

Rural Rental Housing Preservation: Current Policy Issues

Housing Assistance Council

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This policy brief describes a number of recent events related to the preservation of affordable rental housing produced through the U.S. Department of Agriculture's Section 515 Rural Rental Housing program. Section 515 has financed more than 550,000 decent, safe, sanitary, and affordable homes, which are often the only such rental housing in rural communities. Residents' incomes average less than \$10,000 per year, and more than half of resident households are headed by elderly people or people with disabilities.

These much-needed properties face significant challenges, however, and many may cease to be available as decent, affordable housing for low-income people. Under the current law, which allows prepayments of Section 515 loans only in certain circumstances, owners have already prepaid the loans on over 50,000 housing units, thus removing the mortgage provisions requiring them to house low-income tenants. Many more loans are likely to be prepaid over the next several years. Some developments will remain affordable after prepayment, but others will not. At the same time, the buildings' age and condition threaten their continued viability as decent housing, and Congress has cut back the program's funding dramatically for the past ten years.

CPA AND OTHER RECOMMENDATIONS

In November 2004 USDA released *Rural Rental Housing – Comprehensive Property Assessment and Portfolio Analysis* (CPA), a study of the physical and financial conditions of existing Section 515 housing prepared by a team led by ICF Consulting. Based on a survey of randomly selected properties, the CPA reported that no Section 515 developments had reserves or cash flow adequate to cover repairs and maintenance over time. Considering the location, physical condition, and tenant profile of the properties, the report stated, the public interest would be best served by revitalizing most of them as affordable housing for the long term.

Taking government cost into account, the CPA suggested that owners be allowed to prepay where local housing markets made that an attractive option, and that USDA use

vouchers or some other means to protect current tenants against rent increases for a limited period of time. To enable "revitalization" of properties both financially and physically, it recommended refinancing existing Section 515 loans and adding new private capital. It also proposed requiring minimum rent payments from all tenants.

The CPA estimated that about 10 percent of properties would prepay under this scheme. The ICF Consulting team was not asked to determine where these prepayments would likely occur, nor to study past prepayment patterns.

In an open letter to USDA officials, a coalition of organizations (including the Housing Assistance Council) supported the CPA's revitalization recommendations but noted that market-driven prepayments would occur in "hot" markets where housing costs were rising – that is, the very markets where affordable housing would be most needed – and that many prepayments are motivated by non-economic reasons, so more than 10 percent of owners might be interested in prepaying. The group supported continuing the current use of financial incentives to keep owners in the program. Where owners did want to leave the program, the coalition wrote, properties could be preserved by selling them to mission-driven preservation entities.

Other proposals for changes to the existing prepayment and preservation processes have been issued by several groups, including the Council on Affordable and Rural Housing, the National Rural Housing Coalition, and most recently a Task Force on Rural Rental Housing Preservation convened by the Housing Assistance Council and the National Housing Law Project and supported by a grant from the John D. and Catherine T. MacArthur Foundation. Several of the task force's recommendations, released at a national rural preservation conference in April 2005, are reflected in a recent law, described below.

USDA-PROPOSED LEGISLATION

In early February 2006 the Administration sent Congress a budget for FY 2007 that anticipated substantial changes in USDA's handling of prepayments. It proposed to defund the Section 515 program (which received \$100 million in fiscal 2006) and to replace initiatives created by Congress for FY 2005 and 2006 with \$74.25 million for USDA's not-yet-implemented Section 542 voucher program, to be used for debt restructuring and revitalization as well as for vouchers for tenants displaced by prepayments. No funds would be provided for incentives to convince owners not to prepay their 515 mortgages.

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The budget relies on congressional passage of authorizing legislation. USDA sent draft legislation to Congress in July 2005 that would repeal existing prepayment restrictions (a move not discussed in the CPA). It would create a new voucher program for tenants of properties where mortgages were prepaid. Owners of 515 properties would be able to restructure their debts if they were in good standing and their loans were made before January 1, 1992. Finally, in an effort to reduce abuses by tenants claiming to have no income, it would require some tenants to pay minimum rents.

As of the end of February 2006, the legislation has not yet been introduced. It is expected to be introduced in the House of Representatives and not in the Senate. Thus the Senate will not act on it unless it passes the House.

NEW DEMONSTRATIONS FUNDED

The Administration's 2006 budget proposed to eliminate new construction under Section 515, but Congress rejected that change and also did not provide the \$214 million voucher funding USDA requested. The final 2006 USDA appropriations legislation (P.L. 109-97), passed by both houses and signed into law by President Bush, provides \$100 million for Section 515 and \$16 million to fund approximately 3,500 Section 542 vouchers for one year.

In addition, the appropriations law continues a demonstration revolving loan fund established in the FY 2005 appropriations measure, allocating \$3 million for nonprofit intermediary organizations that will, in turn, lend the funds to owners or purchasers of Section 515 developments.

Finally, the legislation provides \$9 million to demonstrate the CPA's revitalization recommendations. These funds can be used to restructure existing loans; defer loan payments; subordinate, reduce, or reamortize debt; and provide advances or incentives to owners.

The law requires the new vouchers to be available for tenants in properties prepaid after September 30, 2005. As of the end of February, USDA has not yet implemented the voucher program quickly.

LITIGATION

Recent court decisions have made enforcement of preservation restrictions expensive for the government and thus helped reduce USDA officials' support for the existing prepayment restrictions in the Emergency Low-Income Housing Preservation Act (ELIHPA). Most significantly, in an August 30, 2004 decision in *Franconia Associates v. United States* the U.S. Court of Claims ordered the government to pay lost profits to Section 515 owners who had been denied prepayment. The decision was based on a breach of contract rationale and did not decide whether ELIHPA is constitutional. (Earlier in its history, *Franconia* reached the Supreme Court, which ruled only that the statute of limitations did not bar the owners' claims for damages. The

Supreme Court did not consider whether the owners' claims were valid, or whether ELIHPA was unconstitutional.)

Damages have since been calculated at an average of over \$400,000 per project involved in the suit. By early August 2005, similar legal actions had been filed involving over 800 Section 515 properties.

The U.S. Court of Claims also held on August 29, 2005 in *Cienega Gardens v. United States* that prepayment restrictions, including ELIHPA, caused a "taking" of HUD-insured rental properties, entitling the property owners to damages.

A third decision applies only in the seven Western states covered by the federal Ninth Circuit Court of Appeals (Arizona, California, Idaho, Montana, Nevada, Oregon, and Washington). On December 12, 2002, the Ninth Circuit ruled in *Kimberly Associates v. U.S.A.* that Section 515 property owners could circumvent the prepayment process entirely by bringing "quiet title" actions in state courts to remove encumbrances – such as prepayment restrictions – from the titles to their property. Tenants tried to appeal, but the Ninth Circuit ruled their claim was moot because the parties had already signed a settlement agreement.

A different federal court of appeals reached a very different conclusion in *Charleston Housing Authority v. USDA*, decided on August 18, 2005 by the Eighth Circuit Court of Appeals, which covers Arkansas, Iowa, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota. The court upheld ELIHPA, and also ruled that an owner's plan to demolish a development with almost all African-American tenants violated the Fair Housing Act.

It can be argued that more litigation will be needed before ELIHPA's future is clear. Advocates also contend that preservation is important regardless of cost because the government should ensure the availability of decent, affordable

housing for all. Nevertheless, the rulings have been mentioned in USDA budget documents and by USDA officials as compelling reasons for terminating rural prepayment restrictions.

This Information Sheet was prepared by the Housing Assistance Council. The work that provided the basis for

FOR MORE INFORMATION

Links to a variety of rural rental housing preservation resources, including items mentioned in this policy sheet, are on the Housing Assistance Council's website at <http://www.ruralhome.org/issues/preservation>.

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