

IRS DENIES EXEMPTION TO LOCAL FRATERNITY FOUNDATION PROVIDING SCHOLARSHIPS TO CHAPTER MEMBERS

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The IRS ruled that a foundation formed to provide tuition and room and board scholarships to members of a local fraternity chapter is not entitled to exempt status as a Section 501(c)(3) educational organization. In the past the IRS has ruled that a fraternity foundation could award scholarships solely to undergraduate members of a designated fraternity or fraternity chapter. The facts surrounding the administration of the scholarship program at issue provide important guidance as to what activities are exempt, and what activities are not.

In this case, the IRS took issue with the method by which scholarship recipients were selected and the potential number of recipients in relation to the number of applicants. The criteria for awarding scholarships were financial need, academic excellence, or both. Scholarship recipients were chosen based on a ranking system whereby the applicants were ranked based on grade point average and financial need. The foundation then began at the top of the list and granted scholarships as far down the list as its resources allowed. The foundation estimated that between 10 and 14 of the chapter's 31 members received scholarships in a typical year. The IRS noted however, that in some years, all of the chapter members could potentially win scholarships if the foundation's fundraising efforts were particularly successful.

The IRS also took issue with the relationship between the foundation and the local house corporation owning the chapter house. In this case, all of the trustees of the foundation were members of both the fraternity and the local house corporation. The foundation planned to solicit funds from members of the house corporation, which, due to its ownership of the chapter house, had a vested interest in scholarships for room and board expenses.



Based upon these circumstances, the IRS determined the foundation was not exempt. The principal reason for the IRS determination was that the class of beneficiaries was too restricted to confer the public benefit required by Code Section 501(c)(3). In other words, the foundation's benefits were overly directed toward a narrowly designated group.

Moreover, there was an unacceptably high level of pre-selection of scholarship recipients such that members of the house corporation donating to the foundation would know, in advance, that their donations would assist only those applicants from a small pre-identified pool.

Finally, the fact that some or all of the room and board portion of the scholarships would be paid to or for the benefit of the house corporation resulted in a significant private benefit to the house corporation.

This ruling should not be read as establishing a hard-line rule precluding exemption for local fraternity foundations that award scholarships solely to members of the local chapter. The ruling does, however establish some guidelines. AVOID:

1. The implementation of a ranking system for selection of scholarship recipients;
2. A system which results in a possibility of awarding scholarships to all or a high percentage of the chapter members and
3. A significant overlap between local house corporation and/or alumni association board members and foundation board members

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PRESERVING GREEK HOUSING

BEST PRACTICES FOR SECURING LOANS

Planning ahead can allow you to balance the financial and physical needs of your chapter house

**By Jim Henson
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Good financial records and prudent management of rent and other fees will serve the local house corporation well when a loan is needed for repairs. Or, for that matter when the national fraternity or sorority wants to assist the local house corporation with financing.

Let's examine a few scenarios:

First, the local house corporation has no debt on the chapter house due to the support of local alums and good financial management of the real estate asset. The chapter house requires some renovation: upgraded mechanicals or a sprinkler system installation, for example. Some updated decorating would be nice. Maybe a cold dorm should be partitioned into individual bedrooms. The local house corporation has estimates for all these repairs and there is not enough time to do effective fund raising. The improvements need to be done while school is not in session.

Second, the local house corporation can no longer manage the chapter house. Although the chapter is thriving, the chapter house has reached the point of needing repairs to be done; or, heaven forbid, unpaid bills have accumulated and the local house corporation cannot determine how to get enough money to pay these bills.

In both situations, the fastest solution is a loan on the chapter house.

All commercial banks view Greek chapter houses as income-producing properties. The bank holds the loan in their portfolio. Therefore, loan officers look to the cash flow from the property to determine adequacy to repay the debt you have applied for. A combination of interest rate, loan amortization and loan term is often set by the internal funding mechanism the bank uses and how that compares with the Net Operating Income from the chapter house. (Net Operating Income, or NOI is the amount remaining after total operating expenses excluding interest payments are deducted from effective gross income.) You must know what you can afford to borrow before making an application for a loan.

Affording the loan payments is only part of the commercial loan officer's analysis. The chapter house will be appraised, probably by a third party appraiser that the bank will retain. Although chapter houses are income-producing properties, many loan officers have to be convinced that the chapter house will not deteriorate over the course of the loan term. The chapter house must also be in good shape when the appraiser conducts the appraisal. In addition, since the appraiser will base the valuation of your chapter house in relation to the local market (other Greek houses in the area), it is important that a member of the local house corporation meet the appraiser and be sure and point out some of the value improving benefits of the house: paved parking, well marked fire escapes, bathrooms that adequately support the occupant levels. In the event the chapter house is in need of these value improving features and that is the purpose of the loan, then be sure and give the appraiser a copy of the contractor's estimate of repairs or improvements. The appraiser will consider those when determining final value.

A three-year history of audited financial statements will be necessary for the loan officer to determine financial viability for the chapter house. IRS 990s will also be required if you had to file them. Loan officers will also want to see copies of the occupants' leases.

Make sure the borrowing entity is in good standing with the state of incorporation and all business filings with the state are current.

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CLOSING A CHAPTER HOUSE

By Rich Jungman, Willis Managing Partner
and an Initiate of Phi Sigma Kappa

BEHAVIORAL PROBLEMS CAN RESULT IN THE NEED TO CLOSE DOWN A CHAPTER HOUSE. PLANNING AHEAD CAN MAKE THIS A LESS RISKY VENTURE.

Each year, many chapters across the country are closed. The decision may have been made by the inter/national fraternity/sorority or by the university administration. The reason for the closing can also vary from hazing to alcohol abuse to declining membership. At many locations, strong alumni/ae organizations are left behind and many with a significant asset...a chapter house in a prime area of a college or university town. In most instances, it is the desire of the inter/national fraternity/sorority and alumni/ae to eventually return to campus; therefore, it is imperative both entities work in tandem to ensure a heated moment goes off without an incident.

Too many times, housing corporations expect their undergraduates to behave like adults; quietly leaving the property on the last day without creating major damage or a disruption. If they behaved like that, the organization would probably still have a chapter on campus. You would not be dealing with the uncertainty that comes with owning a chapter house on a campus where you no longer have an active chapter. Do not make the announcement of the closing in haste. Be prepared! By following a few simple steps, you can vacate a chapter house without damage other than normal wear and tear.

- Work with your inter/national fraternity/sorority. Don't let the announcement be issued prematurely by them and don't let your leaders leak the information to the undergraduates.
- Make the announcement in person with security present.
- Make arrangements for alternative housing for the undergraduate members if the closing cannot correlate with the end of a semester. Many times the university can assist you in finding alternative housing.
- Keep security present the initial 72 hours after the announcement. This will provide the appropriate cool down period for the undergraduates.



- Limit access to the property to the undergraduates and only while in the presence of an alumnus/a or security.
- Have a lease agreement with each tenant and make sure it stipulates it automatically

terminates if the chapter is no longer recognized by the inter/national fraternity/sorority or university.

- Report the vacancy to your insurance agent promptly. All commercial property insurance policies severely limit coverage once an insured location is no longer being used for its intended purposes unless you take the necessary precautions. Your insurance agent will walk you through this process.

In almost all instances, when a housed chapter was closed due to behavioral issues within the FPMA program and the steps outlined above were NOT followed, substantial damage to the chapter house by the members resulted. In one case, undergraduates were suspected of setting an arson fire resulting in nearly \$1,000,000.00 in damage. Errors in judgment have varied from sending notice to the undergraduates via an e-mail to agreeing to allow the undergraduates to reside in the property until the end of the semester. Consider these points when faced with this decision.

- If it is a behavior related closure, you are assuming a huge liability risk. It is not likely their behavior will improve after the closure. Do you really want this going on at your property?
- Depending upon the size of the claim, you may be subject to a claim surcharge or your insurance may be cancelled. While you may no longer have tenants, you still have a need for the proper insurance protection.
- Your facility can be leased to another organization until your chapter comes back. Working through the claim process and the eventual renovations can eliminate your property as an option to a group actively looking for housing.
- Some property cannot be replaced, whether due to its location, method of construction or just sentimental value.
- regret for the rest of their life. Criminal charges can be the outcome of making a bad decision during a passionate moment.

As you consider the factors involved in closing a chapter house, you may wish to consult with a local attorney to ensure that no tenant/landlord laws are violated through the process.

For more information, as well as sample letters and press releases for announcing the closing of a chapter, please contact edconsultant@willis.com, or visit our website, www.WillisFraternity.com.

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Loan officers are favorably disposed to adult supervision at the chapter house. House Mothers or Fathers or House Directors living at the house give the loan officer comfort that the house is well maintained.

The loan process could take 60 days and is largely determined by how long the appraisal takes. Being prepared for the loan application by having all your financial records in order will expedite the bank ordering the appraisal. Typically, the loan officer will make a condition of the loan a certain appraised value of the chapter house.

Be aware that most loans on chapter houses are 60% of the appraised value. You would need to have sufficient reserves for the 40% downpayment. In regards to the second scenario above, the local house corporation would have to deed the chapter house to the national fraternity who would then secure financing.

Once your loan closes, give serious consideration to a fund raising campaign to pay it off. Most loan terms are between 5 to 10 years which should give you sufficient time to formulate a plan and execute it. Be specific about the use of the funds and offer alums the opportunity to make contributions for specific items that were part of your renovation plan.

Jim Henson is the Vice President of Residential Capital Corporation and specializes in working with local housing corporations and national fraternal organizations to source loan products for the acquisition, acquisition/rehab or rehab of Greek chapter houses. Jim is a proud member of Phi Kappa Psi.

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