Negotiations and Disputes in LIHTC Preservation
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The State Agency Perspective

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I. Qualified Contracts

The Internal Revenue Code (“IRC”), Sections 42(h)(6)(E) through (I), allows an owner to remove its property from the extended use period requirements by exercising its right to a qualified contract (“QC”). The owner must notify the Agency that it wants to exercise this right and the Agency then has one year to find a qualified buyer. If a qualified buyer is not found, the project is released from its LIHTC obligations. The right may only be exercised after year 14 of the compliance period. The purchase price is set by the IRC based on outstanding debt, investor equity and other contributions, less distributions. The IRC provides that these provisions may not apply if more stringent requirements are provided in the Land Use Regulatory Agreement (“LURA”) or in State law.
I. Qualified Contracts (continued)

- State agencies generally discourage the use of the QC option as it results in a loss of affordable units. Agencies have exercised several options to discourage the use of the QC:
- Express waiver in the Qualified Allocation Plan (“QAP”), application, and LURA
- Allocation of points – Most Agencies use a competitive point-based system to award LIHTC. If an owner agrees to 30 or more years of LIHTC affordability to receive points, the owner is deemed to have implicitly waived any QC rights.
- Penalty points – If an owner agreed to 30 or more years of LIHTC affordability and received points, but later pursues a QC, the owner is penalized under a “Previous Performance” category which may prohibit or limit the owner’s eligibility for future allocations.
II. Terminating LURA Prematurely

- IRC Section 42(h)(6)(B) requires the project owner and the state agency to enter into a long term use agreement ("LURA") for 30 years; 42(h)(6) provides only two options for early termination – foreclosure or QC

- When a request might arise:
  - Health and safety issues
  - Redevelopment opportunities
  - Older project

- Ability to permit this:
  - Lack of guidance
  - Distinction between initial 15 years vs. extended use period
II. Terminating LURA Prematurely (continued)

- Matters to consider in negotiating an agreement to terminate:
  - Owner must provide replacement units with the following characteristics
    - Location – same or close proximity; will depend on geography
    - Number of units/bedrooms – same or negotiate for more
    - Extension of years – original extended use period plus any vacancy years or negotiate for more
  - Regular reporting on progress of new units
  - Annual 8823 Report of Noncompliance
  - LURA remains in place
  - Penalty points for future applications by project owner
  - Means of last resort
  - Indemnification of Agency by owner
III. Approving New Owners and GPs

Agencies should hold new owners and partners to the same level of review as initial owners, including:

- LIHTC experience
- Property management experience
- Other projects in state LIHTC portfolio
- HUD flags
- Financial capacity
IV. Continuous Compliance Monitoring

- Develop policies for continued compliance monitoring in the Extended Use Period.

- Enforcement of all statutory and regulatory requirements, including:
  - Income and rent restrictions
  - Minimum set asides
  - Applicable fraction
  - General public use rule
  - Fair hosing
  - Habitability/safety
  - Income restrictions
V. Other Workout Solutions to Maintain Affordability

- Income Limit changes -- So long as a project still complies with the minimum IRC income limit requirements, allow projects that lose subsidies to increase income limits and rents on deep-skewed units, with conditions, such as:
  - Loss of rent subsidy was not caused by action/inaction of project owner
  - Owner diligently pursued renewal or other subsidies
  - Project maintains the same percentage of restricted units
  - Excess cash flow is deposited in a tenant subsidy reserve for affected tenant
V. Other Workout Solutions to Maintain Affordability (continued)

- Age limit restrictions in elderly projects -- If the state definition of elderly is more restrictive than the federal definition, allow loosening of restriction so long as it complies with Housing for Older Persons Act (“HOPA”), with conditions, such as:
  
  • Low occupancy is well documented; for example, occupancy is under 90% for six months or has been trending downward for a period of 18 months
  • Project has been well marketed
  • Owner provides evidence of potential tenants between 55 and 62 who were turned away
  • Owner provides evidence that the proximity to newer, more competitive projects has affected occupancy
VI. Portfolio Review for Projects Eligible for Recapitalization

Agencies should conduct a regular reviews of projects nearing the end of year 15 and the end of the extended use period and be proactive in reaching out to project owners to look at options to refinance/rehabilitate/re-capitalize for additional years of affordability.