Misconceptions Regarding Qualified Contracts (QC)

Misconception #1: Lenders and investors will not finance Housing Credit developments, especially bond-financed/4% projects, without the QC Option.

As is abundantly clear in states where QC waiver is required for both 9% and 4% projects, as well as in Rental Assistance Demonstration (RAD) projects in which the documents functionally require perpetual affordability, lenders and investors are very willing to finance Housing Credit projects in which the affordability is "locked down" for 30 or more years. The proof is in hundreds of projects with QC waivers placed in service in just the last several years.

Misconception #2: The 4% credit associated with bond-financed projects is a shallow subsidy, and developers need the QC to induce them to develop bond/4% project.

Bond/4% projects have the same overall feasibility requirements as 9% projects: sources must equal uses, projects can't be over-leveraged with must-pay debt, and adequate "cushions" such as reserves and paid developer fee must be structured into the deal. Additionally, the developer fee structure amount and limits are typically the same for 9% and 4% projects, so the developer's incentives are the same in both types of projects. A 4% project requires more sources other than Housing Credit equity than a 9% project, but no project should proceed if it is considered feasible only on the basis that the development team assumes the property will be converted from affordable to market rate housing in 15 years.

Misconception #3: The QC is needed to reposition projects that are in physical or financial distress.

Allocating agencies and other stakeholders have alternative options when a project is experiencing distress, including:

- easing certain aspects of compliance monitoring (as discussed in Recommended Practice #43);
- restructuring debt;
- making new loans;
- resyndicating the property; and
- in rare cases, amending the extended use agreement to modify the affordability restrictions on a small portion of the units.

Allocating agencies should develop appropriate tools to facilitate preservation and should refuse to release them from affordability restrictions via QC.

Misconception #4: The QC is needed to redevelop an existing Housing Credit development as new affordable housing.

In rare cases, an owner may propose to redevelop a property by demolition and rebuilding (to better meet community needs, increase density, etc.) during the extended use period, which when completed would serve at least the same number of qualified residents. Allocating agencies may allow this under an extended use agreement. Exit from the program via QC is not required.

Misconception #5: Policies which sanction or otherwise dis-incentivize developers who pursue QC for an existing development amounts to reneging on a contractual right that is a part of Section 42.

Allocating agencies typically have many requirements for developers who are applying for Credits, and they may disqualify developers for a variety of past actions. Disqualifying a developer who chooses to pursue the QC process is no different. The core mission of allocating agencies is to develop and preserve affordable housing, and developers are partners in fulfilling this mission. If a particular developer engages in activities that undermine the mission, an agency should take that into account should the developer approach the agency in the future to apply for Housing Credits. Developers are not entitled to Housing Credit subsidies and it is ultimately the developer's choice to request a QC, knowing full well the consequences of such action. For example, anyone has a right to declare bankruptcy, but doing so is problematic under most QAPs.

Misconception #6: Housing Credit limited partnerships are required to maximize the partners' profits, including by requesting a QC if that would result in greater proceeds to them.

As intended by Congress, Housing Credit partnerships are formed for the purpose of developing and operating rental housing affordable to low-income individuals and families for a minimum of 30 years. The partners carry out this purpose by structuring and operating the Housing Credit project in a way that maintains its affordability and its physical and financial viability, and such actions serve the best interests of the partnership.[1] This is possible because return on equity is provided by taxpayers in the form of Housing Credits and deductions, not by cash flow and residuals as in conventional real estate. In exchange, taxpayers—the "public" in these public-private partnerships—expect the partners to act in the best interest of the partnership in carrying out its purpose.

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[1]A 2016 Minnesota trial verdict in *Cottages of Stewartville Limited Partnership vs. American Tax Credit Corporate Fund, L.P.* affirmed this purpose.

Thus, the first priority in a partner exit or other capital event (such as refinancing, sale or investor exit at Year 15) is to maintain the affordability and physical and financial viability of the asset until at least the end of the 30-year minimum affordability period. This requires ensuring that the financial structure, provision for capital needs and operating expenses, and any successor partners continue to serve these goals. If, after all such needs are met, there is residual value which the partners can share, that is a bonus for the partners. However, such residuals should be secondary in a Housing Credit partnership. Use of the QC provision to generate a windfall to the partners is contrary to the purpose of the Housing Credit program and Congress' intent in the extended use provision.