Summary of Issues Regarding the Utilization of Historic Preservation Tax Credits for the Alpha Chi Sigma Houses at 619 & 621 N Lake St

The Alpha Chapter of Alpha Chi Sigma fraternity houses at 621 and 619 N Lake St ("the Houses") are listed as contributing properties in the Langdon Street Historic District. The district was listed on the National Register of Historic Places in 1986 and on the Wisconsin State Register of Historic Places in 1989. This listing grants eligibility for federal and state Historic Preservation Tax Credits ("HPTCs") which can be used to offset the costs of eligible renovation or rehabilitation of a historic building, subject to a number of state and federal qualification standards regarding building elements, IRS rules, and taxing authority. Alpha Chi Sigma explored at length whether such HPTCs could be used as a funding source for the rehabilitation of the Houses. After a thorough investigation and consultation with tax authorities, the conclusion was that HPTCs would not be viable nor allowable option for the organization, due to the fraternity's non-profit organizational structure, decreased utilization requirements, and insufficient financial benefit.

Organizational Structure & Barriers to Tax Credit Use

The Alpha Chapter of Alpha Chi Sigma is organized under two distinct legal entities:

- ALPHA CHI SIGMA FRATERNITY, Inc., ("AXS") a Wisconsin Nonstock Corporation for educational and charitable purposes is a tax-exempt entity under 501(c)(3) of the Internal Revenue Code
    - This corporation encompasses the subordinate collegiate & professional chapters as well as the National Office and conducts the activities and business of the fraternity (e.g., initiating new members, holding events & meetings, furthering the educational and charitable purposes of the organization)
- ALPHA CHAPTER OF ALPHA CHI SIGMA FRATERNITY, BUILDING CORPORATION, Inc., ("Alpha Corp") a Wisconsin Nonstock Corporation which is tax-exempt under 501(c)(2) of the Internal Revenue Code
    - This corporation's purpose is to hold title to real "property, collect income therefrom, and turn over the entire amount thereof, less expenses, to"[1] the above-named 501(c)(3) organization and is the legal owner of the Houses

This separation of entities and assets is mandated by the Constitution & Bylaws of AXS.[2] Because of their status as 501(c) corporations, neither entity pays federal or state income tax, generally making these credits of no use (Figure 1). While some non-profits have utilized HPTCs for commercial purposes, the use of such credits are not feasible to support the Houses for their intended use as a non-profit fraternal organization, as they do not include revenue generating activities.

As the project proposal has been in public discussion over the several weeks, members of AXS have been questioned on the veracity of their inability to leverage state or federal HPTCs. Recent correspondence[3] with Wisconsin Department of Revenue tax credit specialists provides further

[1] IRC 501(c)(2) - TITLE-HOLDING CORPORATIONS, https://www.irs.gov/pub/irs-tege/eotopicc86.pdf
[2] https://www.alphachisigma.org/file/_documents-new/CB.pdf page 35, lines 8-14
[3] See attached email chain, dated November 18

clarification. Based on these communications and previous analysis, the organization's ineligibility to utilize HPTCs while continuing to use the existing properties exclusively for fraternal lodging (as they have consistently done for nearly a century) is accurate.

2. How can property owned by a tax-exempt entity utilize rehabilitation tax credits?

The rehabilitation tax credit would be of no use to a tax-exempt entity. However, in many instances, tax-exempt entities are involved in rehabilitation projects by forming a limited partnership and maintaining a minority ownership interest as a general partner. In these situations, the limited partners would be entitled to the rehabilitation tax credit and the tax exempt entity is able to ensure that their organizational goals are being met.

Figure 1: Screenshot from IRS.gov website[4]

Critics of the Alchemy Apartments proposal have attempted to suggest the formation of a limited partnership with a minority ownership interest for Alpha Corp. Unfortunately, such a strategy would require the formation of a new for-profit corporate entity to own the titles, and Alpha Corp & AXS would be limited to utilize no more than 50% of the existing space for their organizational purposes. Such requirements would exclude the fraternity to the full use and enjoyment of their house spaces, creating a worse functional and financial situation than has previously existed (Figure 2). Furthermore, federal HPTCs cannot be bought or sold (Figure 3) without ceding ownership of the properties or pursuing a limited partnership strategy, rendering the federal HPTC option nonviable for Alpha Corp and AXS.

19. Can a taxpayer claim the rehabilitation tax credit on property that is leased by a tax exempt entity, i.e. a governmental agency or a non-profit organization?

Yes, taxpayers can lease their property to a tax exempt entity provided the lease does not result in a "disqualified lease" as defined in Internal Revenue Code Section 168(h)(1). A disqualified lease occurs when:

1. Part or all of the property was financed directly or indirectly by an obligation in which the interest is tax exempt under Internal Revenue Code Section 103(a) and such entity (or related entity) participated in the financing,
2. Under the lease there is a fixed or determinable purchase price or an option to buy,
3. The lease term is in excess of 20 years, or
4. The lease occurs after a sale or lease of the property and the lessee used the property before the sale or lease. See Internal Revenue Code Section 168(h)(1)(B)(ii).

An exception under the Treasury Regulations provides that property is not considered tax exempt use property if 50% or less of the property is leased to tax exempt entities in disqualified leases.

23. Can the rehabilitation tax credit be bought and sold?

The rehabilitation tax credit, by itself, cannot be bought or sold. The rehabilitation tax credit is only available to the person or entity who holds title to the property. There can be no transfer of the credit without the requisite ownership. Syndication through limited partnerships is allowed and is a common tool to bring investors into rehabilitation projects.

Treasury Regulation 1.48-12(b)(2)(B)(vii) does allow the transfer of qualified rehabilitation expenditures to a new owner provided the previous owner did not place the property in service.

Figures 2 (top) and 3 (bottom): Screenshots from IRS.gov website[3]

State of Wisconsin HPTCs generally follow the same eligibility rules as federal HPTCs but have some additional flexibility in that they can be awarded to 501(c)(3) entities. There are limited provisions to

[4] https://www.irs.gov/businesses/small-businesses-self-employed/tax-aspects-of-the-historic-preservation-tax-incentives-faqs

allow the credits to be sold or transferred, along with a narrow provision for awarding to other 501(c) entities.[5] However, the complexities involved with such mechanisms are infeasible for the purpose and structure of AXS and Alpha Corp.

AXS is comprised of 66 collegiate chapters and 24 professional chapters/groups dispersed across the United States, all of whom depend upon the organization's 501(c)(3) status to effectively advance the organization's mission of scientific education and charitable activity. For financial risk management purposes, there are also strict policies on the type and nature of expenditures and contracts which can be undertaken by individual chapters, including housing-related expenses. Per national organization standard, using AXS as a transactional vehicle for HPTCs creates unnecessary risk (including potential IRS scrutiny) and further imposes an administrative & financial advisory burden upon the broader organization. There is a prudent reason for the "separate and distinct" structure of AXS and Alpha Corp[6] in this regard, which makes the 501(c)(3) entity unsuitable to provide the transactional functions required for state HPTCs. Nonetheless, Alpha Corp has the tacit approval of their governing body[7] to pursue a redevelopment strategy that is financially viable and compliant with all national adminstrative and financial management policies.

There is one narrow provision by which Alpha Corp may potentially be able to secure state HPTCs, if certified by the WEDC, per Wis. Stat. § 238.17(3)(b):

> (b) The corporation may certify a nonprofit entity not described under section 501 (c) (3) of the Internal Revenue Code for a tax credit under sub. (1) by submitting the proposal for the certification to the joint committee on finance for approval. If the cochairpersons of the joint committee on finance do not notify the corporation within 14 working days after the date of the corporation's submittal that the committee has scheduled a meeting for the purpose of reviewing the proposal, the proposal may be implemented as proposed by the corporation. If, within 14 working days after the corporation's submittal, the cochairpersons of the joint committee on finance notify the corporation that the committee has scheduled a meeting for the purpose of reviewing the proposal, the proposal may be implemented only upon approval of the committee.

The provision, in short, involves preparing a complete project proposal with all work to be done on the site for rehabilitation purposes, which requires up-front speculative spending on engineering, architectural, and other professional services. These services typically include premium pricing in their fee structures due to the restrictions on materials & methods[8] which can be utilized carry out such a project. This proposal is then submitted to the Wisconsin State Legislature Joint Committee on Finance on the hope & prayer that they either do nothing for 14 working days or that they eventually approve the project--with no guarantees on if, when, and exactly how they might do so. Neither the Alpha Chapter nor the national organization would allow such expenditures without a timely or likely path to approval.

Though transferable state HPTCs are theoretically possible for Alpha Corp, the practical realities of the program, coupled with the financial risk to the organization, would provide only a marginal return of an

[5] Wis. Stat. § 238.17(3)
[6] https://www.alphachisigma.org/file/_documents-new/CB.pdf page 35, lines 8-14
[7] See enclosed letter, dated November 7, 2020
[8] https://www.wisconsinhistory.org/pdfs/hp/HPR-Guidelines-Tax-Credit-Projects-for-Income-Producing-Properties.pdf

improved physical structure at the expense of the organization's mission and access to affordable housing for its members.

Financial Benefit Barriers

Shortly after the installation of the shoring wall in 621, Alpha Corp and AXS Housing Committee members investigated the potential costs of rehabilitating the Houses. Estimates from multiple real estate professionals and contractor firms gave a range of $800K to $1.2M for a total rehabilitation of 621, largely owing to the complexities involved in repairing the crumbling foundation while simultaneously keeping a rapidly deteriorating structure intact, as well as the increased costs associated with meeting rehabilitation standards (e.g., many windows are of non-standard size & design, requiring custom glass and millwork for rehab). For 619, total rehabilitation estimates ranged from $200K to $500K since there were fewer structural concerns, giving a range of $1.0M to $1.7M for total rehabilitation cost of both properties.

Assuming the full cost was eligible for the 20% state HPTC, the maximum financial benefit would be between $200K and $340K in tax credit value. According to a WEDC Fact Sheet, state tax credits typically sell for 65 cents per dollar of tax credit value,[9] bringing the maximum potential funding from state HPTCs to a range of $130K to $220K.

This funding would still leave a capital investment requirement of $870K to $1.48M, which rivals the tax assessed value of both properties on the low end and exceeds it by more than 50% on the high end.

Though Alpha Corp maintained a capital reserve for larger projects, recent policy mandating that all multi-unit buildings include fire suppression systems in order to comply with code reduced cash savings to ~$50K and required a restructuring of the existing mortgage to an outstanding debt of ~$180K.

Ignoring any refinancing costs or other fees and using 100% debt financing, the total debt burden would be ~1.0M to ~$1.6M. Assuming a 4% interest rate, 25-year commercial mortgage, and no change to the property tax basis, the mortgage payment, property taxes, and insurance costs would range from ~$10,000 per month to ~$13,100 per month.

Budgeting an additional $6,000/mo for maintenance, management fees, and utilities with another $1,000/mo reserve gives an operating budget range of $17,000/mo to $20,100/mo--equating to an average room rate of $850/mo to $1000/mo if all 20 rooms are at 100% occupancy. These price points are above market rates for area comparables, and inconsistent with our members' perception of affordable rates. Prior to vacating the Houses, residents were paying $550/mo per room. This would effectively price out the organization's members and risk collapse of the fraternity.

As a educational fraternal non-profit organization with no revenue generating sources or mission, Alpha Chi Sigma is wholly unqualified to practically utilize either state or federal HTCs, and its capacity for independent commercial borrowing to finance renovations of the existing structures is a high risk proposition.

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[9] https://newglarusvillage.com/__media/pdfs/Historic-Tax-Credit-Fact-Sheet-2014.pdf

Alpha Chi Sigma Fraternity

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To whom it may concern

The Alpha Chi Sigma (National) Fraternity is a 501(c)3 not-for-profit corporation that is not allowed to own rental property due to its not for profit status. In instances where individual chapters have a house, separate corporations are established to own or manage the property. As such the Alpha Chapter of the Alpha Chi Sigma Building Corporation operates as a separate corporation from the Alpha Chi Sigma (National) Fraternity. Although both corporations are separate entities, with completely separate boards, both corporations serve the members of the Alpha Chi Sigma Fraternity.

The Supreme Council of the Alpha Chi Sigma Fraternity (National) has no objections to the efforts of the Alpha Chapter of the Alpha Chi Sigma Building Corporation in their efforts to provide housing for members of Alpha Chi Sigma at the University of Wisconsin. The Supreme Council understands that the current houses are too expensive to maintain and that the best option for housing of our Fraternity members in Madison is to tear down both structures (619 Lake Street and 621 Lake Street) and replace them with a shared building space. The Supreme Council believes that the Alpha Chapter of Alpha Chi Sigma Building Corporation has done their due diligence and has made their decisions on the best interests of the chapter members, and that this path forward will be one that will be financially viable for the Alpha Chapter of Alpha Chi Sigma Building Corporation so that they can provide housing for chapter members in the years to come.

Regards,

The Supreme Council of Alpha Chi Sigma Fraternity

Kip A. Nalley

Dr. Kip Nalley
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