

This letter is in response to your request for a ruling that the redemption of a pro-rata portion of certain refunding bonds issued by the Authority will result in the termination of the qualified project period within the meaning of § 142(d)(2)(A) of the Internal Revenue Code of 1986, with respect to the low income housing project described below and end the requirement that such project comply with the continuous rental requirements within the meaning of § 1.103-8(b)(5) of the Income Tax Regulations.

Facts and Representations

The Authority was created pursuant to the Act to issue bonds and notes to create a flow of private capital through the Authority into mortgage loans for qualified housing sponsors and certain qualified individuals.

On Date 1, the Authority issued its Series A Bonds to finance residential rental projects pursuant to § 142(a)(7). Proceeds of the Series A Bonds were used to make a loan to the Borrower (the "Loan") to finance a residential rental project (the "Project") and to make additional mortgage loans to parties unrelated to the Borrower or the Authority to finance other projects meeting the definition of qualified residential rental projects pursuant to § 142(a)(7) and (d).

On the Form 8038, filed with respect to the Series A Bonds, the Authority elected to comply with the 20/50 low income set aside set forth in § 142(d)(1)(A). Fifty percent of the units within the Project were first occupied on or before Date 2, a date that is more than 15 years before the date of this private letter ruling request. No assistance with respect to the Project has been or is expected to be received under § 8 of the United States Housing Act of 1937.

On Date 3, Authority issued Series X, Series Y, and Series Z bonds as current refunding bonds and elected to treat each bond series as a separate issue pursuant to § 1.150-1(c)(3). In the Authority's nonarbitrage certificate (the "Certificate"), the Authority treated the loan to the Borrower as a purpose investment allocable to transferred proceeds of the Series X Bonds. The Authority in the Certificate did not allocate particular bonds of the Series X issue to the Project or indicate any relationship between particular bonds in the issue to a particular project. The Authority only enumerated the location, development name, and remaining mortgage loan amount with respect to each loan, including the remaining Loan amount, that the Authority refinanced with the Series X Bonds.

The Borrower has since informed the Authority that it wishes to prepay its mortgage loan. The Authority intends to apply the funds it receives from the Borrower and other monies to redeem a portion of the Series X Bonds based upon the ratio of the remaining portion of the Loan refinanced with the Series X Bonds to the total remaining amount of mortgage loans refinanced by the Series X Bonds.

Law and Analysis

Section 103(a) provides that, except as provided in § 103(b), gross income does not include interest on any state or local bonds. Section 103(b)(1) provides that § 103(a) shall not apply to any private activity bond unless it is a qualified bond. Section 141(e) states that an exempt facility bond is a qualified bond.

Section 142(a)(7) provides that the term “exempt facility bond” includes any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide qualified residential rental projects. Section 142(d) defines the term “qualified residential rental project” to mean any project for residential rental property if, at all times during the qualified project period, the project meets one of the income requirements (as elected by the issuer) specified in § 142(d)(1)(A) or (B).

Section 142(d)(2)(A) defines the term “qualified project period” as the period beginning on the first date on which 10 percent of the residential rental units in the project are occupied and ending on the latest of: (i) the date which is 15 years after the date on which 50 percent of the residential units in the project are occupied; (ii) the first day on which no tax-exempt private activity bond issued with respect to the project is outstanding; or (iii) the date on which any assistance provided with respect to the project under § 8 of the United States Housing Act of 1937 terminates.

Comprehensive regulations have not been promulgated under § 142. Nevertheless, regulations promulgated under the corresponding provisions of the Internal Revenue Code of 1954 (the “1954 Code”) continue to apply, except as otherwise modified by § 1301 of the Tax Reform Act of 1986, 1986-3 (Vol. 1) C.B. 1, 519 (the “1986 Act”) and subsequent law. Section 1.103-8(b)(5) provides that once available for occupancy, each unit in a residential rental project must be rented or available for rental on a continuous basis during the longer of: (a) the remaining term of the obligation, or (b) the qualified project period (collectively, the “continuous rental requirement”).

The principle issue in this case is whether the Authority can terminate the qualified rental period under § 142 and end the continuous rental requirement of § 1.103-8(b)(5) when it redeems a portion of the Series X bonds based upon the ratio of the remaining portion of the Loan refinanced with the Series X Bonds to the total remaining amount of mortgage loans refinanced by the Series X Bonds. A secondary issue is whether the Authority can determine which of the bonds of the Series X are allocable to the Project using the pro-rata approach described above.

With respect to the qualified project period requirement of § 142(d)(2)(A), 50 percent of the residential units were occupied on or before Date 2, which is more than 15 years before the date the letter ruling request was submitted, so the first prong of the qualified residential rental period test has been satisfied. In addition, the Project receives no assistance under § 8 of the United States Housing Act of 1937. Accordingly the

qualified project period with respect to the Project will end on the first day on which no private activity bond issued with respect to the Project is outstanding.

In the case of an issue of bonds that finance or refinance more than one project, we interpret the language of § 142(d)(2)(A)(ii) to mean that the qualified project period for a project ends when all bonds allocable to that project are no longer outstanding. Section 142(d)(2)(A)(ii) provides that the relevant period ends when no bond that has been “issued with respect to” that project is outstanding. We contrast this language, which focuses on the bonds associated with the project, with other statutory language that refers specifically to the issue, see, e.g., § 141(a) (private activity bond means any bond issued as part of an issue...) Accordingly, the qualified project period for a project may end before the entire issue is redeemed provided that the bonds allocable to that project are no longer outstanding. To conclude otherwise would mean that the qualified project period requirements of § 142(d)(2)(A) would apply to all of the projects or purposes financed with an issue of bonds until all of the bonds in the issue have been redeemed. We think this result could not have been intended by Congress.

The continuous rental requirement lasts for a period equal to the longer of the 1) remaining term of the obligation or 2) qualified project period. The word “obligation” is not modified to refer to obligations issued with respect to the project, raising an issue about whether this provision requires compliance throughout the entire term of the issue. We conclude that the continuous rental requirement should be interpreted consistent with § 142(d)(2) to refer to obligations allocable to the particular project and may be understood as referring to a bond which is part of an issue of bonds instead of the issue in its entirety. Thus, in this case the period to which the continuous rental requirement is applied is determined only with reference to the bonds that financed the Project.

With respect to the secondary issue, the Authority must determine which bonds are allocable to the Project and must be redeemed. Although the reference to “bonds” in § 142(d)(2)(A)(ii) implies a bond-by-bond approach for allocations of bonds of an issue, the reference does not provide how the bonds are to be allocated among various projects. Moreover, the Authority has not previously allocated the particular bonds in Series X issue to particular projects. The Authority has now requested that it be permitted to determine which bonds are allocated to the Project using a pro-rata approach, thereby allocating a pro-rata portion of each bond to the Project based upon the ratio of the remaining portion of the Loan refinanced with the Series X Bonds to the total remaining amount of mortgage loans refinanced by the Series X Bonds. Under the facts and circumstances of this case we conclude that the pro-rata method the Authority plans to use is an appropriate method for allocating the bonds of the Series X issue to the multiple projects. In its Certificate, the Authority listed the projects that would be refinanced with the entire Series X projects. It did not indicate that any particular bonds in the Series X issue should be associated with any particular project. Moreover, a pro-rata method will result in the applicable income requirements being applied to each

project in the same manner as if there were only a single issue financing a single project and each project will be effectively financed with bonds having the same average maturity.

Accordingly, upon redemption of a pro-rata portion of Series X Bonds there will be no tax-exempt private activity bonds issued with respect to the Project outstanding and the qualified project period described in § 142(d)(2)(A) and the continuous rental requirement will terminate with respect to the Project .

Conclusion

We conclude that with respect to the Project the use of mortgage loan prepayments and other monies to redeem a pro-rata portion of the Series X Bonds will result in the termination of the qualified project period within the meaning of § 142(d)(2)(A) and satisfy the continuous rental requirements within the meaning of § 1.103-8(b)(5).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,
Associate Chief Counsel
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By _____
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