NLHA

NATIONAL
LEASED HOUSING
ASSOCIATION

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NLHA Assisted Housing Preservation Initiative

The members of the National Leased Housing Association are deeply concerned about the preservation of the assisted housing stock. While congressional efforts to provide for comparable market rents in Section 8 properties have largely been successful in preventing opt-outs, the age of the inventory requires many properties to undergo extensive renovations to ensure long term viability. To that end, many properties have been preserved through property acquisitions that generally utilize the Low Income Housing Tax Credit (LIHTC). However, HUD's role in facilitating such transactions can not be overstated. In recent years, HUD has appeared to pull back from encouraging preservation by implementing policies (some formally, many informally) that serve as barriers to preservation.

NLHA has put together a list of issues that we believe should be addressed in any preservation legislation considered by Congress in 2009. We anticipate that many of the provisions below will be included in a House bill to be introduced in January or February.

However, HUD could act quickly to revise its policies where current law permits, to spur or remove barriers to preservation activities – *we have placed an asterisk before each provision that we believe HUD can implement (or partially implement) without a change in the law*.

We have also included proposed changes in tax law which we hope that HUD will support.

Closing Gaps in Enhanced Voucher Protection: Expand current law to permit the provision of enhanced vouchers to residents living in Section 221(d)(3), Section 236 and Section 202 projects when the owner prepays the loan, when the mortgages mature or when ELIHPA use restrictions expire:

Explanation: In 1996, when Congress restored owners' rights to prepay Section 236 or Section 221(d)(3) mortgages, Congress amended the U.S. Housing Act of 1937 to provide tenant protection to families or elderly living in such properties. Eligible residents who were not receiving rental assistance at the time of the prepayment were now eligible to receive a voucher if/when the owner raised the rents on the units. In other words, the prepayment of the mortgage eliminated the use restrictions related to the previous receipt of a below market interest loan. Once the mortgage is paid off, the owner is free to raise the rents to the market rent resulting in tenants paying more. The receipt of vouchers by eligible residents, those with incomes generally at or below 80 percent of median or in tight rental markets 95 percent of median, enables the families to afford the rents and stay in their homes. The statute was amended again in the next few years to provide enhanced vouchers to families/elderly living in properties in which the owners opted out of their Section 8 contracts.

The current statute needs to be amended to address two situations that were not contemplated in 1996. Firstly, it was not necessary to address mortgage maturations in the context of enhanced vouchers as the Section 236 properties or Section 221(d)(3) BMIR properties were at least ten years from their mortgage maturation (original mortgage terms 40 years and owners in most cases had a right to prepay the mortgage after 20 years). When the mortgages mature, the accompanying affordability requirements expire (including ELIHPA projects). In January 2004, the GAO issued a study on such mortgage maturations and projects that 11,267 mortgages will mature through 2013. The first such maturations have already occurred, and will peak after 2007.

Secondly, the enhanced vouchers provisions did not address situations in which a nonprofit sponsor prepays such a mortgage (or the mortgage expires) because the original eligibility for enhanced vouchers was tied to the ability of owners to prepay their mortgages without HUD permission (nonprofits need HUD permission to prepay in most cases). However, in today's low interest environment, it is not unusual for a nonprofit to seek and receive permission to prepay their mortgages to allow a refinancing and recapitalization of properties that are on average 30 to 40 years old, this includes Section 202 loans that were made prior to 1975, which did not receive Section 8 assistance.

***Facilitating Preservation Transactions:** Clarify that HUD may not restrict the profits generated by nonprofits who seek to prepay their mortgages and sell the property to entities that will keep the property affordable.

Explanation: Where HUD must approve a non profit prepayment or other aspect of a transaction relating to a sale or refinancing, HUD has arbitrarily limited the use of surplus sale or refinancing proceeds to nonprofit sellers. We do not believe that HUD has the authority to restrict such proceeds. Generally, the proceeds are from the sale of low income housing tax credits. HUD's attitude is thwarting the sale of affordable properties to preservation entities. When the mortgage matures or the nonprofit is otherwise free to sell the property without HUD intervention, there is a good chance these properties will be lost to the inventory as the nonprofits will sell to the highest bidder. Further, nonprofits that have multiple properties and have partnered with a for-profit to generate tax credit equity have been thwarted from using the proceeds from the transaction for their other properties. HUD's position is short sighted and has no merit. We asked that HUD reconsider its unwritten policy.

***Facilitating the Sale and Rehabilitation of Assisted Housing Projects**: Clarify that under current law, HUD shall process and provide for a budget-based rent increase to support increased debt service (including debt service coverage), physical rehab needs of the property, and other appropriate budget items including contributions to the reserve for replacement accounts. Such budget-based rents would only become effective upon completion of the rehabilitation and may not exceed comparable market rents (except as provided under current law for Section 202 properties).

HUD already has the authority to process and approve budget-based rents under current law, but does not permit a pre-approval of a post-rehab rent for anything except Section 236 decoupling transactions and is considering disallowing such pre-approval for those transactions. HUD refuses to allow the use of new debt service in calculating rents that are at or below market (except for transaction s under Chapter 15 of the Section 8 Guidebook related to Non Profits and recently limited those to tax credit rents (without any explanation or notice). It is important to note that 1) in no situation is the post-rehab rent paid before the rehabilitation is completed and approved by HUD; 2) rents are capped at the comparable market rent (with the existing exception for 202s; and 3) the property remains in the affordable rental stock.

Maintaining Affordability in Preservation Projects: Ensure that Section 8 contract renewals of ELIHPA and LIHPRHA projects are consistent with other Section 8 contract renewal options.

Explanation: NLHA is proposing an amendment to clarify that HUD can allow the owner the ability to renew the Section 8 contract under any of the other renewal options under MAHRA.

NLHA further proposes to amend current law to allow owners of ELIHPA projects to terminate an existing multi-year contract that runs through the duration of the plan of action and to replace it with a hybrid contract that runs beyond the plan of action.

Explanation: This amendment will facilitate the sale of an ELIHPA project as part of a preservation transaction that will keep the property affordable for at least twenty more years. The new owner would operate at rents pursuant to the terms of the Plan of Action until its original expiration date, at which time the rents would established at rent levels equal to comparable market rents for the area.

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Encouraging Continued Participation in Assisted Housing: We request a revision to MAHRA to provide the clear ability to renew mod rehab contracts using a budget-based approach.

Explanation: Under MAHRA, Section 8 moderate rehab properties without FHA insurance are not provided the ability to renew as an exception project with rents determined by applying the lesser of current rent plus an operating cost adjustment factor (OCAF) or a budget-based rent. As a result, half of the moderate rehabilitation projects have opted out, thus reducing an already scarce supply of affordable housing.

Subsequent Renewals: Clarify the existing statute with regard to contract renewals: 1) to make clear that an owner can subsequently renew a Section 8 contract pursuant to any provision of the section for which it is eligible. While this is currently HUD's interpretation, it was not for the first 8 years, therefore it is important to clarify current law; 2) to address HUD's new interpretation with regard to exception rent contract renewals; 3) to clarify that if a Section 8 project was ineligible for the Mark to Market debt restructuring at initial renewal it remains ineligible at subsequent renewals.

Explanation: 1) for the first 8 years since enactment of MAHRA, HUD interpreted the statute incorrectly to require property owners who initially renew the Section 8 contract under a particular option (exception rent) to use this option for future renewals. HUD has recently reinterpreted the statute, but we believe some clarity is needed to prevent any future misinterpretations. 2). HUD recently changed its policy regarding subsequent renewals of "exception projects." Previously, HUD permitted exception projects initially renewing under subsection (b)(1) at the lesser of current rent plus an OCAF or a budget based rent to subsequently renew with an OCAF adjustment. HUD is now requiring a budget review at every renewal, a wasteful administrative burden. 3) It has always been the intent of MAHRA that the eligibility of Section 8 projects for the Mark to Market debt restructuring program was determined at the initial contract renewal. HUD has recently amended is regulations to interpret that such eligibility may be determined at subsequent renewals instead of the project continuing to operate as an exception project.

***Reconstruction to Preserve Section 236 Projects:** Clarify that under current law, HUD can continue paying Interest Reduction Payments (IRP) in their entirety notwithstanding a reduction of total units because of changing market conditions, physical obsolescence, etc as determined by the state or local housing agency.

Explanation: HUD can do this now, but an amendment would ensure flexibility to continue to use the IRP in a Section 236 project for preservation, rehab or construction of affordable housing units in markets that have experienced changing real estate conditions or projects with unit configurations or physical conditions that no longer meet the affordable housing needs of the community. An example would be a renovation that converts efficiency apartments for the elderly into one-bedroom units for the elderly. There is no loss of assistance in the community as a result of the reconfigurations.

***Transfer of Assistance Contracts**: Authorize the transfer of Housing Assistance Payment (HAP) contracts from one project to another because the current property has been destroyed (example Katrina properties), damaged beyond repair, physically obsolete or economically infeasible. The number of people served in the project receiving the HAP contract is at least equal to the number of individuals that could be served in the project from which the HAP contract is being transferred. Such transfers shall not be restricted based on bedroom configuration or unit count.

While we believe HUD has the authority to transfer HAP contracts from one property to another, NLHA's proposal would make it clear that it can be done at owner option, for certain circumstances as long as the number of people being served is not diminished. Any change in the law should make clear that the transfer shall not be subject to specific unit counts or configurations.

***Preserving Restructured Projects**: Clarify that projects that have undergone debt restructuring under MAHRA may request a budget-based rent adjustment in lieu of OCAF. Further, certain properties that were restructured under M2M in the early years of the program, before HUD adjusted the underwriting criteria, may request a re-restructuring to accomplish additional rehabilitation.

During the first several years of the mark to market debt restructuring program, HUD's underwriting criteria did not allow enough flexibility to deal with increases in operating expenses. HUD eventually changed its criteria, but deals done prior to that are in danger of default where their utilities, insurance and/or other operating costs have spiked. NLHA proposes an amendment to provide that these and other restructured properties with unexpected cost increases could seek a budget-based rent increase when the Operating Cost Adjustment Factor is not sufficient to allow the property to meet its expenses. HUD's Mark to Market regulations permit a budget-based review but HUD has never utilized the option. The statute should be amended to permit early M2M restructurings that were closed prior to HUD amending its underwriting criteria to request a re-restructuring to accomplish additional rehabilitation.

Conversion of Old Assistance Contracts: To encourage continued preservation, amend the law to permit the conversion of old Rent Supplement and Rental Assistance Payment contracts to be converted to Section 8 Loan Management Set Aside (LMSA) HAP contracts. The term of the contract must be at least equal to the remaining term of the converted contract. After the initial year, an owner may convert the LMSA contract to a renewal contract under MAHRA as long as the owner agrees to extend the contract term at least five years beyond the remaining term of the LMSA contract.

Nearly 36,000 units of housing with Rental Assistance Payment (RAP) or Rent Supplement Contracts are set to expire (most in the next ten years). Generally, these contracts expire at the same time as the mortgages. In some cases, the tenants will be provided vouchers, others may not have any protection. In either circumstance hard units of affordable housing will be lost. This provision would allow owners to convert their RAP or Rent Supplement contract to project-based Section 8 (something that was offered in the eighties). The owners would have to renew at a term consistent with its remaining RAP or Rent Supplement term. After the initial year, the owner could renew the HAP contract under MAHRA (and potentially receive a rent increase). However, if the owner chooses the MAHRA renewal, the owner must extend the Section 8 contract term for at least five years beyond the remaining life of the LMSA contract. The benefits of allowing conversion to Section 8 is that such assistance is renewable and could be retained after the mortgage expires.

***Comparable Rents**: With regard to rent studies conducted to determine comparable market rents under MAHRA, this section provides where there is a 15 or more percent differential between the owner's rent study and HUD's rent study, that a third appraiser be hired by HUD and the owner to make a comparable rent determination that would be binding.

While HUD has issued guidance that is intended to ensure consistency with the formulation of rent comparability studies, sometimes major variances occur between appraisals causing a dispute between HUD and property owners. NLHA proposes that a third independent appraiser be retained when the rent differential is at least 15 percent to conduct a third comparable rent study that would be binding on both parties.

***Supporting Acquisition of Restructured Projects by Nonprofit Purchasers**

In order to facilitate nonprofit purchases of Section 8 projects that have undergone debt restructuring through the HUD's mark to market program, NLHA proposes to extend the timeframe for nonprofit purchasers to acquire such properties and exercise nonprofit purchase incentives

As part of HUD's Section 8 Mark to Market (or debt restructuring) program, there are a number of incentives provided to encourage nonprofits to purchase or acquire properties that have undergone restructuring. Specifically, HUD is permitted to assign all or a portion of junior Mark to Market debt, or to forgive the debt entirely – in the case of a sale to nonprofit organizations. HUD has provided administratively that acquisitions of restructured properties by nonprofits must occur within three years after the original restructuring. However, that timeframe has proved insufficient as the original owners may not decide to sell within three years. NLHA proposes to extend the timeframe.

***Addressing Unanticipated Rent Increases:** The industry urges HUD to recognize unanticipated operating cost increases that occur between annual rent adjustments (e.g. insurance, utilities, etc.).

An amendment to current law should legislate an industry proposal (provided to HUD in August of 2006) to provide a "real-time" mechanism to adjust for unforeseen increases in operating costs (especially utility costs). A sudden *cost increase – such as a spike in utility costs, cleanup from a natural disaster, or an upward adjustment in insurance programs – can occur months before the property is eligible for a rent increase. The provision provides for a mechanism to allow the recognition of increased costs going forward by increasing the baseline for the upcoming rent adjustment. This proposal is known as the "Recognized Increased Costs" or RIC proposal.*

Late Payment of HAP Contracts: Congress should require HUD to notify owners when HAP (housing assistance payments) payments will be late; permit owners to use project reserves or make a loan to the project without prior HUD permission. HUD should be required to pay a penalty when Section 8 HAP payments are not timely.

Over the last five years, HUD has been consistently late with subsidy payments to owners under the project-based assistance programs. A number of properties have experienced delays of three months or more, often jeopardizing the financial solvency of the property. The GAO issued a report in December of 2005 outlining the problem and urging the Department, at a minimum, to notify owners when subsidy payments will be late. This provision would require such a notice as well as permit owners to borrow from project reserves or otherwise loan funds to the project to pay the mortgage and any operating costs without prior HUD permission. Lastly, the provision would permit the imposition of late fees on HUD for failure to meet its obligations.

***Recognition of Tax Credit Equity:** A provision to require that HUD consider tax credit equity or other new equity in preservation transactions.

HUD's regulations provide that the initial equity may be redefined by HUD - HUD has rarely used this authority. In other words, properties built more than 30 years ago, with a limitation on dividends, are restricted to a 6 or 10 percent return of the initial equity. Many properties have changed hands with substantial new equity being provided to the property. HUD has not developed a formal policy on redefining equity and only has permitted in a few circumstances the consideration of tax credit equity in preservation transactions.

Other Legislative Initiatives

Recapture Tax Relief: NLHA has encouraged Congress to provide recapture tax relief to the original investors in order to encourage them to consent to a transfer of the property to a preservation entity and extend the useful life and affordability of the property.

Current tax law encourages investors in many assisted housing properties to retain their partnership interest so that upon death their heirs receive a step up in basis. Therefore, many investors will not approve the sale of the property to a preservation entity if the value of the property is insufficient to pay the recapture taxes or exit tax that would be due as a result of the sale. NLHA believes that without exit tax relief that will encourage property transfers, many properties will be lost to deterioration. Bilsl has been introduced in the House and Senate, but no action has been taken. HUD's support for exit tax relief would be helpful.

Statutory Changes to the Tax Credit Program: While the Low Income Housing Tax Credit program (LIHTC) is not administered by HUD, there are a number of legislative changes that could be supported or suggested by HUD that would have a large impact on the ability to preserve the existing assisted housing stock including:

1). Temporarily Reduce the Credit Period from Ten to Five Years: We recommend that for credit allocations made in 2008, 2009, 2010, and 2011, that the credit period be reduced to 10 years.

Explanation: Under the Tax Credit program, the credit period is ten years. In the current economic environment, many would be investor companies cannot predict their tax liability over 10 years and therefore are not willing to invest in the LIHTC program. Further, the ten year credit period reduces the value or yield, to the investor because of the time value of money. Such a temporary change in the law would attract new equity to the tax credit program.

2). Permit carryback of the Tax Credit for up to five years and permit credits to be used to offset AMT liability during that period: Current law permits that Low Income Housing Tax Credits be carried back for one year and carried forward for 20 years. NLHA encourages Congress to change the law to permit a five year carryback (like the marginal oil and gas well production credit).

Explanation: By permitting the taxpayer to carryback the credits for five years, investors would know that if their tax liability were to decrease and they could not use the credits for future years, they could be used in any of five prior tax years. Such a revision to the Tax Code would attract new investors, particularly those that may be profitable today, but are not able to predict their tax liability in coming years. There is also the problem of past investors like Fannie Mae and Freddie Mac who are unable to use their tax credits and if they offer these credits for sale at deep discounts, there will be little ability to raise new capital for new properties. By allowing a five year carryback, companies like Fannie and Freddie or others without current tax liability can use their credits for the previous five years where they had tax liability and therefore receive a dollar for dollar return rather than selling the credits for far less. The five year carryback should be accompanied by an ability to use those credits to offset AMT (currently only properties placed in service after 2007 can use credits to offset AMT).

3). <u>Permit Housing Credit Allocating Agencies an additional year to make allocations before having to return unused credits to the "national pool":</u>

Explanation: Agencies that allocate low income housing tax credits are permitted under current law to carry forward any unused credits for one year and if they are not used after that year, the credits go to a national pool for redistribution to other agencies that have allocated all of their credits. The current lack of equity investment is going to result in many agencies not being able to allocate all of their tax credits. NLHA urges Congress to provide an additional year before unused credits to a national pool out of fairness and recognition of the current economic environment.

4). <u>Temporarily permit Low Income Housing Tax Credits to be applied against ordinary income of individuals without any limit:</u>

Explanation: Current law permits individuals who invest in Low Income Housing Tax Credits to apply those credits to no more than $25,000 of ordinary income multiplied by the individual's tax bracket. With a marginal rate of 35 percent the maximum credit would be $8750. Temporarily removing this limit would permit wealthy individuals to invest substantial sums in tax credits, which would help offset the sharp decline in corporate investments in the tax credit.

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