MORE THAN HOUSING AT STAKE

PRESERVING RURAL RENTAL PROPERTIES
Dear Friends,

Many things have changed since the Winter 2004-2005 issue of Rural Voices focused on rural rental housing preservation. Congress has funded new preservation efforts for rental properties financed by the U.S. Department of Agriculture. Practitioners have learned new lessons as they resolve unique challenges posed by each preservation deal. USDA has worked to clarify its policies and educate its staff.

This issue of Rural Voices, therefore, updates and supplements that earlier issue, thanks to support from the John D. and Catherine T. MacArthur Foundation. Articles by experts review preservation policy, consider barriers and opportunities, report on USDA’s multifamily preservation initiative and its guaranteed loan program, and summarize state preservation activities. In addition, rural housing practitioners describe their preservation work, including some deals that have succeeded and some that are still in process.

These preservation efforts are essential. Recent data show that the supply of decent, affordable rental housing is not keeping up with the need. This spring, the U.S. Department of Housing and Urban Development’s annual study of the housing needs of very low-income renters reported that from 2003 to 2005 their “worst case housing needs” increased 16 percent nationwide, and an astonishing 51 percent in nonmetropolitan areas.

The need for preservation of farmworker housing is becoming increasingly clear as well. To date, most rural preservation efforts have focused on USDA’s Section 515 properties, which house low- and very low-income tenants. Rentals financed with Section 514 Farm Labor Housing loans are also aging, and many need renovation and revitalization.

We are proud that HAC is using its expertise to address rural preservation needs. Some of its preservation activities—which include lending, training, technical assistance, research, and information provision—are highlighted in the HAC Facts section on the opposite page.

Working with its partners in the field, HAC strives to help keep decent, affordable rental housing available for the rural residents who need it most.

Sincerely,

Gideon Anders, Chair
Arturo Lopez, President
Moises Loza, Executive Director

Cover Photo courtesy of USDA Rural Development.
HAC Loans Preserve Affordable Housing

The Housing Assistance Council is accepting applications for its new Preservation Revolving Loan Fund. These low-interest loans can be used to purchase and/or rehabilitate rural rental housing developments to keep them decent, safe, affordable places to live. So far, HAC has approved applications for over $2 million in PRLF loans to preserve properties in Delaware, Kansas, Missouri, New Mexico, New York, and Washington. Another $3 million in applications are pending.

HAC has raised over $5.5 million to support rural rental housing preservation projects through the PRLF. These funds include $4 million awarded by USDA’s Preservation Revolving Loan Fund program and $1 million from the John D. and Catherine T. MacArthur Foundation.

For more information on HAC’s PRLF visit http://www.ruralhome.org/servicesLoans_LoanProducts.php or contact Dan Morris at daniel@ruralhome.org or 202-842-8600.

Training Focuses on Preservation in Declining Markets

Rural preservation practitioners from the Midwest and beyond learned how to structure deals, with an emphasis on working in declining markets, at a HAC training conference in late May. Held in St. Peters, Missouri near St. Louis, the event also included policy updates and a tour of successful projects in Hannibal and Palmyra.

In the conference’s concluding session, participants worked together in groups to analyze three real proposed preservation deals. The groups, along with a panel of experts, provided invaluable advice to the organizations hoping to save these properties.

Preservation Research Connects the Dots

A forthcoming HAC research report analyzes the location, composition, and proximity of federally subsidized rental housing in rural communities, with a special focus on USDA’s Section 515 Rural Rental Housing program. HAC’s study, funded by the John D. and Catherine T. MacArthur Foundation, examines the extent to which Section 515 properties and units coexist with those subsidized by other federal programs. Ultimately, it informs the larger debate on the role, availability, and preservation of affordable rental housing in rural America. Publication of Connecting the Dots: A Location Analysis of USDA’s Section 515 Rental Housing and Other Federally Subsidized Rental Properties in Rural America will be announced at www.ruralhome.org.

Capacity Building Grants Awarded

Rural community-based organizations will be better able to help local renters, thanks to grants made possible by the HAC/Enterprise Community Partners Rural Capacity Building Initiative. The grantees are all preserving affordable rental homes that are in danger of being demolished or converted to units for higher-income tenants.

Organizations funded under the current RCBI round are:
- Community Housing Partners Corporation, Virginia
- Delta Area Economic Opportunity Corporation, Missouri
- Delta Housing Development Corporation, Mississippi
- Hudson Valley Housing Development Fund Company, Inc., New York
- Northeast Community Action Corporation, Missouri
- Southeast Alabama Self-Help Association, Alabama
- Tierra Del Sol Housing Corporation, New Mexico

RCBI is a multi-year project that combines HAC’s depth, outreach, and expertise in rural communities with Enterprise’s resources and services. Over several years, funding from Enterprise has allowed HAC to aid hundreds of community-based organizations in rural areas.

"Tom Sawyer" and "Becky Thatcher" joined conference participants for a tour of a preserved complex in Hannibal, Missouri, Mark Twain’s home town.
TIPS FOR SUCCESSFUL PRESERVATION DEALS

*by presenters at Preserving Rural Rental Housing: A Practitioner’s Conference, May-June, 2007*

- Communicate, communicate, communicate! Figure out early who the players are: funding sources, community leaders, tenants, architect, and others. Talk with them often and build relationships. Designate a single point of contact and ask other parties to do the same.

- Assume everything that can go wrong will.

- Use expert help, especially if you are new to preservation. Do not take on too much too fast.

- Be prepared. For example, review funding sources’ regulations and guidance in advance and be ready to address the issues that will concern them. Identify key deadlines early. Determine early how each party will want appraised value to be determined, and when. Review carefully the capital needs assessment, a major factor in the budget of every preservation project.

- Be flexible. Numerous changes will be needed along the way in each deal. Also, each deal is unique, so what worked last time may not work now.

- Be creative. Find ways to make the deal work (within the regulations, or at least within RD’s waiver authority). Never say never. If trying something new means more work, consider that it may be worth it in the end.

- Simplify the deal where possible. For example, if multiple properties are involved, use one capital needs assessment provider, one attorney/title insurance company, and one appraiser.

- Consolidate multiple properties located close together. Consolidation will allow sharing management, transferring Rental Assistance between related properties, and the like. For a portfolio transaction, RD prefers to do one deal first as a trial run.

- Learn as you go. If something did not work out in your last deal, address it early in future deals. Build on what did work and what has worked for others. Offer suggestions for improvement. Attend as many training sessions as possible.

THANKS TO THE JOHN D. AND CATHERINE T. MACARTHUR FOUNDATION

The John D. and Catherine T. MacArthur Foundation has provided support to HAC as part of a larger preservation initiative called *Window of Opportunity*, a ten-year, $75 million effort to preserve and improve affordable rental housing across the country.

This support funded the development and production of this issue of *Rural Voices*. It has also enabled HAC to provide rural rental preservation training, conduct research, and provide preservation loans and technical assistance.
Since the late 1980s, the main source for affordable rental housing in rural America, the federally subsidized Section 515 program, has been under assault. Not only has new production under the program declined to a trickle, but many owners of existing properties have attempted to exit the program and convert to market rate rents. Some (though by no means all) owners who prepay their Section 515 mortgages then boost the rents, often eliminating the only source of affordable rental housing in a small town.

In 1987, Congress responded to the trend toward prepayments by enacting the Emergency Low Income Housing Preservation Act, an attempt to limit prepayments through a combination of incentives for owners to stay in the program and restrictions on their ability to get out. Since then, the view on how well the ELIHPA preservation system works depends on one’s perspective. Owners unhappy with restrictions on their prepayment rights view ELIHPA as a government violation of their pre-existing contract rights. Their prescription has been to deregulate prepayments and let owners exit the program.

Housing advocates see ELIHPA as a valid and necessary means to accomplish a critical public policy goal, retaining our precious supply of affordable housing. Their view is that ELIHPA should be retained, and fine-tuned to encourage more preservation. Finally, Rural Development, the U.S. Department of Agriculture “mission area” responsible for administering the Section 515 program, has concluded that the program’s most important preservation goal should be addressing the potential physical decline of the Section 515 inventory, rather than focusing on stopping prepayments. As demonstrated in the Administration’s recent budget proposals, RD’s view is that it should concentrate on funding the physical revitalization of Section 515 properties, allowing owners who want to get out to prepay freely, while the agency protects affected tenants.

A number of key developments affecting federal rural preservation policy, shaped largely by these three contending points of view, have occurred in the last couple of years. This article will trace the major recent developments, which appear to be converging toward the most significant changes in rural housing preservation policy in two decades.

RD’s 2004 Study and Demonstration Programs

In 2004, RD released Rural Rental Housing—Comprehensive Property Assessment and Portfolio Analysis, a report that would come to shape the agency’s preservation agenda. The study concluded that the foremost threat to the existing supply of Section 515 properties was the lack of adequate reserves to address the capital needs of these aging properties. It recommended that funding the physical revitalization of the inventory should, therefore, become the agency’s top priority. The study also concluded that avoiding prepayments by providing owners incentives to stay in the program was just too expensive. The agency was better off allowing owners to exit the program freely. Opening the door to prepayments could lead to a loss of
approximately 10 percent of the inventory of properties, but as long as RD protected the tenants from displacement, the policy trade-off was worthwhile, the study concluded.

To test the viability of these proposals Congress appropriated funding for several demonstration programs. One approach was to create a demonstration revitalization program, in which project owners could seek various forms of financial assistance from RD as well as third party sources to upgrade the condition of their properties. [Editor’s note: This program is described in another article in this issue of Rural Voices]

Another demonstration program was established to use a previously authorized but unfunded RD voucher program to protect tenants from the effects of Section 515 prepayments. In fiscal year 2006 RD began issuing vouchers to tenants to cover the increased costs resulting from owners converting their properties to market rate rents. Although it is billed as a tenant protection program, in reality in most cases the effect of providing vouchers simply shifts the cost of protecting tenants against higher rents from the owners (who had to control rents for current tenants as a condition of exiting the program) to the government.

2006 Proposed Legislation

Armed with its study and some limited initial experience with these demonstration programs, the Administration proposed legislation, introduced with some changes as H.R. 5039 in 2006. This bill had two major objectives: establishing a permanent revitalization program and deregulating prepayments (while protecting current tenants). The bill became the subject of a hearing, was amended, and was approved by a House committee, but did not ultimately pass, due in part to significant controversy over key provisions.

Much of the revitalization section of the bill received wide support but one area of disagreement was never fully resolved. The bill originally contemplated post-revitalization rents potentially significantly higher than rents normally associated with a program to serve rural America’s poorest residents. Housing advocates insisted that if owners were to receive substantial funding to upgrade their properties, this had to be accompanied by truly affordable rents. Although the bill’s sponsors eventually moved closer to this principle, the essential problem was that Congress had not identified or appropriated the subsidies necessary to accomplish both revitalization and affordable rents.

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PRESERVATION IS GREEN

Not only is preservation cost efficient, it’s also fundamentally green: renovating an existing building produces less construction waste, uses fewer new materials, and requires less energy than new construction. Preserving existing housing also does not require new land development.

A National Housing Trust examination of current Low Income Housing Tax Credit qualified allocation plans reveals that states are increasingly encouraging responsible and environmentally efficient building. Today nearly every state incorporates at least some incentives in its QAP for building green.

Most states give a preference to green projects by awarding points to these projects when allocating tax credits. Forty states now award points to tax credit projects that include environmentally friendly building practices. Consistent with their commitment to responsible building, some states have begun to recognize that preserving existing affordable housing is inherently green by providing separate scoring criteria for evaluating rehabilitation projects and new construction. A number of states also offer a non-numeric preference for environmentally friendly development.

Twenty states go even further by requiring that projects meet a minimum set of standards to qualify for tax credits. Requirements include meeting certain energy efficiency standards and using low toxic, healthier building materials.

The National Housing Trust has compiled a summary of green incentives in each state that are relevant to preservation developers. For this and other resources on green affordable housing preservation, visit http://www.nhtinc.org/pub_pol_green_new.asp.
PRESERVATION BARRIERS AND OPPORTUNITIES

by Debra D. Schwartz and Erika Poethig

This article was adapted from remarks delivered by Debra D. Schwartz at “Preservation Now and in the Future,” a national symposium convened by the U.S. Department of Housing and Urban Development on May 24, 2007 and by Erika Poethig at a National Preservation Data Meeting convened by the University of Florida Shimberg Center for Affordable Housing on May 17-18, 2007.

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ith so much attention and concern focused on homeownership and rising foreclosure rates, it is easy to forget that one-third of all American households currently rent their homes. The fact is, nearly all of us are renters at some point in our lives.

Unfortunately, our nation’s existing supply of affordable rental homes is eroding, even as the need for decent, low-cost homes continues to grow. Harvard University’s Joint Center for Housing Studies reports that over the past 10 years two existing units were lost for every affordable rental newly built. Without concerted action, our nation’s stock of affordable rental housing is projected to fall by another million units or more in the decade ahead.

Key factors driving the loss of affordable rental homes include escalating rents and condominium conversions in strong real estate markets, demolition of deteriorated or abandoned properties in weaker markets, expiring government subsidies, and a lack of resources and incentives to support the preservation and improvement of existing properties by capable owners with a long-term commitment to providing quality affordable housing.

A Window of Opportunity

The John D. and Catherine T. MacArthur Foundation is supporting a 10-year, $75-million national initiative aimed at tackling this vital affordable housing challenge. This effort is called Window of Opportunity: Preserving Affordable Rental Housing. Its goal is to directly support the preservation and improvement of 100,000 affordable rental homes and to significantly improve the regulatory and funding environment for preservation through policy reforms at local, state, and federal levels.

Affordable housing is one of the Foundation’s top four priorities and the Window of Opportunity initiative is the centerpiece of this work. Other targets for MacArthur’s housing support currently include public housing transformation in Chicago; community development financial institutions across the U.S.; and a new research initiative to better understand the ways that stable, affordable housing matters for individuals, families, and communities.

$3.5 Billion in New, Cost-Effective Investments

The Foundation tracks the preservation activity of nonprofit housing owners and specialized financing intermediaries funded through the Window of Opportunity initiative. Collectively, from the time these organizations received initial funding through the end of last year, they had acquired or provided loans for the preservation of more than 35,000 affordable rental homes across 37 states,
Washington, D.C., and Puerto Rico (see map: right). About half of this activity has taken place in urban markets, a third in suburban communities, and the balance in rural areas.

It is expected that by the end of 2007 over $3.5 billion in new long-term subsidy and financing will have been invested in *Window of Opportunity* projects at an average cost of roughly $80,000 per home. This is significantly less than the cost to build a new affordable rental unit anywhere in the country today.

Preservation owners are using newly raised capital to upgrade properties with new windows, roofs, heating systems, and interior fixtures. Preservation also provides an opportunity to introduce stable, long-term management and provide other important benefits to residents and surrounding communities. For example, one-quarter of the Foundation-supported preservation projects now have computer labs. Almost a third have playgrounds. Twenty-three percent offer financial literacy classes or counseling and about one-quarter offer on-site health and wellness programs.

Preserving affordable rental homes is a sensible, cost-effective way to strengthen communities and conserve taxpayer dollars. The growing track record of preservation leaders also reveals a practical and immediate opportunity to encourage smart growth, support mixed income development, prevent displacement, turn around troubled neighborhoods, make the nation’s housing stock more energy-efficient, and provide suitable, stable homes for the country’s growing senior population.

**Serious Barriers Remain**

While preservation-oriented policy innovations and real-life examples of preservation success have proliferated over the past five years, the annual volume of affordable rental housing preservation in the U.S. still falls short of the overall need. The best available data suggests that 50,000 to 100,000 units are preserved each year but an average of 150,000 or more are being lost.

To solve this problem more fully, three fundamental barriers must be overcome:

- **Properties.** Current resources, incentives, and requirements tied to affordable rental properties do not adequately encourage or require owners to preserve long-term affordability or to sell to other owners committed to that objective.

- **Ownership.** Current policies also limit the ability of owners to recapitalize, earn sufficient cash flow, and build a sustainable capital base from which to successfully maintain, manage, and operate properties that are affordable to low- and moderate-income renters.

- **Transactions.** Current housing programs and regulations are fragmented, cumbersome, often unpredictable, and inconsistently applied. Transactions that would transfer properties to new owners committed to preserving affordability and providing good long-term stewardship are difficult, costly, and slow.

Reforms also are needed to address the limited protection and uneven support currently provided to residents of properties being converted to market-rate rents or condominiums, undergoing preservation sales, or being foreclosed or demolished.

**A Policy Framework for Long-Term Preservation Success**

Fortunately, over the past five years, a growing number of preservation leaders in the nonprofit, private, and public sectors have adopted new policies, programs, and practices...
that are working to tackle the preservation challenge at local, state, and federal levels. Good ideas, experts, and promising programs are spreading throughout the country. This is especially true among states and localities that have increased their support and taken the lead on innovative financing, data, and intergovernmental initiatives to reverse the loss of affordable rental housing.

Today’s rising wave of preservation-oriented policy reform is good news for renters, communities, and all those who are concerned about the country’s large, unmet need for affordable housing. Recent experience also points the way toward a framework for achieving even greater success in the future.

Fundamentally, there are five areas in which model preservation policies need to be widely adopted at local, state, and federal levels:

- **Improve, Expand, and Integrate Information.** Innovative early warning systems are being developed by a growing number of public agencies, community-based groups, universities, and others. But the models and methods vary widely, hindering replication and the ability to draw consistent, clear, or rapid conclusions. Increased philanthropic support and public engagement is needed to collect, standardize, and widely share information about existing affordable rental properties, their residents, and the key factors that pose a potential risk of loss.

- **Clarify, Streamline, and Coordinate Regulation.** Problems that delay or constrain otherwise sensible preservation projects include slow and opaque decision-making, inconsistent application of rules, and varied processes among regional offices within a single federal agency. These problems can be overcome if administrators, regulators, and lawmakers actively seek input from preservation experts. They also need to coordinate within and across agencies at all levels of government.

- **Increase and Align Incentives.** State and local incentives for preservation are increasing. But new trust fund dollars, tax breaks, and other financial resources may fail to have their full intended effect due to offsetting federal tax and debt repayment requirements.

To encourage preservation, reduce speculation, and maximize long-term affordability, all legislators and policymakers should consider ways to increase and align the tax, regulatory, and financial incentives for sellers and owners of existing affordable rental properties.

- **Reward Responsible Long-Term Stewardship.** Ultimately, preservation requires policies that promote responsible long-term stewardship of quality affordable housing. To succeed, long-term preservation owners need to keep their properties physically viable, to maintain continued affordability, to promote their residents’ well-being, and to keep their own organizations well run. This takes a range of resources—from public, private, and philanthropic sources. Long-term owners of affordable rental housing also should be given the ability to tap internally generated resources for new development and preservation projects, so long as their existing properties remain capitalized and managed appropriately.

- **Encourage and Reinforce Innovation.** Government agencies, at all levels, should seek ways to provide flexibility, reward innovation, and remove restrictions that unduly limit the use of particular subsidies or financing tools. For example, policymakers should consider whether certain timing restrictions related to the transfer of properties to new owners can be eased if a preservation purpose is being fulfilled.
Innovation and flexibility are particularly important because, as with all real estate matters, preservation of affordable rental housing ultimately remains subject to local market forces, conditions, and needs. No one measure will work equally well in both strong and weak markets, for subsidized and unsubsidized properties, or in urban, suburban, and rural communities alike. Moreover, not every existing affordable rental home can or should be preserved.

More than Housing at Stake

Billions of public dollars have been invested through tax breaks and subsidies over more than 50 years to create and maintain the affordable rental homes now being lost. If losses from the existing stock continue to outstrip the number of newly built affordable rental homes each year, the value of current taxpayer investments used to build these new properties will be undermined as well.

But more than dollars and buildings are at stake. The loss of affordable rental housing destabilizes families and communities. Without a mix of housing options, communities cannot attract and retain a diverse population with a mix of incomes, ages, and occupations. Moreover, a growing body of research indicates that people who live in stable, affordable homes near where they work do better in holding jobs, and their children do better in school. For aging seniors living on modest fixed incomes and others with health problems or physical limitations, stable and affordable housing is a critical lifeline that also provides a ready-made channel for the delivery of human services.

Preserving affordable rental housing is a national challenge that can and must be met. Working harder to preserve existing affordable rental homes is the only way to fully counter the losses otherwise projected to occur. Preserving the stock that already exists also ensures that newly built affordable rental units truly add to our nation’s total stock.

Local, state, and federal policymakers have an especially critical role to play. Only they can deliver the coordinated information, investment incentives, and regulatory improvements needed to engage private market players more fully, to strengthen the existing supply, and to systematically encourage the transfer of existing properties to a new generation of dedicated, qualified owners.

Across the United States, there is a window of opportunity to preserve and improve tens of thousands of affordable rental properties where seniors, young adults, and working families make their homes. With enough collective resolve, we can capitalize on these existing assets to provide decent, affordable housing for many years to come. But real progress will take more than a one-time or temporary “fix.” To have a truly meaningful impact, preservation must become an integral part of balanced, long-term housing policy throughout the nation.

Real progress will come when we collectively resolve to make the most of assets we already have: millions of existing rental properties that can be preserved and improved to provide decent, affordable homes for another generation of use. The MacArthur Foundation is proud to be helping preservation leaders forge practical solutions to this important challenge in communities across the nation.

Debra D. Schwartz is Director of Program-related Investments and Erika Poethig is Program Officer for Housing and Policy Research at the John D. and Catherine T. MacArthur Foundation Program on Human and Community Development. More information about the Foundation’s support for affordable housing is available on its website, www.macfound.org.

Kitsap County Consolidated Housing Authority is helping to save Finch Place, a 29-unit low-income, senior apartment complex on pricey Bainbridge Island, Washington.
On October 23, 2006, Agriculture Secretary Mike Johanns announced that 78 multifamily housing developments in 16 states were selected for inclusion in USDA Rural Development’s Multi-Family Housing Preservation and Revitalization Restructuring Demonstration program, designed to preserve and rehabilitate apartment complexes financed through RD. During FY 2006, RD’s demonstration, known as MPR, funded a total of almost $47.8 million in loan restructurings plus over $20 million in new financing and tax credits, making it possible to rehabilitate 2,228 apartment units.

“Decent and safe housing is important in any community and this project will help our rural communities to provide it,” said Johanns. “This project will ensure that existing rental properties will be repaired or rehabilitated to bring new vibrancy to rural America.”

**MPR’s Basics**

The MPR demonstration program, which began during FY 2006 and continues this year, allows for the restructuring of selected existing Section 515 USDA Rural Development rural rental housing loans. While many of the properties financed in past decades are in excellent condition, some require substantial revitalization resulting from obsolescence and normal physical depreciation. The program is seen as a way to accomplish that objective. The MPR is intended to assure that existing rental projects will be able to continue to deliver decent, safe, and sanitary affordable rental housing for 20 more years.

MPR funding may be used for debt deferrals, revitalization grants, rehabilitation loans, soft mortgage loans, debt forgiveness, and subsequent rehabilitation loans. Under the 2006 demonstration program, complexes are slated for rehabilitation in Arkansas, Iowa, Kansas, Louisiana, Maine, Massachusetts, Missouri, Mississippi, North Carolina, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Washington, and Wisconsin. For example, in Menno, South Dakota, six apartment buildings containing 24 units, constructed between 1966 and 1981, will receive repairs including new windows, siding, doors, rehabilitated kitchens and bathrooms, and parking facilities. Funds will come from a combination of debt deferral and a $500,000 loan.

During the week of June 25, 2007, Rural Development State Offices in 46 states across the country let 172 owners know that, based on preapplications they submitted, they had been selected for further processing in the FY 2007 MPR demonstration program. The budget authority provided by Congress for the FY 2007 MPR demo is similar to the FY 2006 level. With the use of additional Section 515 rehabilitation money and a more efficient use of demonstration tools, Rural Development hopes to increase the number of properties revitalized during FY 2007 to around 100 rather than last year’s 78. The average Section 515 property has 27 apartment units, so we anticipate expanding the reach of the revitalization funding to almost 600 more very low-income rural families this year than last year.
MPR’s 2007 Goals

After a successful FY 2005 pilot and a successful FY 2006 full MPR demonstration program, we look forward to building on a strong foundation during FY 2007. We grow more confident that the conceptual strategy behind the revitalization process will work to revitalize this much-needed multifamily housing portfolio. This year our focus is on building capacity both internally and externally so that the MPR process becomes routine and highly efficient. While we are growing in competence in processing these transactions, we also recognize that all the parties involved need to work together to make the MPR and revitalization process function more effectively.

During FY 2005, we concentrated on making sure that we had the basic forms and formats in place. During FY 2006, we focused on refining the process and ensuring that it could work well at a higher funding level in just a few states before we opened it up nationwide. This year we have three key goals:

♦ to expand the processing experience to as many states as possible;
♦ to encourage the processing of multiple properties or “portfolio sales;” and
♦ to push our funding flexibility to facilitate the use of third party money.

On another front, we found that many of the MPR transactions also involved transfers and that the transfer advice found in RD’s handbooks did not adequately address portfolio transfers and the use of third party funding. So we added a fourth goal:

♦ to review and update a “transfer” handbook to make sure that it provides useful advice and guidance to those both inside and outside the agency in processing more complex transfer transactions.

Lessons Learned

Our goals this year are a result of some key lessons we have learned so far. The first is simply that there are a tremendous number of owners looking for a preservation solution. Like their properties, owners of Section 515

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The Section 538 Guaranteed Rural Rental Housing Program was authorized by Congress in 1996 as a pilot for the development of affordable multifamily rural rental housing, and was made permanent in 1998. The GRRHP was established as a partnership between USDA and public and private lenders. USDA provides a 90 percent guarantee on losses to program lenders who originate, underwrite, and service loans for new construction and acquisition with rehabilitation of multifamily rental housing in rural areas. The GRRHP started with modest funding levels early on but steadily grew over the years. Fiscal year funding in 1996 was $14 million, and in 2007 it is $100 million.

The GRRHP has become an attractive and necessary alternative to the use of conventional financing for the development of affordable housing. Regulations offer flexibility in lender underwriting and servicing, an interest rate buy-down feature—which has proven to be particularly important in an escalating interest rate market—and benefits to lenders and developers alike. Among developer incentives offered by the program are minimal borrower equity requirements of 10 percent for for-profit entities and 3 percent for nonprofits and public bodies, no Davis-Bacon requirements, and unlimited return on investment. Lender benefits include community reinvestment credit, the ability to sell GRRHP loans to the secondary mortgage market and private investors, and flexible underwriting standards and oversight.

In terms of affordability and project feasibility, the GRRHP permits a minimum 1.15 debt service coverage ratio, allows for a 40-year amortization schedule, and offers interest credit on $1.5 million of the loan amount down to the long-term monthly applicable federal rate at the date of loan closing. These program features make rents affordable and projects achievable. Tenants with incomes up to 115 percent of the area median, adjusted for family size, can qualify for the housing units. The program limits utilities expense to 30 percent of the qualifying rent. More importantly, income qualification requirements apply to tenants only at first-time occupancy. Once qualified, tenants may stay in the housing even if their incomes increase.

The program's income eligibility requirement has earned the GRRHP an undeserved reputation as a mechanism for the development of housing on the periphery of large
metropolises where people have higher incomes. Geospatial data on the program indicate that Section 538 guaranteed properties are located in rural areas, often near Section 515 projects, serving low- to very low-income populations.

The following two examples showcase the program’s flexibility in improving and preserving the housing stock of low- to very low-income tenants. The program’s 40-year amortization schedule, the interest rate buy down, 4 percent or 9 percent Low Income Housing Tax Credits, and tenant-based housing vouchers are complementary factors that achieve affordability for very low-income tenants.

Ownership Transfer with Old Loan Subordinated

Sunrise Villas Place is a 27-year-old property located in northern Maryland, where the median income is $47,150. Sunrise Villas consists of 28 one-bedroom units and 28 two-bedroom units. Construction was initially financed in 1980 with a Section 515 loan in the amount of $1,308,720 with a term of 50 years and a subsidized interest rate of 1 percent. In 1998, the property was approved for a subsequent Section 515 loan in the amount of $234,000 with a term of 50 years at an effective 1 percent rate. The 20-year restrictive use agreement imposed by the Section 515 program was due to expire on April 18, 2017.

Before the property was transferred in early 2007, rents were $498 for a one-bedroom unit and $606 for a two-bedroom apartment. Of the total 56 units, 39 received Section 521 Rental Assistance. The property had 17 income-restricted units without RA. As expected, the debt service coverage was marginal at 1.1. The property struggled to meet the reserve requirement of $192 per unit per month.

The injection of Section 538 guaranteed capital served to improve the physical state of Sunrise Villas Place and preserve affordable housing in a much needed area. This was achieved through a transfer of the property and assumption of Section 515 debt to a new owner. Both the former and new owners are for-profit corporations. The Section 538 guaranteed loan in the amount of $2,177,000 was used for acquisition and rehabilitation; an equity payment of $575,000 was made to the previous owner and $1,602,000 covered hard and soft costs, including the developer fee.

The Section 515 debt was subordinated to the Section 538 guaranteed loan with new loan terms. The new owner assumed $1,389,167 of Section 515 debt at 1 percent for a 30-year term amortized over 40 years. The Section 538 guaranteed loan of $2,177,000 shares the same term and amortization schedule as the Section 515 debt. The rate for the Section 538 loan, however, is 6.9 percent. The interest rate on the first $1.5 million of the Section 538 loan was reduced with interest credit to 4.7 percent while the balance of the note remains at the 6.9 percent rate. Rents increased from previous levels, but RA transferred with the previously designated RA units to alleviate the additional rent burden on tenants. The rent is now $691 for a one-bedroom unit and $793 for a two-bedroom.

The new financial structure of Sunrise Villas Place addressed several pressing issues facing the property. The new structure enabled the previous owner to transfer the property and receive an equity payment. The new financing permitted much-needed rehabilitation of an older Section 515 complex and the funding of reserves in the amount of $465 per unit per month, an adequate figure based on a Capital Needs Assessment. The debt service coverage was set at 1.15. The restrictive use provisions were extended for an additional 30 years, ensuring that the property remains as affordable housing. And the impact on rents was addressed through the continuation of RA for the already existing 39 RA units. The new owner agreed to cover the difference in rent from previous levels for the 17 non-RA units from return to owner funds.

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Preserving affordable housing has become the essential first step in solving the housing dilemma facing communities all across America. Affordable rental homes are an irreplaceable national resource. In rural America, the Section 515 program provides homes to more than 400,000 families and seniors who have an average annual income of only $10,000. Preserving this housing most often means addressing the physical needs of deteriorating properties. Two-thirds of the Section 515 portfolio is now more than 20 years old and many properties do not have adequate cash flow or reserve accounts to pay for essential rehabilitation costs. With federally subsidized housing developments often the only affordable housing available in our nation’s rural areas, preserving and improving this housing has become more urgent.

Fortunately, despite a number of challenges, affordable rural housing is being preserved, in no small part because state and local policymakers are recognizing the importance of reinvesting in the existing affordable housing stock. A major obstacle to preservation is securing financing to address the property’s physical needs, especially since budget constraints have limited the availability of federal funds for property rehabilitation. State and local agencies have been meeting this challenge by digging deep to find needed resources.

**State Housing Agencies Continue to Stress Preservation**

Partnerships with state housing finance agencies are essential for preserving affordable housing. (See case study on Clover Patch Apartments.) Tax credits provide an increasingly important source of funding to facilitate the preservation of rural properties. The preservation landscape has changed rather dramatically in only the last several years. Just five years ago, only a handful of states prioritized preservation in their Low Income Housing Tax Credit allocation plans. Today, 46 states prioritize preservation through points or a specific preservation set-aside in their 9 percent competitive tax credit program (see map). As a result, the number of affordable units preserved increased from 20,000 apartments in 2000 to more than 63,000 in 2006. Over the last four years, housing tax credits have helped preserve and improve more than 215,000 affordable apartments.

Other recent developments include the following:
- 25 states now maintain competitive tax credit set-asides explicitly for preservation.
In just the past year, three states—Florida, Kansas, and North Carolina—created new set-asides for preservation in their competitive Low Income Housing Tax Credit programs.

A majority of states now dedicate a portion of their 4 percent tax credits and private activity bonds to preservation.

In addition to targeting tax credits to preservation, most states have recognized the importance of supporting affordable housing in rural areas and have incorporated incentives for rural development in their tax credit allocation plans. Forty-five states now include a priority for rural development for both new construction and preservation in their tax credits qualified allocation plan. For example,

- 29 states include tax credit set-asides specifically for rural proposals;
- 20 states award points to rural proposals;
- four states offer a non-numeric preference for rural proposals; and
- 12 states combine two or more strategies.

Six states specifically target rural preservation in their QAPs. For example, Colorado awards points to proposals aimed at saving Section 515 properties that are within two years of their mortgage maturity. Indiana, Iowa, and Montana award points for rural preservation projects. Finally, North Carolina provides a $750,000 set-aside for rural preservation proposals.

State Agencies Confront Barriers and Develop Strategies for Rural Preservation

In addition to using tax credits, state housing agencies are finding solutions to preservation challenges that are particular to rural communities. Financing rural rental housing preservation is complicated by the small size of rural properties; the average size of a Section 515 property is around 30 units. In addition, many states identify the lack of local capacity as another barrier to rural preservation.

To meet these challenges, states have composed a variety of strategies for preserving existing affordable rural housing. Where developers use tax credits, states endeavor to group a number of rural properties together in one transaction. The New Mexico Mortgage Finance Authority creatively treated several rural properties, owned by the same entity, as one scattered site development. Five scattered site Section 515 properties were “rounded up” and bundled together in one bond issue. The consolidation of the properties dramatically reduced transaction costs and ultimately led to the preservation of a valuable Section 515 portfolio.

To address concerns about lack of capacity, some states pair local nonprofits with national nonprofits to preserve rural housing portfolios.

Housing Trust Funds Support Preservation

Another increasingly important source of resources for preservation is local and state housing trust funds. Eighty percent of all housing trust funds support affordable housing preservation, according to the Housing Trust Fund Project at the Center for Community Change. The Center recently released its 2007 Housing Trust Fund Progress Report which illustrates the growing impact of state, city, and county trust funds on affordable housing.

Housing trust funds are especially important for affordable housing development because they provide a continuous stream of funding not dependent on annual appropriations and often represent the most flexible funds jurisdictions have available for affordable housing. There are currently 600 housing trusts nationwide that contribute $1.6 billion each year towards critical housing needs.

Nearly all state housing trust funds make financing or grants available for preservation. Some states, including the District of Columbia, Florida, Indiana, Montana, Utah, Vermont, and Washington, prioritize preservation as a preferred activity. At least one state, New Jersey, goes even farther by setting aside a specific portion of its trust fund money for affordable housing preservation activities.

In Utah, the state housing trust fund has become an important source of funding for preserving the state’s invaluable supply of Section 8 and Section 515 subsidized rental units. According to Shellie Goble, multifamily director for Utah’s Olene Walker Housing Loan Fund, the fund’s success can be attributed to the recipients’ ability to combine trust fund loans or grants with other funding sources. “Historically we’ve found that our projects leverage up to $11 in other funding sources for every dollar they receive from the Fund,” she said.
Other State and Local Preservation Tools

Finally, states, cities, and counties are dedicating additional resources, outside of tax credits and trust fund dollars, to the development and/or preservation of affordable housing. Most states use HOME funds to finance preservation. Other resources include providing predevelopment and bridge loans, allowing owners equity take-outs, providing tax incentives to owners who agree to maintain the housing as affordable, developing nonprofit CDFIs that fund predevelopment or provide bridge financing for preservation transactions, and allocating state and local tax revenue, as well as many other tools that are documented in a preservation database available on the National Housing Trust’s website (www.nhtinc.org).

Tracy Kaufman is Director and Todd Nedwick is Assistant Director of National Preservation Initiatives at the National Housing Trust. The John D. and Catherine T. MacArthur Foundation has helped to support NHT’s activities.

Clover Patch Apartments: A Case Study in Successful Rural Preservation

Despite challenges, affordable rural housing is being preserved. Clover Patch Apartments in St. Charles, Minnesota, a Section 515 property saved from market-rate conversion, is a case in point.

Clover Patch was transferred to a nonprofit after the owner decided to prepay the mortgage. But the deal almost did not take place; it was quite a challenge for USDA Rural Development to find a nonprofit willing to take ownership.

Clover Patch was eventually saved because a local nonprofit, Three Rivers Community Action, and the Minnesota Housing Finance Agency developed a successful strategy to raise sufficient rehabilitation funds and overcome the financial obstacles. But the difficulties Three Rivers encountered in saving Clover Patch underscore the challenges of revitalizing Section 515 properties and the need to make saving rural housing much easier, simpler, and more rewarding.

Clover Patch Apartments, built in 1980, was financed through USDA’s Section 515 program. In 2001, the owner applied for prepayment. The 20-year low-income use restriction period imposed on post-1979 Section 515 properties had expired. As a result, the owner could convert the property to market rate, making Clover Patch’s tenants vulnerable to substantial rent increases.

After reviewing the owner’s application for prepayment, Rural Development determined the loss of this affordable housing would adversely affect housing opportunities for minorities in the region. This was significant because it meant the owner had to market the property to a nonprofit or public agency that would maintain affordability.

However, the search for a qualified purchaser was not easy, in part because nonprofits cannot currently be reimbursed for organization costs or earn a developer fee under Rural Development loan programs. Without the ability to earn a developer fee, only one group stepped up to the plate: Three Rivers Community Action. Three Rivers decided to divide the financing into two parts: Rural Development transferred the existing mortgage to Three Rivers and provided a new loan to cover the gap between the owner’s equity and the outstanding loan. Rural Development also increased the number of units receiving USDA project-based Rental Assistance from 18 to all of the property’s 32 units.

Three Rivers then found the funding for rehabilitation and organization costs to undertake the transaction. Minnesota Housing Finance Agency provided a $350,000 deferred loan from its Preservation Affordable Rental Investment Fund Program, a statewide program that provides low-interest deferred loans to help cover the costs of preserving permanent affordable rental housing with long-term project-based federal subsidies that are in jeopardy of being converted to market-rate apartments. The Greater Minnesota Housing Fund provided a deferred loan in the amount of $120,000. An additional $50,000 contribution from First Homes, a local affordable housing foundation initiative, rounded out the financing mix.

Originally printed in the National Housing Trust’s Preservation Newsletter, May 23, 2006
FOUR REASONS TO PRESERVE EXISTING RURAL RENTAL HOUSING

1. Preservation costs less than new construction.
2. Preservation delivers units faster than new construction.
3. Preservation is green.
4. Preservation combats NIMBYism.

needs assessment guidance to make the results of these assessments consistent whenever they are performed. Since there is tremendous pressure to keep rents affordable, we are also making clear in all our underwriting guidance that funding to address properties’ physical needs remains the top priority for all available funding resources.

Internally, the agency continues to build capacity to process MPR transactions, including transfers, and holds weekly teleconferences with field staff to stay in touch on the latest developments. MPR processing is led in the National Office by three experienced senior loan specialists who lead three “teams.” Sherry Engel leads the Midwest and Northeast team, Carlton Jarratt leads the Southern team, and Barbara Chism leads the Western team.

A lead MPR underwriter has been established in each state and we strongly encourage potential owners and developers interested in the MPR or Section 515 revitalization in general to contact the appropriate state multifamily housing underwriter to begin their pursuit of preservation opportunities. We strongly encourage “early and often” communication to provide a much better opportunity for a successful result.

Finally, we continue to work with the Housing Assistance Council and other organizations and entities that are interested in preserving and revitalizing Rural Development’s Section 515 multifamily housing program. It has been a real and tangible benefit to rural communities for over 40 years, and RD looks forward to working with strong partners to assure its continued success into the future.

Laurence Anderson is Assistant Deputy Administrator for Multi-Family Housing at USDA Rural Development.

MPR information, including lists of state contacts and the preapplications selected in the initial round of the 2007 program, is available at http://www.rurdev.usda.gov/rhs/mfh/MPR/MPRHome.htm.
TAX CREDITS AND TIERS: HONEYTREE’S STORY

by Janaka Casper and Kathy Talley

Preservation of the Honeytree Apartments has been a sticky process for Community Housing Partners Corporation, an experienced nonprofit housing developer. CHP began its efforts in 2003 and is still facing unresolved issues in summer 2007. This article tells the story so far.

The Honeytree complex is located in South Boston in south central Virginia, an economically depressed area of the state. Originally developed in the mid 1980s, Honeytree provides 48 apartments for families. In 2003, when CHP decided to purchase it, it was fully occupied and in reasonably good condition although it did need renovation. It had no USDA Rental Assistance, but CHP was able to move 21 units of RA to Honeytree from properties in other parts of the state.

Rent Structure

In March 2003, CHP signed an agreement to purchase Honeytree and applied for an allocation of Low Income Housing Tax Credits from the Virginia Housing Development Authority, the state’s housing finance agency. In July 2003 CHP executed its LIHTC reservation agreement.

Like all tax credit developers, for Honeytree CHP had to balance its desires to serve families in the area, to make its tax credit application competitive by setting aside units for tenants with the lowest possible incomes, and to make the project feasible by bringing in the most possible rental income.

CHP chose to set aside five apartments for families with incomes at 40 percent of area median income, 35 for families at 50 percent of AMI, and eight for families at 60 percent of AMI. For each income level, there would be some one-bedroom units and some two-bedroom units. The rents would be structured accordingly; each unit size would have rent tiers corresponding to tenants’ income levels, as shown in the table. Honeytree would be the first Section 515 property in the country with a tiered rent structure.

Tiered Rent Structure
Honeytree Apartments

<table>
<thead>
<tr>
<th>Number of Bedrooms</th>
<th>Income Level</th>
<th>Number of Units</th>
<th>Rental Rates</th>
<th>Potential Income</th>
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<tr>
<td>Total</td>
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<td>$297,408</td>
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</tbody>
</table>

Acquisition and Obtaining Financing

Between July and December 2003 CHP focused on completing paperwork required by RD. Since that time, RD has simplified this process by creating a checklist of required items and posting its forms online.
By November, CHP should have been ready to acquire the property in order to receive its allocation of the tax credits reserved in July. Since its RD paperwork was not yet complete, CHP asked VHDA for a two-month extension of the acquisition deadline. The agency provided CHP’s tax credit allocation in December 2003 and extended the acquisition deadline. In January 2004, a second extension was needed. In February the purchase finally closed.

The December 2003 tax credit allocation established a critical deadline. Six months afterwards, by June 2004, CHP would have to meet the LIHTC program’s “10 percent test” – that is, incur at least 10 percent of the project’s basis – in order to keep the tax credits. Without them, this deal could not go forward. Furthermore, if CHP did not meet this requirement VHDA would bar it from using tax credits in the state for five years.

In practice, meeting the “10 percent test” requires the developer to spend at least 10 percent of the costs of acquisition or construction (excluding soft costs). For Honeytree, like for most acquisition/rehabilitation projects, acquiring the property meant the 10 percent test was met. CHP staff were relieved and encouraged.

Additional funding was being lined up around this time. In October 2003, VHDA committed to make a $130,000 loan. By September 2004, CHP received funding commitments from the Virginia Foundation for Housing Preservation, an affordable housing lender that has since merged with Virginia Community Capital, and NeighborWorks® America. (These funds are included in the “other” line in the table showing sources and uses of funds.)

In fall 2004 CHP also applied for a subsequent Section 515 loan from RD to cover the cost of unanticipated construction required by RD and VHDA architects and inspectors including, for example, additional modifications for accessibility. In October 2005 RD made the commitment for this loan.

### Sources and Uses of Funds
#### Honeytree Apartments

<table>
<thead>
<tr>
<th>Sources</th>
<th>Uses</th>
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<tbody>
<tr>
<td>Virginia Housing Fund</td>
<td>Hard Costs</td>
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<tr>
<td>RD #1: Original Loan</td>
<td>Soft Costs</td>
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<td>RD #2: Subsequent Loan</td>
<td>Developer Fee</td>
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<td>Other</td>
<td>Acquisition Cost</td>
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<td>Tax Credit Equity</td>
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<td>Deferred Developer Fee</td>
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<tr>
<td>Total</td>
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</tbody>
</table>

In January 2005, the tax credit equity and the construction loan closed. CHP began construction facing another LIHTC deadline: the property was required to be placed in service by December 2005, two years after the tax credit allocation. By December, CHP had spent at least $3,000 per unit, the threshold for Honeytree to be considered placed in service, and met the deadline. Construction was not actually finished by that time, however.

One construction delay occurred because the original plan called for replacing part of the HVAC systems, but VHDA wanted the full systems replaced. When CHP acquired it, the property had a replacement reserve of $144,000, so CHP wanted to use part of those funds to cover the HVAC costs. To obtain the necessary RD approval, CHP began discussing this with the agency in May 2005. The request was approved in October 2006.
Steps Towards Rent Tiers

In October 2005 CHP submitted fiscal year 2006 budgets for all 18 of its RD-financed properties, including Honeytree, to RD for approval. The organization wanted to use tiered rents at most of these properties, but needed to get the concept approved for Honeytree first. The budgets without tiered rents were approved, but Honeytree’s was not.

CHP staff had discussed the tiered rent concept with RD’s state office early in the development process, and had received approval from the state multifamily housing director. Eventually, however, one of the four RD area offices in the state also became involved in the decision. Virginia’s RD staff is structured so that the area director and the state multifamily housing director are peers, and the area staff did not favor the tiered rent idea.

RD’s national office approved the tiered rent concept in February 2006, but that approval has not yet been implemented. In April 2006, CHP submitted its 2007 budgets with tiered rents for all its properties including Honeytree. In October 2006, CHP submitted 2007 budgets with tiered rents for all of its RD properties.

Construction at Honeytree moved forward in 2006, with RD’s final inspection in May, a follow-up inspection in July, and final RD approval in August after RD’s punch list was completed. From September 2006 through March 2007 CHP staff met repeatedly with RD state and area office staff regarding several issues, resolving some but not all of them:

- tiered rents;
- RD’s requirement that soft loans be repaid from the return-to-owner amount shown in the project budget;
- the value of the equity and CHP’s deferred developer’s fee that would be used to calculate the return to owner;
- differences between the vacancy and contingency rates required for the tax credit syndicator’s project budget and those required by RD; and
- guidance on meeting other RD requirements for the project’s budget.

In March 2007, CHP closed on the RD subsequent loan and the other permanent financing from VHDA and VFHP.

Current Issues

By early summer 2007, three issues remain unresolved.

- If construction had been completed at the end of 2005, the permanent financing would have closed in March 2006. Because the closing was delayed, CHP carried the construction loan longer than expected and incurred additional interest costs. RD agreed to include part of the additional costs in a second subsequent loan, but that closing has not yet happened.

- RD’s previous state director of multifamily housing had approved a CHP Rental Assistance Fund sufficient to enable a “ramp-up” of the tenant portion of rents over five years to bring original residents’ rents up to the higher rent levels required for the deal’s finances to work. Now CHP has been asked to create a rental assistance fund to provide permanent subsidies for original tenants who cannot afford the new rent levels. Questions remain as to how to determine the sizing of such a rental assistance fund for the few tenants that are affected.

- RD has not yet approved 2007 budgets for any of CHP’s 18 RD properties.

It is hard to say whether CHP would have chosen to preserve the Honeytree Apartments if we had known in 2003 what we know now. Certainly, if we could start this deal over again, we would have included the RD area office in our communications from the very beginning, rather than meeting initially with the state office only. We strongly recommend that other nonprofits seeking to preserve USDA properties work with all potentially relevant RD offices together from the start.

It is gratifying, despite the difficulties, to know that 48 families in South Boston, Virginia will have decent, affordable homes thanks to CHP. A smaller organization probably could not have taken the risks, spent the time, and incurred the expenses needed to bring Honeytree even this far.

Janaka Casper is President and CEO and Kathy Talley is Director of Multi-Family Housing Development Operations for Community Housing Partners Corporation, a nonprofit community development corporation dedicated to providing affordable housing and services for low-to-moderate-wealth individuals and families. The John D. and Catherine T. MacArthur Foundation has helped to support CHP’s preservation activities.
Deregulation of prepayments became even more controversial. Housing advocates and their allies in Congress made several points. Even if providing incentives to owners to stay in the Section 515 program was expensive, it was still significantly cheaper to preserve existing housing than to build new. Moreover, the expensive properties in good markets that H.R. 5039 would have allowed to leave the program were typically the best properties in the inventory; they were located in strong markets with job growth, the kinds of places that would give lower income households the opportunities to move out of poverty.

Finally, the vouchers proposed to protect tenants were no substitute for long-term preservation. As current tenants vacated the property over time the buildings would convert to market rate rents. Nor was the voucher program even fully adequate to protect tenants; in several important ways it fell short of its counterpart, the Department of Housing and Urban Development’s Section 8 program.

As of this writing, legislation based upon H.R. 5039 is expected to be introduced in the 2007 Congress, which will renew the debate on these and other issues. Given the change in the control of Congress, observers expect the new bill to reflect greater emphasis on preservation of the existing supply.

**Project Owner Litigation**

Although Section 515 project owners were involved in the enactment of ELIHPA, many of them have never been happy with the restrictions on prepayments. In their view, they entered the program relying on their eventual right to prepay and escape the program, and Congress changed the rules in the middle of the game by restricting those rights after the fact. Although the reality is considerably more complicated than that, this complaint has formed the basis for two kinds of legal challenges. One path has led to a pot of gold at the end of the rainbow, while the other appears to be leading to a dead end.

Many owners have filed suit in the federal Court of Claims, contending that the government’s actions in imposing ELIHPA constituted a breach of contract, giving rise to a damages claim for the lost profits from being unable to prepay. After nearly a decade of litigation, the Court of Claims has sided largely with the owners, awarding multi-million-dollar judgments. As of June 2007, the Department of Justice and the plaintiff owners have announced what might be termed a global settlement: 283 cases, involving 800 properties and 20,000 units, have now been jointly settled. The result is that under a formula negotiated by the parties, owners will receive a damages payment and in return will generally be required to stay in the program.

What is important to note is that ELIHPA restrictions remain valid and enforceable. This conclusion has been confirmed by the relative lack of success of owners’ alternative litigation strategy: suing in state court under “quiet title” statutes to attempt to nullify ELIHPA. Although courts have ruled both ways, the trend appears to be in favor of courts upholding the ability of Congress (and the duty of RD) to apply and enforce ELIHPA. In fact, even the damages settlements can be viewed as a preservation outcome, since the plaintiff owners are all committing to stay in the program.

The owner lawsuits have cast a cloud over ELIHPA, causing some in Congress to conclude that restrictions should be removed. Although it is impossible to know for sure if the wave of owner litigation has now largely passed, that may well be the case. This may also dissipate the “cloud” over ELIHPA, allowing Congress to concentrate on how to preserve this precious resource most effectively.

**The Near Future**

Legislation to enact a revitalization program will almost certainly be reintroduced, as will changes to the ELIHPA preservation structure. Housing advocates will have their list of goals, including ensuring that post-revitalization rents remain affordable to the poorest residents, that the essential ELIHPA protections remain in place, and that preservation be strengthened by greater encouragement of preservation transfers to nonprofit purchasers. Finally, the new voucher program must be strengthened to truly protect current and future tenants by borrowing key aspects of the Section 8 program; the voucher subsidy needs to adjust over time to keep rents truly affordable, and recycled vouchers should remain in the community for others to use.

*Tim Thompson is President of the Housing Preservation Project, a nonprofit public interest advocacy and legal organization whose primary mission is to preserve and expand affordable housing for low-income individuals and families. The John D. and Catherine T. MacArthur Foundation has helped to support HPP’s preservation activities.*
WORKING TO REVERSE DECLINING RURAL HOUSING MARKETS IN IOWA

by Kate Ridge

Populations are declining in many parts of the Midwest where National Affordable Housing Foundation works, and affordable rental housing is often limited and in disrepair. Preservation of this housing is a tool that assists Midwestern communities to maintain and, when possible, to grow their economic viability.

NAHF is committed to partnering with local communities in its preservation efforts. Working with the Iowa USDA Rural Development housing office, NAHF has acquired nine RD Section 515 family and senior properties since 2005. These properties were at risk of being sold as market-rate housing, creating the potential for loss of affordable housing for working families and seniors. All told, NAHF now owns and manages about 700 units.

Approximately 70 percent of NAHF’s tenants are elderly. Many of them are women coming off farms and delighted to be able to talk easily with their neighbors. Through its trained site managers, NAHF works to create a sense of community in each of its developments. Each development also includes services such as grocery delivery, information, and referrals.

NAHF recognizes that the need for affordable housing is particularly critical for seniors, but availability of appropriate housing is often extremely limited in rural communities. We believe that, with a commitment to our affordable housing mission and partnerships with others, the decline in rural housing can be reversed. The outcome will be stronger communities and improved quality of life for our most valuable community resources: residents.

Kate Ridge is President of the National Affordable Housing Foundation in Clive, Iowa.
Prepayment with Acquisition and Rehabilitation

In the case of the Cypresswood Apartments in Pearson, Georgia, the Section 538 guaranteed loan was used to prepay the Section 515 debt with a very favorable outcome for property and owners. Cypresswood Apartments was built as a 28-unit family project in partnership with HUD’s Section 8 program in an area where the median income is $22,188. The original Section 515 loan was made in 1982 in the amount of $630,800 amortized over 50 years at an interest rate of 9.5 percent. Reserve requirements were $225 per unit and debt service coverage was merely at 1. But the Section 8 agreement kept the rents affordable. A one-bedroom unit was $436, a two-bedroom was $482, and a three-bedroom was $554.

The new for-profit owner of Cypresswood Apartments was able to refinance and rehabilitate the property using $1,916,249 in tax credits and a $1,010,000 Section 538 guaranteed loan. Tax credit funds were used to make an equity payment of $192,542 to the original owner, cover hard and soft costs, and to fulfill reserve and equity requirements. The Section 538 guaranteed loan was used to pay off the $612,349 balance on the existing Section 515 loan and to cover development and some construction costs. The lender’s note rate was 7.41 percent. Interest credit from the Section 538 program reduced the interest rate to 4.91 percent on the entire guaranteed loan amount. The debt service coverage increased from 1 under the Section 515 program to 1.17 with the new financial structure. Replacement reserves per unit also increased from $225 to $333, providing a cushion for unexpected events.

The impact on rents was negligible. Rents for one-, two-, and three-bedroom apartments increased by $20, $40, and $60 respectively. However, HUD contract rents covered the new rent structure when the new owner renewed the restrictive use agreement with HUD for 20 years. The benefits realized by the property are obvious in the debt service coverage ratio, the increase in reserves, and the new physical state of the project. The new owner benefited from the removal of Section 515’s restrictions on return to owner when the Section 515 loan was paid off. And the benefits to affordable housing were realized with the renewal of the HAP agreement for 20 years and the Section 538 deed restriction for the original Section 538 loan term of 40 years.

While these examples are evidence that the GRRHHP can be an effective tool in the preservation of Section 515 housing, the Section 538 program is not able to address all the specific needs of properties in the Section 515 portfolio in every situation. Nonetheless, it is a financing option worthy of consideration for the benefits and flexibility it offers to developer, lender, and project.

Arlene Nunes is Senior Loan Specialist, Multi-Family Housing, with the U.S. Department of Agriculture Rural Development’s Rural Housing and Community Facilities Programs.
The housing authority’s board, however, bowed to community concerns that the Charleston Apartments’ location adjacent to the authority’s public housing properties concentrated a disproportionate number of low-income households within a small area, resulting in social issues impacting the community’s ability to maintain adequate police and social services to the remainder of the town. In late 1999, the housing authority curtailed rental activities as units became vacant, failed to initiate the renewal of the Section 8 contract, and began the process of prepaying the RRH loan with the intent of demolishing the units during 2002. The housing authority notified the remaining tenants of its plans and by 2002 only two of the units, both of them single-family homes, remained occupied.

During this process, Housing Comes First, a local organization dedicated to preventing homelessness, learned of the situation developing in Charleston, and contacted the National Housing Law Project for assistance in preventing the demolition of the Charleston Apartments and displacement of the low-income tenants. Shortly before the April 2001 expiration of the HAP contract, Legal Services of Southern Missouri, Legal Services of Eastern Missouri, and the National Housing Law Project filed a multi-count complaint in federal district court to prevent the closing and removal of the 50 affordable units from the local housing supply. They claimed the housing authority’s actions violated the Fair Housing Act and the prepayment restrictions imposed by the Emergency Low Income Housing Preservation Act by displacing the minority tenants, as well as depriving future tenants within the community of affordable housing.
Financing Search Begins
Fast forward to 2006. Under a court order requiring the housing authority to repair, maintain, and operate the property, the housing authority and LSSM and LSEM sought ways to return the units to use as originally intended for low-income tenants. Private for-profit developers declined to purchase the property, concerned about the extensive deterioration of the units, the continuing animosity within the community, and the lack of available funding resources. Turning to RD’s prepayment requirements, the housing authority advertised the units for sale.

The Delta Area Economic Opportunity Corporation stepped forward and agreed to purchase the mostly derelict buildings. DAEOC is a regional nonprofit with strong local ties to the community through the child day care and school nutrition programs it operates from facilities shared with the housing authority, and has prior experience as an RD borrower. With the assistance of experienced affordable housing participants, a development plan hatched, calling for the use of bond financing and Low Income Housing Tax Credits provided through the Missouri Housing Development Commission.

With the players identified, the task of securing financing began to unfold. In a perfect world, the project could have considered 9 percent LIHTC sources to fund most of the renovations from the tax credit equity raised. This option soon evaporated, however, due to questions involving the marketability of units in the current configuration of fourplex and large single-family units. Preliminary market analysis indicated the existing seven four-bedroom and five-bedroom single-family units no longer meet the community’s need.

Because of the costs of renovation, mold mitigation, code compliance, and the like, the court’s ruling requiring all 50 units return to service made any suitable financial model infeasible. Lack of available tenant subsidy also made the projected rents insufficient to meet the projected operating costs and the debt service that is required to satisfy the requirements of syndicators providing equity by selling the tax credits, as well the underwriting requirements of MHDC.

Due to Rural Development’s severe budget constraints, the maximum funding available from the agency is limited to a small equity acquisition loan to DAEOC and assumption of the remaining original Section 515 loan, a total of $260,000. Given the estimated development cost of more than $3,281,000, the limited RD funding, the lack of conventional funding, and the basic underwriting standards for a successful project, finding alternative resources has become the priority. This also required expanding communications with the court and the community to find the road to success.

Steps Forward, Steps Back
Since that the original plan to rehabilitate the units as originally configured was no longer feasible, a revised plan evolved that would reconfigure the project while still delivering 50 units of affordable housing. The revised plan eliminates most of the four- and five-bedroom units by converting some of them to duplexes with one- and two-bedroom apartments, designating an on-site resident manager’s unit, and converting units to an onsite office, community and learning center, and maintenance area. This assists in meeting the anticipated needs for the now smaller households in the community, reducing the total density and population of low-income tenants in the area, improving site control and tenant services, and unifying the property as an entity distinct from the neighboring public housing units. It also reduces the original cost estimates.

With the revised plan now meeting the underwriting concerns for basic feasibility, and given the limited availability of tenant subsidy, funding using bonds issued through MHDC became a viable alternative. RD committed to assist by providing recaptured Section 521 Rental Assistance to the extent available under its budget authority and the funding authorizations provided for housing preservation if the buyer secures sufficient capital to fund the renovations fully, including the issues addressed in the agency-required Capital Needs Assessment.

A feasible plan with a committed development team plus bonds supplemented with Rental Assistance and tax credits should equal a successful project. MHDC fell victim to the Missouri bond cap, however, and cannot provide the bond authority necessary for the project in 2007 under its tax credit qualified allocation plan. Suggested alternatives were other bond issuing authorities in Missouri. The next most promising source, however, the Missouri Department
of Economic Development, does not have the specific authority to issue bonds for housing-related rehabilitation projects except through the authorities granted to MHDC.

Missouri law allows bonds to be issued only in specific amounts and for specific purposes based on the issuer’s organizational structure. Therefore the organization, entity, or municipality can issue housing bonds only when specifically authorized to do so and following requirements involving public notice, referendum, and other steps as well as meeting conditions including having the capacity to assure the payment of such indebtedness. Consequently, this becomes an issue on a local political level.

Once again the Charleston Apartments fall victim to the local politics that had originally, but unsuccessfully, attempted to demolish the project. The local resources capable of issuing bonds begin with the housing authority, which for obvious reasons declined to consider any further involvement. The City of Charleston supports the housing authority and can issue bonds only through the housing authority. Strike one.

The Charleston Industrial Development Agency may issue bonds, but requires the city’s approval to issue bonds for purposes that should be fundable from other city sources. Strike two.

Finally, the Mississippi County Industrial Development Agency may issue bonds, but again only for purposes for which a lesser entity such as the city or housing authority is not authorized. Strike three.

Waiting
At this point, the only available option is to wait for MHDC’s 2008 QAP. Currently, MHDC is preparing the requirements for both bond and LIHTC competitions as Charleston Apartments waits for another opportunity for resuscitation and the opportunity to fill the existing void for affordable housing.

In the interim, DAEOC is planning to submit a loan application to the Housing Assistance Council. RD requires a loan commitment before it will reserve Rental Assistance to offer the project any hope of continuing service to low-income tenants in the Bootheel of Missouri. In an ever-changing world of construction costs, building codes, and a deteriorating physical property, this project deserves a chance to serve the population as originally intended. Until then, who you gonna call?

Dean Greenwalt is a rural preservation consultant based in St. Louis and working with the Delta Area Economic Opportunity Corporation.
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