Financing With Tax-Exempt Bonds

The information provided below is not intended to be used as tax advice but is instead a summary of the requirements of both § 142 of the Internal Revenue Code (the "Code") and Virginia Housing policies. All loans financed with Virginia Housing tax-exempt bond proceeds are subject to Virginia Housing underwriting, review by Virginia Housing's bond counsel, and adherence to a Virginia Housing bond pricing schedule. Project facts will be vetted by Virginia Housing's bond counsel to ensure compliance with applicable Code requirements, and the determination of what facts need to be vetted and how much time is needed for such review is made by Virginia Housing and it's bond counsel.

This summary is intended as a preliminary information source for Virginia Housing borrowers and should not be construed as legal advice. Due to the complexities of the rules and regulations governing tax-exempt financing, prospective users of this financing are advised to consult with their own tax counsel concerning their specific projects. Each project may have specific and unique attributes that are subject to Virginia Housing policy review in addition to applicable Code requirements.

Virginia Housing requires, all tax-exempt bond funded projects to use the 4% Low Income Housing Tax Credit (LIHTC). There are no exceptions to this requirement. Borrowers who apply to Virginia Housing for a loan financed in whole or in part with the proceeds of tax-exempt bonds will not be irrevocably allocated any particular amount of tax-exempt bonds. Instead, Virginia Housing, in its sole discretion, will determine the appropriate amount of tax-exempt bonds to issue for each such loan provided it is above the minimum amount required to qualify for the 4% LIHTC.

The following is a summary of some of the more significant requirements imposed by the Code:

Definition of Qualified Residential Rental Projects

A building or structure, which together with any "functionally related and subordinate facilities" containing one or more similarly constructed units that are (1) used for other than a transient basis, (2) available to the general public, and (3) subject to a tenant qualification restriction of either 20% of units reserved for tenants earning 50% or less of area median income, or 40% of units reserved for tenants earning 60% or less of area median income. Multiple building projects must have the same owner.

1. Volume Cap

Borrowers may apply to Virginia Housing for tax-exempt financing on a rolling basis and, if Virginia Housing agrees to make the loan, Virginia Housing will determine the amount of tax-exempt bonds it can and wants to issue, based in part on the amount of issuing authority it has at that time. To issue such tax-exempt bonds, Virginia Housing will need a Declaration of Official

Intent, and TEFRA approval, both of which will require the borrower to provide accurate facts regarding the nature of the proposed rental housing development. See Virginia Housing's website at www.VirginiaHousing.com or consult with an approved Virginia Housing Mortgage Banker for further information regarding the application process. Virginia Housing does not guarantee that all applications will result in financing, either in a specific bond series or at all. In addition, Virginia Housing does not guarantee the allocation of private activity volume cap or Virginia Housing financing even if a project has received a Virginia Housing Declaration of Official Intent and/or advertised in a Virginia Housing TEFRA Notice.

2. Complete Living Facilities

Section 142 of the Code requires all units in tax-exempt bond funded residential rental projects to have complete facilities for living, sleeping, eating, cooking and sanitation.

3. Functionally Related and Subordinate Property

Facilities, exclusively used by tenants of the tax-exempt bond funded residential rental project, including swimming pools, recreational facilities, parking lot or garages, heating and cooling equipment, trash disposal equipment, manager units, some office space, are considered part of the qualified residential rental project as long as their use is functionally related to the property.

4. Used on Other Than a Transient Basis, Available to the General Public

Section 142 of the Code requires that units in a qualified residential rental project be available to the general public and rented on other than a transient basis. Certain protected classes are acceptable. Virginia Housing interprets "transient basis" as rental leases with terms of less than six months. Single-room occupancy units (SROs) have an exception and are not treated as used on a transient basis even though the units are often rented on a month-by-month basis.

5. Low-Income Set Aside

During the "qualified project period" (see below), projects financed by tax-exempt bonds must meet one of the following unit set-aside tests:

- 20% at 50%: 20% or more of the residential units in the project must be occupied by households whose income is 50% or less of area median gross income; or
- 40% at 60%: 40% or more of the residential units in the project must be occupied by households whose income is 60% or less of area median gross income.

  *Virginia Housing restricts the remaining units up to 150% of the area median gross income.

Once confirmed at bond closing, the owner's election of one of the above occupancy requirements is irrevocable.

6. Qualified Project Period

The qualified project period commences on the first day that 10% of the residential units are first occupied and ends on the later of (a) the date that is 15 years after the date on which 50% of the project residential units are first occupied; (b) the date on which no tax-exempt private activity obligations issued with respect to the project are outstanding; or (c) the first day on which any Section 8 assistance provided to the project terminates.

7. 95/5 Rule

Sections 142 and 147 of the Code require that at least 95% of the proceeds of private activity tax-exempt obligations be used for qualified expenditures, or so-called "good money" or "qualified" project costs. To be considered "good money" costs, expenditures must be (a) incurred after Virginia Housing issues a written official action indicating its intent to finance a particular project with tax-exempt bond proceeds. (Virginia Housing's Declaration of Official Intent generally serves this purpose); and (b) chargeable to a project's capital account, and not amortized or expensed. Acquisition of land or building will be "unqualified" or "bad money" if the selling entity owns more than 50% of the buying entity.

8. Limitation on Land Acquisition

No more than 25% of the net proceeds of the tax-exempt bonds may be used to acquire land (directly or indirectly).

9. Existing Properties - Arm's Length Acquisition and Minimum Rehabilitation Requirements

Section 147(d) of the Code prohibits the use of tax-exempt bond proceeds to refinance an existing property unless such refinancing involves (a) the acquisition of the property by a party unrelated to the seller; and (b) minimum rehabilitation expenditures equaling not less than 15% of the proceeds of the tax-exempt bonds allocable to the acquisition of the existing building and equipment. Rehabilitation expenditures must generally be incurred within two years after the later of the date on which the building is acquired or the date on which tax-exempt obligations are issued. In determining whether acquisition of an existing property is by a party unrelated to the seller, Virginia Housing's bond counsel generally will determine whether the seller has a "controlling" interest in the purchasing entity, considering both (a) whether the seller has more than 50% of the capital of profits interest in a purchasing partnership; and (b) whether the seller can be said to control a purchasing partnership by virtue of its decision-making authority over day-to-day management and operational issues, such as the establishment of operating budgets, selection of property manager and other vendors, etc.

10. Related Parties for Purposes of Qualified Residential Rental Projects

Related parties can arise in several ways in connection with qualified residential rental projects. Two sections of the Code that indicate how to determine a related party are §§ 267 and 707(b).

11. Related Party General Contractor & Owner

If there is a relationship or common ownership between General Contractor and Owner, contractor profit should be an unqualified expenditure as it relates to the 95/5 rule.