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Testimony of J. Kenneth Pagano
House Financial Services Committee
Affordable Housing Preservation and Protection of Tenants
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Thank you, Chairman Frank for holding this important hearing to examine preservation of affordable rental housing. Good morning, Ranking Member Bachus and members of the committee.

My name is Ken Pagano. I am honored to be here today to speak on behalf of the National Affordable Housing Management Association (NAHMA). I am currently serving as Secretary of NAHMA, Chairman of NAHMA's Regulatory Committee and Vice Chairman of our Tax Credit Committee. I am also President and CEO of Essex Plaza Management Company and President of NAHMA's regional chapter, New Jersey Affordable Housing Management Association (JAHMA).

Chairman Frank, I would like to begin by commending your leadership on this issue. Preventing a loss of affordable rental housing is an important public policy goal, and you have taken considerable efforts to make preservation a national priority.

NAHMA strongly believes affordable rental housing is an important resource that should be preserved. Our organization represents management agents and owners from both the for-profit and non-profit community who participate in federal rental assistance programs. NAHMA's mission is "to promote development and preservation of quality affordable multifamily housing by advancing legislative and regulatory policy and preparing affordable housing professionals to succeed in evolving economic and political environments." Preservation is at the very heart what our members do. Our testimony will focus primarily on the factors that affect housing providers' decisions about preservation and our recommendations for overcoming the major obstacles to preservation.

<u>Background: What Is Preservation?</u>

The goal of preservation is to prevent a net loss of affordable units. To NAHMA, "preservation" means maintaining the current portfolio of privately-owned, federally-assisted apartments as affordable to low-income families through a public-private partnership which offers **voluntary** incentives to owners and ensures long-term sustainability of the properties, including the ability to recapitalize.

Preservation is a cost-effective way to prevent a net loss of affordable units, but it is not without costs. In our experience, preservation will usually require a rental subsidy to make the unit affordable to families at or below 45 percent of area median income (AMI). Also, properties located in high-appreciation markets with below market rents are the most difficult to preserve. A well administered mark-up-to-market program, a preservation program which increases below-market Section 8 rents to bring them in line with comparable properties, is especially important to preserve these properties. Finally, the Section 42 Low Income Housing Tax Credit (LIHTC) has been used as a preservation tool, but it is designed to serve a higher-income population than traditional U.S. Department of Housing and Urban Development (HUD) subsidy programs. The different regulatory requirements of HUD and LIHTC programs make site management more complicated, and require more staff training to ensure compliance.

What Factors Work Against Preservation?

A number of factors are weighed when owners decide whether to continue participating in affordable housing programs. These include market factors which would determine the property's viability as market-rate housing or condominiums, costs and benefits of remaining in the federal programs, long-term financial and physical viability of the property, and experience with HUD as a business partner. With these considerations in mind, I would like to discuss some of the major impediments and disincentives to preservation.

Market Forces

In April 2007 the Government Accountability Office (GAO) released a report, "Project-Based Rental Assistance: HUD Should Update Its Policies and Procedures to Keep Pace with the Changing Housing Market (GAO-07-290)." This report analyzed contract activity from 2001 to 2005. It focused on the number of opt-outs, which properties were most at-risk, HUD's preservation tools and reasons for the decisions to continue or leave the program. GAO concluded that local market conditions are the primary factor in the opt-out decision, but they also acknowledged that other factors could eventually outweigh purely economic factors.

NAHMA agrees with GAO's assessment, but we would caution that this study was released prior to the financial chaos project-based Section 8 properties experienced from July through September of 2007. Late Housing Assistance Payments (HAPs) from HUD and insufficient contract funding are now an economic consideration. Also, the "HUD fatigue" GAO discussed has increased exponentially among our for-profit and non-profit members.

Undependability of Project-Based Section 8 Funding

In an April hearing before the House Appropriations Subcommittee on Transportation and Housing and Urban Development, Assistant Secretary for Housing Brian Montgomery stated HUD would require an additional $2.6 billion above its FY 2009 request to fully fund the 12 month increments of project-based Section 8 HAP contracts at the time of renewal. Other estimates place the need at $2.8 billion above HUD's budget request. Shortfalls in the project-based Section 8 program have had two immediate impacts on the day-to-day operations of affordable properties: late subsidy payments to owners and "incremental" or partial funding of the housing assistance payment (HAP) subsidy contracts.

When HAP payments are severely late, housing operators have to lay-off staff, cut services to residents, miss mortgage payments, make late utility payments or miss payments to site vendors, borrow from the project's reserves for replacement, postpone maintenance and / or ask owners for loans. In my own experience as a management agent, the cost of operating project-based Section 8 properties has increased as a result of the HAP payment crisis during the summer of 2007. Despite many years of timely payments, vendors are now asking for upfront deposits, and I've lost discounts because I was not able to pay them on time. Banks and vendors are charging late fees. My properties have paid between 12 to 18 percent late fees on water, sewer and tax payments in New Jersey because HUD did not pay us on time. I had to cut the hours of the Neighborhood Networks community learning centers. I've also had to defer scheduled work outlined in the mark-to-market process because I needed the money to make debt service payments. My properties suffered, and my tenants were also affected.

But the funding problems did not end last summer. For example, in late 2007, a NAHMA member operating in the Midwest experienced a two month delay on a HAP payment, first because HUD did not have the funding to pay the HAP, and then because HUD added a an extra step to the contract renewal procedure by requiring the contract administrator's signature. This member was especially frustrated because his company submitted the contract renewal paperwork prior to the HUD's deadline—which is 120 days before the annual contract expires.

Another frustrating consequence of the 2007 funding crisis is HUD's "incremental" or short-term funding language in Section 8 renewal contracts. Project-based Section 8 HAP contracts now obligate funding to owners for a period of time (expressed in months) less than the term of the contract (either one-year or multi-year). For example, the contract language might read, "HUD is providing $350,000, which is sufficient to fund HAPs for approximately 4 months of the Renewal Contract term." At every anniversary date for multi-year contracts, HUD is notifying owners when it does not have enough funding to pay for the full 12 month annual increment. HUD's letters state how much funding will be providing to cover a specific number of months and that HUD will obligate additional funding when appropriations are available.

"Incremental" payments on HAP contracts are ***not*** an acceptable standard operating procedure. Rather than simply request the amount of appropriations *it actually needs to fund the full 12 month terms of Section 8 contracts*, this Administration has made a policy decision to tell owners, "We don't have enough money to pay you." Even worse, we are aware of cases in which the few months allotted on the short-funded contract had already expired by the time the owner or agent finally received the paperwork to receive the payment!

There is simply no substitute for fully funding the 12 month contract terms. When HUD talks about funding contracts for the *fiscal year*, they are referring to payments from October 1 to September 30. HAP contracts are renewed in every month of the calendar year, often overlapping federal fiscal years. NAHMA is firm in our position that Section 8 Project-Based HAP contracts must be fully funded *and* paid on time. This program is at a crossroads. Last summer's severe payment problems, combined with HUD's short-term contract funding, are raising questions throughout the affordable housing industry about whether the federal government is truly committed to the project-based Section 8 program--and whether it is worth the risk of participating in the program. This is an especially important question when the LIHTC program is used to preserve HUD properties. LIHTC investors are leery of 12 month HAP contracts with three or four months of funding.

<u>Poor Relationship with HUD—"HUD Fatigue"</u>

More and more NAHMA members, for-profit and non-profit alike, are experiencing the condition GAO described as “HUD fatigue.” GAO’s report defined HUD fatigue as multiple frustrations with HUD that “could result in owners opting out of their contracts even when doing so might not be in their economic interest.” The top sources of HUD fatigue were “HUD’s one-for-one replacement policy for Section 8 units; policies and procedures that could lead to economic distress, especially Operating Cost Adjustment Factors (OCAF) payments; and a lack of clarity and consistency on HUD’s part in applying policies.”[1]

I would like to make a couple follow-up points to these findings. First, skyrocketing utility costs are one of the most important, if not the most important concerns of affordable housing professionals, but HUD’s OCAFs have not sufficiently accounted for spiking utility costs which occurred over the last four years. In February 2008, HUD released a policy memorandum permitting owners to convert efficiency units to one bedrooms (and waive one-for-one replacement requirements) when “it can be demonstrated that the conversion is warranted by local demands for affordable housing and results in the long-term financial and physical repositioning of the project.” News of this policy revision was welcomed, but NAHMA believes additional measures are necessary when conversion is not practical because of structural and / or financial restrictions. In these cases, we urge Congress to provide an incentive for tenants to accept efficiency units by reducing their rent contribution from 30 percent to 20 percent.[2] On the third point, inconsistent application of policies and procedures, a huge frustration for our members has been HUD’s lack of transparency in policy changes or “clarifications” which are transmitted through e-mails, conference calls or notices to HUD staff and / or contract administrators but not directly shared with owners and agents.

Figure 10: Factors Contributing to HUD Fatigue[3] lists a number of “sources of owner/manager frustration with HUD that could increase the number of opt-outs in the future.” We believe the factors GAO identified which continue to jeopardize preservation efforts include inadequate OCAF rent adjustments, late subsidy payments, high administrative costs for few Section 8 units, outdated HUD

[1] See page 27 of the GAO report.
[2] Under current law, a tenant pays 30 percent of their income regardless of the unit size. We believe reducing the rent contribution for efficiency units would make these units more marketable, reduce transfers to one-bedroom units, save the property money that would otherwise be spent turning-over and remarketing the efficiency, and allow the tenant to pay less money for living in a smaller unit.
[3] See page 29 of the GAO report.

policies and procedures; and inconsistent REAC scores (though we feel this factor is likely the result of inconsistencies between REAC inspectors).

All things considered, it is unrealistic to expect owners in desirable neighborhoods to put up with the status quo indefinitely. Stop-and-go contract funding, along with complicated, expensive regulatory requirements, are making it difficult for management agents to convince owners to stay in the program. I am personally feeling pressure to opt-out from the partners on some properties I manage. My owners and limited partners are looking at this situation where their costs are increasing, returns are diminishing and the uncertainty of HAP funding is putting the projects at risk of default on the mortgages. Risks to properties restructured under mark-to-market include default on the first mortgage, as well as inability to make interest payments on the HUD-held second mortgage. The partners are asking me, "Why am I still in this program?" The limited partners are especially vocal about their desire to leave the HUD programs, since they are not receiving reasonable returns on their investments, and they are not receiving tax benefits. At the same time, they are being approached by investors who would like to convert the properties to condominiums or market rate units. The limited partners put considerable pressure on the general partners, and it is getting more difficult to resist their demands.

Some agents have given up altogether on making the argument for preservation. One NAHMA member commented, "I have gone over to the dark side and in good conscience can no longer recommend that an owner take the Mark-up-to-Market (MU2M) option. I now find myself usually recommending that the owner prepay and opt-out." This member offered specifics about the consequences of the opt-outs:

> "We are in the process of opting-out of an 84-unit family building in San Bernardino. The effective date of the opt-out will be June 30, 2008…The owner will realize a…$45 to $95 increase on the section 8 units. He will also save approximately $20,000 a year in bookkeeping expenses, occupancy expenses, office supply costs and HUD audit expenses.
>
> We are also opting out of a 132 unit building with mostly 0-bedroom [efficiency] and 1-bedroom units in Los Angeles, effective November 30, 2008. We are subject to Los Angeles rent control so the increase in rents will be relatively nominal, but we will save over $20,000 a year in bookkeeping expenses, occupancy expenses, office supply costs attributable to HUD verification expenses and also for the HUD audit expenses.

We have four other Title II family buildings that will reach the end of their Use Agreements between 2010 and 2011. Each owner has already advised us that they plan to opt-out at that time and convert their properties to conventional rental. Several other family properties, which previously opted to take the MU2M option will also opt-out at the end of the 5-year contracts. One of these properties is directly across the street from the University of Southern California...In today's market the owner could obtain between $500 to $800 more for each unit as student housing."

Considerations about Long-Term Financial and Physical Sustainability

As properties age and replacement costs increase, a major concern for owners is where to find funding for recapitalization. Many owners have used HUD's Mark-to-Market program, but the assumptions used to underwrite these properties have become obsolete due to skyrocketing utility costs. The early (pre 2001) Mark-to-Markets are especially strained by the underwriting.

The reality is owners who wish to continue providing affordable housing will almost certainly have to prepare to operate mixed-subsidy properties that use several layers of financing from multiple sources. The more revenue streams are involved in the preservation deal, the more owners feel at the mercy of multiple bureaucracies. If one component of the preservation plan falls through, the whole deal could be jeopardized.

The LIHTC has become increasingly important as a preservation tool for HUD properties. It is often the only significant source of funding for revitalizing properties, maintaining affordability for HUD tenants and creating viable mixed-income communities of quality. Although the LIHTC program is a "go-to" program for older HUD properties, this solution also brings new challenges. First, owners must compete for LIHTCs. State agencies set their own criteria for awarding the credits in their qualified allocation plans. There are no guarantees a property will receive the credits, regardless of how critical they may be to the owner's preservation plans. If the property does receive credits, extensive staff training is necessary to ensure the property stays in compliance with HUD, Internal Revenue Service and state agency rules.

Owners entering the mixed-subsidy arena must also brace themselves for frustrating regulatory conflicts in HUD and the LIHTC programs. Ironically, even in the absence of new HUD programs or funding streams for preservation, HUD often exhibits in accommodating other agencies' regulations. A simple example is HUD's policy which prohibits owners of mixed-finance properties from using project funds to pay the mandatory LIHTC compliance fees imposed by state agencies. According to a newsletter issued by one HUB, "The payment of such fees from project funds is not permitted under Paragraph 6(b) of the Regulatory Agreement and HB 4566.2, Section 3-9, because they are not considered *'expenses reasonable and necessary to the operation of the project.'*" This policy could be reversed today, but HUD believes allowing these charges would unduly benefit the owners and would require more budget authority. When states impose compliance fees on LIHTC projects, payment is not optional. Owners with mixed HUD and LIHTC subsidies are not at liberty to pick and choose which requirements they will satisfy. Owners and management agents constantly strive to balance conflicting HUD and LIHTC requirements and to remain in compliance with each.

<u>Insufficient Operating Cost Adjustment Factors (OCAFs)</u>

Because of its relationship to long-term sustainability of preserved properties, I would like to take a moment to revisit NAHMA's concerns about OCAFs. An insufficient OCAF is extremely problematic because it is the annual factor used to calculate Section 8 renewal rents and rent adjustments under the Multifamily Assisted Housing Reform and Affordability Act (MAHRA), and the Low-Income Housing Preservation and Resident Homeownership Act of 1990 (LIHPRHA) programs. The major OCAF criticisms prior to FY 08 were that they took too long to calculate and were obsolete by the time they were released. Unfortunately, HUD took the OCAF in a very questionable direction for FY 2008. HUD abandoned the nine price indices used to develop OCAFs in the past and replaced them with state-level data derived from changes in operating expenses reported by properties filing Annual Financial Statement (AFS) data. HUD explained,

> "HUD calculated the average, per unit, change in operating costs (excluding debt service and bad debt expense), by state, for all projects submitting consecutive valid financial statement reports with Fiscal Year end dates between July 31, 2005 and July 31, 2007. The projects comprise all multifamily properties excluding nursing homes and hospitals. Furthermore, data for projects with unusually high or low expenses due to unusual circumstances were deleted from the analysis. These changes in actual operating costs experienced by properties within HUD's portfolio have become the FY 2008 OCAFs."[4]

[4] Notice of Certain Operating Cost Adjustment Factors for 2008, *Federal Register* Vol. 72, No. 206, Thursday October 25, 2007, pg. 60689.

Mr. Chairman, basing OCAFs on past expenditures bears no relation to current or future funding needs. This methodology does not even necessarily reflect a property's true costs in the past. It only reflects what the property was able to spend. It is unrealistic and short-sighted for HUD to expect owners to restrict their rents to maintain affordability when housing operators have no faith that the OCAFs used to adjust rents will keep up with inflation.

Worse still, there is no mechanism to help properties offset unforeseen cost increases between rent adjustments. My properties have had to absorb of substantial, unforeseen and unbudgeted expenses due to cuts in municipal budgets. For example, municipalities are requiring costly security measures and refusing to pick up garbage. They are also reluctant to renew tax abatements on affordable properties. When the local governments are willing to renew tax abatements, they offer less favorable terms.

<u>Complication of the preservation deals</u>

Some owners choose not to preserve their affordable properties because it is just too complicated. Preservation involves long-term planning, long-term regulatory commitments with an Agency many owners and management agents no longer trust, and major changes in on-site operations to accommodate the different regulatory requirements on mixed subsidy properties.

<u>Recommended Actions to Preserve Affordable Housing</u>

Immediate, decisive steps which encourage owners to continue participating in affordable housing programs should be taken before more units are lost. NAHMA has reviewed the March 2008 preservation discussion draft. There is much to like within this draft, and we remain committed to working with you and your staff, Mr. Chairman to enact a strong preservation bill. There are a number of industry supported provisions in Title I, Title II, Title IV and Title V, but I would like to focus my remarks on the items most important to NAHMA. Our suggestions incorporate items that were included in the discussion draft, items we hope will be included in the preservation bill when it is introduced, recommendations that fall outside the Committee's jurisdiction but would greatly assist the goal of preservation, and recommendations for executive branch actions. We respectfully suggest:

1. **Restoring confidence in the guarantee of timely, fully-funded project-based Section 8 HAP payments is a cornerstone of preservation. This could be achieved by:**

- **Providing the necessary appropriations to pay the full 12 month increments of HAP contracts at the earliest opportunity;**

  It is generally agreed that the Administration's FY 09 budget request falls between $2.6 billion to $2.8 billion short of the amount necessary to fully fund the 12 month increments of project-based Section 8 HAP contracts. It is absolutely essential to fully fund project-based Section 8 HAP contracts in the FY 09 Transportation-HUD appropriations bill. Likewise, I cannot over-emphasize the importance of ensuring HAP payments are not interrupted due to insufficient funds or administrative problems when HUD operates under continuing resolutions.

- **Addressing any regulatory issues that affect the timeliness of HAP payments;**

  The Administration should submit a budget request which reflects the *true cost of funding project-based Section 8 contract renewals for their 12-month terms*. Likewise, HUD should streamline its contract renewal process, and improve the timeliness of Mark-up-to-Market processing.

- **Creating disincentives for under-funding the Section 8 program and making late payments to owners by requiring HUD to make interest payments on late HAPs.**

  We believe HUD should pay interest on late HAPs, just as owners must pay late fees on missed mortgage and / or utility payments which result from the late HAP. A precedent exists in the U.S. Treasury Department's prompt payment rule, which assesses late interest charges against federal agencies that pay vendors after a payment due date. NAHMA supports the legislative proposal in Representative Maxine Waters' Mark-to-Market Extension and Enhancement Act (HR 3965) which requires HUD to pay interest on late HAP payments to owners after 30 days. We urge Congress to quickly pass this legislation.

2. Ensuring long-term financial and physical sustainability of preserved affordable properties.

- **Of particular importance to NAHMA is Section 506 (b) of the discussion draft, Meeting Rehabilitation Needs of Previously Restructured Projects.** The underwriting assumptions for the early (pre-October 1 2001) mark-to-market properties with respect to operating and utility costs and other factors have become obsolete. This provision will allow a voluntary second restructuring to help the early restructured properties with rehabilitation needs.
- **A mechanism to deal with unforeseen spikes in operating costs is desperately needed.**

In August, 2006 several affordable multifamily housing industry trade groups[5] developed the Recognized Increased Cost (RIC) proposal. The RIC plan would provide real time, mid-cycle relief for unforeseen operating costs between rent increases. It assumes that owners will borrow against future higher rents based on the recognized cost increase. Sources for RIC loans include residual receipts, replacement reserves, forgoing deposits to replacement reserves, or other sources such as owner affiliates. Such an approach yields three regulatory consequences:

> *Baseline rents*. At the next rent increase, the property's baseline rents will be increased by the RIC, as a starting point for processing the next rent increase (budget-based, OCAF, AAF, or otherwise).
> *Market rents*. In similar fashion, the property's 'comparable market rents' will likewise be presumed to have risen by the RIC.
> *RIC borrowing costs as a project expense*. Owners who borrow funds to cover shortfalls between application and the post-RIC rent increase will have the debt service on that borrowing (a "RIC Loan") recognized as a project expense ('above the line').

HUD has declined to implement this through administrative action, citing unspecified legislative barriers due to OCAF. Therefore, we must ask for a legislative change. Draft legislation is provided in Appendix 1.

- **Meaningful OCAFs**

As previously discussed, HUD has punted on an opportunity to improve the reliability of OCAFs. We urge the Committee to request a GAO study to examine the accuracy of OCAFs as an inflation factor to measure operating cost increases at the earliest opportunity.

- **Ensuring timely completion of the Mark-Up-To-Market process.**

NAHMA has received reports from several members that the Mark-Up-To-Market process can drag out for months or even more than a year. Studies have shown that properties most at risk of opting-out are those with below market rents in desirable neighborhoods. We are requesting

[5] The RIC proposal was developed in partnership with NAHMA, American Association of Homes and Services for the Aging, National Association of Home Builders, National Leased Housing Association, National Association of Affordable Housing Lenders, National Housing Conference, National Housing Trust and National Multi Housing Council.

legislation to correct some of the more common time-lapse problems in this process. Draft language is attached as Appendix 2.

- **Providing incentives and funding for green initiatives is increasingly important as energy costs rise.**

  We would simply caution that such incentives should be voluntary on the owner's part, and should not constitute unfunded mandates.

3. Recognizing the Essential Role of the Section 42 Low Income Housing Tax Credit Program to Preservation.

- **The discussion draft's Section 110 Market Rents for tax-credit financed housing is quite important.** This provision, which allows owners of Section 42 properties to receive higher Section 8 rents under the voucher program, is especially helpful to Section 42 properties and voucher holders in high cost areas.

- **It is imperative to overturn HUD's policy prohibiting owners from charging mandatory LIHTC compliance fees as eligible project expenses.**

  HUD's decision seems arbitrary and capricious when one considers that without the equity from the tax credits, many of the preserved HUD properties may have opted-out, defaulted on their mortgages, or fallen into physical disrepair.

- **We also urge the Committee to continue working with the Ways and Means Committee to improve regulatory coordination between HUD and LIHTC programs.**

  Because mixed-finance properties have become so prevalent, we believe it is essential for the Internal Revenue Service and the Rural Housing Service to participate in HUD's Enterprise Income Verification (EIV) income matching program before HUD issues any final rule requiring owners to participate in EIV. It is our understanding that legislation authorizing access to the Department of Health and Human Services' New Hires Directory for IRS and RHS affordable housing programs will likely be necessary to achieve this goal.

  Like HUD properties, LIHTC properties are also struggling with utility costs. In the tax credit program, as the utility costs rise so does tenants' utility allowance. When the utility allowance rises and income limits remain flat, rents decrease. This situation presents a serious challenge to LIHTC properties, for which there is no easy solution. We believe this is another area where

GAO could be helpful in assessing the extent of the strain placed on LIHTC properties (including mixed subsidy properties) by escalating utility costs and recommending solutions for dealing with this challenge.

4. Extending tenant protections when mortgages mature and when HAP payments stop.

NAHMA supports extending tenant protection vouchers to unassisted tenants in properties when the HUD mortgage matures. Without these protections, many residents will face substantial rent increases or have to find new housing. We also believe enhanced vouchers (which protect tenants when owners prepay or opt-out) for tenants should be available when HAP payments stop for any reason (especially due to the government's failure to pay owners)--even before the end of the required one-year notice period.

5. Creating incentives to encourage voluntary transfer and preservation of affordable properties.

We urge Congress to quickly pass the Affordable Housing Preservation Tax Relief Act of 2007 (H.R. 1491) which would provide exit tax relief to owners who sell their properties to buyers who will continue operating the projects as affordable housing. We also believe a grant program which provides gap financing to qualified preservation entities (whether for-profit or non-profit) would facilitate more successful preservation transactions.

6. The highest levels of HUD's leadership should take meaningful, proactive steps to restore a feeling a partnership with the multifamily owner and management agent communities.

There is room for common sense and transparency in regulatory compliance. Simple gestures such as allowing reasonable implementation time to incorporate policy changes, breaking the cycle of micromanagement, placing an emphasis on the "reduction" component of the paperwork reduction act as it applies to multifamily forms and information collections, following transparent procedures for issuing policies would go a long way in addressing the "HUD fatigue" owners and agents feel.

Proposed Policies that NAHMA Could Not Support in Their Current Form

As we reviewed the March 2008 discussion draft, there were several provisions that our members consider counterproductive to preservation. Generally speaking, NAHMA could not support housing preservation legislation that would: severely restrict owners' options to sell or operate privately-owned properties; require public disclosure of confidential, proprietary and personal information; or create burdensome, unfunded administrative requirements, such as additional paperwork. Such measures would inadvertently prompt more owners and agents to leave the HUD portfolio rather than preserve their properties.

<u>Section 103</u> <u>Federal first right of purchase before conversion of multifamily housing</u>

NAHMA strongly opposes restrictions on the sale of private property and the automatic preference for non-profit purchasers proposed in Section 103, which creates a federal first right of purchase before conversion of multifamily housing. We strongly believe the most successful approach to preservation is by providing *voluntary* incentives which encourage owners to continue operating the property as affordable housing or sell the property to a purchaser (who may be either a non-profit or for-profit entity) who will continue to operate it as affordable housing. We look forward to working with this Committee to authorize strong incentives which will make preservation the *first option of choice* for property owners; however, we believe the approach proposed in this Section constitutes a "taking" of private property, which will prompt lawsuits. Owners have contractual rights to prepay, opt-out or remain in the program until the mortgage reaches maturity.

We do believe there is a need for gap financing to facilitate preservation. In my own experience, attempts to sell properties to buyers who intended to continue operating them as affordable housing would have been greatly assisted by a preservation grant program to help purchasers acquire, rehabilitate, and this operate the properties. I've had preservation deals fall through because the purchasers did not have the resources to carry the properties. The key to awarding this assistance should not be whether a purchaser is "for-profit vs. non-profit," but whether the buyer is a "preservation-entity" that has organizational capacity and is willing to do long-term preservation (including significant, quality rehabilitation and supporting long-term use restrictions). Targeted exit tax relief, such as the Affordable Housing Preservation Tax Relief Act of 2007 (H.R. 1491) would also provide an effective win-win incentive for owners to sell their properties to those will continue to maintain affordability.

<u>Section 303 Ongoing enforcement of housing quality standards</u>

We also find the discussion bill's approach to enforce housing quality standards in Section 303 problematic. Procedures already exist for HUD to deal with serious violations under REAC, the 2530 process, and annual management reviews. Additional penalties—such as withholding HAP payments, withholding rent increases, tenants withholding rent, using withheld funds to make repairs, or assuming possession and management of a project to take corrective actions—could seem highly punitive to owners who are already considering opt-outs. As an alternative, we respectfully suggest holding on oversight hearing on the REAC process in order to improve the functionality of the existing program.

Section 304 Third party beneficiary status for residents

NAHMA strongly opposes giving third party beneficiary status to residents in Section 304. We believe it would wreak havoc on an already cumbersome contracting process and encourage frivolous lawsuits. Tenants already enjoy protections from eviction under state and local law and there are rights afforded to tenants in Mark-to-Market use agreements, but with checks and balances. Third party beneficiary status would give tenants the same rights as stockholders, but presumably without the same obligations or consequences since they are free to move at any time.

Section 305 Resident Access to building information

NAHMA also strongly opposes legislative language that would publicly disclose documents that contain personal and proprietary information. Many HUD and property documents (i.e. 2530 information, HUD-92410 annual operating statements, subsidy contracts and HUD/owner correspondence, statements of the balances of & expenditures, and management contracts) contain such private and proprietary information. We are especially opposed to public release of previous participation certifications (i.e. 2530s), because they include sensitive information such as individuals' social security numbers. Releasing that information could put owners, investors, and managers at risk for identity theft. In addition, correspondence among owners, agents, and HUD often involves resident issues and personal information that should remain confidential.

Section 306 Transparency Regarding building information and Section 701 Preservation Database

We certainly understand the intention of these sections in helping tenants to find quality affordable housing. HUD has already provided several of the disclosures called for in these sections. HUD began publishing REAC scores on its website in November 2007. This information can be found at http://www.hud.gov/offices/hsg/mfh/mfdata.cfm. Likewise, HUD created a "Multifamily Assistance and Section 8 Contracts Database" found at http://www.hud.gov/offices/hsg/mfh/exp/mfhdiscl.cfm. This database includes much of the information proposed in Section 701, such as property names, units, rents, and contract expiration information.

We believe HUD has achieved the major goals of these sections. Nevertheless, if the Committee wishes to authorize such databases, we implore members to write the legislation in a way that will not impose addition unfunded mandates on properties by pulling staff away from their property management duties to compile the required information for HUD, and creating more paperwork. The information should come from HUD's existing data.

Conclusion

Thank you again, Mr. Chairman, for allowing me to offer NAHMA's testimony today. We sincerely appreciate your efforts to preserve affordable housing, and we know that you are committed to this issue. Please be assured that we are also committed to working with you and your staff to achieve this goal.

APPENDIX 1: DRAFT RECOGNIZED INCREASED COST (RIC) LANGUAGE

SEC. ____. PRESERVING PROJECTS FROM UNEXPECTED COST INCREASES.

(a) GENERAL. – An increase in the cost of operating an eligible multifamily housing project that is not reflected in the most recently completed annual or other rent adjustment, as determined by the Secretary of Housing and Urban Development ("Secretary"), shall be compensated for in accordance with this section.

(b) ELIGIBLE COST INCREASES. – Eligible cost increases include (1) higher charges for utilities, insurance, property taxes, labor, supplies, equipment, and regulatory requirements; (2) unreimbursed losses from natural disasters; and (3) such other costs as the Secretary may approve, but are limited to those cost increases that cannot be paid for out of excess cash flow to the project or excess project reserves, as determined by the Secretary.

(c) ELIGIBLE MULTIFAMILY HOUSING PROJECT. – An eligible multifamily housing project is a multifamily project for which rents or rent adjustments are required to be approved or determined by the Secretary or the Secretary's designee.

(d) SOURCE OF FUNDS TO COVER COST INCREASES. – For purposes of this section, the Secretary may approve the payment of eligible cost increases from (1) funds in a project replacement reserve or other project reserve; (2) cash made available by foregoing required contributions to a project replacement reserve or other project reserve; and (3) contributions from the project owner or related entity.

(e) TREATMENT OF FUNDS. -

(1) LOAN. – Funds used to pay for eligible cost increases pursuant to this section shall be treated as a loan from the project or project owner, repayable to the project or project owner, without interest, as a payment of a project expense, and amortized over such term as the Secretary may approve, but not to exceed three years.

(2) SOURCE OF LOAN REPAYMENT. - The Secretary, or the Secretary's designee, shall increase the project's next rent adjustment, and any succeeding rent adjustments that may be necessary, by the amount of the loan to be amortized for the period covered by the rent adjustment.

(3) IMPACT ON MARKET VALUE. – During the period the loan is being repaid, the amount of any annual increase in rent to cover amortized repayments shall be added to a determination of comparable rents in the area in connection with the renewal of a housing assistance payment contract pursuant to section 524 of the Multifamily Assisted Housing Reform and Affordability Act of 1997 (42 U.S.C. 1437f note).

(f) INADEQUATE FUNDS. – If a project has inadequate funds to cover eligible cost increases, the Secretary may approve an immediate rent increase to cover those costs.

(g) TIMING. – If the Secretary, or the Secretary's designee, does not approve or disapprove a payment in accordance with subsection (d) within 30 days of the project owner's request, the project owner may advance funds in accordance with subsection (d) and such funds shall be treated in accordance with subsection (e).

APPENDIX 2: DRAFT MARK-UP-TO-MARKET LEGISLATION

SEC._____. CONTRACT RENEWALS AT MARKET RENT.

Section 524(a) of the Multifamily Assisted Housing Reform and Affordability Act of 1997 (42 U.S.C. 1437f note) is amended by adding the following paragraph at the end:

"(6) PROCESSING MARK-UP-TO-MARKET REQUESTS. –

"(A) EFFECTIVE DATE OF RENT. – A rent established at the comparable market rent shall be effective not more than 120 days after a project owner has submitted a request pursuant to paragraph (4)(A) of this subsection. The minimum contract term of 5 years specified in paragraph (3) of this subsection shall commence on the effective date of the rent.

"(B) SHORT-TERM CONTRACTS. – If a final determination on a request made pursuant to paragraph (4)(A) of this subsection and execution of a renewal contract is not made prior to the expiration of a contract, the Secretary shall offer one or more short-term renewal contracts at current rents as adjusted by a partial year operating cost adjustment factor established by the Secretary (which shall not result in a negative adjustment), subject to a subsequent adjustment in rent in accordance with subparagraph (A).

"(C) TIMELY COMPARABLE MARKET RENT DETERMINATIONS. – The Secretary shall make a comparable market rent determination not more than 90 days after a project owner has submitted a request pursuant to paragraph (4)(A) of this subsection. If the Secretary fails to make this rent determination within 90 days, rents shall be established at the levels contained in the project owner's comparable market rent study if this study is conducted by an independent certified appraiser who meets general qualification standards issued by the Secretary.

"(D) CORRECTION OF ERRORS. – Within 30 days after the Secretary has made a comparable market rent determination, a project owner shall be entitled to have errors in the comparable market rent study relied on by the Secretary in making a determination of market rent corrected. The project owner also shall be entitled to have comparable properties used by the Secretary that are clearly inappropriate replaced by appropriate comparable properties. The Secretary shall make any corrections requested by a project owner and any redetermination of market rent within 30 days of the owner's request."