

Protecting Affordable Housing Communities

Baltimore Metropolitan
Council

Right of First Refusal in the Housing Credit Program

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Year 15 Disputes: Nonprofit General Partners

- These challenges of nonprofit transfer rights has led to troubling **legal disputes and litigation**.
- Limited partners (LPs) have typically taken the position that the Section 42(i)(7) ROFR is a common law right-of-first-refusal & they don't have to recognize the rights established in the partnership agreement without their consent and a bona fide offer from an unrelated third party. In essence, **they have rejected a bargained-for-right in the partnership agreement held by the nonprofit** -- taking the position that the contractual language is basically meaningless.
- Often allege breach of fiduciary duty by GP



Year 15 Disputes: For-Profit General Partners

- These disputes also involve for-profit GPs.
 - In those instances, LPs have typically taken issue with the purchase option held by the general partner:
 - disputing fair market valuations
 - demanding payoff of positive capital account
 - insisting on allocations based on liquidation of partnerships
- As with nonprofit deals, LPs allege breach of fiduciary duty to gain leverage

Impact of Year 15 Disputes

- Most GPs don't have the resources to litigate these issues in court, so a stalemate ensues – then the **investors leverage a cash payment or a sale of the property in return for leaving the partnership.**
- The use of scarce funds for this payment undermines the continued viability of the property of affordable housing – **contrary to the intent of Congress.**
- When limited partners drain resources from a property, they **undermine a mission-driven nonprofit's ability to serve its residents, & the broader community.**

Impact of Year 15 Disputes cont.

Detrimental to the public interest because it diverts funds from affordable housing to investors with the following potential effects:

- Erosion of property reserves
- Higher rents
- Deferred maintenance
- Decreased resident services
- Higher levels of debt to fund payoff to investors
- Hits to the nonprofit's balance sheet
- Diverted staff resources
- Sale of property

Industry Trends and Red Flags

- Increased activity by aggregators to obtain control of investor LP interests
 - Acquisition of syndication companies, funds, individual investor interests
- Litigation against fund GPs
- Increasing play by other syndicators and direct investors for residual value
- Emergence of private equity to obtain control of LP interests, including Blackstone acquisition of SunAmerica

HFA Trends

Protecting Existing Properties

- Require agency review of any sales or transfer of investor interest. Allow agency to reject any party that has refused to honor a Section 42 ROFR, been involved in litigation against a nonprofit sponsor, etc.
- Ensure developers understand their ROFR rights & current agency regulations.
- Assist nonprofits to prepare for Year 15 discussions with investors to ensure nonprofit exercises its ROFR rights & to facilitate an orderly exit.

HFA Trends

Protecting New Allocations

- Exclude equity providers which sought early termination of a Housing Credit extended use agreement, refused to recognize a nonprofit ROFR, or otherwise undermined the long-term affordability of a property.
- Require ROFR agreements to include features to protect the rights of nonprofit sponsors.

District of Columbia
Department of
Housing and
Community
Development

2021 QAP

Requires credit applicants to have an investor LOI that includes a “written acknowledgement that they have never sought to undermine the exercise of a ROFR or a non-profit’s option to purchase in prior transactions...”

Where an investor has the right to consent to the exercise of a ROFR, such consent shall not be unreasonably withheld, conditioned or delayed.

ROFR may not be conditioned upon receipt of a bona fide offer.

Agreement must provide that ROFR is not the same as a right of first refusal under statutory, court-interpreted, or common law.

Virginia Housing and Development Agency

2022 QAP

Requires that provisions be included in a credit applicant's organizational documents limiting transfers of partnership interests, and that the extended use agreement include terms requiring notice and approval by the executive director of transfers of partnership interests

Gives the Agency director authority to debar entities that have “demonstrated a history of conduct detrimental to long-term compliance with extended use agreements, whether in Virginia or another state, and the provision of affordable tax credit units.”

Virginia has drafted its own ROFR agreement language which must be included in future partnership agreements

Require partnership agreements to include language that automatically converts the ROFR to a purchase option as proposed in pending federal legislation that would amend section 42(i)(7), the ROFR safe harbor in the Internal Revenue Code

New York City
Department of
Housing
Preservation and
Development

2021 QAP

Requires that all nonprofit applications for credits be accompanied by LOI from an investor that commits to include certain features in its ROFR agreement as part of partnership documents

Eight features listed including most importantly giving nonprofit GP three options for securing ROFR:

Sale to nonprofit ROFR grantee under any of three options: 1) subject to approval of LP which may not be unreasonably withheld; or 2) if bona fide offer received, or 3) if property is offered for sale publicly

Other HFAs Who
Have Either Taken
Action or Working
on QAP Changes

Washington, Michigan, Massachusetts, New
York, Colorado, Michigan, Illinois,
Pennsylvania, Oregon

Response by Congress – Legislation to Amend Section 42(i)(7)

- Change ROFR to Purchase Option for future deals and remove exit taxes from price
- Clarify current law:
 - Reference to “property” includes all assets of partnership
 - Investor consent not required to exercise ROFR
 - Exercise of ROFR does not require bona fide offer and any entity, including a related party may make an offer
 - ROFR may be exercised through purchase of partnership interests as well as transfer of property
 - Clarifications would not supersede express language in agreement