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Unresolved Year 15 Issues Beg For Guidance

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When Congress added the 15 year "extended-use period" for properties that received an allocation of LIHTC after December 31, 1989, it also provided a "qualified contract" exception. After the expiration of the 14th year of the compliance period, the owner can ask the allocating agency to try to find a buyer at the qualified contact price. If no buyer can be located, then the extended use restrictions generally expire. See related story on page one.

But the issue is not as clear as it might appear. Many owners are fearful of opting for a sale under a qualified contract because so many critical issues are unresolved. Internal Revenue Service guidance is needed to ensure that the process can be implemented without undue uncertainty and so that those in the industry can make reasoned decisions on whether or not to make a qualified contract offer to sell a project.

As noted in a May 2003 article in the *LIHTC Monthly Report* by Jerome Breed, if an owner decides to exercise his right to make a qualified contract sales offer, the allocating agency has one year from receipt of the offer to decide whether to acquire the property, assign the contract to another party, or to decline to purchase. If the agency declines to purchase the property, §42 restrictions are lifted and, subject to the three-year vacancy decontrol rules, the owner may convert the property to market rate rental, or sell the property to another owner free of the §42 restrictions.

Beyond that, guidance gets a little sketchy. There is no process in place that specifies how the offer is to be made to the allocating agency. Nor is there a formula by which one can calculate a qualified contract price. Among other things there is no guidance on how to determine the fair market value of the non-low-income portion of the project, the capitalization rate to be used, the vacancy rate to be assumed, whether the valuation should be based upon current, past or projected rents, who should determine the price, what valuation methodology should be applied, and what happens if the allocating agency disagrees with the value.

If, according to Section 42(h)(6)(F), the qualified contract price for the low-income units is to be reduced by cash flow, there should be guidance on how the owner will establish the amount of cash distributed for each of the 15 years of the compliance period and how the cash flow is calculated. For instance, will it include deferred developer fees and incentive management fees paid out of cash flow and will cash flow be subtracted before the application of the cost of living factor? Answers to these and other pricing questions are critical.

Other unresolved questions revolve around how to treat unsecured debt, whether or not the price includes outstanding operating deficit loans, outstanding credit adjuster payments, and outstanding development advances. Also unclear is how "adjusted investor equity" is calculated and whether it is gross equity (including syndication costs) or equity to the project.

Uncertainty exists on how contributions of land or other property will be treated, how general partner contributions will be dealt with, whether or not general partner capital is included in "adjusted investor equity and whether capital contributions to pay for deficits, repairs, casualty loss, etc., can be excluded from adjusted investor equity but included in other capital contributions.

The ambiguity that surrounds the qualified contract must be clarified soon to minimize uncertainty and to ensure uniform application throughout the country. Join your colleagues today in getting the message across to the IRS that the industry needs its guidance. Without it chances are great that owners of affordable housing will face great uncertainty as to the qualified contract price, and allocating agencies will spend undue time and incur undue costs in attempting to comply with the rules.