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PUBLIC HOUSING PRIVATIZATION USING SECTION 8 VOUCHERS AND I.R.C. SECTION 42 LOW-INCOME HOUSING TAX CREDITS IN CONNECTION WITH THE USE OF LEASE TO PURCHASE OPTIONS

F. WILLIS CARUSO*

MARK BRENNAN**

I. INTRODUCTION

Since the enactment of the Tax Reform Act of 1986, the continued presence of high interest rates, the downsizing of the federal government, especially the Department of Housing and Urban Development (HUD), and the cutback of all but a few of HUD's federal housing programs have made developing affordable housing more difficult in the 1990s. With the enactment of the Tax Reform Act came section 42, the Low-Income Housing Tax Credit Pro-

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gram (LIHTC) which has proven to be a limited production program of affordable housing.1 Despite this fact, the LIHTC is beset by intense competition for ever decreasing resources and congressional skepticism as to the program's cost-effectiveness. Amidst this climate, the need and demand for more production of affordable housing remains strong. This need is fueled by the movement towards the privatization of both the ownership and management of public housing, and the demolition of high-rise public housing buildings in favor of low-rise, low-density, scattered site, mixed-income housing. This shift in federal policy is premised on the emergence of public private partnerships, along with the search for new ways to meet these needs.

This article suggests combining lease to purchase options with HUD's Section 8 rent subsidy program2 and the LIHTC, as a means of generating both new construction of a significant number of new housing units and the rehabilitation of a significant number of existing multifamily housing units.

A. The New Housing Supply

The "reinvention" of the ever unpopular HUD includes the divesting of a large number of privately owned but HUD insured housing units through HUD's Sale of Mortgages program,3 the divesting of the stock of public and subsidized housing, and favorable IRS rulings regarding the LIHTC.4 These, coupled with the ever increasing demand for more affordable housing, has spawned new opportunities for housing providers, lenders and entrepreneurs. The effect of this reinvented HUD and its "dumping" of thousands of units has found many of these units in economically attractive, favorably located areas within our urban cities.5 This increased supply of potentially affordable housing units represents a viable vehicle for acquisition, rehabilitation or redevelopment. For this reason, consideration of the lease to purchase option coupled with the Internal Revenue Code (I.R.C.) section 42 LIHTC is attractive in the search for making new affordable housing projects economically feasible.

There is an urgency at HUD with respect to the efforts to move these properties. Changes in the economic and political climate have generated criticism and serious debate about the role of public and assisted housing.6 Down-sizing

4. See infra note 22 and accompanying text.
5. See Blair Kamin, Good Intentions Didn't Prevent the High Rise Fiasco, CHI. TRIB., June 18, 1995, § 1 at 8; William Mullen, In Beginning, CHA High-Rises Were Towers of Hope, CHI. TRIB., June 12, 1995, § 1 at 1.
and privatizing have become watchwords in government and particularly at HUD. There has been a dramatic turn-about at almost all levels of government with respect to the announced positions taken by officials, including federal, state and local, regarding low-income housing strategies. On February 15, 1996, for example, Joseph Schuldiner, the Executive Director of the Chicago Housing Authority, presented the Chicago Housing Authority Long Term Plan 1996-2000, in which he outlined the major changes expected in those years.

Some considered it surprising that it included farming-out of management and privatization. These changes were, nevertheless, well accepted locally.

The new federal housing policy can be seen in HUD's Statement of Regulatory Priorities, published in the Federal Register. Here HUD redefines and substantially limits its supervisory role in the future to monitoring the results of local housing programs, acting as a clearinghouse and cheerleader for homeownership and fair housing information and opportunities, and limiting its direct financial involvement to that of a simple conduit through which federal monies flow directly to local and state level housing agencies through one of three performance based funds.

On May 1, 1995, HUD submitted to Congress proposed legislation entitled the "American Community Partnership Act" which purports to "streamline the delivery of housing and community development assistance to individuals and communities." Within this same document, HUD has also redefined its new central mission to be "Helping People Create Communities of Opportunities." Whether these new hands-off policies and down-stream shifting of responsibility will result in real reform, or are destined to become just another one of the unsuccessful attempts at a quick fix solution, will be determined as these policies are implemented.

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11. Id.
13. Id.
14. For examples of some of these current and past strategies and statements of strategies, see 24 C.F.R. pts. 91, 510, 511, 570, 590, 907 (1996). For additional and prior controlling poli-
Critics are stating that the proposals appear to be designed to purposely abandon the majority of notoriously under-funded, large, inner-city, public housing projects, along with the existing social programs and financial subsidies that have historically formed the economic backbone and safety net for the majority of the residents of these massive urban public housing developments. Whether this is true or not, most HUD officials, housing experts and front line managers seem to agree some change is needed.

The social, economic and cultural problems that have frustrated officials, and which have in some instances resulted in generations of poverty level citizens spending their lives from birth to death subjected to institutionalized poverty, do not lend themselves to simple solutions. A continuing shortage of housing and such institutionalized poverty in public, subsidized and assisted housing has resulted in isolation and segregation of the poor and minorities based on "economic class," race, color and national origin.

To solve these difficult problems, the battle cry is "privatization." The authors believe there is grounds for hopefulness that the private sector can bring salvation through some untested and yet-unfunded miracle that includes mixed-income housing, certificates and vouchers, scattered site housing, private and tenant managed housing, and resident-patrolled public and assisted housing. However, it appears unlikely that "Private Enterprise" is up to the mammoth task that is beyond the capabilities of the multitude of combined governmental entities which have sought to bring this salvation. Governmental agencies, with their experts, years of experience, and, at times almost unlimited funds, have been unable to solve these problems for over the last thirty years.

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15. But see Maudlyne Ihejirika, Cut Public Housing Crime, Spur Ownership—Cisneros, CHI. SUN-TIMES, June 20, 1993, at 18, available in Westlaw at 1993 WL 6536636 (stating that Housing and Urban Development Secretary Henry Cisneros, while visiting Chicago, outlined plans to reduce crime by returning "working people" to public housing and to make home-ownership easier for low-income families).


18. See, e.g., supra note 6 and accompanying text.

Public housing is intended to be safe, sound, efficient and low-cost housing for families headed by a working parent or working parents. Instead, it has been treated, for the most part, as housing of last resort for many. Unfortunately, the residents are predominately single, female heads of household, commonly dependent on some sort of aid or support payments. Many analysts who have studied the phenomena now blame government rules that, among other things, excluded fathers, encouraged women to have children in search of benefits, and created situations where crime and violence could develop without restraint. Though meant to be integrated, both economically and racially, public and assisted housing, with rare exception, is housing that is segregated and for the very poor.

B. The LIHTC: An Equity Resource

Low-Income Housing Tax Credits are a sellable commodity. They are in demand by regular Chapter C business corporations who can use the tax credits to offset high earnings, on a dollar for dollar basis. These corporations are not subject to the passive loss rules which make tax credits less attractive to individual investors. Once a developer produces a multifamily rental project—assuming the developer has been successful in obtaining an allocation of tax credits from a tax credit allocating agency—the developer whose need is for equity investment in his project can sell the tax credits to corporate investors. In today's marketplace, each dollar of tax credit can be sold by the developer...
oper for approximately fifty-five to seventy-five cents on the dollar. Tax
credits are allocated to qualified projects for ten years, and the amount of tax
credits allocable to any project is dependent on each project's qualified basis
and whether the project is financed with government-assisted financing or
conventional financing. Projects financed with government-assisted financ-
ing are only eligible for four percent credits, whereas projects financed with
conventional financing are eligible for ten percent credits. These percentages
are multiplied by the project's qualified basis in order to determine the dollar
amount of credits allocable to each project for ten years. This LIHTC is
highly regulated and contains many programmatic requirements, such as the
requirement of extended use of LIHTC projects, beyond the initial ten year
compliance period. This and the numerous other programmatic requirements
have given rise for the need for tax credit specialists. As a result, since 1986
there has emerged a tax credit industry, with companies organized to bring in-
vester to both private and not-for-profit sponsors of affordable housing.

C. What Is Meant: Affordable Housing

The term "affordable housing" is used by all segments of the housing mar-
ket, but when this term is applied to public housing, subsidized housing and
the LIHTC, there are statutory and regulatory definitions which apply. These
definitions are keyed to income limits and coupled with the federal rule that no
person shall be required to pay more than thirty percent of their annual income
for certain housing. In this article, when we refer to affordable housing for
public housing tenants, we are referring to people whose annual incomes are
less than thirty-five percent of the median income of the area in which they
live. When we refer to subsidized housing, we are referring to people whose
annual incomes do not exceed eighty percent of the median income of the area
in which they live. When we refer to the LIHTC, we refer to people who in-
comes do not exceed either sixty percent of the median income for the area in
which they live, or eighty percent, depending on the election of the developer.
Clearly in the cases of those people with the low incomes, some form of sub-
sidy is required to enable them to afford market rate housing units.

25. LIHTC Workshop, 6th Annual Meeting and Conference of the ABA Forum on Afford-
27. Id.
28. Id.
29. Id.
30. Examples of these include the National Equity Fund, Washington D.C., the Chicago Eq-
uity Fund, Chicago, IL, and the Local Initiatives Service Corporation, with branches in Wash-
ington D.C., New York, NY, Boston, MA, and Chicago, IL.
32. Id.
D. What Is Meant: Subsidized Housing

Since 1974, the primary vehicle for subsidizing housing has been the Section 8 program. This program contained three basic rules of eligibility. To be eligible: (1) the tenant's annual income must not exceed eighty of the median income for the area in which the tenant is living ("income limits"); (2) the tenant must not be required to pay more than thirty percent of the tenant's annual income for housing (the "Brook Amendment"); and (3) the rents for all the subsidized units in a sponsor's development must not exceed the rents published by HUD for the area in which the development is located ("fair market rents," published by HUD annually in the Federal Register). Two types of Section 8 assistance emerged over the years: "project based assistance" and "tenant based assistance." Project based assistance involved a contract between the sponsor and HUD, called a Housing Assistance Payments Contract ("HAP"). The HAP contracts varied in their terms, with some running for five years renewable, and others running for as long as twenty years. The Section Program was implemented in connection with other HUD housing programs, most notably the sections 236 and 221(d)(4) mortgage insurance programs.

Section 8 vouchers are tenant based forms of assistance. In the case of vouchers, HUD funds local housing authorities, who in turn distribute vouchers to income eligible tenants. The tenants then take the vouchers to a landlord who upon acceptance of the tenants, enters into an agreement with the local housing authority. In the cases of both types of Section 8 assistance, the government pays the difference between the fair market rents and the tenant's portion of the rent based on thirty of the tenant's annual income.

II. The Nature of the Private Development Opportunity

The intractable nature of the problems of affecting development and maintenance of affordable housing have been fueled by complex political, social and cultural forces arising out of the difficult issues connected with the

35. Id.
36. Id.
40. See NOVOGRADAC, supra note 22; Bridge Loan, supra note 22.
large inventory of distressed housing.\footnote{41} The existence of this defaulted, in default and troubled housing presents an extraordinary opportunity for private development.\footnote{42} Along with valuable land, sometimes situated in very favorable inner-city locations, many of these are structurally sound buildings that can continue to provide desirable housing. Furthermore, federal, state and local officials are willing to support and assist the effort to protect, rejuvenate and rehabilitate these developments. The current high vacancy rate and deteriorated physical condition is a result of inadequate funding, improper maintenance and a general failure to provide basic services and security.\footnote{43} The situation makes it appropriate to use private as well as public funds to bring these units back on line.

Basic services have long been unavailable to the vast majority of public housing tenants and many tenants of subsidized and assisted housing.\footnote{44} While services and upkeep are available in some instances, they are actually inadequate because the housing providers' staff are poorly paid and lack training and facilities. Stop-gap private security forces have sometimes been presented as the stalwart of public housing crime elimination policies. These efforts have not worked.\footnote{45} The original purposes of public housing, and other forms of assisted housing as well, was to focus on social policy and build the largest number of buildings, at the lowest possible per unit cost. With little thought or advanced study as to the social and cultural problems that might be involved, these programs resulted in the large-scale resettlement of poor and minority Americans.\footnote{46} Nowhere else are the results of this past half decade of misguided and clearly segregationist policies more evident than in the City of Chicago. Nor is there any place more in need of imaginative suggestions for a cure.\footnote{47}

\footnote{41} The average vacancy rate at the CHA in 1982 was 10.3%. \textit{See} CHICAGO HOUSING AUTHORITY STATISTICAL REPORT 1981, at 84. The 1994 and 1995 reports indicated that 44% of the current CHA apartments were in substandard condition and another 16% to 20% of the units were vacant with some projects having vacancy rates as high as 34%. \textit{See, e.g.,} Vacancies at CHA, CHI. SUN-TIMES, Oct. 17, 1994, at 5, \textit{available in} Westlaw at 1994 WL 5574279; Lane's Vision Overlooks Nasty Details, CHI. TRIB., June 27, 1994, §1 at 12, \textit{available in} Westlaw at 1994 WL 6463562.

\footnote{42} \textit{Id.}

\footnote{43} \textit{Id.}

\footnote{44} \textit{Id.}


\footnote{46} \textit{See} Blair Kamin, \textit{Good Intentions Didn't Prevent the High Rise Fiasco}, CHI. TRIB., June 18, 1995, § 1 at 8; William Mullen, \textit{In Beginning, CHA High-Rises Were Towers of Hope}, CHI. TRIB., June 12, 1995, § 1 at 1.

III. LEASE TO PURCHASE OPTIONS

The "lease to purchase option" (LPO) as a financing mechanism should be discussed because of the recent Revenue Ruling with respect to I.R.C. section 42(I)(1). That Revenue Ruling specifically allows for the use of "first right of refusal contracts," as defined under I.R.C. section 42(I)(1), when utilized in conjunction with section 42 tax credit developments without requiring adherence to the "extended use agreement" requirements of I.R.C. section 42(h)(6). This new exception is consistent with I.R.C. section 41(I)(7), which allows for continued income tax benefits even with the existence of a previous "first right of refusal."

Section 42 tax credits can be used to fund either new construction or substantial rehabilitation. This tax credit financing can be paired with LPO contracts in which the ultimate tenant/purchaser is allowed to build equity through monthly rental payments funded with Section 8 vouchers. By utilizing these three integrated financing techniques—section 42 for rehabilitation, LPO’s for ultimate tenant ownership, and monthly Section 8 payments for mortgage pre-payments—the free market forces are expected to generate construction, reha-


49. Id. First right of refusal contracts are a sub-unit of lease to purchase options. First right of refusal can exist independently outside leases in other business contracts (e.g., partnership buy-out agreements); but a lease to purchase option by definition must include the first right to refuse any purchase opportunity created by either the expiration of time, lease term or in some situations by third party attempts to purchase the underlying leased property, subject to the remaining lease term.

50. Id. Under usual terms of I.R.C. section 42(h)(6), developers of low-income housing that utilize I.R.C. section 42 tax credits are required to make an advanced formal written commitment and agreement with the appropriate housing agency that, at the end of the initial fifteen year compliance period, the developer promises that a certain percentage (usually greater than fifty percent) of the units will continue to be made available for rent by low-income tenants at affordable rental rates. These individually negotiated agreements are collectively called "extended use agreements."

While the requirements are binding on all successors and parents, these requirements may be waived for good cause following a special request for waiver, or upon an ultimate sale to a new purchaser after the first fifteen year holding period, provided that like financing terms are made available to the housing agency or its substitute new purchaser under identical terms. This new exception is consistent with I.R.C. section 42(I)(7) which allows for continued income tax benefits even with the existence of a previous "first right of refusal." It was this conflict that gave rise to the request for a private letter ruling by the Enterprise Foundation. See Rev. Rul. 94-49 1995-29 I.R.B. 4.


52. The July 18, 1990 letter from HUD to the Cleveland Housing Network allows Section 8 vouchers to be used with LPOs. HUD officials have no objections to the use of Section 8 vouchers when used to pay rent under LPO contracts, provided the tenants' lease-purchase rights are in compliance with all normal requirements of the Section 8 certificate program.
bilitation, tenant ownership and self management of low-income affordable housing. A concurrent benefit accompanying the use of this model is the substantial reduction in or elimination of governmental housing bureaucracies. Developers are guided by the desire for reasonable profits. The profit motive should result in the creation of a sufficient number of new and rehabilitated housing units to meet all previously unserved needs.

This type of financing mechanism seems to provide a method to continue the movement towards providing long-term solutions to the commonly acknowledged shortages of affordable housing. This is a particularly important financing mechanism for use in the large urban areas where well-documented failures of assisted and public housing are most prevalent and demand is greatest. The private affordable housing developers will gather all the available financing tools at their disposal, as well as explore future financing alternatives that will allow them to meet these new challenges of "deficit and budget reduction." The move towards "fiscal responsibility" will most certainly mean greater competition between those who recognize the need to encourage development of affordable housing and those who argue for reductions in funding and elimination of incentives for development.53

The section 42 LPOs can be partially funded using the current Section 8 voucher program,54 or some other limited duration independent funding or per unit subsidization program.55 The authors believe that specialized LPOs, when combined with employment and educational incentives, have the capability to accomplish what many commentators believe is unachievable: decent, safe and affordable housing; new jobs for the inner-city residents that participate in the program; and a substantial reduction in crime and poverty among a very large group of public housing residents.

The John Marshall Law School Housing Clinic, in conjunction with the Graduate Real Estate Program at John Marshall, has developed a suggested strategy and model proposal for redevelopment of an experimental neighborhood with the lease to purchase option program as the engine that fuels redevelopment. The proposal provides affordable housing, social programs, job

55. The Section 8 and similar voucher programs are distinguishable from other public housing programs in that the actual governmental involvement is limited to approving the individual tenant income guidelines and to approving the habitability of the units themselves. It can easily be argued that existing city and state housing inspection programs are better suited to controlling the approval process of these units, thus reducing this costly and duplicative governmental oversight. This separation of the approval process would greatly reduce the total government involvement and would undoubtedly result in much quicker housing unit approval. It should also greatly increase the creation and approval of additional affordable housing units.
training and job generation, and assistance to community-based organizations. The model is meant to break the cycle of poverty, ignorance, segregation and crime which is associated with inner-city public and assisted housing projects. The plan includes employment opportunities for those enrolled in the LPO program, training, support of local schools, long term development of the surrounding area, and commitments from local employers to help find meaningful employment for persons residing in the area. These initiatives and efforts to fight crime are meant to change the face of the neighborhood itself.

Instituting a realistic home ownership program based on participants being gainfully employed is expected to reverse the poverty cycle and rejuvenate the neighborhood. A key element of this plan is retention of the existing residents in the area so that they will benefit from the change and participate in the new community. This employment scenario, while posing numerous logistical and funding problems, will jump-start self employment, self respect and pride in the neighborhood. Examples where this has worked include the step-up program and step-up type programs which have gained the support of the unions in Chicago and elsewhere.

IV. FINANCIAL AND ACCOUNTING DEFINITIONS OF LEASE TO PURCHASE OPTIONS

The accounting and financial sectors of American business have been dealing with lease to purchase options for a number of years. The original form of financial options are seen in the stock and commodity markets. The basic premise for all options, regardless of whether they are lease to purchase options or straight call and put options, is essentially the same.

There are four possible option situations:

56. See METROPOLITAN HOUSING DEV. CORP., A PLAN FOR THE MT. SINAI AREA—CALIFORNIA-OGDEN PLAN (presentation to the Chicago Housing Authority in 1996).


58. The Chicago Housing Authority reached agreement with the craft unions which provided for their participation in training and some access to union training programs under certain circumstances. See, e.g., CHICAGO HOUSING AUTHORITY REPORTS OF THE GENERAL COUNSEL, F. WILLIS CARUSO (1991); CHICAGO HOUSING AUTHORITY REPORTS OF THE GENERAL COUNSEL, F. WILLIS CARUSO (1992); CHICAGO HOUSING AUTHORITY REPORTS OF THE GENERAL COUNSEL, F. WILLIS CARUSO (1993).

59. In a call option the holder/buyer has the right, but not the obligation, to demand delivery. An early example of call options is the Black-Sholes Pricing Model. The difficulty in transporting large amounts of physical commodity type contracts (e.g., a 5,000 bushel corn option contract versus 100 shares of stock options) has resulted in the complicated system to adjust for differences in shipping costs and pricing increases that have developed the framework for options.
1) The investor is the holder (i.e., buyer) of a call option;
2) The investor is the seller of a call option;
3) The investor is the holder (i.e., buyer) of a put option; or,
4) The investor is the seller of put option.

The key distinguishing factor between a call and a put option is the inher-
et one-way right either to demand delivery (call option) or one-way right to
make delivery (put option). In the LPO situation which the authors are dis-
cussing here, the tenant is in effect the holder of a "call option" with the une-
quivocal right to "call" or request delivery of the title to the unit.

V. BACKGROUND OF LEASE TO PURCHASE OPTIONS

The use of LPOs has a history in both the English and American property
law systems.\(^6\) Real property LPO law, like tenant law, has its genesis in the
early break from serf-master-landowner relationships into currently recognized
tenant-landlord or lessee-lessee relationships. LPOs were developed to miti-
gate the harshness of the practice wherein, during the early tenant-landlord pe-
riod, tenants were often at the mercy of landlords and could be evicted with or
without process of law, irrespective of their time served as tenant or the
amount of valuable improvements they added to real property.\(^6\)

It appears the LPO issue was first addressed in the U.S. Supreme Court in
the case of Kutter v. Smith.\(^6\) This early case involved a series of ten and
double year continuing leases to a maximum of ninety-nine years. In Keogh v.
Peck,\(^6\) the Illinois Supreme Court recognized the enforceability of properly
executed LPOs in non-defaulting leases. The court stated "where the parties
are competent to contract and enter into a contract fairly and understandingly,
with the wisdom or folly of their contract, made for consideration without
fraud, courts have not concern."\(^6\) The court also stated that "the object of
courts of equity, is the enforcement of contracts," thus rejecting other equitable
arguments to defeat the contract.\(^6\)

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60. For purposes of consistency and due to the numerous variations of real property law
between the different states, this presentation will concentrate on U.S. Supreme Court, Seventh
Circuit Court of Appeals and Illinois state court interpretations.

61. For a more complete discussion of these early transitional tenant-landlord years, see J.H.
Baker, Introduction to English Legal History (3d ed. 1990); Mary Ann Glendon, The
Transformation Of American Landlord-Tenant Law, 23 B.C. L. REV. 503 (1982); Morton J.
Horwitz, The Transformation Of American Law 1780-1860 (1977); Morton J.
Horwitz, The Transformation Of American Law 1870-1960: The Crisis Of Legal

62. 69 U.S. 491 (1864).

63. 316 Ill. 318 (1925).

64. Id. at 324-25 (citing Florida Ass'n v. Stevens, 61 Fla. 598 (1911); Mizill Live Stock Co.
v. McCaskill Co., 59 Fla. 322 (1910)). See also Frayser v. Irwin, 401 Ill. 364 (1948)).

65. Id. at 325 (citing Miedema v. Wormhoudt, 288 Ill. 537 (1919)).
One of the defendant's arguments was that since the plaintiff was not the original tenant, and instead was only an assignee of the original tenant, the LPO was personal in nature and did not transfer to the new tenant on assumption of the new lease. The court rejected the argument, holding instead that this LPO covenant in the lease "concerned the thing granted and the occupancy or enjoyment of it," and therefore it "ran with the land" since its performance (exercise) "or non-performance affected the nature, quality and value of the property." The court also explicitly defined the difference between an option contract and straight land sales contracts. The court stated that a land sales contract involves the actual transfer of title from grantor to grantee by an appropriate instrument of conveyance (i.e. a completed contract), whereas, an "LPO" is a contract to be performed in the future, which if fulfilled results in a sale (i.e., an executory contract).

An option, is "simply a contract by which the owner of the property agrees with another person that the person shall have the right to buy property at a fixed price within a time certain." The LPO owner does not sell land or interest, at the election of the other party. The buyer/holder of the LPO gets, "in praesenti, not lands or interest therein, or [even] an agreement that he shall have lands, but he does get something of value, . . . that is, the right to call for and receive lands if he [so] elects." A land sales contract is an executed contract whereas an LPO is an executory contract.

Moreover, an option to purchase, based upon the consideration of the lease, is property, and, as such, is transferable. The consideration to support the option, separate from the consideration under the lease itself, may be found either in increased rent, longer terms, or even that the option itself as an inducement for the tenant to sign the underlying lease. An option agreement, contained in a lease, concerns the land, the leasehold interests and the mode of enjoyment of the property. Therefore, if the lessee exercises the LPO and purchases the leased premises, at that point the prior leasehold interests are terminated, and the exerciser of the option becomes the true owner of the fee. Furthermore, such an agreement (the option) will benefit the demised premises,
since the tenant will be more likely to place improvements upon the premises and therefore will be more likely to maintain the premises than one who was not granted such a LPO. If the option were not exercised, these betterments would inure to the benefit of the landlord.  

The Keogh court also noted that a LPO contained within a lease is not void because it could suspend the "free alienability" of the fee beyond the period permitted by the rule against perpetuities. The rule against perpetuities states "that no interest subject to a condition precedent is good unless the condition must be fulfilled, if at all, within twenty-one years after a life in being at the creation of the interest." That rule concerns rights of property, only, and does not affect the making of contracts which do not create the rights to property. "No interest in land is created in the holder of the option by an option agreement."

The Court also stated that "[t]he validity of an option clause for renewal of a 99 year lease, or for any lease longer than the time stated in the rules against perpetuities, has been almost universally recognized by the courts of this country and of England. Thus, some of the courts have held this to be an exception to the rule against perpetuities, while other courts have based such a decision upon the grounds that such option contracts do not come within the rule against perpetuities."

While Keogh v. Peck addressed many of the critical issues of the times involving LPOs, numerous other issues have been confronted and discussed since 1925. One of first cases to challenge the holding in Keogh v. Peck, was Chicago Title and Trust Company v. Illinois Merchants Trust Company, in which the defendant/landlord refused to honor the plaintiff's exercise of its LPO. One of the defendant's arguments was that the LPO contract was too uncertain and indefinite to be enforced due to an insufficient description of the land within the lease and LPO contracts themselves. The Court rejected the defendant's argument, stating that "the evidence clearly shows the tract to which the [defendant] owned, and even though the language [was] ambiguous (which [it did] not concede), evidence of the property actually owned by the

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73. Id. (citing Hawralty v. Warren, 18 N.J. Eq. 124 (1866)). See also Chicago Title & Trust Co. v. Illinois Merchants Trust Co., 329 Ill. 334 (1919) (citing Woodrow v. Quaid, 292 Ill. 27 (1920); Zempel v. Hughes, 235 Ill. 624 (1908); Ulissperger v. Meyer, 217 Ill. 262 (1905)).

74. JOHN CHIPMAN GRAY, RULE AGAINST PERPETUITIES § 329 (4th ed. 1942).

75. Keogh, 316 Ill. at 332 (citing Dime Savings & Trust Co. v. Watson, 254 Ill. 419 (1912); 61 AM. JUR. 2D 42, 44 (1972)). See also Martin v. Prairie Rod & Gun Club, 39 Ill. App. 3d 33, 35 (Ill. App. Ct. 1976); Atchinson v. City of Englewood, 170 Colo. 295, 305 (1970); Weber v. Texas Co., 83 F.2d 807 (5th Cir. 1936).

76. Id. at 332 (citing Gall v. Stoll, 259 Ill. 174 (1913)).

77. Id. at 333.

78. 316 Ill. 318 (1925).

79. 329 Ill. 334 (1928).
[defendant] renders the description sufficient to support the decree."^{80}

Roughly ten years later, the Seventh Circuit Court of Appeals, in *Williams Building Corp. v. Holman*,^{81} addressed the application of bankruptcy law as it applied to a furniture LPO. The Court concluded that a later court appointed receiver was not bound by an earlier receiver's lease to a third party. Under this lease, the third party installed furniture in a bankrupt hotel and provided the bankruptcy estate with a LPO that would result in the estate receiving complete title upon the completion of all the rental. The court stated, "the bankruptcy court may always alter its administrative decrees where, as here, no intervening rights of innocent parties have been or are likely to be materially interfered with," and therefore the plaintiff-third party could not rely on its claim for equity.^{82}

Whether a government agency may enter into an LPO is fairly clear. A governmental agency may enter into an LPO because it is vested with discretion to determine the necessity and the financial ability of the county to assume such obligations without a previous levy, being bound only by the constitutional provisions prohibiting it from incurring indebtedness beyond prescribed limitations.^{83} In *Diversified Computer Services v. The Town of York*,^{84} the court held that "no contract shall be made by the corporate authorities, unless an appropriation has been previously made concerning that contract."^{85} However, the Illinois Commerce Commission can issue an LPO as part of a "certificate of completion" to a water company that was building water mains for the Village of Island Lake.^{86} As another example, a Department of Institutions may use a LPO in order to build two group homes for institutional care of developmentally disable persons in a residential district of Lakewood Colorado.^{87}

Other substantive LPO issues are: (1) termination of the underlying lease prior to exercise, due to the lessor's death;^{88} and (2) whether the parties did not intend that the LPO could be exercised during a renewal term, in which the forcible entry precludes exercise.^{89} Absent special circumstances, courts have

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80. *Id.* at 349 (citing Decker v. Stansberry, 249 Ill. 487 (1911)); see also Bakaitis v. Fink, 340 Ill. 440 (1930).
81. 99 F.2d 212 (7th Cir. 1938).
82. *Id.* at 217; see also County of Hamilton v. Sloan, 387 Ill. 24 (1924).
83. *Id.* The court cited to ILL. REV. STAT. 1943, ch. 34, para. 24-26 for legislative support.
85. *Id.* at 855.
refused to recognize defenses based on things such as the inadequacy of contract terms, incomplete or missing legal descriptions, and unclear or insufficient contract price, or indefinite terms. The Courts have also generally upheld oral LPO contracts, but have looked with disfavor on plaintiff/landlord claims that LPOs, within the leases, have either expired, been rescinded, been abandoned, overridden under a replevin action, or deemed ineffectual due to improper exercise or conditional acceptance and/or exercise.

Successful areas for the use of LPO transactions include use for municipal buildings and housing projects, land trust transactions, bankruptcy workouts, construction sales contracts, and in the construction of federal buildings. In addition to the use of LPOs with section 42 tax credits, these LPO

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transactions have also been discussed in relationship to other important taxing issues including: Illinois Retailer's Occupation Tax, Investment Tax Credits, Ad Valorem Property Taxes, and the application of proper depreciation and amortization rates.

VI. HOME OWNERSHIP PROGRAMS THAT HAVE USED THE LEASE PURCHASE OPTIONS

A. Public Housing LPOs

There are a number of public housing home purchase programs currently available only to existing residents of public housing. The most well known of these is Turnkey III which HUD developed to enable limited-income families to purchase homes. Those selected are required to pay twenty percent of their family income for housing in addition to paying their own utilities. A portion of each month's rent is set aside in a special "earned home payment account" and another portion to a "non-routine maintenance account." Once the tenant accumulates twenty times the monthly credit, they are able to convert these funds into down payments for private financing.

Public housing ownership opportunities are also available under section 5(h) of the U.S. Housing Act. Under this program a Public Housing Authority (PHA) may sell all or a portion of a public housing project for home ownership if approved by HUD. This plan allows the use of Section 8 assistance administered by the PHA. To qualify, residents must have been in occupancy for thirty days and stayed current on their prior rent obligations for at least six months. Preference is given first to existing residents, then to applicants who have completed self sufficiency and job training programs.

Unlike the Turnkey Program, under section 5(h) the residents must have already saved the necessary down payment and closing costs, and the sum of all monthly payments must not exceed thirty-five percent of the tenant's
monthly income. The major benefits under this program are the substantially discounted purchase prices and the possibility of below-market interest rates. These units are sold outright as fee simple individual units as condominiums or as cooperatives. The program rules also prohibit individual tenant/purchasers from receiving a "windfall profit" on ultimate resale. Furthermore, under the section 5(h) program PHAs must first receive sufficient funding commitments to provide replacement housing for each unit sold under this program.

Another less known program is the Section 21 Home Ownership Program, added by the U.S. Housing Act of 1987, which allows for the purchase of entire buildings by resident management corporations (RMCs). This program was absorbed into HOPE 1 Home Ownership Program. This new HOPE 1 Ownership Program allows HUD to make planning and implementation grants to PHAs, RMCs, resident councils, as well as cooperative associations and public or private nonprofit organizations.

B. Existing or Previous Federal Home Ownership Programs

In addition to the above public housing home ownership programs, there are a number of other federal and state home ownership programs, some of which involve LPO type variations. The section 235 program is similar because it provides a low down payment and interest rate subsidies to home buyers who, at the time of initial occupancy, had adjusted annual incomes of no more than ninety-seven percent of the area median income.

The Housing Opportunity for People Everywhere (HOPE) program has three components: HOPE 1 for public and Indian housing programs, HOPE 2 for multifamily housing and HOPE 3 for one-to-four family properties.

gible families have shares or interest in converted public housing or Indian housing projects. In order to qualify for participation, the tenants must be current residents with income no greater than eighty of the median area income.\textsuperscript{118} These tenant/owners cannot pay more than thirty percent of their family income in combined housing expenses.\textsuperscript{119}

Under the program, home owners must execute promissory notes equal to the difference between the purchase price and the market value. If the tenant sells the property within the first six years, the family will receive only the amount of equity contributed or paid, the value of improvements to the property while the family owned it, and the appreciation in the original equity contribution as measured by the CPI, or other HUD approved index. Additionally, if the home is resold between six and twenty years, HUD will recapture the remaining balance due under the original promissory note. This promissory note is reduced by 1/168th for each month of home ownership so that there is a zero balance before the end of twenty years. In the event that a secondary purchaser acquires the property for a below-market price during the initial twenty year period, this secondary purchaser must provide a substitute promissory note for the amount of its discount. Any balance remaining after the tenant takes its equity and improvement portion is shared equally between the entity that originally sold the unit to the homeowner and HUD.\textsuperscript{120}

The National Home Ownership Program\textsuperscript{121} provides funds or buy downs to reduce the interest rate to first time home buyers with family income no greater than ninety-five percent of the median income for a family of four, with family size adjustments. The buyer must certify there was a good faith effort to obtain a market rate mortgage but that he has been rejected because of insufficient income.\textsuperscript{122} Like the prior programs, on ultimate resell the assistance granted must be repaid from the net proceeds.\textsuperscript{123}

C. State and Local Home Ownership Programs

In addition to the above Federal programs, individual states and local governmental units have received large infusions of funds for home ownership development programs under the HOME Investment Partnership.\textsuperscript{124} These funds

\begin{thebibliography}{9}
\bibitem{} 119. 42 U.S.C. §§ 1437aaa-3(b), 12874(b), 12894(b) (1994).
\bibitem{} 120. 42 U.S.C. §§ 1437aaa-4(g)(4), 12875(d), 12895(c) (1994).
\bibitem{} 124. Created by Title I and II of the Cranston-Gonzalez National Affordable Housing Act, 104 Stat. at 4085, 4094 (codified as amended at 42 U.S.C. §§ 12721-12839 (1994)). \textit{See also} 61
\end{thebibliography}
are allocated to states and large jurisdictions to be used for new construction, rehabilitation, or the purchase of existing housing, provided that the local or state agency also provides matching funds. The rules encourage the development of public-private partnerships to support home ownership programs, and allow a set-aside of fifteen percent of program funds for use by nonprofit community housing development organizations. Individual resident home buyers desiring to receive HOME partnership funds must not have family incomes greater than ninety-five percent of the median income for the area. Additionally, if LPOs are used to acquire the housing the actual purchase must occur within thirty-six months. On resale state or local subsidy recapture provisions will apply if HUD approved. This recapture provision remains in effect for five to fifteen years depending on the amount received. Additionally, state or local resale restrictions may limit any subsequent sale to only another low-income family. Furthermore, the state and local agencies may use LPOs, rights of first refusal, and preemptive rights to reacquire the properties before foreclosure or involuntary sales, in order to preserve their affordability.

Examples of individual home ownership programs in Illinois and the Chicago area include: Mortgage Credit Certificate Program; New Homes for Chicago; Ahkenaton Community Development Corp.; DuPage Homestead Program; Northwest Housing Partnership; New Cities Community Development Corp.; Village of Oak-Park First Time Home Buyers Assistance Program; Neighborhood Housing Services; Chicago Department of Housing home ownership programs. A number of other private financing programs have recently been developed, including: First Nationwide/ACORN programs; Hesed House (which used LPOs to lease/purchase building from city officials in Aurora, Illinois); Logan Square Neighborhood Association; and the National Training Information Center. Funds for large scale affordable housing developments and homeowner development programs are also available from large private equity funds including the Chicago Equity Fund, the Illinois Equity Fund, and the National Equity Fund.

D. Examples of Existing National Home Ownership Programs

In addition to direct government financial assistance programs, there are


also government, quasi-governmental, and private agencies that provide low-cost loans to encourage private home ownership. Some of these agencies also have LPO programs. These programs were initiated under the Federal Home Loan Bank System. Today the Federal Housing Finance Board is the controlling agency of the Federal Affordable Housing Program, and promulgates rules and serves as an advisory board to quasi-government agencies.  

E. Federal Housing Administration (FHA) Programs And Federal National Mortgage Association (FNMA) and Federal Loan Mortgage Corporation (FHLC) Programs

FHA was created in 1934, and is now a part of HUD. FHA insures mortgages issued by private lenders for both single and multifamily loans. Unlike other government programs, FHA loans do not have limits, although the historical focus has been on promoting low- to moderate-income home ownership.

The Federal National Mortgage Association (FNMA), also known as "Fannie Mae," was created as a government agency in 1938 under the 1934 National Housing Act. It was converted to a private corporation in 1968. The Federal Home Loan Mortgage Corporation (FHLC), also known as "Freddie Mac," was created as a government agency in 1970 as a secondary market for savings and loan associations. It was privatized as a quasi-governmental corporation in 1968. These two quasi-governmental corporations buy mortgages from participating lenders.

F. General Electric Capital Mortgage Corporation GE Lease Purchase Programs

General Electric was one of the earliest participants in lease-purchase programs, and its current rules require that any lease-purchase mortgages submitted to it by a lender must be issued in conjunction with a nonprofit organization. General Electric has distinguished itself by allowing participants to buy a wide variety of housing—including single-family homes, townhouses, and row houses—in addition to new construction and builder in-fill housing.

132. FHA was created as part of the National Housing Act of 1934, Pub. L. No. 73-479, 48 Stat. 1246 (1934), and was made a part of HUD in 1965 under the Housing and Urban Development Act of 1965, Pub. L. No. 89-117, 79 Stat. 451 (1965).
135. Id.
136. Id.
137. Ira McCown, President of Lincoln Financial Services, Lease-Purchase Programs that Work, Paper Presented to the Urban Land Institute Fall Meeting in Chicago, Ill. (Nov. 2, 1995).
This program continues to be an early innovator of new LPO financing techniques and strategies.

VII. EXAMPLES OF EXISTING LPO PROGRAMS

A. Wilmington, Delaware

This medium-scale LPO initiative, was started in 1981 in Wilmington, Delaware, and was designed to build 38 row houses for low- to moderate-income families with annual incomes of between $23,000 and $28,000. It required an initial $1,000 down payment, and also allocated fifty percent of the tenant/purchaser's monthly rent towards a total equity accumulation account, so that the tenants accumulated sufficient down payment at the end of three years to get conventional financing. The availability of this financing was insured by advanced arrangements with local lenders. This seemingly innovative idea had been used by local builders for a number of years, but this was the first recorded publicly financed affordable housing development to fully utilize LPOs.

B. New Brunswick, New Jersey

In 1983, Brunswick, New Jersey city officials approved the creation of a public-private joint venture partnership to build a large-scale, owner-occupied affordable housing development, which involved the building of 300 new units in addition to remodeling a large number of older, under-used buildings in a locally blighted area. The total cost of $23,000,000 was financed with low interest rate municipal bonds, and like its predecessor in Wilmington, Delaware, also required a $1,000 down payment.

C. Charleston, West Virginia

A 1985 program in Charleston, West Virginia, was significantly smaller than most housing developments, and included just fifty two-bedroom, 2½ bath units costing an average of $70,000 each and required a mere $2,500,000 bond issuance. The development was unique in that it involved the tenants themselves in the selection process. Like its predecessors in Wilmington and Charleston, this development required a minimum $1,000 down payment, and

139. Id.
140. Id.
141. McCown, supra note 137.
142. Id.
143. Id.
144. Id.
allowed the tenants at the initial time of lease to sign pre-approved mortgages applications for between $61,900 and $63,000.145 In addition, monthly rents were fixed at $595 for a maximum term of two years, which again required the take-out conventional financing. Provided these tenants were thereafter approved by a tenant selection committee, they received a conditional mortgage commitment from the local lender/participant.146 Thus tenants did not have to search out and locate other refinancing or conventional sources.

D. Birmingham, Alabama

A similar medium-scale 1987 LPO developmental program, in Birmingham, Alabama, while not focusing on lower income tenant/owners, nonetheless created 150 new, upscale three bedroom units with a minimum of 1,100 square feet of floor space.147 Most of these new units were offered under a lease/purchase program to individual tenant/owners for under $40,000 per unit, versus a then average price of $72,000 per unit in the Birmingham area. The local housing authority issued $7,000,000 in tax exempt municipal bonds in order to encourage home ownership among middle-income families with a steady work record and good credit, but who were unable to afford the high cost of new homes. These municipal bonds, like most LPO financing bonds, had a maximum term of three years, which again necessitated that the tenant/purchasers had to seek refinancing from conventional sources. And like its predecessors, it again relied on built up equity and unused maintenance and replacement balances for the required down payment at the end of the three year lease term.148

VIII. I.R.C. SECTION 42 TAX CREDITS AND LEASE TO PURCHASE OPTIONS (LPO2S)

Numerous books and publications have addressed in great detail the intricacies of I.R.C. section 42 and its role in development of affordable housing.149 One proposed hybrid, LPO2, is a method suggested to expand the use and opportunities afforded by I.R.C. section 42. I.R.C. section 42 tax credits have been the most important subsidization available to the builder of affordable homes over the last five to ten years. Originally authorized in the 1968 Tax Reform Act, they were made permanent under the Omnibus Budget Reconciliation Act of 1993, although there has recently been public discourse on ei-
ther the elimination or "sunsetting" of the tax credit after 1997.150

The tax credit itself is equal to the "applicable percentage" available (either thirty percent or seventy percent depending on the type and extent of construction and the use of other federal subsidization), times the qualified basis (which is the fraction of the building used to qualify low-income tenants) times the eligible basis (equal to the buildings adjusted basis for new buildings and acquisitions, plus improvement costs for existing buildings).151

These tax credits are generally subject to passive activity and credit limitations rules,152 and investors are deemed to have actively participated in the rental activity regardless of actual participation.153 While individual investors were the recipients of some of the earliest tax credits issued, the marketplace has now evolved to the point where today the vast majority of investors are now corporations who purchase these credits from large private equity funds such as the Chicago Equity Fund, the Illinois Equity Fund, and the National Equity Fund.154

To determine the individual state allocation amount, a state's total population is multiplied by $1.25, and the resulting allocation is reallocated to the designated state or municipal housing agency based upon their individual affordable housing standards, criteria and needs.155 The owners of individual properties qualifying for the I.R.C. section 42 tax credit must continue to lease the qualifying portion of the building to low- and very low-income tenants for a minimum of fifteen years, or face serious penalties from the recapture provisions of I.R.C. section 43. These qualifying property owners must also sign an advanced use restriction agreement stating that following the first fifteen year hold period, they will continue to maintain the same portion of the building as low and very low-income units for a second fifteen year hold period unless they sell the building, at which point the housing authority has the first right of refusal to purchase these building for the same price negotiated with the outside third parties.156

150. NOVOGRADAC, supra note 22, at 1; Bridge Loan, supra note 22, at 24-27; Tax Credits, supra note 22, at 1.

151. NOVOGRADAC, supra note 22, at 1-16; Bridge Loan, supra note 22, at 24-27; Tax Credits, supra note 22, at 1-4.

152. NOVOGRADAC, supra note 22, at 17. See also I.R.C. § 469(a)(1)(B) (1994).


155. NOVOGRADAC, supra note 22, at 197-99; Tax Credits, supra note 22, at 7.

The proposed hybrid fifteen year LPO2 is financed by an investor pool, either private or nonprofit, which can finance construction of new and rehabilitated homes by using the fifteen year LPO2s without violating the second fifteen year extended use agreement. Until recently, this proposition was only theoretical, but thanks to Revenue Ruling 95-49, issued on July 17, 1995, this issue has been resolved in favor of LPO2s. The original problem arose because under I.R.C. section 42(h)(6), a tax credit could only be issued if there was an extended use agreement in effect at the end of each taxable year. This commitment was binding on all successors. However, this code section was in direct conflict with I.R.C. section 42(l)(7), which stated that no federal income tax benefits would be lost merely because a right of first refusal to buy the building at the end of the fifteen year period, was held by the building's tenants. Under Revenue Ruling 95-49, this conflict was resolved when the Internal Revenue Service (IRS) acknowledged that the need to continue the availability of low-income housing was satisfied when first rights of refusal were issued to tenants provided that the sales met the minimum purchase price requirements of I.R.C. sections 42(l)(1) and (l)(7)(B). This revenue ruling effectively opens the door for the use of long term LPO2s and other similar first right of refusal financing techniques.

Another key question is whether the involvement of other types of non-section 42 federal financing, and their associated occupancy rules, will cause the tax credit to be lost. These additional financing sources affect three distinct aspects of the tax credit calculation: the credit percentage, eligible basis and low-income occupancy standards. Generally, the low-income restrictions of these other federal subsidy programs are less stringent. Under I.R.C. section 42(b)(1)(B)(l), a new building that receives a federal subsidy is not eligible for the nine percent credit, but will be eligible for the four percent credit. A federal subsidy is defined as any debt obligation, the interest of which is exempt from taxes under I.R.C. section 103, or a direct or indirect federal loan, if the interest rates on such a loan is below the applicable federal rate. The eligible basis of a property is generally equal to its acquisition and construction costs. However, this eligible basis must be adjusted for various factors, the most common being a reduction in the eligible basis for the amount of federal grants received. The various low-income occupancy percentages under different federal programs must constantly be monitored because there is the very real possibility of a tax credit recapture if these standards are overlooked.

It should be clear that as a result of Revenue Ruling 95-49, if the LPO2 follows the minimum purchase price requirements of I.R.C. sections 42(l)(1) and (l)(7)(B), then there should be no problem with extending the term to a full

158. For a detailed discussion of the conflict in funding requirements, see NOVOGRADAC, supra note 22, at 369.
fifteen years. It is also recommended that the holding agent of the properties
be a nonprofit corporation so that under some state laws there would not be
any property taxes due on these LPO2 properties. The only remaining issue,
which is discussed below, is whether individual tenant-held Section 8 vouchers
can be used to pay the rent on these LPO2 properties.

IX. VOUCHER PAYMENTS AND LEASE TO PURCHASE OPTIONS

In exploring the interrelationship between section 42 and Section 8
voucher payments, it should be noted that there are really two separate issues.
First, will HUD officials approve the use of their individual Section 8 vouchers
for LPO2s given their prior position that vouchers could not be used in an eq-
turn building capacity? Secondly, will the use of these Section 8 vouchers be
considered a federal grant, therefore either reduce or prohibit the section 42 tax
credit, or at minimum, reduce the eligible basis?

The answer to the first question is contained in a 1990 letter from Mr.
George Weidenfeller of the Office of General Counsel at HUD to the Cleve-
land Housing Network,\textsuperscript{159} that confirms that HUD will in fact allow the use of
lease purchase options, provided that the lease itself is in accordance with all
Section 8 rules and the rental payments are subject to the normal statutory lim-
its.\textsuperscript{160} Tenants must not be required to pay any additional monies of any kind
above and beyond the usual thirty percent statutory limit of income, even if
those additional funds would go directly towards building home-ownership eq-
ity since Section 8 payments are only a rental subsidy. Except in the case of
coop\textsuperscript{161} eatives,\textsuperscript{161} payment will stop on the day that the tenant/purchaser takes
actual title to the property.

The remaining question is whether the individual Section 8 payments will
affect the eligible basis or otherwise affect the validity of the tax credit. It is
generally understood, since the Section 8 payments are held in the tenant's
name only, that if tenants decide to move the Section 8 rental subsidy would go
with them. These payments should not be considered as a grant or other direct
subsidy to the building itself, and therefore, would have no negative effect on
the I.R.C. section 42 tax credit.

The most obvious question that arises in the use of LPO2s is what will
happen to the units of residents that do not complete the entire fifteen year

\textsuperscript{159} Letter from George Weidenfeller, of the Office of General Counsel at HUD (1990) (on
file with The John Marshall Law School).

\textsuperscript{160} The staff at The John Marshall Law School Affordable Housing Clinic, as of Feb. 1,
1996, confirmed with the office of HUD's general counsel that there have been no subsequent
changes in HUD's position following the issuance of this letter.

\textsuperscript{161} Cooperatives have long been used as a business form that facilitates the private pur-
chasing and ownership of existing public housing projects. See generally Priv. Ltr. Rul. 95-38-
16, 1986).
holding period. Will the IRS and HUD accept new like-kind substitute tenants, and, if so, must these substitute tenants start the fifteen year clock anew? Conversely, will these substitute tenants be allowed the walk in one day before the end of the initial fifteen year period and thereafter receive all associated benefits in equal proportion to those tenants that have remained throughout the entire fifteen year period? Or will the original tenants be allowed to sell their interest in the LPO2s since all options agreements would have long since been deemed personal property? While there are no easy answers to these questions, it is presumed that these LPO2s will be treated much the same way as land sales contracts in which 'the buyer himself can rely on his right of "equitable title" in order to seek assistance from the courts in the event of conflict or litigation.

Another question concerns what will happen if an already approved tenant misses or is unable to make one (perhaps just the final) of the 180 (fifteen years multiplied by twelve months) lease payments. Will a tenant have no retained or residual value at all, or will such a tenant have another way to recoup some or all of his payments without breaching the I.R.C. section 42 rules? Again, the concept of "equitable title" will come into play and most probably require, at minimum, that the tenant be reimbursed for some portion of his prior rental payments. Presumably, if the tenant is using Section 8 vouchers, this money would have to be returned directly to HUD. This should be contrasted with the right of the tenant, upon successful completion of the fifteen year holding period to sell the property in the open market at a free market price, with his/her corresponding retention of 100% of such sale proceeds. These sale proceeds would presumably be taxed as normal income, or possibly as capital gains given the current lack of "windfall profit" rules.

X. CONCLUSION

The LPO2 suggested here could be used to solve two of our most pressing problems: what to do with the large amount of deteriorated public housing and how to prevent mass homelessness. Using existing Section 8 certificates and vouchers in tandem with LPO2s is a way to deal with these intractable problems.