

DATE: June 22, 2020

TO: Daniel Bauman, Chairman, ARHA Board of Commissioners

FROM: Keith Pettigrew, Secretary/Treasurer

SUBJECT: RESOLUTION No. 694-2020 VOTE TO APPROVE THE FORMATION OF AN AFFILIATE

ISSUE:

Since 2010, ARHA has carried out its development activities through Virginia Housing Development LLC (“VHD LLC”), a Virginia limited liability company, which has operated as an instrumentality of ARHA. It has been the Board’s intent to formalize the board structure of VHD LLC in order to strengthen its function, diversify the Board membership to increase the input of affordable housing professionals, and to become more active in the production of affordable housing in the City of Alexandria.

Changes in US Income Tax Code allow affordable housing producers utilizing allocations of Low-Income Housing Tax Credits (“LIHTC”) in its financing plan options in fee participation and distributions. Toward that end, ARHA seeks to form an affiliated entity in order to optimize ARHA’s participation and expand its flexibility in future 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. By ARHA controlling the entity, 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. For HUD purposes, HUD will treat an instrumentality as if it were 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. In consultation with external counsel we have concluded that from a corporate formality perspective it would be structurally cleaner to retain the structure and characterization of VHD LLC. Therefore, the ARHA Board must authorize the formal board structure and appoint its board members. Based on our discussion with counsel, since the ARHA Board controls the activities of VHD LLC, the board members could be ARHA senior staff or others so designated by the ARHA Board.

To allow structuring options for ARHA to participate in future development opportunities, in consultation with external counsel we have determined that the ARHA Board authorize VHD LLC to form an affiliate to participate in transactions in which using an instrumentality may not be optimal given the financing structures.

A major distinction between an affiliate and an instrumentality is with regard to the Board control over the entity. ARHA has financial control over both entities; except that in an affiliate structure, ARHA participates in its governance, is not the majority of its Board and as such does not 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 could be held by members of the affordable housing development community who are not members of the ARHA Board or staff. Moreover, since the ARHA Board or staff would not 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 on projects that the ARHA Board is considering for redevelopment.

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. To maximize its pricing, investors are generally attracted to affordable housing projects financed in part with LIHTC due to the shorter depreciation recovery period for its investment. In order to accomplish both objectives, a tax-exempt affiliate approved under Section 501(c)(3) of the tax code can form a special purpose entity ("SPE") that it would wholly own, and that allows the SPE to serve as the general partner or managing member of the project owner.

Using the tax code, the SPE can make an election to be taxed as a corporation rather than as a disregarded entity. Therefore, if it is anticipated that a LIHTC project will 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. With qualified allocations, in addition to reasonable fees, the tax-exempt organization typically receives only up to 0.01% of the residual cash flow and sale/refinance proceeds.

In order to take advantage of these elections, the affiliate would need to apply to the IRS for 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. To qualify for tax-exempt status, the affiliate's primary activities must be charitable in nature, which can include assisting in the creation and operation of low-income housing (and as an owner of low-income housing). To the extent 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.

RECOMMENDATION:

ARHA recommends that the Board approve the appointment of the ARHA Chief Executive Officer, Chief Financial Officer, and the Director of Asset Management as ex officio members of the board of VHD LLC.

ARHA recommends that the Board approve the formation of an affiliated entity and submit 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. The name of the entity will be selected after a review the corporations listing for Virginia. The board appointments to the newly created entity shall also be submitted to the ARHA Board at a later date.

FISCAL IMPACT:

None

ALEXANDRIA REDEVELOPMENT & HOUSING AUTHORITY

BOARD OF COMMISSIONERS

TO APPROVE THE FORMATION OF AN AFFILATE

RESOLUTION No. 694-2020

WHEREAS, the Alexandria Redevelopment and Housing Authority (“ARHA”) has a mission to become an industry leader in the development and management of 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 has reduced the financing options available to ARHA to finance new construction or complete renovations to 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 of Commissions of ARHA (“Board”) authorizes the appointment of the ARHA Chief Executive Officer, Chief Financial Officer, and the Director of Asset Management as ex officio members of the board of VHD LLC;

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 **[name]** or such other similar name as may be available in the state of Virginia;

RESOLVED, that the Affiliate have a Board not to exceed five members including, the ARHA’s Chief Executive Officer and Chief Financial Officer (“ARHA Members”) who will serve in an ex officio capacity on the governing body of the Affiliate;

RESOLVED, that with Board consultation, not approval, the ARHA Members 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, 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 22nd day of June, 2020

ATTEST: ALEXANDRIA REDEVELOPMENT AND HOUSING AUTHORITY

By: _____
Daniel Bauman, Chairman

By: _____
Keith Pettigrew, Chief Executive Officer