



# **Housing Tax Credit Program Eventual Tenant Ownership Guide**

*April 2021*

# MINNESOTA HOUSING – HOUSING TAX CREDIT PROGRAM EVENTUAL TENANT OWNERSHIP GUIDE



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## Introduction

### Housing Tax Credits

This guide is intended to provide information and guidance to property owners related to Eventual Tenant Ownership under the Minnesota Housing Financing Agency (Minnesota Housing) Low Income Housing Tax Credit (HTC) program. Minnesota Housing is designated by the Minnesota Legislature as the primary allocating agency for federal HTC in Minnesota.

Qualified local cities and counties have also been designated by the legislature as suballocators of HTC and allocate HTC through their own competitions. Currently the cities of St. Paul and Minneapolis and the counties of Washington and Dakota are suballocators. This guide applies only to developments with HTC allocated or awarded by Minnesota Housing.

### Compliance with Section 42 Requirements

This guide is intended to comply with Internal Revenue Code (IRC) Section 42, as it may be amended or interpreted from time to time by regulation or public pronouncement issued by the Internal Revenue Service (IRS). If any portion of this guide is found to be inconsistent with any provisions of IRC Section 42, or official IRS interpretations thereof, then such inconsistent provision(s) shall be construed and applied in a manner so as to comply with IRC Section 42.

This guide has **not** been reviewed or approved by the IRS and should not be relied upon for compliance with the Internal Revenue Code, Treasury Regulations or any other laws or regulations governing Tax Credits. The responsibility for compliance with Section 42 rests with the property owner. Interested parties should obtain advice from independent sources, including consultation with knowledgeable legal counsel and tax professionals.

## **Chapter 1 – Tenant to Homeowner Transition Requirements**

Under the Low Income Housing Tax Credit (HTC) program, a property owner (which may include tribal governments, for-profits, qualified nonprofits, certain tenant groups, and governmental entities) may convert rental units to homeownership units following the initial 15-year Compliance Period for all buildings. This is accomplished by allowing the tenants to exercise a Right of First Refusal (ROFR) as provided for in Section 42(i)(7) of the Internal Revenue Code (Code).

Detached single family units, duplexes, and multifamily complexes are eligible for transition to homeownership. This process guide describes Minnesota Housing's requirements for an owner to convert one or more rental units to homeownership. This conversion can take place at any time after the initial Compliance Period and during the Extended Use Period.

### **1.1 Summary of Minnesota Housing Approvals Needed**

In order for Minnesota Housing to release a Declaration of Land Use Restrictive Covenants Agreement (LURA) for a unit that is converted to homeownership, the following information must be submitted for approval:

- Proof that the household purchasing the property was originally income-eligible for the property (see 1.2);
- The purchase price for the property meets minimum and maximum requirements (see 1.3);
- A Transition Plan for transition from rental to homeownership, if required by the LURA (see 1.4);
- If the LURA did not originally contemplate transition of units to homeownership, a request to Minnesota Housing to amend the LURA to allow for such transition; and
- A request to Minnesota Housing to release the unit(s) from the LURA (see 1.5).

### **1.2 Tenant Eligibility and Right to Remain**

- Units may only be sold to income-eligible tenants; however, all existing tax-credit-qualified tenants may purchase their units, even if their income is currently above the tax credit income limit.
- If a tenant is unable or uninterested in purchasing their unit, they must be allowed to remain in their unit. They cannot be evicted or have their tenancy terminated unless the lease terms are violated. Tenants may voluntarily relocate to a comparable or better unit. As the LURA is in effect until a unit is sold, vacant units must be made available for rent; they cannot be held vacant until a tenant is found who is both tax-credit-qualified and interested in purchasing the unit.

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- Due to the fact that not all tenants may choose to purchase their units, owners must be prepared to continue operating rental units through the end of the Extended Use Period.
- If the LURA does not allow for transition, the owner must apply to Minnesota Housing to amend the LURA to provide tenants a ROFR.

### **1.3 Purchase Price**

The Code (Section 42(i)(7)(B)) mandates a Minimum Purchase Price for each unit sold to a qualified tenant exercising the ROFR. That price is the sum of:

- i. The principal amount of outstanding indebtedness secured by the building (other than indebtedness incurred within the 5 year period ending on the date of the sale to the tenants); and
- ii. All federal, state, and local taxes attributable to such a sale.

Except in the case of federal income taxes, any additional tax due as a result of (ii) is not included in calculating (ii).

The Maximum Purchase Price for any unit is the amount that is affordable to a household meeting the tax credit income restrictions applicable to that unit.

Once a qualified purchaser has been identified and a Transition Plan has been submitted, the owner can work with Minnesota Housing for the unit to be released from the LURA.

### **1.4 Transition Plan**

If the LURA requires a transition plan be submitted to Minnesota Housing prior to transition to tenant ownership, the owner must submit a plan to Minnesota Housing prior to the unit being released. The plan must detail the timeline and process for converting the property to homeownership. It is recommended that the content of the transition plan include information such as:

- Description of how current limited partner will exit;
- If there is outstanding debt, how it will be handled;
- Proof of the household's original eligibility for tenancy;
- Purchase price of the unit;
- Homeownership education and training services that will be provided, if any;
- If a duplex or multifamily complex, if there will be any units not transitioning to homeownership and how that will be managed; and
- If a tenant will be voluntarily relocating, information regarding the relocation and benefits that will be provided.

A Transition Plan template that may be utilized is attached to this guide as Appendix B.

## **1.5 Request for Approvals**

Requests for approvals related to the Eventual Tenant Ownership transition process should be submitted to Minnesota Housing. Please see Minnesota Housing’s website for information on how to submit requests.

In evaluating requests for approvals related to Eventual Tenant Ownership, Minnesota Housing staff may request any information, may impose any additional conditions or requirements, or may deny a request as determined in the sole discretion of Minnesota Housing. Proposals that seek to transition multifamily developments to tenant ownership will include additional complexity and owners should anticipate additional information and documentation will be required throughout the process. Owners should also be aware that Minnesota Housing may seek additional information and documentation and impose additional requirements or deny a request related to noncompliance with a LURA, purchase price, or exigent health and safety conditions in Minnesota Housing’s sole discretion.

## Chapter 2 – Tenant to Homeowner Transition Best Practices

Strategies such as those suggested below may assist owners in making sure all requirements have been met and a clear plan to move forward for both the new homeowner and the transferring owner is in place. Minnesota Housing recognizes that not all transitions are the same; steps suggested below are at the discretion of the owner.

### 2.1 Transition Teams

Assembling a team of professionals can be helpful in analyzing the possibility of transition and assist in implementing the eventual Transition Plan.

These professionals may include (but are not limited to):

- An attorney to review key Section 42 requirements, partnership documents, the LURA, loan agreements with existing lenders, and to advise on options.
- An accountant to review partnership financials and to advise on Exit Taxes.
- A needs assessor to determine the physical needs of the units. The needs assessor could be a licensed architect, licensed professional engineer, or an individual who meets the definition of a Qualified Rehab Specialist (QRS).
- A cost estimator or construction contractor may be necessary if immediate (life safety) needs and improvements are necessary. Cost estimating may also be provided by a needs assessor.
- A homeownership educator to help create a training and support program.
- Asset or property management staff to determine how to simultaneously operate both the rental property and the homeownership transition program, perhaps for the remainder of the Extended Use Period, if all the units are not sold.

If a transition team is assembled, Minnesota Housing staff in both the multifamily and single family divisions are available to provide further technical assistance on the transition planning and implementation, if desired.

### 2.2 Review of Legal Documents

A review of legal documentation may alert owners to any steps needed to make the eventual transition happen smoothly. Documents to review may include:

- LURA – The LURA must contain language granting the tenants a ROFR allowing for transition. If it does not, the owner may submit a request to Minnesota Housing to amend the LURA.
- Limited Partnership Agreement – Determine if the Limited Partnership Agreement contains an ROFR provision. If not, discuss with the limited partner if the Limited

Partnership Agreement can be amended. This document should also specify what will be necessary for the limited partner to exit.

- Loan Documents – Information that could be helpful include:
  - If any of the loan documents or regulatory agreements contain restrictions on the disposition (e.g., use of reserves or additional income restrictions).
  - If all existing lenders will agree to partial payoffs or releases as individual units are sold.
  - If transition will trigger debt repayment and if so, how lenders will be repaid.
  - If a request needs to be made to Minnesota Housing for subordination or partial repayment of any existing loans.

### **2.3 Working with Renters and Future Homeowners**

Frequent communication with the households in the units to be converted helps create a smooth transition process. Even if a prospective tenant is not interested in becoming a homeowner, they are still eligible to rent a unit and cannot be turned down on that basis. Communication should include:

- A general price estimate for the unit;
- Homeownership training and counseling opportunities available; and
- If a tenant is unable to or uninterested in purchasing their unit, information regarding staying in their unit and continuing to rent.

### **2.4 Assessing and Addressing Physical Needs**

Prior to selling properties to tenants, the owner may want to have the physical needs of the property assessed. Minnesota Housing has templates for physical needs assessments for both multifamily buildings and single family homes that may be helpful. These templates, as well as the Limited Scope Design Standards and Limited Scope Sustainability Standards, can be found on our [Building Standards](#) web page.

### **2.5 Exit of the Limited Partner**

After the initial Compliance Period, owners should work with the limited partner to sell/transfer the limited partnership interest to an affiliate of the general partner or sponsor. Owners should notify Minnesota Housing of a change in ownership by submitting a request.

### **2.6 Financing Homeownership Resources**

Minnesota Housing offers [a variety of programs](#) for first mortgage financing and down payment and closing cost assistance.

In addition to the programs listed at the above-noted link, Minnesota Housing also offers the [Community Homeownership Impact Fund](#) to its partners to finance affordable housing projects

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in member communities. The Impact Fund provides loans and grants awarded through the Single Family Request for Proposals (RFP), a competitive application process that may be used for new construction housing, acquisition-rehabilitation-resale of existing housing or affordability gap financing. Minnesota Housing examines overall scores of applicants based on project eligibility, feasibility and organizational capacity. Partners are required to serve households earning at or below 115 percent of area median income (AMI).

Finally, Minnesota Housing offers [Homebuyer Education, Counseling and Training](#) to provide financial support for the full continuum of homeownership education and counseling services, and to support cooperative relationships and partnerships that provide access to clients for a full range of homeownership education and counseling activities. Eligible entities include nonprofit housing organizations as defined in Minnesota Statutes Section 462A.03, Subd. 22, which includes housing and redevelopment authorities and other political subdivisions.

Additional information is available through the [Minnesota Homeownership Center](#).

Other programs for individuals interested in purchasing their first home are available through various resources, including but not limited to:

- [Department of Housing and Urban Development \(HUD\)](#)
- [Rural Development](#)
- [Federal Home Loan Bank](#)
- [Department of Veteran's Affairs](#)

The best way to determine the most suitable program is for each purchaser to contact a local lender.

Minnesota Housing has a [network of lenders](#) across the state who work with our programs as well as offer other financing programs.

## Appendix A: Terms

Term	Definition
<b>Affordability Restrictions</b>	Recorded tenant income and rent restrictions that are placed on a project by a city, state (including the state credit allocating agency), bank or other lender of funds to the project. These restrictions are monitored by designated credit agencies and are enforceable for a set period of time. The restrictions bind the property and are assumed by any purchaser of the property.
<b>Compliance Period</b>	Begins the first year tax credits are taken for each building and ends at the conclusion of the 15th taxable year after the first credit year.
<b>Extended Use Period</b>	Begins after the Compliance Period and ends on the later of 1) the date specified by the agency in the agreement and 2) the date 15 years after the close of the Compliance Period.
<b>Income Eligible Households</b>	A household whose gross annual income (adjusted for household size) is within the median income limit for a unit given its tax credit restrictions.
<b>Declaration of Land Use Restrictive Covenants Agreement (LURA)</b>	The document containing the Affordability Restrictions and other restrictions placed on the project related to the Housing Tax Credits.
<b>Minimum Purchase Price</b>	The Minimum Purchase Price for a qualified tenant exercising their Right of First Refusal is the sum of the property's Outstanding Debt and any taxes due upon the sale of the property, as defined in IRS Code 42(i)(7)(B).
<b>Maximum Purchase Price</b>	The purchase price which is affordable to the household meeting the tax credit income restrictions applicable to a particular unit.
<b>Outstanding Debt</b>	The sum of all debt secured by the project, including accrued interest. Although a loan may have a 30-year term, upon a transfer, including sale to a tenant, the full amount of the debt must be repaid, assumed or forgiven, unless the lender approves a modification.

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<b>Right of First Refusal (ROFR)</b>	A right offered that gives the holder the right to purchase the property at a Minimum Purchase Price. The statutory authority for the ROFR is contained in Section 42(i)(7) of the Code, which applies to projects with Housing Tax Credits allocated after 1989.
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## Appendix B: Transition Plan Template

Under the Low Income Housing Tax Credit program, a property owner may convert rental units to homeownership units following the initial 15-year Compliance Period for all buildings. The LURA must allow for the transition. If the LURA requires a Transition Plan, a Transition Plan must be provided to Minnesota Housing to complete the transition. Below is a template Transition Plan that may be utilized to satisfy this requirement.

Property Owner:

Property Address:

The property is a: \_\_\_ Single Family Home \_\_\_ Duplex \_\_\_ Multifamily complex; # of units: \_\_\_\_\_

Has the property completed the initial 15 year Compliance Period? (Y/N) \_\_\_ Year complete: \_\_\_\_\_

Does the LURA allow a Right of First Refusal? (Y/N) \_\_\_

If no, has a request been submitted to Minnesota Housing to amend the LURA? (Y/N) \_\_\_

Was the household purchasing the property originally income-eligible to rent a tax credit unit? (Y/N) \_\_\_ (Please attach proof to this plan)

Purchase Price of the property: \_\_\_\_\_

Does this purchase price meet the minimum requirements? (See Section 1.3) (Y/N) \_\_\_

Does the Purchase Price meet the maximum requirements? (See Section 1.3) (Y/N) \_\_\_

Is there a plan for the Limited Partner in the property to exit? Please explain.

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Will homeownership education and training services be provided? Please explain.

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Will there be any units not transitioning to homeownership? Please explain.

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Are there any tenants who are voluntarily relocating? If yes, please explain what information regarding relocation and benefits will be provided.

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Date: \_\_\_\_\_ Signature of Owner:

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