

December 18, 2006

[Bond Property Owner]
[Bond Organization Name]
[Bond Property Street Address]
[Bond Property City, State Postal Code]

RE: Washington State Housing Finance Commission Bond Program Compliance Revisions
Property: *Clarified Bond Vacant Unit and Initial Lease-Up Policies for New construction Bond Properties*

Dear Owner:

I am writing to inform you about immediate changes to the way we monitor the initial lease-up process for **newly-constructed** bond properties. Some of these changes will also affect how you will report to us annually after achieving 90% occupancy.

Our legal counsel has advised that we modify our monitoring procedures in order to maintain conformity with current IRS regulations concerning the meeting of set-aside commitments for bond properties.

Proportionality During Initial Lease-up

In Revenue Procedure 2004-39, the IRS states that bond properties must meet their federal income set-aside commitment at all times during the “qualified project period,” which begins on the first day on which 10% of the residential units in the property are occupied. Our bond counsel has determined this to mean that **leasing must be conducted proportionately between market-rate units and set-aside units**. The property must maintain this proportionality **at all times** during the qualified project period.

Example:

Winter Falls is a 100-unit property that has elected to rent 40% of units at 60% of median income (40-60 test). The property achieves 10% lease-up in April, 2007. In July, 2007, the property reports 50 units leased. Of the 50 units, 20 (40%) of those must be rented to income-qualified households. In August, 2007, lease-up increases to 78 units; of the 78, 31 units (40%) must be rented to income-qualified households.

Quarterly and Annual Reporting Requirements

From 10% to 90% occupancy, newly-constructed bond properties will be reporting to the Commission **quarterly, instead of monthly**. This means that the property will have to prove

that it is meeting its set-aside commitment every 90 days, beginning on the date that 10% occupancy is achieved. Once 90% occupancy is achieved, the property will be required to report annually (every January, as is currently the practice). With annual reporting, the set-asides must be demonstrated as of December 31st of each reporting year.

For quarterly reporting, your report deadline will be determined by the date that 10% occupancy is achieved. The first report will be due at the time of 10% occupancy; subsequent reports will be due on the 7th of the month following the end of each 90 day period. Your property's Compliance Officer will work with you and/or the property manager to establish the reporting schedule for your property.

By converting to a quarterly reporting schedule, you will have more flexibility in meeting the proportional leasing requirement, since the Commission will be monitoring for compliance with this rule at the end of a three-month period, rather than a 30-day period.

The Use of Vacant Units

In order to count a vacant unit toward a set-aside, the **vacant unit must have been last occupied by an income-qualified household**. Vacant units that have never been rented, or were last rented to a market-rate household, cannot be counted toward the property's set-aside commitment. While this practice is intended by IRS regulations, the Commission historically has not articulated it clearly to owners and managers. To help you maintain an accurate accounting of your property's vacant units and their usage in set-aside numbers, the Commission now requires additional unit information on Part B of the *Certificate of Continuing Project Compliance* (CCPC) report. During the initial lease-up period (from 10% to 90% occupancy), you **must list all units in the property on the Part B report**. Once you are reporting annually, you will list **qualified units and any vacant units you are counting toward your set-aside(s), along with information on the last household to occupy the vacant units**, on Part B of the CCPC.

The Commission is updating the instructions of the CCPC so that it will be clear how to list the property's units on your reports.

Non-Compliance

Upon receipt of each report (whether quarterly or annually), the Commission will review the property's information and determine whether or not a correction letter needs to be sent. If we discover non-compliance related to your minimum set-aside requirements, we will issue a correction letter asking you to submit a plan for how your property will be brought back into compliance.

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Letter to Bond Property Owner

This preliminary notice will be copied to our Capital Projects Division Director. If the property responds within the letter's timeframe and continues to work with us to correct the noncompliance, we will extend the correction period as needed. If the letter's response timeframe goes by with no response or action from the property, we will issue a letter giving the property 60 days to come back into compliance. The 60-day notice will be copied to our legal counsel. Again, if the property responds appropriately and continues to work with us to correct the noncompliance, we will extend the correction period as needed. If the 60 day period goes by with no action from the property, we may be required to take steps to convert the property's bonds to taxable status.

The Commission understands that the changes outlined above are significant departures from processes and standards we have communicated previously. We believe that these changes are required to help you keep your property in compliance with bond program requirements, and to help you avoid bond-related, bank-imposed or IRS penalties. Our goal is to partner with and support you in maintaining your bond-financed property according to program rules so that your property can successfully house its residents and serve its community for years to come.

Thank you for your cooperation. Do not hesitate to contact your Compliance Officer, Melissa Donahue, Division Manager, or myself if we can be of service in assisting you to meet these clarified standards.

Sincerely,

Tim Sovold, Director
Compliance & Preservation Division
(206) 287-4419 or toll free within Washington 1-800-767-7663
E-mail: tim.sovold@wshfc.org
Visit our web site www.wshfc.org
Register for Broadcast E-mail at our web site: www.wshfc.org/managers/

cc: Property Manager
Property Name.