

Legal Opinion: GCH-0092

Index: 2.175, 2.800

Subject: Sec. 202 Elderly Program & IRS Exemption 501(c)(3)

March 1, 1994

Mr. Frank A. Hoffman, Esquire
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Suite 2800
Indianapolis, Indiana 46204-2017

Dear Mr. Hoffman:

This is in response to your letters of January 5 and 21, 1994 which has been referred to me. You have requested an advisory opinion on a hypothetical factual scenario and possible conflicts and identity of interests under the section 202 Supportive Housing for the Elderly Program.

HYPOTHETICAL FACTUAL SCENARIO

The section 202 Sponsor is a private, nonprofit entity which has an IRS tax exemption ruling under IRC ¹ 501(c)(3). The project which it has sponsored, is owned by a private, nonprofit entity with an IRS tax exemption ruling under IRC ¹ 501(c)(3). The project is managed by an affiliate of the Sponsor. The Manager and Sponsor have overlapping board of directors. The Manager is a private, nonprofit entity which has an IRS tax exemption ruling under IRC ¹ 501(c)(3). The Manager provides housing development services to the Owners sponsored by the Sponsor, without compensation, and property management services at a fee allowable and approved by HUD to Owners sponsored by Sponsor. The Manager makes monetary grants to Sponsor and Owners. The grants are qualified grants under the IRC and are solely for and to activities or entities which qualify for tax exempt status under the IRC ¹ 501(c)(3). The funds for the monetary grants are derived from the HUD section 202 management fees paid by the Owners to Manager under the HUD approved management agreement. The monetary grants to the Owners are not to induce the Owners to contract for management services of the Manager. None of the persons employed or paid as consultants (or otherwise compensated) by the Manager serve as directors on the Owners' board of directors. None of the funds of the Sponsor, Owner, or Manager inure to the benefit of any private person or entity which is for-profit.

ANALYSIS

The Sponsor, Owner and Manager appear to be legally organized and eligible for participation in the section 202 program. In 24 CFR ¹ 889.105, Definition of Sponsor, it is stated that:

Because of the nonprofit nature of the section 202 program, no officer or director of the Sponsor is permitted to have any financial interest in any contract with the Owner in connection with the rendition of services, the provision of goods or supplies, procurement of furnishings and equipment, construction of the project, procurement of the site, or other matters whatsoever. The prohibition in the preceding sentence does not apply to any management contracts and/or supportive services contracts (including the management fees associated therewith) entered

into by the Owner with the Sponsor or its nonprofit affiliate. In the case of a Sponsor or its nonprofit affiliate managing or servicing the project where persons are in a paid capacity with either the Sponsor or nonprofit affiliate, only two such persons would be permitted to serve as directors of the nonprofit organization (Owner) and only in a non-voting capacity.

This restriction is also stated at 24 CFR ¹ 889.235(a). In the facts presented above, the Sponsor, Owner and Manager would not be engaging in any prohibited conflicts of interest.

In the Section 202 program, certain identities of interest are prohibited. Section 889.235(d) provides as follows:

A person or an entity may not provide services to a project in more than one of the following capacities: attorney, architect, contractor, housing consultant, management agent service provider, or seller of the site for the project, except that the same person or entity may serve a project as management agent and housing consultant. The prohibition of an identity of interest between development team members applies until two years after final closing.

In the facts presented above, the Manager would not be engaging in any prohibited identity of interest because of the exception for entities that serve as housing consultants and management agents.

The above arrangement is also consistent with advice provided in HUD Handbook 4571.3 REV-1, issued 4/9/93. See paragraphs 1-4, 1-11, and 1-12 and Appendices 1-4 of the Handbook. It should also be noted that HUD has never restricted the donation of services by development team member. Prior to the 1990 amendments to the section 202 program, HUD has issued a memorandum dated November 4, 1998 on the subject of identity of interest transactions in the section 202 program. This guidance for the previous Section 202 (Direct Loan) Program is consistent with the latest guidance expressed in the above regulations and Handbook and is enclosed for your reference.

Sincerely,

Michael H. Reardon
Assistant General Counsel
Assisted Housing Division