

THINKING OF SELLING YOUR APARTMENT PROPERTY IN SAN FRANCISCO? YOU MUST OFFER IT TO A NONPROFIT FIRST

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San Francisco's city government now requires private property owners to give non-profits the first right to purchase most multi-family residential properties with three or more residential rental units. The stated purpose of the city's Community Opportunity to Purchase Act ("COPA") is to promote and create affordable housing by allowing nonprofit organizations to purchase multi-family residential buildings at market prices. COPA is implemented and regulated by the Mayor's Office of Housing and Community Development ("OHCD").

Perhaps surprisingly, COPA is not an entirely new idea or a San Francisco idea. Two programs in the District of Columbia, the Tenant Opportunity to Purchase Act ("TOPA") and the District Opportunity to Purchase Act ("DOPA"), preceded COPA. TOPA provides tenants with the right to purchase certain properties and DOPA provides the District of Columbia with the right to purchase certain properties. The latter program, DOPA, was met with considerable challenges and, despite being passed in 2008, was not implemented until 2018.

WHAT PROPERTIES AND TRANSACTIONS ARE SUBJECT TO SAN FRANCISCO'S COPA?

COPA applies to the sale of privately owned property with three or more residential rental units. It includes properties with three or more residential units that are under construction and vacant land that could be developed into three or more residential units. COPA does not apply to the sale of a condominium or the sale of an individual unit in a tenancy in common if it is not substantially connected to the sale of all the interests in the property.

"Sale" is broadly defined under COPA and includes, among other things, the transfer of a fee interest or a controlling interest in a single purpose entity. Certain transfers are excluded from COPA. For example, transfers of qualified properties made as a result of a bankruptcy or those made under a mortgage, deed of trust or deed in lieu of foreclosure are excluded. In addition, any transfer to one's heirs or between and among family members are excluded from COPA.

HOW DOES COPA WORK?

COPA requires sellers to provide qualified nonprofits with: (1) the right of first offer, and (2) in some cases, the right of first refusal. Nonprofit organizations become qualified for COPA by applying to OHCD ("Qualified Nonprofits"). Currently, there are six Qualified Nonprofits that have been approved by OHCD.

First, before listing a property for sale or soliciting offers, an email must be sent to the Qualified Nonprofits and OHCD disclosing the seller's intent to sell the property. The email must contain information about the property, including the number of rental units and rate of rent for each unit. The Qualified Nonprofits then have five full days to consider whether they are interested in the property. If a Qualified Nonprofit expresses interest in the property, then the Qualified Nonprofit has an additional 25 days to submit an offer. If the Qualified Nonprofit makes an offer to purchase the property during this period of time, the seller is free to accept or reject the offer.

Second, after the seller has gone to market following the right of the first offer and before a seller closes escrow on a third party offer to purchase the property, the seller must provide certain Qualified Nonprofits with the opportunity to purchase the property for the same terms and conditions as the third party offer. The seller must provide the right of first refusal to any Qualified Nonprofit that previously made an offer to purchase the property during the right of first offer or any Qualified Nonprofit that was not given the right of first offer. The Qualified Nonprofits have five full calendar days to purchase the property for the same terms and conditions as the third party offer.

Importantly, COPA allows a seller to accept a third party offer contingent on the right of first refusal. Indeed, the California Association of Realtors has promulgated forms to streamline compliance with COPA's right of first offer and right of first refusal.

WHAT DOES THIS MEAN FOR OWNERS OF SAN FRANCISCO PROPERTIES?

It is hard to imagine that COPA will not have a significant impact on the owners and developers of multi-family residential real properties. COPA will undoubtedly affect sales timelines and cause delays in the sales process. In addition, the seller of any multi-family property is required to submit a signed declaration to OHCD within 15 days after the sale certifying that it has complied with COPA. A form declaration can be found on the OHCD's website. Failure to submit the requisite declaration or comply with COPA can lead to civil actions and civil penalties. Indeed, COPA gives a private right of action to Qualified Nonprofits against a seller who fails to comply with COPA, inclusive of attorneys' fees.

COPA will likely be subject to legal challenges. Among other things, there is considerable uncertainty with various aspects of COPA. For example, COPA requires that a seller provide the Qualified Nonprofits with the right of first refusal if, after the initial right of first refusal, the third party offer *materially* changes. Put more simply, every time the terms of the sale materially change, as the result of routine renegotiation during the due diligence period or otherwise, it triggers a new obligation to provide Qualified Nonprofits with the right of first refusal. The OHCD defines "material change" as a change to the significant terms of a contract that a Qualified Nonprofit justifiably relied on in deciding whether to accept an offer. By way of example, OHCD states that material changes may be changes to the parties to the contract, the financial terms, the property, or performance under the contract. This is extraordinarily vague. How will a seller know what the Qualified Nonprofit relies upon in accepting or rejecting its right of first refusal? One would not necessarily assume that a Qualified Nonprofit based its decision to buy on the identity of the third party buyer. Yet, it was one of four examples given by OHCD.

Notwithstanding any legal challenges, COPA became effective on September 3, 2019 and currently applies to the sale of multi-family properties in San Francisco. If a multi-family property is sold to a Qualified Nonprofit, then the seller may take advantage of a partial city transfer-tax exemption and, possibly, federal tax benefits.

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