

LIFT Program Legal Questions – Legislative Counsel Response Summary

Response Overview:

In general, proceeds for Q bonds may be spent only for the purposes of “[a]quiring, constructing, remodeling, repairing, equipping or furnishing real or personal property *that is or will be owned or operated by the State of Oregon,*” (emphasis added) or to pay for costs of infrastructure and indebtedness related to such property.

This constitutional restriction is legally uncharted territory. As we discussed in an opinion dated June 17, 2015, there is no case law or other authority that gives further meaning to the restriction. In the Legislative Counsel’s June opinion, we noted that a textual analysis of the Article XI-Q may justify a wide range of uses for Q bond proceeds, but that in the absence of case law, any such analysis is necessarily speculative. Legislative Counsel advised that even an unsuccessful court challenge would likely lead to seriously detrimental outcomes, and recommended a conservative approach to the use of Q bond proceeds.

Because of the lack of legal precedent, Legislative Counsel is unable to opine unequivocally on the validity of OHCS’s proposal. Instead, they have classified the proposals as low, medium or high risk.

This document provides the questions posed of Legislative Counsel and a summary of the responses and risk categorization provided for OHCS consideration.

OHCS is looking to understand whether or not the following structures satisfy the constitutional requirements for use of Q Bond proceeds.

1. May OHCS satisfy the Article XI-Q Bond ownership requirement by entering into a long-term master lease, as lessee, of all or part of an existing multifamily housing project? The rationale behind such a leasehold ownership structure is that OHCS would be able to effectively “purchase” units at a cost per unit that would be lower than developing an entire project and, therefore, could maximize unit production.

Response Summary: Likely LOW Risk

Low risk associated with actual long term (99 years vs 1 year) leases of real property, where real property is defined in a way that is consistent with how the general public would understand it to be defined. The intent is for these dollars to be utilized for capital expenditures and not as operating subsidy, therefore, there may be more risk associated with leasing existing units versus structuring a long term lease where the lease payment is provided up front to defray the cost of construction.

2. Is there an ability to leverage projects financed with Article XI-Q Bonds with 4% LIHTCs or other funding, utilizing one or more of the structures below? This would greatly increase the number of units that could be financed with the \$40 million of Article XI-Q Bonds.
 - a. OHCS purchases the underlying real property (land) and enters into a long-term ground lease, as lessor, with an affordable housing developer who utilizes 4% LIHTC and other tax-exempt bond programs to finance the overall housing development. If the Q Bond financing is just used for acquisition and, possibly, development of the land, would such an approach satisfy the ownership standard of Article XI-Q?

Response Summary: LOW Risk

As the land would be owned by the state, it is likely a constitutional use of the XI-Q bond proceeds.

This low risk scenario assumes that land lease is not subordinated; for scenario including subordination (high risk) see below #7B.

- b. OHCS purchases a multifamily housing project, land and improvements, utilizing Article XI-Q Bonds and then enters into a master lease agreement, as lessor, with a 4% LIHTC tax credit entity or other entity in which a tax creditor participates to rehabilitate, own, and operate (manage) the project leasehold interest. Would OHCS have an appropriate ownership interest by virtue of holding the deed to the land and improvements for Article XI-Q Bond purposes, while the tax credit entity would be deemed to have sufficient ownership through the leasehold to enable its use of 4% LIHTCs and other tax-exempt bond financing?

Response Summary: LOW Risk

As the state would have the deed to the real property, it would likely satisfy the Article XI-Q ownership requirement.

This low risk scenario assumes that land lease is not subordinated; for scenario including subordination (high risk) see below #7B.

- c. May OHCS meet the Article XI-Q Bond ownership requirement by as a general partner of a limited partnership or managing member of a limited liability company where the general partner or managing member owns a .01% of the limited partnership or limited liability company that actually owns the affordable housing development for which Q Bond funding is used, but would be

responsible for the day-to-day operations of the property? If yes and there is more than one entity within the general partner or managing member, what role would OHCS have to play to meet the Article XI-Q Bond ownership requirement?

Response Summary: HIGH Risk

As Oregon law establishes that LLC members have no interest in the property held by the LLC, it is not likely that property owned by the LP or LLC would satisfy the state Article XI-Q Bond requirement.

- d. May OHCS meet the Article XI-Q Bond ownership requirement in the role of a special limited partner or member in a limited partnership or limited liability company, respectively, where such partnership or company owns the affordable housing development for which Q Bond funding is used?

Response Summary: HIGH Risk

As Oregon law establishes that LLC members have no interest in the property held by the LLC, it is not likely that property owned by the LP or LLC would satisfy the state Article XI-Q Bond requirement.

3. If the answer to Question 2.c. or 2.d. is yes, may OHCS further limit risks inherent in development and still meet the Article XI-Q Bond ownership requirement by becoming a limited partner or limited member in a limited partnership or limited liability company, respectively, on a prorated basis with other limited partners or members after completion of the project development?

Response Summary: HIGH Risk

As Oregon law establishes that LLC members have no interest in the property held by the LLC, it is not likely that property owned by the LP or LLC would satisfy the state Article XI-Q Bond requirement.

4. May OHCS satisfy the operational standard of Article XI-Q with either of the following structures:
 - a. May OHCS satisfy the operational standard of Article XI-Q as a limited partner in a limited partnership or limited member in a limited liability company if OHCS effectively controlled the public purpose use of the project development through

the detailed terms of the entity operating agreement of which it would be a party and by taking (in its own name, with right of action as the beneficiary) the beneficial interest in restrictive covenants guaranteeing operation of the project for the intended public purpose and recorded against the project by the limited partnership or limited liability company owner?

Response Summary: HIGH Risk

In order to be considered an operator, it is likely the case that a role beyond that of a monitor would be required.

- b. If the answer to 4.a. is no, would it make a difference if the ownership interest held by OHCS in the limited partnership or limited liability company were as a general partner or managing member and OHCS? What if OHCS and the general partner or managing member contracted with a management company to perform the day-to-day management of the property pursuant to a detailed management agreement ensuring operation of the project for its intended public purpose?

Summary Response: MEDIUM Risk

Most direct way to accomplish the operating requirement would be to have state employees conducting the day-to-day management of the project. Though the proposal of hiring a third party to conduct such activities is a step removed, the state would maintain control and have an active role in the operations and management of the property. To minimize risk, the state should retain as much control as possible over the management company for example by establishing the ability to unilaterally hire, fire, and direct the activities of the management company.

5. How would the utilization of Q Bonds to fund a project on tribal lands impact the answers above, given tribal sovereignty and the inability of OHCS to obtain fee simple title to project land? Particularly, would a leasehold ownership interest in tribal land satisfy the Article XI-Q ownership standard and would operational control through a limited liability company or limited partnership of a leasehold interest in tribal land still be sufficient to satisfy the operational requirement of Article XI-A?

Response Summary: Responses above apply to tribal land, except in the case of the questions 1 and 2 regarding fee simple ownership. As fee simple ownership is not possible on tribal lands that would support the concept that the court should recognize a long-term master lease as “ownership” for the purposes of Article XI-Q. If fee simple ownership is not possible, then entering into a ground lease would not

be possible as the state would not be able to buy the land at the outset and the property could not effectively revert to the state at the end of the lease.

6. Under what ownership structure(s) could Article XI-Q Bonds be utilized in single family projects that result in homeownership for low income residents?

Response Summary: HIGH Risk

Though Article XI-Q does not specify a duration for the ownership or operations requirements, it does specifically state that the Q bond proceeds must be spent on property “that is or will be owned or operated by the State of Oregon.” While Article XI-Q probably does not required the state to own or operate Q bond financed property in perpetuity, it is likely not permissible to purchase property using Q bonds and immediately sell or exchange it. In the same way, to use the Q bond proceeds to finance property with the established initial intent of transferring said property away from the state is risky as it creates the appearance of sidestepping the restrictions imposed by Article XI-Q.

7. Under a ownership structure of OHCS owning land and entering into a ground lease with an affordable housing owner/operator, please address the questions below:
 - a. What is the threshold, minimum, and/or maximum term that the ground lease would have to be to satisfy the constitutional ownership requirement?

Response summary: There is likely no minimum term for the ground lease to be constitutional. If the state finances only the land with Q bond proceeds, then the land is owned by the state, regardless of the term of the lease. If the state finances development of the land, the improvements “will be owned” by the state regardless of the term of the lease (provided that, under the terms of the ground lease, improvements revert to the state upon expiration of the lease).

- b. OHCS may need to subordinate the ground lease to the primary lender of the improvements. What is any issues would this cause to the ownership requirement?

Response Summary: HIGH risk

By subordinating the ground lease in order to allow for the leverage of loans, the state ownership is contingent upon a third party (the developer) that the state does not control maintaining loan payments and not defaulting. This challenges the ownership requirements of Article XI-Q.