

NATIONAL  
HOUSING  
T R U S T

**Testimony of**

**Michael Bodaken**

**President  
National Housing Trust**

**before the**

**House Committee on Financial Services**

***Hearing on Legislation to Preserve Affordable Rental Housing***

**Washington, D.C.**

**June 19, 2008**

Chairman Frank, Ranking Member Bachus, and members of the Committee, thank you for inviting me to testify today. My name is Michael Bodaken. I am the President of the National Housing Trust (“the Trust”) a national nonprofit organization formed in 1986, dedicated exclusively to the preservation and improvement of existing affordable housing. Our Board of Directors includes representatives of all major interests in the preservation field, including tenant advocates, owners and managers, state housing agencies, national and regional nonprofit intermediaries, housing scholars and other housing professionals who care deeply about protecting this irreplaceable resource.

The Trust acts based on a fundamental belief: preserving existing affordable rental housing is the essential first step in solving our nation’s housing dilemma. Our public policy advocacy is informed by our direct experiences on the ground preserving affordable housing. The Trust’s loan fund, National Housing Trust Community Development Fund, provides loans to other nonprofits to finance affordable housing preservation. The NHT/Enterprise Preservation Corporation, an affiliated organization formed as a joint venture with Enterprise Community Partners, redevelops and owns many federally subsidized properties. Over the past decade, the Trust has helped save more than 20,000 apartments in over 40 states. The vast majority of these apartments have HUD subsidized mortgages or project-based rental assistance contracts.

Today I also testify on behalf of the National Preservation Working Group, a coalition of 24 supporters of affordable rental housing. For over 17 years the Preservation Working Group has convened on a regular basis to respond to preservation issues, share best practices among nonprofit preservation practitioners, and discuss and pursue improvements in public policy to facilitate and expand the preservation of decent, affordable rental homes for low-income households. The members of the Preservation Working Group are:

National Housing Trust  
National Low Income Housing Coalition  
National Housing Law Project  
National Alliance of HUD Tenants  
Housing Assistance Council  
Local Initiatives Support Corporation  
Enterprise Community Partners  
Action Housing (PA)  
California Housing Partnership Corporation  
Chicago Community Development Corporation  
Chicago Rehab Network  
Community Builders (MA)  
Community Economic Development Assistance Corp (MA)  
Community Service Society of New York  
Coalition on Housing and Homelessness in Ohio  
Coalition for Economic Survival (Los Angeles)  
Community Development Law Center (Portland, OR)  
Housing Preservation Project (Minnesota)  
Neighborhood Reinvestment Corporation  
New York Tenants and Neighbors  
Stewards of Affordable Housing for the Future  
Texas Tenants Union  
Urban Homesteading Assistance Board (NY)  
Emily Achtenberg (MA)

Let me begin by thanking you, Chairman Frank, Housing and Community Opportunity Subcommittee Chairwoman Maxine Waters, and others on the Committee who have exercised the commitment and hard work necessary to convene this hearing and present a draft of comprehensive preservation legislation for our review and comment. On behalf of the tenants of assisted housing around the country, residents of the neighborhoods in which these properties exist, and mission minded nonprofit developers, owners, and managers of these properties, the members of the Preservation Working Group thank you for your attention to the critical need to preserve affordable rental housing that is at risk of conversion to other uses. We support the enactment of legislation to strengthen and expand tools for preservation, and welcome the opportunity to work with you to make this proposed legislation become law.

**Federally subsidized housing is an essential housing resource.**

The federally assisted housing rental stock is an especially important resource because it provides homes affordable to those with worst case housing needs at a time when housing affordability challenges are growing worse. The largest of these programs, the project-based Section 8 rental assistance program, provides affordable apartments for more than 1.3 million extremely low income households.

The need for this housing is great. Our nation's most vulnerable families and seniors depend on quality affordable rental housing. According to HUD, between 2003 and 2005 the number of very low income renter households with worst case housing needs increased by more than 15 percent. There are now nearly 6 million such households, the highest number reported since HUD began collecting data in 1990. According to a 2000 HUD survey, nearly 50% of federally subsidized housing is occupied by elderly or disabled persons. More than 77,000 veterans also depend on project-based affordable housing, according to a December 2007 GAO report.

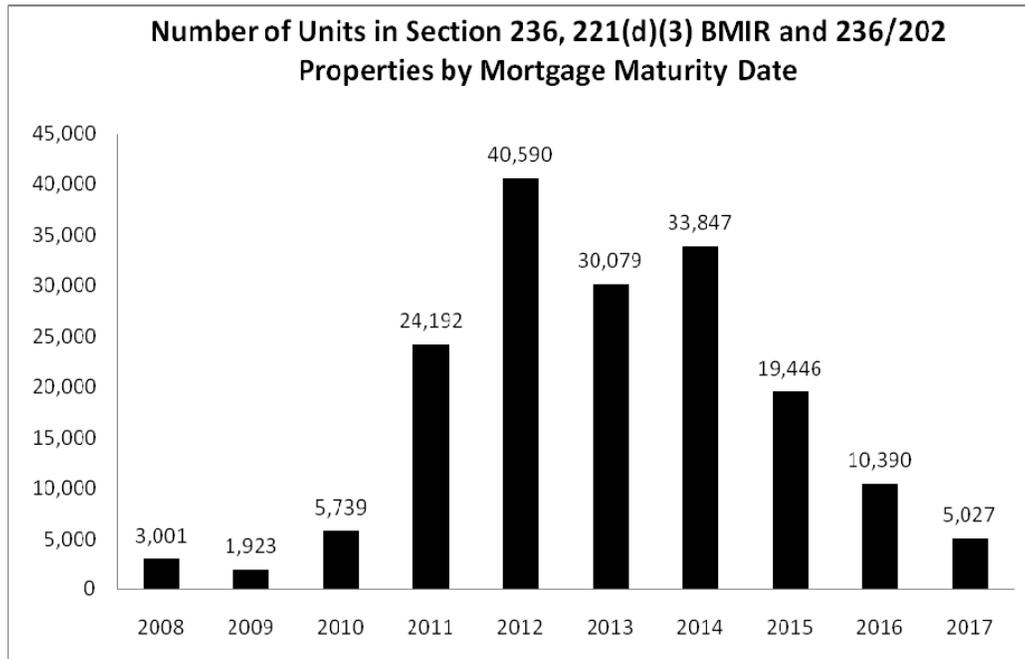
Federally subsidized housing serves nearly every community in the nation. The Trust's analysis shows that nearly 190,000 federally assisted apartments with contracts expiring over the next decade are located in the districts of the members of this committee, as shown in attachment A.

Many federally assisted homes have rents well below market, making them the most affordable housing in the nation. But today their future in high cost housing markets is threatened. Many properties have increased substantially in value, giving owners the incentive to opt out of the federal programs and convert the housing to market rate. Constructed more than 30 years ago, many properties are suffering from physical deterioration and are in need of significant capital improvements.

Despite these risks, current federal policies provide few incentives to retain the property's original use, and many incentives to opt out of affordability requirements. The Trust estimates 350,000 units of subsidized housing have been lost over the past decade through conversion to market-rate housing or physical deterioration. Over the next five years, contracts on more than 900,000 Section 8 units will expire. When a Section 8 contract expires, the owner can choose to opt out of the program, ending the obligation to maintain the housing as affordable.

In addition, nearly 200,000 affordable apartments in properties with HUD subsidized mortgages will be at risk of conversion to non-affordable use when their mortgages mature over the next 10 years. Many of these apartments have project-based assistance included in the numbers above,

but many receive no assistance but remain affordable to residents because of restrictions associated with the HUD-subsidized mortgages.



**Home foreclosures increase new pressure on affordable rental housing.**

As every member of this Committee knows, our nation is currently undergoing a massive foreclosure crisis in the single-family housing stock. According to the Pew Charitable Trusts, one in 33 homeowners is projected to be in foreclosure, primarily over the next two years, as a result of subprime loans made in 2005 and 2006. Homeowners being foreclosed upon will not be the only homeowners affected, according to data cited in the report. An additional 40 million neighboring homeowners may see their property values and their municipalities' tax bases drop by as much as \$356 billion.

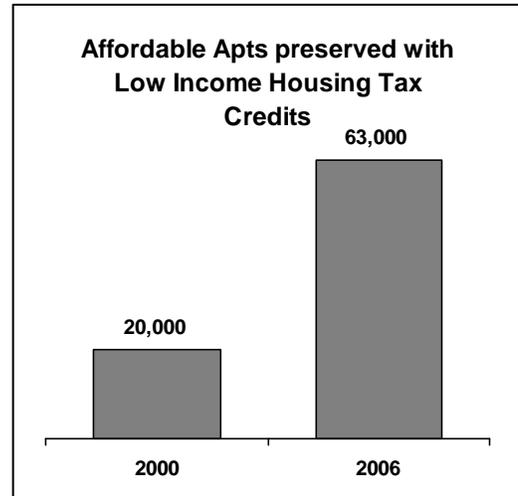
Another clear implication is that future foreclosures will shift many families from homeownership to rental, and that many of these families will be seeking rental units at the lower end of the of the cost spectrum, where there is already a shortage of affordable rental housing for the poorest households. *America's Rental Housing: The Key to a Balanced National Policy*, published by the Joint Center for Housing Studies and funded by the MacArthur Foundation, makes the point that as displaced owners are forced into the rental market, a growing number of renters are competing for a limited supply of affordable housing, adding to market pressures. Addressing this challenge begins with preserving existing affordable housing. As Harvard report notes, "While efforts to create new units must continue, preserving the existing stock of good-quality, subsidized rental housing is even more important."

**Preserving affordable housing is cost effective, environmentally responsible, and is the logical first step in solving our nation's housing dilemma.**

New construction alone will not produce enough affordable housing to meet the increasing demand. From 1995 to 2005, our nation lost nearly 1.4 million apartments with inflation-adjusted

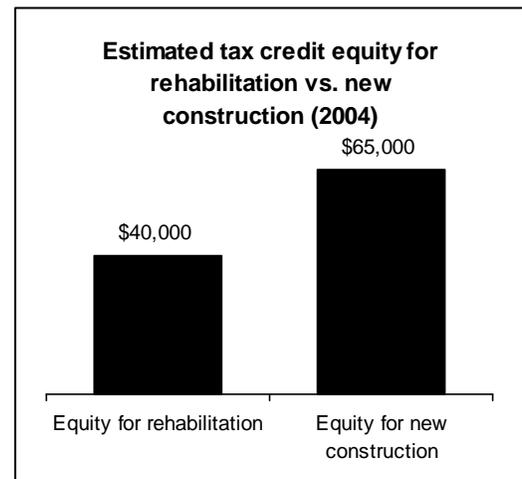
rents of \$600 or less.<sup>1</sup> Although approximately 100,000 affordable apartments are created each year through the low income housing tax credit program, new construction does not add enough to the affordable rental stock to make up for lost units. In fact, for every new low-cost unit created each year, two are lost due to demolition, abandonment, or conversion to more expensive housing. Only when existing, subsidized and unsubsidized housing is preserved will building new affordable housing *add* to the affordable housing supply.

Over the past decade, state and local governments have increasingly devoted scarce resources, including low income housing tax credits, to preserve this housing. These tax credits have attracted billions of dollars in private sector investment in the rehabilitation of federally subsidized housing. The accompanying chart demonstrates how nearly all 50 states are now using low income housing tax credits to preserve existing affordable housing.



States' decisions to emphasize preservation are particularly sensible because preserving an existing home is significantly less expensive than constructing new affordable housing. Using data on the placement of tax credit equity from the National Council of State Housing Agencies, the Trust recently determined that it costs approximately 40% more to build a new affordable apartment than to preserve one in the same community. In more expensive communities, the cost of building new affordable housing is almost double preserving affordable housing in the same neighborhood.

Building enough new housing affordable to low-income families at current wages would be an impossibly expensive solution given budgetary constraints. Current local zoning laws, land use controls, and other regulatory barriers have seriously hampered the production of affordable rental housing and have increased housing prices. High land prices and restrictions on allowable densities have pushed the median asking rent of a newly built apartment to \$1,057 in 2006, a 30 percent increase above the median asking rent in the mid-1990s (measured in constant dollars).<sup>2</sup> Significantly increasing production requires addressing these regulatory obstacles—a substantial challenge considering the strong opposition to building new affordable housing in many communities throughout the country.



<sup>1</sup> Joint Center for Housing Studies. (2008). *America's Rental Housing: The Key to a Balanced National Policy*. Cambridge: Joint Center for Housing Studies of Harvard University

<sup>2</sup> Ibid

In addition, federal government costs increase when an owner opt outs of a federal project-based rental assistance contract because the vouchers provided to protect eligible tenants from being displaced typically cost more—\$1,000 more than the average project-based subsidy.

Preserving existing affordable housing provides an opportunity to reinvest in and improve our communities and protect the historic investment made by the federal government. If we do not preserve and improve the millions of apartments that have been produced through these successful public-private partnerships, we will permanently lose our nation's most affordable homes. This will represent a squandering of billions of taxpayer dollars. Instead, safeguarding this housing presents an opportunity to reinvest in and improve our communities.

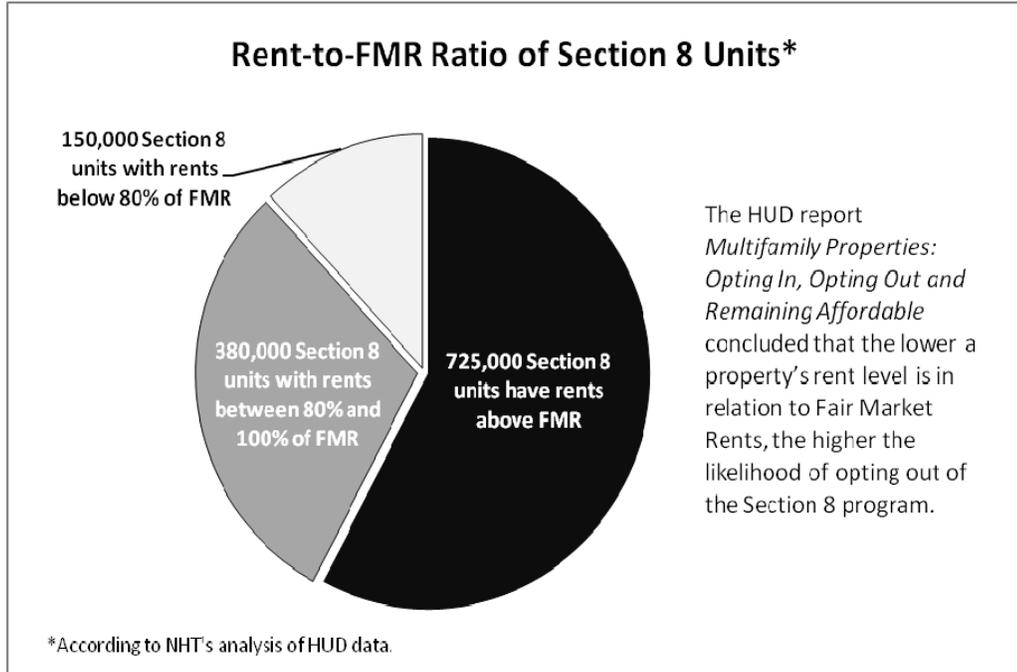
Moreover, it is more energy efficient to preserve existing housing than it is to build new affordable housing where there is not an existing transportation infrastructure. Much of this housing serves as existing transit oriented development in our nation's cities. The National Housing Trust and Reconnecting America have identified federally assisted affordable housing located in close proximity to existing or proposed public transportation in 8 cities: Boston, Chicago, Cleveland, Denver, New York City, Portland, St. Louis, and Seattle. More than 100,000 federally assisted housing units sheltering more than 300,000 individuals in these cities are located within a half mile of rail stations or proposed rail stations. Approximately 63 percent of subsidized apartments near rail stations are covered by federal rental assistance contracts that expire before the end of 2012. The number of units near public transportation increases dramatically when subsidized apartments near frequent service bus lines are included in the analysis.

Policymakers must act to ensure that this essential housing resource remains affordable to families and seniors. Preserving affordable housing near transit means more than simply saving a building—it means preserving meaningful transit opportunities for low-income families and seniors. Affordable housing located near transit allows families and seniors to live an affordable lifestyle in sustainable communities that offer access to employment, education, retail, and community opportunities.

**In order for federally assisted housing to stand the test of time, the federal government must act as a fair and consistent partner by honoring its commitments.**

The stock of privately owned affordable rental housing is the result of a successful four-decade partnership between the federal government and the private sector. This partnership led to the creation of nearly two million units of rental housing that is affordable to economically disadvantaged households, a large portion of which include elderly or disabled individuals. Today, private sector owners, managers, lenders, and investors associated with affordable rental housing have reason to doubt the federal government's willingness to honor its obligations under the contracts that were the basis of that partnership. Last summer, many owners went month after month while the Section 8 payments due to them under these contracts went unfulfilled. This winter, HUD announced that its new scheme to meet these obligations was to provide funding only a few months at a time, rather than for the entire contract period, and that funding would expire at the end of each fiscal year. For the tenants and owners that rely on prompt, reliable payments to meet their own obligations, this is unacceptable.

Owners of buildings with project-based rental assistance projects have the right to opt out of the program. Owners who have properties with market rents proximate to or higher than the current project-based Section 8 subsidy amount will be more inclined to leave the program if the reliability of their payments is in doubt. According to the Trust's analysis of HUD data, approximately 150,000 Section 8 apartments have rents well below fair market rent:



Aside from the impact on local vendors, businesses, and mortgage holders (many of whom depend on FHA insurance for these obligations), these late payments also affect the confidence of lenders and investors needed to finance the recapitalization of older properties in need of repair. If these lenders and investors can't rely on the federal commitment to these properties, our ability to preserve their affordability into the future is severely compromised.

For this reason, the first principle of preservation is prompt, reliable funding for existing housing assistance contracts. Without full appropriations to fund existing contracts, our efforts to preserve affordability face a daunting challenge.

Current policies also tend to limit the ability of preservation-minded owners to recapitalize, earn sufficient cash flow, and build a sustainable capital base. Owners, particularly nonprofit owners, are often not rewarded for taking risk. For example, HUD's current policy is to restrict the ability of nonprofit owners of federally regulated properties to take built up equity from the properties and use it for its housing mission.

In addition, current programs and regulations are fragmented, cumbersome, unpredictable and inconsistently applied. Owners are frustrated with HUD's inability to promulgate meaningful regulations or to sensibly apply them. Here are but a few examples:

- Owners of Section 8 properties financed by State Housing Agencies are not entitled to mark their rents up to market, even though the market rents in the community may be higher than their current rents and the owner could use the funding to avoid operating at a deficit;
- HUD routinely terminates, rather than suspends, the Section 8 contracts on troubled properties, making it quite difficult for a new, mission minded owner to obtain debt and tax credits to repair the property;
- There is no nationwide effort to inform preservation minded organizations when an owner gives notice to convert a property to market rate. Current law requires that owners give notice to tenants and the federal government of a decision to opt out of a Section 8 contract or prepay the subsidized mortgage. But this information is not made publicly available. If preservation minded organizations knew which owners were planning to leave the federal programs, they could offer to purchase the property and preserve the apartments as affordable.

### **Legislative Recommendations**

The John D. and Catherine T. MacArthur Foundation supports the National Housing Trust and NHT/Enterprise, and has supported leading housing developers and others working to promote and finance affordable housing preservation. In October of 2006 the MacArthur Foundation outlined three Guiding Principles for Preservation Policy. These principles still apply today and provide a useful framework for thinking about policy changes that can improve the number and the quality of preservation transactions.

1. To encourage and support responsible long-term ownership of affordable rental housing.
2. To encourage and streamline sales and transfers of at-risk affordable rental properties to qualified preservation owners.
3. To provide appropriate support to existing residents of affordable rental housing who seek to remain in their homes or require relocation assistance.

These guiding principles shaped four basic recommendations for comprehensive preservation policy reform:

**Financing:** Stabilize and dedicate increased public funding to long-term preservation ownership; provide adequate resources to assist residents of at-risk properties; expand public-private financing sources for preservation transactions. Thus, the Preservation Working Group recommends:

1. Providing full appropriations to fund project-based Section 8 contracts on a 12-month basis;
2. Providing tenant protections and alternatives to conversion for properties with expiring contracts or maturing mortgages;
3. Permitting owners to transfer project-based Section 8 to another property;

4. Utilizing all available preservation tools, such as up-front grants and retaining Section 8 for purchasers of distressed properties;
5. Enacting Exit Tax relief, as provided in H.R. 1491.

**Regulation:** Streamline policies and coordinate administrative practices to improve support for long-term preservation owners and make preservation transactions easier, faster and less costly. The Preservation Working Group works with HUD on an ongoing basis to ensure that regulatory changes improve prospects for successful preservation outcomes.

**Incentives:** Increase tax and regulatory incentives for sellers and owners of existing, affordable rental housing to encourage preservation, reduce speculation and maximize long-term affordability. The Preservation Working Group recommends the following incentives for long term stewardship of the existing inventory:

1. Enact enhancements to the Mark-to-Market program;
2. Protect state and local preservation laws against preemption;
3. Permit owners to retain project-based assistance in lieu of enhanced vouchers;
4. Ensure resident participation in the preservation process and full protections for tenants affected by converted properties; and
5. Affirm that HUD has a requirement to maximize preservation.

**Information:** Collect, standardize, and widely share information about the characteristics of existing affordable rental properties, their residents, and key factors that create a risk of loss, as well as innovative and successful preservation strategies. The Preservation Working Group recommends establishing an early warning system for opt-outs, together with easy to access comprehensive information on HUD-assisted properties.

The Preservation Working Group's complete recommendations can be found in Attachment B.

Again, thank you for the opportunity to comment on the need for comprehensive preservation legislation. The National Housing Trust is eager to support this effort as it moves forward and looks forward to the formal introduction of this legislation.

I would be pleased to respond to any questions.

## Attachment A

### Privately Owned, Federally Assisted Affordable Housing In Financial Services Committee Members' Districts

Committee Member	Apts with Project-Based Contracts Expiring in FY08-17
<b>Rep. Frank, MA, <i>Chair</i></b>	4,220
<b>Rep. Bachus, AL, <i>Rnk. Mem.</i></b>	670
Rep. Gary L. Ackerman, NY	1,314
Rep. Joe Baca, CA	2,057
Rep. Michele Bachmann, MN	2,497
Rep. J. Gresham Barrett, SC	2,626
Rep. Melissa L. Bean, IL	2,206
Rep. Judy Biggert, IL	1,466
Rep. Dan Boren, OK	2,979
Rep. Ginny Brown-Waite, FL	176
Rep. John Campbell, CA	1,005
Rep. Shelley Moore Capito, WV	2,694
Rep. Michael E. Capuano, MA	18,246
Rep. Andre Carson, IN	5,772
Rep. Michael N. Castle, DE	4,833
Rep. William Lacy Clay, MO	5,095
Rep. Emanuel Cleaver, MO	5,861
Rep. Geoff Davis, KY	3,099
Rep. Lincoln Davis, TN	2,016
Rep. Joe Donnelly, IN	3,707
Rep. Keith Ellison, MN	6,625
Rep. Tom Feeney, FL	249
Rep. Bill Foster, IL	3,339
Rep. Scott Garrett, NJ	889
Rep. Jim Gerlach, PA	798
Rep. Al Green, TX	2,414
Rep. Luis V. Gutierrez, IL	1,993
Rep. Dean Heller, NV	1,709
Rep. Jeb Hensarling, TX	977
Rep. Rubén Hinojosa, TX	1,997
Rep. Paul W. Hodes, NH	4,097
Rep. Walter B. Jones, NC	1,692
Rep. Paul E. Kanjorski, PA	3,971

*National Housing Trust Statement to House Committee on Financial Services (June 19, 2008)*

Rep. Peter King, NY	388
Rep. Ron Klein, FL	454
Rep. Steven C. LaTourette, OH	1,581
Rep. Frank D. Lucas, OK	2,023
Rep. Stephen F. Lynch, MA	5,578
Rep. Tim Mahoney, FL	612
Rep. Carolyn B. Maloney, NY	2,963
Rep. Donald A. Manzullo, IL	2,508
Rep. Kenny Marchant, TX	538
Rep. Jim Marshall, GA	2,949
Rep. Carolyn McCarthy, NY	2,240
Rep. Kevin McCarthy, CA	1,158
Rep. Thaddeus McCotter, MI	2,521
Rep. Patrick T. McHenry, NC	1,035
Rep. Gregory W. Meeks, NY	2,803
Rep. Brad Miller, NC	2,563
Rep. Gary G. Miller, CA	410
Rep. Dennis Moore, KS	2,815
Rep. Gwen Moore, WI	6,912
Rep. Christopher S. Murphy, CT	5,028
Rep. Randy Neugebauer, TX	2,057
Rep. Ed Perlmutter, CO	1,911
Rep. Ron Paul, TX	1,324
Rep. Steve Pearce, NM	2,309
Rep. Tom Price, GA	534
Rep. Deborah Pryce, OH	4,283
Rep. Adam Putnam, FL	1,338
Rep. Peter J. Roskam, IL	1,906
Rep. Edward R. Royce, CA	757
Rep. David Scott, GA	2,371
Rep. Christopher Shays, CT	3,789
Rep. Brad Sherman, CA	2,647
Rep. Nydia M. Velázquez, NY	5,262
Rep. Maxine Waters, CA	2,107
Rep. Robert Wexler, FL	908
Rep. Charles Wilson, OH	2,443
Rep. Melvin L. Watt, NC	2,961
<b>Total</b>	<b>189,275</b>

## **Attachment B**

### **Legislative Provisions to Support the Preservation of Affordable Housing**

**Compiled by the  
National Preservation Working Group**

#### **SECTION I: Maintain housing at risk of being converted to market.**

From 1965 to the mid-1980s, the government played an essential role in creating affordable rental homes. The federal government partnered with the private sector by providing financial incentives, including interest rate subsidies (Section 236 and Section 221(d)(3) Below Market Interest Rate (BMIR)), or rent subsidies (Section 8), in exchange for a commitment from property owners to keep the apartments affordable to low-income households. As a result of these programs, there are millions of federally assisted, privately owned affordable homes in nearly every community in the nation. The largest of these programs, the project-based Section 8 rental assistance program, provides affordable apartment homes for more than 1.3 million households, including more than 700,000 homes for senior citizens.

**The apartment homes created with the help of the federal government provide some of the most affordable rental housing in our communities.** Many federally assisted homes have rents well below market making them the most affordable housing in the nation, serving a wide range of low- to moderate-income households. But today their future, especially in high cost housing markets, is threatened. Many properties have increased substantially in value, giving owners the incentive to opt out of the federal programs and convert the housing to market rate. Many other properties, constructed more than 30 years ago, are suffering from physical deterioration and are in need of significant capital improvements. From 1995 to 2003, our nation lost 300,000 subsidized affordable apartments through conversion to market-rate housing or physical deterioration. Over the next five years, contracts on more than 900,000 Section 8 units will expire. When a Section 8 contract expires, the owner can choose to opt out of the program, ending the obligation to maintain the housing as affordable.

**Preserving federally assisted affordable housing is the essential first step in solving our affordable housing crisis. New construction alone will not produce enough affordable housing to meet the increasing demand.** Any strategy to ensure a sufficient supply of affordable housing must begin with holding on to what we have. According to the Joint Center for Housing Studies, for every new affordable apartment constructed, two affordable apartments are lost. Without preserving existing housing, we are losing ground.

**Preserving existing affordable housing provides an opportunity to reinvest and improve our communities and protect the historic investment made by the federal government.** If we do not preserve and improve the millions of apartments that have been produced through these successful public-private partnerships, we will permanently lose our nation's most

affordable homes. This will represent a squandering of billions of taxpayer dollars. Instead, safeguarding this housing presents an opportunity to reinvest in and improve our communities.

**Preserving existing affordable housing saves scarce resources.** It is significantly more cost-efficient to preserve existing housing than build new housing. It costs approximately 40 percent less to preserve an existing apartment than to construct a new apartment. It is also far more energy-efficient to preserve existing housing. Renovating an existing building produces less construction waste, uses fewer new materials and requires less energy than demolition and new construction.

**Assure adequate appropriations to meet Section 8 renewal needs in FY '08.**

The Administration is requesting \$300 million less for contract renewals in 2008 than the amount approved for 2007; a funding level that likely falls short of what will be needed to renew all Section 8 contracts expiring in 2008. The National Housing Trust estimates that the president's request of \$5.523 billion for contract renewals is at least \$400 million short of what will be needed.

**Solution**

Congress should appropriate adequate funds to assure the renewal of all expiring contracts.

**Enact Mark-to-Market program reforms.**

Since its enactment 10 years ago, the Mark-to-Market program has preserved 125,000 affordable apartments through full debt restructurings at an estimated savings to the taxpayer of \$2.1 billion. When it was reauthorized in January 2002, the program was improved modestly, to take into account lessons learned during the initial five years of implementation. In 2006, additional improvements were proposed that would have benefited properties and residents by:

- making a broader range of properties eligible for Mark-to-Market debt restructuring;
- extending HUD's authority to approve rents in excess of 120 percent of FMR when necessary to preserve properties; and
- broadening the base of previously restructured properties that could benefit from not-for-profit purchase incentives and lengthening the period of time after an initial restructuring during which such incentives could be utilized.

The case for each of these improvements is provided below.

**Making a broader range of properties eligible for Mark-to-Market debt restructuring.** Bills introduced in the 109<sup>th</sup> and 110<sup>th</sup> Congresses would make two types of properties eligible for M2M debt restructuring: (1) otherwise-eligible properties with rents at or below market eligible and (2) properties in presidentially declared disaster areas. By extending program eligibility to these types of properties, Congress could preserve additional apartments and save additional taxpayer dollars through avoidance of default. The Congressional Budget Office (CBO) scored a savings on the measure extending eligibility to properties in presidentially declared disaster areas. Using the same "avoidance of default" methodology, a savings would accrue from extending eligibility to otherwise-eligible properties with rents at or below market. In fact, over the life of the M2M program, HUD has renewed Sec. 8 contracts (without mortgage restructuring) on more than 10,000 projects whose rents were at- or below market, and 190 of those properties (representing 18,000 affordable apartments) subsequently defaulted. Within the next five years, contracts on approximately 1,500 properties with rents expected to be at- or below market will expire. Of these properties, 1,016 have troubled physical scores, 476 have troubled financial scores, and 377 properties have both. These low financial and physical scores have been proven to have significant statistical correlation to potential for default.

**Extending HUD's authority to approve rents in excess of 120 percent of FMR (exception rents) when necessary to preserve properties.** HUD's ability to approve exception rents is capped at 5 percent of the restructured portfolio. This cap will be reached in April 2007. Beyond that date, the restructurings of approximately 1,000 units that are eligible for exception rents will need to be put on hold until more units become available. HUD will have to determine whether to mark the rents down to market during the hold period, which puts properties at risk, or continue to pay the above-market rent subsidies. Further, many properties need Exception Rents over 120% because of extensive physical rehab needs and/or because they are financially not viable, and both situations will likely worsen if the restructure is put on hold. Lastly, low-income housing tax credits are often combined with Exception Rent transactions, allowing extensive rehabilitation of HUD-subsidized properties using non-HUD funds. Hold times will negatively impact properties' ability to utilize state-allocated credits within a tax credit cycle. Properties requiring exception rents are often the most at-risk properties in the portfolio in terms of physical condition, financial health, and local need for affordable housing preservation. By definition, the properties are not financially viable at market rents. Not restructuring them substantially increases default and foreclosure risk to FHA/HUD, and risk of loss of the units from the affordable stock. According to HUD, the majority of transactions utilizing exception rents over 120 percent of FMR still result in Sec. 8 savings, because the restructured rents, though above market, are lower than the rents prior to restructuring.

**Broadening the base of previously restructured properties that could benefit from not-for-profit purchase incentives.** The average rehabilitation per unit of properties going through a M2M debt restructuring is just under \$2,000. When tax credits are involved, the average rehab. per unit increases to approximately \$30,000 per unit. Many state housing finance agencies give a preference in their qualified allocation plans to not-for-profit organizations and/or preservation. Access to LIHTCs is one of the many benefits that not-for-profit purchasers bring when they purchase properties that have already gone through a M2M debt restructuring. In recognition of this fact, Congress enacted not-for-profit purchase incentives when it reauthorized the M2M program in 2002. Specifically, the HUD Secretary is authorized to assign secondary M2M debt to a qualified not-for-profit purchaser or to forgive that debt entirely. HUD's Office of General Counsel (OGC) has limited to three years (after the initial restructuring) the period of time during which the HUD Secretary can exercise this authority, undermining the utility of this preservation tool. According to HUD, as of February 1, 2007, 65 percent of the closed portfolio is already beyond the three year eligibility window, and the number will increase to 75 percent by the end of FY 2007. Recently, HUD has further undermined the not-for-profit purchase incentives created by Congress by requiring a repayment of junior M2M debt in transactions involving the use of the incentives when a nonprofit assembles additional funds to benefit the property. Congress should prohibit HUD from capturing the value added by a nonprofit purchaser. This policy requires a legislative fix.

### **Solution**

The 110<sup>th</sup> Congress has already extended the Mark-to-Market Program through September 30, 2011, but it has not enacted the program improvements described above. These improvements could become law through the enactment of S. 131 and H.R. 647, companion bills that have already been introduced in the 110<sup>th</sup> Congress. Section 4 of each bill contains language extending the program through September 30, 2011. As this extension has already been accomplished via Public Law 110-5, Sec. 4 could be dropped from each bill. Specifically, the bills would improve the Mark-to-Market program by:

- Extending eligibility to otherwise-eligible properties with rents at or below market eligible and properties in presidentially declared disaster areas;
- Lifting from 5 to 9 percent of the restructured portfolio the cap on HUD's ability to approve exception rents; and

- Extending from three to five years the period during which the HUD Secretary can choose to exercise the not-for-profit purchase incentives and prohibiting HUD from requiring repayment of junior M2M debt in deals involving state or locally allocated housing resources.

### **Preserve properties with maturing mortgages and protect tenants.**

About 200,000 units in properties with HUD-subsidized mortgages and rent restrictions are scheduled to expire by 2013. When mortgages and affordability restrictions expire, under current law neither the housing nor the tenants have access to preservation resources or protections. In 2004, in the 108<sup>th</sup> Congress, Chairman Frank introduced H.R. 4679, the Displacement Prevention Act, to address this problem. The bill authorized assistance to owners and purchasers, for rehabilitation, acquisition, or rent subsidies, in exchange for extending the term of affordability restrictions. The bill also authorized enhanced voucher protections for tenants where the housing is not preserved. Although hearings were held, the bill was never acted upon, nor revised to reflect the suggestions made at the hearing.

### **Solution**

Before enactment, revise the proposed Displacement Prevention Act to reflect the recommendations previously made by NPWG members, including the following:

- To help preserve properties with maturing mortgages:
  - cover all properties with a HUD-insured or HUD-held mortgage that are subject to budget-based rent restrictions, since many were not deregulated and deserve the same protection as the Section 221(d)(3) BMIRs and 236s
  - permit rehab funds to be made available as either loan or grants, to maximize tax credit equity
  - permit HUD to defer or extinguish prior Flexible Subsidy loans as part of a preservation plan
  - clarify that nonprofit acquisition grants can cover acquisition, rehab, and transaction costs, if not funded otherwise, and that HUD-set, per-unit grant limitations should be flexible in light of variable real estate markets
  - clarify that existing nonprofit owners have access to the same rehabilitation assistance and similar rental assistance as for-profit owners, especially if rehab funds do not cover all costs
  - clarify that “nonprofit entities” include limited partnerships or limited liability corporations controlled by the nonprofit organization or its affiliate
  - in the case of an acquisition by a not-for-profit preservation purchaser who commits to renewed, extended affordability and brings additional resources allocated by a unit of state or local government, award 15-year project-based assistance subject to annual appropriations
  - provide more specific guidance on HUD’s authority to determine which market areas qualify for affordability assistance
- To protect tenants:
  - ensure tenant participation and endorsement of preservation planning
  - establish suitability requirements (track record and responsiveness to tenants) for owners and purchasers
  - clarify that the extended affordability restrictions include the preexisting budget-based rent schedule and the duty to renew any expiring project-based subsidy contracts and to accept vouchers
  - establish that tenants may enforce the preservation subsidy requirements and affordability restrictions
  - require HUD to make enhanced vouchers available at a specific point prior to maturity, to enable tenants who wish to move time find other housing and move

- o strengthen notice requirements by requiring owners to certify that they will accept any vouchers ultimately provided (as per HUD Renewal Guide), and requiring a second notice closer to the maturity date concerning the owner's final decision, and specifying other remedies for noncompliance

The National Housing Law Project is available to assist in drafting legislative language to revise H.R. 4679 (included in Appendix) to implement any of the improvements described above.

**Convert Rent Supp / RAP contracts to project-based Section 8.**

There are approximately 35,000 apartments with Rental Supplement (Rent Supp) and Rental Assistance Payment (RAP) contracts. Over the next 10 years, the contracts on 21,433 of these apartments will expire. By 2029, all of the apartments will have been lost to contract expiration. These contracts exist in 35 states, but the majority of them are located in New York, New Jersey, Massachusetts, Michigan, Illinois, Virginia, Washington State, and California, as the table below demonstrates. In addition, owners are not permitted to mark up to market, and as a result needed recapitalization is deterred and some owners have an incentive to prepay underlying mortgages, resulting in loss of the rental subsidy.

State	Rent Supp/RAP Units
New York	17,091
New Jersey	4,775
Massachusetts	2,697
Michigan	2,619
Illinois	1,411
Virginia	916
Washington	851
California	804

Under current law, at the expiration of a contract issued with Rent Supplement (Section 101 of the Housing and Urban Development Act of 1965 (12 U.S.C. Section 1701s)) or Rental Assistance Payments (Section 236(f) (2) of the National Housing Act (12 U.S.C. 1715z-1)), an owner has no right to renew the contract, and tenants are eligible for enhanced vouchers only under limited circumstances.

**Solution**

Congress should permit owners to convert Rent Supp and RAP subsidies to project-based Section 8 assistance. This action would protect low-income tenants in danger of losing their homes, save valuable rental housing, and in some cases make it possible to mark rents up to market to facilitate rehabilitation. This proposal has been scored by the Congressional Budget Office as creating over \$700 million savings in the first two fiscal years it is in effect. The savings are derived from the cancellation of long term-contracts and their replacement with one-year contracts subject to appropriations.

**Preserve state-HFA financed properties.**

Nationwide, there are more than 150,000 affordable apartments at state-financed properties with long-term, project-based Section 8 contracts but without HUD/FHA financing. Between 2007 and 2012 alone, more than 47,000 affordable apartments are at risk as project-based Section 8 contracts begin to expire. At mortgage maturity, owners will have to decide whether to renew their contracts or opt out of the Section 8 program. The potential exists for many property owners to make substantial profits by converting the housing to condominiums or more expensive apartments, either by opting out of the program at contract expiration or by prepaying the state HFA mortgage and terminating the Section 8 contract early.

**Solutions**

There are three easy, non costly solutions that would go a long way toward saving this housing. Specifically, HUD should clarify that it will continue to provide project-based Section 8 upon prepayment of such a property, and it should permit owners to mark-up-to-market.

1. Provide that, should an owner of one of these properties want to refinance prior to maturity, HUD will continue to provide project-based Section 8.

A controversial 2002 opinion from HUD's Office of General Counsel (OGC) threatens approximately 900 Section 8 projects financed under the set-aside program for state housing finance agencies. The OGC ruled that under Section 8 contract language in effect until 1980, the contracts terminated when the HFA mortgages were prepaid. The opinion is not the only reasonable reading of the HAP contract language and is contrary to the regulations in effect at the time and to decades of HUD practice approving such prepayments. HUD has not actually terminated contracts but has issued no guidance clarifying the effect, if any, of the OGC opinion. The lack of clarity has created a chaotic situation that, combined with the problem described below, actually encourages prepayments. The proposed legislative language cures this problem without federal expenditures.

2. Allow owners of such properties the right to mark up to market prior to contract expiration in exchange for an extended Sec. 8 commitment.

Owners of non-HUD insured, state-HFA financed properties are unable to mark-up-to-market (MU2M) or mark-up-to-budget, because their long-term contracts have not yet expired. While they will be eligible to MU2M at contract expiration, many owners either cannot or do not wish to wait. As a consequence, some properties are falling into disrepair. In other situations, owners are anxious to prepay and increase the rents to much higher, market levels via prepayment. This policy effectively provides owners an incentive to prepay their mortgages, and they can use the OGC opinion described above to terminate their HAP contracts. By permitting — not requiring — such owners to MU2M prior to contract expiration in exchange for a commitment to renewed, long-term affordability, Congress could preserve thousands of affordable apartments assisted with project-based Section 8.

3. Permit the cancellation of fully funded, long-term Section 8 contracts and their replacement with new, 20-year contracts subject to annual appropriations in the case of refinancings by preservation owners or sales to preservation purchasers.

#### **Permit Mod. Rehab. properties to mark up to market.**

In the Section 8 Mod. Rehab. program, project-based Section 8 Housing Assistance Payment (HAP) contracts were issued for 15 years by public housing authorities at cost-based rents. Nearly 60,000 affordable apartments currently benefit from Section 8 Mod. Rehab. assistance. When these contracts expire, renewing owners are prohibited from entering the mark-up-to-market process. As a result, these contracts, many of which are deeply below market level, can be adjusted by only a modest operating cost adjustment factor. On the contrary, if owners were able to renew under mark-up-to-market, they would enjoy a significant increase in net income, with all of the benefits flowing to the property and the residents. Under current law, however, even preservation-oriented owners and purchasers have reluctantly been terminating Mod. Rehab. HAPs, resulting in the loss of much-needed deep affordability. In addition, some public housing authorities administering Mod. Rehab. HAPs have refused owners' requests to renew contracts, arguing that MAHRA does not impose the same renewal duty on a PHA as it does with HUD. (A separate problem, the prohibition against the use of Low Income Housing Tax Credits (LIHTC) with continuing Mod. Rehab. Section 8 contracts, also contributes to the loss of Mod. Rehab. apartments, with owners exiting the program in order to access LIHTC equity.)

#### **Solution**

Amend Section 524 of MAHRA to enable Mod. Rehab. Section 8 renewals to be treated in the same way as other project-based Section 8 contracts. Properties that have already renewed subject to the existing language should be given a "hold-harmless" opportunity to restore rents

to the level that would be in effect if not for the existing restrictions. Our proposed legislative language does not provide retroactive rent hikes for moderate rehab properties that have already been renewed but does require that public agencies renew Section 8 mod rehab contracts when requested by the owner.

**Enact a federal first right of purchase.**

For most federally assisted housing, with the exception of Rural Development (RD) properties facing prepayment, federal law establishes no protections for the property when the owner seeks to convert the property to market-rate use. For most converting properties, tenants receive enhanced vouchers or other vouchers, with subsidies set at comparable market rent and supported wholly by federal appropriations, but the housing is lost as an affordable housing resource to the community, despite years of federal investment. For RD properties facing prepayment, Congress established a right for preservation entities to purchase properties at fair market value prior to conversion. (Congress also established similar preservation buyouts at market value for many HUD-subsidized properties facing prepayment in the LIHPRHA program, which remains on the books but has received no funding for almost an entire decade.) Illinois, New York City, and Rhode Island have legislated similar policies.

**Solution**

Require owners proposing to end participation in federal affordable housing programs (at least HUD and RD programs) to offer the properties for sale at fair market value to preservation purchasers, at least for the notice period. Purchasers would have to assemble the resources to support any purchase, using the existing array of federal, state, and local programs, as well as any made available in the future (e.g., project-based enhanced vouchers).

**Protect state/local preservation laws against preemption.**

Existing state and local preservation laws across the country risk nullification unless Congress clarifies that the preemption provisions of the long-dormant Low Income Housing Preservation and Rental Homeownership Act (LIHPRHA) are inapplicable to properties that never participated in that program.

Facing uncertainty concerning the federal government's preservation policies, many state and local governments have enacted notice requirements to enable them to take responsive preservation activities. Federal court decisions since July 2003 now threaten the authority of state and local governments to address the impacts of threatened conversions. Notwithstanding the fact that LIHPRHA is no longer operational for providing federal incentives to preserve additional properties, as well as clear legislative history that Congress intended to build upon state and local preservation policies, the Eighth and Ninth Circuits have held that owners of properties that never executed a LIHPRHA preservation plan may nevertheless use LIHPRHA's express preemption provision to invalidate state and local protections prior to prepayment. The Eighth Circuit has also held that Minnesota's preservation laws are invalid under the conflict preemption doctrine; using logic that threatens any state and local preservation notice law applicable to various federally assisted properties, it rejected any deference to HUD's position that LIHPRHA did not preempt state laws for non-LIHPRHA properties.

Unless revised or repealed, LIHPRHA's express preemption provision and unfounded use of the conflict preemption doctrine will continue to jeopardize state and local prepayment notice laws in nine states (California, Connecticut, Illinois, Maine, Maryland, Minnesota, Texas, Rhode Island, and Washington) and the District of Columbia, and an additional seven cities (Denver; Los Angeles; New York City; Portland, Oregon; San Francisco; Santa Cruz, CA; and Stamford, CT). Despite their narrow original purpose to ensure that owners receive full federal preservation incentives provided under LIHPRHA, these federal laws have since been judicially interpreted to

impede state and local efforts to craft preservation responses and tenant protections suited to local conditions.

### **Solution**

Congress should amend Sec. 232 of the Low Income Housing Preservation and Resident Homeownership Act (LIHPRHA) to clarify that

- the statute does not apply to properties that are not regulated by a LIHPRHA plan of action, and
- state and local preservation initiatives for at-risk, federally subsidized properties are not otherwise preempted.

### **Permit owners to retain project-based assistance in lieu of enhanced vouchers.**

Enhanced vouchers are provided to protect existing tenants from displacement upon the occurrence of an “eligibility event” in a multifamily housing project — generally prepayment of the subsidized mortgage or termination of a rental assistance contract. Upon turnover, these vouchers move with the tenant, and the housing is lost as a resource for future low-income families. Authorizing project-based voucher assistance in lieu of enhanced vouchers will make it possible both to protect existing tenants in a project and to preserve the affordability of units at the project where an owner/preservation purchaser chooses to do so. Project-basing the assistance will provide a financeable revenue stream for preservation-oriented owners and purchasers, without which many worthwhile projects, especially in strong markets, have been forced to exit the affordable program.

### **Solution**

Permit owners to retain project-based assistance, subject to the approval of the PHA. Preservation project-based voucher assistance would be subject to the general rules for project-based voucher assistance, except that it would be exempt from the 25 percent cap on project-based units, it would be disregarded for the purpose of calculating the 20 percent limitation on attaching PHA funding to structures, and it would cover all existing tenants in the project who would otherwise receive enhanced vouchers. In addition to preserving desperately needed affordable units, this provision may result in reduced Section 8 subsidy costs, because maximum rents for project-based voucher assistance (generally 110 percent of fair market rent) in strong market areas may be less than the market rent levels that would otherwise apply for enhanced voucher assistance. Although not required by our draft language, in those situations where only regular vouchers are provided as replacement subsidies due to the narrow technical requirements of the enhanced voucher statute, Congress should also consider permitting nondefaulting owners or purchasers to retain that assistance as project-based as well, with similar exemptions from project-based voucher program rules.

### **Protect the ability of owners to use Section 8 incremental financing.**

Housing agencies across the country have used the project-based voucher program to spur production of new affordable housing in communities where there is an inadequate supply to meet the needs of voucher holders. In particular, innovative agencies have used project-based vouchers to create permanent supportive housing targeted to the chronically homeless. On October 13, 2005, without any notice and contrary to the policy in effect since the statutory provision was added in late 2000, HUD published a Final Rule on the project-based voucher program that eliminated agencies’ discretion to set rents at market when units also receive housing tax credits (a practice known as “Section 8 incremental financing”). In addition, by creating the risk that state and local housing agencies will be required to reduce subsidy payments if HUD reduces the fair market rent by 5 percent or more, the Final Rule also undermined the ability of such agencies to leverage project-based Section 8 vouchers and of housing developers to borrow funds based on a long-term project-based voucher contract.

### **Solution**

Restore the ability of state and local housing agencies to enter into project-based voucher contracts at market rents in buildings financed by Low Income Housing Tax Credits. Establish safe harbor future rents for ongoing project-based voucher contracts.

### **Affirm that HUD has a requirement to maximize preservation.**

HUD has often failed to preserve at-risk affordable housing in policy areas where it has discretion to do so. For example, after Congress gave HUD “flexible authority” to dispose of troubled housing “regardless of any other provision of law,” more than 100,000 units have been sold with vouchers in the past decade when most could have been sold with project-based Section 8 and preserved as affordable housing.

HUD’s failure to use its discretion to preserve at-risk housing was a focus of Senate hearings in 2000 (for troubled housing) and October 2002 (for HUD’s multifamily stock overall.)

### **Solution**

H.R. 44 would repeal HUD’s “flexible authority” regarding the disposition of foreclosed and HUD owned buildings. Congress should additionally direct the Secretary to exercise HUD’s other discretionary powers in a manner which preserves and improves the at-risk stock for current and future Section 8 eligible tenants. We understand the Senate has prepared proposed legislative language to accomplish this objective, following a hearing on Mark to Market extension in June 2006. We support enactment of this proposal.

## **SECTION II: Restore housing at risk of loss due to deterioration.**

HUD multifamily properties are at risk of conversion to market rate or demolition when the property is in poor condition or where the owner has other properties in extremely poor condition or has committed serious program violations. For properties with a Section 8 contract, this risk may occur at or about the time of contract expiration or during a contract term. These properties risk (1) owner default on the mortgage and termination of restrictions or subsidy through HUD’s foreclosure and “property disposition” process and (2) disqualification or termination from the Section 8 program, usually due to a refusal by HUD to renew the Section 8 contract. The problems of the building and its impact on the community will rarely be solved by termination of Section 8. Instead, a number of non-costly changes should be made to help save these properties, so long as project-based Section 8 is maintained.

Despite the financial or physical distress of such properties, it is not uncommon for tenants, nonprofits, and local governments to desire to preserve and improve them. Often, the properties have history of serving very low-income elderly renters or families. Often, local groups believe a change in ownership will help put the project back on the right path.

**Foreclosure and property disposition.** After default, HUD takes an assignment of the mortgage from the original lender in exchange for an insurance payment and becomes the lender for the project. HUD has broad discretion to assure repairs, take possession and operate the property, terminate or extend the Section 8 contract, and force a change in ownership via foreclosure or the threat of it, where major defaults persist. If HUD is the high bidder at the foreclosure sale, HUD takes title to the property and then tries to sell it through the property disposition program.

In 1988 and 1994, Congress adopted and revised a comprehensive preservation policy for troubled properties facing foreclosure and disposition. However, starting in 1995, Congress

granted HUD “flexible authority” (12 U.S.C. §1715z-11a(a)) that HUD has used to ignore those requirements.

For properties acquired by HUD, state and local governments have a right to negotiate the purchase of the property from HUD. HUD is also authorized to make so-called “Up-Front Grants” to purchasers for rehabilitation costs, and until recently funded these grants from the insurance fund. However, as a practical matter, by requiring such grants from the insurance fund to be backed by an appropriation, the Deficit Reduction Act of 2005 effectively eliminated this important preservation tool for troubled properties.

**Renewal of the Section 8 contract.** Renewal of the Section 8 contract is invariably an important part of a preservation solution for these properties, although HUD may require a transfer to new ownership. Under recently enacted law (Section 311 of the FY 06 Appropriations Act), extended for FY 2007, HUD is required to “maintain any rental assistance payments under section 8...that are attached to any dwelling units in the property,” unless the Secretary determines that the property is “not feasible for continued rental assistance payments under such section 8.”

Because both the “flexible authority” and the Deficit Reduction Act impede a comprehensive preservation program, a variety of legislative changes are still needed to enable preservation and improvement of these properties. This section highlights those proposals.

**Require HUD to maintain project-based Section 8 in HUD dispositions.**

An essential ingredient of preserving HUD multifamily properties facing foreclosure or other disposition is retention of the project-based Section 8 contract. Section 311 of the FY 2006 Appropriations bill generally requires HUD to maintain project-based Section 8 contracts when selling properties at foreclosure or from the HUD inventory (P.L. 109-115, 119 Stat. 2936, §311 (2005)). This provision was apparently carried forward as part of the FY 2007 Joint Funding Resolution, which incorporated FY 2006 terms and conditions unless specifically altered.

Section 311 also suffered from language added by the House in conference that allowed HUD to make exceptions where such action is determined infeasible, “based on consideration of the costs of maintaining such payments ... or other factors.” HUD’s May 31 guidance contains several limitations that improperly impair retention of project-based contracts. Specifically:

- Existing Section 8 contract rents, adjusted only per the OCAF formula and no other available authorities (e.g. Mark Up under MAHRAA Section 524), must be sufficient to carry both the operating costs and any debt service on needed repairs, irrespective of other available funding sources and any adjustments ordinarily available; while HUD may sell a property with Section 8 where contract rents alone are insufficient to support operation and rehab, it need not do so.
- “Deteriorated neighborhood conditions” would justify terminating the contract.
- Section 8 assistance will only flow after substandard conditions are remedied.
- HUD need not bid in its mortgage debt and take title to the property, thus undercutting the ability to create local preservation strategies outside the accelerated foreclosure auction process that is often ill-suited to this purpose.
- Both the statutory mandate and HUD’s policy cover just Section 8, not other similar subsidies.
- Residents are consulted only after HUD has made its decision.
- In some cases, as permitted by HUD’s May 31 memo, HUD has avoided Section 311 by terminating or abating the contract prior to placing the property into foreclosure, so there is no Section 8 contract left to maintain because the contract authority has already been used for vouchers.

- Finally, courts have ruled that the current “flexible authority” even allows HUD to ignore Fair Housing and civil rights laws in making disposition decisions.

### **Solution**

Congress should therefore revise Section 311’s language to address these deficiencies and further the preservation goal.

### **Strengthen protections for troubled properties.**

Every year, HUD is required to address the problems of numerous properties in its portfolio that have fallen into disrepair and/or financial distress. Nevertheless, if repaired and placed under responsible ownership, these properties are often a viable community resource. HUD needs additional tools and guidance — without substantial additional cost — to help resolve these problems.

### **Solution**

Revising Section 311 as recommended above would require HUD to maintain project-based Sec. 8 contracts when foreclosing on HUD-assisted properties with HUD-held mortgages or disposing of HUD-owned properties, as well as when taking other enforcement actions under the contract prior to foreclosure. In addition, Congress should enact Sections 3, 4 (b), and 6 of H.R. 44, introduced in the 110<sup>th</sup> Congress, which would:

- Repeal HUD’s “flexible authority,” which HUD has used to relieve itself of obligations to maintain affordability and quality requirements. This, in turn, would require HUD to use all legal tools available, including those established by Congress in 1994 (12 U.S.C. §1701z-11), to ensure future affordability and sufficient renovation of HUD-held and HUD-owned buildings.
- Require HUD to maintain rental assistance to buildings that are undergoing rehabilitation as part of a preservation transfer, while escrowing these funds until the building or units meet housing quality standards, at which time escrowed funds will be made available to the property.
- Amend existing law to grant HUD’s non-judicial foreclosure authority to Units of Local Government that have been designated by HUD as part of the note and mortgage sale process. Authorized Units of Local Government will, in turn, have the ability to determine how to handle physically or financially distressed buildings, including moving to foreclosure. HUD-authorized Units of Local Government must manage and dispose of such projects in a manner that will benefit those originally intended to be assisted under the prior housing program.

### **Strengthen cities’ right of first refusal.**

A key tool for preserving distressed HUD-held and HUD-owned buildings is the ability of Units of Local Government to exercise their statutory right of first refusal to purchase buildings that become HUD-owned. Historically, negotiations regarding sales price for buildings sold by HUD to local government housing agencies were based on number of industry standards, including projected income, operating expenses, and estimated repair and rehabilitation needs. Ostensibly because of the Deficit Reduction Act of 2005, in May 2006, HUD issued guidance stating that it will no longer consider repair or rehabilitation costs in determining an appropriate sales price for HUD-owned buildings and HUD-held loans. These policies directly raise preservation costs for local government purchasers and their private, preservation-motivated designees. Because purchasers must effectively pay twice for these repair costs, such policies make it nearly impossible for any responsible government housing agency and/or any subsequent preservation developer to preserve properties that have HUD-held loans or are HUD-owned.

## **Solution**

Enact Sec. 5 of H.R. 44, which has been introduced in the 110<sup>th</sup> Congress, which specifies that, in determining the market value of all multifamily real property and multifamily loans, the Department shall use industry standard appraisal practices, including, but not limited to, consideration of the cost of needed repairs to at least minimum code standards and maintaining the affordability restrictions of the original loan or grant.

### **Permit owners to transfer project-based Section 8 to another property.**

HUD's authority to approve transfer of "Section 8" project-based assistance (PBA) from physically obsolete or economically non-viable projects to new developments — a useful tool for preserving affordable housing resources that otherwise would be lost — was established by a statute enacted in the late 1990s (42 U.S.C. §1437f(bb)) and again recently in Section 318 of the FY06 HUD Appropriations Act. These statutes have differing requirements. Section 318's highly prescriptive language has impeded the ability of assisted property owners and preservation purchasers to complete transactions.

Sec. 318 expires on September 30, 2007. With a few improvements, the effectiveness of this tool in promoting preservation and neighborhood revitalization could be greatly improved.

(We note that H.R. 1227, introduced on February 28, 2007, contains language permitting the transfer of project-based rental assistance from dwelling units damaged during Hurricanes Katrina or Rita. Our recommendation envisions greater flexibility in the use of this important tool than permitted in the bill, with the goal of maximizing its utility as a housing preservation resource.)

## **Solution**

Congress should permanently extend the Secretary's authority to approve transfer of "Section 8" PBA, and make the following changes in the law:

- Expand the definition of eligible projects to include properties assisted with all types of PBA, e.g., Section 8 mod rehab and others not listed.
- Strengthen tenant endorsement and local government support provisions.
- Provide flexibility to transfer PBA to multiple properties, and to make partial transfers of PBA contracts, retaining some units on-site, provided that there is no reduction in the total number of project-based units.
- Allow temporary tenant relocation prior to the availability of new units at the receiving project, consistent with comparable programs.
- Allow flexibility to change unit mix/configuration of units in replacement housing while maintaining the same number of assisted units.
- Authorize prepayment or defeasance of FHA-insured loans in connection with PBA transfer so long as substantive use restrictions are preserved at the receiving project.
- Allow a subordinate lien position on transferred HUD or FHA-insured debt.
- Allow increases in Federal liability and FHA Insurance Fund exposure, to the extent necessary to secure project financing, as determined by the Secretary.
- Allow flexibility for rent increases where the receiving project is covered by the programs established by the Multifamily Assisted Housing Reform and Affordability Act of 1997 (Mark-to-Market, Mark Up to Market, Mark Up to Budget, etc.), and standard contract extensions similar to that extended to other comparable projects.
- Affirm applicability of existing fair housing laws and regulations.

These changes would extend the life and improve the effectiveness of an important assisted housing preservation tool for thousands of units at risk of loss in physically obsolete and economically non-viable projects.

### **Restore the Up-Front Grants program.**

In 1994, Congress revised the Multifamily Housing Property Disposition Reform Act in order to relax certain property disposition requirements that, in combination with insufficient appropriations, had created a bottleneck at HUD. At the time, there were more than 500 properties in HUD's foreclosed portfolio and hundreds more in the pipeline due to HUD's inability to deal with the problem. As part of the Act, Congress permitted the Secretary to "provide up-front grants for the necessary cost of rehabilitation and other related development costs" from FHA's General and Special Risk Insurance Fund. Congress reiterated HUD's authority to provide such grants several years later, at least when disposing of HUD-owned properties, as part of the "flexible authority" statute (12 U.S.C. §1715z-11a(a)). The Deficit Reduction Act of 2005 ended FHA's mandatory spending authority for rehabilitation grants, effectively eliminating the Up-Front Grants program by requiring any such grant to be backed by an appropriation.

#### **Solution**

Enact H.R. 44, which has been introduced in the 110<sup>th</sup> Congress. Sec. 2 of H.R. 44 will authorize the HUD Secretary once again to provide grants (including up-front grants) and loans from the General and Special Risk Insurance Fund when managing and disposing of HUD-held and HUD-owned multifamily properties.

### **Assure that purchasers are in compliance with local/state housing/health codes.**

No one — not residents, the local government, or HUD — wants a HUD-assisted property to be acquired by an owner who is in substantial violation of local or state housing or health codes. Section 219 of the 2004 HUD/VA appropriations act (Pub. L. No. 108-199) required that HUD establish rules ensuring that other properties owned by prospective buyers of HUD-owned properties and those with HUD-held mortgages facing foreclosure be in substantial compliance with state and local health and building codes. HUD's rules have still not been finalized, and fail to account for substandard properties located outside of the local jurisdiction where the HUD property is located. Moreover, the existing requirement does not apply to ordinary transfers of non-troubled properties.

#### **Solution**

Enact Sec. 7 of H.R. 44, which has been introduced in the 110<sup>th</sup> Congress, which assures that buyers of any HUD-owned, HUD-assisted, or HUD-insured multifamily housing property must be in compliance with local/state housing/health codes.

### **Fund Section 531 rehab grants funded by Interest Reduction Payments.**

Every year HUD has access to a substantial amount of already appropriated but unused affordable housing funds that result from prepaid or terminated Section 236 interest subsidy (IRP) contracts. More than eight years ago, in Section 531 of MAHRAA (Pub. L. 105-65), Congress directed that these funds be used for rehabilitation of HUD multifamily properties. However, HUD never implemented the program, and late in FY 2002 Congress rescinded the accumulated \$300 million (Pub. L. No. 107-206, 116 Stat. 820, 892 (Aug. 2, 2002)). The President's FY 2008 Budget indicates that about \$45 million will return to the Treasury as a result of prepayments and foreclosures on Section 236 properties with appropriated IRP. As Congress recognized a decade ago, these funds can provide important new incentives, coupled with new use restrictions, to preserve and improve properties still at risk of conversion to market-rate.

#### **Solution**

Congress should require that these resources be used as intended by making an appropriation that redirects these funds, as well as mandating HUD action to implement the rehabilitation program.

### **SECTION III: Protect and empower residents facing conversion.**

Since the mid-1990s, when conversions of privately-owned federally assisted properties to market-rate were first authorized, Congress has intended that residents facing conversion be protected with replacement vouchers, and that communities not suffer a reduction in the total number of affordable housing units. In addition, when MAHRAA was enacted in 1997, Congress established the Section 514 program to support education and outreach to affected tenants so that they might work with their communities to preserve their homes or take steps to address any conversion, as well as to offset predevelopment expenses for nonprofit preservation purchasers. HUD has taken steps that are inconsistent with these policies (at least until recently when HUD committed to restarting a Section 514 program), necessitating several legislative corrections to ensure that these provisions operate as originally intended.

#### **Assure that tenant protections are guaranteed as Congress intended.**

To protect tenants facing displacement, in 1999 Congress passed unified authority requiring HUD to provide “enhanced vouchers” for all tenants facing specified housing conversion actions, including owner opt-outs and prepayments ((42 U.S.C. §1437f(t)). In 2000, Congress acted again to clarify the tenant’s right to remain in their home (Pub. L. No. 106-246, §2801 (July 13, 2000)). Unfortunately, the law as written and implemented by HUD fails to clearly protect tenants, as Congress intended, in several important respects: some owners still refuse to accept the voucher and, even if the owner accepts it, the lease fails to set forth the good cause for eviction requirement; PHAs use screening to deny assistance to some tenants previously assisted at the property prior to subsidy conversion; and tenants, usually elderly empty nesters, can be displaced by family/unit size mismatches that would not have threatened their home absent the subsidy conversion.

#### **Solution**

Legislative revisions should address these shortcomings by:

- Clarifying the owners’ obligation to accept the enhanced voucher and evict only for good cause, and requiring this protection to be set forth in the lease;
- Guaranteeing that all affected tenants receive vouchers by clarifying the prohibition on PHA re-screening; and
- Protecting both “empty nesters” and large families facing displacement due to family/unit size mismatches. Congress should allow tenants to remain in their homes with enhanced vouchers until a unit of appropriate size becomes available at the property.

#### **Provide vouchers for residents of all converted units.**

In 2006, against all previous practice, HUD adopted a policy that has caused — and will continue to cause — great harm to our nation’s affordable housing stock. Congress must make clear its desire to have all lost affordable units replaced so that we don’t backslide on our nation’s commitment to affordable housing.

Affordable housing is lost to communities when public housing is demolished or owners of private apartments choose to end their participation in federal subsidy programs. Under previous policy, HUD was required to issue housing vouchers to replace every unit of federally-assisted housing that is lost through demolition or conversion to market rate. These “tenant-protection” vouchers enable some tenants to remain in privately-owned apartments at market

rents or help displaced families to relocate to housing that is affordable. Replacement vouchers ensure that communities will not suffer an overall reduction in affordable housing resources.

In PIH 2006-5, on p. 4, buried in an item headed “Tenant Protection Fees,” the notice states “HAP and administrative fee funding will only be provided for occupied units in the affected project at the time of the PHA’s application for such voucher funding.” It is not clear whether this “policy” applies only to replacement of public housing or also to private housing conversion actions. In either case, it contravenes the language of the 2006 appropriations act (which clearly provides funds for “replacement” and not only for “relocation”), prior HUD notices (which it does not refer to), and sections 18(h) and 24(d)(1) of the U.S. Housing Act, 42 U.S.C. §§1437p(h) and v(d)(1). HUD’s policy to award vouchers for the full number of subsidized units lost is contained in Notices PIH 2005-15 (April 26, 2005) and 2004-4 (March 29, 2004) (for public housing) and PIH 2001-41 (for conversion of privately-owned units). In the latter notice at pages 9 - 10, HUD states: “When HUD provides vouchers to a PHA as the result of a housing conversion action, HUD will offer housing choice voucher funding on a one-for-one replacement basis to make up for the loss of the affordable housing units in the community, subject to the availability of appropriations.”

Thus, in adopting PIH2006-5, HUD unilaterally decided to terminate the one-for-one replacement policy, without congressional authorization. Henceforth HUD proclaimed that funding for tenant protection vouchers would only be provided for units occupied at the time of the Public Housing Authority’s application for voucher funding. As a result, in FY2006 HUD issued 3,441 fewer tenant protection vouchers than in FY2005. Indeed, conceding that they are proceeding without Congressional authorization, the Administration’s 2008 budget proposals would modify current law to permit HUD to replace only those subsidized units that were occupied just prior to demolition or conversion to market rate. The change in policy would lead to a substantial loss of affordable housing resources in communities that have great need for affordable housing.

Across the nation, there are tens of thousands of people on subsidized housing waiting lists. The demand is overwhelming. We simply cannot afford to lose access to any affordable housing units. Units can be vacant for many reasons – normal turnover, tenants who relocate because their buildings are being converted to market rate or are about to be demolished, etc. While the apartments may be empty at a given moment, they are certainly not empty from lack of people who are in need of affordable housing.

Finally, not having one-for-one replacement will be particularly painful for those on the Gulf Coast, where thousands of units are not currently occupied because of the terrible natural disasters in that area. We urge you to reject the Administration’s proposed changes to this by including an affirmative prohibition on HUD’s attempts to change federal policy through administrative action.

Indeed, the Gulf Coast, which now faces critical shortages of affordable rental housing, would likely be hit particularly hard by the proposed policy change. Thousands of federally-assisted apartments were damaged by the storm, and some of these are likely to be demolished or sold. Under the policy proposed by the Administration, few of these units would be eligible for “tenant-protection” vouchers, however, because most were evacuated by tenants displaced by the hurricane damage.

### **Solution**

The former policy of providing “tenant-protection” vouchers to replace lost subsidized housing units on a one-to-one basis helps communities to sustain affordable housing resources at a time of growing need. The Administration’s proposed changes to this policy should be rejected.

**Ensure a vibrant resident capacity building and predevelopment program in expiring Section 8 and other HUD-subsidized properties.**

For many years, HUD has declined to provide the funding authorized by Congress for predevelopment costs and technical assistance to tenants facing threats to their housing, despite the results of extensive audits that found relatively few violations of congressional restrictions. In addition, the Department has on several occasions provided funding to unqualified groups to work with tenants, and refused to permit grantees to work with tenants facing threats to their homes in a wide variety of programs, both falling within and outside the current statutory authorization.

**Solution**

Revise the statute to clarify that HUD must spend the funds authorized each year, ensure that groups working with tenants are qualified and independent from ownership and management, authorize HUD to provide administrative training to grantees to minimize compliance problems, and clarify that funding can be used to assist tenants residing in a wide variety of privately owned subsidized and assisted housing developments.

**Provide residents with access to building information.**

Residents of HUD housing are HUD's best allies in monitoring and overseeing the public's multi-billion investment in multifamily housing. But residents and their organizations are often hindered by an inability to obtain basic information about their properties, ranging from who owns their buildings, what the property's budget is (except when owners seek a rent increase), available balances and expenditures in Reserve for Replacement accounts, and HUD's subsidy and insurance contracts with the owner.

Although REAC scores and Section 8 Opt Out or Renewal Notices are required by law to be made available to tenants, owners and local HUD offices often fail to make these available, even when requested under the FOIA. (For several years, for example, HUD has declined to make available REAC scores for properties referred to the Enforcement Center — precisely the buildings where residents and communities have the most at stake in knowing what is happening to these homes.)

In addition, HUD's long-standing policy has been to release project operating statements to residents only when owners request rent increases, for a 30 day window only. In January 2006, HUD Assistant Secretary Bernardi compounded this problem by issuing an internal directive discouraging the release of any information under the FOIA which could be embarrassing to current or former HUD officials or policies. As a result, many local offices have withheld even documents, such as approved Mark-to-Market plans, which are plainly releasable to residents under HUD regulations. Some HUD offices have treated any request for subsidy contracts between HUD and private companies as "trade secrets" not subject to public review.

Congressional intervention is needed to reverse this disturbing trend toward increased government secrecy and provide residents the information they need to help monitor the public's extensive investment in subsidized housing. Tenants should be allowed access to basic information affecting their homes.

**Solution**

Section 8 of H.R. 44, the Velasquez Troubled Housing bill, would provide for "transparency regarding building information" by requiring HUD to post on the worldwide web REAC scores, Section 8 Opt Out or Renewal Notices, and Wellstone "prepayment" Notices. This is part of the Early Warning System discussed below. We support the adoption of these provisions.

In addition, adopting the “Tenant Access to Information” language would empower residents with the information they need to improve their conditions and to more fully assist HUD in its monitoring and oversight mission.

**List tenants as third-party beneficiaries on HUD contracts.**

When owners violate HUD contracts, tenants often suffer. HUD is sometimes slow to implement effective enforcement measures. Tenants are listed as third-party beneficiaries on Mark-to-Market Use Agreements, but not on other contracts.

**Solution**

List tenants as third-party beneficiaries on Section 8 Housing Assistance Payments Contracts, Mark-to-Market Restructuring Commitments, and Rehab Escrow Deposit Agreements.

**Enlist tenants as partners with HUD in enforcement.**

HUD’s enforcement of housing quality standards in project-based Section 8 housing is often slow and inflexible, and extremely rare in cases of substandard management and especially for violations of residents rights to organize.

**Solution**

Congress should clarify HUD’s ability to utilize flexible enforcement tools to address violations of housing and program standards, including residents rights. In addition, residents should be empowered to pay their portion of the rent into an escrow fund controlled by HUD, and/or make repairs and deduct the cost from their rent, and to trigger HUD withholding of its portion when they do so, as an incentive to owners to comply with repair and management standards. In addition, communities and residents should be empowered to trigger a special inspection or management review by HUD, in addition to inspections regularly conducted by the Department. (Language allowing a tenant/community trigger for HUD inspections and/or a tenant rent withholding into a tenant/HUD escrow was included in HR 3838, adopted by the House in 1994, and SB 1281, as reported by the Senate Banking Subcommittee, but the two versions were not reconciled or adopted. In addition, an amendment to HR 3838 by Rep. Velasquez allowed Section 8 voucher holders to pay for repairs and be reimbursed by HUD.)

**SECTION IV: Provide better data to facilitate preservation transactions.**

From 1965 to the mid-1980s, the government played an essential role in creating affordable rental housing. The federal government partnered with the private sector by providing interest rate subsidies (Section 236 or Section 221(d)(3) Below Market Interest Rate (BMIR)), or rent subsidies (Section 8), in exchange for a commitment from property owners to keep their apartments affordable to low-income households. As a result of these programs, there are more than 1.5 million federally assisted, privately owned affordable homes in communities across the nation. These apartment homes provide some of the most affordable rental housing in our communities.

These programs established a date where the regulatory relationship or subsidy would end and the owner could convert the property to market rate. Most of these properties have reached that date. Thousands of affordable apartments are lost each year as owners opt out of their Section 8 contract or prepay the subsidized mortgage. In the eight years between 1996 and 2003, the National Housing Trust found that 300,000 units of HUD assisted and/or insured, multifamily housing had been “lost” due to prepayment of the mortgage or loss of the Section 8 subsidy through owner or HUD choice. Appropriate analysis of preservation options for a particular property, including both new ownership capacity and resources, requires property-level data.

Fortunately, HUD has property data available for the 1.5 million federally assisted and/or insured, multifamily, affordable rental units.

**Establish an “Early Warning System” based on existing HUD data.**

Current law requires that owners notify tenants and the federal government of a decision to opt out of a Section 8 contract or prepay a subsidized mortgage. However, there is currently no effort to timely inform the public or preservation minded owners of this event. If HUD timely notified the public of opt out and prepayment notices, or other cases where subsidized housing was at risk, mission minded organizations could offer to purchase the property and preserve the apartments as affordable.

**Solution**

With a minimal investment, HUD could create an “Early Warning System” to help save properties where owners intend to prepay the mortgage, opt out of the HUD subsidy or where HUD enforcement actions may lead to loss of the property’s affordability restrictions. Providing this information in a timely fashion to tenants and the public alike will permit development of appropriate local solutions before the preservation opportunity is lost.

The essence of this proposal is a national database of federally assisted properties where the owner has given notice to prepay the mortgage or opt out of the Section 8 contract. The data would be distributed via the web and other means to the public. Mission minded organizations could then assemble the resources necessary to save the housing. Coupling this early warning system with the right to purchase we recommend elsewhere could safeguard many buildings that would otherwise exit the federally supported affordable housing stock, saving resources and avoiding displacement of tenants.

**SECTION V: Enact tax legislation.**

**Enact exit tax relief.**

Between 1965 and the mid-1980s, nearly 1.5 million rural and urban affordable housing units were built with some sort of federally subsidized financing — a meaningful but by no means comprehensive response to our nation’s lack of affordable housing. Changes in tax laws in 1986 and the aging of both the properties and their investors leaves the properties at risk of loss to the affordable housing stock either through deterioration or conversion to market-rate housing. In many instances, owners of these properties are reluctant to transfer them because capital gains taxes due on essentially the entire sales price (due to prior depreciation deductions) exceed the cash sales proceeds, certainly an unfavorable result when compared to the stepped-up basis available for heirs after the taxpayer’s death. These owners are thus often providing no recapitalization and are holding on to the properties until their death, at which point no taxes will be collected on the gain resulting from prior depreciation, not to mention any capital gain above that amount, due to the step up in basis.

**Solution**

Provide a tax incentive to preserve affordable housing in multifamily housing units that are sold or exchanged to purchasers who agree to keep the properties affordable. The incentive would take the form of an exemption from recapture taxes (noncash gain from depreciation) for sellers of federally assisted housing if they sell to a buyer committed to preserving the property as affordable housing for 30 years after the property transfer. Eligible properties include those assisted under the Section 236, Section 221(d)(3), Section 8, or Section 515 programs.

The current House version, introduced in March 2007, H.R. 1491 is a substantial first step in the legislation needed to resolve this important preservation issue.

**Permit the use of LIHTCs with Mod. Rehab. properties.**

The Section 8 Moderate Rehabilitation (“Mod Rehab”) program was developed years ago to provide financial assistance to owners of deteriorating low income rental properties so they could make needed restorations. HUD guaranteed rental subsidies through 15-year contracts to property owners if they agreed to rehabilitate their property. More and more of these contracts will be expiring in the coming years, and most of these properties have not been renovated since the Mod Rehab contract began. An outmoded prohibition on the use of Low Income Housing Tax Credits (LIHTCs) in properties with Mod Rehab contracts jeopardizes the preservation of nearly 60,000 affordable apartments that are home to very low-income seniors and working families. Housing organizations seeking to preserve these apartments have a strong incentive to opt out of the Mod Rehab contract in order to pursue tax credit equity that is badly needed to finance essential physical improvements. Without the deep subsidy provided by the project-based rental assistance contract, it becomes nearly impossible to ensure that these apartments will remain affordable to very low-income families.

**Solution**

Congress could easily solve this problem by repealing the prohibition. Bipartisan legislation introduced in the 109<sup>th</sup> Congress would do just that. H.R. 4873, introduced by Rep. Jim Ramstad (R-MN) and co-sponsored by 39 members of Congress, would eliminate the ban as well as make other improvements to the LIHTC program. This technical fix would come at no cost to the federal government, since equivalent budget authority for vouchers must be provided when Mod Rehab contracts are not renewed.



***Michael Bodaken***  
***President***

Michael Bodaken serves both as President of the National Housing Trust and President and Treasurer of the National Housing Trust/Enterprise Preservation Corporation. The Trust engages in preservation policy, affordable housing lending and development. He has been largely responsible for growing the organization in becoming a leader in the field of affordable housing preservation. Mr. Bodaken's efforts for the Trust have directly led to the preservation and improvement of over 20,000 apartments throughout the nation, involving over \$1 billion in financing. Additionally, Mr. Bodaken serves as President of NHT/Enterprise, an organization founded by the Trust which owns and operates an additional 3,000 affordable apartments in eight states and the District of Columbia, and NHT Community Development Fund, an organization that provides low interest loans to preservation developers across the U.S.

Prior to coming to the Trust, Mr. Bodaken served as the Housing/Community Reinvestment Coordinator ("Deputy Mayor") for the City of Los Angeles. In this position, Mr. Bodaken provided budgetary, legislative and policy assistance to city organizations with annual budgets of more than \$140 million, which were responsible for creation and maintenance of over 15,000 affordable rental and single family homes.

Mr. Bodaken is the convener of the National Preservation Working Group, a member of the Advisory Board of the Housing Development Reporter, as well as the Executive Committees of the National Housing Conference. He serves on the board of directors of the National Leased Housing Association, Homes for America, Housing Preservation Project, Urban Vision, Fairfax and Montgomery County Housing Tax Forces, and Stewards for Affordable Housing (SAHF). He is a frequent guest lecturer and panelist at housing industry events.