



DELAWARE STATE HOUSING AUTHORITY  
LOW INCOME HOUSING TAX CREDIT  
QUALIFIED CONTRACT GUIDE

2019

## INTRODUCTION

Delaware State Housing Authority (DSHA) is a state housing finance agency and housing credit agency responsible for the financing of low-to-moderate income housing development through the Housing Development Fund (HDF), the HOME Program and the Low Income Housing Tax Credit (LIHTC) program.

Delaware has allocated tax credits since shortly after the LIHTC program was created in 1986. DSHA has been designated by the Delaware Legislature as the apportionment agency for the LIHTC program.

The initial compliance period for a development receiving an allocation of Credits is fifteen years. For LIHTC allocations made in 1990 and later, an extended use agreement required by Internal Revenue Code Section 42(h)(6) extends the compliance period up to a minimum of fifteen additional years (Extended Use Period).

Section 42(h)(6)(E)(i)(II) of the Internal Revenue Code (Code) provides that the extended use period shall terminate if a housing credit agency is unable to present a Qualified Contract (QC) to a taxpayer who has requested such a contract.

The Internal Revenue Code contains some of the basic provisions for handling QC requests. However, there are a number of important questions relative to QC's that have not been answered through federal regulation or other guidance. The purpose of this guide is to set forth the procedures to be followed by DSHA and the Owners of Delaware LIHTC developments who are considering making a request for a QC.

The provisions provided in the Code are subject to modification and clarification by the Internal Revenue Service (IRS). Compliance with the requirements of Section 42 is the responsibility of the Owner of the building for which the credit is allowable. DSHA reserves the right to revise this Qualified Contract Procedure Guide at any time. Updates to this Guide will be posted for the public on DSHA's webpage; Owners are responsible for ensuring they are viewing the most recent version.

The request for a QC is a difficult process, involving substantial time and energy on the part of the Owner, management company and DSHA. As such, a QC may not be the best alternative and Owners are encouraged to consider all options. An important aspect in making this decision is that after the Compliance Period, DSHA has adopted policies that reduced compliance requirements and eliminated some of the eligibility criteria (see DSHA's Tax Credit Compliance Manual). As a result, compliance can be achieved much easier, but the spirit of the program is not compromised and the housing will continue to serve the people for whom the program was intended. ***With this in mind, it is hoped that many Owners would choose to continue operating the development under the revised restrictions throughout the Extended Use Period. Alternatively, the Owner may sell the development outside of the QC process. In this instance the purchaser would continue to operate the property under LIHTC restrictions with the reduced compliance requirements referenced above.***

DSHA is under no obligation to undertake an investigation of the accuracy of the information submitted for a QC submission. DSHA's review shall not constitute a warranty of the accuracy of the information, nor of the quality or marketability of the housing to be purchased, constructed, or rehabilitated pursuant to the program. Developers, potential investors and interested parties should undertake their own independent evaluation of the feasibility, suitability and risk in the acquisition of a development. If any information submitted by a building Owner to DSHA is later found to be incorrect in any material respect, it is the responsibility of the building Owner to inform DSHA and to request a reexamination of the information. DSHA is not, and is not acting in the capacity of, a real estate agent or real estate broker, tax attorney or tax accountant. Its role is limited to implementing the Code requirements and facilitating the submission of a QC, as defined in the Code. Interested parties should obtain advice from independent sources, including consultation with knowledgeable tax professionals and legal counsel. This guide has not been reviewed or approved by the IRS and should not be relied upon for interpretation of federal income tax legislation or regulations.

## **QUALIFIED CONTRACT**

Section 42(h)(6)(E)(i)(II) of the Internal Revenue Code created a provision that housing credit agencies respond to the request for submission of a qualified contract for tax credit developments with expiring compliance periods and is governed by IRS regulations at 26 C.F.R. §1.42-18.

A Request for Qualified Contract may be submitted only once for each development.

If an Owner rejects an offer presented under the Qualified Contract, fails to comply with any DSHA request for participation or provide information, withdraws its request at any time after the start of the 26 C.F.R. §1.42-18(a)(1)(ii)(B) one-year period, or otherwise fails to meet the standards in the Qualified Contract Process requirements, Owner's request for Qualified Contract will be terminated and no other opportunity to request a Qualified Contract will be available for the development in question.

### **A. QUALIFIED CONTRACT REQUEST PROCESS**

1. Owners who are contemplating requesting the submission of a Qualified Contract should contact DSHA Housing Program Specialist to give Notice of Intent to File a Request. This preliminary action is required. It binds neither Owner nor DSHA, nor does it start the one-year period described by 26 C.F.R. §1.42-18(a)(1)(ii)(B).
2. If the property is determined eligible to request a Qualified Contract, DSHA will send a letter of acknowledgement to the Owner along with:
  - (a) Qualified Contract Form Notification Letter;
  - (b) Qualified Contract Process Guide and related Application Materials;
3. At any time in the process, DSHA may assign an underwriter to work with the Owner to discuss issues pertinent to the development and possible alternatives to the qualified contract process. Owners should be prepared to present a thorough analysis of all current financing and related restrictions.
4. If a property is not eligible to request a Qualified Contract, DSHA will issue the Owner a letter of denial.

### **B. QUALIFIED CONTRACT NOTIFICATION LETTER**

Owner must submit the Qualified Contract Form Notification Letter, along with all required Application Materials. This request may be submitted only after requesting an eligibility determination request and DSHA's acknowledgment.

The Qualified Contract Form Notification Letter (Notification Letter) is Owner's written request to DSHA to participate in the Qualified Contract Process. For the purposes of 26 C.F.R. §1.42-18(a)(1)(ii)(B), the one-year period described will only begin upon DSHA's review of submission for completeness and resolution to DSHA's satisfaction of any issues identified. DSHA's review may include request for additional documentation or third party reports. The request will not be complete until all information and reports are received to DSHA's satisfaction. "Exhibit A," DSHA's form Notification Letter contains important certifications and acknowledgements related to requirements of DSHA's Qualified Contract Process and should be reviewed carefully. Alteration or amendments to DSHA's form Notification Letter will result in Owner's disqualification from participation in DSHA's Qualified Contract Process.

## C. APPLICATION MATERIALS

The Qualified Contract Notification Letter must be submitted along with the following from the Owner:

1. A thorough narrative description of the development, including all amenities, suitable for familiarizing prospective purchasers with the development.
2. A description of all income, rental and other restrictions, (including easements and deed restrictions) if any, applicable to the operation of the development.
3. A detailed set of photographs of the development, including the interior and exterior of representative apartment units and buildings, and the development grounds. Digital photographs should be included so that they may be easily displayed on DSHA's website.
4. A copy of the most recent 12 months of operating statements for the development which will fairly apprise a potential purchaser of the development's operating expenses, debt service, gross receipts, net cash flow and debt service coverage ratio; along with the three most recent annual audited financial statements.
5. A current rent-roll.
6. All years of tax returns for the Owner.
7. A copy of the development Limited Partnership Agreement, Operating Agreement, or other Owner's organizing documents.
8. Disclosure of Rights of First Refusal, if any.
9. If any portion of the land or improvements are leased, copies of the leases.
10. A physical needs assessment.
11. A fully completed "Calculation of Qualified Contract" Price (form QC-1), including Worksheets A – E (see Section D for a brief description of these worksheets), along with copies of the documents and other information used to support the Qualified Contract Price. This form must be completed and certified by a Delaware licensed Independent Certified Public Accountant.
12. Tenant Notification Letter informing all LIHTC tenants of Owner's request to participate in the QCP, the expected timeline, and information regarding mandatory 3 year rent protection in the event a purchaser is not identified. The notification letter must inform tenants of their legal rights and provide contact information for legal services.
13. Evidence of ability to repay any existing DSHA debt. In order to participate in the QCP Owner will be required to execute a due upon termination loan modification for all DSHA debt. In the event that DSHA is unable to find a purchaser under the terms of the Qualified Contract Owner will be responsible for repaying all existing DSHA debt against the property before completion of the QCP will be approved.
14. Evidence that any existing or currently contemplated debt against the property not controlled by DSHA is pre-payable or assumable. Evidence must be in form of express creditor confirmation.
15. Complete list of all properties supported in whole or in part by any program administered by DSHA held by Owner or an entity with Identity of Interest with Owner.
16. A Qualified Contract processing fee of the lesser of \$25,000 or .25% of the Qualified Contract Price as calculated on form QC-1, payable to DSHA.
17. \$25,000 Deposit to cover all charges incurred by DSHA, including, but not limited to, third-party costs, for submission materials, appraisals, market studies, legal, brokerage fees, and rent comparability studies. In the event that not all of such deposit is expended, the remainder will be returned to Owner at the conclusion of the QC process. In the event that additional funding is needed to cover actual costs, DSHA will issue notice of required additional deposits. Failure to provide additional deposits within 15 days of notification will result in disqualification from the QC process.

## **D. CALCULATION OF QUALIFIED CONTRACT PRICE WORKBOOK**

Form QC-1 contains accompanying worksheets A-E, as described below:

Worksheet A: Outstanding Indebtedness, a summary of all outstanding secured indebtedness on the low-income building(s).

Worksheet B: Calculation of Adjusted Investor Equity in the low-income building(s), by year.

Worksheet C: Other Capital Contributions made by the investor in the low-income portion of the building(s). These are contributions that are not included in other calculations, specifically in the “Outstanding Indebtedness” or “Adjusted Investor Equity” worksheets.

Worksheet D: Cash Distributions from, or available from the development, by year. This calculation also includes a reporting of the cash held in reserve.

Accounts and Partnership Accounts. Also included here are non-cash distributions that have been made by the Owner. These non-cash distributions will not be applied to reduce the “qualified contract price” but must be reported.

Worksheet E: Fair Market Value on non-low-income portion of the building(s). This worksheet requires an appraisal, study or methodology proof or other support used to establish the market value of the non-low-income portions of the building(s).

## **E. REVIEW PROCESS**

1. Upon receipt of the Owner’s Notification Letter and Application Materials, DSHA will have 60 days to review the Owners’ packet of due diligence materials for completeness. DSHA will send the Owner a letter acknowledging that all notification requirements have been met. DSHA’s review may involve hiring third-parties to provide professional services; the cost of these services will be charged against the \$25,000 deposit as described in Section C.16. hereof.
2. After DSHA has received all required documentation, DSHA will have 60 days to validate the Qualified Contract Price (Price) proposed by the Owner. This will require DSHA and the Owner to work closely together to ensure that an appropriate Price has been set.
3. During or after the 60 day period, DSHA will notify Owner of any due diligence concerns, including deficiencies in application materials, encumbrances or debt against the Property, or other issues DSHA determines in its sole discretion to be of import to the QC Process.
4. DSHA will conduct a complete compliance review of Owner’s participation in programs administered by DSHA. Failure to resolve any compliance issues within the applicable cure period by Owner or any entity sharing an Identity of Interest with Owner will result in the disqualification from participation in DSHA’s Qualified Contract Process.
5. At DSHA sole discretion, DSHA will secure independent professional evaluation of the following utilizing Owner’s deposit, if DSHA determines any of the following are required, Owner’s application will not be considered complete and the one-year period will not start until the final and satisfactory completion of all:
  - (a) an accountant to confirm the QC price requested in the application;
  - (b) a physical needs assessment for the entire project;
  - (c) an appraisal for the entire project;
  - (d) a market study for the entire project; and,
  - (e) a Phase I environmental (and a Phase II, if necessary).

6. Owner and DSHA will work together to resolve any identified due diligence or compliance issues. If identified issues are not resolved in the longer of 60 days from notification of Owner by DSHA or 1 year from receipt of Owner's Notification Letter, the request to participate in DSHA's QCP shall be deemed terminated and no future requests by Owner will be considered.
7. Once the Notification Letter has been approved and any independent professional evaluations required have been completed, DSHA will notify the Owner that the one-year period to find a prospective buyer for the development has begun.
8. During the one-year period, DSHA will advertise the property in good faith. DSHA's process to identify an interested purchaser may include, but is not limited to:
  - (a) Post the property information on DSHA's website.
  - (b) Put together an informational flyer and send to a pre-established mailing list. This list will include Owners of tax credit properties; contacts at large management companies; other public funding agencies in the state; local, state and nation-wide nonprofit and for profit Owners interested in preserving housing; and tax credit investor contacts.
  - (c) Present information on the property to regional development groups, preservation groups and other stakeholder meetings that DSHA attends.
  - (d) Act as a conduit for all requests of prospective purchasers by quickly responding to requests for additional information from the Owner and forwarding that information immediately upon receipt.
9. If at any time during review of application or the one-year period Owner fails to maintain property in compliance with program or property standards the QC Request shall be terminated and no further requests will be considered.

## **F. COMPLETION OF QUALIFIED CONTRACT PROCESS**

1. If DSHA has identified a prospective purchaser, it will present to the Owner, a qualified contract as defined in IRC Section 42(h).
2. If the Owner accepts and the property is sold, Owner will notify DSHA of the transfer of Ownership by submitting the Notice of Intent to Transfer Ownership or Change Owner Name or Status along with accompanying documentation.
3. If the Owner rejects the offer, or the sale fails to close through any fault of Owner, the project shall remain subject to the provisions of all use restrictions and Owner will not be eligible for further participation in the QCP.
4. ***If DSHA is unable to locate a purchaser who will continue to operate the property as low income, the Owner will be notified that the extended-use period will terminate. However, as required by IRC Section 42(h)(6)(E)(ii), existing residents will continue to have the right to rent at the restricted rent levels and may not be evicted or have tenancy terminated for other than good cause for a period of three years following the termination of the extended use period. In the event DSHA is unable to locate a purchaser, Tenants must be provided with a notification letter informing of the termination of the extended-use-period and their 3 year rights under Section 42. During this 3-year period, Owners are required to annually submit the Tax Credit Summary Report (LIHTC 13) to DSHA listing all low-income households that occupied a unit at the termination of the extended use period, the respective tenant-paid rent, utility allowance, and move-out date, if applicable, along with a certification that no low-income residents have been evicted or displaced for other than good cause. This report and certification will be due annually on January 15<sup>th</sup> or the next business day. No monitoring fees will be due during this 3-year period.***
5. In the event that DSHA is unable to locate a purchaser, all existing DSHA debt against the property must be immediately paid in full as described in the form Notification Letter. Failure to immediately pay in full all DSHA debt will result in termination of the QC request and no further QC requests will be accepted.

## **G. FEES AND CHARGES**

The fee for processing a Qualified Contract request is the lesser of \$25,000 or .25% of the Qualified Contract Price as calculated on QC-1. The fee must be submitted at the time the Qualified Contract Notification Letter is presented to DSHA, and is nonrefundable.

Under 26 C.F.R. §1.42(d)(1)(v) all charges incurred by DSHA, including, but not limited to, for submission materials, appraisals, market studies, legal, and rent comparability studies will be borne by the Owner. In addition to executing an agreement to reimburse all costs, Owners must deposit with DSHA \$25,000 to cover anticipated third party costs. If third party costs exceed the original deposit, DSHA will request additional deposit be made for anticipated costs. If requested funds are not received within 15 days, processing of the qualified contract request will be terminated and no further requests will be considered.

## **H. MISCELLANEOUS**

1. Identity of Interest means any entity that (i) has a spousal or family relationship, parent-subsidiary relationship, or where Owners, officers, directors, partners, stockholders or members of one business entity have a five percent (5%) or more interest in another entity; or (ii) where a substantial relationship exists between the parties directly or indirectly through (a) common family, (b) common general partners or members, (c) common control of the entities, or (d) the person or entity is otherwise controlled in whole, or in part, by the other person or entity.
2. DSHA reserves the right to disqualify any third party consultant used by an Owner if DSHA determines that a conflict exists between Owner and consultant.
3. DSHA reserves the right to modify this guide at any time. Owner is responsible for ensuring it is using the most current guide.