

Corporation is an organization exempt from taxation under section 501(c)(3). Corporation operates through an affiliate structure, which involves independent, locally run, not-for-profit organizations working in specific locales pursuant to an agreement with Corporation. The affiliates work primarily to enable low-income borrowers to acquire homes, which are built by the various affiliates. The affiliates provide financing directly to the borrowers for the purchase of their homes ("Mortgages"). The Mortgages have maturities from seven to thirty years.

Corporation has created a loan program through which the local affiliates are able to monetize the mortgage payments due under the Mortgages and obtain funds for issuing new mortgages from third-party investors. Corporation enters into a loan and security agreement with an affiliate under which Corporation makes a loan to the affiliate that is secured by a pledge of the Mortgages ("Affiliate Note"). The proceeds of an Affiliate Note are payable to the affiliate who originated the pledged Mortgages, and proceeds must be applied exclusively to the originating affiliate's area of service, among other requirements. The proceeds of each Affiliate Note are used to issue new Mortgages.

Each pledged Mortgage must be secured by a mortgage on land improved with a single family owner-occupied residence in the area specified by the loan and security agreement, must be underwritten in conformity with the affiliate's written guidelines, must not be currently delinquent in the past twelve months, and must provide for equal or increasing mortgage payments during its term. Property, casualty, and flood insurance for the mortgaged property must be in force. Each pledged Mortgage must mature no earlier than a years after the date of the loan and security agreement. Finally, the outstanding principal balance of the pledged Mortgage cannot exceed b percent of the direct construction cost of the property or c percent of the appraised market value of the property determined by an independent, third-party appraiser. The affiliate continues to service the pledged Mortgages and receive payments from the mortgagors.

Payments due to an affiliate under the pledged Mortgages must be greater than or equal to d percent of the payments due to Corporation under the related Affiliate Note, and the outstanding principal value of the pledged Mortgages must be greater than or equal to e percent of the outstanding principal value of the related Affiliate Note. Where either of these requirements fails to be met, the affiliate has f days to rectify by either pledging additional Mortgages to Corporation or otherwise providing funds to a reserve account. If an affiliate defaults on the Affiliate Note or breaches any other term of the loan and security agreement without being timely cured, the unpaid principal amount of accrued interest on the Affiliate Note becomes due and payable and Corporation has the right to enforce its security interest in the collateral, including the pledged Mortgages.

Upon satisfaction of an affiliate's obligations under the Affiliate Note and the loan and security agreement, Corporation must reassign to the affiliate all of its right, title, and

interest in, and any benefits accruing to Corporation to, the collateral including the pledged Mortgages.

Once Corporation receives Affiliate Notes from various affiliates, the Affiliate Notes are bundled and used as security for privately placed securities sold to third-party investors (the "Mortgage-Backed Securities"). These investors include institutional investors. Each pool of Mortgage loans backs a single maturity of notes. Currently, only one tranche of securities is placed.

The current loan program is limited to the issuance of Mortgage-Backed Securities with single maturity dates. Corporation wishes to expand this program (the "new loan program") by issuing securities in multiple tranches with different maturity dates and interest rates in order to attract a broader base of investors with varied investment goals and expand its ability to provide Mortgages to low-income home buyers. The new loan program will promote the issuance of new mortgages because as payments are made on the mortgages, those amounts may be relent through the affiliates to new home purchasers rather than immediately repaid to the investors. Corporation requests a ruling that its financing of pledged Mortgages with debt instruments having multiple maturities under the new loan program does not constitute a taxable mortgage pool under section 7701(i) of the Code.

Corporation represents that, with respect to any financing by Corporation of pledged Mortgage loans that would be a taxable mortgage pool but for the requested ruling, Corporation will hold, either directly or indirectly through an indenture trustee or other custodian who would hold the pledged Mortgage loans to satisfy the debt instruments issued in the financing, the remaining beneficial interest in all assets that support the debt instruments issued in the financing until those debt instruments are retired.

LAW AND ANALYSIS:

Section 7701(i)(1) provides that a taxable mortgage pool shall be treated as a separate corporation which may not be treated as an includible corporation with any other corporation for purposes of section 1501.

Section 7701(i)(2)(A) provides that in general, a taxable mortgage pool is any entity (other than a REMIC) if (i) substantially all of the assets of such entity consists of debt obligations (or interests therein) and more than 50 percent of such debt obligations (or interests) consists of real estate mortgages (or interests therein), (ii) such entity is the obligor under debt obligations with 2 or more maturities, and (iii) under the terms of the debt obligations referred to in clause (ii) (or underlying arrangement), payments on such debt obligations bear a relationship to payments on the debt obligations (or interests) referred to in clause (i).

Section 7701(i)(2)(B) provides that any portion of an entity which meets the definition of subparagraph (A) shall be treated as a taxable mortgage pool ("TMP").

Section 301.7701(i)-4(a)(1) of the Procedure and Administration Regulations excludes certain governmental bond programs from the TMP rules. It provides that regardless of whether an entity satisfies any of the requirements of section 7701(i)(2)(A), an entity is not classified as a TMP if - (i) The entity is a State, territory, a possession of the United States, the District of Columbia, or any political subdivision thereof (within the meaning of § 1.103-1(b) of this chapter), or is empowered to issue obligations on behalf of one of the foregoing; (ii) The entity issues the debt obligations in the performance of a governmental purpose; and (iii) The entity holds the remaining interests in all assets that support those debt obligations until the debt obligations issued by the entity are retired.

The term "governmental purpose" means an essential governmental function within the meaning of section 115 and does not include mere packaging of debt obligations for resale in the secondary market. § 301.7701(i)-4(a)(2).

Section 301.7701(i)-4(a)(3) provides that if an entity is not described in paragraph (a)(1) of this section, but has a similar purpose, then the Commissioner may determine that the entity is not classified as a taxable mortgage pool.

Corporation is not an entity described in section 301.7701(i)-4(a)(1)(i). Nevertheless Corporation's new loan program may qualify for an exemption from the TMP rules pursuant to section 301.7701(i)-4(a)(3), if it is found that Corporation's new loan program has a similar purpose as described in section 301.7701(i)-4(a)(1)(ii), that is, Corporation's purpose in its new loan program is to issue debt obligations in the performance of a governmental purpose and Corporation meets the requirements of section 301.7701(i)-4(a)(1)(iii). In order to meet the requirement of "performance of a governmental purpose," Corporation's new loan program must satisfy the requirements under section 301.7701(i)-4(a)(2) that the new loan program (1) is in performance of an essential governmental function within the meaning of section 115 and (2) is not the mere packaging of debt obligations for resale in the secondary market.

In providing an exclusion from gross income, section 115 requires, among other things, that the income be derived in "the exercise of any essential governmental function."

Rev. Rul. 77-261, 1977-2 C.B. 45, holds, "Income from a fund, established under a written declaration of trust by a State, for the temporary investment of cash balances of the State and its political subdivisions . . . is excludable from gross income . . ." The ruling reasons that the "investment of positive cash balances . . . in order to receive some yield on the funds until needed to meet expenses is a necessary incident of the power of the State or political subdivision to collect taxes and other revenues for use in meeting governmental expenses." In addressing the meaning of an "essential governmental function" for purposes of section 115, the ruling states, "Congress did not

desire in any way to restrict a State's participation in enterprises that might be useful in carrying out those projects desirable from the standpoint of the State government which, on a broad consideration of the question, may be the function of the sovereign to conduct."

CONCLUSION:

Based on the information submitted and representations made, we conclude that Corporation has satisfied the requirements under section 301.7701(i)-4(a)(1) to be exempt from the TMP rules for its proposed new loan program under the facts and circumstances. Corporation, or its affiliates, will hold, either directly or indirectly through an indenture trustee or other custodian, the remaining interests in the Mortgages that support the mortgage-backed securities issued by Corporation until those mortgage-backed securities issued by Corporation are retired. Corporation's activities provide funding to enable low-income individuals to borrow the money they need to purchase affordable housing. Corporation is not in the business of purchasing and selling of low-income housing mortgage bonds on the secondary market but functions through its affiliates as the direct issuer of such bonds. Accordingly, Corporation's new loan program is in the performance of a governmental purpose for purposes of section 301.7701(i)-4(a)(2) because (1) its activities qualify as an "essential governmental function" under section 115, and (2) its new program is not "the mere packaging of debt obligations for resale on the secondary market."

This ruling is limited to the exemption of Corporation's new loan program from the TMP rules under section 301.7701(i)-4. This ruling's application is limited to the facts, representations, Code sections, and regulations cited herein. No opinion is expressed with regard to whether the new loan program could meet the requirements of a REMIC under section 860D(a), whether it would otherwise be a TMP under section 7701(i), whether it is otherwise exempt under section 501(c)(3), or whether Corporation's loan program satisfies either the accrual requirement or the private benefit requirement of section 115.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the provisions of a Power of Attorney on file, we are sending a copy of this ruling letter to your authorized representative.

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,

Alice M. Bennett
Branch Chief, Branch 3
Office of Associate Chief Counsel
(Financial Institutions & Products)