



Legal Minute

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Recent Changes To Texas Legislation Affect Nonprofit Organizations Constructing and Rehabilitating Affordable Housing

By Cynthia Bast, Locke Liddell & Sapp LLP

For the past six years, certain nonprofit organizations that qualified as Community Housing Development Organizations ("CHDO") and constructed or rehabilitated low-income housing in Texas have been able to qualify for an exemption from ad valorem taxation. Over the years, the so-called "CHDO Exemption" (Section 11.182 of the Texas Tax Code) became a popular financing tool. However, House Bill 3546 replaced the CHDO Exemption during the recent 78th Legislative Session, changing the circumstances under which a nonprofit organization qualifies for the ad valorem exemption. The new law, which takes effect on January 1, 2004, and the manner by which an entity qualifies for the exemption, are described below.

Ownership Requirements

To qualify for the exemption, the property must be owned by a **qualified entity**, a qualified entity must satisfy the following criteria:

- For the past three years, it has:
 - (1) Been exempt from federal income taxation under IRC Section 501(c)(3);
 - (2) Qualified as a "charitable" organization under the Texas Tax Code; and
 - (3) Had a purpose of providing low-income housing;
- A majority of its board members have a principal residence in Texas;
- At least two of its board members are:
 - (1) Low-income Texans;
 - (2) Residents of economically disadvantaged census tracts; or
 - (3) Representatives of low-income neighborhood associations; and
- It has a policy for seeking input from low-income communities with regard to the development of housing.

The exemption is also available if the property is owned by

- (a) a Texas limited partnership, the general partner of which is owned (100%) by a qualified entity, or
- (b) another form of Texas entity that has a qualified entity as its parent.

Note: For organizations interested in HUD funding, one-third of the board members must be representatives of low-income communities and not more than one-third can be public officials or representatives of participating jurisdictions.

Property Requirements

In addition to meeting the above ownership requirements, the property must meet the following requirements:

Rental Properties

- At least 50% of the rental property's dwelling units must be rented to low-income tenants at rents not to exceed 30% of the Area Median Family Income ("AMFI").
- Low-income tenants are defined as having incomes that do not exceed 60% of the greater of the AMFI for the property's location or the statewide AMFI.

Sale Properties / Homeownership

- The property must be sold to purchasers with incomes that do not exceed 100% of the greater of the AMFI for the property's location or the statewide AMFI.

Vacant or New Construction Properties

- Housing must be constructed after January 1, 2004;
- The property must be under active construction or physical preparation; and
- Housing must be provided within three years of acquisition.

Rehabilitation Properties

- Original construction must have occurred at least ten years ago;
- The seller must have owned the property for at least five years prior to the nonprofit organization's acquisition of the property;
- The nonprofit organization must complete the rehabilitation in an amount equal to or greater than the equivalent of \$5,000 per unit, or such other amount as may be required by the lender;
- A replacement reserve must be established and maintained at \$300 per unit per year (subject to a cost-of-living adjustment), or such amount as is required by the lender; and
- Housing must be provided within three years of acquisition.

Amount of Exemption

Generally. An owner and property that meet the requirements listed above are exempt as to 50% of the appraised value of the property.

Large County Exception. An exception has been established for counties with a population of 1.4 million people or more (currently Dallas, Harris, and Tarrant counties), which provides that in each such county, each taxing authority can decide, in its discretion, whether to grant an exemption (of any amount) or deny the exemption.

Application Process

Generally. The application process under House Bill 3546 remains the same as that of the CHDO Exemption. Application is made to the chief appraiser in the county in which the property is located and should be made within 30 days of the qualifying entity's acquisition of the property. The pre-determination process remains in place, except that the chief appraiser's response period has been increased from 21 to 45 days.

Large County Exception. In the case of counties with a population of 1.4 million people or more, the nonprofit organization must submit a request for the exemption to each taxing authority, and each taxing authority must make its decision within 60 days.

Duration of Exemption

CHDO Exemption. Properties that are exempt under the CHDO Exemption in 2003 remain exempt under that law until such time as the ownership of the property changes.

New Exemption. Properties that become exempt under the new law continue to be exempt until such time as the ownership of the property changes. There are two exceptions that allow the nonprofit organization to be replaced with a new nonprofit organization without jeopardizing the exemption.

Compliance

A qualified nonprofit organization receiving an exemption under this new law must, within 180 days after the close of its fiscal year, prepare an annual audit and submit it to the chief appraiser and the Texas Department of Housing and Community Affairs. The audit must include a statement of the organization's financial position as well as an opinion as to compliance with the exemption law. A nonprofit organization owning a property with 36 units or fewer may deliver a detailed report and certification in lieu of an audit. The audit requirements apply equally to properties continuing to receive the CHDO Exemption, except that the auditor must include an opinion as to compliance with the CHDO Exemption instead of the new law.

Final Note: This paper is intended to provide a brief summary of the new tax exemption law and is not comprehensive. To determine the application of this new law to any particular property, please review House Bill 3546 carefully and consult with your attorney.