Addressing the Growing Need for Senior Living Projects Through Tax-Exempt Bonds:

A Guide for Senior Living Facility Owners, Developers and Operators

As Baby Boomers begin to reach their seventies and life expectancy continues to increase, the U.S. senior population is expected to grow significantly in the coming years and decades.

A GROWING SENIOR POPULATION

According to the U.S. Census Bureau:

- The population aged 65+ is projected to more than double in size between 2014 and 2060
- The biggest increase is expected to start in just a few years in the decade from 2020 to 2030, when those aged 65 and over are projected to increase by 18 million to a total of 74 million people, accounting for more than 20% of the total United States population

As the senior population continues to grow, so does the need for housing built specifically for seniors, such as multifamily senior apartments, continuing care retirement communities, independent living and assisted living facilities, skilled nursing facilities and memory care facilities ("senior living facilities").

EVALUATING FINANCING OPTIONS FOR SENIOR LIVING FACILITIES

Tax-exempt bonds can be a valuable financing option for senior living facilities because they offer lower rates of interest, longer terms, and more flexible covenants than bank financing. Tax-exempt debt generally may be issued on a long-term, fully amortizing (e.g., 20-30 year), fixed interest rate basis, compared to most taxable debt which is usually issued with a shorter term at a variable interest rate.

Senior living facilities may be financed on a tax-exempt basis under two different sections of the Internal Revenue Code:

(1) Qualified 501(c)(3) Bonds under Internal Revenue Code Section 145 and

(2) Multifamily Exempt Facility Bonds under Internal Revenue Code Section 142.

Learn more about each option below.

OPTION 1: QUALIFIED 501(C)(3) BONDS

What is the threshold requirement for financing senior living facilities with 501(c)(3) bonds? The senior living facility must be owned by a 501(c)(3) organization or by a single member LLC or partnership all of whose members are 501(c)(3) organizations.

For a non-profit corporation to qualify for 501(c)(3) status, it must be organized and operated to further a charitable purpose. The Internal Revenue Service has determined that providing housing to seniors without regard to income is an eligible charitable purpose if the senior living facility adequately addresses the three (3) primary needs of seniors:

- **Age-appropriate housing:** the housing must be suitable to the special needs of seniors
- **Housing-related financial security:** the organization must make an effort, consistent with the financial

viability of the organization, to maintain in residence those who suffer unexpected financial reverses after entering the facility and must attempt to provide housing and related health care at the lowest feasible cost

- **Health care:** the organization can address the health care needs of seniors by providing health and nursing care on-site or by transfer agreements to other facilities and health care providers.[1]

Generally, no income restrictions apply to bond-financed 501(c)(3) senior living facilities[2] if the bonds (i) pay for the construction of the facilities (rather than their acquisition from another party), (ii) refund tax-exempt bonds originally issued for construction of the facilities, or (iii) refinance short term taxable construction debt. Income restrictions as described below under "Multifamily Exempt Facility Bonds" **do apply** if the bonds (i) finance the acquisition of an existing facility or (ii) refinance long-term taxable debt. Nor are there restrictions on the configuration of individual units—they may or may not have kitchens or separate bathrooms.

In general, tax rules prohibit a 501(c)(3) organization from paying above fair market value compensation to any third party for services provided in the development or operation of a senior living facility.

A senior living facility financed with 501(c)(3) bonds may be managed by a for-profit manager, provided that the management contract satisfies guidelines released by the Internal Revenue Service in 2017. These guidelines, among other things, prohibit the manager from receiving compensation that is in any way based on the net profits of the facility or from receiving above-fair market value compensation for services provided.

OPTION 2: MULTIFAMILY EXEMPT FACILITY BONDS

Multifamily Exempt Facility Bonds issued under Section 142 of the Internal Revenue Code can also be used to finance construction and development of senior living facilities. Facilities financed with Section 142 bonds may be owned by a for-profit corporation or limited partnership or a 501(c)(3) organization – the strict ownership requirements for 501c3 bonds do not apply – but the project must qualify as residential rental property by meeting certain low income and other occupancy requirements.

Residential rental property is defined as any accommodation containing separate and complete facilities for living, sleeping, eating, cooking and sanitation. This means that each unit must have its own kitchen and bathroom, although these requirements may on occasion not apply.

Residential rental property must be continuously available for rent to the general public. In addition, either 20% of the units must be rented to individuals with income not exceeding 50% of area median income or 40% of the units must be rented to individuals with income not exceeding 60% of area median income. These requirements last for the longer of (1) 15 years, (2) the retirement of all tax-exempt financing related to the project, or (3) the termination of project-based Section 8 assistance.

In addition, Section 142 bonds may also be used to acquire existing residential rental property, so long as rehabilitation expenditures are incurred within two years in an amount at least equal to 15% of the cost of the building.

Section 142 bonds are often combined with Low-Income Housing Tax Credits (LIHTC) available under Section 42 of the Code, which provide subsidized equity capital for qualifying projects.

For more information on Multifamily Exempt Facility Bonds, see the Orrick Greenbook: *Multifamily Rental Housing: Financing with Tax-Exempt Bonds*.

---

[1] In addition, organizations can qualify for 501(c)(3) status if they provide housing to low and moderate income seniors.

[2] Other than for organizations devoted to providing housing to low and moderate income seniors.

COMPARING TAX-EXEMPT FINANCING OPTIONS FOR SENIOR LIVING PROJECTS: A QUICK REFERENCE GUIDE

See the guide below for a comparison of the main tax-exempt financing options described above. While the information in this table should not be construed or relied upon as legal advice, this chart can provide a helpful overview of tax-exempt financing options for senior living projects which may help inform future requests for legal and financial advice.

If you're an owner, developer or operator of a senior living facility (or facilities), advice from competent bond and tax counsel can help you evaluate and decide on financing options. Attorneys for Orrick, Herrington & Sutcliffe LLP have assisted many clients over the years in the issuance of billions of dollars of bonds to finance senior living projects.

Quick Reference Guide: Tax-Exempt Financing Options For Senior Living Projects

	Qualified 501(c)(3) Bonds	Multifamily Exempt Facility Bonds
Senior Living Facility Ownership	Must be owned by a 501(c)(3) organization or by a single member LLC or partnership all of whose members are 501(c)(3) organizations	Can be owned by a for-profit corporation or limited partnership or a 501(c)(3) organization
What can be financed?	Units may or may not have complete kitchens and separate bathrooms in most circumstances	Residential rental property (meaning any accommodation containing separate and complete facilities for living, sleeping, eating, cooking and sanitation) Each rental unit must have its own cooking facilities, though this requirement is sometimes not applicable
Income Limits on Residents[3]	No, unless 501(c)(3) status is based on providing housing to low and moderate income seniors and not providing housing to seniors without regard to income Income limits may apply if bonds acquire existing property or refinance permanent taxable debt	Yes, for the "qualified project period" [4] 20% @ 50%: At least 20% of the units are rented to individuals whose income is 50% or less of area median income 40% at 60%: At least 40% of the units are rented to individuals whose income is 60% or less of area median income
Volume Cap	No	Yes
Alternative Minimum Tax	Not subject	Not subject
TEFRA Approval	Yes	Yes
Limitations on Contracts with Management Companies	Yes, management contracts for any aspect of operations (including healthcare) must comply with the IRS management contract guidelines	No
Tax Credits	No, since 501(c)(3) organizations do not pay tax and can derive no benefit from them	Yes; Additional affordability requirements may be imposed on project as a condition to receiving tax credits
Low-Income Housing Tax Credits (LIHTC) Equity	No	Yes (typically pays ~25% of total development cost)

[3] Some state statutes add additional rent restrictions or extend the minimum project period.

[4] These requirements last for the longer of (1) 15 years, (2) the retirement of all tax-exempt financing related to the project, or (3) the termination of project-based Section 8 assistance.

Contact Us

For more information about these options or to discuss any senior living project financing needs, please contact:

Jenna Magan
Sacramento
+1 916 329 7980
vcmagan@orrick.com

Scott Schickli
Portland
+1 503 943 4830
sschickli@orrick.com

Justin Cooper
San Francisco
+1 415 773 5908
jcooper@orrick.com

Attorney Advertising

Prior results do not guarantee a similar outcome.

If you have questions, for purposes of New York attorney advertising rules, please contact:

Orrick, Herrington & Sutcliffe LLP
51 West 52nd Street
New York, NY 10019-6142
United States

tel +1-212-506-5000

Disclaimer: http://blogs.orrick.com/aad/

US | EMEA | ASIA | orrick.com