

# THE HFA INSTITUTE 2021

## Mitigating Threats to Long- Term Affordability



National Council of  
State Housing Agencies



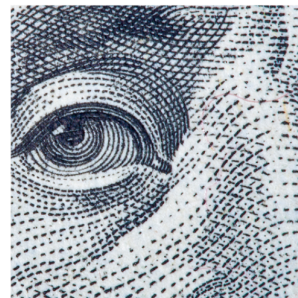
**MRBs and  
Other Federal  
Homeownership  
Programs**  
FEBRUARY 1 – 3



**Housing Credit**  
FEBRUARY 3 – 5



**Section 8 and  
Other Federally  
Assisted  
Multifamily  
Housing**  
FEBRUARY 8 – 10



**HOME and  
Housing Trust  
Fund**  
FEBRUARY 10 – 12



# Y30 Affordability Cliff

- As of 1990, new Housing Credit properties have been required to commit to a minimum of 30 years of affordability... which means that the **first wave of properties reaching Y30 is happening now!**
- We know that properties can exit affordability before Y30 or remain affordable for longer, but existing national data assumes that all properties remain affordable for 30 years.
- This means that we don't know precisely how many properties are at risk, when they are at risk, where they are located, etc.
- Without this information, it is difficult to design effective preservation strategies.

# Y30 Affordability Cliff

- What's the solution? More data!
- Working with SAHF, HFAs, and property owners to analyze the existing Housing Credit stock to:
  - quantity the stock of Housing Credit stock reaching Y30 that:
    - Will lose affordability at Y30;
    - Already exited from the Housing Credit program; or
    - Are subject to a longer affordability period due to resyndication, QAP requirements, or other financing sources.
  - Understand local markets where properties are located, to assess risk of loss;
  - Identify who owns these properties & evaluate their motivations and intentions.

# Qualified Contracts

- As of the end of 2019, **85,546 affordable units** had been lost from the Housing Credit inventory due to early terminations through qualified contracts.
- Since we have been collecting data on qualified contract losses, **more than 10,000 units have been lost every year**, despite many states establishing policies to mitigate qualified contract losses.
- In 2019, 24 states reported to have received at least one request for a qualified contract.
- Over the years, affordable units have been lost to qualified contracts in 33 states.
- Qualified contracts pose an **existential threat** to the Housing Credit program itself – not just to individual properties or states.

Source: NCSHA



# Qualified Contracts

- NCSHA’s Recommended Practices encourage HFAs to do three things:
  - 1) Require applicants for 9 & 4% Housing Credits to waive their right to a qualified contract.

QC Policies in the 9% Housing Credit Program			QC Policies in the 4% Housing Credit Program		
Requirement to waive right to QC	Incentive to waive right to QC	For how many years beyond the initial 15 year compliance period is the right waived?	Requirement to waive right to QC	Incentive to waive right to QC	For how many years beyond the initial 15 year compliance period is the right waived?
28 states	20 states	3-35 years	27 states	7 states	5-25 years

# Qualified Contracts

- NCSHA's Recommended Practices encourage HFAs to do three things:
  - 1) Establish a qualified contract process for existing developments.
  - 2) Establish disincentives for owners to undertake the qualified contract process for existing developments.

## Virginia Housing's 2019-2020 QAP:

- Requires applicants to waive their right to a qualified contract.
- Will reject any application containing a principal that has previously requested a qualified contract, on/after 1/1/19.

## NCHFA's 2020 QAP:

- May disqualify any owner/principal who previously requested a qualified contract in NC.

# Qualified Contracts

- NCSHA's Recommended Practices encourage HFAs to do three things:
  - 3) Formulate other policies to curtail the use of qualified contracts by owners of existing developments, e.g. requiring owners to waive right for transfers.
    - Require a pre-application for qualified contract requests, to determine owner eligibility;
    - Charge an application fee for work associated with qualified contract processing;
    - Require 3<sup>rd</sup> party CNA to verify the qualified contract price – paid for by the owner;
    - Require any owners' requests or modifications to property's financial/rent structure to be contingent on waiving the right to a qualified contract;
    - Use qualified brokers to find buyers to purchase properties at qualified contract price.



# Y15 Disputes

- The Housing Credit program offers nonprofit partners (as well as government agencies & tenant organizations) a **Right of First Refusal (ROFR) to obtain eventual ownership of the property at a minimum purchase price (equivalent to outstanding debt plus exit taxes) after 15 years**, once the investor has claimed all Housing Credits & before the program's rent restrictions expire.
- Recently, some private firms have begun **systematically challenging nonprofits' project-transfer rights & disrupting the normal exit process** in hopes of generating profits &/or selling the property at market value.
- In such disputes, LPs have typically taken the position that the Section 42(i)(7) ROFR is a common law right-of-first-refusal & they don't have to recognize the rights established in the partnership agreement without a bona fide offer from an unrelated third party that the investor has singular authority to accept.



# Y15 Disputes

Scope of Threat Nationally			
	Placed in Service	Properties	Units
Year 1 – 10	2011-2020	661	43,162
Year 11 – 15	2006 - 2010	1,069	67,596
Year 16 – 30	1991-2005	2,964	170,909
Year 1 – 30 (cumulative)	1991-2020	4,694	281,667

Source: National Preservation Database



# Y15 Disputes

## On the property level, this is a threat to affordability

Most nonprofits don't have the resources to litigate these issues in court, so a stalemate ensues – then the investors leverage a cash payment or a sale of the property in return for leaving the partnership.

Housing Credit properties are far more likely to continue operating as affordable housing into perpetuity if left in the hands of mission-driven nonprofits.

The use of scarce funds for this payment undermines the continued viability of the property of affordable housing.

Rising values in certain markets have created an opportunity for these firms to profit far beyond the original investors' expectations.

## On the community level, this is detrimental to public interest

Transfer disputes invariably drain the nonprofit partner's resources that would otherwise be devoted to resident services, building maintenance, & related affordable housing initiatives.

A sale of the property at market value generally leaves the new owner with fewer resources to devote to operations, maintenance, & ancillary services.

When limited partners drain resources from a property, they undermine a mission-driven nonprofit's ability to serve its residents, & the broader community, through education/training programs and partnerships with other organizations that benefit community members.

These disputes can have a racial equity component, by extracting resources from a property & community to increase profits for investors, usually corporations not based in the community.

# Y15 Exit Disputes

- Historical understanding and practices
- Emergence of Aggregators
- Litigation Discussion

# Aggregators

- “Affordable housing asset management” firms have been amassing investor interests in LIHTC partnerships.
- Treat the partnership agreements as purely financial instruments for generating profits, rather than projects intended to promote low-income housing.
- The Aggregators have been extracting maximum value from nonprofit partners at the expense of low-income housing and the communities the LIHTC program is designed to serve.
- Leveraging economies of scale and resource disparities against the nonprofit partners to thwart transfers or obtain significant buyouts.

# Aggregators

- Various tactics:
  - Dispute ROFR triggers or rights.
  - Delay, obstruct, or dispute valuations.
  - Refuse or unreasonably condition consent to refinancing.
  - Dispute fee calculations.
  - Assert prior breaches of the partnership, including failure to maximize rental profits.
- Growing number of lawsuits across the country over the last several years.

# Aggregators

“Since 2012, Alden Torch Financial LLC and its affiliates have represented the interests of investors who have collectively contributed hundreds of millions of dollars to the development of low-income housing throughout the nation,” said Alison Wadle, General Counsel of Alden Torch. “As part of its fiduciary duties to those investors, its obligations to the federal low-income housing tax credit program, as well as its long-term commitment to low-income housing, Alden Torch has a responsibility to ensure that the contractual obligations and entitlements of the parties are upheld and the requirements of the federal program are met.”

Source: *After The Low Income Housing Tax Credits Are Done Investors Want More.*  
Peter J. Reilly, Forbes Magazine. 1.13.21

# Aggregators

“While the vast majority of developers and non-profits in the industry recognize the importance of honoring these fundamental obligations, a few of them have improperly attempted to change the nature of the program in ways that ignore the principles on which it was founded for their own benefit, thereby jeopardizing the benefits that everyone involved in the program enjoys,” Wadle said. “Alden Torch cannot simply stand by idly and allow that risk to the industry to go unchallenged.”

Source: *After The Low Income Housing Tax Credits Are Done Investors Want More.*  
Peter J. Reilly, Forbes Magazine. 1.13.21



# ***CED Capital Holdings 2000 EB, LLC v. CTCW Berkshire Club, L.L.C.***

**2020 WL 6537072 (Fla.Cir.Ct. Nov. 3, 2020)**

Florida Court recognizes several important industry concerns:

- “a trend in the LIHTC industry in which certain entities, like Hunt, are acquiring limited partner interests in LIHTC partnerships – known as “Aggregators” – who then attempt to extract value out of such interests that were not intended by the original parties to the partnerships.”
- the “Aggregator’s playbook” is designed to disrupt year-15 exits “to drive a cash return, ultimately to Hunt, that was never intended by the original tax credit investor or anyone originally involved in the Project.”

# ***CED Capital Holdings 2000 EB, LLC v. CTCW Berkshire Club, L.L.C.***

**2020 WL 6537072 (Fla.Cir.Ct. Nov. 3, 2020)**

- “this type of activity has become more common in the LIHTC industry and the Court’s decision here is in accord with decisions from other, similar cases in different jurisdictions where parties, like Hunt, have come into LIHTC partnership agreements and attempted to extract value or proceeds that is not otherwise permitted under the operative contracts like the Partnership Agreement here. (citing 9 cases and two sources)

# Y15 Exit Litigation

- Right of First Refusal
- Purchase Options and Option Prices
- Fair Market Value / Appraisals / Broker's Opinion of Value
- Ownership Interests
- Capital Transaction / Liquidation / Capital Accounts
- Project Refinances
- Forced Sale Rights
- Limited Partner Removal Initiatives
- Qualified Contracts

# 10 Red Flags in LIHTC Deals

1. Investor limited partner interests have changed hands from original investor limited partner. Is your partner today the same as the one you did your deal with at the beginning?
2. The investor limited partner interests are managed by and/or affiliated with organizations that have been involved in litigation concerning LIHTC project partnerships around year-15.
3. The investor limited partner has a large positive capital account and believes that it should be allowed to monetize the book entry through a “cash-out” process.

# 10 Red Flags in LIHTC Deals (cont)

4. The investor limited partner starts talking to you about future planning, future values, future circumstances beyond year-15, like refinancing or re-syndication, as a means to generate proceeds to “buy them out” after year-15.
5. The investor limited partner undertakes efforts to restrict or limit use of reserve accounts and withholding approvals for project needs.
6. The investor limited partner begins to question otherwise routine financial reports, or suggests that a forensic audit of past events is necessary for some reason.

# 10 Red Flags in LIHTC Deals (cont)

7. Exit negotiations stall or you experience periods of non-responsiveness from your investor limited partner.
8. Qualified Contract requests are suddenly presented.
9. Discussions concerning liquidation of the Partnership are presented.
10. You are not adequately familiar with your documents and/or are talking to or fielding questions from your investor limited partner about their exit.

# Thank you!

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