Right of First Refusal in the Housing Credit program

The Low-Income Housing Tax Credit (Housing Credit) program is the largest federal resource for creating and maintaining affordable housing. The Housing Credit program facilitates partnerships between mission-driven nonprofit organizations and for-profit investors to generate affordable rental housing for low-income families across the country. The program has helped to finance nearly 3.5 million affordable homes since 1986.

Recently, sources of outside capital have acquired the control of investor partnerships in Housing Credit properties and begun systematically challenging general partners' project-transfer rights, disrupting the normal investor exit process in hopes of generating windfall returns.

This has led to a growing number of troubling legal disputes and litigation that both drains the general partner's resources and threatens the long-term affordability of valuable affordable homes.

What is the Impact of the Disputes?

The challenges to general partner's project-transfer rights are focused on the Right of First Refusal (ROFR). The ROFR can be used by the nonprofit to obtain full ownership of a property by purchasing the investor stake once the tax credits have been fully claimed, often at Year 15.

By disputing the transfer of property to the nonprofit general partner through the ROFR, private investors are threatening to extract profits from the nonprofit and Housing Credit program. Recognizing that most nonprofits do not have the resources to litigate these issues in court, private investors leverage a profitable cash payment or the sale of the affordable property in return for leaving the partnership. This undermines the long term viability of the affordable housing properties, leaving them at imminent risk of exiting the affordable housing market. Further, the use of scarce funds for payments from the nonprofit to the private investor is contrary to the original intent of the Housing Credit program.

This detrimental process diverts resources that otherwise would be devoted to resident services, building maintenance, and related affordable housing initiatives. In some cases, limited partners take properties through the Qualified Contract process, ending the affordability restrictions entirely. In high cost rental markets, rising property values have created an increasing opportunity for investors to profit far beyond the original expectations and congressional intent.

What is the Right of First Refusal?

The Housing Credit program, through Internal Revenue Code (IRC) Section 42(i)(7), offers nonprofit general partners a Right of First Refusal (ROFR). The ROFR can be used to obtain eventual ownership of the property at a minimum purchase price equivalent to the outstanding debt plus exit taxes. The provision allows nonprofit general partners to gain ownership of Housing Credit properties as their investors exit after 15 years once the investor has claimed all Housing Credits and before the program's rent restrictions expire.

For most of the Housing Credit program's history, the vast majority of participating nonprofit sponsors have secured the transfer right, exercised it, and obtained full ownership to continue to operate the property as affordable housing in accordance with their missions.

A ROFR is not unique to the Housing Credit program and is often used in common real estate transactions when afforded by a local ordinance. The common law ROFR is triggered by an enforceable, *bona fide* offer of purchase from an unrelated third party. When this offer is made, the relevant party (often a City, designated development partner, or in rare instances the tenants[1]) is given the opportunity to match the third party's offer price and purchase the property for themselves. The ROFR in the Housing Credit program differs in that the price is not based on a third party's offered price, but on the sum of the property's outstanding debt plus taxes, as specified in the federal statute.

What are some Investor tactics for systematically challenging general partners' project-transfer rights?

- disputing the conditions and scope of transfer rights
- delaying, obstructing, and disagreeing with related valuations
- refusing consent to refinancing, either outright or by placing significant conditions on consent
- disputing fee calculations
- arguing over typographical errors
- asserting alleged breaches of partnership duties from many years prior, including by arguing that rents should have been set higher to maximize profits

The National Housing Trust is currently leading multiple approaches across the country to help mitigate the Year 15 / ROFR threat to the long-term preservation of affordable housing. If you are concerned about the loss of affordable housing due to Right of First Refusal disputes, please contact the National Housing Trust to support our effort.

For more information:

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Refusing the Right of First Refusal, Branden Duong from Shelterforce (October 2020).

Nonprofit Transfer Disputes in the Low Income Housing Tax Credit Program: An Emerging Threat to Affordable Housing, Report from the Washington State Housing Finance Commission (September 2019).

Year 15: Facing Off with the Aggregator, David Davenport from Tax Credit Advisor (May 2019).

Beware the Aggregator, David Davenport from Tax Credit Advisor (April 2017).

[1] In the District of Columbia, tenants living in rental properties up for sale receive the first opportunity to buy their building. This "first right" and the opportunity to purchase the building by matching the offer price of a third party is extended to tenants through the Tenant Opportunity to Purchase Act (TOPA).