Journal of
# Affordable Housing
& Community Development Law

VOLUME 31, NUMBER 1
2022

# *FORUM ON AFFORDABLE HOUSING AND COMMUNITY DEVELOPMENT LAW*

**2021–2022**

The *Journal of Affordable Housing & Community Development Law* is the official publication of the Forum on Affordable Housing & Community Development of the American Bar Association, with three issues per year. It is targeted toward attorneys and other housing and community development specialists. It provides current practical information, public policy, and scholarly articles of professional and academic interest.



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*Journal of Affordable Housing & Community Development Law* (ISSN 1084-2268 (print); ISSN 2163-0305 (online)) is published as a membership benefit by the American Bar Association, 321 North Clark Street, Chicago, Illinois 60654-7598. Attorneys who are not members of the American Bar Association and nonlawyers may contact HeinOnline. mail@wshein.com, (800) 828-7571 (or (716) 882-2600) for digital subscription options and information. **Postmaster:** Send address changes to Affordable Housing Member Records, American Bar Association, ABA Service Center, 321 North Clark Street, Chicago, IL 60654-7598.

# *From the Editor-in-Chief*

***Anika Singh Lemar***

**Anika Singh Lemar**

The theme of this issue is expiring affordability restrictions, including those in the Low-Income Housing Tax Credit (LIHTC) program. Regular readers of the *Journal of Affordable Housing & Community Development Law* will not be surprised to know that we have been publishing articles about "Year 15" since the mid-1990s. As a public-private partnership, the LIHTC program balances the needs of public and private capital by mandating affordability, but not forever. And it provides for payment of the public subsidy over a term substantially shorter than that of the affordability mandate. As a result, at Year 15, the incentives faced by participants in the program can diverge. While that divergence is not new, in recent years, with housing demand in many cities rising, construction across the country slowing, and the value of multifamily rental property skyrocketing, that divergence has widened. This issue pulls together various perspectives on Year 15 and affordable housing preservation more generally. The result is a comprehensive survey of the field, in which we present a range of views in conversation with one another. Our writers include regulators, litigators, academics, and transactional lawyers, all puzzling over the policy mechanisms that can best advance the goal of housing affordability in the context of a multi-party public private partnership.

We continue that effort to bring you varying views on a single topic with a pair of reviews of David Wessel's *Only the Rich Can Play: How Washington Works in the New Gilded Age*, a critical appraisal of the political maneuverings that gave rise to the Opportunity Zone program. Our reviewers, Ted De Barbieri and David Schleicher, read overlapping, but again diverging, conclusions into Wessel's work. Is his story a reason to be pessimistic of Washington politics, or does his critique extend to place-based revitalization strategies more broadly?

I look forward to talking about these issues and others in person at our May conference, where you may even be reading these words now! Whether at the conference or over the phone or (shudder) on Zoom, I would love to hear from readers. What are your favorite parts of the *Journal*? What could we do better? Please do reach out and let me know how we can be most helpful to your practice and your thinking on these issues.

# *From the Chair*

***Michael Hopkins***

**Michael Hopkins**

As I write this Chair Message, the Forum's conference committee is in full planning mode for the ABA Forum on Affordable Housing and Community Development Law Annual Conference this May in Washington, D.C. Conference Co-Chairs, Sarah Molseed and Cara Nesbitt of Kutak Rock, have planned a fantastic lineup of panels, and the Forum's Young Lawyer Liaison, Stephanie Johnson of Klein Hornig LLP, has organized a Welcome Back Networking Reception so we can all toast to being together again in person!

In addition to the in-person Annual Conference, the Forum's Governing Committee has been working to re-engage the Forum community. The Forum's Law Student Liaison, Lacey Johnson of Northwestern Pritzker School of Law & Kellog School of Management, has helped the Forum set up a LinkedIn page. Be sure to follow the page to get updates on Forum activities and events, including upcoming CLE teleconferences and Lunch and Learn calls organized by the Teleconference Committee lead by Jill Goldstein of Kutak Rock and Penny Indictor of Berman Indictor LLP. The Forum's Publication Committee led by Schuyler Armstrong of Telesis Corporation has announced two new publications available for purchase: (1) *The Legal Guide to Affordable Housing* (3d ed.) and (2) *Beginner's Guide to Nonprofit and Affordable Housing Partnerships*.

Are you taking advantage of the Forum membership benefits offered through joining a Practice Group? Practice Groups (sometimes known as Practice Committees) offer an additional outlet for engagement and community in the Forum. They provide smaller lunch-and-learn teleconferences on hot topics within focused areas of practice and assist with Forum conference and teleconference planning by proposing panel topics, speakers, and moderators relevant to a specific Practice Group. Sign up today to ensure you're included in the conversation and are receiving notifications on Practice Group calls and events. I've included a list of the Practice Groups and their Co-Chairs below and hope you will join one or more! Thank you to Emily Blumberg of Klein Hornig for corralling the Practice Groups and to the Practice Group Co-Chairs for devoting their time to lead the Practice Groups. I look forward to seeing many of you at the Annual Conference!

**Community Development Practitioners and Legal Educators (CDPLE) Practice Group**

*Practice Group Co-Chair*: Heather Way – hway@law.utexas.edu
*Practice Group Co-Chair:* Laurie Hauber – lhauber@uoregon.edu

The **Community Development Practitioners and Legal Educators Practice Group** provides opportunities to share innovations in the community development field, network with other attorneys, and collaborate on projects and cases. The CDPLE Practice Group holds forums to discuss recent community development and affordable housing scholarship, doctrinal/clinical teaching experiences, and best practices. It also shares resources with its membership, offers opportunities for law students to engage, and hosts panels and other events of interest to practitioners and legal educators. The Practice Group works closely with the *ABA Journal of Affordable Housing and Community Development Law* to solicit articles and highlight recent publications.

**Fair Housing Practice Group**

*Practice Group Co-Chair:* Megan Sylvester – megan.sylvester@tdhca.state.tx.us

The **Fair Housing Practice Group** is comprised of a membership representing public sector attorneys, transactional lawyers, and public interest advocates interested in the intersection of affordable housing, fair housing, and civil rights. The Practice Group is concerned with a broad range of topics, including sharing basic information on the varied requirements of the Fair Housing Act, the civil rights laws governing programs with federal financial assistance, the Americans with Disabilities Act, civil rights related program requirements, and similar laws; identifying and offering training and support in new and emerging issues; and promoting fair and inclusive practices in the site selection, design, tenant selection, and occupancy practices in affordable housing. The Fair Housing Practice Group provides training and support in these areas to members of the Forum.

**HUD Practice Group**

*Practice Group Co-Chair:* Ian Adams – iadams@kantortaylor.com
*Practice Group Co-Chair:* Schuyler Armstrong – sarmstrong@telesiscorp.com
*Practice Group Co-Chair:* Kiara Griggs Price – kprice@kleinhornig.com

The **HUD Practice Group** addresses a cross-section of issues related to practice before the U.S. Department of Housing and Urban Development (HUD). Consideration is given to HUD administrative and legislative initiatives impacting issues and items before HUD at Headquarters and in field offices. Matters addressed may be policy-focused or transactional and can cut across all HUD and HUD-related program areas. This Practice Group often involves direct interaction with HUD senior officials, as well as local HUD counsel. In the past, the HUD Practice Group has reviewed proposed updates to HUD regulations, guidance, and loan documents, and provided comments to the same. The input of the Practice Group is often actively sought by HUD on such proposed updates. Periodic updates to significant HUD policy changes and higher-level staff appointments are provided to the HUD Practice Group members.

**Tax Credits and Equity Financing Practice Group**

*Practice Group Co-Chair:* Donna Rodney – drodney@enterprisecommunity.com
*Practice Group Co-Chair:* Brad Tomtishen – brad@tomtishenlaw.com
*Practice Group Co-Chair:* Judith Crosby – Judith.crosby@kutakrock.com

The **Tax Credits and Equity Financing Practice Group** addresses issues related to Section 42 low-income housing tax credits, Section 45D New Markets Tax Credits, Section 47 Historic Rehabilitation Tax Credits, and Section 48 Energy Credits (within the Housing and Community Development context). The Practice Group addresses issues related to developments that make use of the foregoing credits and focuses on compliance with the rules of each credit and other Tax Code provisions relevant to investment in such syndicated credits.

Michael Hopkins
Bocarsly Emden Cowan Esmail & Arndt LLP

# DIGEST OF RECENT LITERATURE*

The Digest of Recent Literature in the *Journal* is an opportunity for attorneys and law students new to the practice of affordable housing and community development law to participate in the *Journal* and the Forum. This feature of the *Journal* provides brief summaries of academic and nonprofit policy institute reports, federal government notifications and reports, social science publications, and law review articles that have been published in other sources and may be of interest to the *Journal*'s readership. Each summary is accompanied by a citation and link for readers who would like to read the full article or report. Attorneys and law students interested in contributing to future Digests are welcome to contact Emily Blumberg at eblumberg@kleinhornig.com.

**Addressing Segregation and Unequal Access to Opportunity in California with Affordable Housing Investments: A Path Forward for a Comprehensive Approach**

*Dan Rinzler & Jose Loya*

*California Housing Partnership Policy Brief*

*(https://1p08d91kd0c03rlxhmhtydpr-wpengine.netdna-ssl.com/wp-content/uploads/2021/12/CHPC2021PolicyBrief_AFFH_Path_Forward_CA.pdf)*

This brief is based on the premise that residential segregation in California perpetuates racial, ethnic, and economic inequality in the state. In response, the authors argue that deliberate and sustained efforts across many policy areas, including public investments to create affordable housing, will reduce residential segregation and mitigate its negative effects in lower resourced communities of color. Research suggests that segregation persists in California largely due to the constraints on resident housing choices perpetuated by exclusionary zoning, discrimination, and informational gaps in the housing search processes, among other factors.

*Editors: Emily Blumberg, Klein Hornig LLP, Washington, DC (eblumberg@kleinhornig.com) and Claudia Wack, Klein Hornig, Washington, DC (cwack@kleinhornig.com). Contributors: Christopher Azuoma, Nelson Mullins Riley & Scarborough LLP, Washington, DC (christopher.azuoma@nelsonmullins.com); Rita Burns, Berman Indictor LLP, Philadelphia, PA (burns@bermanindictor.com); Adam Cohen, University of Maine School of Law, Portland, ME (adam.cohen@maine.edu); Mark A. Iafrate, Klein Hornig LLP, Boston, MA (miafrate@kleinhornig.com); Kathy Purnell, Fair Housing Center of Southwest Michigan, Kalamazoo, MI (kathy.purnell@fhcswm.org); Crystal Thorpe, Faegre Drinker Biddle & Reath LLP, Minneapolis, MN (crystal.thorpe@faegredrinker.com).

The authors posit that affordable housing, which is typically framed as a solution to the state's chronic housing shortage and rising rates of homelessness, can also play a huge role in reducing residential segregation and mitigating its harmful effects. First, affordable housing is an essential tool for expanding access to opportunity-rich and exclusive neighborhoods that have been inaccessible to people of color and low-income households through decades of racist land use and financing decisions. Second, affordable housing can be part of comprehensive community development initiatives that bring resources and opportunity to lower resourced communities of color.

The brief utilizes property and resident data to assess the degree to which affordable housing investments have reduced racial and socioeconomic segregation in California since the inception of the federal Low Income Housing Tax Credit (LIHTC) program in 1987. LIHTC now funds nearly all new affordable housing in the state. The authors encourage a realignment of California's affordable housing portfolio such that more affordable housing is built in opportunity-rich and predominately-white neighborhoods that currently remain segregated.

The authors conclude by offering three recommendations for reforms to be adopted by California's housing agencies to reduce residential segregation and unequal access to opportunity. First, California should support comprehensive community development in low resourced communities of color. Second, state agencies should establish meaningful long-term targets for affordable housing in opportunity-rich neighborhoods. Third, California should improve access to affordable housing in opportunity-rich neighborhoods.

The brief emphasizes that progress will take time, but California must commit to the comprehensive approaches detailed in the brief for several decades to reverse entrenched patterns that have shaped life in California for more than a century.

### Challenges and Opportunities for Hotel-To-Housing Conversion in NYC

*Noah Kazis, Elisabeth Appel & Matt Murphy*

*NYU Furman Center Policy Brief*

*(https://furmancenter.org/files/publications/Challenges_and_Opportunities_for_Hotel-To-Housing_Conversions_in_NYC_Final.pdf)*

This policy brief explores hotel-to-housing conversions in New York City by discussing the utilization during the COVID-19 pandemic, particularly given the crisis's impact on the hotel industry; the regulatory hurdles that impede successful conversions; and the unique advantages and challenges that apply to affordable housing and supportive housing conversions. The brief examines these questions against the backdrop of the current hotel market in New York City, where the vast majority of hotel rooms are located in Manhattan versus the other boroughs.

The brief provides historical background on the local dynamics surrounding hotel conversions, including the City's practice of housing the homeless in hotels and temporary moratorium on conversions (since expired as of 2019). The authors then explore the regulatory hurdles to hotel conversions, such as zoning restrictions and difficult-to-fulfill accessibility standards. The brief details what pathways to conversion exist under the City's current land use codes, including (1) converting hotels that may be a non-conforming use into a conforming use; (2) conversion of older hotels under the more permissive Article I, Chapter 5, of the Zoning Resolution if certain criteria are met; and (3) rezoning a hotel parcel through the Uniform Land Use Review Procedure (although the authors acknowledge the burdensome time and expense of doing so).

The 2021 "Housing Our Neighbors with Dignity Act" (HONDA) newly incentivizes conversions by authorizing New York State to spend $100 million on acquiring distressed hotels and office buildings to convert to affordable housing. The brief summarizes a California program, Project Homekey, as an example of such a model can succeed, although the authors acknowledge that the California model may not easily translate to New York City. They point to the unionized nature of the City's hotels and proposed zoning changes that would require new hotels to obtain a special permit, as factors that make existing City hotels more valuable in unconverted form.

Finally, the brief compares the challenges and merits of hotel conversions to affordable versus supportive housing. The authors find that challenges exist to converting a hotel to mixed or low-income or affordable housing development, including high acquisition costs; competing uses for housing subsidies; and the locational costs associated with Manhattan, where most New York City hotels are situated. Meanwhile, supportive housing receives certain regulatory carve-outs that may make conversion comparatively easier (e.g., by minimizing the amount of necessary renovations), including exemptions from density controls and other residential zoning requirements. Ultimately, the authors conclude that conversion of distressed hotels into affordable housing and supportive housing can offer a promising opportunity for the creation of new housing in New York City in individual cases, but also faces significant challenges.

### Impact of Rental Assistance Demonstration Program Conversions on Public Housing Tenants

*Christopher Hayes, Matthew Gerken & Susan J. Popkin*

*The Urban Institute (2021)*

HUD launched the "Rental Assistance Demonstration" (RAD) program in 2012 to improve and maintain the country's aging public housing stock. The RAD program seeks to leverage public and private debt and equity in order to rehabilitate certain publicly owned properties. While the program seeks to improve conditions for public housing residents, many stakeholders initially raised concerns regarding whether the rights of tenants—many of whom belong to vulnerable populations—would be protected during the conversion process. The relativeness newness of the program, combined with the lengthiness of the conversions themselves, means that little research has been done to date on how RAD impacts existing public housing tenants.

The authors draw on tenant survey research collected during the first round of RAD conversions (which took place from 2013 to 2018) in order to analyze the program outcomes in three key areas: (1) preservation of tenant rights, including the relocation process, relocation assistance, and communication; (2) improvement of overall property conditions, including maintenance, management, housing quality, and community space; and (3) enhancement of tenant wellbeing through housing costs, employment status, health, safety, and general neighborhood outcomes.

Overall, the authors find that most tenants report a positive or neutral experience with the RAD program. Positive outcomes include the fact that most tenants experience little or no major disruptions in their lives as a result of the conversion, and describe being satisfied with the process in general. The authors note significant room for program improvement, however, in that most tenants did not report an overall improvement in their housing conditions post-conversion.

**Cracking Code Enforcement: How Cities Approach Housing Standards**

*Sophie House*

*NYU Furman Center (2021)*

*(https://furmancenter.org/thestoop/entry/cracking-code-enforcement-how-cities-approach-housing-standards)*

This article conceptualizes code enforcement regimes by focusing on three varying dimensions: (1) the relative priority given to remediating individual housing hazards versus improving overall neighborhood quality through the elimination of blight; (2) the degree to which codes are proactively or reactively enforced; and (3) whether a cooperative or punitive approach is taken to ensure landlord compliance.

First, the article notes that blight-focused code enforcement has long been a focus of historical movements concerned with urban economic development; other regimes target interior violations with particular consequences for tenant health and safety, regardless of a building's exterior disorder. An analysis of forty cities' code enforcement regimes shows that many cities have strong tenant protections designed to ensure habitability and blight removal.

An examination of agencies' code inspection strategies reveals a wide range of proactive and reactive enforcement mechanisms. Due to cost and administrative obstacles, most cities conduct inspections reactively, in response to complaints, rather than taking a proactive approach of regularly scheduled inspections. Nevertheless, some cities have implemented proactive inspection regimes.

Finally, the article highlights different cities' approaches to increasing the efficacy of code enforcement through "carrots," "sticks," or balance of both. The "carrot" approach relies on a cooperative or incentive-based compliance mechanism that provides financial incentives and training programs, while, in contrast, the "stick" approach relies on a punitive mechanism.

The article concludes that, as cities continue to aim to design and implement regimes that are efficient and equitable, to balance the needs of different parties, and to avoid adverse or unintended consequences, they must be innovative and proactively manage the tradeoffs inherent in code enforcement.

**Poverty & Race Research Action Council, How States Can Affirmatively Further Fair Housing: Key Leverage Points and Best Practices**

*Mary Anne Sullivan, Derek Centola & Lara Hakki of Hogan Lovells LLP, along with Peter Kye & Philip Tegeler at PRRAC (Jan. 2022)*

*(https://www.prrac.org/affh-for-states)*

This excellent and timely report serves to remind us that state governments have potential to make innovative and important contributions to affirmatively further fair housing and advance equity and inclusive communities through those initiatives. Under Title VIII of the Civil Rights Act of 1968, known as the Fair Housing Act, the U.S. Department of Housing and Urban Development (HUD), federal agencies, and all recipients of HUD housing and community development funds have a duty to "affirmatively further fair housing" (AFFH).

This obligation, as set forth in 24 C.F.R. § 5.151, requires HUD and HUD funding recipients to engage in "meaningful actions, in addition to combatting discrimination, that overcome patterns of segregation and foster inclusive communities free from barriers that restrict access to opportunity based on protected characteristics." (*See* 24 C.F.R. § 5.151.) Specifically,

> affirmatively furthering fair housing means taking meaningful actions that, taken together, address significant disparities in housing needs and access to opportunity, replacing segregated living patterns with truly integrated and balanced living patterns, transforming racially or ethnically concentrated areas of poverty into areas of opportunity, and fostering and maintaining compliance with civil rights and fair housing laws.

(*Id.*) The report briefly reviews the history of the AFFH provision from its origins in the Fair Housing Act through recent regulatory changes (enacted by different Presidential administrations) regarding its implementation. The most recent 2021 interim AFFH rule seeks to strengthen guidance on the AFFH certification requirement for HUD recipients. (*See* Restoring Affirmatively Furthering Fair Housing Definitions and Certifications, 86 Fed. Reg. 30779 (June 10, 2021) (to be codified at 24 C.F.R. pts. 5, 91, 92, 570, 574, 576, 903).)

The bulk of the report provides detailed examples of how different states have leveraged their resources and legal authority to deploy AFFH initiatives. These efforts include:

1. "Prohibitions on Exclusionary Zoning" to limit local jurisdictions from imposing zoning restrictions that restrict the development of affordable housing. One notable example discussed at length was Oregon's use of model codes to successfully increase the supply of housing while allowing denser development. Their model codes move beyond placing limits on single-family housing to address "setbacks, building height, lot coverage, lot sizes and off-street parking restrictions";
2. Advancing equity through "encouraging the fair allocation of affordable housing across jurisdictions";
3. "Supporting families with housing vouchers through Statewide Anti-Discrimination Laws and Housing Mobility Programs";
4. "State-Level Affirmatively Furthering Fair Housing Laws";
5. Developing practices to ensure that fair housing financing and the development of subsidized housing do not further concentrate poverty;
6. Enhancing state-level tenant protections; and
7. Initiatives to "promote equal access to homeownership."

The report is brief but provides detailed examples across more than ten states and relevant summary data for policymakers on the numbers of states that have enacted particular state-level AFFH initiatives.

### Tenant Protections and Emergency Rental Assistance During and Beyond the COVID-19 Pandemic

*Jade Vasquez, Alayna Calabro, Kim Johnson, Sarah Gallagher*

*National Low Income Housing Coalition (Jan. 20, 2022)*

*(https://nlihc.org)*

The historic financial aid and legal protections deployed for renters during the COVID-19 pandemic have fundamentally shifted the housing policy landscape in the United States. While much has been written about the CDC's national eviction moratorium and federal emergency rental assistance (ERA) appropriations, less attention has been paid to the wide-ranging housing policy efforts of state and local governments throughout the course of the pandemic. In 2021 alone, states and localities passed or implemented over 130 new laws or policies designed to protect tenants from eviction and keep them stably housed.

A recent report from the National Low Income Housing Coalition provides a descriptive analysis of these state and local tenant protection policies, highlighting variations between jurisdictions and pointing to key lessons learned in their design and implementation. The policies described in the report include a mix of "short-term protections"—time-limited interventions designed to prevent, slow, or pause the eviction process to allow time for ERA processing—and "long-term protections" intended to reduce discrimination and promote housing stability over a longer time horizon.

The report groups these efforts into five categories. Following is a brief summary of the policies included in each category and some key takeaways from the report's analysis.

1. *State and Local Eviction Moratoriums*: Forty-three states and several territories implemented their own eviction moratoriums in response to coverage gaps or implementation shortcomings associated with the equivalent CDC provision. The nature and degree of protections by different moratoriums varied, as did their justifications (e.g., public health measure or response to the economic crisis). The state actors responsible for instituting the policies also differed (e.g., governors versus legislatures versus court officials). The report suggests that such moratoriums, while not a cure for underlying causes of housing instability, are a crucial and effective eviction prevention tool that jurisdictions should return to in the event of future public health emergencies or natural disasters.
2. *Pauses on the Eviction Process to Allow for ERA Processing*: Several jurisdictions instituted "eviction off-ramps" as another form of short-term protection. These measures are designed to both phase in evictions for households not eligible for emergency ERA and pause or delay the eviction process to allow eligible households to access ERA funds. Examples of such off-ramps included policies (a) requiring landlords to apply for ERA before filing for eviction, (b) establishing wait periods and safe harbors for ERA applicants, and (c) issuing "stays" on eviction hearings, judgments, or executions. The report notes that the most successful interventions were those that occurred at the earliest points in the eviction process and involved extensive collaboration between the courts and the entities responsible for administering ERA programs.
3. *Mandates Increasing Access to Information and Limiting Late Fees*: At least ten states and localities implemented policies requiring that landlords provide tenants with information on ERA, either prior to or at various stages throughout the eviction process. The report notes that early notice policies can help to avoid the harm that a mere eviction filing often imposes on renters and can be implemented by courts even in the absence of new enabling legislation. Additionally, several jurisdictions implemented policies reducing or limiting late fees on unpaid rent by extending the grace period before such fees apply or placing a cap on the amount of the fees. Several ERA programs implemented equivalent policies requiring landlords to limit

or reduce such fees as a condition of receiving program funds, again without needing to rely on additional legislative authorization.

4. *Increasing Tenant Representation During the Eviction Process*: Two long-term strategies that jurisdictions use to offset the vast disparities between landlords and tenants' legal representation in eviction cases include mediation programs within state and local courts and tenant right-to-counsel laws. As described in the report, mediation programs are most successful when participation is mandatory or properly incentivized, while tenant right-to-counsel policies are most impactful when adequately funded. In addition to protecting tenants' legal rights, such efforts also helped jurisdictions to distribute ERA funds and reduce the administrative burdens that high volumes of eviction filings impose on courts.
5. *Protections Reducing Housing Discrimination and Promoting Housing Stability:* While each of the short- and long-term protections previously described can help to promote housing stability, the report argues that they will be most effective when supported by additional renter protection laws. Examples of such laws that states and localities have enacted include (a) source-of-income discrimination laws prohibiting landlords from refusing to lease based on the income that tenants use to pay rent (i.e., vouchers, ERA funds); (b) laws prohibiting landlords who participate in ERA from evicting tenants in the near term; and (c) eviction sealing and expungement policies to mitigate the harsh consequences to tenants of having an eviction in their rental histories.

The report concludes by acknowledging the meaningful executive, judicial, and legislative victories that housing advocates and organizers achieved throughout the pandemic and arguing that long-term solutions are necessary to ensure that renters across jurisdictions share basic levels of protection and access to safe, stable, and affordable housing. In furtherance of this goal, the report offers a series of policy recommendations derived from the lessons learned through states' and localities' pandemic-response efforts.

# The Origin Story of the Opportunity Zone Incentive: A Review of David Wessel's *Only the Rich Can Play*

*Edward W. De Barbieri**

*Only the Rich Can Play: How Washington Works in the New Gilded Age*
David Wessel
Public Affairs Press (2021)
352 pages; $30.00 (cloth); $14.99 (ebook)

In his recent book, *Only the Rich Can Play: How Washington Works in the New Gilded Age*, David Wessel lays out the history of the Opportunity Zone tax incentive, a largely overlooked barnacle of the 2017 Tax Cuts and Jobs Act. One might ask: does a seemingly benign federal tax incentive need its own book-length origin story? Is that really necessary? There are so many other priorities deserving of ink, paper, and our most precious commodity, time.

Yet, as Wessel uncovers, in twists, turns, and human-interest vignettes, the story behind this tax incentive that amounts to a real estate development subsidy for the already wealthy who do not *need* it, is both juicy and intellectually delicious. The correlation between the passage of a real estate development tax incentive and the existence of a bombastic real estate developer-president does not definitively amount to causation in terms of the incentive's adoption. However, as Wessel's story makes clear, the Opportunity Zone incentive would not have become a law without the involvement of the last presidential administration. Even with all the drama surrounding the former-president's inner circle, the Opportunity Zone tax incentive stands out.

Briefly, the Opportunity Zone law is a tax cut for wealthy individuals and families to reduce, and, in some cases eliminate, their capital gains liability. Wealthy investors who, for example, decide to sell appreciated stock in a company they own, face a twenty-percent federal capital gains tax.[1] When investors plow the proceeds from the sale of an appreciated asset—a

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*Associate Professor of Law, Director, Community Economic Development Clinic, Albany Law School.

1. The proceeds of the sale are also subject to state tax liability, which vary by state.

capital gain—into an Opportunity Zone Fund that will make new investments in designated neighborhoods, they may defer, and even eliminate, their capital gains tax liability.

The Opportunity Zone tax incentive offers investors three main benefits. First, investors can temporarily defer capital gains tax liability arising from the sale of an asset. Second, the basis of invested funds is stepped up. Third, and finally, income earned from invested capital gains can be permanently excluded from taxation. If this all sounds like a boon to professionals who earn their living from advising wealthy investors—some of whom may be readers of this Journal—it is. Though, unlike core tax incentive programs that are discussed and analyzed extensively in these pages, such as the Low-Income Housing Tax Credit, or the New Markets Tax Credit, there are significant differences that are hard to understate.

The origins of the Low-Income Housing Tax Credit have been told by policy leaders in these pages[2] and by legal academics elsewhere.[3] The origin story of the New Markets Tax Credit, enacted in 2000, is largely elusive. Supposedly, Bill Clinton was told about the idea for the New Markets Tax Credit during a round a golf.[4] Eventually, the incentive was passed into law, and it continues today.[5]

That a journalist of Wessel's stature, quality, and expertise set out to tell the Opportunity Zone incentive's origin story is on its own remarkable. The book's publication ought to instill in readers a sense of pause. There is a deeper story afoot.

Opportunity Zones continue to be trumpeted by their supporters, such as Economic Innovation Group founders Sean Parker, John Lettieri, and Steve Glickman, among others.[6] Yet, they lack universal acclaim. Right-leaning think tanks, such as the Cato Institute, have called them a "bad idea," "should be repealed," and identifying landowners within

2. Charles L. Edson, *Affordable Housing—An Intimate History*, 20 J. Affordble Hous. & Cmty. Dev. L. 193 (2011).

3. Tracy A. Kaye, *Sheltering Social Policy in the Tax Code: The Low-Income Housing Credit*, 38 Vill. L. Rev. 871 (1993).

4. The widely circulated story is that Clinton's golf partner was Harvard Business School professor Michael Porter, author of *The Competitive Advantage of the Inner City*. That Clinton and Porter played golf together is documented. *Clinton Marks Holiday, Running the Gamut from Golf to Football*, L.A. Times (Jan 2. 1993), https://www.latimes.com/archives/la-xpm-1993-01-02-mn-2433-story.html.

5. Upon enacting the incentive, Clinton campaigned for the bill over a four-day U.S. tour, visiting poor places in Mississippi, East St. Louis, South Dakota, Phoenix, and the Watts neighborhood in Los Angeles. Lily Geismer, *The Places Left Behind*, Jacobin (Nov. 1, 2016), https://jacobinmag.com/2016/11/bill-clinton-poverty-tour-hillary-new-markets.

6. *See, e.g.*, Ira Weinstein & Steve Glickman, The Guide to Making Opportunity Zones Work: A Resource for Investors, Developers, Entrepreneurs, and Community Leaders (2020).

Opportunity Zones as the "main winners" to the exclusion of poor households.[7] Left-leaning think tanks, such as the Urban Institute, indicate that the structure of the Opportunity Zone incentive "makes it harder to develop projects with community benefits in places with the greatest need," and needs major reform.[8]

I first heard about David's Wessel's book project[9] on the history of the Opportunity Zone tax incentive when he told me about it over email in January 2020.[10] At the time, I was conducting my own research on Opportunity Zones.[11] Wessel reached out after coming across an early draft of my article.[12] We happened to grow up in the same neighborhood, I learned, though at different times.[13]

When asked to review *Only the Rich Can Play*, I was, therefore, incredibly excited. I shared Wessel's interest in how the Opportunity Zone tax incentive was enacted into law. Also, like Wessel, I was very interested to uncover evidence concerning the effectiveness of Opportunity Zones at achieving economic development in poor places in the United States.

Wessel reveals the central questions driving *Only the Rich Can Play* on page 5. Namely, he "wondered how a political novice like [Facebook's first President and Napster founder Sean] Parker[14] had taken his dream from conception to Donald Trump's signature in less than five years, without a single congressional hearing or significant public scrutiny."[15] In addition, "[w]hat did [Parker's] success reveal about how Washington works in this new Gilded Age? And who was playing the OZ game now that it was law?"[16] Finally, Wessel wondered whether Opportunity Zones were serv-

7. Chris Edwards, *New York Times on Opportunity Zones*, Cato at Liberty (Sept. 3, 2019 3:25pm), https://www.cato.org/blog/new-york-times-opportunity-zones?gclid=Cj0KCQiAk4aOBhCTARIsAFWFP9EzxuPFC4xUhqi_JNt9IVytpy6X91zQFbN7944CLqdXyH0qLkHaPrEaApkBEALw_wcB.

8. Brett Theodos et al., *The Opportunity Zone Incentive Isn't Living Up to Its Equitable Development Goals. Here Are Four Ways to Improve It*, Urb. Inst. (June 17, 2020), https://www.urban.org/urban-wire/opportunity-zone-incentive-isnt-living-its-equitable-development-goals-here-are-four-ways-improve-it.

9. David Wessel, Only the Rich Can Play: How Washington Works in the New Gilded Age (2021).

10. E-mail from David Wessel to *Edward W. De Barbieri* (on file with author).

11. Edward W. De Barbieri, *Opportunism Zones*, 39 Yale L. & Pol'y Rev. 82 (2020) (proposing a tripartite use-transparency-participation framework for analyzing the Opportunity Zone tax incentive).

12. *See* Wessel, *supra* note 10.

13. *Id.*

14. The founder of Napster, first president of Facebook, and billionaire behind the Opportunity Zone tax incentive.

15. *Id.* at 5.

16. *Id.*

ing the poor communities for whom the tax incentive promised great economic gain, and not simply resulting in "a big tax win for the wealthy."[17]

Wessel answers these questions in *Only the Rich Can Play*. He begins with a visit to an Opportunity Zone investor conference in Las Vegas. His narrative nonfiction style takes the reader through the history of efforts to reduce capital gains—to Jack Kemp in the 1980s, the United Kingdom, and back to the United States. He covers the formation of the Economic Innovation Group, following through to Senator Tim Scott, and eventually to Donald Trump.

Following enactment of the Opportunity Zone tax incentive, and zone designation, Wessel explores Portland, Oregon, to catalog Opportunity Zone excess. He takes the reader to Baltimore, Maryland, to observe Opportunity Zone drought. And Wessel explores Los Angeles for Opportunity Zone glimmers of hope.

If the Opportunity Zone intervention actually developed poor communities by providing greater economic resources, Wessel's story would be less compelling. Further, were the outcomes more promising for neighborhood development, it would be less likely that one would question with this level of detail the means through which its creators pulled the levers of power in Washington.

As an example, the Opportunity Zone incentive was sold to lawmakers as a mechanism to spur investment in small businesses in struggling places. Yet, Wessel's sources reveal that those responsible for drafting the regulations for the incentive thought "directing money toward risky startup businesses was unwise."[18] Specifically, the drafters at Treasury favored commercial real estate investments in the design of the incentive over small businesses.[19] The implications of this decision, as Wessel relates, have been dire for community-based small businesses.

With *Only the Rich Can Play*, Wessel has done for Opportunity Zones what no one did for New Markets Tax Credits—tell the origin story. It is possible that the New Markets Tax Credit origin story is less interesting, or does not illustrate how it is possible to influence policy in our nation's capital. As Wessel writes, "This is how Washington works: a billionaire-financed organization with a focused legislative agenda hires a former congressional staffer to advise on crafting a tax proposal that not only looks much less costly than it truly is, but also includes a feature that will make it easy for Congress to push off investors' tax due date."[20]

No matter what becomes of Opportunity Zones in the future, be they successes, failures, or in between, the telling of their formation is preserved. We owe Wessel a debt of gratitude for capturing that history now.

17. *Id.*
18. *Id.* at 140.
19. *Id.*
20. Wessel, *supra* note 9.

The comprehensiveness of Wessel's research and reporting is a clear strength of *Only the Rich Can Play*. He has spoken with everyone involved who would speak with him, including, importantly, Sean Parker, John Lettieri, and Steve Glickman. Those individuals have a stake in the public knowing about the work of Economic Innovation Group in convincing Congress to adopt the Opportunity Zone. However, Wessel's account of each is offered in a way that lets the reader make up their own mind about the truth. Wessel pairs these interviews with robust scholarly analysis of how the program has played out in practice.[21] *Only the Rich Can Play* benefits from an incredibly rich presentation of how the law is unfolding by many different players and observers.

For instance, in Chapter 11, Wessel talks about Baltimore's attempts at, and challenges with, attracting Opportunity Zone investment. Wessel tells of how the Trump administration failed to communicate with city leaders, and the city's designated Opportunity Zone professional, in using Baltimore as a backdrop to announce the Opportunity Zone tax incentive. Making matters worse, following a dispute with U.S. Rep. Elijah E. Cummings, a longtime public servant, prominent figure in Congress, and Baltimore denizen, Trump called Baltimore "a disgusting, rat and rodent-infested mess," via tweet. HUD Secretary Ben Carson did not improve matters by attempting to hold another press event in Baltimore in a vacant lot owned by a historic church without first asking for the church's permission. Such public missteps were emblematic of deep flaws in the incentive in failing to actually drive capital to places seeking economic growth.

Finally, in addition to being an excellent journalist, Wessel is a great writer. His narrative prose style is engaging, interesting, and a delight to read. I enjoyed the stories he had to tell: the ones I had heard already and those that were new to me.

There are two possible weaknesses that may present themselves to readers of *Only the Rich Can Play*. The first is that Wessel's argument that Washington is skewed to benefit the wealthy is obvious, and not new. The second is that the process-related aspects of lobbying, lawmaking, and policy implementation can be dull and may strike some as boring.[22]

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21. In addition, Wessel, through his post at the Brookings Foundation, organized in February 2021 one of the most robust academic conferences on the Opportunity Zone incentive to date. The studies of third-party dispassionate scholars find their way into *Only the Rich Can Play* throughout in a way that adds rigor and depth.

Wessel, in the acknowledgments, mentions that Brett Theodos, of the Urban Institute, read an earlier draft of the manuscript and offered comments. Theodos has led the Urban Institute's own publication of an early assessment of the Opportunity Zone. Brett Theodos et al., *An Early Assessment of Opportunity Zones for Equitable Development Projects: Nine Observations on the Use of the Incentive to Date*, Urb. Inst. (June 2020), https://www.urban.org/sites/default/files/publication/102348/early-assessment-of-ozs-for-equitable-development-projects_0.pdf.

22. Certainly, that was not the case with this reader, or likely for readers of the *ABA Journal on Affordable Housing and Community Development*, but I conjecture that those who

With respect to the first potential weakness, that *Only the Rich Can Play* may seem obvious to some, I offer the words of Louis Brandeis, which appear at the beginning of Jane Mayer's 2016 work *Dark Money*: "We must make our choice. We may have democracy, or we may have wealth concentrated in the hands of a few, but we can't have both."[23] For Brandeis, and for many others, wealth concentration, and wealth inequality is not a new story. It is an old meme.

In *Only the Rich Can Play*, Wessel wrinkles the trope enough to make it novel in the context of a capital gains cut. For those readers who might lack familiarity with other authors such as Sabeel Rahman who write about the New Gilded Age and threats to democracy,[24] and others, Wessel's framing around the influence of billionaires in Washington may appear fresh. It may lead those readers to explore less popular academic research, which would be a success. However, for other readers, the New Gilded Age framework may come across as obvious, and unsurprising.

With respect to the second potential weakness, it is a challenge to write an entire book about a little-known tax incentive contained in a larger Republican tax cut. In addition, with so much news, intrigue, conflict, and drama surrounding the Trump presidency, this singular story may seem incredibly minor to some readers.[25] More specifically, the process-related parts of the narrative, including the formation of Economic Innovation Group (EIG), the bi-partisan lobbying strategy created by its founders, and the minutia of how the Opportunity Zone became law may leave some readers skimming pages. However, those looking to replicate EIG's wins will be taking notes.

If I have any critique to offer of this book, it is that there is not enough discussion of how to improve place-based economic development tax incentives to make them work better. Wessel's broad framing of the Opportunity Zone incentive within the myriad dysfunctions in the New Gilded Age may not leave room for a more nuanced critique of place-based tax incentives. As Wessel observes in Chapter 8—*Don't Blame the Players, Blame the Game*—a tax incentive sold to serve the poor, yet designed to benefit the wealthy, is simply the way that Washington works these days. Characters like Anthony Scaramucci and others emerge to mine the newly formed tax

practice in or study affordable housing and community development are a clear target audience of *Only the Rich Can Play*.

23. Jane Mayer, Dark Money: The Hidden History of the Billionaires Behind the Rise of the Radical Right (2016) (quoting Louis Brandeis on the page prior to the table of contents).

24. *See* K. Sabeel Rahman, Democracy Against Domination (2016).

25. Again, for readers of the *Journal of Affordable Housing and Community Development*, this author doubts this is the case.

incentives offered by Congress. "The gold rush is on."[26] Wessel's solution: "Don't blame the players, blame the game."[27]

Wessel's approach, while of course skeptical of the benefits promised by the Opportunity Zone incentive, may appear to the reader more descriptive than diagnostic. He presents the facts in a way that lets the reader make up their own mind, rather than offer proposals for reform. In his final chapter, *The Bottom Line*, he sums up his thoughts on the Opportunity Zone experience thus far in the following way:

> "Whatever the evidence eventually shows about the outcomes, Opportunity Zones stand as a case study of how a clever, ambitious, and big-idea billionaire like Sean Parker can hire the right people and court the right members of Congress to turn an idea into reality even at a time of partisan gridlock."[28]

This quest for something larger—to connect the Opportunity Zone saga to broader themes about power and influence in federal lawmaking—does not advance a strategy to correct a failure in the ideas underlying place-based tax policy. Place-based economic development tax incentives can work.[29] In many instances they do, and, with more tailoring, they can improve the lives of residents in the areas slated for development.[30] Opportunity Zone incentives on balance have not improved the lives of the residents of the designated zones. It is not Wessel's project to make broad analytic claims about place-based incentives. Wessel tees up that task to others.

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26. *Id.* at 148.

27. *Id.* at 146.

28. *Id.* at 281.

29. The Low-Income Housing Tax Credit, while not perfect, and not strictly place-based in design, has been successful increasing affordable housing without increasing public spending for construction. Tracy Kaye, *Sheltering Social Policy in the Tax Code: The Low-Income Housing Tax Credit*, 38 Vill. L. Rev. 871 (1993) ("To increase the stock of affordable housing without appropriating public funds directly for that purpose, Congress decided to give the private sector a tax incentive to build and renovate low-income rental housing."). The New Markets Tax Credit, while also not without room for improvement, shows the promise of place-based incentives as a policy tool. In the most comprehensive evaluation of the New Markets Tax Credit to date, the Urban Institute found that, in areas with New Markets Tax Credit projects, local economic activity, resident employment, and incomes all increased. Brett Theodos et al., *What Are the NMTC Program's Impacts on Local Economic Conditions?*, Urb. Inst. (Apr. 2021), https://www.urban.org/sites/default/files/publication/103959/5-nmtc-impacts-on-jobs-and-poverty.pdf.

30. In addition to my own contribution mentioned above, Michelle D. Layser's work on how lawmakers can better design effective place-based economic development tools is relevant. *See* De Barbieri, *supra* note 11; Michelle D. Layser, *How Place-Based Tax Incentives Can Reduce Geographic Inequality*, 74 Tax L. Rev. 1 (2020). As Layser writes, "The result is not a one-size-fits-all prescription, but a locally tailored approach that can help tax incentives become an effective vehicle for reducing geographic inequality that other policy interventions fail to address." Layser, *supra*, at 4.

The macro-story of Opportunity Zones, of which Wessel is one of the most thorough contributors, should not be overlooked. Spending through the tax code is popular politically because it offers the appearance of limiting government reach. A tax incentive does not add a new *entitlement*, so to speak. Yet, it is government spending obfuscated to hide the real winners. Wessel's work is primary source material in making that claim.

For example, take the debate over whether to increase spending on emergency rental assistance for renters who have experienced economic loss during the COVID-19 pandemic. Proponents of spending argue that rental assistance is important to keeping families housed, and landlords from avoiding foreclosure. Opponents do not want the government to be paying anyone's rent. Yet, such opponents are unlikely to oppose Low-Income Housing Tax Credits to encourage developers to build affordable multi-family units even if developers were restricted to building in designated low-income neighborhoods.

The challenge, of course, is that government's best intentions with respect to policy frequently result in undesirable, and unintended, consequences. About this observation, there appear to be two truths: first, policy changes often do not result in intended outcomes, and second, it can take significant time to assess whether anything changed. But that does not mean government should stop trying. It means, I think, that law and policy efforts should seek continual improvement. A great failure of the Opportunity Zone approach is that there is no governmental effort to track outcomes, and limited zeal to make improvements to the law.

In sum, *Only the Rich Can Play* is incredibly successful in achieving its stated goals. Wessel sets out to tell the history of the Opportunity Zone tax incentive, to examine who is benefitting, and who is not, now that the policy is implemented. Wessel's intent is not to uncover the shadowy underbelly of government. Authors such as Jane Mayer and others excel at that task. Wessel's goal is to describe what is happening in plain sight.

Wessel delivers on each of his goals with incredible detail. He offers narrative to show the reader the facts. Readers are left to decide the truth for themselves, but are very well-equipped to do so with the evidence that Wessel provides.

*Only the Rich Can Play* is an excellent read.[31] The book demonstrates the importance a single idea can play. And it is overwhelming evidence for how ideas can be translated into profits. The question that Wessel leaves us all with is: should we allow this—the process by which the wealthy enact laws to benefit themselves—to continue? The question is both moral and economic. It is philosophical and practical.

Further, if we are going to leave community economic development policy to the "haves," we will continue to see them enforce their will on the "have nots." We are left with Thrasymachus's view of justice as being

31. For those looking to purchase a copy, the publisher, Public Affairs Books, is offering a sale price of $14.99.

the advantage of the stronger. Wessel reveals that governance as it is today in this nation is no more along the path to enlightenment than were the Greeks at the time of Plato.

Wessel has done his homework and assembled a work that is worthy of the reader's time, attention, and focus. For that, I am grateful. Wessel displays a writer's generosity in viewing his reader as worthy of capturing their attention.

For those interested in reading more academic work in this area, I offer a few additional academic-themed suggestions. The *Fordham Urban Law Journal* recently published a special issue with an article and essays from seven authors (all law professors), each of whom took part in a February 2021 conference titled "A Taxing War on Poverty: Opportunity Zones and The Promise of Investment and Economic Development."[32] The *Pittsburgh Tax Review* has a recently published special issue on place-based tax incentives.[33] Finally, Ofer Eldar and Chelsea Garber, both at Duke, have a new essay coming out that frames the Opportunity Zone as a program in search of purpose, echoing themes in Wessel's book.[34]

As the Opportunity Zone tax incentive story continues to unfold, law scholars will continue to study the outcomes of this place-based policy intervention. I appreciate the work of David Wessel and others in raising the profile of the Opportunity Zone law and assisting in telling the story of how place-based economic development policy plays a key role in community economic development in our struggling urban and rural places.

32. *A Taxing War on Poverty: Opportunity Zones and the Promise of Investment and Economic* Development, 48 Fordham Urb. L.J. 1067–403 (2021) (Issue 5). Authors in this issue, such as current Editor-in-Chief Anika Singh Lemar, and former Associate Editor Brandon Weiss, of the *Journal of Affordable Housing and Community Development Law*, are no strangers to the reader of this review. Weiss has another article on Opportunity Zones, 1031 exchanges, and Housing Choice Vouchers forthcoming in the *California Law Review* that is well worth a read. Brandon M. Weiss, *Opportunity Zones, 1031 Exchanges, and Universal Housing Vouchers*, 110 Calif. L. Rev. __ (forthcoming 2022). Michelle D. Layser is another author with an essay in the *Fordham Urban Law Journal* special issue who has developed a significant body of work about place-based tax incentives, including the Opportunity Zone. Those unfamiliar with Layser's work can read more about her study of New Markets Tax Credits and Opportunity Zones in the *Tax Law Review*, Layser, *supra* note 31, and additional recent work in the *UC Irvine Law Review*, Michelle D. Layser, *Subsidizing Gentrification: A Spatial Analysis of Place-Based Tax Incentives*, UC Irvine L. Rev. 163 (2021), among other places. Also, the *Fordham Urban Law Journal* features an article by Tracy A. Kaye about an Opportunity Zone case study in Chicago, as well as essays by Northeastern University School of Law faculty members Rashmi Dyal-Chand and Blaine G. Saito, as well as an essay by this author.

33. That issue includes work by Michelle D. Layser, myself, and others.

34. Ofer Eldar & Chelsea Garber, *Opportunism Zones: A Program in Search of a Purpose*, B.U. L. Rev. (forthcoming 2022).

# Why We Can't Have Nice Place-Based Policies: A Review of David Wessel's *Only the Rich Can Play*

*David Schleicher**

*Only the Rich Can Play: How Washington Works in the New Gilded Age*
David Wessel
Public Affairs Press (2021)
352 pages; $30.00 (cloth); $14.99 (ebook)

David Wessel's *Only the Rich Can Play: How Washington Works in the Gilded Age*[1] is sure to enter the pantheon of Washington, D.C., books that explain the complicated, exciting, and messy ways significant legal changes get through Congress. The book is in many ways a successor to *Showdown at Gucci Gulch*,[2] a book that explains how D.C. really works.

But the book also has important lessons for understanding the future of regional economic development policy. We've had a long national debate about "people-based" and "place-based" responses to entrenched poverty. Most of this debate takes the form of comparing theoretical policy ideas, a war of white papers and academic articles, about what some hypothetical Congress should do. *Only the Rich Can Play* shows why it is hard—and maybe impossible—for our actual Congress to pass decent place-based policies. Whatever one thinks of "place-based v. people-based" policies in theory, *Only the Rich Can Play* should be seen as a powerful argument against our capacity to make place-based solutions work in practice.

As a Washington reportage, the book brings it—and then some. Sean Parker[3] creates a think tank and a team of lobbyists to push for what is now known as the Opportunity Zones (OZs) tax break.[4] The program shields investors who earn capital gains from paying taxes on those gains

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*David Schleicher is a Professor of Law at Yale Law School. and well-known expert in land use, local government law, and urban development. This review is a reprint of his essay published by the Niskanen Center in Washington, D.C., https://www.niskanencenter.org/why-we-cant-have-nice-place-based-policies-a-review-of-david-wessels-only-the-rich-can-play.

1. David Wessel, Only the Rich Can Play: How Washington Works in the New Gilded Age (2021).

2. Jeffrey H. Birnbaum & Alan S. Murray, Showdown at Gucci Gulch: Lawmakers, Lobbyists, and the Unlikely Triumph of Tax Reform (1987).

3. The Social Network (2010), A Billion Dollars Scene (6/10) Movieclips, *available at* https://www.youtube.com/watch?v=k5fJmkv02is.

4. *See* Econ. Innovation Grp., Empowering Entrepreneurs and Investors to Forge a More Dynamic U.S. Economy, eig.org (last visited Feb. 16, 2022).

if they invest their money in economically distressed communities. The group includes wonks you've heard of (Kevin Hassett, Jared Bernstein, and Ron Klain, among others) and others you probably haven't. They pull together a coalition of Democrats and Republicans, most notably Senators Tim Scott and Cory Booker, who put OZs into the broader tax-cut package Republicans pushed through in 2017. The broader coalition supporting OZs is at turns idealistic (likely more than the book allows) and self-interested. Still, the Parker collaborative at its core is at all times smart and coolly strategic, bringing together lobbying muscle, lawyerly savvy, and genuinely expert analysis.

As the OZ package moves through the legislative and administrative process, it becomes increasingly friendly for rich taxpayers. The description of the inner workings of the regulatory process in the Trump administration in *Only the Rich Can Play* is both delightful and horrifying. Fans of the congressional process, budget scores, and "Byrd Droppings" will find many fascinating details. Further, *Only the Rich Can Play* does a better job than any book I can remember at showing how lobbying and the work of policy experts are linked in contemporary politics. Ideas and analysis play an important role in politics and thus an important role in lobbying.

OZs were intended to bring investment to economically distressed communities. People with large capital gains were given a tax break for making long-term investments in targeted areas. Avoiding capital gains taxes was a huge incentive for investors, but the regulatory process made the deal even sweeter. Investments that qualify for the tax break aren't tied to job creation among residents of distressed communities, despite research suggesting that this is the key to ensuring that place-based subsidies target the needy. Even though many OZ-designated places are economically depressed, other designated locations were not. Locations eligible to receive OZ investments ended up including not-exactly-depressed places like the Pearl District in Portland, Ore., Hell's Kitchen in midtown Manhattan and downtown Berkeley, CA. Growing and gentrifying places have received a substantial amount of the overall OZ investment since 2017, providing tax breaks for deals that likely would have happened anyway.

This is a Washington story about how regulation works in the bowels of federal agencies and congressional committees. But the book has a lesson for the broader debate over "place-based policies." The last 40 or so years featured growing geographic inequality, the rise of the New Yorks and San Franciscos, and the decline of the heartland. This has led a variety of wonks and academics to push against the broad agreement in favor of "people-based" solutions to poverty (cash or in-kind aid to low-income individuals). Instead, they argue for "place-based" solutions, like sending money to firms that hire people in distressed areas or their governments. This literature claims that aid creating employment and better services in economically distressed areas will better target true economic disadvantage than social welfare programs targeting aid to low-income individuals. After all, people with low incomes today won't necessarily have them tomorrow. Those in favor of people-based solutions respond that traditional welfare programs do a better job targeting the needy and that place-based policies distort where firms move, reducing economic efficiency.

But this debate is primarily a clash between visions of ideally drawn policy. What *Only the Rich Can Play* shows us is exactly how unlikely it is for a decent version of place-based policy to get through a geographically structured Congress in a country with fifty states.

One of the central lessons of the political science literature on infrastructure spending in Congress (think Barry Weingast[5] or John Ferejohn[6]) is that it tends to get spread around districts. "Distributive politics" norms of pork-barrel deal-making lead to a failure to concentrate spending on valuable projects. The same problem distorts place-based policies. Getting OZs through Congress required three important political steps, each of which took the program further from the ideals of place-based policy.

The first step was tying investment in distressed areas to a powerful interest, namely people with substantial capital gains who would like to avoid taxes. There's no apparent connection between helping poor communities and the tax cut. Tax breaks for investment in these areas could have been given to people who didn't have large capital gains. But tying capital gains reductions to OZ investments had a powerful political logic: it linked the interests of the very rich to a program aimed at the poor.

This marriage came at a price: the lobbying sway of rich investors made the program ever more generous to them as it went through the regulatory process. The result is that a policy designed to alleviate poverty in poor areas makes the tax code less progressive overall.

The second move was making the tax break available for investments in every state. The debate over place-based policies is largely about the economic decline of Appalachia, parts of the South, and the Midwest. But Congress simply isn't going to pass something that does not offer most districts and states benefits. Even in a polarized Congress, the logic of distributive politics is powerful. OZs ended up not being a program designed to alleviate the problems of Appalachia and the Rust Belt; instead, it became a program aimed at places everywhere. The bill used a definition of a "distressed community" that could have applied to about forty percent of the nation's Census tracts, piggybacking on a definition from a previous program, the New Markets Tax Credit. This spread investment around, reducing the program's benefits for truly distressed areas.

Further, the program targeted Census tracts rather than metropolitan areas. This meant that the tax break was available even in rich metropolitan areas, providing benefits to projects where the immediate neighborhood may have been struggling, but the jobs could easily go to people commuting from thriving neighborhoods. Thus, the tax break was not very

5. Barry R. Weingast, Kenneth A. Shepsle & Christopher Johnsen, *The Political Economy of Benefits and Costs: A Neoclassical Approach to Distributive Politics*, 89 J. Pol. Econ. 642 (1981).

6. John A. Ferejohn, Pork Barrel Politics: Rivers and Harbours Legislation, 1947–68 (1974).

well targeted at true need. The problem is not that the designations weren't targeted at all, but rather that, for place-based policies to be better than "people-based" policies, the geographic targeting must be extremely good. And politics stands in the way of that happening.

The third move was allocating decisions about which areas should get subsidies to state governments. Rather than being very specific in the legislation, Congress set out broad parameters about which districts qualified and then gave governors the power to choose twenty-five percent of the eligible districts in their states. Previous targeted programs had bestowed that power on the Treasury Department. OZ supporters handed it to state governments as a way of building political support, getting the decisions out of D.C., and giving governors "skin in the game."

But when states designate areas, they have an incentive not to target the worst-off areas but instead to target the *best-off* areas that qualify. For OZs to drive investment in their states instead of elsewhere, governors needed to choose districts that would be attractive to mobile capital. No governor wanted to choose areas that would lead investors to avoid her state. The result was that many governors designated places that barely fit within the letter of the law. For example, some qualified because they were rich but adjacent to poor areas, and others counted as low-income because they had public or student housing despite being in the middle of rich cities. Several already well-off places that would have attracted investment anyway wound up getting OZ tax breaks—offices in Manhattan, a Ritz-Carlton in Portland, and so on. Providing tax breaks for investments that already would have happened is wasteful.

With these politically savvy moves, the bill sailed through Congress. But this legislative success came at the cost of making the policy fall further from the ideals of place-based policy. The best advocates of place-based policy, like Tim Bartik, have been very critical of the OZ program.[7] They advocate for subsidies for firms that hire people and provide public goods in depressed areas. But policy drift with this particular kind of program is inevitable. Congress has never been good at directing resources only to one type of area. Bills need powerful supporters. State governments are potent interests that need to be cut in on the deal.

One can argue for or against Opportunity Zones, but they are what a realistic, American place-based policy looks like. We live in a kludgeocracy,[8] and place-based policies in the real world look like kludges, not academic articles. And based on this evidence, real-world place-based policies are just unlikely to target aid to people facing economic disadvantages very well.

7. Timothy J. Bartik, *Helping America's Distressed Communities Recover from the COVID-19 Recession and Achieve Long-Term Prosperity*, Metro. Pol'y Program (Sept. 2020), https://www.brookings.edu/wp-content/uploads/2020/09/20200923_Brookings Metro_Distressed-Communities-COVID19-Recovery_Bartik_Report.pdf.

8. Steven M. Teles, *Kludgeocracy in America*, 50 Nat'l Affs., Fall 2013, at 97.

Place-based policies have other flaws beyond their quality in targeting aid they truly need. As I and many others have argued, one of the central problems of place-based policies is how they seek to lock in our existing economic geography,[9] discouraging people and firms from moving in response to technological or economic changes. They are deeply conservative,[10] slowing adaptation to a changing world, whatever gains they offer. The real-world versions of these policies are even weirder, benefiting some rich areas and not others and directing economic activity to this or that pocket of a region for no discernible reason. It is hard to justify using giant capital-gains tax breaks to encourage offices to be built in Hell's Kitchen or Long Island City rather than elsewhere in New York City. It is just an economic distortion without much purpose.

In contrast, people-based programs are straightforward. Things like the Child Tax Credit or "stimmys" may pass or not. But it is less likely that they will be deformed beyond recognition on their journey through Congress. Sometimes, policy decisions associated with them—work requirements, strange phase-out rules, etc.—change their form to increase their political viability. But their simplicity and broad availability are their central political asset. Most of the benefits and costs of these programs are actually captured in white papers, for better or worse. The debate between place-based and people-based policies should consider their likely real-world versions, not their idealized forms. *Only The Rich Can Play* shows a central flaw of place-based policies, the way they inevitably get deformed in the political process.

9. David Schleicher, *Stuck! The Law and Economics of Residential Stagnation*, 127 Yale L.J. 78 (2017).

10. David Schleicher, *Exclusionary Zoning's Confused Defenders*, 2021 Wis. L. Rev. 1315.

## ORGANIZATIONAL PROFILE

# Open Communities Alliance: Confronting Segregation and Its Impact in Connecticut

*Erin Boggs**

The killing of George Floyd in May of 2020 sparked a long-needed racial consciousness awakening across the United States with people of all races filling the streets in cities, suburbs, and rural areas in protest. This energy has been channeled into heightened "Diversity, Equity, and Inclusion" efforts at corporations and foundations, calls to "defund" the police, accelerated efforts to end mass incarceration, and much more, running the gamut from window dressing to deep and meaningful structural change. The housing sectors—non-profit and for profit, builders, financial institutions, and government agencies—are examining their systems and practices. The pressing question is, how do we make this moment mean something?

Open Communities Alliance (OCA), a civil rights organization that will shortly celebrate its first decade, is dedicated to counteracting the history of government policies that compel segregation and their impact. OCA is based in Connecticut, but we work towards solutions that will have national implications, build on the work of many who came before us, and take inspiration from the efforts of partners all around the country.

### Segregation in Blue Connecticut

As one of the most segregated states in the nation, and yet a "blue" state, Connecticut offers a particular petri dish for unwinding segregation. Almost half of Connecticut's Black population lives in the three percent of the state's land area that OCA has assessed as "very low opportunity," with deficits in life outcome predictors like school performance, public safety, poverty concentration, employment, and more.[1] In Connecticut, on average, Black and Latino residents earn half or less of what white residents

**Erin Boggs, Esq. is the founding Executive Director of Open Communities Alliance, a Connecticut-based civil rights organization dedicated to addressing residential segregation and its impact.*

1. The OCA internal assessment based on our opportunity-mapping analysis is available online: https://www.ctoca.org/ct_opportunity_map.

earn, and the state is home to some of the biggest educational disparities by race, ethnicity, and income in the nation.[2]

For decades, Connecticut has invested and reinvested and reinvested again in subsidized housing that is almost exclusively in cities. In some city neighborhoods, upwards of forty percent of the housing stock is deed-restricted to be under-market, often significantly so, for the next two generations.[3] Poverty concentration in such neighborhoods is further reinforced by the state's government voucher program and related policies that suffer from a municipal housing authority system disincentivizing housing choices throughout regions, insufficient state voucher values, and woefully underfunded and geographically limited mobility counseling. As a result, based on data kept incompletely by the state, eighty-one percent of subsidized housing that allows families with children is in low and very low opportunity areas, the same neighborhoods where seventy-four percent of voucher holders live.[4]

Such outcomes are exacerbated by the zoning system used in Connecticut, which allows towns to functionally bar multifamily housing, especially of the size (at least thirty units or greater) most frequently needed to make government housing investments like the Low Income Housing Tax Credit attractive to developers.[5] As in all states, the power to zone is delegated from the state to municipalities. In Connecticut, this delegation comes with strings attached. In addition to the mandate to refrain from perpetuating segregation found in the federal Fair Housing Act, in Connecticut, state and town zoning actions are governed by a state analogue fair housing law.[6] Connecticut also has a state constitutional requirement to not segregate.[7] The state laws explicitly delegating zoning and planning authority to towns include clear requirements that local zoning must be carried out in a manner that allows a variety of housing types, promotes income diversity, and contributes to addressing the regional need for multifamily housing in a manner consistent with local developmental capacity considerations.[8]

2. Conn. Fair Hous. Ctr., Analysis of Impediments to Fair Housing Choice 2015, at 55, https://portal.ct.gov/-/media/DOH/AnalysisofImpediments2015pdf.pdf?la=en (last visited Mar. 8, 2022).

3. Erin Boggs & Lisa Dabrowski, Out of Balance: Subsidized Housing, Segregation and Opportunity in Connecticut 10 (Sept. 2017), *available at* https://d3n8a8pro7vhmx.cloudfront.net/opencommunitiesalliance/pages/360/attachments/original/1510154195/Out_Of_Balance_Report_-_Final_-_Revised_11-8-17.pdf?1510154195.

4. Out of Balance at 12 and 23.

5. Jeffery Lubell & Sarah Wolf, Abt Assocs., Variation in Development Costs of Lihtc Projects 23 (Aug. 30, 2018), https://www.ncsha.org/wp-content/uploads/2018/09/Final-LIHTC-Costs-Analysis_2018_08_31.pdf.

6. *See*, e.g., Conn. Gen. Stat. § 46a-64c.

7. Conn. Const. art. First, § 20.

8. Conn. Gen. Stat. §§ 8-2, 8-23.

Despite this promising framework, Connecticut suburbs and rural areas reliably plan and zone for large-lot single family homes in the majority of their land area, invest to conserve land from potential development (even when much land is already protected), and avoid sewer expansion.[9] As a result, eighty-two percent of towns have less than ten percent of their housing stock affordable at the eighty percent and sixty percent median income or below levels (approximately $60,000–80,000 for a family of four).[10] In many towns, a family needs to acquire land the size of a football field to build a single family home.[11] In a number of overwhelmingly white towns, such as Madison and North Branford, town zoning ordinances actually give explicit priority to current residents and their children in affordable housing developments, which raises substantial perpetuation of segregation concerns.[12]

These practices lead to predictable outcomes. First, with so much of the state off the table for the development of the types of housing likely to be more affordable, either because it is subsidized or denser, the state has an affordable housing crisis. Connecticut is the tenth least affordable state in the nation. A household earning minimum wage would have to work ninety-one hours a week to afford a two-bedroom apartment.[13] OCA has assessed that the state needs about 140,000 units of affordable housing over the next ten years.[14]

Second, blue Connecticut is one of the most segregated states in the country, which brings with it huge costs. In the Chicago region, which is similarly segregated, a local planning group estimated that multiple billions of dollars were lost annually due to the lost income, lives, and potential that accompanies segregation.[15] Such losses are on top of the increased

9. 1 Open Cmtys. All., Zoning for Equity (June 2021), *available at* https://d3n8a8pro7vhmx.cloudfront.net/opencommunitiesalliance/pages/801/attachments/original/1623958276/Zoning_for_Equity_FINAL.pdf?1623958276.

10. Conn. Dep't of Hous., 2021 Affordable Housing Appeals List (2021), https://portal.ct.gov/-/media/DOH/2021-Final-Appeals-For-Report-On-Line.pdf.

11. 1 Zoning for Equity: Identifying Planning and Zoning Barriers to Affordable Housing (June 2021), *available at* https://d3n8a8pro7vhmx.cloudfront.net/opencommunitiesalliance/pages/801/attachments/original/1623958276/Zoning_for_Equity_FINAL.pdf?1623958276.

12. *Id*. at 101; *see also* N. Branford Zoning Ordinance, § 42A.8 (2014), https://www.townofnorthbranfordct.com/documents/p_z_docs/Regulations%20PZ.pdf.

13. Nat'l Low Income Hous. Coal., Out of Reach (2021), https://reports.nlihc.org/oor.

14. David N. Kinsey, Open Cmtys. All., Fair Share Housing Model for Connecticut, 2020 (Nov. 2020, rev. May 2021), https://d3n8a8pro7vhmx.cloudfront.net/opencommunitiesalliance/pages/32/attachments/original/1632427654/Kinsey_-_Report_on_Fair_Share_Model_for_CT_w_Append_A_-_Revised_May_2021_%285-28-21%29_.pdf?1632427654.

15. Metro. Plan. Council & Urb. Inst., the Cost of Segregation (2017), https://www.metroplanning.org/uploads/cms/documents/cost-of-segregation.pdf.

levels of intolerance, prejudice, and bias that come with segregation at the levels experienced in Connecticut.[16]

Third, the limits on where affordable housing can be built drive it into a handful of communities that are now poverty-concentrated and disproportionately Black and Latino. This increases the need for a range of supports for lower income families, creates additional challenges for longtime residents, and drives further disinvestment.

**Does the Moore Family Get a Real Choice?**

And because many historically white and wealthier towns have long maintained exclusionary zoning, lower income families (who are disproportionately Black and Latino), interested in moving to higher opportunity areas, face enormous obstacles to making such moves. The experience of OCA's client Shandra Moore (not her real name) and her family is illustrative. After escaping a domestic violence situation, Ms. Moore and her children, who are Black and lower income, bounced between homeless shelters and living with family in Hartford. All the while, Ms. Moore called housing authorities throughout the state in search of a housing voucher. Discovering that the only open voucher program was in far flung Litchfield County, Ms. Moore reached out nonetheless. She was told that only residents of a dozen or so Litchfield towns, which are predominantly white, were permitted to apply for the available vouchers. Ms. Moore complained to a local fair housing organization that later successfully sued the housing authority for Fair Housing Act violations. Rather than follow the program rules and allow applicants from all across the state to apply for vouchers, the housing authority discontinued its voucher program.

Still, as a result of the litigation, Ms. Moore and her family got a voucher and began looking for housing in a district with high performing schools. Again, they encountered barriers, both in the form of housing that was too expensive under the voucher's price limits (this predated the increase in voucher values in the Hartford region that OCA helped ensure was implemented and that is described further below) and housing discrimination. Eventually, the family settled in Hartford. Ever the advocate for her children, Ms. Moore enrolled them in the Hartford region's school desegregation bussing program, which allows families living in lower performing school districts to attend higher performing schools. For the Moores, that meant that the kids took a bus to and from Glastonbury, Connecticut, every day to attend the town's highly rated schools. Ms. Moore considered this an important opportunity for her kids, but it meant that they could not be fully a part of their school community and that every evening they returned to a neighborhood that faced a plethora of challenges from high levels of crime to environmental contamination.

Because of this difficulty, after a few years, Ms. Moore renewed her quest to live in a higher resource community and once again encountered barriers

16. Eric M. Uslaner, Segregation and Mistrust: Diversity, Isolation, and Social Cohesion (2012).

in the form of discrimination and then-prevailing voucher values that were grossly insufficient to afford a home for her family. This result was due to the way the U.S. Department of Housing and Urban Development (HUD) calculated the value of the vouchers available through its Housing Choice Voucher program. While the Obama administration worked to remedy this issue by instituting a new smaller market-based voucher value calculation, the Trump administration backpedaled, illegally suspending the change.[17] In 2020, OCA successfully sued HUD to reinstate the original pro-housing-choice Obama-era rule.[18] With these new voucher values, plus a whole lot of initiative on the part of Ms. Moore and advocacy and cajoling on the part of OCA, Ms. Moore and her family eventually moved to a beautiful home in Glastonbury, where her children continue to thrive in the public schools. But it should not take such gargantuan efforts on the part of families using vouchers or the network of advocates supporting them to do such a simple thing as accessing a safe area with strong public schools.

Ms. Moore remains committed to Hartford and hopes to move back there someday to work towards revitalization. But her concerns about life for her kids in the neighborhoods in Hartford that she was able to access with her voucher—underperforming schools, high levels of crime, unacceptable apartment unit conditions, substandard services, environmental hazards and more—are also the natural result of the policies that impact affordable housing throughout the state. By generally limiting the ability to build affordable units and confining those units that are built to small areas of the state, housing and zoning policies across Connecticut are functionally acting as poverty-concentrating policies.

It also means that if any (much needed) investments geared towards revitalization of cities actually work to spark revitalization, there is a high likelihood that lower income residents of under-resourced communities will be displaced. Imagine for a moment that a revitalization strategy takes off—suddenly, in Connecticut's most disenfranchised communities whatever is considered broken is fixed—schools begin to universally perform at a high level, high-quality municipal services are provided, streets everywhere are safe, and businesses thrive. The first thing that would happen is more people with higher incomes would want to move to in. This outcome would put pressure on the housing market there, likely increasing rents and triggering the displacement of lower income families. And that is the hitch, or one of them, with "urban revitalization." It turns out that cities are part of interconnected metropolitan regions, and a failure of suburbs to play a role in providing affordable housing generates poverty concentration that we cannot buy ourselves out of.

17. Alana Semuels, *Trump Administration Puts Hold on an Obama-Era Desegregation Effort*, Atlantic (Aug. 30, 2017), https://www.theatlantic.com/business/archive/2017/08/trump-hud/538386.

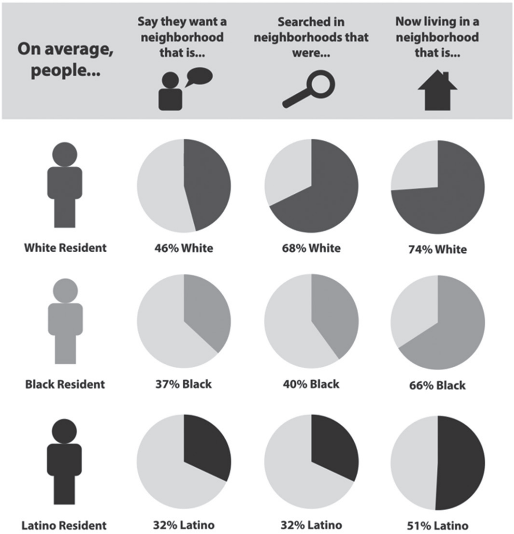
18. Open Cmtys. All., Oca v. Carson (Small Area Fmrs) (Feb. 22, 2018), https://www.ctoca.org/oca_v_carson.

## Feeding the Cycle

Connecticut's racial segregation and urban disinvestment also creates a cycle of mounting stereotypes, prejudice, and racism. It leads some mostly-white suburbanites to attribute all the challenges of poverty and poverty concentration to all lower income people themselves and, for some, to people who are Black and Latino. This, among other reasons, can contribute to some vocal suburban residents fighting affordable housing proposals tooth and nail. On the flip side, for some people who are Black and Latino, direct experience with, or even the perception of, white racism leads them to reject the notion of living in integrated communities. Notably, many other Black, Latino, and other families of color very much want integrated housing choices.[19] Critical to the development of solutions is the fact that the more people of different races and ethnicities actually interact with each other, the more these stereotypes recede.[20]

## What Do Families Want? Depends on the Family

Which brings us to the question of choice. Where do people of different races and ethnicities, especially lower income people, actually want to live? According to Sociologist Maria Krysan and her colleagues, most people, regardless of race and ethnicity, want to live in diverse neighborhoods. The differences come in where people look for housing—white homeseekers are much less likely to look in communities that reflect their professed ideal levels of diversity and actually move to yet whiter areas. Black and Latino homeseekers end up




**Housing Search Results by Race based on research from Professor Maria Krysan. Reprinted from Research Spotlight: Maria Krysan, Institute of Government and Public Affairs, University of Illinois, December 2015. Available at https://igpa.uillinois.edu/sites/igpa.uillinois.edu/files/reports/Research-Spotlight-Krysan_Housing-Search.pdf**

19. Esther Havekes, Michael Bader & Maria Krysan, *Realizing Racial and Ethnic Neighborhood Preferences? Exploring the Mismatches Between What People Want, Where They Search, and Where They Live*, 35 Population Rsch. & Pol'y Rev. 101 (2016), https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4716051.

20. Uslaner, *supra* note 16.

living in areas that reflect their own demographics at higher levels than their ideal.[21] These outcomes are fueled by layers of factors. For whites, racism is surely at play for some people, but also what they can afford with statistically greater incomes and greater wealth, a reality check on the difference in local services and conditions, and "racial blindspotting" or the notion that our segregated living patterns and social networks lead us to consider living in communities that reflect our own race. For Black and Latino families, similar factors drive where people live, for some, a level of prejudice based on very real experiences with white people or institutions or an understanding from others, but also wealth and income disparities, racial blindspotting, and housing discrimination, which is alive and well throughout the real estate market.

OCA has had the opportunity to explore this question in the context of families with federal Housing Choice Vouchers and found that somewhere between forty-five to sixty percent of the 300 voucher holders that we surveyed who lived in Hartford wanted to leave the city, with greater interest in leaving coming from families in more opportunity-isolated neighborhoods and among families experiencing environment-triggered negative health outcomes like asthma. That said, it is critical to emphasize that, among a general population of voucher holders who did not report health issues or specific neighborhood challenges, about fifty-five percent wanted to stay in their Hartford neighborhood.[22]

### Big Picture Solution

We synthesize the reality of the state's affordable and subsidized housing policy, its approach to zoning, and the housing preferences of lower income families to conclude that the necessary solution is twofold: we need to both open up affordable housing choices across regions and make strategic, community-driven investments in under-resourced areas of cities.

### The Opposition

In the face of all of these challenges, from the increase in racial consciousness to the extreme segregation and dire need for affordable housing, the Not-In-My-Back-Yard (NIMBY) forces have emerged as a strong voice for rolling back existing pro-affordable-housing policies in place in Connecticut, never mind adding important new tools supporting housing equity. Opponents of equitable zoning reform, especially from wealthy Fairfield County, such as a group called 169 Strong, are organized and amplifying their message through the press, op-eds, and legislative campaigns. As a part of this effort,

21. Housing Search Results by Race based on research from Professor Maria Krysan. Reprinted from Research Spotlight: Maria Krysan, Institute of Government and Public Affairs, University of Illinois (Dec. 2015), https://igpa.uillinois.edu/sites/igpa.uillinois.edu/files/reports/Research-Spotlight-Krysan_Housing-Search.pdf

22. Erin Boggs, Sam Brill, & Lisa Dabrowski, *Do Housing Choice Voucher Holders Want to Move to Opportunity?*, Poverty & Race Rsch. Action Council (June 1, 2018), https://www.prrac.org/do-housing-choice-voucher-holders-want-to-move-to-opportunity.

one lawmaker representing a wealthy mostly white area recently complained because naturally less expensive housing provided by local country clubs, private schools, and Greenwich Hospital did not count towards a state law that smooths the way for affordable housing development in towns with few units guaranteed to be affordable, missing the important distinction that, unlike the housing relevant to the state law, the units that he referenced were not deed-restricted as affordable and could vary in price with the market.[23]

Open Communities Alliance and its partners take on this opposition using education, organizing, policy development, and, where needed, litigation. We invest time and energy to provide clear information on the need for and positive impact of affordable housing and desegregating options while also marshaling civil rights and other laws to overcome barriers that cannot be overcome with efforts to shift public and political opinion.

### The Work of Open Communities Alliance

When OCA was born close to ten years ago, it was into a world of advocacy almost exclusively focused on stabilizing families in poverty or facing homelessness and working on place-based revitalization strategies. What was needed in that ecosystem was a voice for choice in housing. Thus, for almost the last decade, while cheering on our colleagues focused on place-based solutions, OCA has aggressively advanced policies that expand affordable housing choices in areas with a dearth of them.

We have had both successes and challenges, and there is much that remains to be done. Some of the highlights include:

- As a starting point, we worked to develop a framework of data to inform our work. That included doing our best to wrangle with the state and federal data on the location of subsidized housing and, with Opportunity Mapping inspired by the work of Professor john powell and others, charting the opportunity assets available in each census tract of the state. We were able to show the serious inequities in access to the range of opportunities, from high performing schools to safe neighborhoods to employment opportunities, across neighborhoods, that those inequities had racial implications, and that they were intimately tied to the housing policies across the state.[24]
- We launched a grassroots coalition, which now includes over 400 people around the state and has advanced a range of policies that promote desegregating housing choices.
- In 2015, we successfully advocated for the creation of a statewide mobility counseling program dedicated to ensuring that families

23. Robert Marchant, *Greenwich Lawmakers Seek Changes in Affordable Housing Laws, Saying 8-30g 'Has Failed Every Town,'* Greenwich Time (Feb. 8, 2022), https://www.greenwichtime.com/news/article/Greenwich-lawmakers-seek-changes-in-affordable-16842753.php.

24. Boggs & Dabrowski, *supra* note 3.

using government housing vouchers have full information about their housing options and have true choices in neighborhoods that have been difficult or impossible for voucher families to access.

- In 2017 in the case of *OCA v. Carson*, working with the NAACP Legal Defense Fund (LDF), the Poverty and Race Research Action Council (PRRAC), and Relman and Colfax, the premier fair housing law firm in the nation, we successfully sued the Trump administration for rolling back an Obama-era policy that gave families using mobile housing vouchers greater choices in where they lived.[25]
- In 2020, with the help of the PRRAC, the National Lawyers' Committee for Civil Rights, the American Civil Liberties Union, and the law firm of Cohen Milstein, we again sued the Trump administration in *OCA v. HUD*, challenging the deconstruction of a fair housing rule permitting legal challenges to policies having a negative statistical impact on groups protected by the Fair Housing Act.[26]
- Also in 2020, OCA brought the *Center for Leadership and Justice v. HUD*, a major fair housing civil rights action against the U.S. Department of Housing and Urban Development and others, working with former residents of dilapidated government-funded housing in Hartford's struggling North End to assert their right to have the opportunity to access housing in thriving neighborhoods using their housing choice vouchers. We are grateful to work with the law firm of Covington and Burling and Yale Law School's Jerome N. Frank Legal Services Organization on this matter.[27]
- We challenged exclusionary zoning in the Town of Woodbridge, Connecticut, by filing a submission in 2020 requesting that it make fundamental town-wide changes to its zoning ordinance. The proposed changes would have helped bring the town's zoning into compliance with state and federal law, moved the town toward being able to host its fair share of affordable housing for the region, and addressed decades of exclusionary zoning. This effort highlighted problematic zoning practices that are seen statewide. We were again grateful to work with various local development and land use experts and two clinics at Yale Law School on this zoning application.[28]
- In 2020, we introduced Fair Share Zoning, a new, more equitable approach to zoning in Connecticut modeled on the outcomes of the Mount Laurel series of cases in New Jersey, in which every town

25. Open Cmtys. All., *supra* note 18.

26. For more information on *OCA v. HUD*, see *id.*

27. For more information on *CLJ v. HUD*, see Open Cmtys. All., CLJ v. HUD, https://www.ctoca.org/clj_v_hud (last visited Mar. 8, 2022).

28. For more information on OCA's #OpenWoodbridge effort, see Open Cmtys. All., #OpenWoodbridge, https://www.ctoca.org/openwoodbridge (last visited Mar. 8, 2022).

contributes to meeting an appropriate portion of its region's need for affordable housing. Advocacy around this effort is ongoing.[29]

- In 2021, we launched our Town Ambassador program, a network of local citizen advocates pushing for inclusionary zoning reforms at the town and statewide level.
- In 2021, OCA successfully advocated for the creation of the Open Choice Voucher program, empowering income-qualifying families participating in the Open Choice school desegregation bussing program to move to the higher opportunity communities where their children attend schools.

### Growing Together Connecticut

While we have focused intensely on ensuring that lower income families have a true choice in where they live, we are constantly considering the ways in which our policy proposals will affect under-resourced communities. To truly address the impact of segregating housing policies, all communities must be places of opportunity.

To bring together the yin and yang needed to address the impact of segregation, in 2022, OCA launched a campaign called Growing Together Connecticut, a partnership of over thirty organizational partners dedicated to collective action to both open up affordable housing choices across regions and advocate for equitable investments in under-resourced communities. Already this partnership, which includes the state NAACP, the Hispanic Federation, civil rights legal groups, state commissions, homelessness advocates, planners, developers and more, is generating greater focus on the issues that we are tackling. In our first year, the campaign will focus on advancing Fair Share Planning and Zoning (described above) and undertaking a city-by-city listening tour to inform revitalization policy priorities in the upcoming years.

### Conclusion

Despite the vocal opposition, we must seize this moment and leverage it to advance real and deep systemic changes to the entrenched structures that have allowed even a state like Connecticut, which perceives itself as progressive, to become so segregated and seemingly immune to the desperate housing and other core needs of so many of its residents. Our hope is that OCA can continue to learn from its partners, build on the pathbreaking work of our mentors and predecessors, and contribute to creative and transformative solutions moving forward.

29. For more information on OCA's Fair Share Planning and Zoning efforts, see Open Cmtys. All., A Fair Share Housing Model for Connecticut, https://www.ctoca.org/fairshare (last visited Mar. 8, 2022).

## ARTICLES

# Preserving the Low-Income Housing Tax Credit Public-Private Partnership: Investor Perspectives on Year-15 Exit Disputes

*Steven F. Griffith, Jr., Laura E. Carlisle & Alexandra B. Rychlak**



### Introduction

Last year marked the thirty-fifth anniversary of the Low-Income Housing Tax Credit (LIHTC). Established by the Tax Reform Act of 1986 and codified in Section 42 of the Internal Revenue Code,[1] the LIHTC program is the federal government's largest program aimed at funding the development and rehabilitation of affordable rental housing for low-income families.[2]

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*Steven F. Griffith, Jr. is a Shareholder in the New Orleans office of Baker Donelson Bearman Caldwell & Berkowitz, PC. He chairs the Firm's Business Litigation Practice Group and serves on its Board of Directors, including its Audit and Finance Committee. Laura E. Carlisle is also a Shareholder, and Alexandra B. Rychlak is an Associate, in Baker Donelson's New Orleans office. All three authors regularly represent investors in Year 15 and other disputes with developers, including with respect to evaluations of exit strategies, pre-suit negotiations, and, when necessary, litigation.

1. 26 U.S.C. § 42; I.R.C. § 42.

2. *See, e.g.*, Mark P. Keightley, Cong. Rsch. Serv., RS22389, An Introduction to the Low-Income Housing Tax Credit (Jan. 26, 2021); *see also, e.g.*, Joint Center for Housing Studies of Harvard University, America's Rental Housing

It is also a political anomaly, enjoying bipartisan support for virtually the entirety of its existence and aligning the interests of groups—affordable housing advocates, corporations, and other for-profit and nonprofit organizations—that might otherwise find themselves at odds.[3] By all accounts, the LIHTC has been, and remains, a remarkable success. And it is distinctly market-based.

An outgrowth of the free-market ideology of Ronald Reagan's administration and the policy shifts of the 1980s,[4] the LIHTC is a supply-side tax subsidy in the form of a non-refundable credit that provides or allocates dollar-for-dollar credits to qualified developers for the production and operation of qualified affordable housing projects.[5] A key feature of the program is the developer's ability to sell those credits to private investors in exchange for equity financing for qualified projects, which allows the developer to reduce construction costs and a property's debt burden while providing newly constructed or rehabilitated units at reduced rental prices.[6] In turn, a key factor contributing to the rise and success of the LIHTC has been the emergence and role of intermediaries—or syndicators—in underwriting, bundling, and then brokering portfolios or "funds" of credits across multiple projects and developers to a secondary market of typically corporate or large institutional investors. The demand for credits within that syndication market—and in turn the market price for those credits—has become the engine that propels the entire LIHTC program.[7]

There is debate over whether Congress intended the results of the LIHTC program that we are seeing today, including even the funneling of

2020, at 33 (2020), https://www.jchs.harvard.edu/sites/default/files/reports/files/Harvard_JCHS_Americas_Rental_Housing_2020.pdf; Fact Sheet: Biden-Harris Administration Announces Immediate Steps to Increase Affordable Housing Supply, https://www.whitehouse.gov/briefing-room/statements-releases/2021/09/01/fact-sheet-biden-harris-administration-announces-immediate-steps-to-increase-affordable-housing-supply ("LIHTC is the nation's largest federal program for the construction and rehabilitation of affordable rental housing.").

3. *See, e.g.*, Mihir Desai et al., *Investable Tax Credits: The Case of the Low Income Housing Tax Credit* 5, 18 (NBER Working Paper No. 14149, June 2008), https://www.hbs.edu/faculty/Pages/item.aspx?num=33531; Jt. Ctr. for Hous. Stud. Harv. Univ., What Works Collaborative, The Disruption of the Low-Income Housing Tax Credit Program: Causes, Consequences, Responses, and Proposed Correctives 13 (2009), https://www.jchs.harvard.edu/sites/default/files/disruption_of_the_lihtc_program_2009_0.pdf; *see also, e.g.*, William R. Mitchell, *Sheltering the Rich or Housing the Poor? The Story of the Low Income Housing Tax Credit*, 4 Strathclyde L. Rev. 5, 17–18 (2008).

4. *See, e.g.*, Charles H. Stewart III, *The Politics of Tax Reform in the 1980s*, *in* Politics and Economics in the Eighties 143, 144 (Alberto Alesina & Geoffrey Carliner eds., 1991); Gregg Ip & Mark Whitehouse, *How Milton Friedman Changed Economics, Policy, and Markets*, Wall St. J. (Nov. 17, 2006), http://www.wsj.com/articles/SB116369744597625238.

5. 26 U.S.C. § 42.

6. Keightley, *supra* note 2; *see also* Desai et al., *supra* note 3, at 3.

7. *See generally* What Works Collaborative, *supra* note 3.

private capital into low-income housing developments, or whether it fully grasped the scope of the program in that regard.[8] But it is undeniable that, as it stands today, the continued viability and success of the government's largest—and many would argue most successful—affordable housing program is dependent on the continued engagement and incentivizing of its investor base.

This article examines investor considerations with respect to a critical juncture within the lifecycle of a LIHTC deal—Year 15—and the potential consequences for continued investor engagement and participation, and even the preservation of affordable housing itself, posed by current disputes among program participants over Year 15 exit issues. More specifically, this article examines attempts by non-investor participants to acquire control of LIHTC projects at or around Year 15 and, in certain instances, exclude investor participants from sharing in an asset's fair market, and at times much-appreciated, value. As this article discusses, such attempts not only erode an investor's expected return on investment but threaten basic tax principles underlying the program and investor participation. Ultimately, this article proposes that decisionmakers navigating these disputes must account for investor considerations, expectations, and well-established legal and tax principles if they are to best incentivize new and return investors and ensure the continued powering of the engine that drives the LIHTC program.

Part I of this article discusses the mechanics of the LIHTC and the role of private capital within the program, as well as the role of nonprofit entities, as a backdrop to understanding the emergence of certain issues at Year 15. Part II examines certain of those "Year 15 Issues," as well as recent case law surrounding these issues and the potential consequences of these and other trends for investor participation and the long-term health of the LIHTC program. Finally, Part III surveys recent developments in the affordable housing sector and the role of the LIHTC in addressing the country's continued affordable housing shortage.

## I. Background

Issues surrounding affordable housing—and specifically the relative lack of affordable housing—have been the subject of vigorous debate for almost 100 years.[9] In the 1980s, the perennial effort to address the country's affordable housing needs collided with Friedman-influenced free-market ideology and a fundamental shift in how leaders and the public viewed the

8. *See generally* Mitchell, *supra* note 3.

9. *See* United States Housing Act of 1937 (Wagner-Steagall Act), Pub. L. No. 93-383, 88 Stat. 653, 42 U.S.C. § 1437, which provided the statutory structure for public housing and funding for public housing through direct assistance to local housing agencies; *see also* Charles L. Edson, *Affordable Housing—An Intimate History,* 20 J. Affordable Hous. 194 (2011).

government's role in society.[10] The LIHTC reflects that ideology and shift. Enacted as part of the Tax Reform Act of 1986,[11] the LIHTC initially was set to sunset in 1989. Congress extended the program on an annual basis until making the LIHTC permanent in 1993.[12]

The LIHTC operates as a mechanism for funneling private capital and investment into low-income housing developments. It does so by way of tax credits provided to developers of low-income housing units following an application process who then agree to comply with certain affordability and other restrictions for a specified period of time, and who can in turn sell those credits in exchange for equity financing.[13] The proceeds from that investment, in turn, enable lower-cost development, reduces the debt burden on a property, and makes it "financially feasible to offer lower, more affordable rents."[14] In exchange, the investor providing the equity financing receives an ownership interest allowing it to claim the lion's share of the LIHTCs allocated to and claimed by a project as well as the other benefits typical of a real-estate investment, including depreciation and tax losses flowing from the property, cash from operations, and a share of the residual value of the property.[15]

In short, a LIHTC asset is a real-estate investment that happens to also provide affordable housing. The program generates billions of dollars in private investments annually,[16] and it serves the extremely low-income and most vulnerable of households.[17] Since its inception in 1986, the program has funded the construction or rehabilitation of more than 3.6 million

10. *See, e.g.*, Report of the President's Commission of Housing xvii (1982) ("The genius of a market economy, freed of the distortions forced by government housing policies and regulations that swung erratically from loving to hostile, can provide housing far better than Federal programs.").

11. Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085; *see also* Edson, *supra* note 9, at 206.

12. Revenue Reconciliation Act of 1993, Pub. L. 103-66, Aug. 10, 1993, 107 Stat. 416, 26 U.S.C. § 1; *see also* Edson, *supra* note 9, at 206.

13. *E.g.,* Keightley, *supra* note 2.

14. Office of the Comptroller of the Currency, *Low-Income Housing Tax Credits: Affordable Housing Investment Opportunities for Banks* at 2 (Mar. 2014), https://www.occ.gov/publications-and-resources/publications/community-affairs/community-developments-insights/ca-insights-mar-2014.html [hereinafter OCC Report]; *see also* Keightley, *supra* note 2.

15. *E.g.*, Keightley, *supra* note 2.

16. *See* Jeffrey R. Pankratz & Craig A. Emden, *Section 704(b) Regulations and Tax Credit Transactions: Structuring Low-Income Housing Tax Credit Transactions to Avoid Reallocation of Tax Credits and Losses*, 11 J. Affordable Hous. & Cmty. Dev. L. 339 (2002).

17. Nearly half of the American households utilizing LIHTC housing are extremely low-income. *See* Lauren Loney & Heather Way, *Strategies and Tools for Preserving Low Income Housing Tax Credit Properties*, 28 J. Affordable Hous. & Cmty. Dev. L. 255, 256 (2019). It shoudl be noted that extremely low-income (ELI) households include those households with an income at or thirty percent of the particular area's median income.

affordable units.[18] In that same timeframe, it has funded the construction, redevelopment, or preservation of over 2.5 million units affordable to households at fifty to sixty percent of the Area Median Income (AMI).[19]

### *A. Overview of the LIHTC Program*

The LIHTC is an indirect federal subsidy that offsets the credit holder's federal tax liability dollar-for-dollar. The LIHTC is codified in Section 42 of the Internal Revenue Code,[20] and the program is administered at the federal level by the Internal Revenue Service (IRS).

The process of allocating, awarding, and ultimately claiming LIHTCs is relatively complex.[21] The process begins with the IRS making an annual LIHTC allocation to each state based on the state's population.[22] Each state—typically acting through the state's housing finance agency (HFA)—then allocates credits to developers of "qualified low-income housing projects" according to state-specific qualified allocation plans (QAPs).[23] Federal law requires that states give priority in allocating credits to projects that serve the lowest-income households and remain affordable for the longest period of time, but QAPs may also incorporate state-specific policy considerations and objectives or impose additional requirements on developers.[24]

Once credits are allocated to a developer, the developer typically has two years to place a project in service so that the tax credits may be claimed.[25] Credits may not be claimed until a project is placed in service, and an allocation of credits to a developer does not necessarily mean that all allocated credits will be claimed.

Once a project is placed in service, the LIHTCs allocated to the project are claimed over a ten-year "Credit Period"[26] but earned over an initial fifteen-year "Compliance Period"[27] during which the project must comply with affordability restrictions and other program requirements. Among other things, the project must meet certain tests that restrict both the income of eligible tenants (typically limited to fifty to sixty percent of AMI)[28] and the rent charged to those tenants (limited to thirty percent of the AMI applicable to the unit).[29]

For projects developed after 1990, in addition to the fifteen-year initial Compliance Period, the IRS requires that LIHTC properties have an

18. State HFA Factbook, 2020 NCSHA Annual Survey Results 95 (2020).
19. America's Rental Housing 2020, *supra* note 2, at 33.
20. 26 U.S.C. § 42.
21. Keightley, *supra* note 2.
22. *See id.; see also* 26 U.S.C. § 42.
23. Keightley, *supra* note 2; Desai et al., *supra* note 3, at 3.
24. *See* 26 U.S.C. § 42(g)(1), (h)(3); *see also* Keightley, *supra* note 2; Desai et al., *supra* note 3, at 3.
25. Keightley, *supra* note 2.
26. *See* 26 U.S.C. § 42 (f)(1).
27. *See id.* § 42 (i)(1).
28. *Id*.
29. Keightley, *supra* note 2.

"extended use agreement" with the state housing agency that extends the project's affordability for at least an additional fifteen years, ensuring affordability for a minimum of thirty years.[30] States may require even longer affordability or extended use periods,[31] though housing advocates have cautioned against such longer periods given the physical toll on properties and the increased cost and burden of physical maintenance for older properties.[32] Extended use periods ensure continued affordability beyond the Compliance Period regardless of who owns the property after Year 15.

### *B. Investors and the Role of Private Capital*

Many developers lack the upfront capital or financing necessary to complete construction. As a result, developers often sell or exchange their allocated credits to investors or syndicators in exchange for equity financing, in a process known as syndication.[33] This equity financing reduces the debt burden on the project, lowers the cost of development, and allows the project to offer more affordable rents.[34]

The "sale" of credits in exchange for equity financing typically occurs within a partnership formed between the developer (as general partner and manager of the property)[35] and the investor entity (as limited partner).[36] The partnership exists for the sole purpose of constructing, owning, and operating the LIHTC property. In this arrangement, the investor entity receives 99% or more (typically 99.99%) of the tax credits allocated to the project, as well as an equal share of the project's taxable income and losses,[37] certain fees and cash flow, and a share of the property's residual value. A limited partnership agreement is negotiated and executed to govern the rights and obligations of the parties within this construct.

LIHTC deals typically utilize the partnership structure because of its ability to legally bind the parties and satisfy federal tax requirements that the tax credit claimant have an ownership interest in the underlying property.[38]

30. 26 U.S.C. § 42(h)(6).

31. *See, e.g.*, A.B. 1584, Reg. Sess. (Cal. 2021) (proposing extended use period of fifty-five years).

32. *See, e.g.,* Most LIHTC Properties Stay Affordable, But Concerns Remain, available at https://www.housingfinance.com/news/most-lihtc-properties-stay-affordable-but-concerns-remain_o.

33. *See* Desai et al., *supra* note 3, at 4–5.

34. *See* Keightley, *supra* note 2; Pankratz & Emden, *supra* note 16, at 339–40; *see also* Office of the Comptroller of the Currency, Low-Income Housing Tax Credits: Affordable Housing Investment Opportunities for Banks at 2 (Mar. 2014), https://www.occ.gov/publications-and-resources/publications/community-affairs/community-developments-insights/ca-insights-mar-2014.html [hereinafter OCC Report].

35. The authors use the term "partnership and partner," which has been the most common type of ownership structure for LIHTC properties, but LIHTC deals may also be structured as limited liability companies.

36. Keightley, *supra* note 2.

37. Pankratz & Emden, *supra* note 16, at 339–41.

38. Keightley, *supra* note 2; *see also* Pankratz & Emden, *supra* note 16, at 339–40.

Hence, the share of credits distributed to the investor partner will match that partner's equity ownership in the partnership: a limited partner that receives 99.99% of the tax credits will own 99.99% of the equity in the partnership. And, because of the "economic substance doctrine," in order to support the distribution of credits between the partners (for which the investor partner provided upfront capital), and the deal not be deemed a sham, it is critical that the investor partner be and remain the true owner of the underlying property.[39]

The economic substance doctrine is a common law judicial doctrine designed to prevent taxpayers from entering transactions lacking economic reality for the sole purpose of reaping a particular tax benefit.[40] Although codified in Section 7701(o) of the Internal Revenue Code in 2010,[41] the doctrine has been used by the IRS and courts for years to evaluate and disregard non-compliant transactions.

In short, the economic substance doctrine disallows tax benefits of a transaction if the transaction lacks "economic substance" or a business purpose. "Under the economic substance doctrine, 'the objective economic realities of a transaction,' rather than its legal form, determine who is an owner for tax purposes."[42] To demonstrate true ownership, Section 7701(o) requires a party to establish that

(A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and

(B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.[43]

Relatedly, Section 704 of the Internal Revenue Code governs partnership allocations and is intended to ensure that allocations "follow the 'economics of the deal.'"[44] Pursuant to Section 704(a), "a partner's distributive share of income, gain, loss, deduction, or credit shall . . . be determined by the partnership agreement."[45] However, pursuant to Section 704(b), a "partner's distributive share of income, gain, loss, deduction, or credit shall be determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances), if the allocation to a partner under the agreement does not have substantial economic effect."[46] Section 704(b) and corresponding regulations are

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39. 26 C.F.R. § 1.42-4 specifies that the economic substance doctrine applies to LIHTCs.

40. *See, e.g.*, Bret Wells, *Economic Substance Doctrine: How Codification Changes Decided Cases*, 10 Fla. Tax Rev. 411, 412 (2010).

41. 26 U.S.C. § 7701(o).

42. Homeowner's Rehab, Inc. v. Related Corp. V SLP, L.P., 99 N.E.3d 744, 755 (Mass. 2018) (quoting Frank Lyon Co. v. United States, 435 U.S. 561, 572–53 (1978)).

43. 26 U.S.C. § 7701.

44. Pankratz & Emden, *supra* note 16, at 340.

45. I.R.C. § 704(a).

46. *Id.* § 704(b).

designed to guard against potential abuses related to the flexibility inherent in the Code's treatment of the partnership structure.[47]

Section 42 specifies that the "losses, deductions, or credits attributable to the ownership and operation of a qualified low-income building with respect to which the low-income housing credit under section 42 is allowable may be limited or disallowed under other provisions of the Code or principles of tax law."[48] It goes on to mention the economic substance doctrine and sham analysis specifically,[49] demonstrating clear legislative intent to apply these enduring tax law principles to the LIHTC program.

Congress intended—and Section 42 requires—that the investor owner have and maintain a true property ownership in the LIHTC property. To this end, the investor partner must sustain the economic realities of property ownership, and the parties to a LIHTC transaction must comply with the Section 704(b) regulations, including at exit. Failure to do so may have "adverse consequences for the investor, namely, a reallocation [or loss] of [claimed] losses and credits and a corresponding failure to achieve its expected economic return."[50] For this reason, before an investor will invest the private capital necessary to build a LIHTC project, it typically requires an opinion letter from experienced tax counsel attesting that the project and the project's partnership agreement comply with applicable tax regulations and Section 42's provisions regarding economic substance.

### C. *The Role of Nonprofits*

The creation of the LIHTC and its thirty-five-year survival attests to lawmakers' faith and confidence in the market and for-profit entities' ability to effectively and efficiency direct government resources and address the country's affordable housing needs. But nonprofits have also played a role in the history of the program, for a very specific reason: the idea that a nonprofit will be less motivated by profit and more likely to maintain the affordability of properties beyond the statutorily required time period. One product of such thinking is the nonprofit right of first refusal (ROFR). While extended-use periods largely negate concerns over continued affordability, the ROFR remains at the center of new legislative proposals as well as much of the litigation surrounding Year 15 Issues.

Since the inception of the LIHTC program, lawmakers have sought out ways to discourage the market-rate conversion of LITHC properties. In

47. Pankratz & Emden, *supra* note 16, at 340.

48. 26 C.F.R. § 1.42-4(b).

49. *Id*. ("Notwithstanding paragraph (a) of this section, losses, deductions, or credits attributable to the ownership and operation of a qualified low-income building with respect to which the low-income housing credit under section 42 is allowable may be limited or disallowed under other provisions of the Code or principles of tax law." (citing sections 38(c), 163(d), 465, 469; Knetsch v. United States, 364 U.S. 361 (1960), 1961–1 C.B. 34 ("sham" or "economic substance" analysis); and *Frank Lyon Co. v. Commissioner*, 435 U.S. 561 (1978), 1978–1 C.B. 46 ("ownership" analysis)).

50. Pankratz & Emden, *supra* note 16, at 340.

1988, Senators George Mitchell (D-ME) and John Danforth (R-MO) created a task force to review the LIHTC program and propose improvements.[51] The result of those efforts was a report identifying potential modifications and measures to encourage the continued affordability of LIHTC units beyond the initial Compliance Period.

Among other things, the Mitchell-Danforth Report identified specific concerns associated with the sale of LIHTC properties to for-profit entities following the Compliance Period,[52] including what the task force believed to be the greater likelihood of for-profit entities converting properties to market rate.[53] Aimed at maintaining the supply of affordable housing, the Mitchell-Danforth Report urged Congress to identify a mechanism to position nonprofit groups as the owners and managers of affordable housing projects.[54] It specifically urged Congress to create a unique nonprofit option allowing nonprofits to purchase LIHTC properties at below-market prices following the end of the Compliance Period.[55]

Congress rejected the Mitchell-Danforth Report's proposal for a below-market purchase option. Instead, Congress enacted the Omnibus Budget Reconciliation Act of 1989[56] and the Omnibus Budget Reconciliation Act of 1990,[57] which, in part, created a nonprofit right of first refusal that permitted nonprofit participants to purchase a LIHTC property for a statutorily prescribed minimum price equivalent to the remaining debt on the property and any taxes attributable to the sale.[58] The legislation further modified Section 42 to mandate that each state reserve ten percent of its allocable tax credits for LIHTC projects developed by qualified nonprofit organizations.[59] Such provisions are intended to encourage nonprofits' control of LIHTC properties based on the assumption and objective that the nonprofits will maintain the properties as affordable housing.[60]

The nonprofit ROFR provides nonprofit entities an opportunity to purchase LIHTC properties for a below-market price, but only where the

51. *See* Tracy A. Kaye, *Sheltering Social Policy in the Tax Code: The Low-Income Housing Tax Credit*, 38 Vill. L. Rev. 871, 883 (1993).

52. Report of the Mitchell-Danforth Task Force on the Low-Income Housing Tax Credit (1989)).

53. *Id*. at 4.

54. *Id.* at 4, 19.

55. *Id.* 19.

56. Pub. L. No. 101-239, 103 Stat. 2106, 2306–22.

57. Pub. L. No. 101-508, 104 Stat. 1388, 1388–475.

58. Pub. L. No. 101–239, tit. VII, subtit. A, § 7108(q), 103 Stat. 2321 (1989).

59. 26 U.S.C. § 42(h)(5).

60. Homeowner's Rehab, Inc. v. Related Corp. V SLP, L.P., 99 N.E.3d 744, 755 (Mass. 2018) ("By creating this safe harbor, § 42(i)(7) also furthers one of the key policy goals of the LIHTC program, which is to ensure that affordable housing remains affordable in the long term. Nonprofit organizations are more likely to continue to operate properties as affordable housing, even after the affordability restrictions are lifted, because it is their mission to do so."*).*

owner chooses to sell the property at the end of the Compliance Period.[61] Nonprofit entities, solely by virtue of the statutory revision, have no right to compel a sale of the property.

Even so, developers (both for-profit and nonprofit) have attempted to use the nonprofit ROFR to force sales of LIHTC projects from unwilling owners and investors, giving rise to one of the several Year 15 Issues currently facing investors. Recent legislative proposals have also sought to retroactively convert these ROFRs into purchase options, attempting to do what Congress twice before rejected.[62] From the investor's perspective, such measures would unfairly change the rules the program has lived by for thirty-five years, as well as undermine certain of its core tax foundations.

## II. Year 15 Issues Affecting Investors

Although not always the case, because of the timing of LIHTC delivery and compliance and the delivery of losses versus gains, the end of the initial Compliance Period at Year 15 is often a point at which the developer or general partner and its investor partner decide to part ways. As a consequence, the partnership agreements governing LIHTC partnerships typically spell out what happens—or can happen—at and after Year 15, including with respect to the investor's exit from the deal. From the investor's perspective, such provisions exist not merely to advise the partners of their contractual rights: they exist to ensure that the tax foundations and assumptions on which the partnership was conceived and according to which the partners have been operating for fifteen or more years remain true and intact.

Various factors have contributed to a recent uptick in disputes surrounding Year 15 and specifically investor exit at or around Year 15. Projects are increasingly reaching Year 15. In addition, property values in many regions have appreciated more than initially anticipated, while capitalization rates have fallen dramatically, resulting in asset value that participants may not have anticipated when they first struck their deal. At the same time, where a property does not deliver the losses or return originally projected for the investor partner, the investor may have an unexpectedly large capital account for which it expects to be accounted and compensated at exit.

61. The relevant House committee report clarifies the legislative intent behind the § 42 nonprofit ROFR, defining ROFR as "the right of first refusal (with one year's notice) to purchase the building, for a minimum purchase price, *should the owner decide to sell* (at the end of the compliance period)" (emphasis added); *see also* H.R. Rep. 101-247, 1195, 1989 U.S.C. 1906, 2665.

62. S. 1703 § 303(30(i)-(ii) (purposing a "clarification" to § 42: "(i) such option or right of first refusal may be exercised with or without the approval of the taxpayer, and "(ii) a right of first refusal may be exercised in response to any offer to purchase the property, including an offer by a related party.").

This section discusses three particular Year 15 Issues and areas of dispute: property valuations, the treatment of positive capital accounts, and the nonprofit ROFR.

*A. Property Valuations*

While not always present, the general partner's option to purchase the limited partner's ownership interest or the LIHTC property itself following Year 15 is the most prevalent mechanism for investor exit.[63] If an option is provided, the partnership agreement or a separate option agreement will typically provide for a process by which the parties are to value the property (or limited partner interest) using a specified valuation method and one or more qualified appraisers. Assuming that the property has sufficient value to trigger what is typically provided for as a fair market value valuation, the interests of the partners in this context are at odds: whereas the general partner wishes to acquire the partnership or the limited partner interest for a bargain, at the lowest price possible, the investor or limited partner understandably wants top dollar or the true fair market value of its interest.

Appraisals are opinions of value and, by their nature, are subject to some (key word being "some") variation and difference of opinion across different appraisers. However, the appraisal process is also one in which partners—and general partners specifically, in their role as managers of the partnership—can influence the valuation of a property or interest to suit their own interests. For example, the appraiser might be persuaded not to include certain categories of income, such as additional income provided by vouchers, in calculating the property's net operating income (NOI), resulting in a decreased valuation. The appraiser might decide to make downward adjustments to income for vacancy and other factors, or upward adjustments to costs, based on surrounding market data but contrary to the actual historical experience at the property. The general partner or manager might not even provide the appraiser with all requested or desired data for a property. Small variations in the assigned capitalization rate can have relatively large consequences for the overall valuation. Multiple points in an appraisal provide an opening for the general partner to potentially influence the valuation. There also have been more overt attempts to subvert the appraisal process.

In *Multi-Housing Tax Credit Partners XXX v. Alexander Dairy Associates, LLC*,[64] for instance, the United States District Court for Eastern District of Virginia considered claims surrounding a general partner's alleged improper exercise of its option to buy a limited partner's interest in an LIHTC partnership and looked specifically at a provision in the

63. Kenneth N. Alford, MAI, & David C. Wellsandt, *Appraising Low-Income Housing Tax Credit Real Estate*, Appraisal J., Fall 2010, at 15.

64. Multi-Housing Tax Credit Partners XXX v. Alexander Dairy Assocs., LLC, No. 3:20CV612, 2021 WL 2711468, at *1 (E.D. Va. July 1, 2021).

partnership agreement mandating that the partners "agree on an appraiser whose appraisal sets the purchase price for [the Limited Partner's] interest in the partnership."[65] The court observed that the general partner, "believing that it '[was its] time to get paid,' notified [the limited partner] that it intended to exercise the Purchase Option" and proposed an appraiser to provide a valuation of the limited partner's interest.[66]

The limited partner rejected the general partner's appraiser but suggested three alternatives.[67] The general partner then provided a proposed engagement letter purporting to provide an appraisal of the limited partner's interest (the "valuation analysis") and an appraisal of the partnership property's fair market value.[68] The limited partner objected to the appraisal and advised that it would agree only to "an appraisal of the Partnership's improved real property [as opposed to a valuation analysis], in accordance with the Partnership Agreement" conducted solely by an appraiser holding the requisite qualifications. [69] The limited partner offered to work towards an agreement as to the appropriate valuation instructions, cautioning that moving forward unilaterally would violate "the Partnership Agreement, which requires that the partners agree on the selected appraiser."[70]

The general partner responded with a revised engagement letter providing the same valuation analysis.[71] The limited partner refused to sign the revised engagement letter containing terms and conditions identical to those to which it previously objected.[72] Despite the limited partner's objections, the general partner unilaterally proceeded with the appraisal[73] and, the following month, advised it was prepared to close on the sale of the limited partner interest for a purchase price of $675,000.[74] The limited partner refused to cooperate with the closing or accept any funds.[75]

Notwithstanding, the general partner "believing that he had acquired [the] interest in the Limited Partnership" began acting as if he "could do whatever we wanted to do with" the Partnership,[76] refusing to deliver required financial documents and contemplating a refinancing of the debt on the property.[77] The limited partner filed suit based on the general

65. *Id.* at *1.
66. *Id.*
67. *Id.*
68. *Id.* at *3.
69. *Id.* at *2.
70. *Id*, at *3.
71. *Id*.
72. *Id*.
73. *Id*.
74. *Id*.
75. *Id*.
76. *Id.*
77. *Id*.

partner's failure to comply with the limited partnership agreement and improper exercise of ownership over the limited partner's interest.[78]

The federal court found that "the parties *did not* agree on an appraiser to set the purchase price for [the Limited Partner's] interest in the partnership" and, therefore, the general partner improperly claimed to own the limited partner's interest.[79] The court further concluded that the general partner breached the partnership agreement by purporting to exercise the purchase option despite the limited partner's refusal to consent to the appraisal and found that the general partner's behavior "amount[ed] to nothing more than manifest opportunism."[80] The "manifest opportunism" recognized in the *Dairy* case demonstrates the tactics taken by certain general partners with respect to option rights, which potentially operate to transfer value away from the investor to the general partner in violation of both the tax underpinnings of the program and the partnership agreements between the parties.

### *B. The Treatment of Positive Capital Accounts*

A further issue often attendant to a general partner's purchase of a LIHTC property or the limited partner's interest is the treatment of the partners' respective capital accounts at exit. Capital accounts are a measure of each partner's economic interests in a transaction or arrangement.[81] For this reason, the law requires that capital accounts be considered as part of a buyout or exit, and the parties' agreements include provisions confirming it.

Guided by the overarching principle that allocations must "follow the "'economics of the deal,'"[82] Section 704(b) of the Internal Revenue Code provides the rules for measuring partners' respective equity stakes and the economic relationship among partners.[83] It also provides a safe harbor whereby partnerships that maintain their capital accounts in compliance with Section 704(b) and follow specific requirements for liquidation will be deemed to have their allocations possessing the "substantial economic effect" required by the Regulations.[84]

Capital accounts track partners' respective economic investment in a partnership. A partner's capital account initially consists of their initial capital contributions (cash plus fair market of any property contributed, net of any liabilities associated with the property) and then is adjusted upward or downward each year depending on the transactions occurring within the partnership during that year. Generally speaking, a partner's capital account is increased by (1) additional contributions (cash or the fair

78. *Id.*
79. *Id.*
80. *Id.*
81. Pankratz & Emden, *supra* note 16, at 341.
82. *Id.* at 340.
83. *Id.* at 342.
84. *See* Treas. Reg. 1.704-1(b)(2)(ii).

market of contributed property, net associated liabilities) by the partner to the partnership, and (2) any allocations of partnership gain or income allocated to the partner.[85] A partner's capital account is generally decreased by (1) distributions (cash or the fair market value of distributed property, net any attendant liabilities) to the partner, and (2) the amount of any partnership losses or deductions allocated to the partner.[86] Positive or negative 704(b) reevaluations may also take place but are less common.

Several basic tenets are inherent and reflected in this framework. First, partnership assets must be recorded at fair market value, as opposed to cost basis at the time of liquidation or sale. Second, partners' capital accounts determine distribution rights. Therefore, upon liquidation, the partnership must make liquidating distributions in accordance with the partners' positive capital account balances, and a partner is unconditionally obligated to restore a deficit capital account balance following a liquidation of the partner's partnership interest.[87]

With respect to Year 15 Issues, disputes over capital accounts have generally arisen where the investor or limited partner has a significant positive capital account at the time that the general partner seeks to exercise an option right or the parties otherwise seek to sell the property to a third party. For the limited partner or investor, a significant positive capital account in this context typically reflects investments by the investor at the beginning of the partnership that are not returned through operations (i.e., distributions and loss allocations).[88] For the general partner, it can pose a significant (and often unexpected) financial hurdle to acquiring 100% of a LIHTC partnership or result in the limited partner receiving more sale proceeds than the general partner might have anticipated. As such, general partners may attempt to avoid paying the limited partner for its positive capital account in an actual or hypothetical liquidation as required by Section 704(b).

While courts have started to address disputes over positive capital accounts, the case law on this issue is emerging and mixed.[89] From the investor's perspective, however, the partnership agreements and the Internal Revenue Code and associated Regulations require that the limited partner's positive capital be accounted for at exit.

85. *Id.* § 1.704-1(b)(2)(iii).

86. *Id.*

87. *Id.*; *see also* Pankratz & Emden, *supra* note 16, at 340–41.

88. *See* Bradley Myers, *The Low-Income Housing Tax Credit: A Proposal to Address IRS Concerns Regarding Partnerships Between Non-Profit and For-Profit Entities*, 60 Tax Law. 415, 443 (2007).

89. *Compare, e.g.*, Saugatuck, LLC v. St. Mary's Commons Assocs., L.L.C., No.19-cv-0217 (SJF)(SIL), 2021 WL 4813170, *4 (E.D.N.Y. May 19, 2020), *with* Centerline/Fleet Hous. P'ship, L.P. - Series B v. Hopkins Ct. Apartments, L.L.C., 195 A.D.3d 1375 (N.Y. App. Div. 2021); CED Capital Holdings 2000 EB, L.L.C v. CTCW-Berkshire Club, LLC, No. 2018-CA-013886-O, 2020 WL 1856259, at *1 (Fla. Cir. Ct. Apr. 08, 2020).

In *Saugatuck, LLC v. St. Mary's Commons Associates, L.L.C.*, the United States District Court for the Eastern District of New York examined the price owed for a general partner's option to purchase a LIHTC property, which comprised substantially all of the partnership's assets, or the limited partner's interest in the partnership at the end of the Compliance Period.[90] The partnership agreement between the parties specified the amounts owed to each partner in the event of liquidation or, specifically, the "disposition of all or substantially all of the assets of the Partnership."[91] The agreement also included a section governing the "Distribution and Application of Cash Flow and Proceeds from Sale or Refinancing Transactions," which provided a calculation for the proceeds owed to each partner in the event of a sale of a portion of the project to a third party or a refinancing of the debt.[92] Notably, the liquidation waterfall accounted for the limited partner's positive capital account balance, while the sale or refinancing proceeds waterfall did not.

The general partner argued that the partnership agreement required only a $242,064.39 purchase price for the option, contending the option constituted merely a sale rather than a liquidation.[93] In contrast, the limited partner claimed the purchase price for the option should be calculated as a liquidation, because the sale of the property—the partnership's only asset—was a liquidation event. The liquidation calculation accounted for the limited partners' positive capital account balance of $3,927,499.[94]

The federal court found no dispute that the "Property comprises 'substantially all of the assets of the Partnership'" and, further, concluded that the Partnership Agreement specified "'[t]he sale of other disposition of all or substantially all of the assets of the Partnership' as an event that immediately causes a dissolution of the Partnership." On that basis, the court held that the liquidation provision controlled the calculation of the option price, and, therefore, the price owed for the option must reflect the limited partner's positive capital account balance.

The federal court's decision in *St. Mary's* is not only consistent with the partnership agreement between those parties: it is consistent with and adheres to the tax principles underlying the LIHTC program and partnership tax law generally.

### C. *The Nonprofit Right of First Refusal*

Nonprofit organizations serve a well-intended goal within the LIHTC program: to ensure continued affordability of properties beyond Year 15. As also noted earlier, however, extended use agreements ensure affordability for at least thirty years regardless of the owner, mitigating concerns in this

90. *Saugatuck*, 2021 WL 4813170, at *4.
91. *Id.*
92. *Id.*
93. *Id.*
94. *Id.*

regard. Moreover, as a property ages, it requires more maintenance and, ultimately, rehabilitation. Nonprofit entities may lack sufficient resources to meet these needs, meaning that a property will need to re-enter the LIHTC program at the end of the Extended Use Period to fund the costs of rehabilitation if it is to remain both attractive to tenants and affordable. Disputes surrounding the ROFR must be viewed against this backdrop, with a healthy appreciation for both the role of nonprofit owners and the potential challenges that they face.

Case law surrounding the nonprofit ROFR is relatively more developed and has been far more uniform than that surrounding disputes over capital accounts. However, recent proposals in Congress have threatened to fundamentally change the ROFR, demonstrating a desire and willingness to enact a regime specifically rejected by prior Congresses and the courts. These proposals also threaten the continued engagement and participation of investors who potentially stand to see basic terms and principles to which they have long adhered summarily undone. Finally, this area is not immune to abuse by for-profit general partners seeking to seize value belonging to the investor or limited partner.

As noted above, the origin of the nonprofit ROFR lies in lawmakers' efforts to discourage market-rate conversions of LIHTC properties, the notion being that a nonprofit entity is less likely (or should be less likely) to convert a property to market rate following the statutorily prescribed period for affordability. On that basis, Section 42 was modified to include a statutory "right of 1st refusal" for qualified nonprofit organizations.[95]

A ROFR is a defensive right that "limits the right of the owner to dispose freely of its property by compelling the owner to offer it first to the party who has the first right to buy."[96] It guarantees the holder an initial opportunity to purchase a property in the event that an owner decides to sell. Unlike a purchase option, a ROFR does not entitle the holder to compel a sale from an unwilling owner.[97] In short, "[a] right of first refusal does not become an option to purchase until the owner of the property voluntarily decides to sell the property and receives a bona fide offer to purchase from a third party."[98] Furthermore, unlike a purchase option, a ROFR cannot be exercised unilaterally by the holder.

It is clear from the legislative record that Congress intended Section 42's nonprofit ROFR to operate as a common-law ROFR, not a purchase option.

95. 26 U.S.C. § 42(i)(7)(A).

96. 25 R. Lord, Williston on Contracts § 67:85, at 502 (4th ed. 2002).

97. *Id*. ("[A] right of first refusal has no binding effect unless the offeror decides to sell.").

98. Senior Hous. Assistance Grp. v. AMTAX Holdings 260, LLC, No. C17-1115RSM, 2019 WL 687837, at *6 (W.D. Wash. Feb. 19, 2019), *clarified on denial of reconsideration*, No. C17-1115 RSM, 2019 WL 827232 (W.D. Wash. Feb. 21, 2019) (citing Kelly v. Ammex Tax & Duty Free Shops W., Inc., 162 Wash. App. 825, 830–32 (2011)) *see also* SunAmerica Hous. Fund 1050 v. Pathway of Pontiac, Inc., No. 19-11783, 2021 WL 391420, at *4–7 (E.D. Mich. Feb. 4, 2021).

For instance, the House committee report described the nonprofit ROFR as "the right of first refusal (with one year's notice) to purchase the building, for a minimum purchase price, *should the owner decide to sell* (at the end of the compliance period)."[99]

Interpreting the below-market ROFR to apply as a below-market option would further violate the economic substance doctrine's requirement that "'the objective economic realities of a transaction,' rather than its legal form, determine who is an owner for tax purposes."[100] The right to receive the profit associated with a property's appreciation is customarily recognized as a right fundamental to property ownership.[101] A purchase option that permits the holder to compel the purchase of a property at a below-market price effectively shifts that right of ownership from the owner to the option holder and, thus, severs property ownership from the tax benefits and burdens assigned to it. The risk here is creating a sham entity for tax purposes,[102] disqualifying the owner from the receipt of the tax credits and undoing fifteen or more years of tax treatment between the parties.[103] It is precisely to avoid this risk that investors and developers include provisions in their agreements requiring that the exit provisions (and all provisions) of those agreements be read in a manner that ensures adherence to the economic substance doctrine.

1. Survey of Relevant Case Law

Nonprofit (and even for-profit) entities nonetheless have pursued litigation claiming that the ROFR or other provisions of the partnership agreement permit them to compel the sale of an LIHTC property at a below-market price from an unwilling owner.

For instance, in *Senior Housing Assistance Group v. AMTAX Holdings 260, LLC*,[104] the United States District Court for the Western District of Washington concluded that the nonprofit ROFR provided in the LIHTC partnership agreement before it did not allow the holder to purchase the property unless the owner received a bona fide, third-party offer that the owner was willing to accept. In *SunAmerica Housing Fund 1050 v. Pathway of Pontiac*,

99. H.R. Rep. 101-247, 1195, 1989 U.S.C. 1906, 2665 (emphasis added)

100. Homeowner's Rehab, Inc. v. Related Corp. V SLP, L.P., 99 N.E.3d 744, 755 (Mass. 2018) (quoting Frank Lyon Co. v. United States, 435 U.S. 561, 573 (1978).

101. *Homeowner's Rehab*, 99 N.E.3d at 755 (citing Dunlap v. Commissioner of Internal Revenue, 74 T.C. 1377, 1436–1437 (1980), *rev'd and remanded on other grounds*, 670 F.2d 785 (8th Cir. 1982).

102. Since the LIHTC program's inception, Congress has intended the true ownership tax-law principle to apply in the LIHTC context. *See supra* text accompanying notes 40–43.

103. *Homeowner's Rehab*, 99 N.E.3d at 755. (citing Dunlap v. Commissioner of Internal Revenue, 74 T.C. 1377, 1436–37 (1980), *rev'd and remanded on other grounds*, 670 F.2d 785 (8th Cir. 1982) (citing Rev. Rul. 55–540, 1955–2 C.B. 39, § 4.01(e)).

104. Senior Housing Assistance Group v. AMTAX Holdings 260, LLC, No. C17-1115RSM, 2019 WL 687837, at *8 (W.D. Wash. Feb. 19, 2019), *clarified on denial of reconsideration*, No. C17-1115 RSM, 2019 WL 827232 (W.D. Wash. Feb. 21, 2019).

*Inc.*,[105] the Eastern District of Michigan, considering an illusory third-party offer solicited by the general partner for the sole purpose of triggering its ROFR, determined that an offer made without an intent to execute a sale did not suffice as a bona fide offer triggering the ROFR.[106]

In *Riseboro Community Partnership Inc. v. SunAmerica Housing Fund* 682,[107] the United States District Court for the Eastern District of New York considered a nonprofit entity's challenge to the term "right of first refusal" and claim that the ROFR provided in Section 42 gave the nonprofit designee an unconditional right to purchase an LIHTC project at any point following the Compliance Period.[108] The plaintiff, Riseboro Community Partnership, Inc. (Riseboro), a nonprofit entity, was not a partner to the LIHTC partnership in question but rather a designee of the general partner and brought the action based on provisions of the partnership agreement providing a nonprofit ROFR, claiming further that the provision permitted Riseboro's unilateral purchase of the LIHTC property at any point after the Compliance Period.[109] The federal court disagreed, finding that the Section 42 ROFR did not operate differently than common law ROFRs and, therefore, did not provide an unconditional option to purchase the project.[110]

The recent case of *Centerline Housing Partnership v. Palm Communities*[111] involved a still further, more troubling phenomenon: an attempt by a for-profit general partner to manipulate and abuse the nonprofit ROFR. In *Palm Communities,* the United States District Court for the Central District of California considered a partnership agreement that provided both a purchase option and a ROFR. The court distinguished between the two: whereas the ROFR "to purchase the Property at a below-market price permitted by Section 42(i)(7) of the Internal Revenue Code following the end of the Compliance Period, but only if the Partnership 'shall desire to accept a bona fide offer from an unrelated third party to purchase the Property' from the Partnership,"[112] the purchase option provided the general partner a right to unilaterally compel the sale of the property, though the purchase price could not be less than the property's fair market value.[113]

In the case, the for-profit general partner executed an "Agreement of General Partners" (AGP) with its nonprofit general partner that transferred the nonprofit's below-market Section 42(i)(7) ROFR to the for-profit

105. SunAmerica Hous. Fund 1050 v. Pathway of Pontiac, Inc., No. 19-11783, 2021 WL 391420, at *4 (E.D. Mich. Feb. 4, 2021).

106. *Id.* at *4.

107. Riseboro Cmty. P'ship Inc. v. SunAmerica Hous. Fund 682, 482 F. Supp. 3d 31, 36 (E.D.N.Y. 2020), *as corrected* (Aug. 31, 2020).

108. *Id*.

109. *Id*.

110. *Id.* at 39.

111. *Centerline Hous. P'ship v. Palm Cmtys.*, No. 8:21-cv-00107-JVS-JDE, at *1 (C.D. Cal. Jan. 12, 2022).

112. *Id.* at *3.

113. *See id.* at *1.

general partner.[114] Once it secured the ROFR, the for-profit general partner sought to trigger the ROFR to acquire the property for millions below the fair-market price by claiming that it "'desired to accept' a third-party offer to purchase the Property" before receiving any third-party offer.[115] The for-profit general partner then refused to negotiate with the offeror and refused to conduct any due diligence on the third-party offer.[116] The court found that the for-profit general partner "devised a scheme to acquire the Property for 'millions of dollars' less than the price it was entitled to under the LPA and ROFR Agreement" in an effort to "enrich itself at the Limited Partners' expense."[117] Accordingly, the court ruled that the for-profit general partner breached its fiduciary duty to the limited partner when attempting to subvert the limited partner's profits through manipulating the nonprofit ROFR.[118]

As recognized by the court in *Palm Communities*, AGPs like the one at issue in that case permit for-profit entities to obtain the investor limited partner's asset at a below-market price. Their incentive in doing so is not to maintain a property's affordability but rather to seize value that would otherwise flow to the investor partner. Meanwhile, the investor loses money that may have otherwise funded new LIHTC or rehabilitated affordable developments.

### 2. Recent Policy Measures

Courts addressing disputes over the nonprofit ROFR generally have come to the same conclusion: the LIHTC ROFR is a common law ROFR and must be respected as such. At the same time, however, members of more recent Congresses and some state housing authorities have indicated a desire to fundamentally change the ROFR.

For instance, in March 2017, Senators Maria Cantwell (D- Washington) and Orrin Hatch (R-Utah) introduced the Affordable Housing Improvement Act of 2017. That legislation would have operated to convert Section 42(i)(7)'s nonprofit ROFR into a below-market purchase option.[119] Notably, the 2017 bill would have applied only proactively to LIHTC projects initiated after the bill's passing. As such, the 2017 legislation had no effect on existing LIHTC projects. The bill failed to become law.

In 2019, however, in the months following the court's ruling in *Senior Housing Assistance Group v. AMTAX Holdings 260, LLC*,[120] members of Congress introduced a new version of the 2017 bill, the Affordable Housing

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

118. *Id.*

119. *See* S. 548 (modifying I.R.C. § 42(i)(7)(A)(1) by striking "a right of 1st refusal" and inserting "an option").

120. *See supra* text accompanying note 99.

Improvement Act of 2019,[121] which on the whole purported to "expand and strengthen the Affordable Housing Tax Credit (also known as the Low-Income Housing Tax Credit) to produce more units of affordable housing and better serve a number of at-risk and underserved communities."[122] In part, the proposed legislation addressed the nonprofit ROFR. More specifically, the proposed legislation would have replaced the words "a right of 1st refusal" in Section 42(i)(7) with "an option," for purposes of agreements on a going forward basis. But the 2019 bill also included a "clarification with respect to the right of first refusal and purchase options" in *existing* agreements, potentially—*retroactively*—converting all existing nonprofit ROFRs to below-market purchase options.[123] The 2019 proposal failed to pass. A similar version of the Affordable Housing Improvement Act was reintroduced in 2021[124] but also failed to pass.

On November 19, 2021, the U.S. House of Representatives passed the Build Back Better Act (H.R. 5376), which, among other spending and tax measures, includes a significant expansion of the LIHTC program, through measures such as increasing state credit allocations, reducing the threshold for 4% tax-exempt bond-financed projects, and increasing the eligible basis of buildings designated to serve extremely low-income households.[125] But the Act also seeks to replace Section 42(i)(7)'s nonprofit ROFR with a below-market option, and it would even go further than prior proposals in making the "option" an option to purchase the LIHTC property or the partnership interests and reducing the statutory price by excluding exit taxes from the price formula.[126]

121. The Affordable Housing Credit Improvement Act of 2019 was introduced in both the House (H.R. 3077) and the Senate (S. 1703).

122. Press Release, Sen. Maria Cantwell, Cantwell, DelBene, Bipartisan Colleagues Introduce New Legislation to Combat Affordable Housing Crisis (June 4, 2019), https://www.cantwell.senate.gov/news/press-releases/cantwell-delbene-bipartisan-colleagues-introduce-new-legislation-to-combat-affordable-housing-crisis.

123. S. 1703 § 303(30)(i)–(ii).

124. The Affordable Housing Credit Improvement Act of 2021 was introduced April 15, 2021, in the 117th Congress as H.R. 2573.

125. *See* H.R. 5376, 117th Cong. (2021): Build Back Better Act, H.R. 5376, 117th Cong. (2021); *see also, e.g.,* Build Back Better Includes Historic Expansion of the Low-Income Housing Tax Credit Program (Dec. 10, 2021), *available at* https://www.jdsupra.com/legalnews/build-back-better-includes-historic-9028137.

126. *See* H.R. 5376, § 1235506.

**SEC. 135506. MODIFICATION AND CLARIFICATION OF RIGHTS RELATING TO BUILDING PURCHASE**.

(a) MODIFICATION OF RIGHT OF FIRST REFUSAL.—

(1) IN GENERAL.—Subparagraph (A) of section 42(i)(7) is amended by striking ''a right of 1st refusal'' and inserting ''an option''.

(2) CONFORMING AMENDMENT.—The heading of paragraph (7) of section 42(i) is amended by striking ''RIGHT OF 1ST REFUSAL'' and inserting ''OPTION''.

(b) CLARIFICATION WITH RESPECT TO RIGHT OF FIRST REFUSAL AND PURCHASE OPTIONS.—

(1) PURCHASE OF PARTNERSHIP INTEREST. —Subparagraph (A) of section 42(i)(7), as amended by subsection (a), is amended by striking ''the property'' and inserting ''the property or all of the partnership interests (other than interests of the person exercising such option or a related party thereto (within the meaning of section 267(b) or 707(b)(1))) relating to the property''.

(2) PROPERTY INCLUDES ASSETS RELATING TO THE BUILDING.—Paragraph (7) of section 42(i) is amended by adding at the end the following new subparagraph:

''(C) PROPERTY.—For purposes of sub23 paragraph (A), the term 'property' may include all or any of the assets held for the development, operation, or maintenance of a building.''

(3) EXERCISE OF RIGHT OF FIRST REFUSAL AND PURCHASE OPTIONS.—Subparagraph (A) of section 42(i)(7), as amended by subsection (a) and paragraph (1)(A), is amended by adding at the end the following: ''For purposes of determining whether an option, including a right of first refusal, to purchase property or partnership interests holding (directly or indirectly) such property is described in the preceding sentence—

''(i) such option or right of first refusal shall be exercisable with or without the approval of any owner of the project (including any partner, member, or affili1ated organization of such an owner), and

''(ii) a right of first refusal shall be exercisable in response to any offer to purchase the property or partnership interests, including an offer by a related party.''.

(c) CONFORMING AMENDMENTS.—Subparagraph (B) of section 42(i)(7) is amended by striking ''the sum of'' and all that follows and inserting ''the principal amount of outstanding indebtedness secured by the building (other than indebtedness incurred within the 5-year period ending on the date of the sale to the tenants). In the case of a purchase of a partnership interest, the minimum purchase price is an amount not less than such interest's ratable share of the amount determined under the first sentence of this subparagraph.''

(d) EFFECTIVE DATES.—

(1) MODIFICATION OF RIGHT OF FIRST REFUSAL.—The amendments made by subsections (a) and (c) shall apply to agreements entered into or amended after the date of the enactment of this Act.

(2) CLARIFICATION.—The amendments made by subsection (b) shall apply to agreements among the owners of the project (including partners, members, and their affiliated organizations) and persons described in section 42(i)(7)(A) of the Internal Revenue Code of 1986 entered into before, on, or after the date of the enactment of this Act.

(3) NO EFFECT ON AGREEMENTS.—None of the amendments made by this section is intended to supersede express language in any agreement with respect to the terms of a right of first refusal or option permitted by section 42(i)(7) of the Internal Revenue Code of 1986 in effect on the date of the enactment of this Act.

As of the date this article went to print, it does not appear that the Build Back Better Act will pass the Senate, but similar proposals concerning the LIHTC are likely to appear in future legislation.

## III. Implications for Combating the Affordable Housing Shortage

The shortage of affordable housing in the United States is not a new phenomenon, and it is not a phenomenon that is going away, especially for low-income and extremely low-income (ELI) households. Indeed, the demand for affordable housing—and the crisis for low-income and extremely low-income families—has only worsened with the COVID-19 pandemic.[127]

A number of factors were contributing to this trend even pre-COVID-19. As noted in the *America's Rental Housing 2020* report of Harvard University's Joint Center for Housing Studies, the rental market has fundamentally changed since the Great Recession of 2008, with rising demand for rental housing among higher-income households pushing rents higher as well as shifting the focus in new construction towards more expensive units.[128] Rising demand among higher-income households may also fuel the

127. *See* Stefan Sykes, *8 Million Americans Slipped into Poverty amid Coronavirus Pandemic, New Study Says,* NBC News (Oct. 16, 2020), https://www.nbcnews.com/news/us-news/8-million-americans-slipped-poverty-amid-coronavirus-pandemic-new-study-n1243762; *see also* Fact Sheet: Biden-Harris Administration Announces Immediate Steps to Increase Affordable Housing Supply, www.whitehouse.gov/briefing-room/statements-releases/2021/09/01/fact-sheet-biden-harris-administration-announces-immediate-steps-to-increase-affordable-housing-supply ("The large and long-standing gap between the supply and demand of affordable homes for both renters and homeowners makes it harder for families to buy their first home and drives up the cost of rent. Higher housing costs also crowd out other investments families can and should make to improve their lives, such as investments in education.").

128. *See generally* Joint Center for Housing Studies, *supra* note 2.

conversion of existing units to higher-rent units.[129] Meanwhile, if not converted to higher rents, existing rental stock continues to age, demanding more and more maintenance and updates.[130] Rising construction, land, and labor costs increasingly pose challenges for subsidized as well as market-rate developments.[131] Along with other factors, these trends have conspired to shrink the supply of low-cost units as a share of the rental stock and increase the share of cost-burdened renters.[132] Even prior to the COVID-19 pandemic, the number of renters paying at least thirty percent of income for housing and utilities was on the rise, with more than half of these cost-burdened households being severely burdened and paying more than fifty percent of their incomes for housing.[133] As of 2015, 8.3 million very-low income households suffered from severe cost burdens or were living in housing with serious deficiencies.[134]

The LIHTC has a role to play in addressing this mounting rental affordability crisis, and history has shown that it can be quite effective in doing so. Recent legislative proposals to increase the 9% credit allocation cap, reduce the threshold for 4% tax-exempt bond-financed projects, and increase the eligible basis for buildings designated to serve extremely low-income households would allow the LIHTC program not only to expand to meet the country's growing rental housing needs but also to better serve families most in need. Such proposals are crucial to the country's ability to address the growing rental affordability crisis. At the same time, investment markets are fluid and highly efficient—from the investor's perspective, proposals like those targeted towards fundamentally changing the nonprofit ROFR threaten to alter core tax principles underlying the program that have fostered such a successful private-public partnership for the program's thirty-five-year existence. To the extent that Congress or the courts threaten those principles, they threaten continued investor interest and participation.

To be sure, nonprofits have a role to play in helping the country meet its rental housing needs, especially in markets (geographic or otherwise) where the market for credits is not able to fully meet those needs. But such considerations on such a blanket basis as that reflected in recent proposals should be balanced—and must be balanced, if the program is to see continued success—against the incentives and tax principles that guide and facilitate investor participation in the first place.

129. *Id*. at 2.
130. *See id.*
131. *Id*. at 30.
132. *Id*. at 31.
133. *Id*. at 26.
134. *Id*. at 32.

## CONCLUSION

The LIHTC is the primary and arguably most successful government mechanism for spurring the development and rehabilitation of affordable rental housing in the United States. Investor participation—and the demand for tax credits—is the engine that has propelled the program's success thus far, and it is the engine that must be preserved and fostered if the program is to remain successful in the future. Indeed, now perhaps more than ever, the United States needs *more* investor participation in the LIHTC program, as well as greater demand for the tax credits among participants.

As such, the LIHTC program's success is largely centered on the demand that comes from a horizon view of expected stability of investments, with the concrete expectations of returns on investments free from legislative interference. Preserving and growing such demand requires, at a minimum, adhering to the basic, long-held tax principles that have guided investor participants thus far. This goal is true not only for legislators, but also for courts increasingly faced with disputes over ownership among program participants.

# Year-15 Disputes in the Low-Income Tax Credit Program, Aggregators, and Their Playbooks

*David A. Davenport & Samuel T. Johnson*[*]



* David A. Davenport and Samuel T. Johnson are attorneys at BC Davenport. As further set out in this article, the authors of this article have been involved in some of the litigation discussed herein.

## Introduction

The federal government's Low-Income Housing Tax Credit (LIHTC) program has been exposed to a troubling trend in recent history. The culprits—known throughout the LIHTC industry as "Aggregators"—are private firms that have collected limited partner interests in LIHTC entities that own affordable housing and have been systematically employing vulturine strategies meant to extract unintended cash windfalls out of affordable housing projects to line their pockets with cash. In the face of Aggregators carrying out this business model, developers and sponsors of affordable housing, which include both nonprofit and profit-based organizations, are being deprived of the promised, bargained-for exchanges that first incentivized them to develop the affordable housing and participate in the LIHTC program. These Aggregators are neither involved in the initial phase of LIHTC project development, wherein the tax credits central to the LIHTC program are sought, secured, and syndicated; nor are they part of the initial investment in low-income housing, or its planning, development, or operation. Yet Aggregators generally assume some interest in the applicable LIHTC entity, typically a limited partnership or limited liability company, prior to the end of a fifteen-year period known as the "Compliance Period." The Compliance Period marks a significant turning point, since prior to this juncture the tax credit exchanges at the heart of the LIHTC program are subject to recapture under Section 42(j) of the Internal Revenue Code of 1986, as amended (the "Code"), unless participants comply with complex federal, state, and local regulations throughout those fifteen years. In the post-compliance period, however, the tax credits have been secured without risk of recapture.

Yet, despite the years of work that sponsors and developers have necessarily exerted, first, to secure an award of tax credits, and second, to maintain and deliver the tax credits and other benefits to investors while also managing the day-to-day operations of the related LIHTC property for low-income residents, Aggregators come in, often toward the twilight of the Compliance Period, to disrupt this homeostasis by executing an "Aggregator's Playbook." In a more recent but related troubling development, some who might otherwise be referred to as a traditional tax credit investor have begun adopting these tactics in a spillover effect that further threatens the LIHTC program's equilibrium. The Aggregator's Playbook is generally the same: obfuscate and misconstrue the atypical arrangement and lengthy business agreements that govern LIHTC entities so that the current limited partner can potentially secure further gains that were not intended by the original parties or envisioned by their partnership agreement—*despite* that the tax credit investor has most likely received virtually *all* of the benefits of the LIHTC entity already (*i.e.*, *both* tax benefits *and* cash benefits associated with its investor interest).

Notwithstanding that Aggregators have done virtually *zero* work over the fifteen-year Compliance Period and typically invested no capital into the LIHTC entity, a central part of the Aggregator's Playbook leverages litigation as a bargaining chip to secure this unjust enrichment. It is becoming increasingly clear that Aggregators will proffer whatever interpretation of the governing agreement will extract for themselves the largest windfall, even if such position is wholly unreasonable or self-contradictory. Not uncommonly, the ultimate goal is to assume total control of the entity and, potentially, remove low-income housing from the LIHTC program's regulatory scheme so that the property can be converted into market-rate rental housing or transferred to those who may otherwise seek the same end.

Hoping to curtail these threats to the sustained viability of the LIHTC program and affordable housing stock, state agencies across the country are beginning to address the trend and utilize their regulatory authority to generate protective measures. In addition, federal legislation is floating through Congress and aimed at ensuring nonprofits that possess rights of first refusal in LIHTC properties are able to exercise such rights without the increasingly common disruption or prevention being marshalled by Aggregators and others like them. Even where state agencies develop measures to mitigate the harm that Aggregators pose to the LIHTC industry, Aggregators quickly turn to litigation to protect their controversial business model. At least one state housing commission has now been embroiled in a costly court battle aimed at preventing legitimate, prophylactic measures from implementation. Ultimately, though, this rapacious business model can be overcome through regulatory changes, the courts, and prudent contracting.

First, this article considers the importance of affordable housing; second, the LIHTC program is examined; third, the emergence of Aggregators and the various tactics in the Aggregator's Playbook are considered; and finally, legislative and regulatory measures to address the Aggregator problem are outlined.

## I. The Program: The Low-Income Housing Tax-Credit Program

### *A. America's Affordable Housing Shortage*

According to the National Low Income Housing Coalition (NLIHC), affordable housing is widely considered to be "the key to reducing intergenerational poverty and increasing economic mobility."[1] However, most recent statistics demonstrate a shortage of more than seven million affordable rental homes nationwide.[2] This problem plagues every state.[3]

Worse still, this gap is only increasing. According to the president of the National Council of State Housing Agencies, "If current rent and income trends continue, the number of severely cost-burdened renters, those paying 50 percent or more of their income for rent, will reach nearly 15 million

1. Nat'l Low Income Hous. Coal. (NLIHC), Why We Care: The Problem (2022), https://nlihc.org/explore-issues/why-we-care/problem.

2. *Id.*; NLIHC, *The Gap: A Shortage of Affordable Homes*, at 1–2, app. A (Mar. 2021), https://reports.nlihc.org/sites/default/files/gap/Gap-Report_2021.pdf.

3. *Id.*, app. A.

nationwide by 2025"—a "25-percent increase."[4] Meanwhile, the United States also stands to "lose countless affordable homes to [market-rate] conversion and obsolescence."[5]

### *B. The Low-Income Housing Tax Credit Program*

The LIHTC program, enacted in 1986 and implemented in 1987, was created to help alleviate this "severe shortage" of quality affordable housing.[6] It is the "largest [affordable housing] program in U.S. history";[7] and has been recognized as the "federal government's primary policy tool for encouraging the development and rehabilitation of affordable rental housing."[8]

The LIHTC program is governed by I.R.C. § 42, certain Treasury Regulations, guidance from the United States Department of Treasury and the Internal Revenue Service, and state-specific procedures contained in various documents adopted by designated housing agencies in each state (collectively, the "Tax Credit Rules"). The LIHTC program's key feature is the Low-Income Housing Tax Credit ("Housing Credit"), which provides a generous dollar-for-dollar (as opposed to a fractional) tax liability offset, thus incentivizing robust institutional investors with large tax liabilities to invest capital in the development of affordable housing.[9] More specifically, because developers of affordable housing rarely, if ever, have sufficiently large, predictable annual tax liabilities to make use of Housing Credits, the LIHTC program effectively facilitates the use of the Housing Credits by tax credit investors in exchange for capital needed to develop the affordable housing.[10]

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4. *America's Affordable Housing Crisis: Challenges and Solutions: Hearing 115-288 on S. 548 Before the S. Comm. on Fin.*, 115th Cong. (2017), https://www.govinfo.gov/content/pkg/CHRG-115shrg30902/html/CHRG-115shrg30902.htm (statement of Grant Whitaker, President, National Council of State Housing Agencies).

5. *Id.*

6. S. Hrg. 115-288 (Whitaker statement); *see also* H.R. Rep. No. 101-247, 101st Cong., 1st Sess., at 1188 (1989) ("The committee believes that encouraging the provision of low-income housing is an important goal of national housing policy [and] that providing tax incentives to private investors to invest in low-income housing projects is the most appropriate way to achieve this aim.").

7. Jill Khadduri et al., U.S. Dep't of Hous. & Urb. Dev., What Happens to Low-Income Housing Tax Credit Properties at Year 15 and Beyond? 2 (Aug. 2012), https://www.huduser.gov/publications/pdf/what_happens_lihtc_v2.pdf [hereinafter Year 15 HUD Report].

8. Mark P. Keightley, Cong. Rsch Serv. RS22389, An Introduction to the Low-Income Housing Tax Credit, at Summary & 1 (Jan. 26, 2021), https://sgp.fas.org/crs/misc/RS22389.pdf [hereinafter CRS Report RS22389].

9. *See, e.g.*, H.R. Rep. No. 101-247, 101st Cong., 1st Sess., at 1188 (1989) ("[P]roviding tax incentives to private investors to invest in low-income housing projects is the most appropriate way to achieve this aim."); *see also* CRS Report RS22389, *supra* note 8, at Summary & 1, 5; Year 15 HUD Report, *supra* note 7, at 25.

10. Year 15 HUD Report, *supra* note 7.

In a typical affordable housing project ("project"), the owner of the project is organized as a limited partnership or limited liability company (the "owner entity"), in which one or more "project sponsors" act as the general partner or managing member of the owner entity or developer of the project.[11] The project sponsor first obtains the right to claim the Housing Credits on behalf of the owner entity by engaging in a complex, "extremely competitive" application process administered by state housing authorities.[12] Once the Housing Credits are awarded, the owner entity becomes entitled to claim them over a ten-year period following the project being "placed in service," known as the "Credit Period"; however, to retain the Housing Credits (i.e., secure them from being "recaptured" by the Internal Revenue Service (IRS)), the owner entity must comply with the applicable, complex federal rent restrictions for a concurrently running fifteen-year Compliance Period.[13] At the end of the Compliance Period, the Housing Credits are fully secured and the risk of recapture ceases.[14]

The owner entity's other owner(s) or sponsor(s) are usually a real estate developer or a qualified nonprofit organization that, as already mentioned, do not have sufficiently large, predictable tax obligations,[15] and thus "sell" the right to be allocated the Housing Credits to a tax-credit investor in exchange for capital needed to develop or rehabilitate the property. These project sponsors are responsible for, *inter alia*, acquiring property or even supplying property that they already own, forming the ownership entity, and applying for a Housing Credit allocation through an "extremely competitive" process administered by the state housing authorities.[16] Once the Housing Credits have been awarded, the project sponsor agrees to admit into the owner entity (as a limited partner or investor member) the tax credit investor offering the most advantageous terms.[17] The tax credit investor is then admitted into the owner entity upon its commitment to make capital contributions in exchange for the right to benefit from substantially *all*

11. Office of the Comptroller of the Currency, Low-Income Housing Tax Credits: Affordable Housing Investment Opportunities for Banks 3 & n.11, 16, 21 (Mar. 2014, rev. Apr. 2014), https://www.occ.gov/publications-and-resources/publications/community-affairs/community-developments-insights/pub-insights-mar-2014.pdf [hereinafter Comptroller Report]; CRS Report RS22389, *supra* note 8, at 6; Year 15 HUD Report, *supra* note 7, at 25.

12. Comptroller Report, *supra* note 11, at 24; CRS Report RS22389, *supra* note 8, at 4; Year 15 HUD Report, *supra* note 7, at 56.

13. Comptroller Report, *supra* note 11, at 3, 23; CRS Report RS22389, *supra* note 8, at 4; Year 15 HUD Report, *supra* note 7, at xiii, 29.

14. Comptroller Report, *supra* note 11, at 3, 23; CRS Report RS22389, *supra* note 8, at 4; Year 15 HUD Report, *supra* note 7, at xiii, 29

15. Nonprofits are even less likely to have *any* predictable tax obligations.

16. *See* Year 15 HUD Report, *supra* note 7, at 5, 25, 56, 77; *see also* CRS Report RS22389, *supra* note 8, at 6; Comptroller Report, *supra* note 11, at 17, 21.

17. *See, e.g.*, Comptroller Report, *supra* note 11, at 17 ("Direct investors—or syndicators, in the case of LIHTC funds—are responsible for negotiating rights and responsibilities in the partnership agreement with the general partner.").

(usually ninety-nine (99) percent-plus) of the Housing Credits available to the owner entity, along with certain other expected tax benefits (primarily, tax losses and property depreciation deductions).

Because the amount a tax credit investor contributes is based on the amount of Housing Credits and other tax benefits forecasted to be received—*not* cash flow and resale profits (*i.e.*, residual value)—the amount invested is referred to as the "price" paid for the Housing Credits.[18]

Similarly, because tax benefits (*i.e.*, Housing Credits and tax losses) flow in accordance with respective ownership interests, and because tax-related benefits are the tax credit investor's bargain, the tax credit investor is virtually always given ninety-nine percent-plus of the ownership stake in the owner entity.[19] However, this exchange does not translate either to other economic benefits from operation of the LIHTC partnership, or to the management and control rights over it, since the tax credit investor assumes only a "passive" role with respect to the operations and management of the owner entity and its property (assuming zero liability or responsibility for the day-to-day goings on).[20] Thus, any management rights allowed to the tax credit investor are typically limited to rights that ensure it receives its Housing Credits and other tax-based benefits.[21]

Thus, the project sponsors or developers, who hold one percent or less of the owner entity's ownership stake, *assume virtually all responsibility* for

18. *Id.* at 23; *see also id.* at 22 ("LIHTC investors receive financial benefits on their investments through the [Housing Credits], as well as the additional deductions from real estate losses."), at 24 (noting investors also "negotiate so-called tax credit adjusters . . . so investors can reduce their . . . capital contributions in the event that the general partner fails to meet certain benchmarks that affect the amount or timing of the tax credits"); CRS Report RS22389 at 6 ("Typically, investors do not expect their equity investment in a project to produce income. Instead, investors look to the credits, which will be used to offset their income tax liabilities, as their return on investment . . . . The larger the difference between the market price of the credits and their face value ($1.00), the larger the return to investors . . . . The right to claim [other] tax benefits . . . will [also] affect the price investors are willing to pay."); CRS Report RS22389, *supra* note 8, at 25 ("LPs [limited partners] get financial returns primarily from tax benefits, including both tax credits and tax losses.").

19. Comptroller Report, *supra* note 11, at 3; CRS Report RS22389, *supra* note 8, at 5; Year 15 HUD Report, *supra* note 7, at 25, 32.

20. AMTAX Holdings 227, LLC v. Tenants' Dev. II Corp., 15 F.4th 551, 553 (1st Cir. 2021) (noting "large ownership percentage with an otherwise passive role"); CRS Report RS22389, *supra* note 8, at 6; Comptroller Report, *supra* note 11, at 3; Year 15 HUD Report, *supra* note 7, at 25.

21. Year 15 HUD Report, *supra* note 7, at 25 ("The LPs have restricted responsibilities and managerial rights, although they hold the right to approve any major alterations to the project or its management team and the right to step in and remove the GP if the development runs into trouble."); *id.* at 44 (noting that tax credit investors "are deeply concerned with avoiding foreclosure, which is considered a premature termination of the property's affordability and results in recapture of tax credits, with interest, and forfeiture of all future tax credit benefits from the property").

a project's development, operation, management, and compliance with the LIHTC program throughout the fifteen-year Compliance Period to ensure, among other things, that the tax credit investor realizes the tax benefits for which it has invested.[22] The developers or project sponsors *also assume virtually all risk* associated with delivering the benefits of Housing Credits to investors through completion, operating, and tax-delivery guarantees, with an unconditional guarantee of construction completion being most important because an unfinished project cannot produce Housing Credits.[23] Such agreements act as "guarantees on investment yields" for the tax credit investor.[24]

By the end of the Compliance Period ("Year 15" or "back end"), the owner entity has collected all Housing Credits, as well as other desired tax benefits, and Housing Credits are fully secured from recapture by the IRS. As a result, tax credit investors customarily seek to exit the partnership by the end of the Compliance Period because "the greatest benefits of ownership" are "both gone and safeguarded," leaving "little economic motivation to stay in the deal," especially when "tax reporting and other administrative burdens" remain.[25]

Simply put, in a LIHTC owner entity, "investors typically do not expect to receive their returns from cash flows, but rather from tax-related events," because that is what the tax-credit investor bargains for—virtually all the Housing Credits and all other available tax-related benefits that follow the Housing Credits (most notably, tax losses and property depreciation deductions).[26] In exchange, the project sponsors, whether a qualified nonprofit or profit-based developer organization, may be granted the right to receive a development fee, management fee, a portion of cash flow

22. *Id.* at 25; *see also* Comptroller Report, *supra* note 11, at 16 ("The general partner of the LIHTC partnership plays a key role in the investment decision. The investor is entering into a 15-year partnership with the general partner, and it is important that the general partner has the capacity and expertise to develop and manage LIHTC properties throughout the life of the investment."); CRS Report RS22389, *supra* note 8, at 6.

23. Comptroller Report, *supra* note 11, at 17, 24.

24. *Id.*

25. Year 15 HUD Report, *supra* note 7, at 25, 29 ("[I]t is in the interest of limited partners (LPs) to end their ownership role quickly after the compliance period ends. They have used up the tax credits by Year 10, and after Year 15 they no longer are at risk of IRS penalties . . . . [A]s a matter of policy, [investors] work to engineer an investor exit as quickly as possible after [Year 15]."); Comptroller Report, *supra* note 11, at 3 ("Most often, investors exit between year 11 and 16, having collected [the Housing Credits]."); *accord* AMTAX Holdings 227, LLC v. Tenants' Dev. II Corp., 15 F.4th 551, 553–54 (1st Cir. 2021) ("At the end of the compliance period, the time may be ripe for the investor to bid farewell.").

26. *See* Year 15 HUD Report, *supra* note 7, at 11, 29, 82; *see also* Comptroller Report, *supra* note 11, at 23 ("LIHTC investors receive financial benefits on their investments through the [Housing Credits] . . . as well as the additional deductions from real estate losses."); CRS Report RS22389, *supra* note 8, at 5–6 (same).

available from operations, and *crucially*, the right to acquire full control and ownership of the affordable housing community once the tax-credit investor's bargained-for Housing Credits are no longer at risk of "recapture" by the federal government.

1. Buyout Options at Year 15: Options and Rights of First Refusal Unique to LIHTC Partnerships.

To facilitate their exit near or following the end of the Compliance Period, the tax credit investor often agrees to grant property transfer rights to the applicable developer or project sponsor in the form of either (1) a buyout option, wherein (a) the tax credit investor's interests in the owner entity (*i.e.*, personal property) may be purchased, *or* (b) the general partner or managing member may be entitled to purchase the affordable housing property itself; or (2) a right of first refusal (ROFR), wherein a qualifying organization (typically a nonprofit) is permitted to hold a below-market purchase right provided that the ROFR complies with three minimal safe harbor requirements established by Congress and discussed more fully below.

*a. Changes to the LIHTC program and the § 42 ROFR*

Building upon the LIHTC program's original foundations, Congress enacted important amendments to the program in 1989 and 1990 to enhance the LIHTC program's ability to preserve affordable housing and to create a special role for nonprofits.[27] *First*, through an "Extended Use Period," Congress obligated compliance with the low-income rent restrictions for an additional fifteen years beyond the Compliance Period, although noncompliance during the Extended Use Period is not reported to the IRS and does not carry the risk of recapture.[28] *Second*, with a requirement that state housing finance agencies administer the LIHTC program through a complex application scoring system, Congress gave preference to projects that operate as low-income housing "for the longest periods."[29] In this regard,

27. *See* H.R. Rep. No. 101-247, 101st Cong., 1st Sess., at 1187 (1989); 26 U.S.C. §§ 42(h)(5)(C)(iii), (m)(1)(A)–(C).

28. 26 U.S.C. § 42(h)(6)(A)–(D); (j); Comptroller Report, *supra* note 11, at 3, 14.

29. 26 U.S.C. § 42(m)(1)(B)(ii)(II). Because of these enactments, local housing authorities "are likely to look favorably on applications from non-profits because of their concern for long-term stewardship and their lower emphasis on financial return via cash flow." Year 15 HUD Report, *supra* note 7, at 60; *see also id.* at 70 (noting LIHTC properties owned by nonprofits "will almost certainly not be repositioned" as market-rate housing following the expiration of rent restrictions, whereas for-profit owners "are likely to make a financial calculation about what to do with the property that depends on the housing market"). "[I]ndeed, adding these properties to the non-profits' permanent ownership portfolio is part of [their] missions. They expect the properties to remain with the non-profit owners in perpetuity and to continue to be operated as affordable housing." *Id.* at 29, 41; *see also id.* at 79 (noting mission-driven developers "maintain[] what they own, acquir[e] and reinvigorate[e] older properties, or develop[e] new ones"); *id.* at 85

Congress identified "sponsor characteristics" such as nonprofit status, as a criterion that *must* be considered.[30] *Third*, by a "10% set-aside," Congress required, without exception, that no less than ten percent of all Housing Credits *must* be awarded each year to low-income housing projects sponsored by a 501(c)(3) "qualified non-profit."[31] However, 501(c)(3)-status alone is insufficient because Congress mandated that these nonprofits also (1) have a dedicated purpose of "fostering of low-income housing"; and (2) not be "controlled by" or "affiliated with" "for-profit" interests.[32]

*Fourth*, a new property right was created—a special ROFR (the "§ 42 ROFR")—permitting the taxpayer-subsidized, low-income housing to be easily and inexpensively transferred to "qualified non-profits" for the preservation of low-income housing in perpetuity after the end of the Compliance Period.[33] Congress described this as the right "to purchase the building for a *minimum purchase price*, should the owner decide to sell (at the end of the compliance period)."[34] Nothing more is required, thus allowing this § 42 ROFR to be, *presumably*, easily triggered and exercised. And by establishing a "minimum purchase price"—that being the assumption of debt on the property plus the payment of any associated taxes, which are usually *de minimis*[35]—28 U.S.C. § 42(i)(7) fulfilled Congress's long-term preservation goal by deliberately authorizing *nonprofits* to retain *all* equity that appreciates or depreciates in the affordable housing over the Compliance Period.[36,37] Nonprofit organizations can then harness this retained

("Mission-driven developers . . . are the organizations to which [local housing authorities] will frequently need to turn to purchase older LIHTC properties in high-value locations and to operate the housing under use restrictions that keep it affordable.").

30. 26 U.S.C. § 42(m)(1)(C)(iv).

31. *Id.* § 42(h)(5).

32. *Id.* § 42(h)(5)(A)–(C), (E).

33. *Id.* § 42(i)(7).

34. H.R. Rep. No. 101-247, at 1195 (1989) (emphasis added).

35. Hence, the § 42 ROFR is often referred to as the "debt plus taxes" or "$1" ROFR.

36. *See* CommonBond Inv. Corp. v. Heartland Props. Equity Inv. Fund IV LLC, 2014 WL 8266277, at *2 (Minn. Dist. Ct. Nov. 14, 2014) ("The ROFR is one of the primary economic incentives for the developer in a typical low-income housing project. . . . It would seem apparent that the LIHTC program provides a right of first refusal as an incentive for non-profit participation in a project.").

37. As HUD, too, has recognized: "If a[n] [operating] agreement contains this option, then the transfer of a property to full control of a non-profit-owned [sponsor] *may be quickly discussed and concluded* . . . ." Year 15 HUD Report, *supra* note 7, at 31 n.20 (emphasis added); *id.* at 41 (stating parties "tended to anticipate [a] back-end sale at [the §42] price in the deals' initial structure from the outset of the LIHTC Program," and, as these § 42 ROFRs became ubiquitous, investors "who choose to work with these non-profit syndicators do so with the understanding that resale value is not expected to be among the investors' own benefits"); *id.* at 76 ("[A]s investor competition to purchase LIHTC equity intensified, 'back-end' dynamics moved decidedly in favor of [project sponsors]. The industry has evolved to the point that benefits offered to investors now often include little or no residual value or return of capital.").

equity to make needed repairs and improvements to the property after the Compliance Period, as well as leverage the equity to gain access to capital for the development of additional affordable housing and community reinvestment.

In short, the § 42 ROFR is a vital tool to the LIHTC program's central, critically important purpose of uplifting communities in need through the long-term preservation and ownership of affordable housing,[38] and by empowering community-based organizations, to pursue and implement programming designed to create opportunities and effect generational change, racial equity, and social justice in communities across the nation through access to capital.

*b. Buyout Options in typical LIHTC partnerships*

A tax credit investor's exit may also be accomplished through a purchase option usually exercisable at the end of the Compliance Period. These buyout options, which are also commonly found in analogous limited liability companies, are usually bargained for when the initial tax credit investor is admitted into the LIHTC partnership and provides for the tax credit investor's exit from the partnership at the end of the Compliance Period under two distinct sale scenarios, both of which typically require a particularized fair market value appraisal and assume that the apartment complex will continue to operate as affordable housing: (1) a fair market value sale of the limited partner interests in the partnership to the general partner at a price based upon the discounted future income streams and cash benefits to be derived by the limited partner from their ownership interests in the partnership's operations after the sale (a "going concern" valuation), or (2) a sale or transfer of the affordable housing complex to the general partner based upon the amount of sale proceeds that would otherwise be received by the tax credit investor if the apartment complex were sold to a third-party at fair market value (a "hypothetical sale" valuation).[39]

And, to incentivize the general partner to facilitate this exit, as well as to compensate it for fifteen years of services and substantial risk, the tax credit investor also customarily agrees—pursuant to a "sale and refinance" (*i.e.*, a capital transaction) "waterfall provision"—to provide the general partner with the super-majority of any residual proceeds generated by a sale or refinance of the project occurring upon its anticipated exit.[40] Indeed, the

38. S*ee* NLIHC, Why We Care: The Problem, *supra* note 1, at 5.

39. *See* Year 15 HUD Report, *supra* note 7, at 29 ("[The Limited Partner's] exit can be accomplished by selling the Limited Partner interests (usually to the existing General Partner) or by selling the property (either to the existing General Partner or to a third party).").

40. *See* Year 15 HUD Report, *supra* note 7, at 25, 44 ("GPs may look to property cash flow as an important source of financial return for their efforts. . . . A property's operating success can also have an impact on its resale value.").

LIHTC "industry has evolved to the point that benefits offered to investors now often include little or no residual value or return of capital."[41]

The original parties to a LIHTC partnership, or analogous limited liability company, often rely upon these sale proceeds waterfall provisions—and the minimal share of sale proceeds to which a limited partner would be entitled—to establish a buyout price for limited partner ownership interests when the time comes for their exit, most often at the end of the Compliance Period (Year 15).[42] In short, developer general partners and project sponsors regularly bargain for, and are routinely granted, the right to receive the super-majority of the traditional, cash-based economics flowing from a real estate project, which can include developer fees, "some or all of the property's cash flow" (both of which are often modest, *if* paid),[43] and the right to receive the lion's share of appreciated equity (either by acquisition of the project or receipt of capital transaction proceeds) generated by their fifteen years of services. This is, in turn, reflected in the price attendant to an exercise of a general partner's option right (the "option price").

41. Year 15 HUD Report, *supra* note 7, at 76 ("For-profit . . . owners of later properties may find it easy to buy out the LPs for outstanding debt. Syndicators and industry observers describe a shift over time in the nature of LIHTC investment agreements. In later years, as investor competition to purchase LIHTC equity intensified, 'back-end' dynamics moved decidedly in favor of GPs [general partners]."); *cf. id.* at 30 ("In the early years of the LIHTC program, many partnerships were formed under terms that *permitted* the LPs to share in the property's value at the time of sale." (emphasis added)); Comptroller Report, *supra* note 11, at 23 ("Transactions early in the program's history reflect a great deal of uncertainty about [Housing Credits]. Over time, as investors became more comfortable with [Housing Credits], the industry became much more standardized and predictable. Prices became much more competitive . . . from 2000 through 2004.").

42. *See also* Comptroller Report, *supra* note 11, at 14 ("When negotiating with the general partner over the terms of the limited partner buyout, limited partners should factor into their establishment of the exit price the general partner's need to maintain the requisite restricted rents during the extended-use period."); Year 15 HUD Report, *supra* note 7, at 30 (same); *see also id.* at xiii ("While the strong majority of LIHTC projects operate successfully through at least the first 15 years after they are placed in service under the tax credit, some properties fall into financial distress by the time they reach Year 15. . . . LIHTC properties tend to operate on tight margins both because of the stiff competition to obtain these subsidies initially and because of allocating agencies' obligation to ensure that they are providing the minimum amount of subsidy necessary to render the deals feasible.").

43. Developer fees are usually required to be deferred in large part and paid only if the project generates sufficient cash flow. *See* Year 15 HUD Report, *supra* note 7, at 25. And, because "the LIHTC program's design provides incentives for property managers to operate on very thin margins, with net cash flow frequently near zero," and "positive cash flow reduces the value of the depreciation deductions" inuring to the benefit of the tax credit investor, large portions of such fees are often not paid and effectively serve as capital contributions by project sponsors. *Id.* at 11, 44–45 & n.25 ("[D]eferred property management fees are effectively GP contributions.").

2. Summarizing the Unique Nature of the LIHTC Program

Simply put, participation in the LIHTC program results in the formation of a unique business arrangement, governed by unique contracts negotiated by private parties. In fact, the "LIHTC program is designed to counter the . . . effects of reduced rents by providing a tax benefit to owners that compensates for the loss of cash flow and resale profits."[44]

Further demonstrating the special dynamics at play in LIHTC projects are IRS rules that specifically account for tax consequences that would otherwise arise in investments made primarily for tax benefits. These LIHTC-specific rules promulgated by the IRS recognize the reality that there is "little or no residual value or return of capital" to tax credit investors.[45] For example, the IRS promulgated 26 C.F.R. § 1.42-4, a regulation that expressly excepts Housing Credit investments from section 183 of the Internal Revenue Code (section 183), which otherwise operates to disallow tax deductions and tax credits when an individual (or entity subject to pass-through taxation) engages in activity with no intent to profit but instead only to mitigate tax obligations. Significantly, in its preamble to this regulation, the IRS states:

> Although no explicit reference is contained in section 42 or its legislative history regarding its interaction with section 183, the legislative history of the [Housing Credit] indicates that Congress contemplated that tax benefits such as the credit and depreciation would be available to taxpayers investing in low-income housing, *even though such an investment would not otherwise provide a potential for economic return*. Therefore, to reflect the congressional intent in enacting section 42, the regulatory authority under section 42(n) is being exercised to provide that section 183 will not be used to limit or disallow the credit.[46]

44. Year 15 HUD Report, *supra* note 7, at 24, 82 (noting that "reduced expectations of cash flow and resale potential" is "inherent in the design of the LIHTC program," and "the tax credit compensates investors" for this result).

45. Even twenty-five years ago companies recognized that investment in LIHTC property was a tax credit investment, *not* a real estate or cash flow investment. *See, e.g.*, Laura Ochipinti Zaner, *The Low-Income Housing Tax Credit*, Nat'l Real Est. Inv. (Apr. 1, 1996), https://www.nreionline.com/mag/low-income-housing-tax-credit (quoting then-Senior Vice President Mark Hasencamp, of SunAmerica Affordable Housing Partners, Inc., who noted that "[i]nvestors are *not* looking at these [LIHTC] properties to generate traditional real estate benefits in the same way as conventional multifamily investments—*it's not the cash flow they're looking at—but the ability to reduce their federal tax liability*"). This sentiment is still recognized by large institutional accounting firms today. *See* CohnReznick LLP, *Housing Tax Credit Investments: Investment and Operation Performance*, A CohnReznick LLP Report, Tax Credit Inv. Servs. at 18 (Apr. 2018), https://www.cohnreznick.com/-/media/resources/tcis/cr_lihtc_march2018_interactive.pdf ("*Investors do not anticipate receiving cash flow distributions*, because housing tax credit properties are generally underwritten to perform slightly above breakeven *and developers or syndicators are generally the recipients of any remaining cash flow*.").

46. T.D. 8420, 57 Fed. Reg. 24749–24750 (June 11, 1992) (emphasis added).

This position has historic support from tax courts ruling, similarly, that tax benefits available in connection with investment into low-income housing under other statutory schemes are also excepted from section 183.[47] This exception is recognized even though "the partners anticipate that little or no funds will be available for distribution" because the legislative history indicates Congress's approval of "an adequate return to investors" via "partnership losses for tax purposes . . . . which would compare favorably with the return which most industrial firms realize on their equity capital . . . ."[48]

## II. The Problem: The Emergence of Aggregators, and Others Now Employing Their Tactics

Notwithstanding the purposefully designed balance orchestrated by lawmakers in these unique "private-public partnership[s],"[49] an increasing number of private investment firms have emerged to frustrate these post-Compliance Period property transfer rights by seeking unbargained-for financial boons.[50] Their aim is to siphon unintended cash windfalls out of these affordable housing projects and thereby strip developers or qualified nonprofits of the bargain for which they diligently worked to obtain and utilize, often for fifteen-plus years.[51]

> Some . . . are taking advantage of the investor interests they already hold in LIHTC projects, while others have been acquiring investor interests in LIHTC partnerships *en masse* for this purpose. . . . Recently, . . . a number of private firms have been challenging LIHTC project transfer rights across the country as a way of obtaining additional profit from these deals at the back end [i.e., at the end of the fifteen-year Compliance Period]. These firms appear to be aggregating investor interests in LIHTC partnerships; asserting myriad claims and arguments against project transfers, including transfers to non-profits; and extracting value from the project or [project sponsor] in the shadow of protracted litigation. As noted, some in the LIHTC industry have dubbed these firms "aggregators."[52]

47. *See* Rev. Rul. 79-300, 1979-2 C.B. 112.

48. *Id.*

49. *America's Affordable Housing Crisis: Challenges and Solutions: Hearing 115-288 on S. 548 Before the S. Comm. on Fin.*, 115th Cong. (2017), https://www.govinfo.gov/content/pkg/CHRG-115shrg30902/html/CHRG-115shrg30902.htm (statement of Grant Whitaker, President, National Council of State Housing Agencies).

50. *See* Beth Healy & Christine Willemsen, *Investors Mine for Profits in Affordable Housing; Leaving Thousands of Tenants at Risk*, WBUR (Apr. 29, 2021); *Local Officials and Congressional Leaders Decry Investors Who Put Affordable Housing At Risk*, WBUR (May 7, 2021) [hereinafter collectively, NPR Articles].

51. NPR Articles, *supra* note 50.

52. Wash. State Hous. Fin. Comm'n, Nonprofit Transfer Disputes in the Low Income Housing Tax Credit Program: An Emerging Threat to Affordable Housing 1, 5 (Sept. 2019), https://www.novoco.com/sites/default/files/atoms/files/washington_nonprofit_lihtc_housing_report_091919.pdf [hereinafter WSHFC Comm'n Report]; *see also* NPR Articles, *supra* note 50; Brandon Duong, *Losing Non-profit Control of Tax Credit*

The Aggregator's Playbook utilizes "burdensome tactics that take advantage of legal ambiguities, resource disparities, and economies of scale" to push "unsupported positions" that wring economic benefits out of the LIHTC owner entity not provided for by the parties' contracts.[53] The intended impact of an Aggregator's litigiousness is to force project sponsors to succumb to unreasonable demands.

### *A. A Signature Purchase Option Case*, CED Capital Holdings 2000 EB, L.L.C. v. CTCW Berkshire Club, L.L.C.

In *CED Capital Holdings 2000 EB, L.L.C. v. CTCW Berkshire Club, L.L.C.*, for example, such posturing backfired in an emblematic case, after a court trial in which a Florida state court awarded over $1.2 million, plus on-going *per diem* damages, in favor of the developer general partner (CED) against the limited partner (CTCW), who was then owned and controlled by an organization (Hunt Capital Partners) that was not the original tax credit investor.[54] The LIHTC partnership had been formed in 2001 for the purpose of developing, owning, and operating a 288-unit affordable housing apartment complex, wherein CED served as the general partner without issue for over fifteen years.[55] In 2002, the LIHTC property was developed after the original tax credit investor limited partner purchased the right to benefit from, *inter alia*, "99.99% of all of the tax credits awarded for the Project, as well as other tax benefits over [the Compliance Period]" in exchange" for $11.5 million in capital.[56] "For its part, CED, as General Partner, held complete discretion and control over the operations of the Partnership"—*i.e.*, it was responsible for the day-to-day operations of the LIHTC partnership and property.[57] In exchange, CED negotiated to receive the vast majority of surplus cash flow and any proceeds from a sale or refinancing of the LIHTC property and, importantly, "a contractual purchase option" granting it

> the right to purchase the Limited Partner's interest in the Partnership . . . at the end of the Compliance Period. The price to be paid under the Purchase

*Housing?*, Shelterforce (Oct. 16, 2020); Peter J. Reilly, *After The Low Income Housing Tax Credits Are Done Investors Want More*, Forbes (Jan. 13, 2021); Peter J. Reilly, *Low Income Housing Tax Credit—Aggregators Fight Sponsors in Year 15*, Forbes (Feb. 16, 2021). https://www.forbes.com/sites/peterjreilly/2021/02/16/low-income-housing-tax-creditaggregators-fight-sponsors-in-year-15/?sh=59cb707f1dd5.

53. WSHFC Comm'n Report, *supra* note 52, at 1, 5–6.

54. CED Capital Holdings 2000 EB, L.L.C. v. CTCW Berkshire Club, L.L.C., No. 2018-CA-013886-O, 2020 WL 6537072, at *5–6, 10 (Fla. Cir. Ct. Nov. 3, 2020), *affirmed per curiam*, No. 5D20-2531, 2021 WL 5142108 (Fla. Dist. Ct. App. 5th Dist. Nov. 5, 2021). The authors of this article are part of the law firm that is representing a party to this lawsuit.

55. *Id.* at *1–2.

56. *Id.* at *2.

57. *Id.*

Option was to be determined by conducting a hypothetical sale of the Project for fair market value as determined by an agreed upon appraisal process.[58]

CED effectively and reliably carried out its responsibilities as general partner without issue throughout the ten years during which "[a]ll tax credits awarded to the Project vested" and through to the end of the Compliance period when those tax credits ceased to be subject to recapture in 2017—in total, "nearly $14 million in tax credits were awarded to the Partnership, and . . . were allocated to the benefit of the Limited Partner as intended."[59]

However, in 2006, "after the original limited partner tax credit investor had exited the Partnership by selling its interests, CTCW acquired the limited partnership interest in the Partnership and was admitted as Limited Partner" despite having "never [been] involved in the original transaction establishing the Partnership or the construction of the Project, and contributed no capital to the Project."[60] Then, in 2018, the Aggregator's Playbook began to unfold, at which time Morrison Grove Management, who had "directed CTCW's limited partner interests in the [LIHTC partnership at issue] until October 4, 2018," was acquired by "Hunt Capital Partners (Hunt) . . . and [Hunt] began its control and direction of CTCW's limited partner interests . . . ."[61] This sequence signified the beginning of the end of a once beneficial relationship between general and investor limited partners.

First, as CED's manager testified, when discussing CED's impending purchase option with a CTCW representative in 2017, the unrebutted court trial testimony demonstrated that the entity now controlling the tax credit investor "intended to use the upcoming maturities of [a loan taken to finance the construction of the LIHTC property and an affiliate partnership's] indebtedness to leverage a higher buyout price in negotiations with [CED]."[62] Even at this time, however, CTCW's option price estimates did not include consideration for its "capital account balance and did not assume a liquidation of the Partnership."[63] But, as per the Aggregator's Playbook, "CTCW changed [its] position," reversing this course by "advanc[ing] an interpretation of the Partnership Agreement that gave credit for Defendant's capital account balance, and assumed a liquidation of the Partnership, in order to achieve a higher purchase price under the Purchase Option . . . ."[64] The court found this "to be inconsistent with and in violation of the Partnership Agreement."[65]

58. *Id.*
59. *Id.*
60. *Id.*
61. *Id.* at *3.
62. *Id.*
63. *Id.*
64. *Id.*
65. *Id.*

This scheme is a common Aggregator tactic—despite that the Housing Credits and other tax benefits have been dutifully secured by the general partner or other project sponsor, *and* notwithstanding the beneficial return that tax credit investors *have already received*, Aggregators attempt to recapture some part of the original tax credit investment (*i.e.*, the limited partner's positive capital account balance (if such exists)). Additionally, similar "bewildering and incorrect argument[s]" have been advanced in other cases designed to grossly inflate the price that a project sponsor must pay to exit a tax credit investor at the end of the Compliance Period.[66]

This strategy is not the entire Aggregator's Playbook, however, as disruptions to needed refinance opportunities often arise and are then used as "leverage" against the general partner. For instance, in *CED Capital Holdings*, CTCW, as controlled by Hunt, refused to consent to the "Permanent Loan" being refinanced, despite an approaching balloon payment (where such refinance would have secured a more-favorable 3.3% interest rate compared to the status-quo 6.51% interest rate).[67] This refusal occurred just months before CED's option was set to ripen.[68] CTCW even withheld consent to a holdover extension loan with a 4.75% interest rate meant to give the parties time to iron out the details of the Permanent Loan refinancing.[69] This behavior—which the court ultimately found an "unreasonable refusal to consent" and caused CED to experience lost opportunity damages[70]—is not anomalous. The Aggregator's Playbook often corners general partners into initiating litigation to avoid defaulting on partnership loans due to unreasonably withheld limited partner consent, and to avoid claims that general partners have been removed from LIHTC partnerships for failing to refinance such loans before they mature and go into default.[71, 72]

66. Wesley Hous. Dev. Corp. of N. Va. v. SunAmerica Hous. Fund 1171, No. 1:21-CV-1011, 2021 WL 6061890, at *5 (E.D. Va. Dec. 22, 2021) (relating to a failed attempt to remove a state court case to federal court). The authors of this article are part of the law firm that is representing a party to this lawsuit.

67. *CED Capital Holdings*, 2020 WL 6537072 at *4–5.

68. *Id.*

69. *Id.*

70. *Id.* at *5, *11.

71. *See, e.g.*, Cottages of Stewartville L.P. v. Am. Tax Credit Corp. Fund, LP, No. 55-CV-14-5113 (Minn. Dist. Ct. Dec. 22, 2016) (unreasonable and in violation of duty of good faith and fair dealing to withhold consent to a refinance proposal in order to secure or leverage benefits not otherwise entitled to receive under partnership agreement). The primary author of this article was part of the law firm that represented a party to this lawsuit.

72. Pelican Rapids Leased Hous. Assocs. I, LLC v. Broadway/Pelican Rapids, L.P., No. 56-CV-16-372 (Minn. Dist. Ct. Aug. 29, 2016) (vacated upon stipulation) (unreasonable to withhold consent for refinance to leverage benefits not intended under the operative LIHTC agreements). The primary author of this article was part of the law firm that represented a party to this lawsuit.

Another Aggregator tactic seeks to remove the project sponsor completely, which would allow for either the LIHTC owner entity's dissolution and the LIHTC property to be sold, or an affiliate to be inserted as the LIHTC owner entity's general partner or managing member, thereby effectively facilitating the Aggregator's complete control of the LIHTC owner entity. This plan was also attempted in *CED Capital Holdings*, where aggressive efforts were pursued to remove CED after its purchase option had matured.[73] The court characterized CED's conundrum and Hunt's motivations succinctly:

> CTCW's intentions were clear: force CED into a Hobson's Choice. On the one hand, CED could choose to let the Permanent Loan mature and then receive notice from CTCW that it was removing CED as general partner because it allowed the Partnership to default on the Permanent Loan. Or, on the other hand, CED could facilitate an assumption of the debt to stave off a default, but then receive a notice (like it did) from CTCW that CED was being removed from the Partnership for not receiving CTCW's consent for the assumption of the debt.[74]

Faced with this catch-22, CED was able to arrange for its parent entity to assume the Permanent Loan and avoid a default.[75]

Ultimately, the court found such "motivations were in bad faith and in direct conflict with the [original investor's] financial expectations and entitlements" regarding the "negotiated residual value upon its exit from the Partnership," and concluded:

> [T]his type of activity has become more common in the LIHTC industry and 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.[76]

### B. *Other Examples of the Larger Trend*

The Aggregator's Playbook utilized in *CED Capital Holdings* is not unique, as recognized by the district court, but is symbolic of the larger trend affecting participants in the LIHTC industry across the country where myriad tactics are employed. For example, general partners have fought off meritless arguments that the price they must pay to exercise their option is based upon the liquidation of the entire LIHTC partnership.[77] Similar attempts to manipulate option prices have been rejected at the summary judgment

73. *Id.* at *6. CTCW subsequently sought a declaratory judgment, later rejected, that CED was removed by function of this letter.

74. *Id.* at *5.

75. *Id.* at *6.

76. *Id.* at *5, *10.

77. *See, e.g.*, Centerline/Fleet Hous. P'ship, L.P.—Series B v. Hopkins Ct. Apartments, L.L.C., No. 812426/2016, 2020 WL 201150, *1 (N.Y. Sup. Ct. 2020) (noting that option price

stage where a new limited partner argued that a sale preparation fee credit that would be owed to the general partners in a hypothetical sale should not be considered in calculating option purchase prices. [78] In general, the LIHTC space is rife with litigation surrounding options, option prices, and appraisals related to setting option prices near Year-15.[79, 80, 81]

Removal attempts, like in *CED Capital Holdings*, are not unique either. In *Hidden Hills Mgt., LLC v. Amtax Holdings, 114, LLC*, for example, newly-controlled limited partners in a LIHTC partnership sought to remove the general partners based on an alleged failure to provide a *single* years' audited financial statements on time.[82] This was the "first time" that the managing general partner's principal—who was characterized as a "credible witness" that "ha[d] worked as a general partner with a number of limited partners during her 23 years in the LIHTC industry"—had "a limited partner [attempt] her removal as general partner or accused her of breaching any contract or duty to the partnership or limited partner."[83] In fact, she had "a good working relationship with the pre-Alden Torch managers of [the limited partner's] interests in the partnerships . . . ."[84]

Yet things changed when Alden Torch, who "was not involved in the original structuring or financings of the[] projects[,]" was able to "purchase[] the right to manage the interests of the [limited partners] . . . in the secondary market in 2011 . . . ."[85] Following this change of hands, the

is based upon a hypothetical sale), *aff'd*, 151 N.Y.S.3d 272 (App. Div. 2021) (slip op.). The authors of this article are part of the law firm that is representing a party to this lawsuit.

78. *See* Urb. 8 Fox Lake Corp. v. Nationwide Affordable Hous. Fund 4, LLC, 431 F. Supp. 3d 995, (N.D. Ill. 2020). The authors of this article are part of the law firm that is representing a party to this lawsuit.

79. *See, e.g.*, Downtown Action to Save Hous. v. Midland Corp. Tax Credit XIV, LP, No. C18-0138-JCC, 2019 WL 934887 (W.D. Wash. Feb. 26, 2019) (summary judgment allowing the nonprofit general partner to purchase the new limited partner's interests under an option agreement). The primary author of this article was part of the law firm that represented a party to this lawsuit.

80. Arch Apartment Mgmt., L.L.C. v. AMTAX Holdings 224, LLC, No. A19-0421, 2019 WL 4745331 (Minn. Ct. App. 2019) (affirming district court's determination of an option purchase price and rejection of new investor member's efforts to inflate price by more than $1 million). The primary author of this article was part of the law firm that represented a party to this lawsuit.

81. *See also* Judgment Transcript at 45:7-46:23, 54:15-18, Centennial Partners, L.L.C. v. O.R.C. Tax Credit Fund 10, L.L.C., No. 17-cv-006214 (Wis. Cir. Ct. Nov. 7, 2018) (No. 106) (noting option price not based on a capital transaction and thus could not consider capital accounts). The primary author of this article was part of the law firm that represented a party to this lawsuit.

82. Hidden Hills Mgt., LLC v. Amtax Holdings, 114, LLC, No. 3:17 CV-06047-RBL, 2019 WL 3297251, at *4 (W.D. Wash. 2019), *aff'd,* No. 19-35861, 2021 WL 1116269 (9th Cir. Mar. 24, 2021).

83. *Id.* at *2.

84. *Id.*

85. *Id.* at *1.

goal became transparent, and "[t]he record contains multiple examples of [limited partners'] efforts to force the GP to sell the Hidden Hills property on the market prior to [limited partners' purported removal of the GP."[86] The district court concluded that when those efforts failed and the limited partners sought removal for what amounted to a "foot fault," the obvious goal was "to defeat the option" held by the managing general partner to purchase the limited partners' interests in the partnership.[87] Although the district court rejected the attempted removal as "'a bridge too far[,]'" finding instead that "it was [the limited partners'] actions that caused [the auditor]'s disengagement prior to the completion of the audit[,]" it took extensive litigation and a costly trial to preserve option rights held by the managing general partner, who had steadfastly worked toward realizing this back-end equity for over seventeen years.[88]

Even where general partners commit technical defaults, the Aggregator Playbook does not allow for amelioration or opportunity to cure. In another case near the Year 15 mark when the general partners' options were set to ripen, limited partners again sought the extreme remedy of removal.[89] Removal was based on (1) loans the general partners made to affiliates and (2) out-of-order cash flow distributions.[90] The general partners maintained (1) that the affiliate loans were transparent, since they "ha[d] always been fully disclosed and paid down," and (2) any improper distributions they made lacked nefarious or malintent, and were cured through corrective payments the limited partners accepted into a trust account.[91] The general partners also argued that their "removal after fifteen years of generating tax benefits for the Limited Partners would result in a windfall to the Limited Partners and a forfeiture by the General Partner[s] of over $2 million in equity" despite that the defaults amounted to less than 1% of the cumulative benefits delivered to the limited partners.[92] Given the potential inequitable forfeiture the district court found issues of fact precluded summary judgment, setting up trial to resolve whether the technical defaults were material or intentional, as required by the respective governing agreements.[93]

The Aggregator Playbook also results in unnecessary and sanctionable discovery disputes, as in *Urban 8 Fox Lake Corp., et. al v. Nationwide*

86. *Id.* at *3.

87. *Id.* at *14, *16 (noting that the "decision to seek removal in these circumstances was an effort to make performance of the option impossible, contrary to the [limited partnership agreements] and Washington law").

88. *Id.* at *13–14, *18, *20–22 (quoting the trial court).

89. Creative Choice Homes XXX, LLC v. Amtax Holdings 690, LLC, No. 8:19-CV-1903-TPB-AAS, 2021 WL 5178493 (M.D. Fla. 2021). The authors of this article are part of the law firm that is representing a party to this lawsuit.

90. *Id.* at *1–2, *4.

91. *Id.*

92. *Id.* at *4–5.

93. *Id.*

*Affordable Housing Fund 4, LLC*, where the limited partner made "exaggerated and improper claims of attorney-client privilege" that were characterized as representative of problems that "continue to impermissibly affect discovery specifically and the adversarial process generally."[94] In *Urban 8 Fox Lake Corp.*, the limited partner was subject to sanctions for making "invalid claims of privilege" where certain "privilege chart[s], brief[s], and claims of privilege . . . were all made in bad faith."[95] "[D]efense counsel could not have possibly even bothered to review the documents they dumped on the court"—instead submitting the "the *in camera* inspection version of a brief written in gibberish."[96]

The examples above are an illustrative sample of the larger trend. Significantly more litigation is currently making its way across federal and state courts throughout the nation.

### C. *A Signature Section 42 ROFR Case,* Opa-Locka Community Development Corp., Inc. v. HK Aswan, LLC

A different, but similarly motivated affront to the LIHTC program's purpose pursued by Aggregators is occurring in various courts across the country with respect to the § 42 ROFR. Here, Aggregators have systemically engaged the judicial process in hopes of dismantling the § 42 ROFR to transform it into a meaningless, illusory right. The end result, where successful, strips affordable housing communities of their built-up equity and prevents nonprofit organizations from realizing the carefully constructed benefits that Congress designed expressly for them.[97] Aggregators advance this part of their business model by purveying arguments that, if adopted, would make the § 42 ROFR practically impossible to trigger.

Indeed, part of the logic set forth by Aggregators in many cases imposes a catch-22 upon § 42 ROFRs, wherein, as they argue, project sponsors must somehow *genuinely* intend to sell the LIHTC property *to an unrelated third-party* and that third-party must make a *bona fide* binding offer before the § 42 ROFR is triggered. In the prototypical, common law meet-and-match ROFR scenario, this is inconsequential, but, for § 42 ROFRs, which are altogether different, a third-party purchase offeror willing to expend the time, effort, and money to craft a qualifying offer knowing that a

94. Urb. 8 Fox Lake Corp., v. Nationwide Affordable Hous. Fund 4, LLC, 334 F.R.D. 149, 155 (N.D. Ill. 2020).

95. *Id.* at 164–65.

96. *Id.* at 165 (citing McCurry v. Kenco Logistics Servs., LLC, 942 F.3d 783, 792 (7th Cir. 2019) ("Bad writing does not normally warrant sanctions, but we draw the line at gibberish.")).

97. *See* WSHFC Comm'n Report, *supra* note 52, at 4 ("For decades, the widespread expectation and practice has been that the non-profit partners will secure ownership of LIHTC projects as a matter of course after the 15-year compliance period . . . "); *see also* NPR Articles.

well-below-market-value fixed-price ROFR is waiting to spring is highly unlikely to materialize.[98]

The campaign against the § 42 ROFR is exemplified by *Opa-Locka Community Development Corp., Inc. v. HK Aswan, LLC.*[99] In *Opa-Locka*, a nonprofit (OLCDC) "whose mission is to transform under-resourced Florida communities into desirable, engaged neighborhoods by improving access to, among other things, affordable housing," collaborated with Banc of America Community Development Corporation (BACDC) to acquire, develop, and operate an affordable housing development under the LIHTC program by creating a "Company" to do so.[100] After the Housing Credits were secured as part of the ten percent set-aside amendment to the LIHTC program, in 2003 OLCDC and BACDC restructured the Company to admit Banc of America Housing Fund (BOA) as tax credit investor, and Aswan Development Associates, LLC (ADA) as the Class A Member, while OLCDC and BACDC withdrew from the Company.[101] An operating agreement was also created to ensure that the Company and the property (Aswan Village) would be operated in compliance with the LIHTC program to "'[p]rovide quality affordable housing and combat further community deterioration.'"[102]

OLCDC also "bargained for, and the Company agreed to" a § 42 ROFR that matured at the end of the Compliance Period.[103] The operating agreement obligated the Company "not [to] sell the Project [Aswan Village] or any portion thereof to any Person without first offering the Project for a period of forty-five (45) days to [OLCDC] . . . at a price (the "Buyout Price") [set forth in Section 42(i)(7) of the Code]"—*i.e.*, the debt-plus-taxes or $1 ROFR.[104] "In 2014, after the Credit Period was over and BOA had received all of its bargained-for tax credits," Hallkeen Management, Inc. (HKM) purchased, through an affiliate (HKA), BOA's tax credit investor position and "acquired all of BACDC's ownership interests in ADA for between

98. *See* Homeowner's Rehab, Inc. v. Related Corp. V SLP, 99 N.E.3d 744, 748–50 (Mass. 2018) (affirming district court's rejection of an effort to prevent nonprofit purchase of project pursuant to a § 42 ROFR).

99. Opa-Locka Cmty. Dev. Corp., Inc. v. HK Aswan, LLC, 2020 WL 4381624 (Fla. Cir. Ct. July 7, 2020), *aff'd per curiam*, No. 3D20-1651, 2021 WL 4190914 (Fla. Dist. Ct. App. 3d Dist. Sept. 15, 2021) (affirming summary judgment disposition). The authors of this article are part of the law firm that is representing a party to this lawsuit.

100. *Id.* at *1.

101. *Id.* at *1, *3 (noting that "the obtainment of [the Housing Credits] is highly competitive—for projects developed and operated in conjunction with a qualified nonprofit organization, such as OLCDC," required by the 10% set-aside amendment to the LIHTC program).

102. *Id.* at *1 (citing operating agreement).

103. *Id.* at *2.

104. *Id.* (noting that the § 42 ROFR also required OLCDC, if it exercised the ROFR, to maintain Aswan Village as low-income property for an Extended Use Period, that is, at least another fifteen years after the Compliance Period).

$250,000– $400,000."[105] After HKA became "51% owner and the Company's Manager," HKM, through HKA, "caused ADA to redeem all of BOA's interests in the Company, leaving ADA as the sole member of the Company and HKA as the controlling member of ADA and the Company."[106] After this consolidation, HKM became the Company's Management Agent and "sought to eliminate the ROFR, but OLCDC refused."[107] The new operating agreement (Agreement) changed the ROFR language: "OLCDC shall have the right to direct [HKA] to cause [the Company] to put [Aswan Village] on the market for sale," and "[i]f, after having directed [HKA] to cause [the Company] to put the Project on the market for sale, OLCDC elects to exercise its right of first refusal, then OLCDC agrees that . . . OLCDC shall purchase all of the Interests owned by HKA in ADA . . . ."[108] Even after this change, however, the court found that HKM held "no real equity in the Company and Aswan Village because of the ROFR," and there was "no value except through operating cash flow."[109] This is the typical arrangement and the purposeful result of the § 42 ROFR.[110] As the court succinctly described, OLCDC's "ROFR [was] consistent with the policy goals and objections of Section 42 and the LIHTC program in general."[111]

A precipitous turning point came in October 2018, however, when, after a news article was published "regarding Miami's drinking water," HKM and HKA "unilaterally commenced discussions regarding the sale of Aswan Village, engaged brokers to obtain broker opinions of value for Aswan Village, concluded that Aswan Village had substantial equity, and conducted potential disposition analyses regarding Aswan Village."[112] Despite knowing that the § 42 ROFR existed, HKM "engaged in a sequence of events to execute their [plan] . . . [to accomplish] the ultimate fee simple sale of, or transfer of ownership interests in, Aswan Village and two other Florida LIHTC properties . . . to a new ownership entity."[113] Before approaching OLCDC with this intent, "[HKM] had already begun soliciting proposals from third parties to [sell] the . . . properties . . . ."[114] In fact, HKM was set to make a final decision before informing OLCDC "of what the deal is", but "did *not* understand OLCDC to have decided to buyout HKA's interests under the [§ 42 ROFR] . . . ."[115]

105. *Id.*
106. *Id.*
107. *Id.*
108. *Id.* (alterations in original).
109. *Id.*
110. *Id.*
111. *Id.*
112. *Id.* at *3.
113. *Id.*
114. *Id.* at *4.
115. *Id.* (emphasis in original).

In April 2019, HKM received a solicited and negotiated letter of intent (LOI) from a third-party purchaser with "the pricing c[oming] in a bit better than . . . expected with . . . $21,000,000 for Aswan [Village]."[116] OLCDC was then informed of the LOI as "Defendants [(*i.e.*, HKM)] sent for partner approval"—again, *after* the LOI was negotiated and executed.[117] HKM continued, without consent, to forge ahead, drafting a purchase and sale agreement and developing sales projections.[118] In May 2019, OLCDC provided its "partner approval" subject to the "exercise if [its] ROFR, thus providing full ADA member approval of the sale but preserving and exercising OLCDC's § 42 ROFR. OLCDC made it clear that it did not intend to terminate or waive its right of first refusal" and, in fact, exercised it.[119] However, as per the Aggregator's Playbook, "Defendants [(*i.e.*, HKM)] refused to permit OLCDC to exercise its ROFR and/or close on the sale of Aswan Village pursuant to [the] resulting option contract that arose when OLCDC exercised its ROFR."[120] OLCDC was then forced to initiate a lawsuit to protect its rights.

HKM's central argument, as mirrored in many § 42 ROFR cases in which Aggregators attempt to thwart nonprofits from exercising their § 42 ROFRs, was that because the LOI was not a binding "offer" and "because no sale was ever scheduled to occur . . . [HKM] was not obligated to offer the Property to OLCDC for purchase because the ROFR was not triggered and remains unripe."[121] Specifically, HKM argued (1) that the LOI "[could not] constitute an 'offer' capable of 'acceptance' and, therefore, [could not] trigger OLCDC's [§ 42 ROFR]," and (2) that HKM's express willingness to accept a binding offer was required before the § 42 ROFR could be exercised.[122] OLCDC, conversely, argued that its § 42 ROFR was triggered "the moment [HKM] manifested an intention to sell Aswan Village," which occurred during the LOI process.[123]

The court resoundingly rejected HKM's arguments and incorporated "the explicit references to Section 42 [made] throughout the ROFR" and operating agreement into its consideration of the parties' intent in including the § 42 ROFR in their deal.[124] Finding HKM's "position unpersuasive," the court explained:

116. *Id.* at *5.
117. *Id.*
118. *Id.*
119. *Id.*
120. *Id.* at *6.
121. *Id.*
122. *Id.*
123. *Id.* at *7.
124. *Id.* ("Defendants would have this Court not only read the ROFR isolated from the remainder of the parties' Amended Operating Agreement . . ., but would have this Court ignore the replete references to Section 42 weaved into the ROFR itself.").

> The explicit references to Section 42, throughout the ROFR and the Amended Operating Agreement, commands that Section 42 is directly incorporated into and is just as much a part of the plain language of those contracts as the other express words appearing therein. In addition to the text of the ROFR explicitly referencing Section 42, the ripening of OLCDC's "right of first refusal" is tied to the end of the Section 42 "Compliance Period"; the contractual "Buyout Price" is defined, not in accordance with price first offered by a third party, but in accordance with 26 U.S.C. § 42(i)(7) [the § 42 ROFR price]; and the exercise of "such right of first refusal" is conditioned only upon OLCDC's agreement to continue to use the Project as affordable housing for no less than the Extended Use Period as defined by Section 42. Therefore, it is the finding of this Court that the proper "context" in which to interpret a right of first refusal granted in accordance with Section 42 is, "as reflected in the language of the agreements," Section 42. *See Homeowner's Rehab*], *Inc. v. Related Corp. V SLP, L.P.*, 479 Mass. 741, 760, 99 N.E.3d 744, 760 (Mass. Sup. Jud. Ct. 2018)].[125]

Put simply, the court found that OLCDC's § 42 ROFR was triggered when HKM engaged in a negotiation process to sell Aswan Village to a potential third-party purchaser, going so far as to accept and execute the LOI without informing OLCDC.[126] This plan furnished the requisite intent to sell.[127]

The implantation of the Aggregator's Playbook unfolding in the § 42 ROFR space, illustrated by *Opa-Locka*, attempts to "impose a third-party 'offer' requirement onto the ROFR" despite that this requirement arises only in the prototypical "*meet-and-match ROFR*," wherein a ROFR is triggered by the requisite intent to sell for a price determined by a third-party's offer.[128] But in *Opa-Locka*, the court rejected this argument, noting that HKM "erroneously overlook[ed] the Florida Supreme Court's subsequent clarification . . . that rights of first refusal vary in form" and "are not the same as rights of first refusal that . . . proscribe the owner's ability to sell the property without first offering the property at a fixed price (a '*fixed-price ROFR*')."[129] Thus, the court made the important distinction between typical common law ROFRs (the meet-and-match ROFR) and § 42 ROFRs (the fixed-price ROFR), describing the "transposi[tion] of this meet-and-match, third-party 'offer' requirement onto a fixed-price ROFR, like OLCDC's ROFR" as "nonsensical" that "would serve absolutely no purpose because a fixed-price ROFR supplies its own definite terms of sale (here, debt plus taxes)."[130] The court similarly noted that "common law across the

125. *Id.* at *8 (internal citation omitted).

126. *Id.*

127. *Id.*

128. *Id.* at *10 (emphasis in original) (citing Old Port Cove Holdings, Inc. v. Old Port Cove Condo. Ass'n One, Inc., 986 So. 2d 1279, 1281, 1285 (Fla. 2008)).

129. *Id.* (internal quotations omitted; emphasis in original) (citing *Old Port Cove Holdings Inc.*, 986 So. 2d at 1285).

130. *Id.*

nation . . . [u]niversally . . . recognizes that the defining characteristic of the [ROFR] is that its binding effect turns on whether the offeror *decides to sell*."[131] Accordingly, the court preserved the integrity of Aswan Village as continuing affordable housing for low-income residents and OLCDC's § 42 ROFR interest in the LIHTC property.[132]

And, finally, as concerns these efforts by Aggregators to shoehorn the § 42 ROFR into the traditional common law right of first refusal analysis, two federal district courts and one circuit court have recently confirmed that the triggering mechanisms of a § 42 ROFR are contractual in nature, subject to negotiation by private parties, governed by state law and bedrock contract interpretation principles, and must merely satisfy three congressional requirements that are not significant enough to justify federal question jurisdiction where disputes arise regarding the interpretation and enforcement thereof.[133]

## III. Solutions to the Aggregator Problem

In the authors' view, the LIHTC program has historically operated successfully and remains a critical tool to the creation and preservation of affordable housing in the United States: its continuation is of vital necessity. But regulatory and legislative paths need to be explored and implemented to ensure the sustained viability of the program, protect the important role played by general partners and project sponsors (both nonprofit and for-profit organizations) at the heart of these LIHTC partnerships, and mitigate the harmful impact of Aggregators and those like them.

131. *Id.* at *11 (internal quotations omitted; emphasis added) (collecting authorities).

132. While many courts see the complete picture and interpret the governing agreements as intended and according to their plain and unambiguous meaning, it has not been universal. *See* SunAmerica Hous. Fund 1050 v. Pathway of Pontiac, 19-11783, 2021 WL 391420, at *5–6 (E.D. Mich. Feb. 4, 2021) (rejecting that § 42 ROFR was validly triggered). (The authors of this article are part of the law firm representing a party to this lawsuit on appeal); Senior Hous. Assistance Grp. v. AMTAX Holdings 260, LLC, No. C17-1115-RSM, 2019 WL 1417299, at *9–11 (W.D. Wash. Mar. 29, 2019) (imposing a *bona fide* enforceable offer requirement in order to trigger a § 42 ROFR under Washington ROFR common law).

133. *See* Wesley Hous. Dev. Corp. of N. Va. v. SunAmerica Hous. Fund 1171, No. 1:21-CV-1011, 2021 WL 6061890, at *4, *6 (E.D. Va. Dec. 22, 2021) ("[T]he present case is a contract dispute, not a tax case," wherein state law principles of contract interpretation apply. The court found that "this state law contract dispute is properly litigated in state court."); Tenants' Dev. Corp. v. AMTAX Holdings 227, LLC, No. CV 20-10902-LTS, 2020 WL 7646934, at *4 (D. Mass. Dec. 23, 2020) ("[T]he Agreement's interpretation is squarely a matter of state contract law."), *aff'd sub nom.* AMTAX Holdings 227, LLC v. Tenants' Dev. II Corp., 15 F.4th 551, 557 (1st Cir. 2021) ("The notion that section 42(i)(7) independently voids noncompliant agreements rather than simply making a party or a project ineligible for certain tax benefits borders on the specious and seems too thin a reed to support federal jurisdiction.").

### *A. Congressional Efforts*

One way to curtail Aggregators and those employing their playbook is through federal amendments to the LIHTC program. In fact, legislation has already been introduced to the House Ways and Means Committee, as recently as September 2021, to make important changes to the LIHTC program and protect nonprofit ROFRs.[134] The proposed changes would, *inter alia*, convert the § 42 ROFR safe harbor into a purchase option without requiring the approval of the tax credit investor, a *bona fide* third-party offer, or the LIHTC partnership's genuine intent to sell, although the provision would not retroactively apply to existing agreements.[135] This legislative change would also clarify that the revised ROFR includes the acquisition of partnership interests related to the property, as well as assets held for the development, operation, or maintenance of the property.[136] However, these changes, although essential to fixing a glaring problem, are subject to two, primary obstacles—political will and substantial investments by Aggregators employing lobbyists to resist such amendments. This legislation is currently attached to the hotly debated Build Back Better reconciliation bill that has stalled in Congress.

### *B. State Agencies Thinking Ahead*

Similarly, state housing authorities overseeing local implementation of the LIHTC program have begun to take action to counteract the predatory actions of these firms.[137] Even here though, Aggregators will try to prevent

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134. H.R. 5376, 117th Cong. (Nov. 3, 2021) (to provide for reconciliation pursuant to title II of S. Con. Res. 14, Sec. 135105. *Modification and Clarification of Rights Relating to Building Purchase*).

135. *Id.*

136. *Id.*

137. *See* Wash. State Hous. Fin. Comm'n, Tax Credit Compliance Procedures Manual, ch. 9 Property Transfers 9-3 to 9-4 (Dec. 2019), https://www.wshfc.org/managers/ManualTaxCredit/110_Chap09PropertyTransfers.pdf (stating that the "Commission will consent to a proposed Property Transfer . . . only if it is determined that: . . . For [a] limited partner . . . the Transferee has not had a claim filed against it in litigation in any jurisdiction concerning a sponsor's, partner's, or member's ownership interest in a low Income Housing Tax Credit project after the initial term of the partnership (Year 15 Exit)"); Mass. Dep't of Hous. & Cmty. Dev., Notice of Funding Availability: March/April 2021 (indicating that, to obtain a Housing Credit allocation, the "investor cannot have been involved in any 'aggregator' activity, in Massachusetts or in other states"); City of New York, Dep't of Hous. Pres. & Dev., Low Income Housing Tax Credit Qualified Allocation Plan 19–20 (Sept. 2021) (noting that nonprofit applicants "must submit a letter of intent from a tax credit investor that clearly grants" a ROFR and that "the operation or partnership agreement . . . will . . . provide that the general partner may elect to do any of" three options that protect the nonprofit from having its ROFR "unreasonably withheld, conditioned or delayed," where the tax credit investor's consent is required, or that bypass the tax credit investor's consent altogether); Va. Hous. Dev. Auth., The Plan of the Virginia Housing Development Authority for the Allocation of Low-Income Housing Tax Credits 10 (2022) (noting that "the executive director is hereby authorized to require

any attempt to stymie their business practices. For example, in November 2020, Alden Torch Financial, which has been the subject of several investigative reports,[138] caused a lawsuit to be filed against the WSHFC, along with its volunteer board members, to stop the state agency's attempts to protect affordable housing in Washington.[139] The WSHFC characterized Aggregators as entities who "threaten[] the long-term viability of LIHTC projects" by "us[ing] tactics—often involving litigation with the [project] sponsor—that the Commission claims are calculated to acquire control of the partnership. This activity culminates in enabling the investor to sell the property on the open market at a substantial profit" and "threatens to undermin[e] the intended functioning and goals of the LIHTC program."[140] The Complaint was properly dismissed, but an appeal is nonetheless underway.[141]

## Conclusion

In sum, some market forces are undermining the LIHTC program's purpose to create and maintain affordable housing for low-income residents in communities throughout the nation. These Aggregators, and those adopting their playbook, seek to take advantage of the LIHTC program's complexity by assuming ownership or control of LIHTC partnerships or other interests in LIHTC property *after* the Housing Credits and other tax benefits part and parcel of the LIHTC program have been secured. Aggregators engage secondary markets where these interests are sold as commodities, often in bulk, similar to derivative investments. Despite that the benefit of the tax credit investor's original bargain has already been reliably delivered, these Aggregators enter the frame toward the end of the Compliance Period and nevertheless implement schemes meant to extricate, purely for themselves, further financial windfalls that are not in line with the LIHTC program's goals or the intent of the original parties. The effect can be costly and catastrophic for those who have worked diligently, often for more than fifteen years, to create, develop, and operate these affordable housing communities. Despite that Aggregators have deep pockets and are willing to leverage litigation in pursuit of securing these unwarranted cash boons, it is up to practitioners, courts, and regulators to preserve the integrity of the LIHTC program.

. . . limiting transfers of partnership or member interests or other actions detrimental to the continued provision of affordable housing . . . . A designated form of [ROFR] . . . . Debarment from the program of principals having demonstrated a history of conduct detrimental to long-term compliance with extended use agreements [in any state] . . . .").

138. *See* NPR Articles, *supra* note 50.

139. *See* AMTAX Holdings 260, LLC., v. Wash. State Hous. Fin. Comm'n, No. 2:20-cv-1698, 2021 WL 3738987 at *1 (W.D. Wash. 2021) (noting that "AMTAX [affiliates in Washington state] . . . are investor/limited partners in LIHTC partnerships operating housing projects . . . and have been involved in litigation over control of those LIHTC partnerships in this state") (citing cases).

140. *Id.*

141. *Id. at* *1–2.

# LIHTC Year 15 Solutions: The Role of State Housing Finance Agencies

*Moha Thakur & Cynthia Bast**

On October 14 and 15, 2021, the Forum hosted a Deep Dive on Preservation of Affordable Housing. The full series of panels from the Deep Dive is available for purchase and continuing legal education credit on the American Bar Association's website. Here, we print an edited excerpt of one of the panels, which addressed the role of state housing finance agencies in developing policies and transactions around issues that sometimes arise in Year 15 of LIHTC transactions. The panel was moderated by Mark Shelburne of Novogradac Consulting LLP, and featured presentations by Moha Thakur of the National Housing Trust, Cynthia Bast of Locke Lord LLP, and Kerry LaBotz of the New York City Department of Housing Preservation and Development. In her presentation, Ms. LaBotz described approaches taken by the New York City Department of Housing Preservation and Development in connection with Year 15 issues, including a provision in the Qualified Allocation Plan related to rights of first refusal, and strategies with respect to recapitalization. Excerpts from Ms. Thakur's and Ms. Batz's presentations follow.

**Moha Thakur:** I'll be kicking off our panel today with a bit of background information on the nonprofit right of first refusal, and talking about the National Housing Trust's current strategy around education, advocacy, and engagement with state housing finance agencies, . . . and the nonprofit right of first refusal as laid out in Section 42(i)(7) of the Internal Revenue Code. . . .

Now, one caveat I do want to make is that for most of the program's history, with both for-profit and nonprofit developers, we have seen that the limited-investor partner usually does exit the partnership at the end of the fifteen-year compliance period. This then allows the general partner to obtain full ownership and continue to maintain the affordable housing in line with their mission and with their goals. Recently, we've been seeing some troubling changes that are sweeping across the housing credit industry: outside capital buys up control of housing with the goal of extracting resources out of affordable housing properties after the end of that initial fifteen-year compliance period. This is a pretty rapidly growing phenomenon. . . . These major sources of outside capital have discovered what is essentially a commercial sector to exploit . . . hundreds of millions of dollars of profits, contrary to the original intention of Congress, and these outside firms have been named aggregators. . . .

We've seen these challenges to general partners' project transfer rights involving both nonprofit and for-profit general partners. So that includes, as

* Moha Thakur is the Public Policy Manager at the National Housing Trust in Washington, DC; Cynthia Bast is a Partner at Locke Lord LLP in Austin, TX.

I mentioned earlier, the nonprofit right of first refusal and then the for-profit purchase option. Most often on the nonprofit side, these aggregators have taken the position that Section 42(i)(7) is in fact a common law right of first refusal and that they are not required to recognize these rights established from the partnership agreement without a third-party bona fide offer. On the for-profit side, we're seeing limited partners take issue with and disputing the market valuations, demanding payoff, and insisting on allocation based on the liquidation of partnerships. Recognizing that most general partners, particularly nonprofits don't have the resources to litigate many of these issues in court, these private investors often leverage profitable cash payment, or the sale of the affordable housing property, in return for leaving the partnership. We believe this undermines the long-term viability of the affordable housing properties, sometimes leaving them at risk of exiting the affordable housing market outright. The use of these scarce funds, especially as a nonprofit—from general partners to private investors—is also contrary to the original intent of the Housing Credit program. Traditionally, investors have understood that their return is based on tax subsidies and limited cash flow, and not an expectation of residual value. But, of course, as we have seen, rising values of housing in certain markets has created opportunities for firms to reap profits beyond . . . original expectations.

These legal disputes definitely divert resources that otherwise would be devoted to residents' services, or even building maintenance and other related affordable housing initiatives. . . . Now I'll talk a little bit about our general stakeholder engagement. This has been done primarily at the state level or local level. It's been done through webinars like this, or forums; we've been asked to come and speak with smaller stakeholder groups, essentially, educating individuals, various parties who are involved in these issues. I think that was the biggest hurdle to cross, to provide education, and share this knowledge that we have around this issue. I was recently advised that there are now over forty-five cases that have passed through courts around the country related to these legal disputes around the nonprofit right of first refusal or the for-profit purchase options. So this is not a very small law or a minor issue that we're talking about anymore.

One important element of the stakeholder engagement and education that we found is the creation of statewide working groups that include nonprofit and for-profit developers, investors, syndicators, lawyers that all learn and work together to figure out how their state can react and engage and potentially combat this issue together and within the state itself. We've often supported our partners in recommending a number of policies to be implemented. In working with a small number of HFAs, we were approached by them to create an HFA working group. This is a changing group of about ten or fifteen housing finance agencies that we convene every quarter or so. And we found that this is a great place for these housing finance agencies to come and learn from each other. We've seen some really exciting policy discussions and ideas . . . coming out of this working group. The goal is to work on a fix [for] this issue at the national level; but we also need to understand that the language and policies and education at the state level are just as important on this issue in the meantime.

So the last thing I'll talk about in terms of our advocacy and engagement strategy is around the HFA toolkit. Through some trial and error, working with various stakeholders, the National Housing Trust has created a toolkit of policy and regulatory options for these state and local housing finance agencies or other Housing Credit allocating agencies to adopt to protect their affordable housing assets. This includes both future Housing Credit development by nonprofit developers, as well as existing Housing Credit properties in their states. These policies or regulatory language can be implemented in either a Qualified Allocation Plan [(QAP)], a request for proposals, or any sort of policy manual. I know a number of states have tax credit manuals, for example. In this toolkit, we outlined eight policy and regulatory options that we believe will help stem this growing trend, and ensure the long term affordability of Housing Credit properties. And many of the items in this toolkit, we've taken directly from our engagement and conversations with other states, what they may have already implemented . . . and really pushing the envelope on trying to manage and mitigate the disputes against the nonprofit [right of first refusal (ROFR)] and the for-profit purchase option with language and either their QAP or a tax credit manual, or sometimes both.

Finally, I will touch briefly on the federal legislative advocacy. This legislation would actually amend Section 42, where it refers to the nonprofit ROFR and would impact both future and current existing deals. For future deals, this would convert the nonprofit right of first refusal to a purchase option for agreements entered into after the passage of this bill and would change the nonprofit ROFR to be a simple purchase price and remove exit taxes. For current deals, this would allow for the inclusion of partnership assets related to the building in the definition of property, allowing the option holder to exercise a right of first refusal without requiring the approval of an investor or require a third-party bona fide offer. It also changes the purchase price to only debt and not debt plus exit taxes, and clarify that the right of first refusal can be exercised through purchasing partnership interests and the property. The change in statute would not change what has already been clarified and what has been made explicit in existing partnership agreements. But it would be trying to fill that gap between where there might be some ambiguity in some . . . partnership agreements that do exist.

**Cynthia Bast:** Why are we talking about Texas today? Texas was actually an early adopter of the right of first refusal; they used the ROFR in Section 42(i)(7) as an anticipated means of preservation, by awarding points in their 9% competitive process for any applicant that chose to provide the right of first refusal at the end of the compliance period. Since then, we are now in a position where the Texas ROFR rules and the process are honestly a pretty complex web, often requiring legal assistance to navigate. On top of that, Texas has also a robust policy for review of ownership transfers. In particular, they are looking at transfers of the property and fee simple, but they're also looking at transfers of general partner interests. And they have two basic priorities here in having such a robust review process. One is to make sure that they're not getting bad actors into the program and ownership so that the property will remain viable. The other, frankly, is monitoring for the ROFR and making sure that if there's going to be a change of ownership or control that it is done in conjunction with the ROFR rules. So let's take a little trip back in time, to the era of 1994, 1995. At that point in the QAP for the 9% competition, they offer points for an owner that was willing to offer a ninety-day right of first refusal to a qualified nonprofit organization or a tenant organization.

Interestingly, first of all, this was drafted more like an option than a right of first refusal. So it was really more of a right to buy than something that needed to be triggered by a third-party offer. Originally, their price was fair market value, but they quickly changed that to the Section 42(i)(7)(b) minimum purchase price. It's important to note that they've excluded governmental entities from a qualified purchaser under this ROFR. Section 42 obviously allows governmental entities to be purchasers, but Texas chose not to include them. The other thing that became important here is that Texas's ROFR did not really coordinate very well with ROFRs that might have been contractually established between a nonprofit sponsor and the investor. Theoretically, an outside nonprofit could potentially trump the sponsor nonprofit in the way this was established. After thinking about it for a while, the nonprofit advocates were concerned that a ninety-day ROFR would not provide them sufficient time to execute on the purchase. And they wanted to really make sure that these opportunities that they felt were provided to them in Section 42 would come to fruition. They went to our legislature, and the result of this was a two-year right of first refusal that was applicable at all times after the end of Year 15. If the owner wanted to sell the property, then in the first six months, it could only sell to a Community Housing Development Organization (CHDO). In the second six months, it could only sell to a qualified nonprofit organization or a tenant organization. In the last twelve months, it could only sell to any of those above plus the Texas Department of Housing and Community Affairs (TDHCA). Again, the language was drafted a bit more like an option than a ROFR. It established the ROFR price at that 42(i)(7)(b) minimum. Once again, governmental entities are excluded, other than TDHCA, which is an interesting exclusion given that, here in Texas, there are quite a few public housing authorities and other governmental agencies getting involved in the tax credit program to expand or renovate their portfolio.

The idea behind all of this at the time was a good idea, which was that CHDOs as community-based organizations would be the ones in the very best position to preserve and take care of these properties in their own communities in the future. One of the things that happened here after we got this law is that TDHCA was slow to adopt rules for how it would be administered. We knew what the law said, but we had no idea what the agency's role was going to be in implementing the law. Finally, when the rules were established, they created a system for an owner to submit a great deal of information about its property, and they would post that property for sale at the ROFR price on their website, almost like a qualified contract. The rule said that once the property was posted for the right of first refusal, if an offer was received from a qualified purchaser at the 42(i)(7)(b) price, then the owner either needed to sell at that price, or they couldn't sell to anybody else.

Another part of TDHCA interpretation was that the sale could only be to the qualifying nonprofit organization. So let's say you're in the first six months, and there's a CHDO that wants to buy. The CHDO can buy. But the CHDO can't create, for instance, a limited partnership in which it's the general partner. So that effectively prohibited resyndication and wound up being a preservation choice. But they also allow the owners to avoid this whole ROFR thing entirely, and not have to post and not have to wait for two years if they would sell directly to a CHDO, again directly to the CHDO, not an entity controlled by the CHDO. So, again, the motivation here was to protect the nonprofit's rights to acquire, and thinking that that would be the best preservation move for this portfolio. As you might imagine, the results were perhaps not what they thought they originally might be. Neither the owners nor the investors wanted to go through the ROFR process and risk a minimum purchase price sale. Even if the owner wanted to sell to a CHDO, the CHDO often didn't have the economic capacity to generate equity capital that it would need for the acquisition.

All this uncertainty created a lot of impact on the market values of these properties. And we wound up in just a stalemate, where owners did not want to sell the properties. This coincided with a time when the investors were beginning to realize that they had very valuable assets. And they certainly weren't wanting to give their asset away. So no one did anything, really. And there was this potential for deterioration of the portfolio as no one really had an incentive to do something positive for these properties. General partners (GPs) also tried . . . during this time, when GPs were negotiating with limited partners, to try to take them out of the partnerships, if the general partner wanted to retain the property; we're using this right of first refusal as a tool to tell their investors that their interests were worthless. Because if the property were sold, there would be no proceeds to roll through a waterfall and to vest in the investor. . . . Some were successful a little bit to indicate that that was a major impact on the limited partners' value.

So with all of this uncertainty and stalemate, we needed a change. So we get to our second change, which came in 2015. Advocates went to the legislature and asked for a change in the law. So from here, we went from a two-year ROFR to a 180-day ROFR. But we had to sort of stay in the same boxes that we were in before with this rolling priority concept. Because the nonprofits, particularly the ones that were CHDOs, felt that their rights were valuable, and they didn't want to relinquish those rights at all. So they wanted to maintain the same basic structure, but acknowledged that perhaps two years for a ROFR was way too long. So the new ROFR language made some really important changes. First of all, we kept the CHDO priority; instead, in the first sixty days, you can only sell to a CHDO. But since then, the law has been also been amended to include a public housing authority if that public housing authority is already in the deal. So now we finally have the governmental entities being able to participate in the process. But the more important thing that it did is it allowed the CHDO or the public housing authority to create what we call a "qualified entity." A qualified entity is an entity that that nonprofit, or qualifying organization, controls. So now we've opened the door for a CHDO to form a limited partnership, be the general partner and go get an investor partner, whether that be through a re-syndication, or some sort of other private equity capital to acquire these properties.

We have a second sixty-day tranche and a third sixty-day tranche where again, we have different categories of nonprofit or otherwise qualified entities, including tenant organizations and governmental entities, that can make the acquisitions either individually or through a qualified entity that they control. The Texas ROFR is still drafted a little bit more like an option than a ROFR. Another important change in the law is that it also now allows existing owners to resyndicate for themselves. So for instance, let's say a for-profit developer owns a tax credit partnership that has one of these rights of first refusal on it. Under TDHCA interpretation, if that sponsor were to want to resyndicate, let's say, using 4% credits and bonds, and needed to transfer the property for acquisition credit purposes, that transfer would trigger the ROFR previous to 2015. The concept was, you couldn't even sell to yourself without triggering the ROFR. But that was removed in this new legislation in 2015. And then finally, we have a provision that basically says anybody with one of those old ROFRs, you can opt into this new one, if it would be beneficial to you, and you have a right to opt into the new one, which is something that most owners now are doing or have done in connection with a sale. Now we finally have a shift in the policy priority, which is to facilitate the marketability of these properties after the end of Year 15 while retaining certain of the rights in the nonprofits. The results are as you might expect, there was an immediate impact on the market. People who were in that logjam finally started to find ways to transfer properties. Today, we have for-profit entities from all over the country that are partnering with CHDOs to acquire these properties.

So after twenty-five years of a ROFR strategy, did Texas evolve to a better preservation policy? I'll let you answer this for yourself. One thing that I think is can be beneficial for preservation is that by prioritizing CHDOs, many of these ROFR properties are actually eligible for a property tax exemption. But the property tax exemption does require at least $5,000 per unit of renovation. So there's at least some incentive to invest capital back into the property for renovation and preservation. Properties are also getting into the hands of very well-capitalized owners, many of which have strong affordable housing purposes and experience while they are partnering with CHDOs, but frankly, there are very few CHDOs doing this work. The nonprofits that are not CHDOs really have limited opportunities, whether they are big national nonprofits or whether they are small local nonprofits, that maybe don't have the ability to have an employee as required now by the CHDO rules or something like that. We're finding that the CHDOs also have limited operational authority in their partnerships. The capital investors, you know, just like a tax credit investor, want to protect their investment and they have rigorous restrictions on the CHDO's operational authority. And the CHDOs actually have some pretty limited economics in these partnerships. . . . TDHCA really doesn't have readily available data on any of this. . . . So it's decisions like these, like how to define "at risk" or whether to change your bond reservation program that are made a different times and sometimes in a vacuum that ultimately impact our overall preservation policy. So have we evolved to a better policy? I would say . . . to be continued.

# Repositioning or Recapitalization of Public Housing, Mixed-Financed Housing, and Section 202 Elderly Housing and Keeping It Affordable

*Vickie S. Longosz**



## I. Introduction

The United States Housing Act of 1937, and as amended between 1974 and 2016, states as its Declaration of Policy:

(1) To promote the general welfare of the Nation by employing the funds and credit of the Nation, as provided in this chapter—

(A) To assist States and political subdivisions of States to remedy the unsafe housing conditions and the acute shortage of decent and safe dwellings for low-income families;

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*Senior Attorney, Assisted Housing Division, Office of Assisted Housing and Community Development, Office of General Counsel, U.S. Department of Housing and Urban Development, Washington, D.C. Ms. Longosz is a frequent speaker at ABA Affordable Housing and Community Development Forum Events.

(B) To assist States and political subdivisions of States to address the shortage of housing affordable to low-income families; and

(C) Consistent with the objectives of this subchapter, to vest in public housing agencies that perform well, the maximum amount of responsibility and flexibility in program administration, with appropriate accountability to public housing residents, localities, and the general public;

(2) that the Federal Government cannot through its direct action alone provide for the housing of every American citizen, or even a majority of its citizens, but it is the responsibility of the Government to promote and protect the independent and collective actions of private citizens to develop housing and strengthen their own neighborhoods;

(3) that the Federal Government should act where there is a serious need that private citizens or groups cannot or are not addressing responsibly; and

(4) that our Nation should promote the goal of providing decent affordable housing for all citizens through the efforts and encouragement of Federal, State, and local governments, and by the independent and collective actions of private citizens, organizations, and the private sector.[1]

Relatedly, the Cranston-Gonzalez National Affordable Housing Act of 1990[2] created a new Supportive Housing for the Elderly Program with the purpose

(a) to enable elderly persons to live with dignity and independence by expanding the supply of supportive housing that—

(1) is designed to accommodate the special needs of elderly persons; and

(2) provides a range of services that are tailored to the needs of elderly persons occupying such housing.

With this Declaration of Policy as the guide for assisted housing (Public Housing and Section 8 housing) and the purpose of the Supportive Housing for the Elderly Section 202 Program, this article will explore how repositioning or recapitalization of Public Housing, Mixed-Financed Housing and Section 202 Supportive Housing for the Elderly can keep this housing—developed under the programs of the U.S. Department of Housing and Urban Development (HUD)—affordable and preserved into the future.

1. 42 U.S.C. § 1437.
2. Pub. L. No. 101-625 (1990); 12 U.S.C. § 1701q.

## II. A Brief History

### *A. Public Housing*

The Federal government began to provide housing for families of limited income in 1933 with the National Industrial Recovery Act (NIRA),[3] creating the Federal Emergency Administration of Public Works (FEAPW) to develop, own, and operate public housing[4] in cities throughout the country. The Administrator of FEAPW had the power to take land through eminent domain for low-income housing, but direct Federal ownership of public housing and the related power of eminent domain proved to be controversial.

Congress responded with the United States Housing Act of 1937 Act (1937 Act)[5] to deal with the constitutional problems of NIRA; this law authorized development funding for low-rent housing by state and local governments. To receive Federal low-rent housing funds, the 1937 Act required the state or local government to establish an independent legal entity, now known as a Public Housing Authority (PHA),[6] to serve as developer, owner, and manager of the low-rent housing. The PHA was required to enter into an Annual Contributions Contract (ACC)[7] with the Federal government that defined the responsibilities of the Federal government and the PHA. Each state or local government was required to sign a Cooperation Agreement[8] with the PHA for basic services for the housing, such as police and fire protection, and to accept a payment in lieu of taxes ("PILOT") instead of property taxes. Federal funds provided for the construction of over 1.2 million units of public housing.[9] Today, about 960,000

3. Pub. L. No. 73-67 (1937).

4. As currently defined in 42 U.S.C. § 1437a(b)(1), "[t]he term 'low-income housing' means 'decent, safe, and sanitary dwellings assisted under this chapter.' The term 'public housing' means low-income housing, and all necessary appurtenances thereto, assisted under this chapter other than under section 1437f [Section 8] of this title. The term 'public housing' includes dwelling units in a mixed finance project that are assisted by a public housing agency with capital or operating assistance. When used in reference to public housing, the term 'low-income housing project' or 'project' means (A) housing developed, acquired, or assisted by a public housing agency under this chapter, and (B) the improvement of any such housing."

5. 42 U.S.C. § 1437 *et seq.*

6. 42 U.S.C. § 1437a(b)(6)(A) ("Except as provided in subparagraph (B), the term 'public housing agency' means any State, county, municipality, or other governmental entity or public body (or agency or instrumentality thereof) which is authorized to engage in or assist in the development or operation of public housing, or a consortium of such entities or bodes as approved by the Secretary.").

7. Current HUD Form 53012 (Apr. 2018).

8. HUD Form 52481.

9. HUD, Public and Indian Housing, https://www.hud.gov/program_offices/public_indian_housing/publications.

units of public housing are administered by 3,300 PHAs, serving nearly 1.8 million public housing residents.[10]

Originally, the 1937 Act provided that a public entity would own the housing, but the private sector was included in the financing structure. The Federal government paid the debt service on bonds issued by the PHAs to finance the construction of the public housing. Initially, rents paid by tenants, while low, provided adequate funds to operate the public housing units and maintain them in good condition when coupled with subsidized debt service. At first, public housing was designed to serve families in need only of temporary housing until they could move to privately owned rental housing or purchase their own homes. It was not intended to provide permanent housing solutions for low-income families.[11]

As the program matured, however, Federal policies increasingly made public housing the housing of last resort. Admission preferences that favored the neediest of families created isolated pockets of poverty. The requirement that residents pay thirty percent of their income for rent, while helpful to those with the lowest incomes, encouraged many working residents to leave public housing to avoid paying more than market rates for rent. As a result, rents from residents decreased and did not generate adequate funds to operate public housing.[12]

According to HUD's Real Estate Assessment Center, public housing properties are larger than assisted multifamily properties. The median size of a public housing property is 100 units; by contrast, the median size of an assisted multifamily housing property is 60 units. Public housing properties, being family-oriented, have larger dwelling units (sixty percent of inspected units have two or more bedrooms) than do multifamily properties (sixty percent of multifamily housing units having zero or one bedrooms). The median age of the typical public housing property is approximately fifty-six years, whereas the age of a typical assisted multifamily property is approximately thirty-five years old. [13]

10. HUD, Public Housing, https://www.hud.gov/program_offices/public_indian_housing/programs/ph; HUD, REAC Library, https://www.hud.gov/program_offices/public_indian_housing/reac/library/reaclibrary (last visited Feb. 14, 2022); HUD, U.S. Housing Market Housing Conditions, https://www.huduser.gov/portal/ushmc/home.html (last visited Feb. 14, 2022).

11. Council of Large Public Housing Authorities, Public Housing Today (1986), https://www.huduser.gov/portal//Publications/pdf/HUD-11649.pdf; 2 Judith Robinson et al., Public Housing in the United States, 1933-L949; A Historic Context (1985), https://www.huduser.gov/portal/sites/default/files/pdf/Public-housing-in-US-1985.pdf.

12. *Id*.

13. HUD, REAC Library, https://www.hud.gov/program_offices/public_indian_housing/reac/library/reaclibrary (last visited Feb. 14, 2022); HUD, U.S. Housing Market Housing Conditions, https://www.huduser.gov/portal/ushmc/home.html (last visited Feb. 14, 2022).

In 1969, the 1937 Act was amended to permit the Federal government to provide operating subsidies to PHAs to enable them to meet basic operating costs. Also, in the late 1960s, Congress created a funding source often referred to as *modernization*[14] to enable PHAs to rehabilitate public housing, much of which had been built in the 1940s. For FY2021, Congress provided annual appropriations of approximately $4.9 billion for Operating Funds[15] and $3.4 billion for Capital Funds.[16]

### *B. Mixed Financed Housing*

The Diaz memorandum, written by HUD General Counsel Nelson Diaz in 1994,[17] provided the legal opinion supporting the use of public housing funds (development[18] and operating subsidy[19]) as a tool to leverage private financing. In an interim rule in 1996, HUD authorized and established procedures for mixed finance development to "allow PHAs to incorporate other financing sources into the redevelopment of public housing communities" and structure a transaction that "accommodates the requirements of the other financing sources."[20] The Mixed-Finance Program is a broad-based authority to provide discretion in designing grant projects to best accomplish HUD's objectives of securing additional funding by leveraging grant funds, ensuring the financial viability of the proposed mixed-finance development, and fostering safe neighborhoods.[21] Mixed-finance development allows for development through new construction or acquisition, with or without rehabilitation or modernization of public housing, where the public housing units are owned in whole or in part by an entity other than a PHA.

14. The Comprehensive Improvement Assistance Program (CIAP) evolved into the Comprehensive Grant Program (CGP) and is currently the Capital Fund Program (CFP).

15. 42 U.S.C. § 1437g(e); 24 C.F.R. pt. 990 (2022).

16. 42 U.S.C. § 1437g(d); 24 C.F.R. pt. 905 (2022). FY2021 Appropriations Act combined Public Housing Capital Fund and the Public Housing Operating Fund into the New Public Housing Fund, totaling $8,324,444,000. HUD, Office of Public and Indian Housing, Public Housing Fund (2022), https://www.hud.gov/sites/dfiles/CFO/documents/9_2022CJ-PHFund.pdf; https://crsreports.congress.gov/product/pdf/R/R46465; Transportation, Housing and Urban Development, and Related Agencies Appropriations for FY2021, Pub. L. No. 116-260 (2020).

17. Memorandum from Nelson A. Diaz, General Counsel, HUD, to Joseph Shuldiner, Assistant Secretary for Public and Indian Housing (Apr. 8, 1994).

18. Pub. L. No. 73-67, 42 U.S.C. §§ 1437a(c)(1) (definition of "development"), 1437g(d) (Capital Fund authorization).

19. *Id*. 42 U.S.C. §§ 1437a(c)(2) (definition of "operation"), 1437g(e) (Operating Fund authorization).

20. Public/Private Partnerships for Mixed-Finance Development of Public Housing Units, 61 Fed. Reg. 19,708, 19,709 (1996) (to be codified at 24 C.F.R. pt. 941).

21. 24 C.F.R. 905, subpt. F (2022).

### C. *Section 202 Elderly Housing*

The Section 202 program, established under the U.S. Housing Act of 1959, was designed to provide housing for moderate-income *elderly* tenants—that is, with incomes that are too high for public housing but too low for market-rate housing. [22] It began as a loan program through which HUD made low interest loans directly to developers for up to fifty years, with no income eligibility restrictions on the properties**.** After stopping the Section 202 program from 1970 to 1974, Congress enacted the Housing and Community Development Act of 1974[23] and reactivated the Section 202 program and instituted a number of changes. The primary changes were to make twenty-year, renewable projected based Section 8 rental assistance available to building owners, and to direct loans of forty years and interest rates based on Treasury-set amounts. Services to elderly tenants were required. Developers often used seventy-five percent of the project-based Section 8 rental assistance that they received to service their loan debt. The loans essentially required budget authority both when they were initially extended, and then again when Congress appropriated Section 8 funds that were largely used to pay them back.

Because of concern over budget authority involved in extending the Section 202 loans, the Cranston-Gonzalez National Affordable Housing Act of 1990[24] created the Supportive Housing for the Elderly Program, replacing loans to developers with Capital Advances that did not accrue interest and did not need to be paid back as long as the properties were made available to very low-income elderly households for at least forty years. In addition, Congress provided for Project Rental Assistance Contracts (PRAC), which permit a contract between the Owner and HUD, setting forth the rights and duties of the parties with respect to the project and the payments under the PRAC. Capital Advance funds are competitive and awarded via a Notice of Funding Availability.[25] Receipt of a Capital Advance makes the Owner eligible to receive a PRAC. The key program agreements include the Capital Advance Agreement, PRAC, Regulatory Agreement, Mortgage, Deed of Trust/Security Deed and Use Agreement.[26]

In 2011, Congress cut new funding for Section 202 developments and only funded renewals. Partial appropriations were provided in FY2017. Full appropriations were provided in 2018 for development of new Capital Advance Projects.[27] Current regulations at 24 C.F.R. part 891 cover the Section

22. 12 U.S.C. § 1701q.
23. Pub. L. No. 93-383 (1974).
24. Pub. L. No. 101-625 (1990).
25. HUD now refers to a competitive award notice as a Notice of Funding Opportunity.
26. HUD, Section 202 Supportive Housing for the Elderly Program, https://www.hud.gov/program_offices/housing/mfh/progdesc/eld202 (last visited Feb. 14, 2022).
27. HUD, Section 202 Portal, (last visited Feb. 14, 2022).

202 Supportive Housing for the Elderly Program.[28] As these 202 PRAC projects age, long-term portfolio issues, as discussed in Part IV, have occurred.

## III. Long-Term Portfolio Issues for Public Housing

In addition to the Declaration of Policy of the 1937 Act, quoted in the Introduction, the ACC was designed "to provide maximum responsibility and flexibility to PHAs in making administrative decisions within all applicable statutes, executive orders, regulations and [the ACC]."[29] To operate and maintain public housing, PHAs contend with issues concerning community and resident needs such as supportive services, predictability and affordability, local control, and funding sources. These issues have grown with backlog funding needs,[30] tenant income, and PHAs' failure to keep pace. Federal funding sources options such as CIAP,[31] CGP,[32] MROP,[33] HOPE VI,[34] and ARRA[35] supplement the needs, but the backlog

28. 24 C.F.R pt. 891 (2022).

29. HUD Form 53012 (Apr. 2018).

30. "The most recent portfolio-wide Capital Needs Assessment (CNA), completed in 2010, estimated the backlog of unmet public housing capital need at approximately $26 billion. The projected annual accrual of needs across the inventory was estimated to be at least $3.4 billion per year on average at that time. Since the 2010 study, the Public Housing Capital Fund grant program has not been funded at the annual accrual need estimated in 2010, much less the increased need caused by inflation in construction and modernization costs over time. Although the public housing inventory has been reduced and many units have been rehabilitated since 2010, the financial impact of inflation and deferred capital investment in the public housing inventory are substantially greater than any decrease in need associated with the units that have left the inventory or have since been revitalized. HUD is currently conducting a new portfolio-wide CNA to determine an updated estimate for the unmet capital need backlog." *See* HUD, Public Housing Fund, https://www.hud.gov/sites/dfiles/CFO/documents/9_2022CJ-PHFund.pdf (last visited Feb. 14, 2022).

31. Former § 14 of the 1937 Act (competitive funding program at former 24 C.F.R. pt. 968).

32. *Id.* (competitive and formula funded program at former 24 C.F.R. pt. 968).

33. Major Reconstruction of Obsolete Programs authorized by the Housing and Community Development Act of 1992, with regulations at former 24 C.F.R. pts. 904, 941.

34. HOPE VI was created by the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act of 1993 (Pub. L. No. 102-389). It was approved on October 6, 1992, was originally known as the Urban Revitalization Demonstration (URD), and was developed as a result of recommendations by the National Commission on Severely Distressed Public Housing, which was charged with proposing a National Action Plan to eradicate severely distressed public housing.

35. American Recovery and Reinvestment Act, Pub. L. No. 111-5 (2009). HUD awarded $2.985 billion in ARRA Capital Fund amounts calculated in accordance with the 2008 Capital Fund formula. The Department withheld $15 million of the $3 billion allocated for formula grant funding under ARRA to fund a 0.5% set-aside outlined in ARRA to pay for costs associated with implementing the Act.

has continued to grow, and HUD has suggested new options: *repositioning* and *recapitalization*.

### *A. What Is Repositioning?*

HUD uses the term *repositioning* to describe the process of converting properties currently assisted under the Public Housing Program platform to the Section 8 Program platform. Repositioning options include the Rental Assistance Demonstration (RAD), "Faircloth to RAD," Section 18 Disposition, and Streamlined Voluntary Conversion (SVC). HUD has issued *Guides on Public Housing Repositioning* based on PHA size[36] and a chart that compares important program characteristics for each of the current repositioning options.[37]

### *B. What Is Recapitalization?*

HUD uses the term *recapitalization* to describe the use of current HUD funds or third-party sources to complete necessary physical improvements to Public Housing properties, often by leveraging Section 8 rental assistance. Current recapitalization options discussed below include Mixed Finance Development, Capital Fund Financing, and Operating Fund Financing based on legislative and regulatory authority.

### *C. The Public Housing Options Today*

#### 1. RAD

Rental Assistance Demonstration (RAD) is a competitive demonstration "designed to preserve and improve public housing and certain other multifamily housing through the voluntary conversion of properties with assistance under Section 9 of the United States Housing Act of 1937."[38]

36. HUD, A Guide for Medium/Large PHAs (Mar. 2021), https://www.hud.gov/sites/dfiles/PIH/documents/Guide_Repositioning_Medium_Large_PHAs.pdf (251+ public housing units); HUD, A Guide for Small PHAs (Mar. 2021), https://www.hud.gov/sites/dfiles/PIH/documents/Guide_Repositioning_Small_PHAs.pdf (51–250 public housing units); HUD; A Guide for Very Small PHAs (Mar. 2021), https://www.hud.gov/sites/dfiles/PIH/documents/Guide_Repositioning_Very_Small_PHAs.pdf (50 or fewer public housing units).

37. HUD, Repositioning Options: Summary of Key Characteristics (Mar. 2021), https://www.hud.gov/sites/dfiles/PIH/documents/Asset_Repositioning_Overview%283-21%29.pdf.

38. RAD is authorized by the Consolidated and Further Continuing Appropriations Act of 2012 (Pub. L. No. 112-55 (2011), as amended by the Consolidated Appropriations Act, 2014 (Pub. L. No. 113-76 (2014), the Consolidated and Further Continuing Appropriations Act, 2015 (Pub. L. No. 113-235 (2014), 2014), the Consolidated Appropriations Act, 2016 (Pub. L. No. 114-113 (2015), approved Dec. 18, 2015), the Consolidated Appropriations Act, 2017 (Pub. L. No 115-31, approved May 5, 2017), and section 237 of Title II, Division L, Transportation, Housing and Urban Development, and Related Agencies, of the Consolidated Appropriations Act, 2018 (Pub. L. 115-141, approved Mar. 23, 2018). The current RAD Notice REV 4 issued in 2019 is published at HUD H-2019-09 and PIH 2019-23 (HA) and remains in effect until amended, superseded, or rescinded. Previous

RAD has two separate components. The First Component allows projects funded under the Public Housing Program to convert their public housing assistance (Operating Funds and Capital Funds) to long-term, project-based Section 8 rental assistance contracts, with the choice of two forms of Section 8 Housing Assistance Payment (HAP Contracts): Projects-Based Vouchers (PBVs) or Project-Based Rental Assistance (PBRA). The FY2018 Appropriations Act currently caps the amount of public housing conversions at 455,000 units.[39] The Second Component does not cover public housing but allows owners of projects funded under the Rent Supplement, Rental Assistance Payment, and Moderate Rehabilitation Programs to convert to PBV or PBRA. Since 2018, Section 202 Supportive Housing for the Elderly (202 PRAC) has been added to the second component conversion authorities for PBV or PBRA.[40]

Since its creation, RAD has had various and significant revisions, including increasing resident notice requirements to improve communication with residents throughout the conversion process; partnerships between PHAs to pool resources or capacity with each other; limited rent increases for public housing conversions to PBRA in certain scenarios such as designated Opportunity Zones; flexible staging of conversions; streamlined Capital Needs Assessment requirements; broadened use of tiered environmental reviews; RAD rent updates every two years; and priority for Section 3 employment and other economic opportunities for residents of public housing and Section 8 assisted housing.[41]

Major goals of RAD are, first, to test the conversion of the public housing assistance to long-term, project-based Section 8 assistance available to project owners of assisted multifamily housing and, second, to generate additional sources of private financing. HUD has used its statutory waiver authority and ability to establish limited alternative requirements on a limited basis to facilitate the goals of RAD and to maintain the existing distinction between PBV and PBRA forms of contract assistance.[42]

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versions of RAD Notices appeared at PIH 2012-18 (Mar. 8, 2012, superseded by Notice PIH 2012-32); Notice PIH 2012-32 (July 26, 2012); Notice PIH 2012-32 REV-1 (July 2, 2013); Notice PIH 2012-32 REV-1 Technical Correction (Feb. 6, 2014); Notice PIH 2012-32 REV 2 (June 15, 2015); Notice PIH 2012-32 (HA) H 2017-03, REV 3 (Jan. 12, 2017); Notice PIH 2018-11 H 2018-05 (July 2, 2018); and Notice PIH 2018-22 H 2018-11 (Dec. 11, 2018). Generally, the Notice in effect at the time of closing governs the public housing projects converting under either Component of RAD. RAD guidance can be found online at https://www.hud.gov/RAD, and the RAD Resource Desk, https://www.radresource.net.

39. Section 237 of Title II, Division L, Transportation, Housing and Urban Development, and Related Agencies, of the Consolidated Appropriations Act, 2018 (Pub. L. 115-141, approved Mar. 23, 2018).

40. *See* discussion *infra* Section IV.

41. Section 3 of the HUD Act of 1968, 12 U.S.C. § 1701u (2022), and its associated regulations, 24 C.F.R. pt. 75 (2022).

42. *See* Section 1.5 of HUD RAD Notice REV 4.

The RAD conversions require PHAs to comply with all applicable site selection requirements consistent with the requirements of the Fair Housing Act, Title VI of the Civil Rights Act of 1964, Section 504 of the Rehabilitation Act of 1973, and the Americans with Disabilities Act.[43] The RAD Fair Housing, Civil Rights, and Relocation Notice[44] also provides PHAs and their developer partners with information and resources on the Uniform Relocation Act and requirements of Section 104(d) of the Housing and Community Development Act of 1974 when planning for or implementing resident moves under RAD First Component. These important resident rights include relocation planning, resident right to return, relocation assistance, resident notification, initiation of relocation, and fair housing and civil rights.[45]

### 2. "Faircloth to RAD"

Section 9(g)(3) of the 1937 Act ("Faircloth Amendment") limits the construction of new public housing units.[46] The Faircloth Amendment states that the Department cannot fund the construction or operation of new public housing units with Capital or Operating Funds if the construction of those units would result in a net increase in the number of units the PHA owned, assisted, or operated as of October 1, 1999. This requirement is referred to as the "Faircloth Limit." The Faircloth Limit is adjusted for PHA transfers of public housing units, consolidations, and RAD removals.[47] PHAs will not be funded for public housing units that exceed the Faircloth Limit. Many PHAs have unused potential for public housing unit development. To streamline the development of public housing units and to convert the assistance from public housing to Section 8 through RAD, once the unit construction is complete and units are entered into the Public Housing Information Center (PIC),[48] HUD has developed guidance outlining this process.[49] The development of the public housing units can be accomplished

43. *See* HUD's RAD Fair Housing, Civil Rights, and Relocation Notice (H 2016-17, PIH 2016-17) (HA).

44. *Id.*

45. *Id*.

46. 42 U.S.C. § 1437g(g)(3).

47. See 1.5.D of RAD Notice REV 4.

48. HUD's Public Housing current system for recording data for the public housing inventory, the characteristics of public housing and Housing Choice Voucher for assisted families, the characteristics of PHAs, and performance measurement of PHAs receiving Housing Choice Voucher funding.

49. HUD, Guidance on Faircloth to RAD Conversions, https://www.hud.gov/sites/dfiles/PIH/images/FairclothGuidance.Faircloth.to_.RAD_.Conversions.pdf (last visited Feb. 14, 2022); HUD, Faircloth to RAD Conversions (2022), https://www.hud.gov/sites/dfiles/Housing/documents/Faircloth_Resource_Package.pdf.

through Mixed-Finance development,[50] conventional development,[51] turnkey development,[52] acquisition,[53] or force account labor.[54]

### 3. Section 18 Disposition

#### a. General

Disposition of public housing is authorized under Section 18 of the 1937 Act.[55] The Special Applications Center (SAC) within HUD's Office of Public Housing assists PHAs in their efforts to dispose or demolish public housing.[56] HUD has provided recent guidance on how to request HUD approval to demolish or dispose of public housing and the eligibility of Tenant Protection Vouchers for these actions,[57] as well as the use of proceeds under Section 18 dispositions.[58] Under Section 18, HUD may approve dispositions when retention of the property is not in the best interests of the residents or the PHA and when the PHA demonstrates one of the following reasons:

> 18(a)(2)(A)(i): conditions in the area surrounding the public housing project adversely affect the health or safety of the residents or the feasible operation of the project by the public housing agency; or
>
> 18(a)(2)(A)(ii): disposition allows the acquisition, development, or rehabilitation of other properties that will be more efficiently or effectively operated as low-income housing;[59]
>
> 18(a)(2)(B) the public housing agency has otherwise determined the disposition to be appropriate for reasons that are—
>
>> 18(a)(2)(B)(i) in the best interests of the residents and the public housing agency;
>>
>> 18(a)(2)(B)(ii) consistent with the goals of the public housing agency and the public housing agency plan;[60] and
>>
>> 18(a)(2)(B)(iii) otherwise consistent with this subchapter [1937 Act]; or
>>
>> 18(a)(2)(C) for property other than dwelling units, the property is excess to the needs of the public housing project[61] or the disposition is incidental

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50. 24 C.F.R. § 905.604 (2022).
51. *Id.* § 905.600(b).
52. *Id*.
53. *Id*.
54. 24 C.F.R. § 905.108 (2022) (definition); *id*. § 905.314(j).
55. 42 U.S.C. § 1437p, and implementing regulations at 24 C.F.R. pt. 970 (2022); HUD, Demolition/Disposition, https://www.hud.gov/program_offices/public_indian_housing/centers/sac/demo_dispo (last visited Feb. 14, 2022).
56. HUD, Special Applications Center (SAC), https://www.hud.gov/program_offices/public_indian_housing/centers/sac (last visited Feb. 14, 2022).
57. PIH 2021-07 (Jan. 19, 2021).
58. PIH 2020-33 (Sept. 9, 2020).
59. 42 U.S.C. § 1437a(b)(1).
60. *Id.* § 1437c-1 (2022); HUD form 50075-5Y.
61. 42 U.S.C. § 1437a(b)(1).

to, or does not interfere with, continued operation of a public housing project.[62]

b. Section 18 RAD Blends

Another Section 18 disposition-related option for PHAs involves blending Section 18 disposition approvals with a RAD conversion.[63] This option can occur when a PHA is converting a portion of its public housing units within a Converting Project and replacing the public housing units proposed for disposition with project-based Section 8 assistance within the Covered Project.[64] The proposed transaction may not use 9% Low Income Housing Tax Credits (LIHTC).[65]

For PHAs with 250 or fewer public housing units under its ACC, the PHA has an option to dispose up to eighty percent of its public housing units in a Converting Project (the "Small PHA Blend"). This type of transaction has the following restrictions: the PHA must submit a feasible repositioning plan approved by the PHA's Board of Commissioners; the PHA may not develop additional public housing units under its otherwise available Faircloth authority; the PHA may not transfer its Faircloth authority to another PHA;[66] and the Small PHA Blend will result in a closeout of the PHA's Section 9 public housing program and termination of its Section 9 ACC.[67] PBV contracts created under this blend must be administered by a Housing Choice Voucher (HCV) contract administrator with at least 250 HCV units under its HCV ACC prior to creation of the PBV contract. These blends usually are processed by Housing's Office of Recapitalization and subject to RAD requirements.

4. Mixed Finance Development

As mentioned earlier in this article, mixed finance is another public housing development method. Mixed finance development allows for various structures of the ownership of a mixed-finance project, such as public housing unit ownership entirely by a private entity, co-ownership by the PHA and the private entity, or ownership by a PHA affiliate or instrumentality.[68] Partnerships or contractual arrangements with a third-party entity

62. *Id.* § 1437p(a)(2) (2022).

63. PIH 2021-07, § 3.e.

64. RAD Notice REV 4 defines "Converting Project" and "Covered Project."

65. PIH Notice 2021-07 describes the other eligibility requirements.

66. HUD, Notice PIH 2014-24 (Process for Public Housing Agency Voluntary Transfers and Consolidations of the Public Housing Program) (Sept. 23, 2014), https://www.hud.gov/sites/documents/14-24PIHN.PDF.

67. HUD, Notice PIH 2019-13 (May 24, 2019), https://www.hud.gov/sites/dfiles/PIH/documents/PIH-2019-13.pdf (Public Housing ACC Termination and PHA Closeout).

68. 24 C.F.R § 905.604 (2022); HUD, Mixed-Finance Public Housing, https://www.hud.gov/program_offices/public_indian_housing/programs/ph/hope6/mfph (last visited Jan. 29, 2022).

are also possible. As part of mixed-finance development, PHAs have been developing public housing projects using 4% or 9% LIHTCs; this option provides another source of equity and helps with long-term viability. However, as Year 15 approaches for many of these mixed-finance projects, there is a need for recapitalization or restructuring. The Owner Entity and PHA must continue to follow the contracts and agreements to which HUD is a party or beneficiary (for example, a Mixed-Finance ACC Amendment,[69] a Regulatory and Operating Agreement,[70] and a Declaration of Restrictive Covenants[71]). Notice to HUD of changes or HUD approval is needed depending on the contract or agreement.[72]

5. Capital Fund Financing

Authorized by Section 9(d)(1)(A) and Section 30 of the 1937 Act, the regulations at 24 C.F.R. part 905, subpart E, describe the requirements for the Capital Fund Financing Program (CFFP),[73] which permits PHAs with written HUD approval to borrow private capital to make improvements and pledge, subject to the availability of appropriations, a portion of its future annual Capital Funds to make debt service payments for either a bond or conventional bank loan transaction. The loans or bonds are obligations of the PHA. HUD does not guarantee or insure or provide any full faith and credit for CFFPs. With HUD approval, PHAs may pledge, encumber, or otherwise provide a security interest in public housing assets or other property, including Capital Funds, and may use Capital Funds for the payment of debt service or other financing costs. To receive HUD approval, a PHA must submit a financing proposal that includes a term sheet, financial documents, and a justification for the use of Capital Funds for financing. The PHA obligation is subject to compliance with statutory and regulatory requirements, such as Declarations of Trust, and to be a standard or high performer under the Public Housing Assessment System (PHAS).[74] The financing proceeds may only be used for modernization or development of public housing, including non-dwelling space and related costs.

69. HUD, Mixed-Finance Amendment to the Consolidated Annual Contributions Contract, https://www.hud.gov/sites/dfiles/PIH/documents/MixedFinanceACCAmendment.pdf (last visited Jan. 29, 2022).

70. HUD, Model Documents for Mixed-Finance Transactions, https://www.hud.gov/program_offices/public_indian_housing/programs/ph/hope6/mfph/mf_modeldocs (last visited Jan. 29, 2022).

71. HUD, Form 52190 (Aug. 31, 2023), https://www.hud.gov>form52190.

72. The following document sets out the various requirements for refinancing and recapitalization: HUD, Required Document Submissions when a Mixed Finance Project's Ownership Structure Changes (Aug. 7, 2020), https://www.hud.gov/sites/dfiles/PIH/images/HUD_Req_MF_Projects_Ownership_Change_Refinancing.pdf.

73. HUD, Capital Fund Financing Program (CFFP), https://www.hud.gov/program_offices/public_indian_housing/programs/ph/capfund/cffp (last visited Jan. 29, 2022).

74. 24 C.F.R. pt. 902 (2022); *id*. § 905.505 (listing CFFP program requirements).

Streamlined application requirements are provided for standard and high performing PHAs.[75] A list of PHAs with approved CFFPs is provided on the Capital Fund webpage.[76] A list of transactions approved to date in chronological order also appears on the Capital Fund webpage.[77]

6. Operating Fund Financing

Authorized by Section 9(e)(1)(I) and Section 30 of the 1937 Act, the Operating Fund Financing Program (OFFP) permits "the costs or repaying, together with rent contributions, debt incurred to finance the rehabilitation and development of public housing units,"[78] subject to HUD requirements. HUD has not published regulations for OFFP but has allowed PHAs to borrow private capital to finance the development and modernization of public housing units.[79] PHAs can use a portion of their Operating Fund reserve balances[80] to collateralize financing and pay debt service and financing costs. Very few OFFP transactions have been submitted and approved.

7. Streamlined Voluntary Conversion (SVC)

Section 22 of the 1937 Act[81] and regulations at 24 C.F.R. part 972, subpart B, provide for the voluntary conversion of public housing to tenant-based housing or project-based assistance for the residents of public housing that is being removed. This type of conversion does not necessarily mean the physical removal of the public housing project from the site.[82] An update to this program was published in 2019 through PIH Notice 2019-05,[83] which explains how a PHAs with 250 or fewer public housing units can convert to tenant-based housing choice voucher (HCV) assistance through streamlined authority permitted by the waiver authority under Section 22(b)(3) of the 1937 Act. Specifically, small PHAs are not required to complete the conversion assessment described in statute and regulations and are not

75. 24 C.F.R. § 905.507 (2022).

76. HUD, CFFP Alphabetical List (Apr. 3, 2019), https://www.hud.gov/sites/dfiles/PIH/documents/CFFP%20Alphabetical%20List.pdf (untitled list of locations).

77. HUD, HUD PIH Office of Public Housing Investments, Approved Proposals (Apr. 3, 2019), https://www.hud.gov/sites/dfiles/PIH/documents/CFFP%20Chronological%20List.pdf.

78. 42 U.S.C. § 1437g(e)(1)(I).

79. Under the statute, PHAs may not use CFFP for non-dwelling public housing property such as administrative buildings. For application guidance, *see* HUD, Operating Fund Financing Program (2016), https://www.hud.gov/sites/dfiles/PIH/documents/URD_OFFP_guidance.pdf.

80. Operating Fund reserve balances are funds accumulated through the operation of public housing under the Operating Fund. 24 C.F.R. pt. 990 (2022), and section 2 of the Annual Contributions Contract HUD Form 53012 (Apr. 2018).

81. 42 U.S.C. § 1437t (2022).

82. 24 C.F.R. § 972.203 (2022) (definition of conversion).

83. Notice PIH 2019-05, Streamlined Voluntary Conversions of Last Remaining Projects of Small Public Housing Agencies (Mar. 21, 2019), https://www.hud.gov/sites/dfiles/OCHCO/documents/19-05pihn.pdf.

required to complete the cost-test or to evidence that the conversion is cost-effective. SVC authority gives small PHAs greater flexibility to respond to local needs, allows them to pursue private financing, and provides greater housing choice and mobility to assisted households. [84] Streamlined Voluntary Conversions must principally benefit the residents of the units, the PHA, and the community; they also must not adversely affect the availability of affordable housing in the community. PIH Notice 2019-05 provides the eligibility criteria for SVCs. HUD presented this option as a way to preserve this housing and provide a more sustainable funding platform, in addition to the option for repositioning under the RAD and new flexibilities under Section 18 Disposition and Section 18 RAD Blends.[85] In conjunction with this type of conversion, PIH Notice 2019-05 provides guidance on planning for the relocation, close-out information, and administration of the section 8 HCV program and other requirements.[86]

## IV. Long-Term Portfolio Issues for Section 202 Elderly Housing and the Options Today for Section 202 PRACs

Risk profiles of various HUD multifamily programs vary. Notably, Section 202 (Supportive Housing for the Elderly) non-profit owners of 202 Project Rental Assistance Contracts (PRACs) face emerging capital needs and decisions to preserve or terminate this assisted housing. HUD's FY2018 Appropriations Act[87] authorized RAD conversion of PRACs under Section 202(c)(2) of the Housing Act of 1959.[88] The RAD Notice REV 4 covers the Second Component, which includes the conversion of Section 202

84. *Id*.

85. PIH Notice 2018-04; PIH Notice 2021-07; *see also* HUD, Streamlined Voluntary Conversion, https://www.hud.gov/program_offices/public_indian_housing/centers/sac/svc (last visited Jan. 29, 2022).

86. *See also* PIH Notice 2020-23 (Sept. 9, 2020) (use of proceeds under Section 18 Disposition or Section 22 Voluntary Conversion).

87. Section 237 of the General Provisions—Department of Housing and Urban Development in the Consolidated Appropriations Act, Pub. L. No. 115-141 (2018).

88. Section 237 ("[P]roject rental assistance contract under section 202(c)(2) of the Housing Act of 1959, shall be eligible, subject to requirements established by the Secretary, including but not limited to the subordination, restructuring, or both, of any capital advance documentation, including any note, mortgage, use agreement or other agreements, evidencing or securing a capital advance previously provided by the Secretary under section 202(c)(1) of the Housing Act of 1959 as necessary to facilitate the conversion of assistance while maintaining the affordability period and designation of the property as serving elderly persons, and tenant consultation procedures, for conversion of assistance available for such vouchers or assistance contracts to assistance under a long term project-based subsidy contract under section 8 of the [1937]Act, which shall have a term of no less than 20 years, with rent adjustments only by an operating cost factor established by the Secretary, which shall be eligible for renewal under section 524 of the Multifamily Assisted Housing Reform and Affordability Act of 1997 (42 U.S.C. 1437f note), or, subject to agreement of the administering public housing agency, to assistance under section 8(o)(13) of the [1937] Act, to which the limitation under subsection (B) of section

PRACs.[89] Congress provided HUD with certain flexibility to implement RAD, including the authority to waive certain statutory provisions; however, Second Component (including Section 202 PRAC conversions)[90] does not have the same broad statutory waiver authority as First Component for public housing, but provides that participation in Section 202 PRAC conversions is subject to requirements established by HUD.

A 202 PRAC Owner may convert an eligible PRAC to one of two forms of long-term Section 8 Housing Assistance Payment (HAP) Contracts: project-based vouchers (PBVs) or project-based rental assistance (PBRA). The Project Owner makes the choice: "If the Project Owner requests a Section 8 PBV HAP, HUD will make a reasonable effort to find an eligible PHA with a Housing Choice Voucher Program and with operational jurisdiction, that is willing to enter into and administer the PBV HAP Contract with the Project Owner."[91] The resulting vouchers and budget authority will be added to the PHA's ACC. Most regulatory and statutory requirements of the PBV program at 24 C.F.R. part 983 will apply. Many Project Owners have not selected PBVs because they are unfamiliar with the PBV program, and there is a delay in funding with this type of conversion. HUD rules clarify that "[i]f a Project Owner requests to enter into a Section 8 PBRA HAP Contract (subject to annual appropriations), the HAP Contract will be executed by HUD's Office of Housing."[92] The Covered Project is governed by 24 C.F.R. part 880 as modified in Appendix 1 of the RAD Notice,[93] the site and neighborhood standards in Appendix III of the RAD Notice,[94] and by HUD Office of Housing's other notices and handbooks. As of February 2022, seventeen 202 PRACs have been reviewed and closed. [95]

The Section 8 regulatory platform is well understood and provides residents with deep rental assistance and a known package of resident rights. Section 8 was designed with private sector financing in mind and has a history of reliable, easily underwritten, rental assistance funding. Section 8 enables housing authorities and owners to leverage private investment to address capital needs, improve conditions for residents, create jobs, and stabilize the assisted portfolio. Given this Section 8 background, there are

8(o)(13) of the [1937] Act shall not apply and for which the Secretary may waive or alter the provisions of subparagraphs (C) and (D) of section 8(o)(13) of the [1937] Act.").

89. HUD H-2019-09; PIH 2019-23(HA).

90. Second Component also includes Section 8 Moderate Rehabilitation, McKinney Vento SRO, Rent Supplement (all Rent Supplement conversions have been completed), and Rental Assistance Payment (all Rental Assistance Payment conversions have been completed).

91. HUD H-2019-09, § 4.2 A; PIH 2019-23(HA).

92. HUD H-2019-09, § 4.2 B; PIH 2019-23(HA).

93. HUD H-2019-09; PIH 2019-23(HA).

94. *Id*.

95. *See generally* HUD, RAD Resource Desk, https://radresource.net/search_categories.cfm?xid=93 (last visited Feb. 14, 2022); HUD, RADBLAST!, https://radresource.net/mf_data.cfm; https://www.hud.gov/RAD/news/RADBlasts (last visited Feb. 14, 2022).

several key features of 202 PRAC Conversions including rents,[96] capital needs,[97] tenant rights,[98] and non-profit stewardship.[99] Although some Project Owners struggle with continuity of service coordinator funding and are challenged by technical requirements and transaction costs, HUD procedures are designed to support the Project Owners with the conversions.

At conversion, the Converting 202 PRAC Projects are released from the following outstanding obligations: the Capital Advance Agreement, the Capital Advance Mortgage Note, the Capital Advance Program Regulatory Agreement, the Capital Advance Program Use Agreement, as well as any related or collateral documents, such as Uniform Commercial Code filings. The recorded conversion documents include a Termination Agreement (terminating the Capital Advance-related agreements and recorded immediately prior to the execution of the new PBV or PBRA HAP Contract and recording of the RAD Elderly Use Agreement), and the RAD Elderly Use Agreement is recorded as a restrictive covenant in first position on the Covered Project for a term of twenty years, plus the balance of the term left on the Capital Advance Program Use Agreement at the time of conversion.[100]

To be eligible, a Project Owner must be in compliance with HUD requirements under the Section 202 Program.[101] Any change in ownership will require a Form HUD-2530 Previous Participation approval. Project Owners must comply with Fair Housing and Civil Rights requirements.[102] There are general requirements including applicability of PRAC requirements, Capital Needs Assessments (CNA), Replacement Reserve, financing and repairs, accessibility requirements, design considerations for elderly housing, healthy housing and energy efficiency, and existing Residual Receipts and Operation Reserve requirements.[103]

96. Contract rents are initially based on current 202 PRAC funding. Rents are adjusted by Operating Cost Adjustment Factor (OCAF).

97. All properties are assessed for capital needs, environmental hazards, energy efficiency, and accessibility requirements. Owners must secure financing for all current needs and fund a Replacement Reserve to address twenty-year needs.

98. Tenant notices and consultation are required as well as the right of return and prohibition against rescreening.

99. One-for-one hard unit replacement is required. Ownership or control must be by a non-profit. The RAD Elderly Housing Use Agreement is recorded on the land. The Long-Term HAP Contract must renew during the RAD Elderly Housing Use Agreement.

100. HUD, RAD for Section 202 Project Rental Assistance Contracts (PRACS), https://www.hud.gov/RAD/rad2/RAD202PRAC (last visited Feb. 14, 2022).

101. Project Owners may not have a history of non-compliance with program and contractual requirements and must maintain the units in a decent, safe, and sanitary condition.

102. This requirement includes compliance with 24 C.F.R. § 5.105(a) (2022), resolution of all outstanding fair housing or civil rights matters arising prior to conversion, and demonstration of consistency with Voluntary Compliance Agreements, consent orders or consent decrees, and final judicial rulings or administration rulings or decisions.

103. Each Converting Project is required to have a CNA and to demonstrate both short-term and long-term capital needs that can be addressed through the Replacement

Non-profit entity ownership or control is required for the Covered Project. A non-profit entity is an organization that has tax-exempt status under Sections 501(c)(3) or 501(c)(4) of the Internal Revenue Code of 1986 or that is a non-profit consumer cooperative or non-profit affiliate with a public agency. Non-profit entity ownership or control may be satisfied if a non-profit entity directly or through an entity wholly owned by the non-profit meets one or more ownership or control established in Section 4.4 J of RAD Notice REV 4.[104]

Other general requirements include restriction on net proceeds from refinance or sale,[105] environmental reviews,[106] relocation and right to return,[107] site selection and neighborhood standards,[108] change in unit configuration,[109]

Reserve Account and or through financing. The Reserve for Replacement must be in an interest-bearing account at a level set by HUD and sufficient to the meet the twenty-year CNA needs. Federal accessibility requirements apply to all conversions including Section 504 of the Fair Housing and Americans with Disabilities Act. If systems and appliances are being replaced, they must use the most energy and water efficient options that are financially feasible. They may apply any balance of the Residual Receipts as a source in the development budget.

104. These include the following: the non-profit entity "(1) holds a fee simple interest in the real property of the Covered Project; (2) is the lessor under a ground lease with the Project Owner; (3) has the direct or indirect legal authority (via contract, partnership share, agreement of an equity partnership, voting rights, or otherwise) to direct the financial and legal interests of the Project Owner with respect to the RAD units; (4) owns 51 percent or more of the general partner interests in a limited partnership or 51 percent or more of the managing member interests in a limited liability company with all powers of a general partner or managing member, as applicable; (5) owns a lesser percentage of the general partner or managing member interests and holds certain control rights as approved by HUD; (6) owns 51 percent or more of all ownership interests in a limited partnership or limited liability company and holds certain control rights as approved by HUD; or (7) other ownership and control arrangements approved by HUD. Note however, that prior to conversion, the Converting Project must continue to meet the ownership requirements set forth in the Housing Act of 1959, as amended." HUD H-2019-09, § 4.4 J; PIH 2019-23(HA).

105. Section 4.4 L. of HUD H-2019-09 and PIH 2019-23(HA). Net proceeds are restricted to benefit the new RAD Covered Project.

106. Section 4.4 M and Attachment 4A of HUD H-2019-09 and PIH 2019-23(HA).

107. Section 4.4 N of HUD H-2019-09 and PIH 2019-23(HA). Anyone on the lease at the time of submission of the Conversion Plan has the right to remain or, in the event that rehabilitation will result in the relocation of residents, a right to return to an assisted unit in the RAD Covered Project. Relocation is subject to the Uniform Relocation Assistance and Real Property Acquisition Policies Information Act of 1970 and regulations at 49 C.F.R. pt. 24 and must use a General Information Notice (GIN). If CDBG or HOME funds are used, then one-for-one replacement is required.

108. Section 4.4 O of HUD H-2019-09 and PIH 2019-23(HA).

109. Section 4.4 P of HUD H-2019-09 and PIH 2019-23(HA). Change in Unit Configuration may not result in involuntary permanent displacement of any resident or reduction in accessible units below the minimum percentage.

transfer of assistance,[110] Davis-Bacon prevailing wage rates,[111] supportive service for the elderly,[112] provisions of services,[113] lead-based paint hazards,[114] and compliance certification.[115] In addition, special provisions affect conversions to PBVs[116] and conversions to PBRAs.[117] The submission process and closing process is outlined in the RAD Notice REV 4.[118]

## V. Conclusion

HUD has provided to PHAs various long-term options for repositioning and recapitalizing their public housing portfolios and to non-profits participating in the Section 202 Supportive Housing for the Elderly Program with PRACs for their projects. For PHAs, it provides thousands of families across the country with better-maintained units, while creating opportunities to leverage public and private resources, easing administration, and preserving affordable housing. With the repositioning and recapitalization described in this article, PHAs can preserve affordable housing units, address rehabilitation and physical needs, and place properties on a more stable financial foundation. HUD's repositioning efforts provide communities with additional flexibilities to better meet local needs and funding options to achieve long-term viability for their affordable housing. For Section 202 non-profit owners with PRACs, the option to convert to long-term Section 8 assistance under RAD provides an opportunity for the aging stock of Section 202 PRAC properties to be recapitalized while protecting residents, maintaining non-profit control, and extending the period that the properties must remain affordable.

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110. Section 4.4 Q of HUD H-2019-09 and PIH 2019-23(HA). Transfers of assistance are possible depending on site and neighborhood and other restrictions.

111. Section 4.4 R of HUD H-2019-09 and PIH 2019-23(HA). If construction or rehabilitation is performed on nine or more units that were not previously rent-assisted or -restricted and will be newly assisted by the conversion, then Davis-Bacon wage rates apply. Davis-Bacon wage rates apply in such cases to both PBRA and PBV conversions.

112. Section 4.4 S of HUD H-2019-09 and PIH 2019-23(HA). The Project Owner must describe the supportive services and how they will meet the needs of the anticipated residents as they age and how they will be provided on a consistent long-term basis.

113. Section 4.4 T of HUD H-2019-09 and PIH 2019-23(HA).

114. Section 4.4 U of HUD H-2019-09 and PIH 2019-23(HA). The Lead Disclosure Rule and the Lead Safe Housing Rule, 24 C.F.R. pt. 35, subpts. A, B, H and R, apply if a child under age six resides in one or more units.

115. Section 4.4 V of HUD H-2019-09 ("HUD may require a certification or evidence of completion of any requirements the Project Owner is required to complete following the conversion of assistance)."

116. Section 4.5 of HUD H-2019-09 and PIH 2019-23(HA).

117. Section 4.6 of HUD H-2019-09 and PIH 2019-23(HA).

118. Section 4.7.1 and 4.7.4 of HUD H-2019-09 and PIH 2019-23(HA).

# Cooperative Ownership of LIHTC Affordable Housing Post Year 15

*Steven M. Virgil**

## Introduction

Developing and maintaining an adequate supply of affordable housing is a challenge to communities throughout the United States.[1] The rapid growth in real estate prices over the last decade has priced many working families out of homeownership, while also attracting speculation and decreasing the availability of affordable housing stock.[2] This article provides developers and advocates with an introduction to cooperative ownership and its potential to provide a reasonable response to the loss of affordable housing through the Low-Income Housing Tax Credit program[3] (LIHTC). The LIHTC is the United States' largest resource supporting the development of affordable housing.[4] However, the LIHTC program's structure faces an inevitable challenge as the financers, private investors, receive an option to exit.

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*Professor Virgil (virgilsm@wfu.edu) is the founder and director of the Community Law Clinic at Wake Forest University School of Law. Since 1994, he has practiced in the areas of micro-enterprise, community economic development, and cooperative development in communities in the United States and Central America. Professor Virgil has assisted nonprofit LIHTC developers in exiting LIHTC partnerships and currently advises housing and worker cooperatives. He would like to thank Sarahan Moser (Wake JD 2022) for her invaluable research and editing assistance on this article.

1. The Office of Policy Development and Research at the U.S. Department of Housing and Urban Development broadly defines "affordable housing" as a house that costs its occupants no greater than thirty percent of the occupant's household income. *Glossary*, U.S. Dep't of Hous. & Urban Dev., https://archives.huduser.gov/portal/glossary/glossary_all.html. As of 2021, approximately forty-three percent of new and existing homes were affordable to families earning the U.S. median income of $79,000. *NAHB/Wells Fargo Housing Opportunity Index (HOI)*, Nat'l Ass'n Home Builders, https://www.nahb.org/news-and-economics/housing-economics/indices/housing-opportunity-index (last visited Jan. 17, 2022); *see also* Meryl Finkel et al., ABT Assocs. Inc., Capital Needs in the Public Housing Program, at v–vi (2010), (noting that affordable housing's quantity and quality is rapidly declining).

2. *See* Thomas Wade, *Understanding the National Increase in House Prices*, Am. Action F. (July 20, 2021), https://www.americanactionforum.org/insight/understanding-the-national-increase-in-house-prices/.

3. 26 U.S.C. § 42 (2020).

4. *See Low-Income Housing Tax Credit (LIHTC)*, U.S. Dep't of Hous. & Urb. Dev., https://www.huduser.gov/portal/datasets/lihtc.html (last visited Jan. 17, 2022) [hereinafter HUD LIHTC].

Housing cooperatives have emerged as a viable response to secure affordable housing in several communities.[5] In addition to providing housing, cooperatives bring the added benefit of nurturing social and political capital for working poor families. As discussed here, housing cooperatives may be used as an effective tool to retain LIHTC projects as affordable housing. Few attorneys or community developers, however, appreciate the potential on how they may be organized. This article introduces these issues. Timing and preparation are crucial for any community-based effort to convert LIHTC properties to cooperative ownership. This article provides a possible strategy for preparing to move LIHTC properties to cooperative ownership. Cooperative ownership of LIHTC properties is a viable strategy to retain affordability while enhancing the role of communities who live in LIHTC housing seem well suited to serve affordable housing policies.[6]

## I. The Low-income Housing Tax Credit Program

### *a. Context*

The LIHTC is the largest government subsidy to support the development and retention of affordable housing in the United States.[7] Enacted as part of the Tax Reform Act of 1986[8] (1986 Act), the LIHTC has helped finance more than 2.4 million units of affordable housing as part of more than 30,000 multi-family housing developments across the United States.[9] The subsidy plays a crucial role in affordable housing strategy at every level of government.

Even while the LIHTC is central to affordable housing policy in the United States, the program depends on private developers and investors. LIHTC developments are surprisingly complex, involving multiple parties, including state and federal agencies. Private developers, who may be either for-profit or nonprofit entities, organize and develop the project. Private investors provide access to financing. State housing finance agencies enable the allocation of federal tax credits, which are often syndicated through the work of private banks and brokers. Despite what might be seen as varying interests involved, the LIHTC program has been described

5. *See Cooperative Housing*, Co-operative Housing Int'l, https://www.housinginternational.coop/about/ (last visited Jan. 17, 2022).

6. *See* Andrea J. Boyack, *Equitably Housing (Almost) Half a Nation of Renters*, 65 Buff. L. Rev. 109, 113–16 (2017) (discussing LIHTC policies to promote ownership, community stability, asset development).

7. *See* HUD LIHTC, *supra* note 5.

8. Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (codified as amended at 26 U.S.C. § 42 (2020)).

9. Emily Cadick, *The Low-Income Housing Tax Credit*, Enterprise, https://www.enterprisecommunity.org/policy-and-advocacy/policy-priorities/low-income-housing-tax-credits (last visited Jan. 22, 2022).

as providing a "win-win" for the parties involved.[10] Developers, whether for-profit or nonprofit entities, have access to the capital and financing that they need to build and operate a multi-family housing development. Tenants and community members more broadly have increased access to safe, affordable housing, along with enhanced tenant protections in many instances. Investors are provided with a low-risk, high-value investment. Government is able to expand affordable housing stock. However, the situation does not last forever.

The mix of private and public interest, and the motivations attendant to each, contribute to long-term instability of a large portion of LIHTC projects. This instability is mostly due to the time-horizon facing private investors as they recoup their investment and expected return. The investors who initially provide financing for LIHTC projects may see the program as an attractive investment at the beginning,[11] but once the tax advantages of the LIHTC have been exhausted at the end of the fifteenth year (Year 15), the investments might become less attractive. The loss of economic benefit to the investors that provide financing to LIHTC projects encourages investors to exit the project, meaning that the LIHTC project must restructure or recapitalize to continue operating as affordable housing or convert to market-based rent.

If and when private investors exit, their departure also creates an opportunity for broader community engagement and ownership of the LIHTC property, which may be seen more clearly within the LIHTC structure.

### *b. LIHTC Structure*

The 1986 Act significantly changed federal affordable housing policy.[12] For the first time, a designated tax credit was provided under Section 42 of the 1986 Act to subsidize affordable housing development.[13] The LIHTC provides incentives for private sector developers to build or revitalize affordable housing by subsidizing private financing for the construction, substantial rehabilitation, moderate rehabilitation, acquisition, and repair of low-income housing.[14]

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10. *Boyack*, *supra* note 7, at 143.

11. *See* office of U.S. Senator Maria Canwell, Meeting the Challenges of the Growing Affordable Housing Crisis: Expanding and Improving the Housing Tax Credit 5 (2017), https://www.cantwell.senate.gov/imo/media/doc/03062017_Meeting%20the%20challenge%20of%20the%20growing%20affordable%20housing%20crisis%20REPORT.pdf.

12. Mark Lipschultz, *Merging the Public and Private: The LIHTC Program and a Formula for More Affordable Housing*, 36 Rev. Banking & Fin. L. 379, 382 (2016).

13. The 1986 Act contained a new mechanism, described in section 42 of the Internal Revenue Code (IRC), for financing the construction of low-income rental housing. 26 U.S.C. § 42 (2020).

14. Lipschultz, *supra* note 13, at 381.

The LIHTC is codified in what is the longest section of the Internal Revenue Code, Section 42, and is perhaps one of its more complex credits.[15] A brief overview of the LIHTC structure follows to explore how community ownership may be furthered through the program.

LIHTCs are structured as a partnership between private developers, investors, and government agencies. The objective of this partnership is to create affordable housing in communities where there is need.[16]

The LIHTC begins with the U.S. Treasury, which issues tax-credits to state intermediaries: state housing finance agencies.[17] State housing finance agencies serve as the intermediary between the federal government and private developers. The housing finance agencies allocate the LIHTC tax-credits to real estate developers for use in financing affordable housing.[18]

15. Much has been written about Section 42 and the LIHTC, and more than an introduction to its structure is not needed here.

16. *See, e.g.*, *Low-Income Housing Tax Credits*, N.C. Hous. Fin. Agency, https://www.nchfa.com/rental-housing-partners/rental-developers/rental-development-financing-options/low-income-housing-tax-credits, (last accessed Jan. 17, 2022) (discussing selection criteria for developers seeking an allocation of LIHTC, including project location, local housing needs, and the ability to serve the lowest-income tenants for the longest periods).

17. LIHTCs are allocated by the IRS to state agencies on a per capita basis, subject to a variety of step-ups and boosts. Each state is allocated $1.75, adjusted for inflation since 2003, per resident, which amounted to roughly $2.09 in 2009. Only the first year of the ten-year compliance period counts against the allocation. This means that when the state finance agency allocates $1,000,000 of tax credits are over ten years, only $100,000 count against the state's LIHTC allocation, even though there is an ongoing credit liability to the Treasury. Having received the allocation from the Treasury, the state agency then passes them through to individual developers who are constructing or substantially remodeling "qualified projects." Developers then sell these credits to investors to raise equity for their projects, which reduces the debt that the developer would otherwise have to borrow. Because the debt is lower, a tax credit property can in turn offer lower, more affordable rents. *See* Ed Gramlich, Low-Income Housing Tax Credits 5-19 (2021), https://nlihc.org/sites/default/files/AG-2021/05-05_LIHTC.pdf.

18. Each year, the IRS allocates housing tax credits to designated state agencies. These agencies are established by state legislation and organized and operated with the sole purpose of receiving allocated tax-credits and then allocating the credits to what are called "qualified projects." The tax credits that are allocated to each state are limited to $1.75 per resident, adjusted for cost-of-living increases beginning in 2003. Only the first year of the ten-year award is counted against the allocation limit. An example illustrates this dynamic. Allocation of the tax credit is accomplisGenehed through a competitive process. Developers seeking to receive an allocation of credits must submit their application to the state housing finance agency by set deadlines. The applications are extremely detailed and involve hundreds of hours of work to prepare. States receiving tax credits must develop and publish a plan for determining how to allocate the credits they receive from the federal government. This is known as the Consolidated Plan. Each application for an award of tax credits is assessed against the state finance agency's Consolidated Plan. *See Consolidated Plan*, HUD Exchange, https://www.hudexchange.info/programs/consolidated-plan (last visited Jan. 22, 2022).

Allocation is based on a competitive process in which points are provided to project proposals based upon criteria published by the finance agency,[19] and the amount of LIHTCs awarded to an individual project is determined based upon the project's budget and commitment to affordable housing.[20] LIHTC developers may be either for-profit or nonprofit organizations.[21] Developers create a partnership or limited liability company to receive the LIHTCs and develop the property.

The relationships and entities within this structure are complex, and many online sources publish diagrams illustrating the structure.[22] Investors who receive LIHTCs as part the transaction may use these credits to offset, dollar for dollar, their federal income tax liability, or they may sell the tax credits to other taxpayers who can also use them to offset their own tax liability.[23] LIHTCs are allocated to investors over a ten-year period, after which the investor has received the total expected return on its investment.[24]

Because the investor uses the tax-credit over a ten-year time period when filing his or her returns, the investor pays a price that reflects present day value for the tax-credit.[25] The LIHTC provides developers with a "present value" tax credit equal to seventy percent of the cost of new construction or thirty percent of the cost of acquisition of existing low-income housing. In exchange for accessing LIHTC financing, the developer agrees to limit rents on the properties for a period of up to thirty years.[26] Tax credits are allocated over a ten-year period based upon the Applicable Federal

19. *See, e.g.*, *Low-Income Housing Tax Credits*, *supra* note 17 (listing selection criteria including, inter alia, "[d]esign and quality of construction," "[f]inancial structure and long-term viability," [e]xperience of development team and management agent(s)," etc.).

20. The number of tax credits awarded to a project is calculated based on the portion of the costs of the development that is defined as the "Qualified Basis" and the number of Qualified Low-Income Units in the development. Tax credits allocated to a state must be awarded to projects within two years of the allocation. Tax credits that are not awarded within this time frame are returned to the federal government. *See* Gramlich, *supra* note 18, at 5-20.

21. *Exploring the Low-Income Housing Tax Credit (LIHTC) Program*, HUD Loans, https://www.hud.loans/hud-loans-blog/lihtc-program-hud-multifamily-loans (last visited Jan. 20, 2022).

22. *See, e.g.*, Albert Lavalley, Diagram of capital flow among the various role-players in the LIHTC program, *in* https://mammoth.us/blog/2009/05/on-finance.

23. *Exploring the Low-Income Housing Tax Credit (LIHTC) Program*, *supra* note 22.

24. Mark P. Keightley, Cong. Rsch. Serv., RS22389, An Introduction to the Low-Income Housing Tax Credit 2 (2021).

25. LIHTC prices are also influenced by demand. In environments with few taxpayers needing tax credits, the price of LIHTCs falls. *Id.* at 6.

26. This known as the "tax compliance period." From 1986 to 1990, the tax compliance period was fifteen years. It was extended to thirty years in 1990, although developers may request relief for the additional fifteen-year compliance period. *Most LIHTC Properties Stay Affordable, But Concerns Remain*, Affordable Hous. Fin. (Sept. 1, 2012), https://www.housingfinance.com/news/most-lihtc-properties-stay-affordable-but-concerns-remain_o.

Rate (APR). The value of the credit is nine percent annually for the seventy percent credit and four percent annually for projects receiving the thirty percent credit. For example, over ten years, the investor annually receives 9% of the total LIHTC allocated to the project.

The LIHTC program enables affordable housing developers to access significant amounts of private financing. In 2021, approximately $1 billion in financing for affordable housing was made available through LIHTCs.[27]

### c. *Affordability Under the LIHTC Program*

The LIHTC serves the need for affordable housing in communities across the United States. Only multi-family residential properties that have been committed to providing affordable housing to low-income residents qualify for subsidy under the LIHTC program.[28] Affordability is measured based on one of two low-income occupancy thresholds. The first is the 20-50 Rule, which requires that twenty percent of the units financed with LIHTCs must be rent restricted and occupied by residents with incomes at or below fifty percent of the HUD-determined area median income. The second is the 40-60 Rule, which requires that at least forty percent of the units financed with LIHTCs must be rent restricted and occupied by households with incomes at or below sixty percent of the HUD-determined area median income. In each case, the area median income is adjusted for household size.[29]

The developer or manager then agrees to restrict rents, including utilities, to no more than thirty percent of the tenant's income for those units, for a period of at least fifteen years, but in most cases the developer agrees to operate under rent restrictions for thirty years or longer. At the end of

27. Since 1986, the program has grown to become the single largest source of funding to finance affordable and low-income housing development, providing nearly $1 billion a year in new funding for new development of affordable housing—but this sum does not consider previously allocated tax credits, which increases the total amount of tax credits being used in any given year to at least $10 billion. *See IRS Issues Population Figures Used to Calculate 2021 LIHTCs*, Tax Credit Hous. Mgmt. Insider (Mar. 24, 2021), https://www.taxcredithousinginsider.com/article/irs-issues-population-figures-used-calculate-2021-lihtcs.

28. LIHTC statutory provisions incorporate very little incentive for developers to rent to very poor people. Developers applying for the tax credit must agree to either dedicate twenty percent of their rental units to tenants living at or below fifty percent of the area median income, or alternatively dedicate forty percent of their units to tenants making sixty percent of the area median income. Rents in these tax credit funded developments are capped at thirty percent of either fifty percent or sixty percent of the area median income—depending on which option the developer selected form above. Eighty-eight percent of developers choose the 40-60 option, meaning they choose to dedicate a larger number of rental units for higher-income tenants than choosing fewer units to low-income tenants. Because of this LIHTC has been criticized as system that benefits the developers foremost, people on the fringes of poverty next, while ignoring the housing needs of the poorest among us. David Cohen, *Improving the Supply of Affordable Housing: The Role of the Low-Income Housing Tax Credit*, 6 J. L. & Pol'y 537, 542 (1998).

29. Keightley, *supra* note 25, at 5.

the rent restricted time, the developer has the option to convert the property to market rate rent. Through the use of restricted rent that is benchmarked to area median income, LIHTCs provide affordable housing to families. The LIHTC program also incentives developers who expand access to affordable housing for lower income families and who promote long-term affordability.[30]

The amount of rent that may be collected for LIHTC-financed properties is limited to a percentage of the area median income and cannot exceed established market limits. The LIHTC limitation only applies to the amount of rent paid by the tenant, not the total rent. A tenant's total rent may be subsidized by Section 8 assistance, keeping in mind that rents subsidized by project-based Section 8 may exceed the LIHTC limit, but tenant-based Section 8 rents may not.

Projects that are financed with LIHTCs are required to maintain their rent restrictions and occupancy requirements for a period of thirty years. This thirty-year period is reached by adding the fifteen-year compliance period with the fifteen-year use period that follows. This time line is known as the *Affordability Period*. A longer Affordability Period may be required for specific properties or in certain circumstances. These situations will be negotiated individually between the developer and the state agency.

Each year during the Affordability Period, the project manager certifies that the restrictions on rent and occupancy are being complied with to the state agency that awarded the tax credits. The state agency that awarded the tax-credits is responsible for monitoring compliance under an agreement with the Internal Revenue Service (IRS). An annual report is filed by the state agency with the IRS.[31]

#### *d. Compliance and Tax Credit Recapture*

Once the development is built and in use, the developer is responsible for maintaining continued compliance with Section 42 and the LIHTC program. This responsibility means that rent restrictions must be maintained, and occupancy restrictions must be observed. The state agency is responsible for ensuring that these requirements are met for the fifteen-year compliance period.

30. The LIHTC program requires state allocation plans to give priority to projects that (a) serve the lowest income families; and (b) are structured to remain affordable for the longest period of time. Federal law also requires that ten percent of each state's annual housing tax credit allocation be set aside for projects owned by nonprofit organizations. These priorities are published, along with detailed guidance, in the annual Qualified Allocation Plan (QAP). The QAP becomes the tool used to define needed low-income housing development and determine the best allocation of available LIHTC by each state. *See* Joint Ctr. for Hous. Studies of Harv. Univ., Long-Term Low Income Housing Tax Credit Policy Questions 11–12 (2010).

31. *See, e.g.*, LIHTC Compliance Monitoring Requirements, New Hampshire Housing (Dec. 31, 2020), https://www.nhhfa.org/wp-content/uploads/2019/08/LIHTC_Compliance_Monitoring.pdf.

If a project fails to comply with the LIHTC rent and occupancy restrictions, the tax credits may be subject to recapture. Recapture allows the IRS to pull the tax credits back, with a resulting payment by the taxpayers/investors who financed the deal at the beginning. Such a process will subject a taxpayer to significant tax liability for past-due taxes and penalties.

While the potential for recapture is real, there has never been a reported instance of either a state agency or the IRS recapturing credits awarded to a project. If a project were to be found subject to the recapture provisions, the investors who purchased the tax credits would be required to repay income taxes previously offset with the tax credits, along with penalties and interest. The amount subject to recapture is calculated as the difference in the number of credits that would have been available over the fifteen-year period minus the amount claimed according to the ten-year schedule.

*e. The General Partner and Investor*

Developers most often sell LIHTCs to investors or to a syndicator who assembles groups of investors who each take a part of the tax credits to reduce their federal tax liability. One of, if not the only, reason for the use of syndicators in the LIHTC arena is the ten-year time period that applies to the tax credits. As noted above, the tax credits must be used by the taxpayer over a ten-year period. This requirement creates a challenge for the developer, who needs money to pay the costs of the development immediately, as bills are presented. By selling the tax credits, or more precisely the right to participate in the tax credits over the ten-year period, the developer can assemble the money that is needed for the development. To accomplish this outcome, a few complicated structures are used.

The most common structure used to sell the LIHTC is a Limited Liability Partnership (LLP) or Limited Liability Company (LLC), which is functionally the same for purposes of distributing and claiming LIHTCs. Under this arrangement an investor buys a partnership interest in the LLP or a membership interest in the LLC and becomes part of the ownership. Typically, 99.99% of the ownership of these LLPs or LLCs is owned by investors with .01% owned by the developer who serves as the general partner or managing member for management and tax purposes.[32] The general partner or managing member is responsible for the day-to-day management of the development and the partnership and usually serves as the partnership representative for tax matters, the person designated both for IRS correspondence and to serve as an agent with the IRS. The investors serve in a purely passive role.

32. Comptroller of the Currency Administrator of National Banks, Low-Income Housing Tax Credits: Affordable Housing Investment Opportunities for Banks 2 (2008), https://www.novoco.com/sites/default/files/atoms/files/occ_insights_0208.pdf.

Profits, of which there are rarely any, losses, of which there are usually some, and depreciation are shared between the partners based upon their percentage ownership interest. The project must have positive cash flow to operate, and the money is generated from rents. From this cash flow, the costs of maintaining the property, paying utilities, and covering vacancies will be paid. These costs are usually paid to a management company that is selected by the general partner in a partnership or managing member in an LLC.

The developer and most often general partner may be either a for-profit or nonprofit entity, although Section 42 provides a set aside for nonprofit developers. Each year, roughly 21.4% of LIHTC projects are developed by nonprofit entities.[33] Nonprofits whose missions align with housing and community development may see the LIHTC program as a way to further their mission by using federal subsidies while also expanding their network of supporters.[34] The specialized and technical programs can present challenges for nonprofit developers who are unfamiliar with the LIHTC's structure and complexity. While nonprofit developers do play a large role in implementing the LIHTC, at least one writer has found it necessary to warn potential developers of the possible difficulties of the program:

> Nonprofit developers should be aware that this LIHTC program is extremely complicated and rife with land mines for those uninitiated in this type of financing. Early in the development process, sponsors who are seriously considering a tax credit project should retain tax counsel experienced in the low-income housing tax credit.[35]

### *f. The Year 15 Problem*

Even while the mutual benefits of the LIHTC deal are crafted as part of the LIHTC program, there comes a time when the balanced benefits that flow to multiple stakeholders no longer exist. Several reasons exist for an LIHTC transaction to unravel and no longer serve all stakeholders.[36] The end of Year 15, and an incentive for investor LPs consider exiting from the project, are structural within the LIHTC transaction.

Developers who receive LIHTCs agree to rent housing units to tenants with low incomes at specified rents for a specified time. The maximum allowed rent is limited to thirty percent of the Area Median Income (AMI)

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33. *Low-Income Housing Tax Credit (LIHTC): Property Level Data*, Off. Pol'y Dev. & Rsch. (Apr. 30, 2021), https://www.huduser.gov/portal/sites/default/files/pdf/tables9518.pdf.

34. *See* Financing and Funding, Nat'l Ctr. Healty Hous., https://nchh.org/tools-and-data/financing-and-funding (last visited Jan. 22, 2022).

35. Bennett L. Hecht, Developing Affordable Housing: A Practical Guide for Nonprofit Organizations 148 (1994).

36. Corianne Payton Scally et al., The Low-Income Housing Tax Credit: How It Works and Who It Serves 12–14 (2018), https://www.urban.org/sites/default/files/publication/98758/lithc_how_it_works_and_who_it_serves_final_2.pdf.

associated with the LIHTC unit, less a "utility allowance." Tenants must have incomes below sixty percent of the AMI and rents must be no more than eighteen percent (that is, thirty percent of sixty percent) of AMI.[37] For projects developed between 1986 and 1989, Section 42 required developers maintain affordability provisions for a period of fifteen years.[38] For projects developed after 1990 LIHTC projects are required to maintain affordability for thirty years.[39] During the first fifteen years, known as the *Initial Compliance Period*, developers are required to maintain affordability under the rent restriction that was elected when credits were awarded.

Importantly, after the Initial Compliance Period, the tax credit investor has received everything that they had expected when they entered the transaction and the allocated tax credits are no longer subject to recapture, even though rent and tenant income restrictions remain in place.[40] After the Initial Compliance Period, the developer can leave the LIHTC program and its rent restrictions through a regulatory Relief Process,[41] enabling the developer to convert their property to market-rate units.[42] This scenario creates an opportune time for the tax credit partner to exit the LIHTC partnership, with a resulting sale of the LIHTC property.[43]

The structure of the LIHTC program and its reliance on private investors promotes instability in LIHTC projects after Year 15. This is significant for the nation's affordable housing stock. As noted, the LIHTC is the single largest source of funding for the construction of new affordable housing.[44] Between 1987 and the end of 2019, the LIHTC funded 49,449 multifamily housing projects and more than 3.34 million units of affordable housing, all of which are subject to conversion to market rates following the Initial Compliance Period. [45] While many investors, indeed most, will stay in the LIHTC transaction beyond the Initial Compliance Period, a large portion will decide to exit. Roughly a third of LIHTC investors may be expected to exit, resulting in conversion of LIHTC properties to market rates. For LIHTC developments whose compliance period ended by 2009, thirty-two percent of LIHTC units were no longer subject to LIHTC affordability

37. Keightley, *supra* note 25.

38. *See* Joint Ctr. for Hous. Studies of Harv. Univ., *supra* note 31, at 27.

39. *Id.* at 25.

40. *Id.* at 19.

41. *See* Corianne Payton Scally et al., *supra* note 37, at 12–13.

42. It should be remembered that not all LIHTC projects have this option due to state restrictions that require longer rent-restriction compliance periods. Gramlich, *supra* note 18, at 5-19.

43. Kyle Shoemaker, *Diversity into Affordable Housing Investing with LIHTC and HAP Deals*, Forbes (June 8, 2020), https://www.forbes.com/sites/forbesrealestatecouncil/2020/06/08/diversify-into-affordable-housing-investing-with-lihtc-and-hap-deals/?sh=4540050e673f.

44. *See* Joint Ctr. for Hous. Studies of Harv. Univ., *supra* note 31, at 27.

45. HUD LIHTC, *supra* note 5.

requirements following Year 15.[46] At this rate, roughly 1,000,000 units of affordable housing are at risk of conversion to market rates even when the majority of investors remain in the project beyond Year 15.

*g. Options at the End of Year 15*

Once a LIHTC project has reached the end of the Initial Compliance Period, the alignment of interests between the investor members and other stakeholders weakens. At this point, the investor has received the expected return on the investment yet remains a partner in a real estate transaction that no longer provides an economic benefit. A default position at this point would be for the LIHTC project to operate as it has in the past, while waiting for new options to emerge over time. Such a default position is the easiest approach available to the partnership, but only serves to move a delay the decision, without providing a permanent resolution to the investors who will undoubtedly one day seek a further return on their investment. Several other options exist for developers and investors at the end of the Initial Compliance Period, some of which create opportunities to promote community owned affordable housing.

Resyndication is an option for some LIHTC projects. Resyndication allows for new limited partners to replace earlier partners and for the project to receive a new allocation of tax credits, enabling a restructuring of the project. When a LIHTC property has finished the Initial Compliance Period, during the extended use period, the owner has the option of rehabbing the property, usually involving a change in ownership and a new allocation of tax credits to finance the rehab or acquisition. Resyndication describes the subsequent allocation of LIHTCs on a qualified project that has previously received LIHTCs.[47]

While resyndication does allow the original limited partner to exit, such a transaction also involves a new financing along with numerous technical considerations that restrict the project's use going forward. Two situations suggest the use of resyndication when it is available under Section 42: (1) a general partner is a nonprofit developer who is committed to sustaining affordability; or (2) a local rental market with rents at parity with restricted rents under the LIHTC program, thus discouraging a decision to leave the LIHTC program and seek market rents. Resyndication under other circumstances is less likely to seem appealing to the general partner.

46. Jill Khadduri et al., What Happens to Low-Income Housing Tax Credit Properties at Year 15 and Beyond? 39 (2012), https://www.huduser.gov/portal//publications/pdf/what_happens_lihtc_v2.pdf; *What Happens to LIHTC Properties After Affordability Requirements Expire?* HUD User, https://www.huduser.gov/portal/pdredge/pdr_edge_research_081712.html (last visited Jan. 22, 2022).

47. Resyndication is only available if several rules from Section 42 are met. First, the building must be acquired by purchase. Second, at least ten years must have elapsed between the date the building was last placed in service or substantially rehabilitated and the acquisition date, and lastly, the building was not previously placed in service by the original ownership entity or a related party. *See* 26 U.S.C. § 42(d)(2)(B) (2020).

Another option would be for the interest in the project to be sold to new partners or for the LIHTC project as a whole to be sold to a third party, allowing all project partners to exit. While a sale is possible, it would involve significant complexity as the LLP or LLC is unwound and assets are distributed. Moreover, an outright sale, in many instances, might not be possible due to rent or use restrictions placed on the project by the state finance agency. Another alternative would be for the investor partner or general partner partnership interests to be sold. In this case, the acquiring entity would step into the place of the exiting partner with the original rights of that partner under the transaction documents.

The general partner or managing member may also exercise their purchase option to buy out the limited partnership interest in the LIHTC project. The original partnership or operating agreement will provide terms and conditions for exercising the option. General Partners (GPs), which are nonprofit organizations, will sometimes have a right of first refusal to any sale, which may provide a means to sustain affordability over a longer period of time.[48]

Several possible outcomes following Year 15 present opportunities for cooperative ownership of the LIHTC project. The first involves an outright sale of the LIHTC project, where all partners exit. Resyndication, with an existing investor partner, is the next. Another is a transaction in which the nonprofit general partner retains a right of first refusal. The following section discusses how cooperative ownership may be structured in a way that promotes broad community engagement in maintaining affordable housing.

## II. Exit to Community Strategy for Expiring LIHTC Projects

Of the four options available to owners of LIHTC projects at the end of Year 15,[49] buying out the investor partnership interest and an outright sale of the property lend themselves to cooperative ownership. Under the buyout option, the general partner would purchase the investor partner's interest, or the investor partner's interest would be sold to a new limited partner who would step into the exiting partner's place. Any investor partnership buyout must comply with the limited partnership agreement (LPA), or operating agreement (OA) used as part of the project. The LPA or OA will almost certainly have a well-defined exit plan for partners, and this plan will include a mechanism to determine the price of the exiting member's interest. An outright sale of the LIHTC is a fairly straightforward transaction. Even though affordability restrictions will be required beyond Year 15, the LIHTC property will continue to generate revenue that can be used by the new owners to support the project's refinancing.

48. The right of first refusal under 26 U.S.C. § 42(i)(7).

49. These options are to hold the property, execute an investor partner buyout, resyndicate the property, or conduct an outright sale of the project and liquidate the partnership. *See* Khadduri et al., *supra* note 47, at 29–64.

This section introduces structural options for cooperative ownership of the LIHTC property and an overview of broad community-supported financing options.

### *A. Organizing an Entity for the Transaction and Developing the Housing Cooperative*

The first step to moving an LIHTC project to broad community ownership is developing an organizational structure for the effort. Families living in the LIHTC project may be motivated by the promise of owning their home and organizers might draw on the benefits associated with home ownership to build community support. Owning a home provides many benefits to families. For many families, a home is the largest asset that they own and provides access to both equity, when needed for things like starting a business or financing an education, as well as long-term savings.[50] Children who live in a home owned by their family do better in school, read at a higher level when they enter school, and have lower encounters with the justice system.[51] While the traditional model for home ownership in the United States is a single family home that is owned by the family that lives there and financed by a private lender, this is not the only structure available to families seeking home ownership. Cooperative ownership of housing projects offers the same promise to families as found in single family ownership. Moreover, cooperative ownership nurtures community and interdependence between people, thereby enhancing social capital and political voice.[52] Consequently, cooperative ownership structures provide a somewhat ideal way to organize efforts designed to maintain affordable housing stock after Year 15.

### *B. Cooperative Ownership Generally*

Cooperatives represent a particular type of ownership and governance, and they operate in all sectors of the economy. The Cooperative may also be known as a Cooperative Association or Coop Corporation. It is a legal entity that is organized and operated according to a set of principles to support the shared interest of members. Cooperatives first came into prominence in the United States in the early twentieth century, when they provided a way to accumulate capital for infrastructure development and were used to coordinate agricultural producers to increase crop prices.[53]

50. Julie D. Lawton, *Limited Equity Cooperatives: The Non-Economic Value of Homeownership*, 23 J. Affordable Hous. & Cmty. Dev. L. 383, 389–99 (2015).

51. *Id.* at 401.

52. *Id.*

53. The Tax Code provides for special tax treatment of co-ops in Subchapter T ("Cooperatives and Their Patrons"). In general, cooperatives are governed under Subchapter T of the Internal Revenue Code of 1986 which comprises Sections 1381–1388 inclusive. The rules in these sections also relate to exempt Farmers' Cooperatives organized under Section 521. Cooperatives may or may not be organized as such under state law. They can also be corporations or limited liability companies under the "Business Statutes" of state

Most states have statutes dedicated to the cooperative form,[54] with many of these statutes dating from between 1910 and 1930.[55] More recently, cooperative statutes have been revised in several states to allow for a broader range of cooperative activities, which include worker cooperatives, consumer cooperatives, and housing cooperatives.[56] Organizing an entity under state cooperative law provides one way to form a cooperative venture, but cooperatives may be formed under state business corporations and limited liability company laws as well. This is because cooperative enterprises are designated as such by certain factors that may be integrated into any of these entity forms.

Cooperatives, by their nature and definition, follow certain principles. Democratic governance, meaning one-member-one-vote, is one of the central principles that define a cooperative. Distribution of profits based on patronage and not equity is another. Equity ownership is subordinate to participation, so no one owner holds a controlling position in the cooperative. Patronage is a particular way to distribute profit among owners. In contrast to the typical stock corporation, where profit is distributed to shareholders in proportion to their ownership interest, in a cooperative, profit is distributed to member owners in proportion to each member owner's contribution to the cooperative's overall profit and not ownership. For example, consider a cooperative with ten member owners, each of whom owns an equal share. In a corporation, any profit would be distributed among these ten members equally. But in a cooperative, any profit will be distributed in proportion to the work done by each member. So, if one of the ten generated one-half of the profits, that member would receive one-half of the distribution, even though they only own the equivalent of one-tenth of the entity.

Additional cooperative principles include voluntary and open membership; member economic participation; autonomy and independence; education; cooperation among cooperatives; and a concern for community.[57] Organizations that operate in a cooperative manner, no matter the form of their organization, reflect at least some of these cooperative principles and may be seen as cooperatives even when not organized under a state statute specific to cooperative associations.[58]

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laws. Subchapter T essentially acts as a default: the entity may be a "cooperative" for federal tax purposes even though it is organized under a state business corporation or trade association statute. 26 U.S.C. §§ 1381–1388.

54. *See Group-Equity Housing Cooperative Incorporation Statutes by State*, NASCO, https://www.nasco.coop/resources/group-equity-housing-cooperative-incorporation-statutes-state (last visited Jan. 22, 2022).

55. *See id.*

56. *Id.*

57. Lawton, *supra* note 51, at 413–24.

58. The definition of "operating on a cooperative basis" was established in a court case, *Puget Sound Plywood, Inc. v. Commissioner of Internal Revenue*, 44 T.C. 305 (1965). It requires that a corporation possess the following characteristics to qualify for Subchapter

### *C. Cooperative Housing Ownership*

Cooperative ownership of housing has existed for more than a century in the United States.[59] The model has gained greater attention over the last forty years, however, in response to increasing housing costs in some areas and as a means to enable new immigrants to step into ownership.[60]

Cooperative ownership of real property is a special form of ownership. In cooperative ownership, a cooperative corporation, business corporation, or limited liability company operating under cooperative principles owns and holds title to real estate. Members of the cooperative, also known as cooperators, own a share or interest in the company, which entitles the member to possess and use a particular unit. In a multi-family project, the unit will be a designated apartment, and, in a mobile home park, the unit will be a designated manufactured home, etc.

The ownership interest of property held cooperatively does not fit cleanly within historical classifications of a property interest. The member's property interest is derived from their ownership of the share or LLC interest, and as such does not fit neatly within real property law. The cooperative corporation is not a business corporation, in the ordinary sense, nor may it be a nonprofit corporation. It operates instead as a mechanism for the common ownership of real property. As with cooperatives generally, governance of the housing cooperative lies with the members/shareholders who in addition to owning their share also manage and operate the property.

Membership in the cooperative allows each member to have possession and use the real property, even though their ownership interest is not in the real estate itself. Shares of the cooperative are personal property, not real property, even though share ownership provides the shareholder with

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T treatment: "[p]romotes the subordination of capital, with respect to control over the cooperative undertaking (i.e., power and control are not allocated based on the amount of capital invested); [a]ffords democratic control by the members; [v]ests in and allocates among the members all net profits in the form of patronage. One important note on naming—organizations that operate cooperatively but that are not organized under a state cooperative association law are not able in most states to use the word "cooperative" in their name. *Id.*at 405–08.

59. Cooperative ownership of housing gained interest in the United States as early as the 1920s, *see e.g.*, Otis H. Castle, *Legal Phases of Co-operative Buildings*, 2 S. Cal. L. Rev 1, 2 (1928), *see also* Ackerman, *Cooperative Housing*, 10 J. Am. Inst. Architects 388, 389 (1922), but gained broader use as a means to address affordability following World War II, *see Postwar Co-ops*, 88 Arch. Forum 93 (1948). "In the era following World War II, many observers viewed cooperative housing as the ultimate source of shelter for practically every income group." Patrick J. Rohan, *Cooperative Housing: An Appraisal of Residential Controls and Enforcement Procedures*, 18 Stan. L. Rev. 1323, 1324 (1966).

60. Immigrant-Owned Cooperatives, Sustainable Econ. L. Ctr. (July 2017), https://www.theselc.org/immigrant_coops.

a right to use and possess real property. Cooperative ownership thus contains elements of both personal property and real property ownership.[61]

Conversion of existing multi-family real estate to cooperative ownership is an effective way to preserve, stabilize, and maintain affordable housing in communities.[62] Multi-family real estate projects may convert to cooperative ownership. To accomplish a conversion, coop developers create a cooperative ownership plan consisting of the vesting of title in the real property in a corporation and the designation of a specific unit for use by each shareholder/member, along with distribution of shares in the corporation—usually proportionate to the investment made. A monthly installment payment is negotiated between the corporation and each shareholder/member. This payment is based on a proportionate cost to carry any debt on the real estate, cover repairs and maintenance, taxes, and joint improvements.

Elements of property ownership are found in the housing cooperative structure, although it is in many ways a more complicated form of ownership for some. Members/shareholders are primarily interested in obtaining and securing a home. The relationship between residents differs, however, from that found in most multi-family rental housing. Residents pay monthly maintenance payments that look like rental payments in a landlord-tenant relationship, and residents make a substantial financial investment in their housing and share a direct interest in the cooperative's financial stability. As such, there is a shared interest in maintaining the character of the property, including maintaining a reputation as a desirable place to live and assuring personal conduct that protects not only the shared investment but also quality of life.

### *D. The Challenges in Cooperative Ownership*

While cooperative ownership for housing offers many benefits, it is not without challenges. Cooperatives have long been seen as suspect, by some, and as a means of enabling sellers to exact higher prices for their developments in areas with rent control or tenants protections.[63] Those who sponsor housing cooperatives may easily take advantage of their position

61. The unique dualism of both personal and real property interests leads to complexity: whether a housing cooperative membership should be treated as real property, and thus vested with protections available in a mortgager relationship or treated as personal property. Cases show that the courts have not adhered to any one characterization of the housing cooperative membership interest, opting instead for a case-by-case approach to determine the application of any particular law or rule. *See* Julie D. Lawton, *Unraveling the Legal Hybrid of Housing Cooperatives*, 83 UMKC L. Rev. 117 (2014).

62. At the same time, conversion can create hardships for some. Tenants who either cannot afford to purchase a member share or who do not desire to be part of a housing cooperative at all may face hardship in either financing the purchase or needing to move.

63. *See Cooperative Apartment Housing*, 61 Harv. L. Rev 1407 (1948)

to exact exorbitant profits through development and management fees.[64] The lack of adequate consumer protection methods throughout the 1950s and 1960s created an overall dissatisfaction with housing cooperatives for many tenants.[65]

Managing the housing cooperative brings additional challenges. Housing cooperatives depend on a shared understanding among members as to how they will live together and what rules will be followed. Control of commons areas, maintenance standard, and noise or occupancy restrictions are enforced through a set of rules adopted by members.[66] Such residential controls when adopted by cooperatives are often more extensive than those found in other housing arrangements, such as market apartments or rental housing. Perhaps inevitably, disputes arise that lead to management challenges that may doom the cooperative, or at the very least lead to significant time investments to manage both resident controls and the disputes that follow.

Additional concerns arise in the context of maintaining affordability. While cooperative housing ownership provides a lower cost way for residents to secure affordable housing, the housing may transition to market rates and lose its affordable character. Such transitions also offer a potential windfall to coop members. For example, the West Village Houses in New York City is a 418-unit multi-family housing complex in Greenwich Village. In 2006, residents formed a housing cooperative and purchased the development.[67] At that time, tenants were able to purchase their units for prices between $125,000 and $350,000. Tenants, now coop members, also enjoyed reduced property taxes. The cooperative had instituted a cap of resale prices in an effort to maintain affordability over time. By 2018, however, increases in property values made reconstituting the cooperative at market rates highly attractive. In 2018, after resale restrictions were removed, ninety percent of the coop members elected to convert to market rate sales, enabling members to sell their apartments into a market with a median price of $999,000.[68]

Cooperatives are often viewed with skepticism and do require significant managerial skill. Moreover, maintaining affordability in a housing cooperative is not a necessary certainty over time and is perhaps made

64. *See* Edward Parker, *Cooperative Housing in the United States, Mid-1950*, 73 Monthly Lab. Rev. 258 (1951), cited by Rohan, *supra* note 60, at 1323.

65. Gerald Sazama, *A Brief History of Affordable Housing Cooperatives in the United States* 3–4 (Univ. of Conn. Econ. Working Paper No. 199609, 1996).

66. See Rohan, *supra* note 60, at 1326–28.

67. *West Village Houses Co-op Transitions from HDFC to Market Rate*, Habitat Mag. (June 8, 2020), https://www.habitatmag.com/Publication-Content/Board-Operations/2020/2020-June/West-Village-Houses-Co-op-Transitions-From-HDFC-to-Market-Rate.

68. Robert Frank, *Manhattan Real Estate Prices Reach Record as Buying 'Frenzy' Takes Hold*, CNBC (July 2, 2021), https://www.cnbc.com/2021/07/02/manhattan-real-estate-prices-reach-new-record-with-buying-frenzy-.html.

more tenuous in highly appreciating real estate markets. Nevertheless, the ownership structure does offer promise to both secure affordability over time and to enable family asset development.

### *E. Limited Equity Housing Cooperative*

The Limited Equity Housing Cooperative (LEHC)[69] is a particular type of housing cooperative ownership that secures long term affordable housing by fixing an upward limit on the amount of equity that a member may receive when selling their member share or when the project demutualizes.[70] In many ways, the LEHC looks and operates similarly to "market cooperatives."[71] As with the market cooperative, once organized the LEHC becomes a separate entity enabled to conduct business in its own name. The LEHC may purchase and manage real estate, subject to state real estate broker laws, for the use and exclusive occupancy by the LEHC's members. LEHC members have exclusive rights to use the property where they live subject to the LEHC governance documents. The key distinction is found in what members may expect from their cooperative.

The LEHC restricts the amount of equity that a member may realize on the sale of their member share and couples this limitwith an affordability measure for new members who join the cooperative. By doing this, the LEHC assures that its housing stock will remain affordable indefinitely. Affordability restrictions are contained within the LEHC in the form of transfer restrictions on the sale of stock and, usually, in the articles of organization or incorporation.[72] In many cases, the member's equity is limited by use of a formula that caps appreciation at a set percentage over time.

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69. In states that offer cooperative statutes that are well suited to owning and operating housing, the LEHC may be organized by filing creation documents under those statutes, usually articles of cooperation or articles of organization, with the Secretary of State. As noted above, it is not necessary to rely on state cooperative statutes to organize the LEHC. The LEHC may also be formed under state Limited Liability Company acts and state Business Corporation Acts. The particular entity form that is selected is not as relevant as whether the entity observes certain principles in governance and ownership. *See* Hilary Abell et al., California Cooperatives 7 (2021).

70. *See* Lawton, *supra* note 51, at 410.

71. A Market Cooperative places no restrictions on the residents who live in the cooperative or on the resale price that may be charged by a member when they leave the cooperative. In effect, the market sets these prices. *Id.* at 409–10.

72. Restrictions within the organizational documents are likely to be enforced by courts more easily than deed restrictions placed directly on real property, which would be recorded in the form of a restrictive covenant or equitable servitude. Enforcement of such restrictions is itself burdensome, most often involving injunctive and other equitable remedies, but in some circumstances such restrictive covenants may be set aside. *See generally* Risa Lynn Wolf-Smith, *Shedding Burdensome Restrictive Covenants in Real Estate Sales*, 33 NOV Am. Bankr, Inst. J. 30 (2014).

For example, the member's share is limited to increase in value by two to five percent each year.[73]

A LEHC can be used to purchase the limited partners' interests or the project as a whole following the affordability period. The LEHC is particularly well suited to acquiring the LIHTC project because of the affordability requirements of the structure itself. The revenue models of the LIHTC project contain affordability mandates and will have operated based on these mandates for at least fifteen years. The LEHC, as such, steps into a project that operates in a way that is aligned with the coop's mission and purpose.

## III. Financing Cooperative Ownership of LIHTC Projects

Although financing the acquisition of the LIHTC requires some advanced planning and preparation, it is not impractical. In fact, the very nature of a cooperatively owned housing initiative aligns with financing options through broad public offerings under existing securities regulations.[74]

Generally, any company engaging in a securities offering, either in the form of the sale of equity or the issuance of debt, is required to register those securities with the Securities and Exchange Commission (SEC), as well as any appropriate corresponding state office. Registration is a very time-intensive process that requires a degree of expertise, along with a significant budget for fees and costs. Numerous exemptions to this broad registration requirement exist, however, and these exemptions may be relied upon by cooperative entities issuing shares to finance the acquisition of a LIHTC project. This section provides an overview of common securities

73. While the LEHC does offer the promise of preserving affordability, that promise comes at a cost for members who are unable to benefit from unbounded appreciation in the value of their property. For example, in markets where real estate is rapidly increasing in value, the LEHC member is unable to participate in the wealth that is created. *See* Chelsea Catto, *Manufactured Housing Cooperatives: Innovations in Wealth-Building and Permanent Affordability*, 26 J. Affordable Hous. & Cmty. Dev. L. 13, 17 (2017).

74. The following section discusses rules that apply to broad offerings made to individuals who would not necessarily live in a formerly LIHTC property. There is a dedicated exemption from registration under Section 15(a) of certain securities offered in connection with cooperative housing. See 17 C.F.R. § 240.15a-2 ("Shares of a corporation which represent ownership, or entitle the holders thereof to possession and occupancy, of specific apartment units in property owned by such corporations and organized and operated on a cooperative basis are hereby exempted from the operation of section 15(a) of the Securities Exchange Act of 1934, when such shares are sold by or through a real estate broker licensed under the laws of the political subdivision in which the property is located."). The exemptions' availability depends upon the purchaser's motivation being a desire to use the cooperative housing for their own use. *See, e.g.*, Teague v. Bakker, 35 F.3d 978, 987–89 (4th Cir. 1994). For practical reasons, it is unlikely that residents of a LIHTC property would have the finances to purchase shares in a cooperative created to own the housing. It is more likely that individuals who will not live in the property will be needed to fund the acquisition, and the following regulations will apply to such an offering.

registration exemptions that may be used to finance the purchase of the LIHTC interest.

*a. Section 4(a)(2)*

Section 4(a)(2) of the Securities Act of 1933 (Securities Act) exempts from registration those transactions that do not involve a public offering. The section does not define either "public offering" or "private offering." The SEC, however, has focused on certain factors to determine whether a transaction will be deemed to involve a "public offering." These include the sophistication of the buyer, the number of offerees, and the manner of the offering—excluding general offerings to the public and making an offer to sale through a direct communication with eligible buyers.[75] Section 4(a)(2) is transaction-specific and does not provide a blanket, indefinite exemption covering resale of the securities.

*b. Regulation D*

Adopted pursuant to Section 4(a)(2), Regulation D offers an objective test for determining when an offering qualifies as a private placement under Section 4(a)(2). Regulation D contains several individual exemptions, each of which has its own requirements and eligibility. Two of the exceptions—found in Rules 504 and 506—fit nicely with the type of broad public fund raising that would be pursued to finance the purchase of the LIHTC interest.[76]

Rule 504 allows an issuer to offer up to $5 million in securities during any twelve-month period without filing a registration statement. Securities offered under Rule 504 may be made to any number of investors, including investors who are not accredited or sophisticated. General solicitations to the public, however, continue to be disallowed. As with many exemptions, Rule 504 does not preempt state securities laws, and the issuer must comply with registration of any state where the securities are being offered and sold.

Rule 506 contains two relevant subrules: 506(b) and 506(c). There are no limits to how much an issuer may raise under Rule 506, which is attractive,

75. One of the factors, which is regularly considered, is the sophistication of the buyer of the offered security. A sophisticated buyer is a person who has sufficient business knowledge to evaluate the risks involved in making an investment. *See* Adam J. Levitin, *Safe Banking: Finance and Democracy*, 83 U. Chi. L. Rev. 357, 407 (2016).

76. All Regulation D exemptions disqualify certain individuals, named "bad actors," from relying upon the exemption when offering a security. The bad actor provisions preclude an issuer or other "cover person" who has experienced a "disqualifying event" from relying on Regulation D to avoid registration for some period of time. Disqualifying events include convictions for securities fraud, bars by certain federal or state regulators from engaging in the business of securities, insurance, or banking, or from savings association or credit union activities; certain cease-and-desist and other orders by the SEC; and certain suspensions, expulsions, or bars from association with a registered national securities exchange. 17 C.F.R. § 230.506 (2013).

but there are limits on to whom an issuer may offer a security. Rule 506 allows only accredited investors, for the most part, to invest. An accredited investor is a potential investor who meets certain investment and income thresholds.[77] Accredited investors do not receive the disclosure protections under the Securities Act because individuals with significant wealth are deemed to be better able to assess the risks in an investment and, second, better able to bear a loss.

Rule 506(b) permits an unlimited number of accredited investors along with thirty-five nonaccredited investors, who nevertheless must be seen as financially sophisticated, to purchase shares from the issuer. Issuers relying on Rule 506(b) may not widely advertise the offering and must also take affirmative steps to assure the accredited investor status of each investor.

Rule 506(c) allows for an unlimited number of accredited investors but does not allow any investors who are not accredited and continues to require the issuer confirm the investors status. While more restrictive on this point, 506(c) does allow the issuer to advertise the offering without violating the rule. In addition, compliance with Rule 506(c) preempts requirements of state Blue Sky laws. An issuer may, as a result, face significantly reduced regulatory burdens by relying on Rule 506(c), compared to Rule 506(b).

Finally, securities offered based upon Regulation D will be considered "restricted securities," meaning that they may not be resold unless they are subject to another registration exemption. The investor must be notified of the restricted character of the securities.

*c. Crowdfunding and Regulation CF*

Regulation D provides two useful options for issuers who seek to raise funds primarily from accredited investors. For those issuers who have access to such investors, Regulation D is often the preferred mechanism for complying with the Securities Act. With the passage of the Jumpstart Our Business Startups (JOBS) Act of 2012,[78] Congress provided a new registration exemption that offers greater flexibility for attracting investors who are not accredited or sophisticated: Regulation CF.[79]

Regulation CF implements relevant JOBS Act provisions; through it, an issuer may make a broad public offer to solicit investments, including through social media and online promotion. Regulation CF allows certain companies[80] to raise money without regard to the number or type of inves-

77. Accredited investors include, among others, any of the following: a bank or savings and loan, a private business development company, a charitable 501(c)(3) organization with more than $5,000,000 in assets, and a natural person who individual net worth exceeds $1,000,000—excluding a primary residence. See 17 C.F.R. § 230.501(a).

78. Jumpstart Our Business Startups Act, Pub. L. 112-106, 126 Stat. 306 (2012).

79. *See*, Regulation Crowdfunding, 15 U.S.C. 77d et seq, 17 C.F.R. pt. 227.

80. Issuers who are not reporting companies, investment funds, a non-U.S. issuer or disqualified under the SEC's "bad actor" rules may take advantage of Regulation CF to

tors. Consistent with Regulation CF, a company may solicit investments from the general public without registering the offer and sale as otherwise required under the Securities Act. Further, under Regulation CF, any investor, regardless of wealth or income, may invest in the offering, although total investment amounts from any one investor may be fairly limited. Regulation CF, in short, enables issuers to make broad public appeals for investors without first registering the offering, while not creating ways to confirm an investor's status.

Regulation CF enables expanded access to financing without creating additional potential for fraud or misrepresentations to investors by relying upon independent intermediaries to complete the transaction. All offerings made pursuant to Regulation CF must be conducted through a single online intermediary. The online intermediary may be a FINRA- or SEC-registered broker dealer or a funding portal that has been recognized as such by the SEC.[81] The issuer may rely upon the intermediary to assure that the offer and purchase of a security comply with Regulation CF and related regulation.

Offerors may advertise under Regulation CF as long as the advertisement consists solely of a notice directing potential investors to the intermediary, funding portal, or broker, who will provide additional information and close the transaction. Once a potential investor has contacted the intermediary, however, the issuer may communicate directly with that potential investor regarding the offer.

Regulation CF preempts state laws, so an offer that complies with all aspects of Regulation CF does not need to run a second regulatory scheme under state blue sky laws. As with Section 4(a)(2), securities sold under the Regulation CF exemption may not be resold for one year, other than to a limited group of transferees.

While Regulation CF offers many appealing features, it can be a difficult and expensive option. As noted, the SEC requires that Regulation CF transactions take place through an SEC registered intermediary, either a registered broker or funding portal. This requirement can increase the cost of the transaction significantly. Although the issuer may make broad solicitations, essentially enabling them to reach out to any potential investor, the amount that an individual investor may invest is limited based on that particular investor's income. In some cases, that limit may be as low as $2,200 across all funding portals during any twelve-month period. Adding additional complications, the maximum that may be invested varies with the income and assets of each investor and limits even accredited investors seeking to invest in a Regulation CF offering. Issuers under Regulation CF also have ongoing reporting obligations once the transaction closes.

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attract a broad range of investors to their company. 17 C.F.R. § 227 (2012).

81. *See* 15 U.S.C. § 77(a)(6); 17 C.F.R. § 227.300.

*d. Intrastate Offerings and the JOBS Act*

In addition to enacting Regulation CF, the JOBS Act also adopted a simplified intrastate offering exemption under Rule 3(a)(11) and contained in Rule 147A. The issuer must satisfy the following criteria to quality for the exemption under Rule 147A: the issuer's principal place of business must be in the state where the offer is being made; the issuer must conduct business in the state where the offer is made;[82] sales must be made to instate residents or buyers who the issuer reasonably believes are residents of the state; and each buyer must provide the issuer with a written representation as to their residency.

Prior to the JOBS Act, Rule 147 similarly offered an exemption to wholly in-state offerings, although through a more complicated mechanism. In addition to the requirements noted for the exemption under Rule 147A, offers made under Rule 147 require that the issuer be organized in the state where the offer was made, and offers may only be made to residents of that state. Rule 147A, in contrast, allows a much less restricted path to offering securities.

There is no ceiling to the amount that may be raised through an intrastate offering under Rule 147 or Rule 147A, although a single out-of-state purchaser voids the exemption for the entire offering. It is therefore critical for the issuer to confirm that each purchaser is a resident of the state where the offer is made.

*e. Offerings from Nonprofit Organizations*

One other option is to collaborate with a charitable, nonprofit organization whose mission is dedicated to expanding affordable housing. Securities issued by an entity organized and operated exclusively for religious, educational, benevolent, fraternal, charitable, or reformatory purposes and not for profit are exempt from the Security Act's registration requirements as long as no part of the net earnings of the issuer inures to the benefit of any private individual.[83] To qualify for the exemption, the issuer must not have any purpose or activity that is inconsistent with the terms of the exemption within the Securities Act, as well as being organized and operated for an exempt purpose. While the Securities Act tracks similar language regarding tax-exempt organizations under both the Tax Code and state law, the fact that an organization is recognized as tax-exempt due to charitable activities under state of federal law is not enough, in itself, to qualify an

82. To meet this requirement, the issuer must (1) derive at least eighty percent of its consolidated gross revenues from the operation of a business or of real property located in-state or from the rendering of services in-state; (2) have at least eighty percent of its consolidated assets located in-state; (3) intend to use and use at least eighty percent of the net proceeds from the offering towards the operation of a business or of real property in-state, the purchase of real property located in-state, or the rendering of services in-state; or (4) have a majority of its employees based in-state. 17 C.F.R. § 230.147A (2021).

83. *See* 15 U.S.C. § 77c(a)(4).

issuance for the exemption.[84] Nor are the articles of incorporation or other formational documents adequate in themselves to establish qualification for the exemption; courts may judge whether an organization satisfies the exemption based upon all available facts, going well beyond the organizational documents.[85] In addition, the organization must operate in a manner that does not generate "pecuniary profit." This restriction requires the nonprofit organization to assure that no part of its net earnings inure to the benefit of any person, shareholder, or individual.[86] Profit includes not only positive revenue generated from activities, but also any part of the organization's net earnings that inure to the benefit of a private individual. The term "profit" has been construed to include profits from the organization's earnings from any source where such profit inures to the benefit of any private individual connected directly or indirectly to the organization.[87]

"Charitable purpose" requires dedication to a general public benefit for an indefinite group of people, who are not required to give adequate consideration for benefits received from the organization.[88] Developing and operating affordable housing is a long recognized charitable exempt purpose under the Tax Code.[89]

It would be possible for a 501(c)(3) organization to issue securities to fund the acquisition of either the exiting partners' interest or the project as a whole. Once the 501(c)(3) organization has ownership of the property or interest, that organization could then contract with a housing cooperative to manage the property to secure affordable housing for a group of people who align with the charity's mission and purpose.

## IV. Identifying a LIHTC Project Nearing Year 15

Finding an appropriate LIHTC project to convert to cooperative ownership post Year 15 will take time and effort, but there are well defined paths to move along. Each state housing finance agency maintains a database on LIHTC deals and years left in the initial compliance period. Once a property is identified, two lines of work will begin, with details regarding the transaction on one line and the organizational capacity to form a cooperative to step into ownership on the other.

Developing the transaction will start with a review of the partnership or operating agreement. This agreement should contain a description of the procedure to be followed when a member exits. The process usually begins with the withdrawing member giving the company manager notice of its

84. *Id.*; E.H.I of Fla., Inc. v. Ins. Co. of N. Am., 499 F. Supp. 1053, 1062 (E.D. Pa. 1980).

85. *See, e.g.*, SEC v. Am. Found. for Advanced Educ. of Ark., 222 F. Supp. 828, 831 (W.D. La. 1963); SEC v. Children's Hosp., 214 F. Supp. 883, 889 (D. Ariz. 1963).

86. 15 U.S.C. § 77c(a)(4).

87. *See, e.g.*, Calderon-Serra v. Wilmington Trust Co., 715 F.3d 14, 18 (1st Cir. 2014).

88. 15 U.S.C. § 77c(a)(4).

89. *See* Timothy L. Horner & Hugh H. Makens, *Securities Regulations of Fundraising Activities of Religious and Other Nonprofit Organizations*, 27 Stenson L. Rev. 474, 474 (1997).

voluntary withdrawal or transfer to another person or entity. It should be remembered that LLCs are creatures of contract,[90] and members are provided with great flexibility to craft a relationship between members/partners that suits their individual needs and goals. This flexibility means that exit mechanisms may differ across any given group of operating agreements, requiring a close review of relevant provisions before proceeding.

Price will also be an early consideration. Pricing an LIHTC project interest can involve a number of factors. Practitioners report that LIHITC multifamily projects will often sell for 225 to 350 basis points above long-term debt prices.[91] Section 8, either Housing Choice Voucher or Project Based Rental Assistance, adds an additional 50 to 100 basis points to the pricing.[92] Once a price and process for the sale can be set, financing goals can be set, and the capital raise begun or finalized.

Organizing the cooperative runs on the second line. The first step is to identify the developer. Cooperatives begin with a developer, a person or organization that takes responsibility for moving the cooperative from idea to realization. Developers offer technical assistance, organizational templates, best practices, and access to a network of similar mission-driven organizations. In some instances, the developer has access to capital that enables the cooperative to purchase a housing development.[93] The developer will often take on an administrative role within the new cooperative, serving as the decision maker on day-to-day decisions while the cooperative is still developing internal leadership.[94] During the beginning stage of a new housing cooperative, the developer is responsible for exploring potential projects for conversion, developing financial projects, and structuring a cooperative plan. The developer also is responsible for onboarding new members of the cooperative, a process that requires an understanding of the common bonds between members and the organizational culture that develop among them. The developer's role is highly specialized, requiring not only finely tuned understanding of organizational development, but also some understanding of the legal environment for coops and how best to administer the coop's operations.

Once a developer is identified, this leads the creation of a cooperative development plan, which will require its own specialized skills. This plan

90. *E.g.*, Del. Code Ann. tit. 6 § 18-1101.

91. *See An Overlooked Option for Financing Multi-Family Affordable Housing*, Williams Mullen (Nov. 15, 2011), https://www.williamsmullen.com/news/overlooked-option-financing-multi-family-affordable-housing-obtaining-tax-exempt-housing-bonds-local.

92. *See Housing Choice Vouchers*, U.S. Dep't Hous. & Urb. Dev., https://www.hud.gov/topics/housing_choice_voucher_program_section_8 (last visited Jan. 22, 2022).

93. *See, e.g.*, Seed Commons: A Community Wealth Initiative, https://seedcommons.org/about-seed-commons (last visited Jan. 22, 2022).

94. *See* Democracy at Work Institute, U.S. Fed. Worker Coops., https://institute.coop/about-dawi (last visited Jan. 22, 2022).

contains all elements of a business plan[95] as well as an assessment of membership development and elements of cooperative management that are unique to housing cooperatives. These include mechanisms to manage an existing member, financing the purchase of the exiting member share, and mission-driven limits on equity growth and membership, as well as other elements.

Creating the financial plan is the next step in forming the housing cooperative—one that depends on the development plan. The developer might create this plan, but it is more common for someone with focused finance experience to take on this responsibility.[96] The financial plan reviews the target LIHTC project and analyze the project's market value, revenue streams (both prior to and following a conversion), operating costs, costs of improvements or rehabilitation, and transaction costs. With these projects in hand, the developer and initial members may plan to move forward with making an offer for an identified project.

Others are certainly needed, such as an attorney who understands cooperative ownership, for example. Once the financial plan is developed, however, the developer and potential members are able to assess whether to proceed with making an offer on the LIHTC interest. The cooperative will only succeed if all members mutually agree to commit to the financial and personal commitments needed to make both the acquisition and operation successful. The financial plan provides the first opportunity to assess these commitments. If members are committed to the idea and the financial plan promises viability, then the acquisition may proceed. If members withdraw support once presented with the plan, then the nascent cooperative can move on to the next opportunity or end. With the cooperative development plan, business plan, and financial plan in hand, the cooperative can move forward with securing the membership required for it to progress.

## V. Conclusion

As LIHTC projects complete their initial compliance period, communities might lose affordable housing stock in communities where such housing is needed. Cooperative ownership models provide one strategy to retain affordable housing indefinitely. This article has introduced the challenges facing LIHTC projects at Year 15 and the role that housing cooperatives may play in retaining affordable housing after the tax credits expire. Timing is a key to success here; advocates and developers seeking to purchase expiring LIHTC projects through a cooperative ownership model need to plan well in advance, developing the organizational structure and technical ability required of the transaction. Once completed, however, cooperative housing ownership offers broad-based community ownership for affordable housing and long-term stability for securing affordable housing stock.

95. Co-op Mastery: Co-op Business Planning, Ohio State Univ., https://u.osu.edu/coopmastery/co-op-business-planning/ (last visited Jan. 22, 2022).

96. *See id.*