

Recent Legislation Affects CHDOs

In the 2001 Session, the Texas Legislature passed two bills affecting the exemption of real property owned by Community Housing Development Organizations (CHDOs). HB 1392 and HB 3383 effectively strengthen the CHDO's property exemption.

HB 1392 strengthens the exemption in two ways. First, in place of the current law requirement that the local appraisal district determine that a CHDO's property qualify for an exemption each year, the local appraisal district will make a one-time determination that the property qualifies. This determination will remain in effect until the organization no longer qualifies as a CHDO or it disposes of the property. The Act provides that the appraisal district can require the CHDO to resubmit an application if it believes that the property or organization no longer qualifies for the exemption. The Act now allows a CHDO to apply for a preliminary determination from the appraisal district prior to closing as to the qualification of the project.

HB 3383 imposes certain requirements on CHDO's benefiting from the tax exemption, but in so doing clarifies what a CHDO must do to maintain its status and reaffirms Legislative intent to maintain the CHDO exemption on a long-term basis. The act requires that a CHDO spend 40% of the amount of the exempted taxes each year for specified purposes and spend 90% of its "cash flow" (net of expenses) for these same purposes.

For those projects that are not exempt, the meeting of these requirements need not have a significant impact on a residential project's net operating income. A CHDO must spend the 40% of the exemption and 90% of "cash flow" for capital improvement projects, for rent reductions, or for social, educational or economic development services, all for the benefit of eligible persons in the project or in the county in which the project is located. For a new residential project, the amount of rent reductions necessary to meet the low income requirements for either 20% or 40% of the units in the development is likely to exceed 40% of the amount of the tax reduction by a large margin.

For an existing residential project, the annual amount of "capital improvement projects," as determined by GAAP is likely to come close to or exceed the 40% expenditure requirement. Proof of meeting these expenditures would come from an independent accountant's audit, which must be submitted to the Texas Department of Housing and Community Affairs and to the local appraisal district.

The requirement for a CHDO to spend 90% of "cash flow" for these purposes would often require CHDO and bond documents to operate somewhat differently but should not affect debt service coverage. The Act defines "cash flow" to be what is normally thought of as net operating income less "expenses required in satisfaction of requirements of lenders, including reserve requirements" and "employee compensation." Presumably, the bond documents would hold project cash flow in a lender reserve and allow for its release based upon a prescribed waterfall. Any unrestricted release to the

CHDO presumably would be subject to its having first met the 90% expenditure requirement. For projects with large amounts of net cash flow, a CHDO might decide, subject to the approval of the lender or credit enhancer, to pay taxes in a given year and be released from the restrictions.

The Act exempts a CHDO from meeting these spending requirements with regard to any project

- Acquired by December 31, 2001,
- Required to make a payment in lieu of taxes to the school district in which the project is located,
- Subject to rent restrictions by the bond issuer, or
- Has fewer than 36 units.

We understand that some HFCs are adopting rent controls in order to come within the exemption from the expenditure requirements of the new laws. Time will tell if this works.

The next Legislature should be interesting as city and appraisal district organizations arm to gut this exemption. Stay tuned.