ongoing relationship with another City Council member with whom ARHA wishes to work, counsel has recommended that ARHA approach Councilman John Taylor Chapman with the ARHA request for the request to be included on the City Council's agenda.

RECOMMENDATION:

ARHA recommends that the Board appoint the following as ex officio officers of VHD LLC: the ARHA Chief Executive Officer as President of VHD LLC, the ARHA Chief Financial Officer as Treasurer of VHD LLC, and the ARHA Director of Asset Management as Secretary of VHD LLC. ARHA further recommends that the Board authorize these officers to make day-to-day decisions regarding the management and operations of VHD LLC. Since ARHA is still the sole member of VHD LLC, the Board would continue to be asked to approve major decisions and transactions for VHD LLC. Finally, ARHA recommends that the Board authorize such modifications as may be necessary to the VHD LLC Articles of Incorporation, Operating Agreement, and/or other governing documents to effectuate the foregoing.

ARHA recommends that the Board approve the formation of an affiliated entity and the application for tax-exempt status under Section 501(c)(3) of the tax code and any applicable state law exemptions, in order to provide additional flexibility for ARHA to optimize economic participation in LIHTC projects.

FISCAL IMPACT:

None

**ALEXANDRIA REDEVELOPMENT & HOUSING AUTHORITY
BOARD OF COMMISSIONERS**

**TO APPROVE THE FORMATION OF AN AFFILIATE and
TO APPOINT THE OFFICERS OF VHD LLC**

RESOLUTION No. 694-2020 Amended

WHEREAS, the Board of Commissioners (“Board”) of Alexandria Redevelopment and Housing Authority (“ARHA”) authorized Resolution No. 694-2020 on June 22, 2020, and now has resolved to amplify the content of such resolution and supersede it as follows:

WHEREAS, ARHA has a mission to become an industry leader in the development and management of model mixed income communities, while simultaneously increasing ARHA residents’ self-sufficiency and quality of life;

WHEREAS, ARHA has been carrying out its development activities principally through its instrumentality, Virginia Housing Development LLC (“VHD LLC”);

WHEREAS, the reduction of federal subsidies have reduced the financing options available to ARHA to finance new construction or renovation of its existing public housing stock;

WHEREAS, in order to increase the options available to ARHA to continue redeveloping its properties and developing affordable housing, and generate additional affordable housing funding, and pay project costs, ARHA has determined VHD LLC should establish an affiliated, but not controlled, entity to participate in the redevelopment of ARHA properties and other affordable housing opportunities in the City of Alexandria; and

WHEREAS, the mission and purposes of the affiliated entity shall be to support the affordable housing and redevelopment work of ARHA.

NOW, THEREFORE, BE IT RESOLVED:

RESOLVED, that the Board authorizes the appointment of the ARHA Chief Executive Officer, Chief Financial Officer, and Director of Asset Management as ex officio officers of VHD LLC in the respective positions of President, Treasurer, and Secretary, and authorizes them to make day-to-day decisions regarding the management and operations of VHD LLC.;

RESOLVED, that the Board authorizes such changes as may be necessary to the VHD LLC formation and operations documents to implement the immediately prior Resolution;

RESOLVED, that the Board authorizes VHD LLC to form an affiliated entity (the “Affiliate”) to support the mission and purposes of ARHA;

RESOLVED, that the Affiliate shall be called **Premier Affordable Housing** or such other similar name as may be available in the state of Virginia;

RESOLVED, that the ARHA’s Chief Executive Officer and Chief Financial Officer (“ARHA Members”) shall be included, ex officio, on the governing body of the Affiliate;

RESOLVED, that the ARHA Members (not the ARHA Board) shall appoint the other members of the governing body of the Affiliate;

RESOLVED, that the Board authorizes the Affiliate to submit to the Internal Revenue Service an application for a 501(c)(3) determination and authorizes the preparation, adoption, and submission of any and all necessary and advisable materials and information for tax-exempt status under section 501(c)(1) of the Internal Revenue Code, and Virginia as required, including but not limited to bylaws and a conflict of interest policy; and

RESOLVED, that the Board authorizes and approves taking any and all actions necessary to implement this resolution, including without limitation, filing for corporate registration with the state of Virginia, seeking any necessary approvals from the Alexandria City Council or its designee, and applying to the various departments of the state of Virginia for any and all tax exemptions, and any other filings or registrations necessary to pursue the Affiliate’s purpose.

The undersigned attest that the Alexandria Redevelopment and Housing Authority adopt the foregoing resolution.

Adopted this 27th day of July, 2020

ATTEST: ALEXANDRIA REDEVELOPMENT AND HOUSING AUTHORITY

By: _____
Daniel Bauman, Chairman

By: _____
Keith Pettigrew, Chief Executive Officer