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Housing Nonprofits Push Congress to Ease Investor Tax Credit Fights

By Samantha Handler

- Lawsuits over nonprofit 'right of first refusal' ramping up
- Groups join banks, private equity to build low-income housing

Recent high-profile court decisions favoring nonprofits in disputes over who can buy Low-Income Housing Tax Credit properties after all the tax credits have been collected aren't enough to fix the problem, affordable housing advocates say.

Nonprofits are pushing Congress for a legislative fix to clarify the law on whether the organizations running the housing have the right to buy the property at a low price. Advocates hope the housing tax package a bipartisan Senate duo is crafting—expected to be compiled sometime this spring—is a chance to limit future lawsuits on the issue.

"We're trying to do everything that we can at the state level, but having that change in federal law was really important," said Jennifer Schwartz, the director of tax and housing advocacy at the National Council of State Housing Agencies.

The biggest federal funding boost to create affordable housing, the LIHTC program provides \$8 billion in annual budget authority to agencies to buy, build or rehab rental housing in low-income neighborhoods.

Under some LIHTC deals, nonprofits form partnerships for funding with investors, such as a bank or private equity firm, which get tax credits in exchange. After 15 years of compliance with the program, nonprofits say they should be able to buy out the investor's interest and take ownership of the property for below market-value.

Some investors, who may have come into the deals after the original funders sold their stakes, are now looking for more money to exit the deals, leading to lawsuits across the country over how the so-called right of first refusal works between nonprofits looking to buy the properties and their partners.

From the investor side, the current language is clear, said Eric S. Pettit, a King & Spalding partner who has defended LIHTC investors. Nonprofits need the developer's consent and bona fide offer for the properties before trying to buy them at below-market value, Pettit said.

"I think there's a lot of money sometimes at stake here," Pettit said. "And I think you have some developers who have nonprofit affiliates who are aggressive and want to litigate this."

Housing advocates say the moves by investors threaten the availability of affordable housing, while investors in lawsuits have argued that the nonprofits need their approval to buy the properties, or are otherwise in breach of their contracts.

Lawmakers have been proposing a tweak to the law for some time. A fix was in the 2019 version of the Affordable Housing Credit Improvement Act—the major bipartisan legislation that would provide more LIHTC resources—though the provision fell out in more recent iterations of the bill. Senate Finance Committee Chairman Ron Wyden (D-Ore.) included the fix in his housing tax legislation, known as the Decent, Affordable, Safe Housing for All Act.

"More and more private equity firms are taking advantage of this loophole to squeeze profits out of affordable housing without providing any value to the system at all," Wyden told Bloomberg Tax last week. "Above all else, Congress needs to increase the supply of affordable housing, and allowing Wall Street firms to get away with this kind of rent-seeking is a real impediment to that goal."

New Court Precedent

Tax code Section 42(i)(7) allows a nonprofit a right of first refusal to buy a LIHTC property at a below-market rate after the first 15-year period has expired. Lawsuits over the contracts and what triggers that right have popped up all over the country in the past decade, with courts in Washington, New York, Delaware, and a handful of other states weighing in.

The US Court of Appeals for the Sixth Circuit came out with a decision last year in favor of a nonprofit seeking to exercise its right of first refusal. The judge wrote that the exit of the investor is "crucial to the efficacy of the LIHTC program" and the right of first refusal is a "means for nonprofits to regain ownership and continue the mission of affordable housing."

The Sixth Circuit decision likely had a ripple effect on other suits around the country, spurring settlements a few months later, said David A. Davenport, a BC Davenport managing partner who represented the nonprofit in the case.

The appeals court holding is helpful, Davenport said, as well as some other rulings in favor of the nonprofits, legislation is still needed.

"I feel like we have a lot of momentum in the last couple of years, getting some pretty high profile successful outcomes," Davenport said. "There's still a long way to go."

Legislation

While the Affordable Housing Credit Improvement Act may be modified to include provisions like clarifying the nonprofits' right-of-first-refusal, the provision moving through Wyden's DASH Act or separate legislation is more likely, said David Gasson, the executive director of the Housing Advisory Group, a national housing advocacy organization.

Some lawmakers are concerned the change would draw more scrutiny and more litigation in terms of existing deals, Gasson said.

Section 208 of the DASH Act would modify existing law to clarify that the right of first refusal may be exercised at the minimum purchase price "without the need for a bona fide offer by a third party or approval from the investor/limited partner," according to the legislation.

The DASH Act measure would apply to future deals, replacing Section 42(i)(7) with a purchase option for nonprofits that would "hopefully mitigate hurdles that some organizations participating in the LIHTC program have sought to create or impose through litigation to frustrate what Congress intended," Davenport said.

It's not clear that the proposed legislation would only apply to future deals, Pettit said. Investors would oppose the change if it were to apply retroactively, he said.

"If Congress wanted to change the right of first refusal into an option going forward, prospectively, I think there would be less concern on the investor side because then the investors would price their deals accordingly," Pettit said. "Under the language of the bill, as I read it, it would purport to apply for retroactively."

Lawsuits are likely to keep popping up without the change, Gasson said.

"Things would stay the way they are," Gasson said. "We would continue to have issues with affordable housing developments probably coming out of the housing stock ... people being displaced."

To contact the reporter on this story: Samantha Handler in Washington at shandler@bloombergindustry.com

To contact the editors responsible for this story: Kim Dixon at kdixon@bloombergindustry.com; Alex Clearfield at aclearfield@bloombergindustry.com

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