Philip L. Nelson
Circuit Court Judge
(503) 325-8555

CIRCUIT COURT OF THE STATE OF OREGON
FOR THE COUNTY OF CLATSOP
Clatsop County Courthouse
749 Commercial
PO Box 835
Astoria, OR 97103

March 14, 2010

Mr. Brooks Cooper
Attorney at Law
520 SW Sixth Avenue, Suite 914
Portland, OR 97204

Mr. Daniel H. Rosenhouse
Ms. Susan A Miller
Assistant Attorneys General
1515 SW Fifth Avenue, Suite 410
Portland, OR 97201

Mr. Peter McKittrick
Farleigh Wada Witt
121 SW Morrison, Suite 600
Portland, OR 97204

RECEIVED
MAR 23 2010
FARLEIGH WADA WITT

RE: Ellis v. Department of Justice and Wintercross Foundation
Clatsop County Circuit Court Case No. 09-2215

Dear Mr. Cooper, Mr. Rosenhouse, Ms. Miller and Mr. McKittrick:

Trial on this matter was held March 2 and 3, 2010. Obviously, there are extensive exhibits which I have now had the opportunity to review in more detail. From the evidence presented, I find as follows:

1. Barry Beutel (hereinafter Beutel), successfully invested in real estate. He took plaintiff (hereinafter Ellis), into his organization known as Jensen Investment in 1988. Beutel taught Ellis how he located and invested in real property. Eventually, Beutel made Ellis an officer in Jensen Investment and turned much of the operation of the company over to her.

2. Beutel developed an interest in South American art. He established The Wintercross Foundation, LTD on September 20, 1990 by incorporating it with the State of Oregon and creating a set of by-laws. Exhibits 130-131. The purpose of Wintercross was to qualify as a tax exempt charitable organization. Beutel established a board of directors, which included Ellis. Even though Wintercross was incorporated in 1990, it was not funded with any assets until Beutel's death. When Beutel died, Wintercross was the beneficiary of several life insurance policies which totaled $2,350,000.00. Exhibit 173.

Jensen Investment received $900,000.00, the estate received $850,000.00 and Ellis received $750,000.00 life insurance proceeds from Beutel's death. Others received life insurance proceeds as a result of Beutel's death. The Beutel estate paid the estate taxes associated with the passing of life insurance proceeds outside the estate. Wintercross "loaned" the Beutel estate $410,000.00 in order to pay estate taxes, Wintercross later "forgave" that obligation. Exhibit 165, copy final account.

3. Prior to his death, Beutel through Jensen Investments paid $100,000.00 earnest money to purchase the Acoma Casitas Apartments (Acoma) in Glendale, Arizona. To complete the purchase, Jensen Investments borrowed $1,600,000.00 from Wintercross, executing a note with monthly payments of $12,883.64 and interest at 8.5% per annum. The Wintercross Board of Directors did meet and approve the transaction. Exhibit 122. The estate also wrote a check to Jensen Investments for $450,000.00. Jensen Investments then completed purchase of Acoma for $2,700,000.00 and assumed an already existing mortgage against the property. Jensen Investment ownership eventually passed from the estate to Wintercross. Jensen Investments initially made some payments on the note but essentially, no effort had been made to keep the obligation current.

4. At the board meeting to approve the loan, the Wintercross directors discussed its obligation to make minimum distributions to pursue its objective of promoting South American art. Exhibit 122. The board during that discussion indicated it would still have enough cash available to complete that obligation. Ellis was present at that meeting as was the estate lawyer, Redden, and the Wintercross lawyer, Kelly. The mandatory minimum charitable distributions were made for 1999 through 2001. For 2002, Wintercross started to fall behind in those payments and at some point around 2006, stopped making payments altogether. The current minimum amount which should have been contributed is $189,182.00, which has resulted in tax penalties of $56,755.00. Since 1998, there have been no other meetings of the Wintercross board; Ellis has maintained operation of that entity as well as Jensen on her own. While the purpose of Wintercross was to promote South American art, contributions were made to other art related organizations. Defendant's concern is not that other arts were funded but that no contributions were made for several years.

5. Wintercross became the owner of several items of South American art from the Beutel estate. The value of the art is $200,000.00. Exhibits 136-137. Other than one show in Portland, most of the art was kept in the home of Ellis or her mother. A few pieces were kept with other board members or the accountant serving Ellis, Wintercross and Jensen Investments. While evidence was presented indicating there may be a market to rent art, it is insufficient to show any of the art kept by Ellis had a rental value. The art could

have been distributed to another qualifying entity which would have reduced or eliminated the tax penalties for not making the required Wintercross distributions.

6. In the course of managing the Acoma property, Ellis purchased a home adjoining Acoma. Ellis then had the Acoma property owner live in the home. Acoma paid the mortgage and utilities on the manager's home even though title remained with Ellis. By having the manager not live in an actual Acoma unit, a unit was available to rent. Ellis benefitted by having her obligations for the manager's house covered by Acoma while she maintained ownership.

7. At some point in 2002, Jensen Investments refinanced the Acoma property. Some of the proceeds went for improvements to the real property. It appears there was another $400,000.00 realized from the refinance which has not been accounted for, although the Acoma money market account shows a "loan" to Jensen for $440,300.98 on October 1, 2002. Exhibit 129. The decision to refinance and how to spend the proceeds was made by Ellis. Exhibit 128 indicates $440,300.98 was deposited by "exchangor" Jensen Investment as part of a final settlement statement to purchase apartments in Seaside dated October 3, 2002. Exhibit 128.

8. Jensen Investments, at the direction of Ellis, purchased residential apartments in Seaside, Oregon. Ellis purchased an adjoining group of apartments approximately a year later in her own name. Ellis provided her accountant a summary of how that took place in exhibit 140. Ellis acknowledges she sold her apartments as well as those she purchased in Jensen Investments name 17 months later. Ellis admits she structured the sale so she would receive the cash portion of the transaction and Jensen Investments would carry the balance of the deferred purchase price. The purchaser was unable to pay the total obligation to Jensen Investments and as a result, Jensen lost $70,000.00 in principal and $95,000.00 interest. Had the cash/debt been prorated, Ellis would have faced 28% of the loss and Jensen Investments would have faced 72%.

9. Ellis, through Jensen Investments, arranged to sell the Acoma property on February 6, 2004. At the time of the sale, the Fidelity Title closing statement indicates Jensen received $2,300,296.75. Exhibit 148. Ellis turned that around and used the proceeds from Fidelity Title, which by August 13, 2004, had increased to $2,304,462.38, to purchase what is called the Gearhart property. Exhibit 150. (I recognize a difference between the amount in escrow and the amount spent for the Gearhart property in the next paragraph. I have not been able to determine where that difference went but will assume it went to cover Jensen Investments/Wintercross operating expenses.)

10. The Gearhart property purchase price was $8,000,000.00. By piecing together the testimony and exhibits, Ellis had to deposit

$2,178,745.66 cash from the Acoma transaction to purchase the Gearhart property. She also executed a note and trust deed with Bank of Astoria for $3,000,000.00 and the seller financed the balance, also apparently another $3,000,000.00. Since taking control of the Gearhart property, the vacancy rate increased which decreased the cash flow. The recession in the real property market started October, 2007, and as a result, the value of the Gearhart property has decreased by 24% to where encumbrances exceed the appraised value. Ellis did not obtain her own appraisal regarding the value of the Gearhart property in 2004. An appraisal done by Hickok for the Bank of Astoria in 2004 indicated the property had a value of less than the purchase price Ellis paid.

11. The purchase of the Gearhart property was structured pursuant to IRS code section 1031. According to the accountant Mr. Lajoy, with operating losses, there would have been a taxable gain of approximately $700,000.00 (he started at $1,100,000.00 and as he thought it through, estimated it might end up below $700,000.00). As a result, the gain which would have resulted in an income tax liability of $225,000.00 for federal purposes was deferred. He indicated the state rate was 6.6% which was also deferred (which would have resulted in state taxes of $46,200.00) using his figures. Mr. Lajoy told Ellis she should consider paying off the Jensen Investment note, paying the required distributions and putting all the proceeds in a safer investment, such as bank certificate of deposits. Ellis instead relied on a statement previously made by Beutel indicating investment in the Gearhart, Oregon area would some day be profitable.

12. As she did with the Acoma property, Ellis purchased a home near the Gearhart property. She made the home available for the maintenance person for the Gearhart property. Jensen Investments or Silverstone paid for the mortgage and other expenses.

13. Ellis had no training or instruction operating charitable foundations. When she took on operation of Wintercross, according to her testimony, she did not receive any warnings from members of the board or legal counsel representing Wintercross, Jensen Investments or herself as personal representative regarding the standard of care she should consider. By her testimony, she thought she could keep the art work in her home rather than pay to store it. There were enough issues that came up over the years that Ellis should have been aware about rules against the appearance of self-dealing and the need to be a careful investor of foundation assets. In fact, one of the instructions from Beutel himself raised that concern. Exhibit 208.

14. Even with the current recession, investing in a 60/40 split between stocks and bonds would yield an annual return of three percent.

15. There is no indication or evidence Ellis directly diverted Wintercross or Jensen Investments assets to herself. She used her control to benefit when the Seaside apartments were sold. She benefitted when she forgave the note to the estate and did not pay the estate for the taxes it incurred due to her receipt of life insurance benefits. By purchasing real estate next to investment properties, she benefitted by having managers stay in her properties and having those expenses paid by entities that should have benefitted Wintercross.

16. On April 28, 2009, Ellis paid attorney Redden $40,000.00 from the Jensen Investments account for future legal services related to this proceeding. Pursuant to stipulation, those funds have remained in attorney Redden's trust account. Earlier in the month, Ellis made several large payments to the accountant and attorney Redden for services rendered to Jensen Investments. Ellis also had Jensen Investments pay her $80,000.00 for "loan payback" in July, 2009. Exhibit 166.

RULINGS

Ellis did not make prudent investments. In light of what has happened to our economy, I could understand a reluctance to invest in stocks today, but in 2004, that should not have been a concern. Putting some assets into real estate might not be unreasonable but putting everything into one venture is against all prudent investment standards. Ellis failed to diversify the investments for Wintercross and as a result, all the assets are gone. She also put her interest first when she took the cash out of the Seaside apartments sale and left Jensen Investments with the risk of future payment defaults. She did not follow the advice of the accountant, Mr. Lajoy, to pay off the note and look to safer investments. She can claim ignorance but she took on the responsibility of handling the affairs of Wintercross and in the process, benefitted herself. Ignorance of her duties does not create a defense to her liability.

Wintercross suffered losses twice as a result of actions by Ellis. When she invested the Acoma proceeds into the Gearhart properties, she ended up losing $2,178,745.66. Mr. Cooper is correct to point out that had she not made that investment, Jensen Investments and Wintercross would have had to pay the IRS $225,000.00 and the Oregon Department of Revenue $46,200.00 for taxes. Therefore, defendants will be awarded a judgment for $1,907,545.66 for that transaction. In addition, interest will be imposed at three percent per annum from March 1, 2004 until the date the judgment in this case is entered.

By putting her own interests first, Ellis also caused Jensen Investments, and as a result Wintercross, a loss of $165,000.00. Even though Ellis said she would take responsibility for the full amount of the loss, Jensen Investments should have faced 72% of the risk and an

actual loss of $118,800.00. Defendants will also have judgment for the reduced amount and interest at three percent from the date Ellis received her cash proceeds from the Seaside apartment sale until the date the judgment in this case is entered.

Defendants have pointed out other costs and liabilities Wintercross incurred due to Ellis not following legal requirements. Even though she did not pay the mandatory contributions, she is being charged for the loss in assets. If the assets are now gone, then the things she should have done are pretty much moot. Also, with the in-kind distribution of the art work and the ability to file an amended return for the last three years, much of that penalty may be removed.

The $40,000.00 in attorney Redden's trust account shall be immediately paid to the receiver. Those proceeds belong to Wintercross and are not available to Ellis for filing or defending her personal action in this proceeding. In fact, I am surprised there is a contention those funds should go to attorney Redden or as much as his name came up during this proceeding he would file the initial complaint. The amount of judgment against Ellis will be reduced by the amount the receiver recovers from the trust account.

The assets of Wintercross, as well as all entities that Wintercross owns, will continue to be placed with the receiver. The receiver shall continue to handle all affairs for Wintercross and determine the best way to wind up its affairs. Ellis shall be removed as a director and officer for Wintercross and the entities it controls.

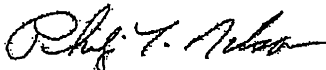
Ellis is permanently enjoined from serving as a trustee, officer, director or fiduciary for any charitable trust, foundation or other entity.

Even though the Department of Justice requested an accounting, it has had at least a year to investigate and go through financial records. There is no indication any other records will be found or other evidence of loss by Ellis will be located.

Any claims Ellis has for further compensation from Wintercross or its entities and any further claims for loans she claims to have made to Wintercross or its entities are denied.

Mr. Rosenhouse can submit an appropriate judgment. Claims for costs and attorney fees will be handled pursuant to ORCP 68.

Sincerely,



Philip L. Nelson
Judge

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4 IN THE CIRCUIT COURT OF THE STATE OF OREGON

5 FOR THE COUNTY OF CLATSOP

6 ANN ELLIS, 7 Plaintiff, 8 v. 9 DEPARTMENT OF JUSTICE; and THE WINTERCROSS FOUNDATION, LTD., an 10 Oregon nonprofit corporation, 11 Defendants.	Case No. 09-2215 LIMITED JUDGMENT

12 This matter came before the Court for trial on March 2 and 3, 2010. The Court's findings

13 and rulings are set forth in its letter to counsel for all parties, dated March 14, 2010 and attached

14 hereto and incorporated by reference.

15 Notwithstanding the Court's continuing jurisdiction over the receiver, the Court finds that

16 there is no just reason for delay in entry of this Limited Judgment.

17 It is hereby adjudged as follows—

18 1. The claims of Plaintiff Ann Ellis against defendants are dismissed with prejudice.

19 2. The Department of Justice is awarded judgment against Ann Ellis in the amount of

20 $1,907,546.66 plus interest thereon at 3% per annum from March 1, 2004 until the date

21 of entry of this judgment; plus $118,800 plus interest thereon at 3% per annum from

22 December 8, 2006 until the date of entry of this judgment.

23 3. Ann Ellis is removed as a director and officer of The Wintercross Foundation, Ltd. and

24 any and all entities it controls, including Jensen Investment Company, Silverstone Coast

25 Properties, LLC, and Silverstone Group I, LLC.

26

DEPARTMENT OF JUSTICE
1515 SW Fifth Ave, Suite 410
Portland, OR 97201
PHONE: (971) 673-1880

1 4. Ann Ellis is permanently enjoined from serving as a trustee, officer, director or fiduciary
2 for any charitable trust, foundation, or other non-profit entity.
3 5. The receiver, McKittrick, Inc., shall continue with its duties, subject to the oversight of
4 this Court, for the purpose of winding up the affairs of The Wintercross Foundation, Ltd
5 in an orderly fashion and as otherwise set out in the Court's STIPULATED ORDER FOR
6 APPOINTMENT OF RECEIVER, signed by the Honorable Paula Brownhill and filed on
7 August 7, 2009, the terms of which Order shall continue in effect until further order of
8 this Court.
9 6. The request of the Department of Justice for an accounting is denied.
10 7. Any collection of the award made in Paragraph 2., above, shall be held by the
11 Department of Justice for the benefit of The Wintercross Foundation, Ltd, or transferred
12 to such other charitable organization as the Department of Justice shall determine
13 pursuant to the doctrine of *cy pres*, such determination to be reviewed by the Court prior
14 to transfer.
15
16 MONEY AWARD
17 1) Judgment Creditor: State of Oregon, acting by and through its Department of Justice
18 Address of Creditor: Charitable Activities Section, 1515 SW Fifth Ave., Suite 410,
19 Portland, OR 97201
20 Judgment Creditor's Attorney: Daniel H. Rosenhouse, Assistant Attorney General
21 Address of Creditor's Attorney: Oregon Department of Justice, 1515 SW Fifth Ave,
22 Suite 410, Portland, OR 97201
23 Phone Number of Creditor's Attorney: (971) 673-1880
24 2) Judgment Debtor: Ann Ellis
25 a) Address: 89434 Manion Drive, Warrenton, OR 97146
26 b) Date of Birth: N/A

DEPARTMENT OF JUSTICE
1515 SW Fifth Ave, Suite 410
Portland, OR 97201
PHONE: (971) 673-1880

1 c) Social Security No.: N/A

2 d) Driver's License No.: N/A; State of Issuance: N/A

3 e) Judgment Debtor's Attorney: Brooks Cooper

4 f) Address of Debtor's Attorney: 520 SW Sixth Avenue, Suite 914, Portland, OR 97204

5 g) Telephone of Debtor's Attorney: 971 645-4433

6 3) Other persons or public body entitled to any portion of payment made on judgment: None

7 4) Principal Amount of Money Award: $2,026,346.66

8 5) Interest as of date judgment is entered: $354,868.56 plus $166.55 per day from March 1, 2010

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10 6) Interest accruing on judgment after entry: Legal rate of 9% per annum on Items 4) and 5), above.

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12 7) Periodic Accrual/Accrued arrearages: n/a

13 8) Costs, disbursements and attorney fees to be determined pursuant to ORCP 68

14 DATED this ____day of ____________, 2010.

15

16 ______________________________
Circuit Court Judge

17

18 Submitted by:

19 Daniel H. Rosenhouse #773275
Assistant Attorney General
Department of Justice

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23

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DEPARTMENT OF JUSTICE
1515 SW Fifth Ave, Suite 410
Portland, OR 97201
PHONE: (971) 673-1880

HARDY MYERS
Attorney General

PETER D. SHEPHERD
Deputy Attorney General

DEPARTMENT OF JUSTICE
CIVIL ENFORCEMENT DIVISION

May 27, 2008

PUBLIC AUDIT REPORT
Oregon Corporation for Affordable Housing (aka Homestead Capital)
DOJ File No. XCT006-07

Dear Board Directors:

The Department opened its investigation of Homestead in March 2007. The Attorney General has the authority and responsibility to investigate charitable organizations to determine whether the organization is carrying out its charitable mission or breaching any fiduciary duty arising under statutory or common law. ORS 128.680.

Our review focused on the following issues: (1) the reasonableness of compensation paid to its former President and CEO; (2) the reasonableness of the expenses incurred by its former President and CEO; and (3) the appropriateness of the transactions between Homestead and Mr. Ibn Saweuyer-Parks, the husband of the former President and CEO.

Homestead was cooperative and responsive throughout this review and, on its own initiative, took many steps to address the issues raised by this review before the review was even complete. The CEO/President has stepped down, the organization anticipates providing a smaller compensation package to her replacement, and the organization has adopted new expense and whistleblower policies. We commend Homestead in taking these actions, which we believe will contribute to the organization's performance of its mission.

The purpose of this report is to outline and discuss the issues noted above and to provide guidance and recommendations regarding future practices. This report is based on the records provided by Homestead, interviews with former employees, board members, and counsel, and the Department's own research. This report is the public record of our review and findings and should be shared with all board directors for the organization.

I. LIHTC BACKGROUND

Homestead is an Oregon public benefit corporation with 501(c)(3) tax exempt status. Homestead was incorporated in 1993 and its charitable purpose is to promote and facilitate the construction, development, and operation of low-income housing. Homestead generally does not solicit or rely upon donations from the public. Instead, Homestead receives revenues from fees charged to investors in connection with Homestead's role as a Low-Income Housing Tax Credit ("LIHTC") syndicator.

1515 SW Fifth Ave, Suite 410, Portland, OR 97201 Telephone: (971) 673-1880 Fax: (971) 673-1882 TTY: (800) 735-2900

Homestead is relatively small in terms of employees, which have roughly ranged between 20 to 30 in recent years. Its gross revenues in its 2005 fiscal year, the most recent year for which we have reports, were approximately $4.6 million. However, Homestead has stated that its income is not fully reflective of the size and complexity of investments it has facilitated through its syndication, which has ranged from $15 million in its first year of operation to more than $70 million a year.

The LIHTC program was created by the Tax Reform Act of 1986 and authorizes the issuance of tax credits for the acquisition, rehabilitation or construction of low-income housing. The goal of the program is to encourage additional investment in the development of affordable housing by granting tax breaks in the form of tax credits to for-profit firms that provide capital for such projects. The LIHTC started slowly, but grew more rapidly after 1993 when federal legislation was enacted strengthening the program. Accordingly, Homestead's growth is consistent with the growth of the program and industry as a whole.

Each year, the federal government allocates tax credits to each state based on a per capita formula, which is presently indexed to inflation. The Oregon Housing and Community Services administers the tax credit program for Oregon. Developers compete against one another for a limited supply of tax credits by submitting project proposals to the state agency. The agency scores the applications and selects the winning proposals. The agency allocates credits to developers, who then sell the credits to syndicators. The syndicators form limited partnerships with investors, passing the credits to the investors in exchange for capital to develop or rehabilitate these housing projects. The investors retain an equity interest in the project and also receive tax deductions for depreciation of the developments.

Although the tax credits are claimed by the investors over a 10 year period, the housing project must maintain low income occupancy for a 15 year compliance period. Failure to satisfy the 15 year compliance period may result in the recapture of claimed tax credits. Since 1989, projects must be pledged to low income occupancy for 30 years, but there is an opt-out provision that may apply after 15 years. Some states require that projects be pledged as low income housing for even longer than 30 years.

Syndicators serve as the general partner/managing partner and the investors are limited partners who take a passive investment role. As a general partner in these entities, Homestead retains a very small ownership interest, but is responsible for management of the partnership, overseeing the investment projects, and daily decisions. Syndicators such as Homestead charge fees for putting together the investment fund, usually based on the size of the investment and charge ongoing management fees.

Partnership arrangemens like the ones in the LIHTC sector between for-profit and nonprofit entities are somewhat unusual. The IRS has issued guidelines creating a safe harbor for tax-exempt organizations that participate in these LIHTC partnerships to ensure that charitable interests predominate over those of the for-profit partners. For example, as part of the safe harbor guidelines, a tax-exempt organization should secure a right of first refusal to acquire the project at the end of the compliance period. We assume that Homestead is operating as general

partner consistent with the guidance established by the IRS and the nature of those partnerships is not at issue in this report.

LIHTC syndication is also an unusual field because for-profit and nonprofit entities compete side-by-side for rights to a limited pool of tax credits. This highlights a tension that exists in the operation of nonprofits. While there are many who suggest that charities should be more "business like" in their operations, there also exists a line of cases in which tax exempt status has been revoked or denied on the basis that the tax-exempt organization operated in manner too similar to that of a taxed for-profit business. This principle arising from this line of case law has been referred to as the "commerciality doctrine" and is more fully described below.

We note that Homestead is well-regarded in the low income housing community and has been involved in many projects approved by the Oregon Housing and Community Services program, with favorable results. The LIHTC program itself is generally considered successful. According to the National Council of State Housing Agencies, the LIHTC has produced 2 million units of affordable housing. The program is now the primary mechanism for the development of low income housing, accounting for 90% of new development.[1]

According to the study *Understanding the Dynamics IV: Housing Tax Credit Investment Performance* by Ernst & Young LLP (2007), foreclosure rates for LIHTC properties averaged just 0.03% for the period 1991-2005, far less than for other real estate assets. The report also found that the median occupancy levels in LIHTC properties was 96%, with the northeast and western regions performing best at 97%. The Ernst & Young study also reported that smaller developments had slightly better occupancy rates than large projects and specialized projects had better occupancy than family units, with senior units having the best occupancy rate.

Despite its successes, it appears that the LIHTC program may be vulnerable to economic cycles. During favorable economic conditions, there has been great demand among investors for LIHTC credits as investors have greater amounts of taxable income to offset and it appears that the demand for such credits has frequently exceeded the supply. However, when investors' taxable income drops, so does their interest in tax credits. Recent news reports indicate that some large investors have pulled out of the program entirely as the market conditions have declined and investors' need for tax credits has evaporated.

II. EXECUTIVE COMPENSATION

With background on the nature of Homestead's activities and the LIHTC program in place, we turn to the issue of Homestead's compensation practices.

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[1] The LIHTC program is not without its critics. Some contend that the tax credit program is more complicated and ultimately more costly to taxpayers than housing voucher programs, may not be more effective than alternative programs in increasing the stock of affordable housing, and does not adequately serve the needs of very low-income households. A recent Congressional Research Report noted that there is a lack of empirical data to measure the effectiveness of the LIHTC program relative to alternative approaches. CONGRESSIONAL RESEARCH SERVICE, The Low-Income Housing Tax Credit: A Framework for Evaluation (2007).

A. *Background on Nonprofit Compensation Standards*

While charities are entitled to pay reasonable compensation, unlike for-profit entities, charities are prohibited from transferring net income to a private individual.[2] IRC501(c)(3) prohibits the inurement of the net income of a tax-exempt organization to any individual. For charitable organizations, any income remaining after payment of reasonable compensation for personnel or other goods and services necessary to the organization's operation is to be used to further the charitable purpose of the organization.

The IRS defines reasonable compensation as "such amount as would ordinarily be paid for like services by like enterprises under like circumstances." Treas. Reg. § 1.162-7(b)(3), Treas. Reg. § 53.4958-4(b)(1)(ii). Compensation includes wages and contributions to pensions or profit sharing plans, deferred compensation, payment of personal expenses, personal use of an organization's facilities, and the like.

Private inurement could result in the revocation of an organization's tax exempt status and/or the imposition of intermediate sanctions by the IRS. Intermediate sanctions include imposition of excise taxes on transactions that give excessive economic benefits to insiders of tax-exempt organizations on both the recipient that received the benefits and the directors that approved the excess benefit transactions. The IRS has provided guidelines for avoiding intermediate sanctions. In the area of compensation, the IRS has stated that an organization can create a rebuttable presumption that compensation is reasonable if: (1) it was approved in advance by directors, none of whom have a conflict of interest; (2) the board relied on appropriate data regarding comparability; and (3) the board concurrently documented its decision. Treas. Reg. § 53.4958-6.

The Department does not directly enforce IRS rules and regulations, but acknowledges that the regulations form an expectation of the norms and practices in the community. As such, the Department does look to IRS rules and regulations for guidance, but its primary focus is on whether the officers and directors fulfill or breach their fiduciary duties to the organization, whether a transaction qualifies as an improper distribution under ORS 65.551, and whether the officers or directors have committed waste of charitable assets.

Determining what constitutes reasonable compensation and the line between reasonable compensation and improper inurement are among the most difficult issues for boards and regulators. We also note that for most Oregon-based nonprofits, executive compensation is relatively low. Only those relatively few nonprofits able and interested in compensation arrangements at the upper end are likely to expend resources to retain compensation consultants and studies. Many organizations may find it sufficient to cull information on comparable

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[2] The concept of reasonableness is long standing and arises from principles of trust law. The application of reasonable compensation to tax exempt entities is similar to Internal Revenue Service requirements that executive compensation may be deducted as a business expense, only so far as the compensation is reasonable. In the for-profit context, if the amounts deducted as compensation were greater than reasonable, the transfer may be treated as a distribution of profits and subject to different taxation standards.

nonprofits by identifying similar organizations and reviewing their Form 990 financial reports, which are generally available for free at www.guidestar.org.

B. *Homestead's Executive Compensation*

Deborah Saweuyer-Parks served as President and Chief Executive Officer ("CEO") of Homestead from 1993 to June 2007. Ms. Saweuyer-Parks did not have a written employment contract with Homestead. According to the bylaws, she was employed at the will of the board. In June 2007, shortly after this review was initiated, her duties as President were delegated to a board member, Mr. McCormick, but she continued to serve as CEO. At the time of this transition, it was announced that Ms. Saweuyer-Parks intended to step down as CEO in June 2008. As it happened, she stepped down in December 2007, earlier than anticipated. Ms. Saweuyer-Parks also served as a director throughout this time and continues to serve in that capacity, although her term ends in June 2008.

Mr. McCormick continues to serve as President and now receives annual compensation in the amount of $200,000 and the organization has undertaken a search for a new CEO/President. It appears the functions will again be consolidated into one position.

Ms. Saweuyer-Parks' compensation and benefits in recent years as an officer of Homestead are set forth below. Homestead operates on July-June fiscal year. For purposes of this review, we generally relied upon and refer to the compensation reflected in the organization's financial reports filed with the IRS and our office, referred to as Form 990s. The compensation reports and other documents reflect somewhat different figures for compensation and reveal the amounts of compensation delineated as a bonus. Accordingly, we also provide a chart based upon the data contained in sources other than the Form 990s.

Deborah Sawyeur-Parks Compensation Data and Categories shown on Form 990s			
Fiscal Year	Compensation	Employee Ben Plan Contribution	Expense Account
1998	$128,500	$ 6,364	$0
1999	$193,573	$12,150	$0
2000	$243,923	$ 6,684	$0
2001	$269,615	$ 5,850	$0
2002	$280,297	$14,341	$0
2003	$357,243	$12,656	$0
2004	$435,000	$33,716	$0
2005	$270,000	$36,830	$0

Deborah Sawyeur-Parks Compensation Data from compensation studies and Homestead documents		
Calendar Year	Base Salary	Bonus
1998	$75,000	$13,500
1999	$100,000	$30,000
2000	$144,000	$35,000
2001	$200,000	$45,000
2002	$220,000	$50,000
2003	$230,500	$100,000
2004	$250,000	$175,000
2005	$270,000	$0
2006	$283,500	$0

At the time the Department opened this review, Homestead had not yet filed its 2005 financial report and the CEO's compensation appeared to be on a steep upward trajectory, having more than tripled between 1998 and 2004. However, we subsequently learned that even prior to the Department's initiation of a review, the board's minutes reflected that the payment of a $175,000 bonus in 2004 was an exceptional event that the board did not intend to continue in future years. Nevertheless, while Ms. Saweuyer-Parks' compensation in subsequent years was less than its 2004 peak, it still remained relatively high in comparison to most Oregon-based nonprofits.

At the time of the writing of this report, Homestead has not yet filed its 2006 financial reports but has informed the Department that her 2006 base pay was $283,500. In prior years, the benefits paid to Ms. Saweuyer-Parks included health insurance and a 401(k) plan with a 5% match that was implemented in 2005(a 404(b) plan was in place prior to the adoption of a 401(k) plan). Although Ms. Saweuyer-Parks resigned as CEO effective December 31, 2007, she receives severance pay for one year at her base salary of $283,500, plus employer contributions toward health benefits through June 2008.

1. *First Compensation Study*

In all, Homestead commissioned three different studies related to Ms. Saweuyer-Parks' compensation. In 2004, Homestead hired a consultant to conduct a compensation review to advise the board regarding Ms. Saweuyer-Parks' compensation. The report was prepared by Mr. Wells' firm, CCi, and was presented to the Executive Committee of the full board in July 2005. Mr. Wells had previously provided compensation review services to Parr Lumber, including a review of the compensation for David Hamill, CEO of Parr Lumber. David Hamill was chair of Homestead's board and Mr. Wells served on the board of Parr Lumber at the time he made his report to Homestead's Executive Committee. This relationship was disclosed to the Executive Committee, to whom Mr. Wells made his presentation. It was also disclosed to the full board when they reviewed and discussed the Executive Committee's recommendations.

Ms. Saweuyer-Parks attended the first portion of the Executive Committee meeting regarding the generalities of the report but excused herself when the committee discussed her compensation specifically. Much of the information Mr. Wells provided was done through his oral presentation, although some portions of his written report were attached to the Executive Committee minutes. The minutes also contained a description of his oral presentation.

Mr. Wells concluded that Ms. Saweuyer-Parks had been underpaid historically in comparison to CEOs of for-profit start-up ventures. The study estimated her total underpayment since 1994 at $598,000 and recommended her base pay be $260,000. At the time, her base pay was $250,000. The minutes reflect that the executive committee discussed the finding and recommended the following: a 2005 bonus of $100,000 for performance; a $100,000 bonus for prior services; a 2006 base salary of $260,000; a future $130,000 maximum bonus; and a future $65,000 maximum deferred compensation.

At its July 2005 meeting, the board held an executive session to discuss these recommendations. The board determined that a one-time bonus of $175,000 would be given, citing the significant increase in amount of capital raised, the significant increase in area of activity (new regions being developed), and improvement of the management portfolio, and that there would be no further discussion about compensation for prior service. The board engaged in further discussion before setting her future base salary at $270,000 without deciding any incentive package.

2. *Second Compensation Study*

The Department contacted Homestead about its review in March, 2007. At its next board meeting in June 2007, Homestead separated the duties of President and CEO as part of a restructuring. Ms. Saweuyer-Parks retained the position of CEO and her duties were focused on developing investment funds, while Mr. McCormick assumed the duties of President and managed the internal affairs of Homestead. Mr. McCormick did not initially receive pay for his services. Ms. Saweuyer-Parks continued to receive her base pay, which increased to $283,500 in fiscal year 2007.

Homestead employed another compensation firm to conduct study for this new organizational structure. The report also considered whether the bonus that was previously given was reasonable.

The report concluded that an appropriate salary range for the CEO was $245,653 - $474,646 and the appropriate salary range for President was $174,691 - $318,293. This report focused to a greater extent than the previous report on Homestead's closest peers, who are other members of NASLEF – the National Association of State and Local Equity Funds. NASLEF is a nonprofit organization of LIHTC syndicators. It is common within this group to report the total number of housing units placed on the market as well as total assets invested as a result of the organization's syndications. However, this second study placed an emphasis on annual revenues as being the appropriate criteria against which to measure Homestead against its peers and against for-profit firms.

The report acknowledges that within NASLEF, at the 75th percentile the 2005 compensation would be $239,649 (less than what Homestead was paying). The study then looked to tax-exempt organizations with revenues of $5,000,000 and concluded $125,706 was the median with a maximum of $356,505 for 2006. The study also reported that the median 2006 compensation of for-profit organizations with revenue of $5,000,000 was $460,821 and then adjusted this for 2005 to reach a figure of $438,702.

The report also concludes that the bonus was reasonable, especially if it was considered allocated over a longer time period. The consultant offered recommendations about ways for Homestead to improve its incentive compensation in the future.

3. *Third Compensation Study*

Ms. Saweuyer-Parks resigned as CEO in December 2007 and the board provided her a severance package of one year's salary and limited benefits. The board obtained another compensation study from Organizational Consulting Group to determine whether it was appropriate to pay severance and, if so, what amount would be reasonable. OCG concluded that one year's salary was a reasonable severance, though it acknowledged obtaining comparable data was virtually impossible. Despite the lack of data, the consultant stated it identified nine instances of reported payments of severance by nonprofits, including the American National Red Cross, Harvard College, and the J. Paul Getty Trust, which are also among the largest and most prominent nonprofits in the country. Based on those limited examples, the consultant concluded that a severance payment of one year's salary to an exempt executive was reasonable.

C. *Comments on Compensation Studies*

1. *Compensation Studies Should Compare Like-to-Like and Include Sufficient Detail to Establish Comparability*

As noted earlier, reasonable compensation as defined by the IRS is the amount that would ordinarily be paid for like services by like enterprises under like circumstances. In order to take advantage of the intermediate sanctions safe harbor, the organization must demonstrate that it used appropriate comparability data in setting compensation and it should properly document that fact. Among factors to consider in evaluating comparability is whether the employee has similar responsibilities to those with whom the employee is being compared, whether the other organizations are comparable in terms of activities and type, and whether they are of a similar size in terms of employees, revenues, and assets. In addition, the organization should consider the pool of talent for which it is competing and the impact of geographical considerations on compensation.

There is an obvious, readily available data pool of comparables for Homestead – NASLEF. Many NASLEF members are also nonprofits and their compensation information is public information. Homestead is itself a member of NASLEF. Thus, one would expect the board to be aware of this organization and its data pool.

Yet, the first compensation study barely discussed the significant or relevance of the NASLEF peer group. The report simply noted that Homestead ranked 2nd in terms of compensation by tax-exempt members of NASLEF, and that a compensation range of $304,000 - $382,000 was appropriate based on what three NASLEF members, including Homestead, paid their CEO. During the presentation, it was suggested that the other members of NASLEF that paid lesser compensation may have generated smaller amounts of equity, but this was not documented, nor was there much discussion of the size of the other two NASLEF members to which Homestead was compared. In fact, according to data provided by Homestead's second compensation consultant, Homestead is significantly smaller in virtually every respect.

Rather than probing more deeply into the NASLEF data, the first compensation report moved on to presenting information concerning median compensation for west coast tax-exempt organizations, which it stated was $126,000 - $260,000. The report noted that at the 90th percentile, the figures were $241,000 - $551,000 but proffered no explanation as to how Homestead's activities compare or why Homestead should be deemed to fall within the uppermost tier of all west coast nonprofits. The report went on to use figures from for-profit companies within the financial sector with gross revenues of $25 to $99 million, indicating the average base pay was $260,000 with a median total compensation at $349,000 and an average total compensation at $475,000. Homestead's gross revenues are nowhere near the levels of the for-profit financial sector comparables, but the presentation noted that this reflected the smallest size of for-profit financial sector firms for which there was available data.[3]

While the guidelines for IRS Intermediate Sanctions provide that comparable data can include functional equivalents from the for-profit sector, the CCi presentation did not justify or explain how these for-profit financial company CEOs provide like services or are like enterprises in like circumstances or why the NASLEF data was insufficient for comparison purposes. It appears that market forces and competition for talent have already impacted the salaries of NASLEF members, which appear generally higher than other types of nonprofits. Furthermore, NASLEF members would appear to provide a pool of talent for recruitment purposes as NASLEF members have the necessary expertise in syndication. Thus, although a compensation study can consider functional equivalents from the for-profit sector, the need to do so seems limited in these circumstances.

The third study relating to severance does not even purport to have identified "comparable" organizations. The report details nine instances involving nonprofit severance packages that the consultant identified from various sources, including news media and the Internet, in reaching the conclusion that it was reasonable to pay one year's salary as severance. As noted above, the nine instances included several of the largest nonprofits in the country. The Department is fully aware that Homestead's point was to demonstrate that some nonprofits have paid or negotiated compensation agreements in which severance amounts of 0.9 to 7.0 times the departing

[3] Homestead may contend that the overall level of investment generated by its activities is close to the gross revenue ranged used in comparing itself to for-profit entities. However, there is very little detail about the for-profit financial sector firms included in the comparison and like Homestead, those firms' gross revenues may reflect only a portion of investment activity generated or managed. It may be that financial firms with gross revenues of $25 to $99 million are in fact much larger than Homestead.

executive's annual compensation, rather than suggesting that Homestead is comparable to the organizations cited in the report. Even so, we question whether it is appropriate for Homestead to justify its severance practices by looking to the practices of the American Red Cross and Harvard College. Furthermore, although the consultant claimed that it was able to conclude on the basis of those nine instances that payment of one year's severance was reasonable, we question whether one can draw any specific conclusions about reasonable practices from the nine instances described in the report, which by their very nature appear to be outliers. It may be that comparable data is difficult to obtain because most nonprofits the size of Homestead have not historically paid severance to departing executives. Severance issues are discussed in more detail below.

2. *The Primary Purpose of Compensation Studies Should Be to Assist the Board in Setting Appropriate Compensation, not to Produce Documentation for Intermediate Sanctions*

The compensation studies and the minutes related to their discussion reflect very little about how the board viewed the organization's needs and objectives, how those relate to the compensation under consideration or how Homestead's performance and activities and the achievements of its CEO compared to those of Homestead's peers, all of which might be relevant to compensation decisions.

Instead, the board appeared to focus on the intermediate sanctions standard and what data existed that could be used to support the contemplated CEO compensation. We note that what compensation amounts and practices are appropriate for a particular charity to facilitate the accomplishment of its objectives is a different question than how much compensation can be paid before there is a substantial risk of intermediate sanctions. We believe it is appropriate for boards to focus initially on the first question. Doing so will likely reduce the risk of intermediate sanction and helps to ensure that the data utilized for comparison purposes is, in fact, appropriate. The issue of intermediate sanctions is always subject to consideration, but the board's role in setting compensation of key officers should not be limited to simply attempting to avoid the imposition of such sanctions.

The compensation reports themselves, even if prepared by independent consultants[4] do not convey the impression that they were providing a full and objective review of the data for the board's consideration. Instead, it appears that the consultants focused on data that supported high levels of compensation while discounting with very little explanation the data that might be used to support lower levels of compensation. For example, the median total compensation among NASLEF peers was lower than that under consideration by Homestead. The first consultant suggested the board disregard those other entities and instead look only to those two peers that paid amounts similar to Homestead. The second consultant provided more detail about the NASLEF peer group, but discounted the importance of looking to assets or number of units developed as a measure of comparability and focused instead on revenues. However, in evaluating compensation against peer groups, the board should consider each of these factors.

[4] Given Mr. Wells' ties to the Chair of Homestead's board, his firm may have less been than ideal in terms of independence.

Similarly, the second compensation study glossed over the very real reduction in the CEO's responsibilities to conclude that her duties were still comparable to that of other CEOs to which she was being compared, although there was little support provided for the conclusion that the CEOs of other organizations had no internal management responsibilities. Common sense suggests that a reduction in responsibilities should lead to a reduction and not an increase in compensation, but the second compensation study concluded the opposite.[5]

To the board's credit, it did not unquestioningly adopt every conclusion in the compensation reports. We believe the board was appropriately skeptical concerning the first consultant's conclusions about the extent to which Ms. Saweuyer-Parks had been underpaid and about the reliability of the data upon which that conclusion was based. The board discussed but never clearly resolved whether a portion of the $175,000 bonus could or should be attributed to underpayments in previous years. However, it is not clear why the board was even considering the issue of purported underpayment in light of the lack of any prior agreement or understanding that Ms. Saweuyer-Parks would receive additional compensation in connection with her previous services beyond that which she had already been paid.[6] It is also not clear what was motivating the board to award a large discretionary bonus. While the first report made mention of the fact that Ms. Saweuyer-Parks may have received a competing offer in 2001 which may have resulted in a raise at that time, there was no discussion in 2005 that suggested that the purpose of the award of a large bonus was to match a competing offer.

We have some concern that the board's compensation decisions concerning its CEO were motivated less by the needs and goals of the organization, and more out of a sense that Ms. Saweuyer-Parks was a successful entrepreneur and like her for-profit counterparts, was entitled to share in the financial success of the organization she created. This concern is based on several factors, including the for-profit orientation of the board and the fact that Homestead itself perceives itself in competition with for-profit syndicators. In addition, the board failed to articulate or develop a compensation strategy in connection with setting Ms. Saweuyer-Parks compensation, failed to defer payment of a portion of the bonus, and did not engage in a meaningful discussion of how Homestead compares to its peers.

What seemed most important to the board was not Homestead's success relative to other syndicators or what compensation levels and structures were necessary for the organization to attract and retain talent, but that Ms. Saweuyer-Parks had created a profitable business from modest beginnings. This carries with it the implication that the board wished to reward her

[5] In describing the change in management structure, the second consultant noted that Homestead, which employs approximately 24 people, had experienced staff turnover of 35% to 40% a year. Internal organizational responsibilities were being transferred to the new president so that Saweuyer-Parks could focus on external relations.

[6] An organization has no legal obligation to compensate an employee for past service if the employee agreed to provide the services for the specified compensation and there was no understanding or agreement that additional compensation was being deferred or contingent upon some future event. While IRS guidance suggest that it may consider whether a payment reflects compensation for underpaid past services in evaluating the reasonableness of the total compensation, under state law, if a charity had no legal obligation to pay additional amounts for past services, such payment could constitute waste or an unlawful distribution.

financially for the success of the organization. However, unlike for-profit organizations, nonprofits are prohibited from distributing net profits to private individuals. A desire to bestow financial benefits on entrepreneurs merely because their endeavors are successful may be misplaced in the context of nonprofit compensation, in which the focus should remain on what compensation is reasonable and appropriate in terms of accomplishing the organization's objectives, which relates to the next observation.

3. *Compensation Arrangements Should Be Determined in Advance and Should Correspond to the Organization's Objectives.*

The board concluded that the data provided by Mr. Wells was sufficient to support a base salary of $270,000 for future years and a one-time bonus of $175,000. However, it failed to establish in advance a bonus structure for the following year and what objective criteria the organization would use to measure performance. The second compensation report noted the importance of establishing objective goals in advance if an organization chooses to utilize incentive compensation. In failing to establish the terms of any incentive compensation, the board missed a key opportunity to identify the organization's goals and to communicate them for implementation by the CEO.[7]

In awarding a full $175,000 bonus in a single year, the board also missed the opportunity to structure the terms of the bonus in a manner that would assist the organization in accomplishing its goals. If the board was attempting to ensure Ms. Saweuyer-Parks' retention, it would have been more appropriate to spread the payment of such a large bonus over a longer period of time. Indeed, the compensation consultant recommended the board offer some form of a deferred bonus structured over time, but the board rejected that recommendation.

If compensation terms are agreed on in advance through an employment contract, it is easier to resolve compensation issues that may arise later. For example, it appears that the board's decision about what the bonus should be for 2004 was complicated by the lack of a prior understanding as to what the maximum amount of such a bonus would be and how the amount paid would be determined. Similarly, if there had been an employment contract in place, it could have included the terms of any severance, which would have provided clarity and guidance at the time of the employment separation.

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[7] Although nonprofits are prohibited from distributing net profits, some forms of incentive compensation based on the organization's financial performance is permissible, but as Homestead's consultants have noted, the terms of incentive-based compensation should be set in advance and clearly articulated. That helps to ensure that payments relate to the accomplishment of the organization's objectives and are not a disguised form of distribution. We note that in the first compensation study, the consultant suggested that the board consider awarding a bonus to Ms. Saweuyer-Parks for generating investments in excess of $40 million for the year and suggesting a bonus cap at one-half the base salary. While we support the suggestion that incentive compensation should be capped, we note that the $40 million a year base was proposed not based upon an assessment of what investment targets were appropriate to encourage achievement, but because that is the point at which Homestead begins to generate net profits and can thus, afford to pay bonus compensation. While having sufficient revenues from which to pay bonuses is obviously a controlling factor, the point of incentive compensation should be to encourage advances and reward exceptional achievements. If the incentive structure is just a mechanism to distribute profits to exempt organization officers, it is not an acceptable form of compensation.

Without an employment agreement in place, the board commissioned yet another study to assist it in evaluating severance. Perhaps the most relevant information that the study provided was a description of a conversation the consultant had with an IRS representative about what the IRS would consider in evaluating the appropriateness of severance pay. Those considerations include identifying what the payment was for, whether the subject gave up any valuable rights, and how those rights were valued. The report itself did not identify what Homestead's severance pay was for or whether any valuable rights were given up, stating that these matters are typically handled by the nonprofit's legal counsel. The report noted a dearth of guidance on the appropriateness of severance payments by nonprofits, a lack of data on the practice, and an inability to identify comparable organizations for comparison purposes. Despite having essentially no relevant information from which to draw any conclusions, other than nine reported instances devoid of factual detail, the consultant concluded that payment of one year's severance was reasonable.

We disagree that conclusions regarding the reasonableness of severance pay can be reached without relevant factual information. As the factors outlined above suggest, there must be a bargained-for and fair exchange in the payment of severance. If severance is negotiated in advance and incorporated into an employment agreement, then it becomes a contractual obligation subject to review under the reasonable compensation standards. However, in this case, there was no employment agreement and no contractual obligation to pay severance.

Although not reflected in the severance study, Homestead provided information to indicate that the severance package was not simply a parting gift to the former CEO, but a bargained for exchange in which Ms. Saweuyer-Parks released Homestead from any and all employee claims and liabilities, while Homestead did not give any comparable release. How the board and the counsel arrived at an assessment of the value of such a release is uncertain, but we presume there were genuine concerns about litigation and that the release was not pretextual. Accordingly, the determination to pay severance in this case may fall within business judgment standards.

However, we reach this conclusion more in spite of the severance study than because of it. The study itself tends to undermine Homestead's claim that the release was valuable and material to the board in terms of a bargained-for exchange because the study attempts to package the payment of severance as justified compensation without regard to what the organization received in return.[8]

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[8] Again, it is important for boards to focus first on how proposed actions advance the organization's objectives and not simply on obtaining expert advice to ratify proposed actions. Although boards are entitled to rely on the advice of experts, such reliance must be reasonable. If the board's severance decision was based on the severance study, as opposed to an assessment of litigation risks, then the decision may not have been reasonable, in light of the report's evident deficiencies.

4. *Don't Overlook Opportunities Compensation Studies Provide to Objectively Compare and Consider the Organization's Performance and to Develop Appropriate Performance Goals.*

In setting compensation, the board focused primarily on growth in investments and revenues. The board appeared to conclude that the organization's performance and that of its CEO were exceptional so long as those investments and revenues were on the increase from prior years. However, in reviewing the second compensation report, we thought it noteworthy that the compensation consultant identified Homestead as placing above the median of its NASLEF peers in terms of the amount of investment generated, but below the median in terms of housing units generated. The report downplayed the significance of these facts as they might relate to compensation, but we think the board may wish to give some consideration as to how the combination of these statistics reflects overall on Homestead's performance.[9]

One way syndicator's efficiency and performance might be measured is to evaluate the ratio of the number of affordable housing units developed to dollars invested. After all, the goal of the LIHTC program is to increase the amount of affordable housing. By this standard and based on the compensation consultant's data, Homestead would appear to be among the least efficient of its NASLEF peers in generating affordable housing units. While Homestead would likely contend that this measure of efficiency does not adequately account for the high quality of its projects, we note that some of Homestead's NASLEF peers similarly claim an emphasis upon quality.

We are uncertain as to the extent to which Homestead has attempted to objectively measure its efficiency or the quality of its projects in evaluating its performance. Although the second compensation study suggested that Homestead's occupancy rate of 97% is unparalled, the Ernst & Young study cited earlier suggests that such an occupancy rate is essentially average (and which we think may be consistent with a shortage of affordable housing). Moreover, in terms of incentive compensation, Homestead has focused on rewarding growth in total investments more so than quality or efficiency. We understand that in developing low-income housing, the quality and quantity of units are competing considerations that must be balanced. We do not know where the appropriate balance lies, but we encourage the board to give some consideration to what it believes to be the appropriate balance and to develop objective criteria by which to measure Homestead's performance in this regard.

Homestead's emphasis on measuring performance based primarily on the growth of its investment portfolio is similar to that which one would expect from a for-profit firm interested in maximizing profits, but we question whether it is necessarily the best measure for evaluating how well Homestead is accomplishing its charitable mission of encouraging the development of

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[9] Boards may wish to give some consideration to the extent to which compensation studies and decisions are influenced by the "Lake Wobegon effect," in which all CEOs are above average and accordingly, are entitled to above average compensation. Some have suggested that this effect leads to rapid escalation of CEO salaries. In fact, the Lake Wobegon effect appears evident in the second compensation report, in which the consultant disregards staff turnover issues, units built, or other less favorable facts to conclude that Homestead's CEO's performance has been above average relative to NASLEF peers and suggests a compensation range that begins at the 75th percentile of the NASLEF peer group and goes up from there to incorporate for-profit data.

low-income housing. This question arises from the particular dynamics of the industry in which Homestead operates. The total pool of tax credits available for syndication and the amount of such credits available for projects in each state is fixed by federal legislation. In its initial years of operation, Homestead's syndication services may have ensured that the tax credits were more completely utilized and thus, Homestead's activities likely led to the development of more affordable housing than might have otherwise occurred.

However, with the maturation of the LIHTC program, high demand for LIHTC tax credits (at least up until very recently), and competition between syndicators, one cannot necessarily conclude just by the fact that Homestead is growing that its activities are increasing the utilization of such credits or that it is producing more or better housing than its competitors. While a for-profit firm might find it sufficient to measure its performance based on growth, market share, and net profits, for Homestead, the evaluation of its performance may be more complex. We think it should include some evaluation as to the quantity and quality of the housing generated by its activities and how that compares to its peers.

III. EXPENSES INCURRED BY FORMER CEO AND PRESIDENT

The Department received complaints that the former CEO and President incurred lavish expenses which were arguably inappropriate for the executive of a nonprofit.

Homestead now operates in several states and Ms. Saweuyer-Parks traveled to both investigate and supervise ongoing projects and to meet with potential investors. Expense reports and ledgers reflect that she always flew first class. She also stayed at premium hotels such as Four Seasons, Hotel Monaco, and the Alexis when they were available. In addition, she regularly had $100-$200 lunches at premium restaurants such as the Blue Hour and Southpark and similarly priced dinners at places such as Clarklewis.

While acting as Homestead's CEO and President, Ms. Saweuyer-Parks also served on the board of Mercy Housing and Oregon Public Broadcasting ("OPB"). Many of the lunches, dinners and travel expenses relate to board meetings or activities for these other organizations. Homestead has had some development projects with Mercy Housing and, thus, some of those expenses would be appropriate for Homestead. However, the number of first class flights and accommodates incurred for trips to Colorado and California for Mercy Housing and Las Vegas and San Francisco for OPB stand out. The organization also made a few small corporate gifts to OPB and paid for other incidental perks for Ms. Saweuyer-Parks such as membership to the Arlington Club and the United Red Carpet Club.

If all of these expenses were born solely by Homestead, the Department would have no hesitation in concluding they were inappropriate. However, because of the structure of the LIHTC program, many of the expenses were allocated to the limited partnerships (for-profit entities) and paid from those funds, not out of charitable assets. Because Homestead acts as the general partner of those limited partnerships, Homestead handles these decisions, does the accounting and cuts checks back and forth between the limited partnerships and Homestead itself, so that many of the travel and entertainment expenses incurred were ultimately reimbursed

by the for-profit limited partnerships. Apparently, the expenditures were acceptable to the for-profit investors and may have gone unnoticed since they were small relative to the millions invested.

To the extent Homestead paid for travel and entertainment expenses directly, Homestead notes that those expenses were small when compared to its annual revenue and reminded us that the expenses were in fact business-related as opposed to personal. The expenses were reviewed and approved by a board member on a regular basis. The board member believed the expenses had been internally vetted and relied on the professionalism and expertise of Ms. Saweuyer-Parks in approving them. However, the expenses were not internally vetted. Ms. Saweuyer-Parks indicated that she believed the expenses were acceptable so long as the board approved them. She further reports that the former chair of the board authorized first class air travel. Other members of the staff were also required to travel for business, but it does not appear that any of them traveled first class, had regular meals at premium restaurants or stayed at luxury hotels if not part of a convention.

Since the majority of travel expenses appear to have been paid by the for-profit LLCs, those expenses have been paid from funds held by for-profit entities that are not subject to the same constraints that apply to charitable assets. However we note that the lavishness of Ms. Saweuyer-Parks' travel and entertainment appeared to create considerable tension within the organization. Employees who may not have been privy to the details of how Homestead was reimbursed by the for-profit LLCs for the expenses Ms. Saweuyer-Parks incurred observed funds being used in a manner that seemed inconsistent with Homestead's charitable status and purposes and that appeared to be a factor in prompting complaints and problems with employee morale within Homestead.

During the course of this review, Homestead revealed that the full board had not been aware of the nature or scope of expenses incurred by the former CEO and President and it then adopted a new expense policy which limits these sorts of expenses. The adopted policy is a sound one and Homestead has indicated that future expenses will be markedly different and the new policy will be adhered to. The new policy should help in demonstrating to both internal and external interests that Homestead is fiscally responsible.

IV. CONTRACT WITH IBN SAWEUYER-PARKS

In May 2006, Homestead entered into a contract with Sawhorse Construction Management LLC ("Sawhorse") to provide construction oversight on its housing projects. Sawhorse was owned and operated by Ibn Saweuyer-Parks, the husband of Deborah Saweuyer-Parks. Questions arose regarding this conflict of interest transaction.

Homestead had previously contracted with LDC Design Group (now called Parati) for some of these services and also employed staff for those purposes. When Homestead contracted with LDC, Ibn Saweuyer-Parks was an employee of LDC. Homestead also employed an in-house construction manager to oversee projects, but he left Homestead's employment in 2006 while several projects were pending. Homestead reports that the sudden departure caused tremendous

problems because the workload was high with so many projects pending and one out of state project was particularly problematic. Homestead was familiar with Ibn Saweuyer-Parks through LDC.

In April 2006, the Executive Committee met outside the presence of Ms. Saweuyer-Parks to discuss the proposed contract with Sawhorse. It is not clear to the Department how the Executive Committee came to discuss Sawhorse alone, i.e, the minutes do not reflect that the committee was considering multiple bids at that moment. It may be that the executive committee previously eliminated some options or were simply acting quickly because of the sudden departure of staff. The proposed hourly rate for the Sawhorse contract was $100, which the committee believed was below market rate. The committee looked at the construction administration/management/review costs incurred by Homestead during the 2005-2006FY and determined it would be more cost-effective to contract with Sawhorse. The information was presented by the prior chair of the board. Homestead had paid its employee $89,000 per year, had paid LDC $95 per hour for construction administration, and paid $160 per hour to another consulting firm, DMC, for construction review and administration. We note, however, that only two board members comprised the executive committee – the former chair and treasurer – at this meeting and question whether that was sufficient.

The final Sawhorse contract provided for an hourly rate of $125, rather than the $100 discussed in the minutes. No clear explanation was given for the discrepancy. Homestead paid Sawhorse a total of $69,880.88 for services in 2006 (May – December) and $72,587.74 in 2007 (January – June). In addition, Homestead (or its partnerships) paid Sawhorse $79,157.96 in travel expense reimbursement in 2006 and $81,337.59 in 2007. The expenses seem high, but the Department acknowledges there was a great deal of travel out of state at that time for this function and that extensive travel expenses are customary for this position, which are born by the appropriate limited partnership (investment fund) as opposed to Homestead itself. It appears that the total compensation for services fell within its normal budget for this function if the comparable data relied on is accurate. The data provided for hourly rates for various contractors but does not definitely state what Homestead had generally billed to these contractors over the years and if those costs were in addition to the salaried positions at Homestead. The former board chair reported that the quality of the work was far above what they had received previously. Homestead reports that Ms. Saweuyer-Parks never supervised her husband's work or processed his billings. In 2007, Homestead hired an in-house construction manager and the contract with Sawhorse has thus ended.

Homestead had a conflict of interest policy in place and its minutes reflect that it adheres to the policy including in evaluating the potential contract with Sawhorse. The board generally has counsel present at meetings to clarify points of law with respect to the LIHTC and legal issues such as the conflicts policy. It appears the relationship with Sawhorse was the product of exigent circumstances and the board followed its procedures to ensure that it acted in the best interests of the organization.

V. EMPLOYEE COMMUNICATION AND WHISTLEBLOWER POLICIES

During the course of this review, Homestead adopted a whistleblower policy. The former CEO/President had instructed employees that they were not to contact board members. Although it is reasonable that board members should not be inundated with the minutiae of daily operations, employees should have a mechanism for reporting misconduct, particularly when it appears the offending party is a supervisor or executive. As noted above, there appeared to be concern among staff as to the extent to which Ms. Saweuyer-Parks was financially benefiting from the organization's operation, but staff believed that reporting such concerns to the board would result in termination or other form of retaliation. If dissatisfied employees had a more formal internal channel through which to voice their concerns and less fear of retaliation, they may not have found it necessary to express their concerns publicly and to the Department.

The BoardSource (formerly the National Center for Nonprofit Boards) and the Independent Sector (a leadership foundation for charities, foundations, and corporate giving programs) published a joint report, *The Sarbanes-Oxley Act and Implications for Nonprofit Organizations* in which they recommend nonprofits adopt formal procedures to handle complaints and prevent retaliation. The safety valve of a whistleblower policy serves an important function and the Department is pleased that Homestead has adopted a new policy and made its provisions clear to the staff.

VI. OTHER ISSUES

Homestead created and administers a scholarship fund. The fund is restricted to students in Oregon and Washington with an interest in low-income housing issues. Homestead has awarded approximately $10,000 per year and the individual awards have generally been in the range of $1,500-$2,500. At Ms. Saweuyer-Parks' recommendation, the board approved a $10,000 scholarship to one of Homestead's employees for tuition at UCLA. Ms. Saweuyer-Parks also incurred (first class) travel expenses to attend the graduation, although her expense ledger indicates that other business was also conducted on the trip. However, it is worth noting that Homestead does not have any developments in southern California. Homestead had indicated that was an isolated event and that employee was pursuing housing-related studies.

Homestead moved into the Fox Tower in 2005. It had previously leased space in Koin Tower at approximately $9,000 per month and before that, leased space on the east side for approximately $2,000. Its Fox Tower lease is for ten years. Under the terms of the lease, Homestead now pays approximately $16,000 per month. As part of the agreement, it received the office furniture from the prior tenant which Homestead values at $268,483. Homestead insists that the rent is below B class rent for downtown Portland and that is it important for Homestead to demonstrate and project a high degree of professionalism and competence so that investors are confident it can manage millions of dollars in investment funds. However, every nonprofit that seeks to obtain large grants from institutions must present professional competence, trust, and skill and most do so in more modest surroundings. Homestead itself has demonstrated that its own success was based on its personnel, not its office space.

While we do not expect nonprofits or their employees to forego reasonable accommodations and compensation or to impoverish themselves for the sake of their charitable mission, as discussed below, there is case law to suggest that the operations of tax-exempt entities should be distinguishable from those of for-profit counterparts. With Homestead's movement toward emulating its for-profit colleagues in salient respects, including compensation practices, employment of family members, generous travel and entertainment policies, office space and furnishings, scholarship programs for its own employees, etc., it becomes difficult to distinguish how Homestead's practices differ from those of syndicators that do not have charitable, tax-exempt status.

VII. COMMERCIALITY DOCTRINE

As indicated above, Homestead's practices in many respects resemble those more commonly associated with for-profit corporations. Homestead has indicated that its expenditures are similar to that of for-profit corporations because it is in direct competition with its for-profit peers for a limited pool of tax credits.

In some instances, the IRS and courts have found that a nonprofit was not entitled to tax-exempt status where its activities took on too much of a "commercial hue." This line of rulings has come to be referred to as the "commerciality doctrine." One leading commentator, Bruce R. Hopkins, summarizes the commerciality doctrine as follows:

> [A]n organization is engaged in nonexempt activity when that activity is engaged in a manner that is considered commercial. An Act is a commercial one if it has a direct counterpart in, or is conducted in the same manner as is the case in the real of for-profit organizations. Bruce R. Hopkins, *The Law of Tax Exempt Organizations*, Ch. 25.1 (8th ed. 2003).

The doctrine is not explicitly set forth in the IRS statutes or regulations and has, therefore, been criticized. Nevertheless, the doctrine has been invoked by both the IRS and enforced by courts as a basis for denying or revoking tax-exempt status. In applying the commerciality doctrine, the IRS and courts have looked to a variety of factors and examined the totality of circumstances surrounding an organization's operation to determine whether the public purposes that support the tax-exempt status predominate or are secondary to private financial interests. *Airlie Foundation v. IRS*, 283 F Supp 2d 58, 65 (2003). In cases where an organization's activities could be carried out for either exempt or nonexempt purposes, courts must examine the manner in which those activities are carried out to determine their true purpose. *Id.* (citing *BSW Group v. Commissioner*, 70 T.C. 352, 356-7 (1978)). The courts and the IRS focus on the manner in which the operations are conducted because the end purpose can be inferred from the chosen means. *New Dynamics Foundation v. U.S.*, 70 Fed Cl. 782, 800 (2006).

Courts have stated that the factor of greatest importance is whether the nonprofit is in direct competition with for-profit entities. *Airlie*, 283 F Supp at 63, *BSW Group*, 70 T.C. at 358. As part of that analysis, courts will examine whether the nonprofit is marketing itself in a similar fashion and uses similar methods as its for-profit counterparts. The court and IRS also look at

the extent to which the organization is publicly supported through donations and controlled by an independent board, whether it provides discounted or below-costs services to a charitable class, whether it is accumulating profits and whether those profits are used for charitable purposes or to pay private interests. *Airlie*, 283 F Supp at 63; *BSW Group*, 70 T.C. at 357-9. A single organizational activity can have multiple purposes, but if there is a nonexempt purpose that is substantial in nature, the organization may not qualify for tax-exempt status. *Better Business Bureau of Washington, D.C. v. U.S.*, 326 U.S. 279-283 (1945). If a substantial purpose of the organization includes advancing private financial interests, the organization may not qualify for tax-exempt treatment, even if it also promotes charitable purposes. *Id.*

The fact that an organization's activity may constitute a trade or business, does not in and of itself disqualify it from classification under Section 501(c)(3). The critical inquiry is whether the primary purpose for an organization engaging in its sole activity is an exempt purpose or the nonexempt one of operating a commercial business producing net profits. *BSW Group*, 70 T.C. at 357-9. In such an inquiry, particular transactions when viewed in isolation may not be unreasonable, but an organization still risks its tax-exempt status if it appears on the whole from the manner in which the organization operates that a substantial purpose of the organization is to benefit or advance particular private interests, including providing financial compensation to particular persons.

In marketing its services, Homestead has emphasized its nonprofit status, so we presume that the organization believes that status connotes qualities or values that distinguish it from for-profit syndicators, since all syndicators are engaged in activities that support the development of low-income housing. Homestead contends that it is distinguished by the types and quality of the projects for which it provides syndication services and its greater overall support for low-income housing. We encourage the board to be mindful of the cases described above and to public expectations of transparency and accountability for the charitable assets entrusted to the organization in overseeing the organization's future operations.

VIII. CONCLUSION

We are pleased that Homestead has implemented many changes that may have been prompted by our review or already under consideration. We are aware that Homestead has a good reputation within the community and there is no doubt but that Ms. Saweuyer-Parks is a talented business person, who is in large part responsible for Homestead's success.

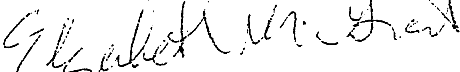
Overall, the minutes reflect a board that is thoughtful, engaged, and detailed in its governance. It appears the board has focused more on the housing projects themselves rather than the operations of the organization itself. It is not an uncommon occurrence for nonprofit boards to allow the organization to be dominated by a strong executive director, particularly one who founded the organization and to whom much of the organization's success can be attributed. Indeed, one of the compensation studies included a quote from a board member that "Deborah Saweuyer-Parks is Homestead." That statement probably says more than was intended.

It is important for a nonprofit board to develop an organization that extends beyond that of one strong leader. Indeed, part of the board's responsibility is to engage in succession planning and to ensure that the organization as a whole is strong and not dependent upon the talents of any particular individual. An organization's charitable mission and assets are endangered if they are tied too closely to any one person.

It seems Homestead is poised for a new chapter. In light of the board's adoption of revised practices and other recent changes, the Department will take no further action at this time and will close the file. We wish the organization success in its efforts to encourage the development of low-income housing.

We wish to thank the board for its cooperation in this matter.

Sincerely,



Elizabeth M. Grant
Attorney-in-Charge

Sincerely,

Susan A. Miller
Assistant Attorney General

http://www.doj.state.or.us/releases/pdf/gicwauditfinal.pdf

Link to Oregon DOJ 12/19/05 Audit of Goodwill Industries of the Columbia Willamette, finding excessive compensation paid to Goodwill's CEO. Provides best practices guidance to Boards of Directors setting executive compensation. –*Nancy Murray*