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

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Introduction 60
I. The Program: The Low-Income Housing Tax-Credit Program 61
A. America's Affordable Housing Shortage 61
B. The Low-Income Housing Tax Credit Program 62
1. Buyout Options at Year 15: Options and Rights of First Refusal Unique to LIHTC Partnerships. 66
a. Changes to the LIHTC program and the § 42 ROFR 66
b. Buyout Options in typical LIHTC partnerships 68
2. Summarizing the Unique Nature of the LIHTC Program 70
II. The Problem: The Emergence of Aggregators, and Others Now Employing Their Tactics 71
A. A Signature Purchase Option Case, CED Capital Holdings 2000 EB, *L.L.C. v. CTCW Berkshire Club, L.L.C.* 72
B. Other Examples of the Larger Trend 75
C. A Signature Section 42 ROFR Case, *Opa-Locka Community Development Corp., Inc. v. HK Aswan, LLC* 78
III. Solutions to the Aggregator Problem 83
A. Congressional Efforts 84
B. State Agencies Thinking Ahead 84
Conclusion 85

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AffordableHousing_V31No1.indd 59 4/8/22 9:17 AM

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.

AffordableHousing_V31No1.indd 62 4/8/22 9:17 AM

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

AffordableHousing_V31No1.indd 66 4/8/22 9:17 AM

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).

AffordableHousing_V31No1.indd 70 4/8/22 9:17 AM

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]

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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.*

AffordableHousing_V31No1.indd 72 4/8/22 9:17 AM

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

AffordableHousing_V31No1.indd 75 4/8/22 9:17 AM

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).

AffordableHousing_V31No1.indd 80 4/8/22 9:17 AM

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.*

AffordableHousing_V31No1.indd 82 4/8/22 9:17 AM

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.

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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

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.