

**From:** Scott Culp  
**Sent:** Friday, January 05, 2018 9:19 AM  
**To:** [trey.price@floridahousing.org](mailto:trey.price@floridahousing.org)  
**Subject:** Rule Making with regard to Qualified Contract and "Bona Fide Contract"

Trey,

Thank you for meeting with me yesterday and providing us the opportunity to discuss the future direction of the FHFC programs as well as initiate discussion on other specific issues of concern.

As we discussed, we think there needs to be rule making undertaken by FHFC with regard to the IRS regulations governing Qualified Contracts.

By way of background I provide the summary below;

## **General Overview**

Section 42 provides a tax credit for investment in low-income housing buildings placed in service after December 31, 1986.

Section 42(h)(6)(D) defines the term extended use period as the period beginning on the first day in the compliance period (as defined in section 42(i)(1)) on which the building is part of a qualified low-income housing project and ending on the later of: (1) The date specified by the Agency in the commitment, or (2) the date which is 15 years after the close of the compliance period.

Section 42(h)(6)(E)(i)(II) provides for the termination of the extended use period if the Agency is unable to present within a specified period of time a qualified contract for the acquisition of the low-income portion of the building by any person who will continue to operate such portion as a qualified low-income building.

Section 42(h)(6)(F) defines the term qualified contract as a **bona fide contract** to acquire (within a reasonable period of time 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 commitment) of 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 these amounts; reduced by cash distributions from (or available for distribution from) the project.

Section 42(h)(6)(I) provides that the Agency must present the qualified contract within the 1-year period beginning on the date (after the 14th year of the compliance period) the owner submits a written request to the Agency to find a person to acquire the owner's interest in the low-income portion of the building.

## **Definition of Bona Fide Contract and Resolution of Disputes**

Some commentators to regulations adopted by the Federal Government for “Qualified Contracts” suggested the inclusion of a specific definition of a bona fide contract under section 42(h)(6)(F), addressing issues such as whether the terms and conditions of any offered contract are unreasonable or impractical. Further, commentators suggested the creation of a mechanism for resolving disputes among the parties concerning the meaning of a bona fide contract. The IRS and the Treasury Department believe that because of variations under State laws concerning the terms of a bona fide contract and methods for resolving disputes, the final regulations should not explicitly address these issues. Instead, the final regulations provide that an Agency has the administrative discretion to specify other conditions applicable to the qualified contract consistent with section 42 of the Code and the final regulations.

**Based upon this general overview, we believe there is a need for rule-making in Florida to define “bona fide contract” and the conditions related to buyers not closing. Such rule making will avoid costly and time consuming litigation in this regard.**

Every week, owners receive “offers” to purchase real estate. The super majority of these “offers” are from “Buyers” who are fishing or trying to tie up the property. These “Buyers” often lack the competence and capability to own and operate the real estate that is the subject of their “offer”, and their agreements provide them with an option to buy the asset, not a contract to purchase.

The Qualified Contract provisions in the IRS Code provide a material inducement for Owners/Developers to build LIHTC communities. In order to fulfill the agreement with the Owners/Developers, FHFC needs to provide a written framework/outline to define the term “bona fide contract” and what is required to fulfill these Qualified Contract provisions.

We believe there are two critical conditions that must be met in order for an Agency to be able to assert that they have provided a “Qualified Contract” under the Code:

1. A prospective Buyer provides a “bona fide contract” to purchase the asset, not an option to purchase the asset.
  - a. Potential Buyers of real estate frequently present Owners with an agreement to purchase real estate which gives the potential Buyer the right to cancel it for any reason without any financial penalty. This in effect is an option to purchase the asset, not a contract to purchase the asset.  
This can be contrasted with the Regulatory Agreements that FHFC signs every day, which are contracts. Compliance is mandatory, and there are severe penalties (financial and otherwise) if a party doesn’t perform.
  - b. If a Buyer is serious about the purchase, then they will be knowledgeable about the asset (i.e. they will have completed a property tour and due diligence), they will be capable (i.e. financial capability and ability to own/manage LIHTC property), and they will provide a contract which requires them to perform. This contract would require the Buyer to post a meaningful deposit (i.e. 5% of purchase price) with a third party escrow agent which is non-refundable in the event the Buyer chooses not to proceed.
2. The purchase must close.
  - a. The Michigan State Housing Development Authority (“MSHDA”) has provided a guide for qualified contracts. The language below was extracted from page 15 of this guide,

and provides a framework for what happens when a Buyer, having provided a bona fide contract, does not close on the purchase through no fault of the Owner.

Qualified Contract Is Accepted But Fails to Close (from MSHDA's 2009 Qualified Contract Guide)

If the sale pursuant to any QC that is accepted by the owner does not close for any reason other than a default by the owner or matters within the owner's control (e.g. failure of a condition precedent to closing such as the purchaser's inability to obtain financing or the purchaser's dissatisfaction with other aspects of the project), then MSHDA will continue to seek offers at the QCP through the end of the 1YP and the owner's obligation to cooperate in the marketing of the project will continue. If no other QC is presented to the owner during the 1YP, then the project will be treated as if no QC had been presented and the Extended Use Period will terminate.

If the sale does not close due to a default by the owner or other matters within the control of the owner (such the owner's failure to clear title, to provide financial information or otherwise act in good faith), then unless another QC is presented, accepted and closed, the project shall remain subject to provisions of the LURA for the entire Extended Use Period. In addition, the owner will be liable for payment of any broker's fee or commission that is earned upon presentation of a QC but the sale fails to close due to a default by the owner.

The first condition above is addressed in the "Bona Fide Contract Proposed Rule Definition" document attached.

The second condition above is addressed in the "Proposed Revision to FHFC Rule 67-48.031(9)" document attached.

**I would appreciate your guidance with regard to the appropriate strategy for requesting FHFC rule-making in this regard.**

**Thanks for your time.**

**W. Scott Culp**



**200 East Canton Avenue, Suite 102**

**Winter Park, FL 32789**

**407-741-8521**

**[s.culp@atlantichousing.com](mailto:s.culp@atlantichousing.com)**

*You can send me large files via this confidential drop box;*

<https://dropbox.yousendit.com/Scott-Culp>

**INTERNAL DISCUSSION DRAFT- Wed. 11/22/17 NOON**

**Proposed Revision to FHFC Rule 67-48-031(9)**

(9) The owner shall cooperate with the Corporation and its agents, real estate brokers and prospective buyers in connection with the processing of the owner's qualified contract request and the marketing of the Development to prospective buyers. The owner shall exercise good faith in acting upon a qualified contract as may be presented within the one-year period. If the owner enters into a Qualified Contract and the contract does not close for any reason other than a default by the owner or matters within the owner's control, then the Corporation may continue to seek offers for a qualified contract at the Qualified Contract price through the end of the one-year period. If no other qualified contract is presented to the owner during the one-year period, then the Development will be treated as if no qualified contract had been presented and the owner will be entitled to termination of the Extended Use Period attributable to housing credit financing. If the Corporation provides a qualified contract within the one- year period and the owner rejects or fails to act upon the contract, the Development shall remain subject to the Extended Use Agreement, and the owner shall be deemed to have waived any right or option to submit another qualified contract request for the Development.

**INTERNAL DISCUSSION DRAFT- 11/22/2017, NOON**

**67-48.031(11)** For purposes of 26 CFR 1.42-1.8, Section 42 of the IRC, as applicable, and this rule section, a “Qualified Contract” means a bona fide contract in which, at a minimum, all of the conditions enumerated in subparagraphs (a) through (f) below are met. Owner in its sole discretion may waive any or all of the conditions below; however, Owner’s decision not to waive any or all of the conditions shall not be deemed by the Corporation to be the rejection of a “bona fide contract” offer. Further, nothing herein shall be deemed by the Corporation to require an Owner to enter into or close on a contract that satisfies all of the elements set out below; and the Owner retains its rights under 26 U.S.C. § 42 to reject or fail to act upon the contract offer.

(a) The Contract requires the Buyer to post a deposit of at least five percent (5%) of the Qualified Contract price before the contract is deemed effective, with such deposit being immediately nonrefundable except in the case of material default by the Owner.

(b) The Buyer has, before entering into the Contract, conducted a sufficient physical site inspection and review of maintenance records for the Development to be fully informed of the physical condition of the Development.

(c) The Buyer has, before entering into the Contract, evaluated the completed Qualified Contract application package previously submitted to the Corporation by the Owner, and has obtained from the Owner and reviewed a copy of the most recently available 12 months of operating statements (as of the date of the Buyer’s offer), a current rent roll, and such other information for the Development to be fully informed of the financial performance of the Development.

(d) The Buyer has provided to the Owner the Buyer’s financial statements, funding commitment from a regulated financial institution, or other evidence satisfactory to the Owner of Buyer’s access to sufficient funding to close on the purchase of the Development

in a reasonable period of time.

(e) The Contract otherwise demonstrates a definite and binding commitment by the Buyer to purchase the Development.

(f) The Contract contains all other elements and attributes of a real estate contract that is valid and enforceable under Florida law.