

AFFILIATED ENTITIES IN THE NEW HUD WORLD

"Affiliates." This word is suddenly everywhere in the public housing community. Seminars are scheduled expressly on the need for public housing authorities to establish affiliates. The U.S. Department of Housing and Urban Development ("**HUD**") has even issued a notice on the topic. So the questions are: (i) what are affiliates; and (ii) why do housing authorities need them?

Affiliated entities ("**Affiliates**") are not a new concept. In fact, Affiliates have been in existence since the advent of corporations. They are widely used by private companies to shield assets, undertake risky investments and sometimes to spin off profitable companies. Affiliates are only new to the world of public housing. Housing authorities did not begin to use Affiliates until 1995; at the beginning of the mixed-finance initiative.

So, what is an Affiliate? An Affiliate is a fictitious legal entity established under state law. Generally speaking, Affiliates are legally distinct entities connected through ownership or control, either as a parent company controlling one or more subsidiary companies, or as two or more sibling companies under a common parent company. Within the context of housing authorities, an Affiliate is not a part of a housing authority, but it is related to a housing authority through its ownership or control. Typically a housing authority will own all or most of an Affiliate and/or will control an Affiliate's board of directors or other management body. An Affiliate can be organized as a corporation or a limited liability company and can be either a for-profit or a not-for-profit entity. As a separate legal entity, an Affiliate can shield a housing authority from liability for the Affiliate's actions. This containment of risk is one reason developers use different Affiliates for every development.

The first thing one should consider when setting up an Affiliate is the governing law. Affiliates, like a housing authority, are established under state law. Each Affiliate is treated as a separate legal entity. To maintain its distinct legal status and shield a housing authority from liability, an Affiliate must have its own board, meetings and minute books. This means that meetings of an Affiliate's board must be separate from those of the housing authority. The records of such meetings must be kept in their own minute books. The general ledger, journals and registers of an Affiliate should all be kept independently. No inter-fund transfers between an Affiliate and a housing authority should be permitted. In the event money is transferred from a housing authority to an Affiliate or from an Affiliate to a housing authority, it should be done by a check, an actual cash transfer or a bank transfer with receipt. Anything else runs the very real risk of violating state law and giving a disgruntled plaintiff a way to pierce the corporate veil of an Affiliate and reach the housing authority assets.

This brings us to the second question: why do housing authorities need to create Affiliates? In part, HUD has supplied the answer. As appropriations continue to shrink, housing authorities are being implored to seek new sources of funding. At the same time, HUD is attempting to claw back funds that have already been distributed to housing authorities. Accordingly, not only has operating subsidy been reduced, but HUD has looked to housing authority reserves for additional sources of revenue.

Affiliates can help housing authorities follow HUD's directive to obtain new sources of funding, while also helping to keep that funding out of HUD's hands. An Affiliate shields a housing authority from the risks of activities undertaken by the Affiliate. It can engage in profitable enterprises and help a housing authority build reserves. As long as the funds are held in the name of the Affiliate, those funds are one step further from HUD's reach.

Affiliates can be organized as not-for-profit or for-profit entities based on the intended use. For example, if a housing authority is receiving developer fee payments, those monies should go to a not-for-profit Affiliate. The money earned will not be taxed. On the other hand, if an Affiliate is going to serve as a co-general partner or co-managing member, it will most likely need to do so through a for-profit Affiliate. The reason is simple. Investors purchase low-income tax credits, as well as depreciation. If the general partner is a not-for-profit, depreciation must be taken over 40 years. If the general partner is a for-profit, that can be reduced to 27 ½ years.

Layered on top of state law is HUD's view. This view is set forth in HUD's *Notice of the Applicability of Public Housing Program Requirements to Transactions Between Public Housing Agencies and Their Related Affiliates and Instrumentalities* (the "**Notice**"). This article is not long enough to delve into HUD's Notice; its creation of the "instrumentality" concept and the differentiation between an affiliate from an instrumentality. Any housing authority considering an Affiliate must familiarize itself with the Notice before proceeding.

Affiliates have become the new normal for housing authorities. The use of these entities can be enormously beneficial so long as housing authorities are cognizant of the applicable laws surrounding them.

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