A Case Study: LIHTC-to-Condo Conversion

by

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ABSTRACT

By the end of the decade, approximately half of Low-Income Housing Tax Credit (LIHTC)-funded housing units are anticipated to reach the end of their affordability restrictions. This thesis examines the potential benefits and challenges associated with the transformation of LIHTC rental units into homeownership condominium units through an in-depth case study of Quality Hill Phase IIB, a LIHTC Rental-to-Affordable Condominium project based in Kansas City, Missouri. The case study identifies key regulatory and financial factors that contributed to the model's initial success. Most significant was the legal theory that the Internal Revenue Service (IRS) has no jurisdiction after the 15-year compliance period and sole jurisdiction lies with the State Housing Finance Agency (SHFA). This predicate was the basis for a private letter ruling granted from the Internal Revenue Service, with participation with the SHFA, that allowed a LIHTC tenant the right of first refusal to buy his or her unit as part of the condominium homeownership plan after year 15 of the compliance period. Despite the model's initial success, the project grappled with substantial obstacles related to the 2008-2012 financial crisis, recapitalization of the capital partner, lack of end loan financing, and tenant eligibility issues that led to its eventual downfall. Despite these challenges, LIHTC-to-condominium conversions hold potential as a strategy for creating affordable homeownership options. The case study provides lessons learned and tools to be applied to its application in a future condominium attempt. These include the use of tax codes sections 108, 183 and IRS Revenue Procedure 2014-12 to tackle feasibility of the model as well as securing mortgage financing from alternative lending institutions that can better accommodate to low-income tenants. In conclusion, this research broadens the academic dialogue on rent-to-own models. By highlighting the primary challenges associated with this approach and offering practical insights, this thesis hopes to provide a valuable resource for stakeholders considering LIHTC for affordable homeownership solutions.

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Title: Assistant Professor of Law and Urban Planning

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Introduction

There is a national on-going debate on whether affordable housing should be homeownership or rental. It is not the focus of this paper to weigh on the homeownership vs. rental debate, but it is worth noting that inflation has driven up Section 42 rents so high that affordable rents in coastal cities exceed market rents in Midwestern cities. This means that the income levels for income averaged Section 42 tenants are going to be potentially high enough to qualify for bank underwriting if the purchase price is low enough.

The latest published United States Department of Housing and Urban Development (HUD) 2023 Fair Market Rent for a one-bedroom unit is $795 and a two-bedroom unit is $999 in the City of St. Louis[1]. The median family income is $101,200. The HUD 2023 Fair Market Rent for the City of Boston is $2,198 for a one-bedroom unit and $2,635 for a two-bedroom unit. The median family income is $149,300. The City of Boston's maximum affordable rent amounts are $1,670 for a one-bedroom unit and $2,004 for a two-bedroom unit at 60% AMI.[2] The most recent May 2023 HUD rent increase was approximately 7% in AMI rents. The question becomes, at these monthly incomes, does the mathematics for affordable homeownership work?

By the end of the decade, approximately half of Low-Income Housing Tax Credit (LIHTC)-funded housing units are anticipated to reach the end of their affordability restrictions.[3] At the end of the affordability restrictions, which could be as short as 15 years in the LIHTC program, there is a three-year vacancy decontrol period before a project can go to market rate. Some states require affordability restrictions at the 30-year level and a limited number of states require affordability restrictions as long as 55 years, such as the case in California. At the end of the compliance period, another Section 42 re-syndication is possible to keep the LIHTC units affordable. This thesis presents another new option to turn a LIHTC rental units into homeownership units and serves to support Madison Park Development Corporation's research into rent-to-own models through a case study of Quality Hill Phase IIB, a LIHTC Rental-to-Affordable Condominium project based in Kansas City, Missouri.

Quality Hill IIB is believed to be the only LIHTC-to-condominium conversion attempt to date in the United States. Though the model ultimately failed mainly due to the 2008-2012 financial crisis, there are valuable lessons that could be applied to the application of similar approaches in Boston.

The paragraphs below explain how the conversion was structured, reasons the model failed, and key recommendations to ensure its success in a future attempt. This research serves to supplement the "Creating Homeownership Opportunities at Scale: Rental Property Conversion for Boston CDCs" 2021 report completed by Laurie Gould at Viva Consulting. Research into Cleveland Housing Network (CHN) Housing Partners' LIHTC Lease-to-Purchase model was intentionally left out of this report given prior attention to the program in the Viva Consulting report and the challenge with the model's reliance upon a single-family detached home typology for conversions. While this report serves as a high-level overview of the Quality Hill IIB case study, additional analysis of the tax and accounting concepts presented in this report are best directed to attorneys better versed in this field.

I am deeply grateful to Steven Stogel who spent hours working with me to develop this case study. Steven was the co-general partner at McCormack Baron Salazar who structured and negotiated the Quality Hill Phase IIB development and served as a mentor for my thesis.

[1] Source: HUD FY 2023 Fair Market Rents for St. Louis City

[2] Source: HUD FY 2023 Income Limits Summary for Boston City

[3] Source: What Can Be Done When LIHTC Affordability Restrictions Expire? (Duong, 2022)

Brief Literature Review

There is little-to-no direct scholarly research on LIHTC-to-Condo conversions. As such, the following is a brief high-level summary of literature on extending affordability requirements and considering rent-to-own programs that offer policymakers and practitioners a different approach to expand access to affordable homeownership opportunities.

Woo, Joh, and Van Zandt (2016) suggest that policymakers consider the LIHTC program as a tool for stabilizing neighborhoods and preserving affordable housing units.[4] Lens and Reina (2016) recommend several policy changes to address the expiration of federal housing subsidies, including extending affordability restrictions, providing financial assistance to low-income households, and creating programs to support the acquisition and rehabilitation of expiring subsidized properties.[5] They also recommend that policymakers consider the impact of subsidy expiration on neighborhood opportunity. As demonstrated in the case study for thesis, there are mechanisms to extend affordability restrictions when converting LIHTC rentals to condominiums.

Galante, Reid, and Sanchez-Moyano (2017) recommend several policy changes to support lease-purchase programs as a means of expanding access to homeownership for low- and moderate-income households.[6] These include providing financial assistance to cover down payments and closing costs, creating standardized lease-purchase agreements, and establishing regulations to protect tenants' rights. Jaggia and Patel (2017) suggest that rent-to-own contracts can be a viable option for increasing access to homeownership for households facing financial constraints.[7] They propose a valuation framework based on option pricing theory to design effective rent-to-own programs. In a separate article, Jaggia, Roche, and Anderson (2019) find that rent-to-own contracts are priced higher than traditional rental contracts but lower than outright purchases. They suggest that policymakers consider this pricing differential when designing rent-to-own programs.[8]

Overall, whether rent-to-own or another model, each housing strategy has its own strengths and weaknesses, and policymakers should carefully consider the local context and the needs of the target population when selecting a strategy. For example, lease-purchase programs may be more appropriate for households with limited financial resources, while shared equity homeownership programs may be more suitable for households seeking to build wealth over time. Policymakers need to work closely with community stakeholders and engage in ongoing evaluation and monitoring to ensure that these strategies are effective in achieving their intended goals. In doing so, they can help to promote stable neighborhoods, preserve affordable housing units, and build wealth for low- and moderate-income households.

Site and Development History[9]

After the Civil War, Quality Hill, located on the western side of downtown Kansas City, was a desirable neighborhood for the city's commercial elite. However, after 1890 the area began to decline, resulting in neglect or abandonment of dozens of historic buildings.

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[4] Source: Impacts of the Low-Income Housing Tax Credit Program on Neighborhood Housing Turnover (Woo et al., 2014)
[5] Source: Preserving Neighborhood Opportunity: Where Federal Housing Subsidies Expire (Michael & Reina, 2016)
[6] Source: Expanding Access to Homeownership Through Lease-Purchase (Galante et al., 2017)
[7] Source: Rent-to-Own Housing Contracts Under Financial Constraints (Jaggia & Patel, 2017)
[8] Source: Rent-to-Own Pricing: Theory and Empirical Evidence (Jaggia et al., 2019)
[9] Source: McCormack Baron & Associates Developer Memorandum Paper/History

In 1983, McCormack, Baron and Associates, Inc., Missouri Corporation, teamed up with the Hall Family Foundation and the City of Kansas City to redevelop 7.36 acres in the center of Quality Hill. The $42,000,000 project created 52,000 square feet of commercial and retail space in addition to 363 apartments and condominiums in 23 new and historically restored buildings. The second phase in 1988 followed with the development of 49 additional residential units in two more buildings. Finally, the last phase, Quality Hill phase IIB, in 1993 consisted of 84 multifamily residential units that were built on 2.1 acres. The units were built as a LIHTC property serving households with incomes at or below 60% of average median income. The three phases collectively encompassed more than 10 acres of redevelopment in Kansas City's urban core that catalyzed over 2,000,000 square feet of office space built on all contiguous sides.

In 2008, McCormack Baron sold the apartment properties from the first two phases to a buyer who upgraded the units to market rate rental units and converted a few to condominiums. For Quality Hill Phase IIB, the original limited partner Sun America Affordable Housing Partners exited for $1 (see footnote note 4 on section 183). An affiliated AIG entity then stepped in as the new capital partner with the $4.4 million capital contribution to convert the LIHTC rental units into affordable condominiums that became known as Quality Hill Square Condominiums.[10]

Facts of the Case Study

- Entity: Quality Hill Historic District phase II-B, L.P. (Taxpayer): a Missouri limited partnership formed to acquire, rehabilitate, develop, own and operate the project.
- Project: The project, "Quality Hill Historic District - Phase II-B Apartments", consists of an 84-unit rental housing development, each unit of which is a low-income unit as defined under Section 42(i)(3)(A) of the Code.
- General Partner: MBA Urban Development Co. i.e McCormack Baron & Associates and DCF Financial Group, Inc.
- Limited Partner: SunAmerica Housing Fund XXIII, L.P.
- Capital Partner: American Insurance Group, Inc. (AIG)
- State Housing Financing Agency (SHFA): Missouri Housing Development Commission (MHDC)
- LIHTC Allocation: 1991
- First Year of Credits: The Taxpayer acquired and rehabilitated the Project in 1993. In the same year, the project received an allocation of low-income housing credits pursuant to Section 42 of the Code from MHDC. First year of the project's credit period was 1993.
- LIHTC Award: 9% LIHTC
- Extended Use Agreement: The project has a recorded extended use agreement, a Declaration of Land Use Restriction Covenants for Low-Income Housing Tax Credits, dated as of December 27, 1993, as amended, for the 30-year period required by Section 42(h)(6) of the Code, which agreement covers the entire project.
- Code: Internal Revenue Service (IRS) Code of 1986
- Section 42: The IRS Code that pertains to the Low-Income Housing Tax Credit

[10] Note 1: SunAmerica is an affiliate of AIG. Therefore, the shift from SunAmerica Affordable Housing, Inc. to AIG was an internal shift. SunAmerica Affordable Housing Partners, Inc. has a charter restriction to strictly conduct affordable rental housing investments based on what they are allowed to do within an insurance company. The second affiliated AIG entity, on the other hand, has a charter to do investments in other types of real estate investments.

- Ownership Plan: Ownership Plan contemplates that all 84 units in the Project would be converted to condominiums in accordance with the Missouri Condominium Property Act and Kansas City Ordinances.
- Partnership: MBA Urban Development Co. and SunAmerica Housing Fund XXIII, L.P. 1993-2008 then MBA Urban Development Co. and the second AIG entity from 2008-2019.

IRS Ruling

The Partnership requested and received Private Letter Ruling 200703204 (PLR) from the Internal Revenue Service (IRS) January 19, 2007. The Partnership at a cost of $100,000 applied for a private ruling letter with participation of MHDC. It took a year for the Partnership and MHDC to work out the terms of the new proposed Land Use Restriction Agreement (LURA) and complete the PLR request. The Partnership's legal theory for the ruling was the IRS had no jurisdiction after the 15-year compliance period so the sole jurisdiction going forward rested with the State Housing Finance Agency (SHFA), including the ability to monitor vacancy decontrol for three years after the LURA. That predicate was the basis for the IRS's concurrence in the issuance of the ruling.

The request included the following[11]:

- "The right of first refusal granted by Taxpayer to each tenant as part of a condominium homeownership plan to purchase their unit after the close of the compliance period applicable to that unit will satisfy the requirements of § 42(i)(7)(A) of the Code, and"
- "Assuming Project's existing commitment otherwise satisfies § 42(h)(6) of the Code, it will continue to satisfy § 42(h)(6) even though it will (i) be amended to grant each tenant occupying their unit a right of first refusal to purchase that unit; (ii) terminate after the compliance period of the buildings in Project; and (iii) be replaced with a new commitment which will provide for (a) continuing § 42 rental income restrictions for all units which continue as rental units, and (b) § 42 income restrictions for all buyers (other than the existing tenants) of the units sold at the time they are sold."

The PLR granted a LIHTC tenant the right of first refusal to buy his or her unit as part of the condominium homeownership plan after year 15 of the compliance period, even if that fell within the "extended use term" of another 15 or more years. It also allowed the SHFA to amend any of the terms of the existing Land Use Restriction Agreement (LURA) to allow affordable homeownership.

In Quality Hill Square Condominiums case study, the Missouri Housing Development Commission (MHDC), Missouri's SHFA, issued a new LURA once the 15-year tax credit compliance period ended and the conversion began in year 16. The new LURA required that all condominium resales be made to low-income buyers at or below 60% AMI for the extended use term of 30 years (more detail located in the LURA section). Note that the initial extended use term of 15 pre-conversion was also extended to 30 years post conversion.

The partnership was able to get a Letter of Support from MHDC due to the following policy reasons:

[11] Source: Novogradac: Private Letter Ruling 200703204

- Conversion of a rental unit to homeownership unit did not diminish the affordable housing rental pool since the tenant had the option to become a homeowner or remain as a renter.
- The existing tenant had the right of first refusal to purchase the unit she or he lived in prior to the conversion date. This would incentivize the tenant to remain in his or her unit, which could result in better upkeep of the property, more financial stability, and overall community benefit.
- At the end of the 15-year compliance period, the owner of the project is not at risk for tax credit recapture and has usually fully realized all economic returns. This reduces the owner's incentive for operating and maintaining the property in a manner consistent with Section 42 of the tax code, which could cause a potential risk to the stability of the project. However, the tenant-owner would have the economic capacity and incentive to maintain the property.
- The SHFA would not be required to issue a new allocation of housing tax credits or deploy other additional resources in assisting owners to raise new equity to refurbish or maintain the project after the initial 15-year compliance period.
- The project's use for affordable housing was maintained and extended through affordability restrictions on resale included in the deed of the property.

MHDC also required oversight of the conversion process as detailed in the next section.

Land Use Restriction Agreement (LURA)

The development partnership and MHDC agreed that provisions of the extended use agreement would terminate after the completion of the compliance period and the exercise of the tenant's right of first refusal regarding his or her unit pursuant to Section 42(i)(7) of the Code six months from the commencement of the conversion. A new extended use agreement was issued effective the date of conversion March 2008 and included affordability restrictions for 30 years. The new agreement contained two parts: (i) <u>rental units</u>: the unit would continue to remain as a rental unit subject to the terms in the exiting extended use agreement until the tenant vacated his or her unit, and (ii) <u>condo units</u>: converted units were required to be sold to a tenant or resold to a qualified buyer whose income satisfied the applicable Section 42 income limitation that the project was subject to at the time. Once all the rental units were sold, only the provisions pertaining to the condominium units would apply.

MHDC also required that Quality Phase IIB LP to do the following:

- request consent from the agency to amend or terminate the new extended use agreement
- keep the agency apprised of the implementation of the sales program during regular intervals before and after the start of the condominium conversion
- provide the agency with a 60-day advance notice prior to the issuance of the "Tenant Notice" to allow the agency to comment on the mechanism for reviewing the sale prices and overseeing that the condominium units were sold to qualified buyers
- monitor and report continued occupancy and sales to qualified buyers of the condo units or tenants of the remaining rental units to the agency

Please see section 8 titled "Grantor Certification and Reports" of the LURA for more detail.

Condominium Declaration

Once the PLR was received, Quality Phase IIB LP recorded (i) a condominium declaration and (ii) a condominium plat. The actual conversion to condominiums was not effective until the end of the 15-year compliance period. The condominium conversion was viewed by MHDC and Quality Phase IIB LP as the most beneficial structure to allow tenant ownership and it was easier for the owner to finance given that banks would require less equity as a down payment.

Financing

Estimates of Sources and Uses

Original Limited Partner SunAmerica bought the LIHTCs for approximately $2.8 million to help build the project in 1998. By the end of the compliance period in 2007-2008, SunAmerica had received all its federal tax credits and was bought out by the developer MBA Urban Development, Co. for $1 under section 183 of the Code that stipulates that a tax credit investor does not require a profit motive.[12]

The existing debt by December 31st, 2016 consisted of the first mortgage of $1.11 million + $4 million± of the collective second to fifth mortgages, equaling a total of roughly $5.11 million. The original balance of the $1.5 million first mortgage financed through AFL-CIO Housing Trust Fund and the $1.755 million soft loan issued by the Land Clearance for Redevelopment Authority of Kansas City (Redevelopment Authority) in 1998 were paid down to $1.11 million and $540,000 respectively by the time of the conversion. Both loans were paid down through positive cash flows of the property, which had a net operating income of approximately $200,000 by 2005-2006. Note that the net debt on the Quality Hill Phase IIB property at the time was in the range of $2.5 million.

A co-investment equity pool with a fund of approximately $4.4 million was then created to finance the condominium conversion with a new capital partner, AIG. AIG and MBA Urban Development Co. provided 98% and 2%, respectively, to fund the initial $4.4 million capital stack. The $4.4 million capital source paid off at par the $1.1 million first mortgage and the $1.3 million program related investment-based mortgage from the Hall Family Foundation. In addition, the common equity funds were applied to buy out the approximately $3 million of City Community Development Block Grant (CDBG) and Urban Development Action Grant (UDAG) funds for a reduced price of less than $200,000.

The balance of the dollars was then used to upgrade the by-then 17-year-old property. Approximately $1 million was spent for the exterior improvements and unit upgrades to prepare for the conversion.[13]

[12] More information on section 183 can be found here.
[13] Pictures sourced from the 'Private Letter Ruling 200703024' presentation provided by Steven Stogel.

None of loans, including the Hall Family Foundation second mortgage or the two City of Kansas City soft loans in third and fourth positions, had affordability restrictions in 1993 or when the compliance period expired. The oversight and requirement was left solely to MHDC at the commencement of the tax credit period in 1993 and then again during the conversion in 2007-2008.

In addition, MBA Urban Development Co. required consent of the Limited Partner and existing lenders in order to do the conversion. The institutional first mortgage lender required full repayment of the loan before the conversion occurred and the soft lenders required to be involved upfront before any application to a State Agency to do the conversion began.

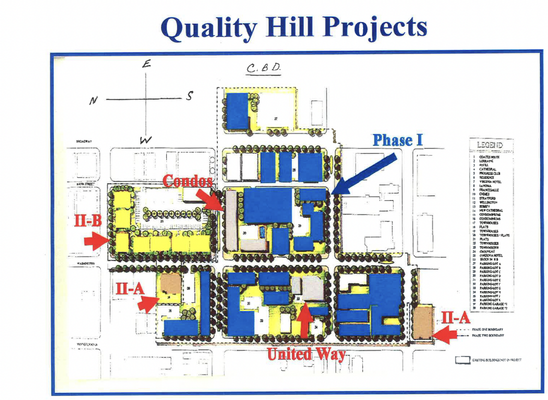
Support from the City of Kansas City

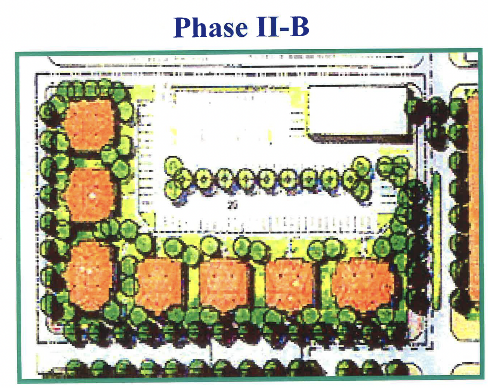
The Redevelopment Authority re-committed $252,000 of the remaining outstanding loan in 2008 to be used solely for the benefit of the qualified buyers. The escrow funds were kept in an interest-bearing account held by the title company and were disbursed to the condominium association as outlined in the new escrow agreement. Quality Phase IIB LP was also able to obtain a release of the Deed of Trust and other mortgage documents.

The funds were to be used as part of a Buyer's Assistance Grant Program managed by Quality Hill 2B LP. Disbursements of $3,000 were solely to be allocated for the initial sale of each of the 84 housing units within the property for the following uses: (i) "payment of discount points or fees on the loans for such housing units"; and/or (ii) "credit for down payment and/or closing costs in the connection with the purchase of such housing units, all in accordance with the Redevelopment Contract and the Private Letter Ruling".[14] Transfers to the Partnership's account did not require consent by the Redevelopment Authority; however, the Partnership was required to cost-certify expenditures of the escrow account disbursements and send written statements to the Redevelopment Authority evidencing the use of the disbursements six months after closing and every six months thereafter. Any remaining funds after July 1st, 2014 would be returned to the Redevelopment Authority without consent of the Partnership. In addition, the City froze real estate taxes at the current rental valuation of the property for ten more years post conversion.

[14] Source: Amended and Restated Escrow Agreement effective May 25, 2011

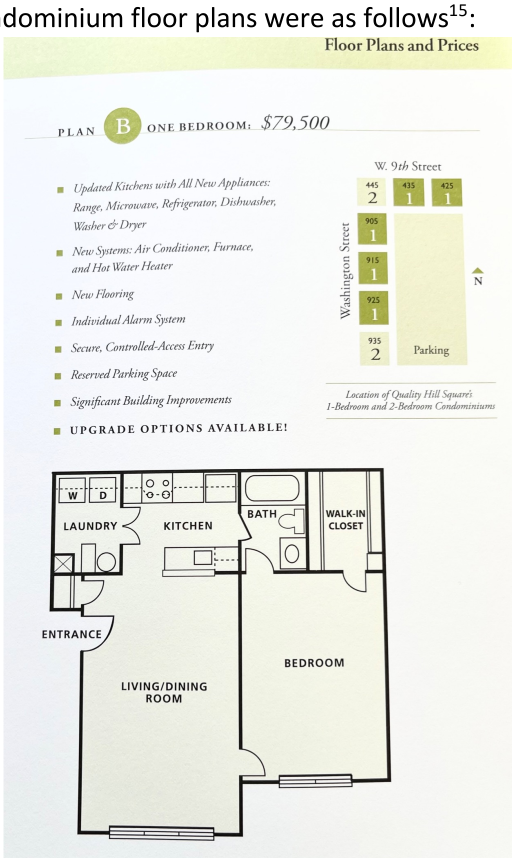
Project Description

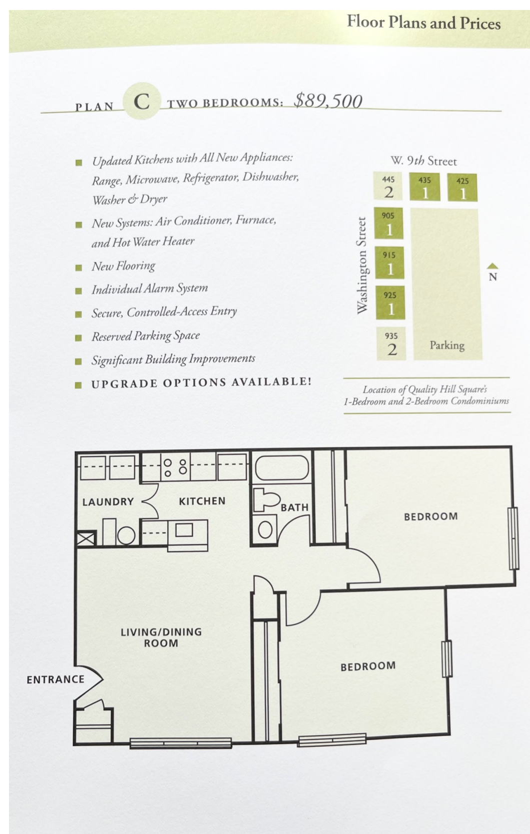




Quality Hill Square Condominiums is a 84-unit development with 60 one- and 24 two-bedroom condos. Each condo unit had one reserved parking space included in the purchase price. Quality Hill Phase IIB LP also reserved up to 15 additional parking spaces that could be sold to homebuyers if desired. There were a total of 90 parking spaces at the property.

The condominium floor plans were as follows[15]:





[15] Source: Unit Sales Disclosure Book provided by Steven Stogel

Non-existing tenants eligible to purchase an available unit if their annual household income met the following MHDC guidelines, which as of September 15, 2007 had been:

Number of Persons	Household Income Limit
1 Person	$28,740
2 Persons	$32,820
3 Persons	$36,960
4 Persons	$41,040

The breakdown of how responsibilities and costs were divided was as follows:

Owner's Responsibilities	Costs Included in Condo Fees
• Repairs and maintenance of the interior of the homeowner unit • Payment of the monthly mortgage payment and condo fee • Payment of annual property taxes, which were included in the condo fee • Payment of insuring the contents • Payment of monthly gas, electricity, cable and telephone	• Annual property taxes • Insurance, utilities and maintenance of common areas • Landscaping • Management company fees • Replacement reserve contribution • Snow removal • Trash removal • Water and sewer

The annual replacement reserve could not be less than $42,000 a year ($500 per unit per year) per the new LURA. The development partnership was also required to make an initial deposit of $250 per unit to the replacement reserve at the time of the sale of the first condo.

Program Overview

Once the PLR was received, Quality Phase IIB LP provided notice that the condominium conversion would occur at the end of the compliance in all new and renewed tenant leases. At the time of the conversion, tenants were given another notice that described when the commencement and timing of completion of the conversion process, the intent to sell the units, the method used to sell and calculate the sale price of the units, and information about the new extended use agreement.

Tenants were allowed up to six months from the commencement of the conversion to exercise their right of first refusal. The qualified buyer would need to provide sufficient documents to the homeowners' association to substantiate income eligibility of all intended residents for that unit. Income certification of the qualified buyers and sales information would then be sent annually to MHDC as mentioned earlier. If a tenant chose not to purchase his or her unit, the unit would remain as rental property and the tenant could continue to live in the unit as long as she or he desired. Rents for those rental units would continue to be restricted to maximum rents for individuals or families earning at or below 60% AMI allowed under Section 42(g) and the LURA. Once the tenant chose to move out, the owner could either maintain the unit as a rental unit or offer it for sale to a qualified buyer.

After the existing tenants were offered the opportunity to purchase their units, vacant units were made open to City employees before marketing the units to the general public. This was part of the negotiation with the City of Kansas City to provide the option of below market priced units to city employees in exchange for favorable refinancing terms of the City's subordinated debt.

Each new home buyer was required to complete a 16-hour homeownership course provided by the Kansas City NeighborWorks Chapter and to meet with a Homeownership Counselor. The condominium association was required to engage a third party property manager who had experience with LIHTC projects to operate Quality Hill Square Condominiums, which in this case was McCormack Baron Management Inc., which was the property management arm of McCormack Baron & Associates, Inc.. Each tenant would have brand new appliances, new flooring and fresh paint, a new furnace, hot water heater and air conditioner upon moving in. Tenants were responsible for any repairs in the unit after moving in but could request help from the on-site maintenance staff for a fee.

Calculation of Sale Price

The purchase price for each condo unit was based on mortgage payments and condominium fees that could not exceed the maximum Section 42(g) rents for individuals or families earning incomes at or below 60% AMI at the time of sale. In addition, the new LURA mandated the purchase price does not exceed an amount determined by assuming a 5% down payment and a mortgage equal to 95% of the purchase price, with monthly payments amortizing over a 30-year period at 6% interest per year.

The mathematical formula calculated 18-20% of the buyer's income to be allocated to principal and interest payments of the mortgage and the other 10-12% to utilities, taxes, insurance and homeowner fees. As a result, the 18-20% bandwidth for principal and interest payments was below Fannie Mae's 32% calculation for a homeowner's capacity to pay principal and interest. To maintain affordability for future buyers upon resale of a condominium unit, the resale price for each unit was restricted to the gross sales price paid by the seller at the time she or he purchased the unit plus a 10% per annum cumulative increase based on that gross sales price.

Quality Phase IIB LP offered each tenant a discount on the purchase price of his or her unit. The discount was tied to the compliance period of the building occupied by the tenant and was based on the duration that each tenant had lived in his or her unit at 1% for each year that tenant had lived in his or her unit during the ten years preceding the year of the condominium conversion (example provided below). In order to receive the discount, the tenant had to do the following: (i) reside in his or her unit at the time of the condominium conversion, and (ii) exercise his or her right of first refusal to purchase the unit within six months from the date of conversion.

In the case of Quality Hill Square Hill Square Condominiums, the Partnership has arranged an end-loan program for each home buyer with a national bank to provide this exact product, with a buy down formula: $905 all-in for closing costs, a fixed interest rate and a full 30-year amortization. This bank had its associates on site to meet and help each homebuyer make the appropriate financial underwriting and credit assessment.

One Bedroom Sales Price Example

The following provides an example of the financing for a one-bedroom apartment:

Price of One-Bedroom Home	$79,000
Subtract Homeowner Grant	$3,000
Subtract 1% Annual Residency Credit (ex. 7 years = 7%)	$5,565
Subtract $500 Downpayment	$500
Adjusted Price of One-Bedroom Home	$70,435
Add Closing Costs, Bank Fees & Title Insurance	$1,800
Amount Needed for Mortgage	$72,235
Monthly Mortgage Payment 30 Year Loan @ 6% Interest	$433
Add Monthly Condominium Fee	$227
Monthly Housing Payment	$660

The following demonstrates the higher-level breakdown between the one- and two-bedroom units:

	1 BR	2 BR
Price	$79,500	$89,500
Closing Costs	905	905
Less:		
City Grant	($3,000)	($3,000)
Credit 3 yr Occupancy	($2,385)	($2,685)
Cash Down Payment	($500)	($500)
	$74,520	$84,220
Monthly Payment		
Loan (6%, 30 years)	$ 447	$ 505
Condo Fee	232	276
Total	$ 679	$ 781
Max Tax Credit Rent (Net Of Utility Allowance)	$ 695	$ 817

Lenders

The main lenders for Quality Hill IIB were a regional bank, Boatman National Bank, and a community bank out of Hannibal, Missouri. Per the new LURA, the homeowners association could rely on a lender's qualification of a potential buyer's income if the lender completed the Qualified Affordable Condominium Mortgage Lender Statement of Loan Underwriting Procedures and verified the applicant's income by "obtaining and reviewing employment verification, thirty (30) days' most recent pay stub(s) with year-to-date earnings, most recent two years' tax returns, copies of W-2 and 1099 forms, three months' statements on all checking, savings, investment, and/or retirement accounts, and additional information to verify income from divorce or gift when applicable".[16] See section 6(g) of the LURA for more detail.

Quality Hill IIB Program Flaws

Breakdown of Sales

Sales efforts started in 2008; however, only 20 of 84 units had been sold by April 2014. The number of units sold per year was as follows:

Year	# of Units Sold
2008	5
2009	3
2010	2
2011	7
2012	3
2013	0
2014	0

The Partnership tried to use three different brokerage firms to sell the remaining units with no success. The Partnership had to assist 13 of the 20 units with purchases by arranging financing with a rural bank as well as guarantee and post cash collateral on the loans. In addition, one of the 13 loans had been prepaid, the second had to be pre-purchased, and the third was in default.

Attempts by the Partnership to improve unit sales included requesting to increase the income level for the qualified buyers from 60% AMI to 80% AMI while holding the pricing constant for the units. The argument was that the change would still support workforce housing and sustainable homeownership. It was granted by an amendment to the LURA in 2011. In addition, the Partnership infused $6,462,000, comprising $4.4 million originally to acquire the land, to purchase the five mortgages and refurbish the

[16] Source: 2008 Land Use Agreement

units and over time an additional $2 million of capital required for carrying cost and additional refurbish costs as the saga unfolded.[17]

Reasons

The five flaws the program experienced were as follows:

1. 2008 Financial Crisis + Material Change in the Capital Partner
2. Lack of End Loan Financing
3. Tenant Eligibility Issues
4. Lack of Sophisticated Broker

Details on the flaws are as follows:

1. The timing of the program coincided with the 2008-2012 financial crisis, which resulted in the collapse of the housing market. Sales stopped as banks froze lending, interest rates went up, and home prices declined. The collapse affected homes everywhere in the country, which added a fear factor of the prospective condo buyers in Kansas City. In 2009, capital partner AIG was also in a highly publicized federal government-assisted recapitalization, borrowed $135 billion, and issued $45 billion in preferred stock. AIG canceled, among other investment programs, the homeownership conversion plan. The 2008 onset of the Great Recession was triggered by the collapse of the housing market, particularly in the Sand States but affected homes everywhere in the country, which added a fear factor of the prospective condo buyers in Kansas City.

2. In addition, MBA Urban Development Co. did not arrange with AIG to bridge out the first 51% of sales (43/84 sales). At the time, Fannie Mae and Freddie Mac had mortgage buyout programs where they would finance directly to any eligible bank and buy the remaining 49% of mortgages. Once 95% of sales were achieved, Fannie or Freddie could then buy out the first 51% of mortgages AIG had financed in order to have control of the entire inventory of units. However, the homeownership conversion plan was not contemplated this way and the amount of the mortgages were too small to request approval from AIG Global Real Estate's board. In retrospect, the Partnership would have benefited from doing an alternate form of financing entirely through Federal Housing Administration (FHA), a Government Sponsored Enterprise such as Fannie and Freddie, MHDC's first home buyers' program, or Community Development Financial Institution (CDFI).

3. Furthermore, it was difficult to find eligible low-income tenants who wanted to own a home and out of the few low-income potential buyers, very few qualified for financing. The developer found that despite having a diligent screening process, there were financial payables that the tenants had not disclosed in their rental application. Note that tenant income eligibility is only determined on the day the tenant signs their lease application. With more rigorous underwriting, banks were equipped to identify these issues due to access to better research tools and credit agency reports. The lesson learned was that underwriting for homeownership is more scrupulous than for renting.

[17] The PRL from the IRS was requested in 2006 and was issued in Q1 2007. It took 18 months to get all the City and MHDC approvals in place and line up the launch date of the conversion, taking the project back out to 2008. However, surely thereafter AIG needed a recapitalization detailed in the thesis and the program was halted.

In addition, the 2008 onset of the Great Recession was triggered by the collapse of the housing market, particularly in the Sand States, but affected homes everywhere in the country, which added a fear factor of the prospective condo buyers in Kansas City.

4. Finally, McCormack Baron & Associates mostly had experience managing rental units and did not have the expertise needed to sell the units effectively. They ended up having to pay for a real estate broker to sell the units, which took a while until a good fit was found for the project.

Consequences

In this period, 71% (60 units) of the units at the property had become vacant over time. The Partnership did not have capital because the capital partner AIG itself was stressed. That duality created a strain on the property's finances and rental operations as well as the existing tenant residents. In addition, there was no capital to fix the units to sell to the low-income individuals and families, causing the property to languish.

At that point, the Partnership went to MHDC May 2014 to share the recognition that the conversion program had not worked and asked for the 2008 new LURA to be extinguished. MHDC granted the termination of the LURA as the IRS's jurisdiction had long expired. This resulted in the state's loss of land inventory restricted for affordability uses that it could not retrieve back since the project was allowed to "go to market". The tenant-owners and tenant-renters were allowed to maintain their units at the maximum amounts allowed per Section 42(g). The 18 existing tenant-owners were also notified that the income resale restriction was lifted per MHDC's approval and were allowed to sell at market-rate once they moved out. Unit prices increased to approximately $140,000 for one-bedroom condos and $155,000 for two-bedroom condos.

By the end, all units at the property were sold at market-rate and the Partnership only recovered enough to recoup the original $6.4 million in capital advances. The hope-for profit split between AIG and MBA Urban Development Co. at 80% and at 20% in the conversion never materialized. In fact, given the eight plus years of effort and the overhead costs, both AIG and MBA Urban Development Co. functionally lost money.

Considerations for Future Attempts for a LIHTC-to-Condominium Conversion

The fellow are considerations to re-attempt a LIHTC-to-Condominium conversion:

1. Stress importance of utilizing tax code section 108(c)
2. Allow tenant to exercise transferable debt
3. Request that MassHousing provide and guarantee the tenant mortgages

Tax Code Section 108(c)

Section 108 is a statutory path for developers to reset a LIHTC deal to write down on a tax deferred or no tax basis any soft debt that is still outstanding at the end of the compliance period. The statute is most beneficial for for-profit developers given existing pathways for nonprofit developers to extinguish soft debt.

Technicalities of the Code

Section 108(c)(3) defines "qualified real property business indebtedness" as indebtedness which:

- (A) was incurred or assumed in connection with real property used in a trade or business and is secured by that real property;
- (B) was assumed or incurred before January 1, 1993 or after 1992 if the debt is either:
  - (i) debt incurred to refinance qualified real property business indebtedness incurred or assumed before 1993 (but only to the extent the amount of such debt doesn't exceed the amount of debt being refinanced), or
  - (ii) qualified acquisition indebtedness.
- (C) with respect to which the taxpayer makes an election to exclude from gross income.

The provision does not apply to a corporation and does not include qualified farm indebtedness.[18]

Section 108(c)(4) generally defines "qualified acquisition indebtedness" as indebtedness which:

- (A) was incurred or assumed to acquire, construct, reconstruct, or substantially improve the real property that is secured by such debt; and
- (B) results from the refinancing of qualified acquisition indebtedness to the extent the amount of such debt doesn't exceed the amount of debt being refinanced.

The following are key points from the tax code in Rev. Rul. 2016-15:

- Section 108(c)(1) provides that if a taxpayer excludes cancellation of debt (COD) income under section 108(a)(1)(D), the taxpayer must reduce the basis in depreciable real property by the same amount in accordance with section 1017[19].
- Section 108(c)(2)(A) provides that the amount of COD income that a taxpayer may exclude is limited to the excess of the outstanding principal amount of debt of the qualified real property business indebtedness (QRPBI) immediately before the cancellation over the fair market value of the real property securing the debt, as reduced by the outstanding principal amount of other QRPBI secured by the property.
- Section(c)(2)(B) provides that the amount of COD income that a taxpayer may exclude under section 108(a)(1)(D) may not exceed the aggregate adjusted basis (after basis reduction under sections 108(b) and (g)) of depreciable real property held by the taxpayer immediately before the cancellation (other than depreciable real property acquired in contemplation of such cancellation). Any excess is included in income.[20]
- Section 1.1017-1(c)(1) provides that, for basis reduction under section 108(c)(1), a taxpayer must reduce the adjusted basis of the qualifying real property to the extent of the discharged QRPBI before reducing the adjusted basis of other depreciable real property. For this purpose, "qualifying real property" means real property with respect to which the indebtedness is QRPBI.

[18] The provision does not apply to a corporation unless it is an S corporation.

[19] Section 108(d)(1) Indebtedness of Taxpayer: For purposes of this section, the term "indebtedness of the taxpayer" means any indebtedness (i) for which the taxpayer is liable or subject to which the taxpayer holds property.

[20] More information on sections 108(b) and 108(g) can be found here.

- Section 167(a) allows as a depreciation deduction, a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the taxpayer's trade or business or held by the taxpayer for the production of income. Residential rental property is depreciable property. See section 168(e)(2)(A).[21] However, section 1.167(a)-2 provides that no depreciation deduction is allowed for inventories, stock in trade, or land separate from the physical improvements made to the land.

Note that a depreciable property is “any property eligible for depreciation or amortization but only if a basis reduction would reduce the amount of depreciation otherwise allowable for the period immediately following such a reduction”. LIHTC rental properties are considered depreciable property.

One example in in the revenue ruling shows the power of section 108;

A sole proprietor i.e. taxpayer (by assent of all its partners) borrowed a loan of $10 million from a bank and used the entire proceeds to build an apartment building for use in the taxpayer’s rental trade or leasing business. The taxpayer secures the loan with the apartment building. Before the loan matured, the taxpayer reduced the loan principal to $8 million but was unable to pay it off on the maturity date. The fair market value of the apartment building was $5 million, and the proprietor’s adjusted basis was $9.4 million. After negotiations, the bank agreed to accept $5.25 million to forgive the loan. The taxpayer was not insolvent or bankrupt when the loan was forgiven. For the taxable year in which the bank cancels the loan, the taxpayer elected to exclude under Sec.108(a)(1)(D) $2.75 million ($8 million - $5.25 million) of COD income that arose from the cancellation / forgiveness of the loan.

The debt in this example is qualified real property indebtedness because the taxpayer (i) held the property for use in a trade or business (ii) secured the loan by real property i.e. the apartment building and (iii) allowed the property to depreciate. As a result, the taxpayer was able to exclude the $2.75 million gain i.e. COD income from gross income and reduce the basis in the building by the same amount.

Applicable LIHTC Explanation in Layman’s Terms

A developer could request to buy back the subordinate soft debt on a LIHTC deal issued by state and local agencies for a reduced price. The cancellation of the loans would result in COD income and in exchange, the developer would elect, through tax code section 108(c), to reduce the original basis in the depreciable real property that secures the debt by the same amount. The statute allows the developer to either minimize, defer or terminate tax on the cancellation of debt income arising from the cancellation of the loan. The election is made at the partner level and not partnership level. This allows the developer not to incur phantom income when all the debt is extinguished and creates an incentive to participate in the condominium conversion due to an ability to make profit.[22]

<u>LIHTC Project Example</u>: Take a LIHTC development that costs $14 million to construct: (i) $4 million in federal tax credit equity (ii) a $4 million first mortgage (iii) a $3 million second mortgage, $2 million third mortgage, and $1 million fourth mortgage, collectively constituting $6 million of soft debt. Note that the original loans used to finance the project must be secured by the mortgage and originate from the start date of the project in order to qualify for qualified acquisition indebtedness. The developer has the choice in this example of writing down the soft debt by a basis reduction and not having to confront either (i) a

[21] More information on section 168(e)(2)(A) can be found here.

[22] Phantom income is unrealized income through a sale that is still subject to taxes by the IRS.

cancellation of indebtedness tax issue at some point down the road when the project is sold or (ii) have to pay back in full the soft loans upon the sale of the property.[23][24]

Returning to the example, there is $10 million of debt and the property is able to pay down that amount to $8.5 million from positive cash flows by the end of the compliance period. The developer would ask to buy back the $6 million of soft debt originally made by the state and local agencies for less than par. From the developer's point of view, section 108(c) allows the developer to write down inside and outside basis in depreciable real property by the same amount as the cancellation of debt income. The developer would then not have phantom taxable income. From the state agency's point of view, this write-down positions the unit to reset at a market price, which a low-income tenant can afford.

In the example above, assume the developer builds 100 units for $14 million and has a per unit cost of $140,000. If $6 million of soft debt can be written down, then the purchase price of that unit could be $x (i) less the principal paid down during the compliance period (ii) plus upgrades agreed upon refurbishment of the unit as if new again (iii) plus third party costs plus developer profit (iv) plus set aside reserves (v) perhaps money recouped by the state agency. This new math would reflect the condominium conversion and resale cost as displayed below. But know that each deal will be like a snowflake as the equation will not change but the numbers will. The key to this formula is why section 108 is a potential tool to incentivize developers and state agencies to work together on this equation to create affordable-for-sale condominium units from LIHTC projects at the end of their compliance period.

The new condo formula in this illustration would be as follows;

- $14 million - $4 million of tax credit equity[25] = $10 million in debt
- $10 million - $1.5 million pay down on the first mortgage debt = $8.5 million of debt
- $8.5 million of debt - $6 million of soft debt = $2.5 million as a starting point to build up the condo math formula i.e. the new total development cost. Note the $2.5 million is the amount still owed to the first mortgage lender since $4 million - $1.5 million = $2.5 million.
- $2.5 million / 100 units = $25,000 a unit

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[23] Note 2: The depreciation schedule for the project requires the developer to write off depreciation over 27 years on a straight-line basis. By the end of the 15-year compliance period, there is often quite an amount of basis left on LIHTC deals. There are two types of basis: (i) *inside basis*: the calculation of your original cost + income - expenses - depreciation + principal amortization (ii) *outside basis*: the calculation of the sum of the partner's capital + cash put in the property + percentage of non-recourse debt. Both inside and outside basis are required to balance out per federal regulation.

[24] Note 3: The developer would have other tax implications depending on whether they made or lost money during the compliance period. The property may have made money during the compliance period and paid down the first mortgage. While depreciation reduces the developer's capital account, amortization of the debt increases it, which could result in a positive capital account. In a tax credit deal, if all the basis is exhausted within the compliance period, the developer may end up with phantom income and losses from years 1 – 10 can be reallocated to another tax credit partnership. As such, most developers want to ensure that there is sufficient basis in the deal.

[25] Note 4: Section 183 of the Code defines, as a general rule, "the term *activity not engaged in for profit* means any activity other than one with respect to which deductions are allowable for the taxable year under section." Section 183 applies to a tax credit equity partner as they have a no-profit motive in financing a LIHTC project. The tax credit equity partner assumes no cash flow and no residual value as it gets its return ON and OF its capital solely from the tax credits. Therefore, the tax credit equity partner can exit at $1 as mentioned earlier. The specific ruling is Section 1.42-4 "Application of not-for-profit rules of section 183 to low-income housing credit activities". The ruling states the following: "(a) *Inapplicability to section 42.* In the case of a qualified low-income building with respect to which the low-income housing credit under section 42 is allowable, section 183 does not apply to disallow losses, deductions, or credits attributable to the ownership and operation of the building. Source: Internal Revenue Service, Treasury § 1.183–2. and Novogradac Section 1.42-4.

In the illustration above, 100 units for $14 million has a per unit cost of $140,000 but if $6 million of soft debt can be written down, then the purchase price of that unit would start from $25,000 a unit to get to a new condominium sales price that could be afforded by a low-income tenant all on math that could be less than his or her rent.

Transferable Debt

Allow tenants to finance through assumable mortgages that allows the buyer interested in purchasing the converted condo to take over the existing seller tenant's mortgage loan. There are several reasons why this financing arrangement is advantageous: (i) allows the seller tenant to make money in the event of rising interest rates without impacting the resale affordability restrictions, (ii) it allows the prospective buyer to finance their mortgage with a lower interest rate if rates have risen from when the tenant seller originally purchased the condo, and (iii) it provides the lender with a more cash invested homeowner, lowering the bank's leverage to the purchase price.

The way assumable mortgages work is similar to traditional mortgage loans with a few exceptions. The buyer is limited to financing through the seller's lender and must meet that lender's qualifications. The buyer assumes the seller's current mortgage i.e. the current principal balance and interest rate on the loan, the repayment period, and all other contractual terms of the seller's mortgage. In the event that the price of the home exceeds the remaining mortgage, the buyer is required to pay a downpayment that covers the difference between the sale price of the condo and the mortgage.

There are two types of assumable mortgages: (i) simple assumption, and (ii) novation. The simple assumption involves the transfer of the mortgage from the seller to the buyer through a private arrangement that does not involve the lender. The lender is therefore not privy to the transfer and does not put the buyer through their underwriting process. The simple assumption can be risky because the original borrower i.e the seller retains full liability for the mortgage. In the event that the buyer falls behind or fails to continue making payments on the mortgage or breaches the terms of the mortgage contract, both the seller and the buyer are liable. In novation, the lender participates and consents to the transfer of the mortgage. The buyer is required to go through the lender's underwriting process to ensure the buyer's financial eligibility for the loan. As a result of that underwriting process, the mortgage lender also releases the original borrower i.e. the seller from all future liability associated with the mortgage and transfers that liability to the new borrower. Most assumable mortgages fall under the novation category.

Advantages or disadvantages depend on the existing mortgage balance on the loan, the home equity and/or interest rates and include, but are not limited to, the following[26]:

Advantages	Disadvantages
● The buyer can take over an existing mortgage rather than go through the rigorous process of obtaining a mortgage from the bank. ● In a high interest rate environment, the	● Not all loans are assumable. ● The buyer is limited to the seller's lender and their qualification requirements. This restricts the buyer's search for more competitive interest rates or terms.

[26] Source: [Assumable Mortgage: What It Is, How It Works, Types, Pros & Cons](#) (Investopedia)

buyer can save money if the interest rate on the assumable loan is lower than current interest rates approved by banks. ● The buyer is able to incur lower closing costs than those associated with traditional mortgages. For example, an appraisal is not usually required for an assumable mortgage. ● Creates a marketing advantage for the seller through offering a simplified home buying process and a potentially lower interest rate than what is being offered in the market.	● If the seller's home equity appreciates or is high, the buyer either has to pay a substantial down payment or secure a new second loan to pay the difference between the sale price of the home and the existing seller's mortgage. ● There is risk to the seller in a simple assumption mortgage. If the buyer i.e. new borrower defaults on the mortgage payments, the seller remains liable to make up for missed payments. This includes risk for the buyer transferring ownership to an undisclosed third party without the knowledge of the seller.

Most non-government-backed mortgages are not assumable. Conventional mortgage loans usually contain a "due on sale" provision that requires full payment of the mortgage balance once the home is sold, therefore making the loan non-assumable. However, loans insured by the Federal Housing Administration (FHA), Department of Veterans Affairs (VA), and United States Department of Agriculture (USDA) are assumable under specific requirements. Note that a tenant seller is required to obtain lender approval for most FHA and VA assumable mortgage loans.

State Housing Finance Agency (SHFA)

The Massachusetts Housing Finance Agency i.e. MassHousing would be the optimal candidate to help pilot the LIHTC-to-Condo conversion program and could test case the model through opening an application to five candidates that could include for-profit and nonprofit developers as well as community development corporations. The SHFA could best work with the regulatory government agencies that issued the original soft debt and advance the section 108 model to create a programmatic conversion from rental to homeownership program.

As demonstrated in the Quality Hill IIB case study, MassHousing could weigh into the terms needed to make the conversion such as, but not limited to, the resale price affordability restrictions, duration of the extended use term, and oversight or approval requirements. Most importantly, MassHousing could serve as the originator of the mortgage loans to the tenants through MassHousing loan products or administration of the FHA first-time buyer loans.

Reasons include the following:

- The SHFA may want to go back to the IRS to reconfirm the Revenue Ruling as it would recraft the terms of the Quality Hill Phase IIB model now that it is 2023. However, the baseline of that 2007 private letter ruling remains unchanged simply being the IRS has no jurisdiction after the compliance period ends, as the jurisdiction then solely rests with the SHFA.
- The SHFA would have stronger political capital than individual non-governmental entities to rally other financial intermediaries of capital and operating subsidies to allow for the forgiveness of their subordinate soft debt and amendments to any regulatory obstacles to allowing the LIHTC

rental property to convert to affordable condominiums. In addition, this reduces the reputational risks placed on a single developer or community development corporation who would attempt to take this charge in the event the model goes array or fails.

- The SHFA's presence would institutionalize the program first on a pilot basis and then as its annual Qualified Allocation Plan (QAP).

Brief Commentary on the Viva Consulting Report

As mentioned in the introduction, this thesis serves to complement the research in the "Creating Homeownership Opportunities at Scale: Rental Property Conversion for Boston CDCs" 2021 report.

A few additional thoughts from this thesis as to the Viva Report would be:

1. Given that the LIHTC-to-Condo conversion would be a pilot, the ideal number of units is best suited to be between 60 to 80 units in the City of Boston and closer to 40 to 60 units in less dense cities in Massachusetts.

2. The report suggests allowing tenants to borrow at 97% of the sale price. While permissible, it would be more ideal to lower the amount to 88% to 92% through utilizing (i) soft debt recycled from the City to help with down payment and closing cost assistance, and (ii) transferable debt. In doing so, tenants are able to have some "skin in the game" by paying around $3,000 to $4,000 for the home purchase but participate in a less burdensome financial package. Doing so would help build financial sustainability and provide the tenants more comfort knowing they have equity in their pursuit for homeownership.

3. Perhaps a focus for conversions could be on LIHTC projects that were built from and after 2007 that were twined with federal and/or state historic tax credits. Although these projects have a higher total development cost because of the inefficiencies of historic buildings, the amount of capital that can exit at the end of the compliance period starts from a higher number. As noted, the LIHTC investor exits for a $1 and the historic investor can exit under IRS Revenue Procedure 2014-12 for the lesser of fair market value or 5% of the capital invested.

4. Equity or limited equity cooperatives are difficult to unwind at exist and may present challenges due to push back from co-op members to convert the housing project to condominiums. This classification of project is not fertile ground for homeownership conversion.

5. It will be politically challenging to convert HUD Section 8 projects to homeownership condominiums. In addition, Section 8 project-based developments may have difficulty in supporting a mortgage for 15 years and a developer would be more likely to seek consent to transfer and sell the Housing Assistance Payments (HAP) contract than to give up the contract entirely. Therefore, to convert this property type to homeownership, clear legal guidance is needed from both HUD and the IRS to convert the HAP contract or the Section 8 mobile vouchers to apply towards payments assistance for the condominium homeownership costs. If that guidance were received, the tenant receiving this special kind of voucher would either apply it to homeownership or use it as rental assistance for a new unit at a new location. In Boston, given the scarcity of units using Section 8 mobile vouchers, that market condition may preclude the viability of this asset class being a candidate for homeownership conversion.

Given the above five points and the principles of this thesis, the best prospects on paper (not knowing any of the field conditions) for a pilot program conversion to homeownership in Massachusetts would be (1) Ruggles Shawmut (if the HAP contract can be converted to 100% mobile vouchers), and (2) Harvard Hill (if the land use restriction can be lifted or modified), because both projects have a low first mortgage and little soft debt, are financed through LIHTC, and are better sized to attempt the conversion. A third project Rockvale is too small at 15-units, but perhaps could work if associated with a larger nearby project.

Conclusion

The Quality Hill Phase IIB case study teaches us important lessons if a LIHTC-to-Condo conversion is to be successful in a future attempt. The first is selecting properties that LIHTC properties built from or after 2007, with 60-80 units, financed with federal and/or historic tax credits, and with low soft debt. The second is to utilize section 180, section 183, and IRS Revenue Procedure 2014-12 to buy down the tax credit investors and minimize or terminate the soft debt on the project. The third is to select a GSE, CDFI or MassHousing to originate the mortgages given their favorable terms for low-income first-time homebuyers and mission-focused goals. Finally, the fourth is to allow transferable debt to create opportunities for tenant sellers, tenant borrower, and lenders a like in times of high interest rates. Further analysis is needed to research renovation costs and reserve amounts needed to make the model feasible. Critical to the pilot is identifying well-kept up projects as mentioned in the Viva consulting report. In addition, Massachusetts can refer to the Private Letter Ruling from the Quality Hill IIB example to use as a reference to begin contemplating the regulatory infrastructure to allow conversions to occur. The hope is that this case study adds valuable information to the existing research on rent-to-own models in order to expand pathways to homeownership.

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