Financing Multi-Use Facilities

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Final Regulations

- Final Private Activity Allocation and Accounting Regulations published October 27, 2015, generally effective 1/25/16

- What do the Regulations do?

  - Allow tax-exempt financing of the governmentally used portion of a project financed with bonds and equity ("mixed-use projects")

  - Permit tax-exempt financing of the governmental portion of a partnership between a private party and a governmental issuer or a 501(c)(3) entity

Existing general rules for 501(c)(3) bond financing

- Entities that finance facilities with tax-exempt bonds have limitations on how much of the facility can be used by private parties
  - 5% limit on private business use and unrelated trade or business use for facilities owned by a 501(c)(3) organization (reduced to the extent of costs of issuance financed with bond proceeds)
  - All financed property must be owned by a 501(c)(3) organization or a state or local government

Private use – How is it caused?

- Private business use ("PBU") can result from
  - Ownership
  - Lease
  - Sale
  - Use in unrelated trade or business
  - Use under a sponsored research contract that does not meet IRS safe harbors
  - Use in a partnership or joint venture
  - Use under a management contract that does not meet IRS safe harbors
    - Examples: food service, professional service agreements

Defining a mixed-use project

- Project defined as what bond proceeds are used to finance (can be multiple, discrete buildings or types of facilities)
- What is an “eligible mixed use project”?
  - A project that is financed with both bond proceeds that when issued are 501(c)(3) bonds and with “qualified equity”
  - Use of bond proceeds and equity for projects that are part of the same “plan of finance”

Example - Medical Office Building

- Hospital expects to build a new medical office building and is looking to finance it with bonds and equity. It started a capital campaign and plans on receiving pledges over 5 years. Capital campaign funds will be used for the MOB. Hospital expects the MOB to have offices for Hospital physicians, private practices, a pharmacy, meeting space and a laboratory.
- Hospital just received a grant of $1 million to finance the architectural plans for the MOB.
- Three years ago, a donor contributed the land for the MOB.

Example - continued

Sources:

- Equity ($1 million in hand, $4 million over time in capital campaign funds)
- Bond proceeds
- Land contribution
- $1m grant for architectural expenses

Uses:

- Hospital Physicians
- Private Practice Physicians
- Pharmacy
- Hospital Meeting Space
- Laboratory

Exclusive Allocation Method: Undivided Portion

- Undivided portion allocation method is the exclusive method of allocating sources of funding to expenditures and uses
  - Method divides a project into 2 <u>abstract</u> undivided portions, one financed with bonds and one with equity
  - Applies even if a project can be divided into physically discrete portions (such as floors of a building)
  - Allows qualified equity to be allocated to private use portion and bonds to 501(c)(3) portion, thereby treating the privately used portion as a separate project not subject to tax rules

Exclusive Allocation Method: Undivided Portion

- Allocation permits "floating private use" – private use can be allocated to one portion of the project and when the private use ends, the equity can be allocated to private use in another portion of the project
  - For example, private physician offices will be on the 3rd Floor of the MOB for 2 years and then on the 5th Floor of the MOB starting in the 3rd year.
  - Confirm that there is enough equity (upfront and during the construction period) in the project to finance all the anticipated PBU such as the private physician, pharmacy and some portion of the laboratory
  - If not enough equity in the project to cover PBU, need to track PBU in the bond-financed portion to make sure do not exceed 5%

Qualified Equity

- Qualified equity" includes:
  - Taxable debt (not tax-exempt or tax credit bonds)
  - Cash
- Qualified equity" does NOT include:
  - The value of contributed real property or tangible personal property
  - Funds used to make scheduled debt service or to redeem bonds after the measurement period

MOB example:

-$1 million grant received for architectural plans for MOB is equity

Common Plan of Finance/Timing

- Same plan of finance: Qualified equity and 501(c)(3) bonds finance a project under the same plan of finance if the equity pays for capital expenditures of the project on a date that is:

  (1) no earlier than the date that is 60 days before the intent resolution; and

  (2) No later than the date on which the measurement period begins (the date the project is placed in service)

- Need to identify carefully the equity in the plan of finance

- Best practices might involve expanding intent resolution to provide an adequate description of what is being financed and the sources of money

Intent Resolution – Sample Language

RESOLUTION OF BORROWER DECLARING OFFICIAL INTENT

WHEREAS, ____________________(the "Borrower"), expects to borrow the proceeds of tax-exempt bonds issued by a state or local government (the "Bonds") to finance a portion of the project described on Exhibit A (the "Mixed-Use Project"), estimated to cost $_______________.

WHEREAS, the Borrower additionally expects use its equity, including funds received from capital campaigns, cash on hand and grants (collectively, the "Qualified Equity") to finance portions of the Mixed Use Project;

NOW, THEREFORE, the Borrower hereby resolves and declares its intent under Treasury Regulation § 1.150-2 to use proceeds of the Bonds and Qualified Equity to finance the capital costs of the Mixed-Use Project, together with costs of issuance and reasonably required reserves, subject to the following conditions:

1. The maximum principal amount of Bonds expected to be issued to finance the Mixed-Use Project is $__________.
2. Pending issuance of the Bonds, the Borrower may finance the Mixed-Use Project with other funds which will be reimbursed with the proceeds of the Bonds, provided that (a) the Bonds shall not be used to reimburse any expenditure paid more than 60 days prior to the present date; (b) the Bonds shall not be issued more than 18 months after the later of (i) the date of the first expenditure to be reimbursed with the proceeds of the Bonds, or (ii) the date the Mixed-Use Project is placed in service; and (c) in no event may the Bonds be issued more than three years after the date of the first expenditure to be reimbursed with the proceeds of the Bonds; and provided further that the limitations of this paragraph 2 shall not apply to qualified "preliminary expenditures" as permitted by Treasury Regulation § 1.150-2(f).
3. Issuance of the Bonds shall be subject to documentation acceptable to the officers of the Borrower providing for payment of principal, interest, and redemption price of the Bonds.

Implications of New Final Rules

- Discuss with bond counsel what the “plan of finance” will be; how the project will be funded
- Describe the project in the intent resolution or capital budget document
- Prepare final allocation of bond proceeds and equity
- Update bond compliance procedures already in place to reflect the new rules

Financing 501(c)(3) Portion of Partnerships with Private Partners

- New Regulations permit something that was not previously permitted and allow greater flexibility for financing projects
- A 501(c)(3) organization may now enter into a partnership with a private entity and finance the 501(c)(3) portion with bonds
- Regulations provide method for measuring the PBU of the financed property resulting from use of the property by the partnership
- Ownership by a partnership does not violate the 501(c)(3) bond requirement that all bond-financed property must be owned by a 501(c)(3) entity as long as only the 501(c)(3) portion is bond financed

Financing 501(c)(3) Portion of Partnerships with Private Partners

- Amount of the private partner's use is equal to the private partner's greatest percentage share of any specified partnership item (income, gain, loss, deduction, or credit) attributable to the time during the measurement period that the partnership uses the property
- Accommodates need of private party for a "return" by sharing net profits through a partnership rather than trying to meet the management contract safe harbor rules

Partnership Examples:

- Hospital forms a joint venture with a for-profit entity ("Company") for a start-up business for computerized medical records. Both Hospital and Company fund the venture as 50/50 partners, each contributing equal amounts. The program will take place in new building to be owned by the joint venture. Hospital plans to borrow tax-exempt bond proceeds to fund its 50% contribution for the building. Company will use its own funds for its share. Profits and expenses will be split 50/50 between the parties. The intent of the new rules is to permit Hospital to fund the building otherwise qualifying 50% share in this instance even though the building is owned by a partnership.