



# What Happens When an Investor Refuses to Recognize the Nonprofit Right of First Refusal

In 1989, Congress amended the Low-Income Housing Tax Credit (Housing Credit) program to permit Housing Credit partnership agreements between property owners to give nonprofits a Right of First Refusal (ROFR) to obtain full ownership of affordable housing property after Year 15. Congress took this action to encourage ownership by nonprofits for the purpose of maintaining rent affordability restrictions in perpetuity. The statutory ROFR price in Section 42(i)(7) permits a nonprofit to obtain full ownership by assuming the debt on the property and paying any exit taxes owed by the investor.

Increasingly today, however, outside capital is obtaining control of Housing Credit investor limited partnerships, and then refusing to recognize the purchase rights of nonprofits until they receive a payment of money in excess of the agreed upon price in the ROFR agreement. This action may precipitate any or a combination of the following impacts:

## **Deferred Maintenance and Diverted Staff Capacity**

In a typical ROFR dispute, the prudent management of the affordable housing property is essentially frozen as the investor refuses to permit the general partner to undertake necessary capital improvements. While a dispute with an investor is taking place, over a number of months or years, due to protracted negotiations or litigation, the nonprofit general partner may be unable to obtain the investor's approval to secure loans or otherwise raise funds needed to complete necessary capital improvement projects.

### ***Deferred Maintenance and Capital Improvement projects may include:***

- replacing worn out roofs, carpets;
- updating aging kitchens and bathrooms;
- mold and asbestos remediation;
- paving and accessibility compliance;
- plumbing and appliance replacement;
- replacing windows and doors;
- energy efficiency retrofits which will reduce energy costs and improve the quality of life for residents; and
- upgrading internet service.

When a nonprofit is forced to defer capital improvement projects because it cannot access the necessary funds during a dispute with an investor, that owner is prevented from extending the affordability and useful life of a property. The residents ultimately suffer.

Similarly, during a dispute, a nonprofit owner may be unable to utilize the funds necessary to provide basic social services to residents, such as job training, technical assistance with small business development, financial literacy training, health and wellness services, and after school arts and cultural programs. The owner may be forced to curtail or stop these services due to lack of financing, again, needlessly penalizing the residents.

During the months or years in which a dispute typically drags on, the nonprofit organization is forced to allocate resources and divert staff attention to dealing with the investor's intransigence. These disputes monopolize the nonprofit's time and energy, which would otherwise be spent analyzing and meeting residents' needs and planning for future investments in affordable housing.

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*During a ROFR dispute, operating and maintenance reserves normally maintained to ensure the continued operation of the property may be claimed as a source of cash to pay off the investor.*

*When the reserves are stripped out of the affordable housing property, its ongoing financial feasibility is undermined. Depending on the circumstances, the condition of the property may deteriorate, or the nonprofit may be forced to curtail services to residents.*

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### **Reserves Diverted to Investor**

The property's rents may be increased if they are less than the maximum permitted under Section 42 and the regulatory agreement with the credit allocating agency. Although permitted, such rent increases to protect the financial viability of the property pose a burden on existing low-income residents.

If the reserves are insufficient or may not be accessed under regulatory or partnership agreements, the nonprofit general partner which holds the ROFR may derive cash to pay the investor from its balance sheet or by borrowing money. If the nonprofit determines this action is necessary to retain control and full ownership of the Housing Credit property it developed, it may undermine the financial viability of the organization or the property.

If the nonprofit lacks the resources to make such a payment, additional cash might be raised by refinancing the Housing Credit property and using a portion of the new debt to make a payment to the investor to satisfy its ransom demands. This option also could undermine the financial viability of the property since a higher level of mortgage debt will be required to pay off the investor. Refinancing also may require that rents be raised higher than would otherwise be the case.

### **Investor Demands Sale of Property**

If none of the above options are available to secure the cash necessary to meet the investor's demands, the investor typically will insist on the sale of the Housing Credit property to a new owner. If the purchaser is a for-profit entity, the property is much more likely to be converted to market rate housing after the conclusion of the extended use period, in direct contravention of Congress's intent in enacting Section 42(i)(7) to facilitate nonprofit ownership and maintenance of the property's affordability in perpetuity.

Similarly, in states that permit it, a new for-profit owner is more likely to exercise the right to a qualified contract and remove the affordability restrictions on the property after only 15 years, leaving residents to face a likely increase to market rate rents after a three-year transition period. Some partnership agreements enable investors to force owners to initiate the qualified contract process.

As is true with the other options described above, selling the property increases the likelihood that residents pay higher rents during the extended use period. In gentrifying neighborhoods, existing residents are likely to be displaced due to rent increases.



## **Uncertainty for Residents**

ROFR disputes put the future ownership structure and affordability of properties at risk, which creates uncertainty and anxiety for residents. In some cases, the control of the property can be in dispute over a period of years, leaving residents' lives in limbo. Some owners try to shelter residents from these disputes, but the actions of investors sometimes make the situation hard to conceal, for example, when a property's maintenance is deferred. In one Year 15 dispute, an investor conducted a "raid" forcing onsite property staff to leave, which was extremely stressful for residents and made it harder for the owner to attract future staff to work at that location.

## **Racial Equity Implications**

In communities of color undergoing gentrification, displaced residents are likely to be forced to leave the neighborhood and move to less expensive areas, while being replaced by younger, whiter residents. Further, when investors extract resources from a mission-driven nonprofit dedicated to serving the disadvantaged members of a community, those resources may be shifting from a community of color to a privileged White investor from an outside area.