



DELAWARE STATE HOUSING AUTHORITY

LOW INCOME HOUSING TAX CREDIT

QUALIFIED CONTRACT GUIDE

March 2009

## 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.

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 term "Qualified Contract" means a bona fide contract to acquire (within a reasonable period after the contract is entered into) the non low-income portion of the building for fair market value and the low-income portion of the building for an amount not less than the applicable fraction (specified in the extended low-income housing commitment) of:

(i) the sum of—

(I) the outstanding indebtedness secured by, or with respect to, the building,

(II) the adjusted investor equity in the building, plus

(III) other capital contributions not reflected in the amounts described in subclause (I) or (II) , reduced by

(ii) cash distributions from (or available for distribution from) the project.

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 from time to time.

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 reduced compliance requirements referenced above.***

## **FOREWORD**

Delaware State Housing Authority (DSHA) shall be under no obligation to undertake an investigation of the accuracy of the information submitted for a Qualified Contract (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 Internal Revenue Code (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. The request for submission of a qualified contract may occur after year 14 of the compliance period. The request for submission of a qualified contract is a request that the housing credit agency find a buyer (who will continue to operate the property as a qualified low-income property) to purchase the property for a qualified contract price (QCP) pursuant to IRS regulations. If the housing credit agency is unable to find a buyer within one year, the extended use period is terminated.

Many owners have chosen to waive the right to request a qualified contract and have committed their developments to thirty years or more of operation as low-income rental housing. Owners should review the respective Qualified Allocation Plan, tax credit application, carryover agreement, and Declaration of Land Use Restrictive Covenants of the development to determine whether the development has waived the right to request a Qualified Contract prior to contacting the DSHA.

A Request for Qualified Contract may be submitted only once for each development. If an owner rejects an offer presented under the Qualified Contract or withdraws its request at any time after the Notification Letter and Application Materials have been received by DSHA, no other opportunity to request a Qualified Contract will be available for the development in question.

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

1. Owners who are contemplating requesting the submission of a Qualified Contract should contact the DSHA Tax Credit Compliance Coordinator. DSHA will verify the development's eligibility.
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 Notification Letter.
  - (b) Qualified Contract Process Guide and related Application Materials.
  - (c) Current year dates when requests for Qualified Contracts will not be accepted by DSHA.
3. The Tax Credit Qualified Contract request will 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**

The next step in the process for requesting a Qualified Contract is to submit the Qualified Contract Notification Letter, along with all required Application Materials. This request may be submitted any time after the fourteenth year of the compliance period.

The Notification Letter contains statements from the owner that the owner will reasonably cooperate with DSHA and its agents with respect to the marketing of the property, and acknowledges that the Application Materials may be shared with prospective purchasers, real estate brokers and other interested parties and that summary data may be posted on DSHA's website.

Owners will be asked to acknowledge in the Notification Letter that they have reviewed the due diligence materials used in the calculation of the qualified contract worksheets and that they are solely responsible for documents and information used in the calculation of the Qualified Contract Price, using the procedure set forth in Section 42(h)(6)(F) of the Internal Revenue Code. The owner will be asked in the notification letter to sign a statement verifying the accuracy of the assumptions used in the computation of the Qualified Contract Price and to hold DSHA harmless with respect to the use of the development information.

Additional information may be requested by DSHA, including but not limited to, additional rent rolls, income certifications and other Section 42 compliance records, records with respect to repair and maintenance of the development, operating expenses and debt service. Before information is shared with a prospective purchaser, the owner may require that the Agency and/or the prospective purchaser enter into a commercially reasonable form of nondisclosure agreement.

The owner shall also be asked by DSHA to share, upon request, the documents and other information that were used to prepare the Calculation of Qualified Contract Price (QC-1). The owner will be asked to allow DSHA, its agents, or prospective purchasers, upon reasonable prior written notice, to visit and inspect the development, including representative apartments units.

### **C. APPLICATION MATERIALS**

The Qualified Contract Notification Letter must be submitted along with the following materials 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 Partnership.
7. A copy of the development Limited Partnership Agreement.
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 Certified Public Accountant.
12. A Qualified Contract processing fee of \$5,000 payable to DSHA.

## **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.
2. After DSHA has received all required documentation, DSHA will have 60 days to validate the Qualified Contract Price (QCP) proposed by the Owner. This will require DSHA and the owner to work closely together to ensure that an appropriate QCP has been set.
3. Once the QCP has been approved, DSHA will notify the owner that the one-year period to find a prospective buyer for the development has begun.
4. During the one-year period, DSHA will advertise the property in good faith. DSHA’s process to identify an interested purchaser may include, but not be 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.

## 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 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, pursuant to 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. 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 and DSHA is not required to perform inspections.***

## FEES AND CHARGES

The fee for processing a Qualified Contract request is \$5,000. The fee must be submitted at the time the Qualified Contract Notification Letter is presented to DSHA, and is nonrefundable.

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.