the Network
Supportive Housing Network of NY

Joint Venture Partnerships for Supportive Housing Development

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EXECUTIVE SUMMARY

Joint venture partnerships for the purpose of housing development are not a recent phenomenon. The IRS has provided guidance to organizations seeking to enter into a joint venture since the 1980's. However, two events have led non-profits to increasingly rely on these partnerships in New York City: 1.) a shortage of city-owned land; and 2.) changes to the term sheets of housing finance and social service agencies, permitting for-profit involvement. Since non-profit developers and service providers have historically undertaken the creation and preservation of supportive housing units, the increasing involvement of for-profit developers in this realm provided the impetus behind this report.

This report has two goals: 1.) to provide an overview of joint venture partnerships and highlight particularly intricate areas for consideration; and 2.) to analyze and identify certain reoccurring concepts in the ways joint ventures are structured.

The analysis section discusses the four joint venture partnership structures identified through interviews and studies of prior joint ventures. The structure of the joint venture depends on a variety of factors, though primarily related to: economics, control, and risk. These structures, evaluated from the perspective of the non-profit, are:

1. Equal split of the economic incentives, the non-profit primarily controls management (as evidenced by decision-making authority) after construction is complete.
2. Equal split of the economic incentives, the co-venturer continues to primarily control management after construction is complete.
3. Uneven split of the economic incentives, the non-profit primarily controls management after construction is complete.
4. Uneven split of the economic incentives, the co-venturer continues to primarily control management after construction is complete.

Each "structure" presents a variety of pros and cons. The structure of the joint venture will be determined by what the non-profit is seeking to accomplish by participating in the joint venture. Often the non-profit is seeking to benefit financially, limit risk, or some combination of the two. Therefore, the parties' degree of control over the project will vary depending on their goals, respectively. A non-profit should assess their negotiation position when deciding whether to joint venture by evaluating its expectations, assets, and organizational capacity.

Ultimately, since the benefits and risks to the parties are deal-specific, this paper suggests that both private and public stakeholders allow for flexibility in the joint venture structure.

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INTRODUCTION

This paper is intended for the Supportive Housing Network of New York's non-profit members as a guide to the issues involved in joint venture partnerships entered into for the purpose of constructing or rehabilitating supportive housing. Most of the following advice is derived from interviews with non- and for-profit developers, government partners, tax-credit investors, housing consultants, and underwriters. To quote one of the stakeholders interviewed, "a joint venture is like a marriage – except more binding." In light of this observation, the aim of this paper is to address the questions of when an organization should consider a joint venture, what legal issues might arise when a non-profit enters into a joint venture, and provide a framework for non-profit organizations to self-evaluate and translate the value they bring to a partnership into tangible, financial terms.

Originally, this paper intended to identify and discuss the "joint venture structure". Research and interviews with stakeholders quickly revealed that there is no single, joint venture structure. The most important take away from the research and writing process is that the way a joint venture partnership is structured is highly specific to the parties and their individual circumstances. There are many issues for a non-profit co-venturer to carefully consider before, during, and after the partnership is formed.

At the end of the day, stakeholders repeatedly indicated that, if they would not enter the deal on a handshake, they would not enter into a partnership regardless of the protections available to formalize the relationship. Joint ventures in the realm of supportive housing creation are unique and relationship driven. This paper provides an overview of the important issues a non-profit should consider before entering a joint venture.

CURRENT LANDSCAPE

There are numerous ways, in addition to the joint venture structure, for a non-profit to accomplish its mission and develop supportive housing. Other models for non-profits seeking to develop or secure supportive housing units include sole development or entering into a master lease agreement.[1] However, the joint venture model has been used increasingly in the past few years in response to economic and governmental changes. Many stakeholders interviewed attributed the increased reliance on joint ventures to the shortage of city-owned land. A joint venture can provide a non-profit with the resources to act quickly in the competitive market for private real estate. Access to restricted funding is often a strong incentive for for-profit to consider a joint venture, as well. However, this situation should not be presumed. The benefits, risks, and parties' involvement are often deal-specific.

RECOMMENDATIONS

Non-profits should institute certain best practices when evaluating proposals for joint development. These best practices encourage a non-profit to honestly evaluate their strengths and weaknesses [see addenda]. This evaluation should include:

1.) Clear articulation of strengths and negotiating position;

2.) Due diligence by vetting potential venture partners and the financial aspects of a proposal with LIHTC investors and/or lenders;

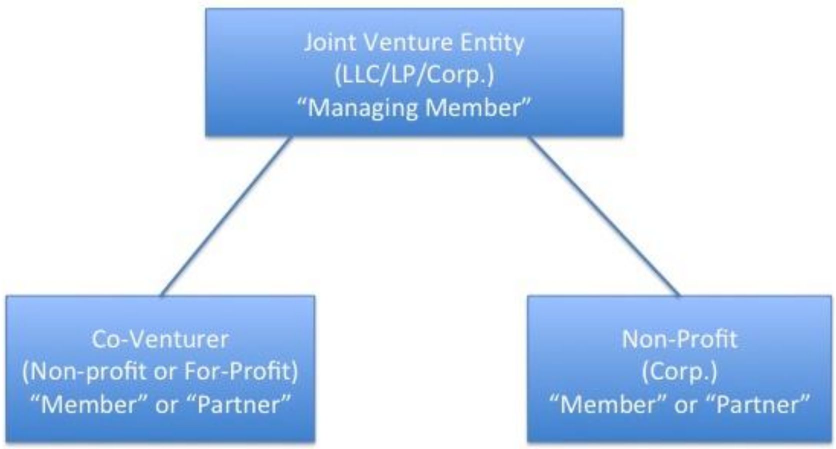
3.) Internal preparation by assessing managerial capacity for the project, as well as the strength and weaknesses of the venturers' relationship.

[1] Arlo Chase, NYSAFAH Conference 2015, Presentation, "A Survey of Non Profit/For Profit Partnerships in Affordable and Supportive Housing Development."

BACKGROUND: THE JOINT VENTURE RELATIONSHIP

<u>What is a Joint Venture?</u>

A joint venture is an association of persons or entities jointly undertaking a particular transaction for mutual profit.[2] This means that two (or more) unrelated parties enter into an arrangement to pool and/or exchange certain resources for their mutual gain. These resources are held by an entity separate from the parties, but subject to their shared control. In the case of supportive housing, the parties create an entity which will act as the "developer" to carry out the construction or rehabilitation portion project. The developer entity is typically responsible for the pre-development, construction and post-construction operation of the project.



The Joint Venture Entity

A joint venture can be utilized for any type of development project. In a LIHTC transaction, the "joint venture" entity is generally the general partner or managing member of the beneficial owner. The tax credit investor would be the limited partner or investor member in the beneficial owner. The legal entity representing the relationship between the tax credit investor and developer is typically the owner of the project. *[see "Legal Formalities," below, for a discussion on the entities involved and how they interact.]*

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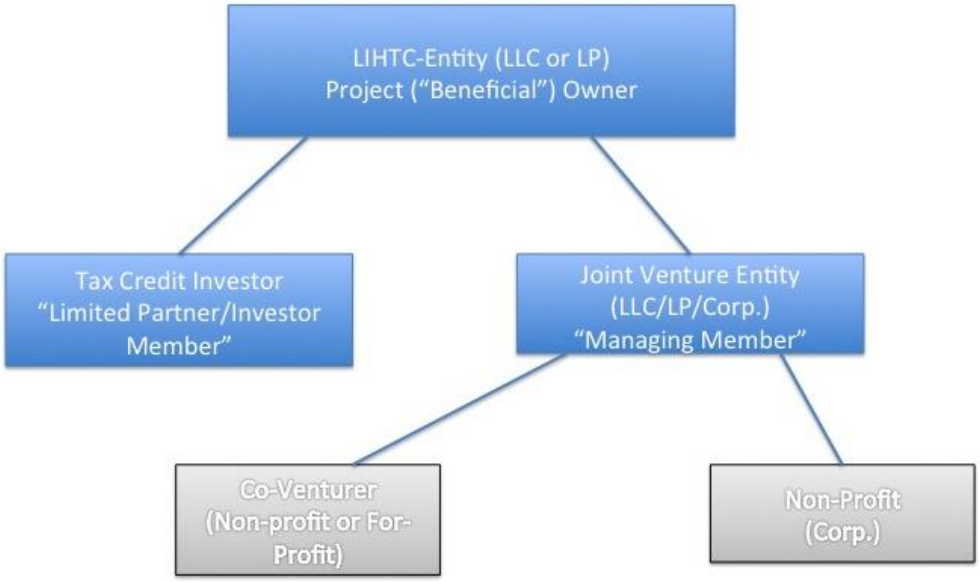
[2] Black's Law Dictionary



Low-Income Housing Tax Credit Partnership Structure

Despite sharing resources, the parties to the joint venture remain independent, which distinguishes a venture from a merger. This distinction is important – although the parties' interests may closely align at the time the parties make an arrangement, they are not necessarily identical, nor should the parties assume that their current common purpose will continue indefinitely. To ensure that the venture is carried out the way the parties intended, the parties assume certain legal rights and duties to one another, as well as to the entity representing the venture and third-parties. The chief concepts driving the various ways these rights and duties are assigned are: **economics, control, and allocation of risk**.[3]

These concepts often reappear in legal documents governing the parties' behavior during construction and post-construction operations. The internal mechanisms that enable the joint venture entity to function smoothly are highly specific to the individual capacity and preferences of the parties involved. Although there are specific-yet-reoccurring issues presented by most joint ventures, the way they are resolved is very dependent upon the facts and circumstances of the parties. There is no "model" joint venture. A non-profit considering a joint venture must carefully consider its own circumstances.

Furthermore, a sampling of parties to recent joint ventures indicates three external factors affecting its structure: real property values, construction costs, and available funding. The parties' assumptions about these factors during preliminary negotiations can be very influential in shaping the terms of the joint venture, whether accurate or not. It is very important that a non-profit clearly understand the project as it is presented to them.

Bottom line: the venture is driven by the relationship between the parties. Regardless of what the legal documents say, a joint venture partnership is only as resilient as the underlying relationship.

[3] Alan Epstein, Panel Discussion – "Joint Ventures: Creating Partnerships that Last," 2013 SHNNY Conference.

Why Should a Non-Profit Consider a Joint Venture Arrangement?

A non-profit might consider a joint venture when:[4]

- It has a social service contract but does not have control of a site or the cash to buy a property.
- It does not have the staff and/or expertise to efficiently develop real property alone.
- A non-profit may not desire to allocate its internal resources to development. However, it should also be noted that a joint venture can be a mechanism for transfer of expertise from a for-profit to a non-profit that is willing to allocate resources to development going forward.
- It does not have the net worth or liquidity to access financing opportunities.
- It would like to leverage its resources to create additional units to advance its mission.
- It would like (i) a share of the economic incentives in development projects, and/or (ii) to mitigate the risks associated with construction.

There are a number of situations that might lead a non-profit to consider a joint venture. However, the first step for a non-profit is to carefully evaluate its expectations, available assets, and capacity for development.

[4] Michael Sanders, Joint Ventures Involving Tax-Exempt Organizations (Wiley 2d ed. 2000); Michael Sanders, Joint Ventures Involving Tax-Exempt Organizations – Cumulative Supplement (Wiley 2d ed. 2005).

Legal Formalities

The parties must consider their interests in the venture, governance of the joint venture entity, and how to share rewards and allocate financial assurances to third parties. The way the parties perceive these factors will determine the type of organizational form for the entity. The joint venture entity can be structured as a limited liability company or corporation.[5]

For simplicity, this paper assumes a two-party joint venture.[6] ***As a guiding principal, if a non-profit would not agree to a joint venture without the assurance of legal formalities, it should probably reconsider.*** On the flip-side, even if the parties have a good working relationship, they should err on the side of caution by putting the terms of their agreement into writing.[7]

Finally, there are certain legal mechanisms that can be provided in organizational documents. Whether they apply is subject to the project particulars. However, the most relevant mechanisms for a joint venture pertain to dispute resolution, including, forced arbitration, pre-identified third-party decision maker, and/or the non-profit holding the final determination when mutual consent cannot be found. A non-profit should pay careful attention to how decision-making power is assigned to overcome conflict.

[5] In the case of a non-profit/for-profit joint venture, the joint venture entity will likely be a limited liability company ("LLC"). In an LLC, each party (a "member") will serve as a member of the company; the parties' respective shares can be allocated in the Operating Agreement. An LLC is preferable to a limited partnership ("LP") because it limits the liability of all members; whereas the general partner in an LP can be personally liable for the partnership's losses. Another distinction between an LLC and LP is the ability to transfer management authority. In an LLC, management and control can be transferred, whereas in an LP, the general partner cannot transfer management or control without also obligating the recipient to increased liability. An LLC allows for more flexibility, unlike an LP.

[6] The JV form can accommodate multiple parties, which results in a more complex structure.

[7] Formally committing to the terms of an agreement in writing is especially important when the non-profit is contributing land to the agreement. If the non-profit later attempts legal action to enforce a term(s) of the agreement as it relates to the land, a written recording evidencing the agreement is necessary before a judge will consider intervening.

Key Documents and Corresponding Issues

A ***term sheet*** (or ***memorandum of understanding***) is a document that outlines the terms and conditions of the agreement. The term sheet can act as a guide for the joint venture agreement or stand in its place. The key terms include: stated purpose, description of property, fee ownership of property, economic interest in JV, contribution of pre-development expenses, operating control structure, division of the developer fee, division of cash flow from operations, proposed development team [general contractor, architect, project attorney], contracts for future operating services [property manager/marketing & lease-up/LIHTC compliance], and which party will receive the right of first refusal/purchase option at year 15 when the tax credit investor exits the transaction. When reviewing a term sheet, be sure to pay particular attention to whether it is binding and/or requires that the terms remain confidential.

The ***joint venture agreement*** provides a contractual basis for the joint venture. The agreement will typically articulate the context for the venture, as well as assign the legal rights and obligations between the parties. Typically, the joint venture agreement is a fully developed iteration of the agreement set forth in the term sheet – it often takes the form of the General Partner or Managing Member Operating Agreement. It is important to note that this agreement is typically the result of extensive negotiation between the parties. *The non-profit should consult and retain a legal practitioner with real estate development experience for the negotiation period.* The non-profit's General Counsel should be consulted about organizational requirements and limitations that might affect the joint venture structure or vice versa. For example, a narrowly drafted purpose clause in the Certificate of Incorporation and/or by-laws might limit the organization's permitted activities and need to be amended. The key terms to consider when negotiating the joint venture agreement include: control, major decisions requiring consent of both venturers, allocation of developer's fee and cash flow, provision of guaranties[8], and an exit strategy.

The ***operating agreement*** (if a limited partnership, the *limited partnership agreement,* or if a corporation, the *by-laws*) is an agreement by the members of a limited liability company, which articulates the member's financial and managerial rights and duties. Regardless of the name, the document's main purpose is to provide organizational structure for the JV and outline the entity's operating procedures by assigning the parties' respective shares of control and decision making, as well as the way assets, liabilities, revenues, and expenses are allocated.

Together, these documents address the primary joint venture issues: economics, control, and risk. The resulting structure of the joint venture is a function of the ways the parties allocate these three issues, which depends upon the parties' respective goals and desired outcomes for the project. Although there isn't a "cookie-cutter" model for a joint venture to develop supportive housing, interviews revealed a couple different, but reoccurring, structures. These structures are addressed in the following analysis.

[8] A guaranty is a promise to answer for the debt or obligation of another in the event of non-payment, non-performance, and/or other defaulting scenarios. There are typically guaranties provided to a private lender to secure timely and within budget construction and then guaranties provided to the tax credit investor to secure operating requirements post-construction.

ANALYSIS

The primary economic elements in a LIHTC transaction are the developer fee, the project's cash flow, and the right to purchase the project or the tax credit investor's interests in the project at year 15 for preferential terms. The developer fee is divided between the parties and paid out over various points during the term of construction. A portion of the fee is paid from equity installments from the tax credit investor upon the achievement of certain benchmarks, typically construction completion, conversion, and receipt of IRS Form 8609 (the "paid fee") and a portion is paid from project cash flow during operations (the "deferred fee").[9]

The length of involvement of the for profit-venturer is a function of when managerial control shifts to the non-profit, the assignment of guaranties and their anticipated expiration, whether the for-profit has agreed to sell their interest in the venture at a designated time, and if the joint venture affords the non-profit an opportunity to buy the property.

The structure of a joint venture will be determined by what the non-profit is seeking to accomplish by participating in the project. For example, if a non-profit's primary concern is limiting liability, it can probably negotiate a structure where the for-profit takes all guaranty risk during construction and operation. However, in such a structure the non-profit will not control and will be limited in its ability to negotiate an equal or close-to-equal share of the developer fee. Alternatively, if the non-profit is focused on maximizing their share of the developer fee, it would likely have to accept a meaningful share of the guaranty risk.

A non-profit must assess their negotiating position prior to signing any joint venture or partnership agreement (see attached addenda.) The primary variables for consideration include: (i) willingness and/or ability to provide meaningful guaranties during construction or operation, (ii) which party owns and/or controls the project site, (iii) whether the non-profit brings any particular funding to the table (i.e. HHAC/OMH/MRT capital, operating subsidy contracts for special needs units, extra points on the tax credit scoring), (iv) whether the non-profit has the ability to deliver greater community and/or local official support for the project, and (v) willingness and/or ability to provide predevelopment funding or secure predevelopment funding. Finally, if the for-profit venturer is also the general contractor then the non-profit should bear in mind that the for-profit will profit on the general contractor side. In this situation, the non-profit might push harder for more of the developer fee.

I. Equal split of developer fee, co-venturer is a short-term partner

Under this structure, the developer fee will be split at or about 50%-50%. An equal fee split might mean that the paid fee and the deferred fee are shared equally OR one party takes more of the paid fee and the other more of the deferred. In either case, the deferred fee is paid out to both parties proportionately. The co-venturer can relinquish managerial control at a specified time – usually completion of construction – to the non-profit. Additionally, the co-venturer may hold the option to sell its management share, which it agrees to do at a specific time, designated by the parties, shortly after completion of construction. In this case, the construction guaranties are held by the co-venturer and the post-completion guaranties to the equity investor are held by the non-profit.

[9] The parties can decide whether this will be paid out of future project cash flows or explicitly not out of cash flows.

Pros:

- *Fostering Long-term Mission*. Creation of permanent supportive housing units.
- *Control*. Non-profit controls use and management of units during operation.
- *Economics*. Extracting a bigger share of the developer fees is a substantial economic benefit.

Cons:

- *Opportunity Cost*. Requires high degree of involvement by non-profit – taking on operating period equity guaranties, quick response time to requests, designated member of the organization to act as JV point-person to answer requests and demands.
- *Risk*. A risk-averse Board of Directors may have a hard time agreeing to the long-term demands and responsibilities associated with this form.
- *Availability*. Not the norm – deals with these terms are usually unavailable to less-established non-profits.

Recommendations:

If a non-profit can negotiate a deal under these terms, it probably has extensive development and/or service provider experience, or is an experienced service provider but not developer. *In these cases, the question for the non-profit is: "could you develop this project alone?"* This question gets to the issue of what, exactly, the co-venturer is providing. Typically, the answer is land. If a non-profit has the expertise to oversee development, the financial health to take on debt guaranties, and access to land, why share the developer fee? In this case, joint venturing might be a way to diversify a development pipeline and mitigate the risks associated with other projects.

A non-profit should not undertake the property management contract without management expertise. If the co-venturer receives the property management contract, the non-profit might consider asking for a larger portion of the developer's fee since the co-venturer will receive a greater portion of project profits. If a non-profit is interested in expanding into property management, it might request the opportunity to review the books and records of the co-venturer's property management arm.

II. Equal split of developer fee, co-venturer as a long-term partner

Here, the developer fee is shared equally. However, there is no agreement for the co-venturer to exit after completion. Additionally, the co-venturer will likely assume some or all of the post-construction guaranties to the equity investor.

Pros:

- *Limited liability.* By permitting the co-venturer to take on the post-construction guaranties, the non-profit is not solely financially responsible to the equity investor for operating deficits.
- *Better access to credit.* If the co-venturer is a for-profit organization with a strong balance sheet and track record, banks may find the joint venture entity more attractive. During the operating phase the collateral for the permanent loan is the building. During construction the bank is relying more on the creditworthiness of the borrower/guarantor.

- *Capacity building*. Long-term involvement by the co-venturer may provide the opportunity for the non-profit to learn development (as well as property management, if applicable) from the co-venturer.

Cons:

- *Organizational inefficiency*. Shared decision making required for a longer period of time.
- *Mission conflict.* For-profit has input in how non-profit will run the building; exacerbating an inherent conflict – the non-profit must further its charitable purposes and the for-profit is seeking to maximize profits. This model may be best utilized in a non-profit - non-profit joint venture.

Recommendations:

Identify and clearly define the decisions that will be reserved to one party. Conversely, define the decisions that will require consents from both parties.

Strong conflict resolution mechanisms should be included in the joint venture agreement and/or operating agreement. A named, neutral third-party might be pre-selected to resolve disputes; as well as expedited arbitration required for applicable matters.

The parties should outline an exit strategy upon the end of year 15 or the extended LIHTC-compliance period. When drafting an exit strategy the parties should consider:

- Will the non-profit buy the ownership interest in the joint venture entity from the co-venturer? If so for what price?
- Will the non-profit buy the project/ownership interest from the equity investor, if so, for how much?
- Will the joint venture entity remain intact after year 15 and exercise the purchase option with respect to the property/tax credit investor ownership interests? If so will there be any change in economics, control or risks during the post year 15 period?

III. Uneven split of developer fee, co-venturer is a short-term partner

In this scenario, the co-venturers will split the developer fee unevenly. Often the larger share of the fee goes to the party that is responsible for most of the guaranty risks. Additionally, the party earning more of the fee might provide additional resources, for example: access to land and/or pre-development loans or grant money. The co-venturer will sell their shares in the partnership either post-construction or as soon as they receive their portion of the deferred developer fee.

Pros:

- *Limited risk*. For-profit takes on all construction risk and, possibly, part of the equity investor guaranties.

Cons:

- *Lack of accountability*. The non-profit will be largely responsible for long term property maintenance, operating revenue, compliance issues, etc. Does this create a situation where the non-profit is not involved with design/construction choices to ensure long-term quality of building?

Recommendations:

Ensure the non-profit has the right to approve the final design and construction documents and certain changes in design and/or construction - for example, changes in the amount or placement of community space; floor, exterior, and/or roofing material. Also, the non-profit should consider retaining an owner's representative to represent its interests during the construction process. The cost of such owner's representative might be able to be included in the project development budget.

IV. Uneven Split of Developer Fee, co-venturer as long-term partner

The developer's fee might be split unevenly because the co-venturer has taken on all or almost all of the guaranty risk. By providing the operating period equity investor guaranties, the co-venturer is a long-term partner, by default. Additionally, the co-venturer may not explicitly provide the non-profit with the option to buy their ownership interests and/or the project.

Pros:

- *Limited risk.* For-profit might take on all guarantor responsibilities.

Cons:

- *Concerns over private benefit from non-profit to a for-profit.* Appearance of the non-profit having limited control might cause certain governmental agencies to scrutinize the project more closely.
- *Economics.* In exchange for providing all or most guaranties the for-profit will extract the bulk of the developer fee

Recommendations:

Control may shift between the parties throughout the life of the venture. Thus, the organizational documents should delineate decision-making and management by the parties during construction and post-construction phases. The party at risk for financial guaranties or other obligations during a particular time period should be the party to control the venture during that period.

Multi-Party Joint Venture

Any of the above examples can accommodate a multi-party joint venture. An equal fee split would be 33%-33%-33%, for example, instead of 50%-50%. The party in control can usually be determined by: which party is the manager, which decisions are categorized as "major," and the way the management vehicle of the joint venture entity is selected and maintained.

Pros:

- *Lesser burden on non-profit staff.* Responsibilities can be split across more entities (i.e., one entity responsible for development and another responsible for management and yet another responsible for providing social services).

Cons:

- *Increased administrative costs.* The complex relationship should be maintained with formal agreements and increased oversight.
- *Economics.* Smaller developer fee paid out, per party.

Recommendations:

In the case of a multi-party joint venture, a non-profit should pay attention to whether their organization requires supermajority consent for any particular corporate governance issues, the joint venture entity operating agreement provide the co-venturer the ability to dilute their control, and termination and exit rights in the joint venture entity operating agreement.

Conclusion

The structures identified in this analysis are not the only ways to structure a joint venture partnership. These examples are intended to create a framework in which parties can fine-tune the partnership structure, in light of their situation's particular facts. The control element is primarily concerned with the issue of who will dictate the terms and manner of services provided to the residents. As previously mentioned, there is no "ideal" structure. The resulting joint venture partnership is a product of the parties' ability to communicate their goals clearly and willingness to make reasonable trade-offs. Finally, a non-profit should view potential partnerships and their terms in the context of their responsibilities as tax-exempt organization. The final section of this paper outlines the issues non-profits should consider in order to avoid scrutiny by Internal Revenue Service ("IRS").

PROTECTING CHARITBLE DESIGNATION

A non-profit must consider certain New York State and federal laws in connection with a proposed joint venture, to avoid jeopardizing its tax-exempt status.

Under New York Non-Profit Corporation Law ("NPCL"), a non-profit corporation may not be formed for "pecuniary profit or financial gain"… "except to the extent that such activity supports its other lawful activities."[10] Under the NPCL, a non-profit may be an incorporator of other corporations or a partner in a redevelopment company formed under the private housing finance law.[11] A separate for-profit subsidiary, which is wholly owned and operated by the non-profit, will stand in for the non-profit in a joint venture with a for-profit to ensure compliance with the NPCL. The primary reasons to form a for-profit subsidiary, at least on LIHTC transactions are (i) limiting liability to the parent and (ii) tax issues – using a non-profit as general partner can result in the project being subjected to extended depreciation, which reduces the returns to the LIHTC investor and may require the partnership to return a portion of the initial equity investment.

A substantial, non-exempt activity or purpose by a non-profit could result in revocation of tax-exempt status.[12] It is important that the joint venture and operating agreements clearly state the charitable purpose of the joint venture. The IRS will apply a two-part test to evaluate whether a non-profit's participation in a joint venture threatens its tax-exempt status.[13] Specifically, in the case of joint ventures formed to develop housing, a non-profit must: 1. show that their participation in the joint venture furthers their exempt purposes; and 2. prove to the IRS that the joint venture does not place their assets at risk for the benefit of a for-profit co-venturer and that the for-profit does not receive more than an incidental benefit from participating in the joint venture.

For an organization formed to provide services to homeless individuals and/or develop supportive housing[14], a joint venture project will satisfy the first portion of the test by demonstrating that it falls within the safe harbor guidelines articulated by the IRS.[15] Even if the safe harbor guidelines are not met, the IRS may still find that an organization provides relief to the distressed and poor by applying a "facts and circumstances" test.[16]

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[10] Non-Profit Corporation Law §204

[11] NPCL §202(a)(15)

[12] *See* IRS Housing Partnership guidance. *See also* Housing Pioneers, Inv. v. Commissioner, 65 TCM 2191 (1993), aff'd 49 F.3d 1395 (9th Cir. 1995), amended, 58 F.3d 401 (9th Cir. 1995) [stating that a non-profit involved in a partnership will not qualify for TE status if its participation furthers a substantial non-exempt purpose and resulted in impermissible private benefit to the for-profit partners.]

[13] GCP 39005 (June 28, 1983), articulating the "Charitable Purpose Test"; aka "Private Benefit Test" – 1. Does the org's participation in the partnership serve its exempt purpose?; 2. Does the partnership arrangement permit the org to act exclusively in furtherance of exempt purposes rather than for the benefit of for-profit partners.

[14] Relief of the poor and distressed is not the only permissible exempt purpose. A housing organization may also satisfy the first part of the test by establishing that they further exempt purposes, including: combating community deterioration, lessening burdens of the government, elimination of discrimination and prejudice, lessening neighborhood tension, and relief of the elderly or physically handicapped. Rev. Proc. 96-32, 1996-1 C.B. 717, 5.

[15] Id. at 2. Stating that, an organization will be considered "charitable", that it provides relief to the poor and distressed and falls within the safe harbor guidelines, if it satisfies the following requirements: 1.) Within each project (a) at least 75% of the units are occupied by individuals earning no more than 80% of area median income (AMI); and (b) either 20% of the units are occupied by residents earning no more than 50% of AMI, or, 40% of the units are occupied by residents earning no more than 60% AMI. 2.) The project is actually occupied by poor and distressed residents. 3.) The housing is affordable to charitable beneficiaries.

[16] Id. at 3. Stating that, relevant facts and circumstances may include, but are not limited to: the degree the non-profit deviates from the safe harbor income limits, degree of community control over the non-profit's operations,

In determining whether the second part of the test is satisfied, the IRS will evaluate whether the joint venture structure obligates the non-profit to act in a way that promotes private financial interests at the expense of their charitable mission.[17] An impermissible tension between the non-profit's obligations, carried out through the general partner, and its exempt purposes will be found when: 1.) the joint venture's primary motive is profit; 2.) the non-profit's degree of control over the project and the joint venture is limited to "ministerial and advisory functions"[18]; and 3.) the general partner's directors and officers are not independent from the limited partner.

A non-profit must have substantial authority and a strong degree of control over the operations of the partnership. In practice, this means that a non-profit should have the authority to use partnership resources to cause the partnership to operate in a manner that will comply with set-aside requirements, regulatory agreements, extended use agreements, and all material provisions of the project's organizational documents. The non-profit should have authority to oversee management's compliance with regulatory and set-aside agreements, as well as the day-to-day operations. While a non-profit may provide guaranties of financial compensation to co-venturers, these promises cannot effectively transfer the non-profit's entire portion of control over, or the finances of, the project.

Finally, income derived from a non-profit's participation in a joint venture partnership and the development and operation of a supportive housing building will be tax-exempt so long as the project is substantially related to the organization's exempt function.[19] Otherwise, income derived from activities inconsistent with a non-profit's charitable purpose(s) will constitute unrelated trade or business income, which is taxable.[20] Practically, this means that a non-profit must ensure that charitable purposes of the venture are clearly articulated in the venture's organizational documents, particularly the partnership agreement. It is a good idea for a non-profit to check their organizational documents to ensure the proposed activities fall within the stated charitable purposes and, if necessary, amend accordingly. Conducting activities inconsistent with the purposes under which the organization was incorporated, or that compromise the internal management and control requirements, could cause the New York State Attorney General and/or Internal Revenue Services to scrutinize your organization.

provision of additional social services, acceptance of residents with unusual burdens (i.e., high medical costs), provision of homeownership opportunities, existence of affordability covenants on the property.

[17] General Counsel Memorandum 39005.

[18] Private Letter Ruling 9736039 (Sept. 5, 1997) at 2.

[19] This also includes management fees, developer fee, social services fees, and the non-profit's share of the partnership profits.

[20] Internal Revenue Code §511-514.

ADDENDUM 1

Who are the Stakeholders?	Interest	Involvement in Joint Venture
Non-Profit	Service provider, housing developer, or both; financial; building capacity; creating units.	Primarily, post-construction period; long-term owner, as well as service provider and/or property manager.
For-Profit	Creation of affordable units; Developer's fee	Primarily, construction period; Potential long-term management of JV entity.
Consultant	Consulting fee; building non-profit capacity for independent development.	Presence may help a risk-averse board of directors, new to joint ventures, feel more comfortable.
Syndicator/Equity Investor	Low-income housing tax credits; financials.	Co-venturers provide guaranties to investor to ensure return on equity investment.
Government	Creating more supportive housing units.	Capital, operating, & service funding – interests secured by regulatory agreements.
Private Lenders	Community Reinvestment Act requirements.	Repayment and completion typically secured by loan guaranties – often provided by party responsible during construction period.

ADDENDUM 2

Pre-Partnering Questions: *Below is a list of questions to consider prior to determining the more detailed aspects (i.e., financials) of a partnership.*
Why are you interested in <u>this</u> joint venture project?
How did the project come to your attention?
Is the proposed project consistent with your mission? Is the outcome of the project (building owner v. service provider) consistent with your mission?
What amount of time and resources (financial and/or staffing) are you willing to commit to this project?
Is the proposed venture the best way to maximize your subsidy dollars?
How will your board of directors perceive the joint venture? What is your organization's capacity for risk? How will other interested parties – such as government entities and donors – perceive the joint venture?
Does your organization have a prior relationship with the co-venturer? If not, have you conducted adequate – such as visiting prior projects and speaking to past partners and/or government entities – due diligence?
How will you evaluate whether the venture is a success or failure?
What is the best possible outcome of the venture? What is the worst?

ADDENDUM 3

"Should our organization joint venture for this project or go it alone?" – A Rubric				
The more "yesses", the stronger your case to: 1. Develop this project alone; OR 2. Extract a larger percentage of the developer's fee and greater control over the project.				
What is the proposed project?	1. A rehab of existing property?** - Is this a rehab of a multi-property portfolio? Y/N	2. Is this a new development? Y/N	3. Is the project eligible for 9% LIHTC credits? Y/N	4. Do you have a soft-commitment for service funding? Y/N
What will you contribute to pre-development costs?	1. Do you have a pre-development grant? Y/N	2. Will you apply for an acquisition loan? Y/N Note: CSH will only lend to a non-profit or a joint venture partnership involving a non-profit.	3. Can you provide cash, up-front, for at least 20% of hard and/or soft costs? Y/N	4. Are you contributing land? Y/N - Is this property alone sufficient for the proposed project? Y/N
What will/can you contribute during the construction phase?	1. Do you have prior development experience and/or a designated executive development position? Y/N	2. Will your board of directors consider jointly guarantying the construction loans?	3. Would your org's balance sheet convince a bank and equity investor to finance the project? Y/N - Do you have other proposed development projects in your pipeline? Y/N	4.a Construction financing – do you have/can you secure funding from HPD SHLP, HHAC, MRT?
(con't)	4.b Is the project applying for 9% tax-credits? Y/N	5. Will the project apply for and receive NYC sales-tax exemption? Y/N	6. Will the project apply for and receive 420-C? Y/N	
Post-construction operation of project:	1. Does your organization have an experienced property management arm? Y/N	2. Does your organization have the experience to oversee lease-up? Y/N	3. Are you willing to be responsible for LIHTC-compliance throughout the regulatory period? Y/N	4. Can you provide the operating guaranties to the LIHTC investor? Y/N

** Typically, the rehabilitation of an existing property will not require a joint venture since the majority of the construction work is already complete.