

**Ad Valorem Tax Exemption for CHDOs
2001 Texas Legislative Session Update**

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This memorandum provides a brief summary of changes made in the most recent Legislative Session with regard to the Texas Tax Code ad valorem exemption for CHDOs.

Section 11.182 of the Texas Tax Code previously provided that an ad valorem tax exemption was available to an organization qualified as a CHDO with a charitable purpose under Section 501(c)(3) of the Internal Revenue Code that engaged exclusively in the building, repair, sale, or rental of affordable housing and held the property for sale or rental as affordable housing. Pursuant to **HB 3383**, which will be **effective on January 1, 2002**, the statute is expanded to specifically permit projects financed with tax credits or tax-exempt bonds to be exempt from ad valorem taxation as follows:

(e) . . . to receive an exemption . . . for improved real property that includes a housing project constructed after December 31, 2001, and financed with qualified 501(c)(3) bonds . . ., tax-exempt private activity bonds subject to volume cap, or low-income housing tax credits, the [CHDO] organization must:

(1) control 100 percent of the interest in the general partner if the project is owned by a limited partnership;

(2) comply with all rules of and laws administered by the Texas Department of Housing and Community Affairs applicable to community housing development organizations; and

(3) submit annually to the Texas Department of Housing and Community Affairs and to the governing body of each taxing unit for which the project receives an exemption for the housing project evidence demonstrating that the organization spent an amount equal to at least 90 percent of the project's cash flow in the preceding fiscal year as determined by . . . audit . . . for eligible persons in the county in which the property is located, on social, educational, or economic development services, capital improvements projects, or rent reduction.

For purposes of Section 11.182(e)(3), the definition of "cash flow" means:

the amount of money generated by a housing project for a fiscal year less the disbursements for that fiscal year for operation and maintenance of the project, including: (A) standard property maintenance; (B) debt service; (C) employee compensation; (D) fees required by government agencies; (E) expenses incurred in satisfaction of requirements of lenders, including reserve requirements; (F) insurance;

and (G) other justifiable expenses related to the operation and maintenance of the project.

The interpretation of what can be included as a disbursement for the definition of "cash flow" and the application of that definition to the satisfaction of Section 11.182(e)(3) will undoubtedly bring questions as this law is implemented. These questions will be more prevalent in limited partnership arrangements where the limited partnership agreements call for specific distributions of partnership cash flow to items including payment of deferred developer fee.

There are two additional conditions to the receipt of the tax exemption:

(d) A multifamily rental property consisting of 36 or more dwelling units owned by the organization that is exempted . . . may not be exempted in a subsequent tax year unless in the preceding tax year the organization spent, for eligible persons in the county in which the property is located, an amount equal to at least 40 percent of the total amount of taxes that would have been imposed on the property in that year without the exemption on social, educational, or economic development services, capital improvement projects, or rent reduction. [Note that this requirement does not apply to properties acquired using tax-exempt bond financing between January 1, 1997 and December 31, 2001.]

(g) . . . an organization must annually have an audit prepared by an independent auditor. The audit must include a detailed report on the organization's sources and uses of funds. A copy of the audit must be delivered to the Texas Department of Housing and Community Affairs and to the chief appraiser of the appraisal district in which the property subject to the exemption is located.

The statute also contains a new exception that says:

(h) . . . Subsections (d) [with respect to the requirement that 40 percent of the tax savings be spent on social services] and (e)(3) [with respect to the requirement that 90 percent of the cash flow be spent on social services] do not apply to property owned by an organization if:

(1) the entity that provided the financing for the acquisition or construction of the property:

(A) requires the organization to make payments in lieu of taxes to the school district in which the property is located; or

(B) restricts the amount of rent the organization may charge for dwelling units on the property; or

(2) the organization has entered into an agreement with each taxing unit for which the property receives an exemption to spend in each tax year for the purposes provided by Subsection (d) or (e)(3) an amount equal to the total amount of taxes

imposed on the property in the tax year preceding the year in which the organization acquired the property.

This exception poses an interesting question in that virtually all projects using tax credit or tax-exempt bond financing have investors or lenders that require the project to comply with federal law on rent restrictions as a condition to their financing. Does that requirement equate to restricting "the amount of rent the organization may charge"?

Another important change to Section 11.182 of the Texas Tax Code came in **HB 1392**, which was **effective on June 14, 2001**. It removes the yearly renewal requirement for CHDO property tax exemption.

HB 1392 also added a pre-application determination that should be helpful in financing projects with CHDO tax exemptions. A new subsection (c) was added to Section 11.436 of the Tax Code to read:

To facilitate the financing associated with the acquisition of a property, an organization, before acquiring the property, may request from the chief appraiser of the appraisal district established for the county in which the property is located a preliminary determination of whether the property would qualify for a [CHDO] exemption if acquired by the organization. The request must include the information that would be included in an application for an exemption for the property under [the CHDO exemption]. Not later than the 21st day after the date a request is submitted under this subsection, the chief appraiser shall issue a written preliminary determination for the property included in the request. A preliminary determination does not affect the granting of an exemption under Section 11.182