



Analyzing 42(i)(7) right of first refusal

By Louis Dolan and Theodore DiSalvo

On March 27, 2019, Chief Judge Ricardo S. Martinez of the U.S. District Court for the Western District of Washington (Seattle) released his “Findings of Facts and Conclusions of Law” in *Senior Housing Assistance Group v. AMTAX Holdings 260, LLC, et al.*, W.D. Wash. No. C17-1115 RSM, holding that an exercise of a right of first refusal (ROFR) under 26 U.S.C. § 42(i)(7) must also comply with applicable state law requirements for a right of first refusal generally.

The low-income housing tax credit (LIHTC) originates out of 26 U.S.C. § 42—a federal tax credit program “designed to promote the development of affordable rental housing for low-income households.” Findings of Fact and Conclusions of Law at 3. The LIHTC program “encourages private investment” in affordable rental housing “by providing tax credits to owners of qualifying LIHTC projects over a fifteen-year ‘Compliance Period.’” *Id.* To promote continued availability of affordable rental housing, Section 42(i)(7) allows a nonprofit partner to hold a contractual ROFR to purchase the LIHTC property at the statutory minimum price, which is frequently referred to as the “debt plus taxes” price and below fair market value.

The dispute in *Senior Housing Assistance Group* (SHAG) centered around whether SHAG validly triggered and exercised its ROFR on four disputed properties in order to avail itself of the beneficial ROFR price allowed under Section 42(i)(7).

After a bench trial, the court held that SHAG’s attempt to exercise its ROFRs was insufficient as a matter of law and that SHAG failed to prove that it was entitled to declaratory relief because of its “unclean hands.” *Id.* at 26. While the court’s decision is fact-intensive, it iterates the principle that, in order for a Section 42(i)(7) ROFR to be properly triggered, it must also comply with applicable state common law requirements. To reach its decision, the court considered the following ROFR principles under state law, which are often found in other jurisdictions:

- The owner must have a genuine intent to sell the property.
- The owner must receive “a bona fide offer from a third party, acceptable to the property owner.”
- To constitute a bona fide offer, the offer must be “made in good faith; without fraud or deceit”

and must be “sincere” and “genuine,” (i.e., not designed simply to trigger the ROFR).

- Even if a third party’s interest in the property is genuine, to constitute an offer the communication in question must be enforceable and not merely an expression of interest or invitation to negotiate. *Id.* 19–20.

Ultimately, the court held that SHAG’s attempted exercise of its ROFRs failed at least one of the state law principals noted above. According to the court, SHAG “could only exercise its ROFR if all the elements necessary to trigger the ROFR under common law had been satisfied.” *Id.* at 23. Even when the Investor Limited Partner contracted away their consent rights as limited partners in connection with SHAG’s exercise of its ROFRs, the court upheld the distinction between a ROFR and an option, effectively holding that SHAG’s treatment of the ROFR would impermissibly convert it into an option. *Id.* Finally, the court held that SHAG’s declaratory relief claim was barred by the doctrine of unclean hands, including by soliciting sham offers or otherwise inducing offers in bad faith solely to trigger the ROFR. *Id.* at 24–25.

This decision is in direct counterpoint with the decision reached by the Massachusetts Supreme Judicial Court in *Homeowner’s Rehab, Inc. v. Related Corporate V SLP, L.P.*, 479 Mass. 741 (Mass. 2018). There, the Massachusetts Supreme Court concluded, among other things, that no bona fide offer was required in order to trigger the ROFR.

Given the limited number of LIHTC cases concerning the exercise of ROFR under Section 42(i)(7), *Senior Housing Assistance Group* provides a useful analytical framework through which to view future cases.

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