SACRAMENTO HOUSING AND REDEVELOPMENT AGENCY

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September 17, 1989

Law and Legislative Committee
of the City Council
Sacramento, CA

Honorable Members in Session:

SUBJECT: Federal Housing Bills and Preservation of Federally Subsidized Housing At-risk of Converting to Market-rate Rents - City and County of Sacramento

SUMMARY

The attached report is submitted to you for review and recommendation prior to consideration by the City Council of the City of Sacramento.

RECOMMENDATION

The staff recommends approval of the letter of support for the legislation and refer this matter to the City Council for review.

Respectfully submitted,

Bob Smith

ROBERT E. SMITH
Executive Director

Attachment

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SACRAMENTO HOUSING AND REDEVELOPMENT AGENCY

September 25, 1990

City Council of the
City of Sacramento
Sacramento, California

Honorable Members in Session

SUBJECT: Federal Housing Bills and Preservation of Federally Subsidized Housing At-risk of Converting to Market-rate Rents

SUMMARY

This report recommends adoption of the attached resolution which supports S 566, the National Affordable Housing Act, particularly the creation of a housing block grant, the HOPE proposal, and the preservation provisions. (See summary of the bill, attached as Attachment 1.) The attached resolution also supports four State bills related to preservation, SB 1908, SB 1913, SB 1286 and AB 3277 and directs staff to write letters of support, as appropriate and timely, to applicable federal and state legislative representatives.

The attached issue paper (Attachment 2) provides a brief summary of the issue of preservation of federally subsidized housing units at risk of converting to market-rate rents due either to prepayment of subsidized loans, owner decisions not to renew Section 8 contracts, or expiration of Section 8 contracts.

BACKGROUND

Congress has been seriously working on a new national affordable housing bill. Two bills have been introduced and adopted by both houses: S 566 (Cranston) and HR 1180 (Gonzales). The provisions of each bill are quite different and a compromise must be negotiated in conference committee. A decision is expected in October or November.

The Senate bill dramatically changes the structure of the federal housing finance system, by taking away categorical programs and providing a block grant approach to affordable housing. (Public Housing Operating Subsidies and CIAP are kept as separate

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programs). The House bill creates several new programs and reauthorizes other categorical housing programs.

S 566 contains a new rental housing program, Housing Opportunity Partnerships (HOP), a three-year, $7.5 billion program to stimulate new low-income housing opportunities. The funds, 80 percent of which will be distributed by formula (60 percent to localities, 40 percent to states) must be matched by non-federal funds. If they are used for tenant-based assistance, the match is 25 percent; if for substantial rehabilitation, 33 1/3 percent. If they are used for new construction (only allowed in areas where there is a verifiable shortage of units suitable for rehab) the match is 50 percent.

Ninety percent of a jurisdiction's funds must be used to assist those at 50 percent or less of median income and the balance for those at or below 80 percent of median. Mixed income housing can be assisted, so long as 20 percent of the units are set aside for those at 50 percent of median.

The House bill contains both a new $300 million discretionary rental housing production program, as well as a $300 million Community Housing Partnership program of aid to non-profit housing developers.

Regarding FHA, the key difference between the bills is the amount of up-front costs which must be paid by the insured borrower. The Senate bill, at the insistence of the Administration, requires adding to the current 3.8 percent premium an annual risk-related premium of 0.5 percent on loans with downpayments of 10 percent or less. Borrowers must pay two-thirds of closing costs in cash, rather than financing them in the mortgage. The House bill would lower the 3.8 percent up-front premium over a five-year period to 1.35 percent and would add a 0.6 percent annual premium to be paid over the life of the loan.

The preservation/prepayment issue, also addressed in both bills, will come down to whether owners can prepay mortgages without HUD approval as under the House bill, or whether they can prepay and have the occupancy restrictions lifted only with HUD approval, as is now the case and would continue to be the case under the Senate bill.

Attachment 2 outlines the nature of the preservation problem, the potential magnitude of the issue in Sacramento, and current and proposed federal and State legislation addressing the problem. This issue has received much publicity on the national and State levels and has been highlighted by the local press as well, in articles in the Suttertown News, the "Neighbors" section of the Sacramento Bee and in the Bee itself (see Attachment 2-B).

In Sacramento City and County, approximately 7226 units in 119 complexes are subject to subsidy termination by year 2008. A certain number of these units (5935 in 85 complexes) are eligible to convert from low-income to market-rate rents before 1995.

At present it is unknown which of Sacramento's units are most at risk of conversion. In particular, the upcoming federal legislation will have a major impact on an owner's decision to convert to market rate rents, as will such factors as condition of the property, location and area market conditions.

Staff (as well as almost all housing advocates and numerous local jurisdictions) strongly supports the prepayment provisions in the Senate bill over those in the House bill. The Senate bill alone provides the mechanisms necessary to ensure that units remain affordable. The Senate bill takes a procactive stance to discourage prepayment while also providing reasonable economic incentives to owners for continuing affordability.

The House bill, on the other hand, makes preservation of rent restrictions <u>voluntary</u> on the part of the owner. The House bill also preempts state and local preservation legislation, and appears to provide a less affordable rent structure on projects where the owner does in fact voluntarily decide to accept the preservation incentives.

After final federal and state legislation is adopted and its impact is assessed, staff will report back with an analysis of the legislation. Staff will also report back with, first, a local response and strategy to address the preservation problem, including criteria for, and identification of, projects which should have greatest priority in regards to Agency preservation efforts; and second, recommendations regarding local legislation which may facilitate preservation, (to the extent that local legislation is not pre-empted under the final version of the federal legislation).

FINANCIAL DATA

The actions recommended in the attached resolution will have no financial impact.

After federal legislation in regard to the prepayment problem has been enacted, staff will report back with a local strategy for addressing the issue. This strategy may recommend actions, such as buy-outs of at-risk projects by the Agency or non-profits, which would have costs associated with them. The financial implications of any such strategy will be addressed at the time of presentation of the strategy to the governing boards.

MBE/WBE EFFORTS

MBE/WBE considerations are not required with this activity.

ENVIRONMENTAL REVIEW

The proposed action is exempt from environmental review per CEQA Guidelines, Section 15378(b)(3); NEPA does not apply.

POLICY IMPLICATIONS

The preservation issue in general is one which has large implications in relation to the supply of affordable housing in Sacramento. The Housing Assistance Plan, Program and Financing Strategy ("the Plan"), prepared by the City/County Housing Finance Task Force in June 1988, estimates that the number of very low-income households eligible for housing assistance far exceeds the number of subsidized units which are available. The Plan establishes, as a target, the construction and/or substantial rehabilitation of 1,000 assisted units a year as necessary to attempt to remediate the shortage of such units in the City and County. The cost of such a program is estimated to be $42,000,000 per year. The loss of 5935 units by 1995 (7226 total by 2008) because of federal subsidy termination will be a severe step backward in regard to meeting the City and County's housing targets.

SACRAMENTO HOUSING AND REDEVELOPMENT AGENCY

VOTE AND RECOMMENDATION OF COMMISSION

At its meeting of September 17, 1990, the Sacramento Housing and Redevelopment Commission adopted a motion recommending approval of the attached resolution. The votes were as follows:

AYES: Amundson, Diepenbrock, Pernell, Simon, Simpson, Strong, Williams, Yew
NOES: None
NOT PRESENT TO VOTE: Wiggins
ABSENT: Moose, Wooley

RECOMMENDATION

The staff recommends adoption of the attached resolution supporting:

1) S 566, the National Affordable Housing Act (Cranston), particularly the provisions related to the Housing Block Grant, Housing Opportunity Partnership (HOP), Homeownership and Opportunity for People Everywhere (HOPE), and preservation programs,

2) legislative efforts to make the FHA program fiscally sound while maintaining the program's effectiveness in providing lower income first-time buyers an opportunity to achieve homeownership, and

3) state preservation bills SB 1908 (Mello), SB 1913 (Petris), SB 1286 (Seymour), and AB 3277 (Costa).

The resolution directs staff to write letters of support, as appropriate and timely, to applicable state and federal legislative representatives.

Respectfully submitted,

ROBERT E. SMITH
Executive Director

TRANSMITTAL TO COUNCIL:

WALTER J. SLIPE
City Manager

Contact Person: Thomas V. Lee, 440-1357

RES/LKS\lks
A:\ATRISK\BACKSTAF\CITY

RESOLUTION NO.

ADOPTED BY THE SACRAMENTO CITY COUNCIL

ON DATE OF ____________________

SUPPORT FOR CERTAIN FEDERAL AND STATE
LEGISLATION RELATING TO THE
PRESERVATION OF AFFORDABLE HOUSING

NOW, THEREFORE, BE IT RESOLVED BY CITY COUNCIL OF THE CITY OF SACRAMENTO:

Section 1: The City of Sacramento hereby supports S 566, the National Affordable Housing Act, particularly the provisions related to the Housing Block Grant, Housing Opportunity Partnership (HOP), Homeownership and Opportunity for People Everywhere (HOPE), and housing preservation programs.

Section 2: The City supports legislative efforts to make the FHA program fiscally sound while maintaining the program's effectiveness in providing lower-income first-time buyers an opportunity to achieve home ownership.

Section 3: The City of Sacramento hereby supports the following State legislation regarding the preservation of affordable housing: SB 1908 (Mello), SB 1913 (Petris), SB 1286 (Seymour), and AB 3277 (Costa).

Section 3: Staff is directed to transmit letters in support of the above bills to the appropriate legislative representatives.

____
MAYOR

ATTEST:

____
CLERK

P:\SHARE\LKS\ATRISK1

FOR CITY CLERK USE ONLY

RESOLUTION NO.: ______

DATE ADOPTED: ______

(7)

Housing Act as approved by the Senate Banking Committee on May 2, 1990

HOP

o Creates Housing Opportunity Partnerships (HOP) Program authorized at $2 billion for FY 1991, $2.5 billion for FY 1992 and $3.0 billion for FY 1993. This includes approximately $1.5 billion in new money and $551 million from the consolidation and termination of several categorical housing programs.

o Consolidates into HOP and terminates Public Housing Development, Rental Rehab, Urban Homesteading, 312 Loans, Nehemiah Grants, Homeownership Counseling, Sec. 8 Mod. Rehab, and Public Housing Sales Programs. It does not consolidate into HOP Public Housing Operating Subsidies, Modernization or Sec. 202.

o Distributes HOP funds 20 percent to Secretary for innovative projects and the balance, 60 percent to localities and 40 percent to states. Jurisdictions qualifying for $2 million via the formula (not specified) would get funds directly. Others would receive funds from the state.

o Funds could be used to expand supply of affordable housing including new construction, acquisition, rehab (priority use when it is most cost-effective), and homeownership.

Rental units assisted could have rents no higher than Fair Market Rents or rents of 30 percent of 65 percent of income; have at least 20 percent of units occupied by those at 50 percent of median or less; and will remain affordable for useful life. Homeownership limited to those at or below median income, first time homebuyers with purchase price up to 95 percent of median.

o Funds distributed by a line of credit (trust fund) repayable if the units assisted ceased to be affordable. A 25 percent match would be required.

o Dropped from the bill are the HOME Corporation and its Credit Enhancement.

HOPE

o authorizes $156 million over 3 years for Public and Indian Housing homeownership. Applications must be consistent with housing strategies under HOP; funds are to be matched 25 percent; units sold must be replaced and resale of the unit is restricted to income-eligible persons at restricted price.

o authorizes $78 million over 3 years in grants to enable residents of HUD multifamily projects to purchase their units; funds must be matched 25 percent.

o authorizes $78 million in grants to non-profit organizations to carry out homeownership.

o authorizes an Operation Bootstrap demo program of 5200 vouchers to test the effectiveness of local strategies that coordinate Sec. 8 with local self-sufficiency programs.

o authorizes $10 million in HOPE for Elderly Independence, a 5 year demo to test effectiveness of combining housing vouchers and supportive services to assist frail elderly.

o authorizes Homeownership Opportunity Zones intended to bring FHA insurance to underinsured areas.

The bill also:

o reauthorizes the Community Development Block Grant program at $3 billion in FY 1991, $3.15 billion in FY 1992 and $3.27 billion in FY 1993.

o reauthorizes and block-grants the McKinney Act homeless assistance.

o extends the $124,875 FHA Loan Limit through September 30, 1992.

o continues the restriction on prepayment of mortgages for Section 236 and 221 (d) (3) low income rental housing projects first enacted in 1987. A plan of action, including incentives to maintain it as low income would be required by the owner, or sale to eligible purchasers.

Summary of Key Provisions of H.R. 1180

I. Title I National Housing Trust

o Authorizes a three-year National Housing Trust Fund at $500 million for FY 1991 to provide assistance to first-time homebuyers to lower their mortgage interest rate to 6 percent and to provide them some of the downpayment they require; amounts authorized to be equitably allocated among states based on the number of eligible first-time homebuyers. Borrowers must certify lack of credit elsewhere and put down at least 1 percent.

o Income of households may not exceed 115 percent of median for a family of four (recertified every two years); if income exceeds 115 percent for two years, subsidy may have to be repaid.

o Mortgage amount must be at or under the FHA limit, it must be insured, and the principal amount may not exceed 90 percent.

II. Title II HOPE

o Public and Indian Homeownership authorized at $136 million for FY 1991.

- o requires a one-third federal match
- o requires at least half of the units in a project be in the program
- o requires replacement of each unit in the form of tenant-based assistance.

o Homeownership of HUD multifamily units (same requirements as Public Housing Program) at $102 million for FY 1991.

o Homeownership for single-family units authorized at $72 million for FY 1991 (similar requirements as above programs).

o Elderly Independence - five-year demo to test combining Sec. 8 certificates and supportive services for frail elderly; $10 million authorized for FY 1991 for supportive services; no jurisdiction can get more than 10 percent of the demo's funds.

o Vacant Public Housing Units - authorizes $250 million for FY 1991 in the form of grants to PHAs to rehab vacant units; assistance to be allocated as under CIAP.

III. Title III Rental Housing Production

o Authorizes $300 million for FY 1991 as a revolving loan fund from which repayable advances can be made to nonprofits, for profits, and public housing agencies for up to 50 percent of costs of construction, acquisition, or substantial rehabilitation of affordable rental housing.

o Interest payments are to be made starting one year after project's completion, if cash flow permits; if cash flow is greater than interest, HUD gets 50 percent of excess.

o Principal and accrued interest are payable starting 25 years after project completion; for each year thereafter that the project remains income restricted, 6.7 percent of the balance is forgiven.

o At least 15 percent of units must be occupied by those at 60 percent of area median or less, and 15 percent by those at 80 percent, each paying no more than 30 percent of income for rent.

o Selection criteria to include shortage of low-income rental housing, extent to which project serves low-income persons, extent to which market rents do not exceed FMRs, extent of non-federal public assistance to the project, and other factors.

IV. Title IV Community Housing Partnership

o Authorizes $286 million (plus $14 million for nonprofit organizational support) in grants for nonprofit production of affordable housing; at least 60 percent of funds must be for rental housing.

o 60 percent allocated to metro cities and urban counties using CDBG formula; 25 percent to states and 15 percent to HUD for direct allocation to non profits. Five percent of each grant must be used for project T.A.

o Tenants with incomes below 60 percent to pay no more than 30 percent of income for rent.

o Grant funds can not be used for those above 80 percent of median; 25 percent to be used for those below 30 percent of median; and 10 percent below 60 percent.

o Project rents can not exceed operating costs plus six percent return on equity.

o Homeownership assistance permitted for those below 115 percent of median; at least 25 percent of funds must be for those at or below 80 percent of median.

o Makes unused allocations available to public agencies in six months.

V. Other

o Reauthorizes CDBG at $3.23 billion for FY 1991 and $300 million for Sec. 108 Loan Guarantees, extends 108 to non entitlement communities, extends repayment period to 20 years, and permits borrowing up to five times CDBG allotment.

o Increases targeting of CDBG benefits from 60 percent to 75 percent.

o Requires CDBG recipients to address the needs of those individuals participating in self sufficiency programs like JTPA.

o Requires CDBG recipients to develop data to analyze how public works investments would stimulate local economic recovery. A demonstration to develop a model for the data to be collected is authorized.

o Authorizes a delegated underwriting program to replace coinsurance.

o Reauthorizes McKinney Act as categorical homeless programs.

o Raises FHA Loan limits to $124,875.

o Makes permanent the Housing Preservation Provision of the 19[illegible] Housing Act; authorizes $450 million for FY 1991 for loans and grants for incentives and to provide transfer and cost of a acquisition by nonprofits and public agencies.

ATTACHMENT 2

Summary Paper

Preservation of Federally Subsidized Housing At-risk of Converting to Market-rate Rents

September 7, 1990

SUMMARY

This report provides a brief summary of the issue of preservation of federally subsidized hou..ng units at risk of converting to market-rate rents due to prepayment of subsidized loans, owner decisions not to renew Section 8 contracts, or expiration of Section 8 contracts. This issue has received much publicity on the national and State levels and has been highlighted by the local press as well, in articles in the Suttertown News, the "Neighbors" section of the Sacramento Bee and in the Bee itself (see Attachment 2-A).

In Sacramento City and County, approximately 7226 units in 119 complexes are subject to subsidy termination by year 2008. A certain number of these units (5935 in 85 complexes) are at risk of conversion before 1995. At present it is unknown which of these units are most at risk of conversion. In particular, the upcoming federal legislation will have a major impact on an owner's ability to convert to market rate rents, as will such factors as condition of the property, location and area market conditions.

BACKGROUND

This report will outline the nature of the preservation problem, the potential magnitude of the issue in Sacramento, and current and proposed federal and State legislation addressing the problem.

The Housing Development Unit has contracted with a consultant to assist staff in responding to the preservation problem. The consultant is California Housing Partnership Corporation (CHPC), a non-profit independent corporation created by the State Legislature in 1987 to provide technical assistance to the public and private sectors in preserving affordable housing. (Attachment 2-B is an issue paper prepared by CHPC which outlines the preservation issue in more detail and will be helpful for more extensive insight into the issue.)

Since contracting with CHPC, the staff has received extensive training on the key components of the preservation issue, completed a preliminary discussion of alternative approaches to preservation, and met with the U.S. Department of Housing and Urban Development (HUD) to set up a formal line of communication on preservation issues. CHPC has also met with a sampling of tenant groups and owners to determine their current goals and concerns.

Explanation of the "At-risk" Problem

In the late 1960's, Congress enacted an aggressive federal housing program that encouraged the development of privately-owned low-income housing through low-interest mortgages and Section 8 contracts. It is these projects that are at the core of the federal preservation or "at-risk" problem.

For the purposes of this report, there are two categories of "at-risk" projects. The first category are those developments financed under such federal loan programs as Section 236 and Section 221(d)(3). Under these programs, projects were subsidized with some form of below-market-interest rate, FHA-insured, 40-year loan, with the stipulation that the owner has the option to prepay after the 20th year. Upon prepayment, all use restrictions on the property are lifted, (i.e. rents may be increased to market rates and initial tenant income limits no longer apply). Non-profits which constructed projects under these programs, as well as the Section 202 program, were locked into the full 40-year mortgage term, so non-profit-owned projects are not currently at-risk. However, most owners which built projects under these programs were for-profit and almost all of their projects in Sacramento City and County are eligible for prepayment within the next five years.

The second category of "at-risk" projects are those whose financing was supported with some form of Section 8 contract. Most Section 8 contracts were set up with initial terms of five years, renewable for three additional five-year terms at the option of the owner. At the end of each five-year term, the owner can either withdraw ("opt-out") of the contract or renew. If the owner opts-out, the rent subsidy is stopped and the tenants must either pay market rent or move. In projects where a Section 8 contract is combined with a subsidized, below-market-rate loan, upon opt-out of the Section 8 contract by the owner the tenant will be left paying a restricted rent, (since the low-interest loan remains), but one which is typically greater than 30% of their income.

An added problem is that the Sacramento at-risk inventory contains several projects whose Section 8 terms are simply about to run-out, or expire, regardless of owners' desires to the contrary. Under the expiration scenario, even if the owner wishes to secure an additional Section 8 term from HUD, there is currently no guarantee that HUD will be willing or able to grant a renewal. It should be noted, however, that to date HUD has renewed all contracts if the owner has desired to renew.

About one-third of the projects in Sacramento's at-risk inventory have both subsidized loans and Section 8 contracts, further complicating the issue of what the critical date is for subsidy termination.

Magnitude of the Problem

Statewide, approximately 117,000 privately-owned units are subject to termination of their HUD subsidies by 2008 through prepayment of below-market-rate loans, opt-out of Section 8 contracts, or expiration of Section 8 contracts.

In Sacramento City and County, approximately 7226 units in 119 complexes are subject to subsidy termination by year 2008. A certain number of these units are at-risk of conversion by or before 1995, as shown by the following table, which breaks-down the units and complexes according to their form of subsidy:

*****

Sacramento City and County
Units Subject to Subsidy Termination
by 1995 (1)

(By type of Subsidy)

	Loans Only	Loans and Section 8	Section 8 Only	TOTAL
Units	1843	1711	2381	5935
Complexes	22	24	39	85

(1) The above numbers were derived from the Inventory of Federally Subsidized Low-Income Rental Units at Risk of Conversion, prepared for California Housing Partnership Corporation by the California Coalition for Rural Housing Project. The database is subject to various restrictions which may cause inaccuracies in the numbers. Staff intends to further analyze the database in the future, especially in light of any new federal legislation, which may cause estimates of the number of units actually at risk to vary, perhaps even considerably.

*****

While the rules may allow opt-outs and prepayment, the factors that influence the owner's decision in this regard are quite complex and include such items as: condition of the property, location, market value of the property, market rents for comparable properties, current tenant mix, federal and state requirements, and local, state, and federal resources available to encourage the project to remain affordable.

Staff will continue to assess the inventory to determine the probability that projects will convert to market rate, in order to determine the magnitude of the at-risk problem in Sacramento. After final federal legislation is adopted, staff will report back with an analysis of all projects to determine likelihood of prepayment, the incentives necessary to maintain affordability and which projects should have highest priority in terms of local preservation efforts.

<u>Current Federal Law - ELIHPA</u>

In response to the prepayment and opt-out issue, in 1987 Congress passed the Emergency Low Income Housing Preservation Act (ELIHPA), which was due to sunset in February 1990 but was extended until September 30, 1990.

ELIHPA requires one year notice to HUD and tenants by owners wishing either to prepay loans or opt-out of Section 8 restrictions.

Prepayment Projects: In the case of projects with owners intending to prepay below-market-rate loans, ELIHPA requires that owners prepare a Plan of Action for HUD approval. To obtain prepayment approval, the Plan of Action must demonstrate certain points, among them: 1) there is an adequate supply of housing affordable to low- and very low-income families in the same area to accomodate tenants who would be displaced by rent increases, or 2) housing opportunities of minorities in the community would not be unduly affected by prepayment. Since these points have been difficult or impossible to satisfy, no Plans of Actions which provide for prepayment and conversion have been approved nationally to date. ELIHPA has essentially acted as a "moratorium" on prepayments.

If a prepayment request is denied, ELIHPA requires that HUD provide incentives to the owner to maintain the low-income character of the project, such as: an increase in the allowable return on investment, increased rents, increased access to residual receipts, a revision of the method for calculating equity or financing for capital improvements. However, if HUD finds that the project is already at highest and best use, (i.e. subsidized rents are not lower than market rents for the area), under ELIHPA, HUD does not have to provide any incentives to the owner. HUD has approved incentive-based Plans of Action for several projects in California.

In the City of Sacramento, one owner has filed a Plan of Action to date. The project's name is Florin Meadows Apartments. It is a 244-unit project located on 29th Street near Florin Road in Meadowview. The project was financed in two stages: 120 units have a Section 221(d)(3) loan that was eligible for prepayment in June 1989 and 124 units have a Section 236 loan that was eligible for prepayment in July 1990. All units have Section 8 contracts attached, which are due to expire in June 1991.

HUD's initial determination on this project is that it is already at its highest and best use. This means that the rents the owner receives now (i.e. HUD fair market rents because all units have Section 8 contracts attached) are probably similar to what the owner would receive if the project converted and the rents were set at market rate. Under ELIHPA, even owners of projects where it would not otherwise be beneficial to prepay may still file Plans of Action in order to try to obtain incentives offered under the Act. However, if HUD determines the project is already at its highest and best use, HUD is not required to provide additional incentives to the owner not to convert. Hence, the Plan of Action could be denied, in which case all existing subsidies would remain in place and no additional subsidies are offered.

As mentioned above, the Section 8 contract on Florin Meadows expires in June 1991. To date, though, HUD's practice has been to offer the owner a five-year extension of the Section 8 contract when it expires. If the owner does not accept a renewal of the contract, HUD's practice has been to provide tenants with Section 8 vouchers, which they can use either in the same project or elsewhere.

At the time of this writing, the outcome on this project is still uncertain. If no resolution is decided upon before the new federal legislation is enacted, the new rules will apply.

In Sacramento County, one owner has filed a Plan of Action to prepay. The project, Campus Gardens, on 655 Howe Avenue, is a 126-unit project with a Section 236 loan eligible for prepayment in December 1990. No Section 8 contracts were attached under the original financing. HUD has forwarded the Plan of Action to the San Francisco office with a recommendation of approval of incentives to retain the low-income use requirements. If the Plan of Action is approved, this means that the owner agrees to keep the Section 236 loan on the project for the full 40-year term, but rents for low- and moderate-income units will be increased to 30% of the current tenants' adjusted income over three years, rather than the fixed rents currently stipulated for the units. However, the rents on these units may increase by no more than 10% per year and units with very-low income tenants will have Section 8 contracts attached to them.

Currently, the City and County have the right to review and comment on Plans of Action and HUD has encouraged local government's comments. Staff has monitored the progress of the Florin Meadows and Campus Gardens projects through the Plan of Action process. The final federal legislation adopted may either alter or eradicate the Plan of Action process. (The Senate housing bill modifies, but does not delete, the Plan of Action process. The House bill basically deletes the process, except the owner must fulfill certain noticing requirements to HUD, state or local government and tenants.) One component of the local preservation strategy to be developed by staff will be an assessment of how the City and County may best continue to work with HUD to ensure continued federal subsidy, under whatever the new rules are, to at-risk projects to allow for their continued affordability.

Opt-outs: In the case of opt-outs, ELIHPA requires the owner to notify HUD of their intent to opt-out, at which point HUD is required by federal law to secure vouchers for all tenants under 80% of median income in the project. To date, six projects (322 units) in Sacramento City and County have opted-out. HUD requested that the City apply for Section 8 vouchers on behalf of the tenants and all eligible tenants have received such vouchers. However, there is no guarantee that HUD will continue its policy of providing vouchers, or that Congress will fund enough vouchers to cover all Section 8 projects which choose to opt-out.

In general, vouchers are a short-term solution to displacement and are not preservation of the permanent affordable housing stock. One drawback to vouchers is that they do not provide adequate subsidy in high-rent areas, nor do they add to the supply of new, permanent affordable housing stock. Although Sacramento rents are still affordable, they are increasing and may render vouchers difficult to use at some point within the next ten years. Also, housing advocates are concerned that permanent affordable housing stock is being replaced by the more transitory vouchers, which "go away" if the tenant reaches certain income levels or leaves the County.

Proposed Federal Legislation

At present, both the U.S. House of Representatives and the Senate have addressed the preservation problem in their respective pieces of omnibus housing legislation, HR 1180 (Gonzalez) and S.566 (Cranston). The provisions of each bill are quite different and a compromise must be negotiated in conference committee. The final legislation will probably not be completed until this fall. A briefing paper prepared by the National Housing Trust, in Washington D.C., is included for review as Attachment 2-C. A brief summary of the paper (including excerpts) follows in the next few paragraphs. Staff, (as well as most housing advocates and some cities), strongly favors the Senate version.

The four major differences between the House and Senate bills are in the areas of 1) whether the preservation program is mandatory or voluntary; 2) whether preemption of state and local preservation laws is allowed; 3) what the rent structure under the preservation incentive program would be; and, 4) what duration the low and moderate income use restrictions required in exchange for preservation incentives would be.

Mandatory vs. Voluntary: The Senate bill essentially includes ELIHPA's prepayment criteria and a Plan of Action process. If the owner is not allowed to prepay, HUD must offer incentives to allow a reasonable rate of return on the project or must fund the sale of the housing to a preservation purchaser. The House bill, on the other hand, eliminates the Plan of Action process altogether, and allows the owner the option to <u>either</u> accept incentives in exchange for maintaining use restrictions for the remaining term of the mortgage <u>or</u> to prepay after submitting two notices indicating intent to do so. Hence, the decision as to whether or not to prepay is entirely voluntary on the part of the owner. The only exception to the voluntary nature of the legislation would be if another entity makes a preemptive offer to buy the project, with the intent of preserving it as affordable housing, within six months after the owner's second notice of intent to prepay. The weakness of the House bill is that any preservation of affordable use restrictions is voluntary on the part of the owner. Even with the generous federal incentives offered in exchange for continued affordable use restrictions, many owners are expected to prepay anyway.

Preemption of State and Local Laws: The House bill includes provisions which preempt any state or local law which limits or prohibits prepayment, or is exclusively applicable to at-risk projects. The Senate bill does not address the issue of preemption. Thus, the House bill limits the options of local agencies who elect to take an proactive stance on prepayment/opt-out issues.

Rent Structure Under the Preservation Incentive Program: The difference in the House and Senate bills with regard to rent structure under the preservation incentive program is complex. In essence, the Senate bill provides that, in projects participating in the incentive program, tenant rents not exceed 30% of income, with increases in rents tied to the owner's costs. The owner is allowed an 8% return on adjusted equity. Under the House bill, initial rents on projects which receive incentives cannot exceed 30% of income, but future rent levels are essentially market-based, with no cost-based rent structure or limit on cash flow distributions to the owner. (In many of the at-risk projects, some tenants may not currently be paying 30% of their income in rent because the projects' initial low rents, set 20 or more years ago, have only increased on the basis of cost, rather than income or market factors.)

Duration of Use Restrictions: Under the Senate bill, use restrictions put in place on the project in exchange for preservation incentives are in effect for the remaining useful life of the project. Under the House bill, basically the owner can decide on one of several actions, which impact the duration, if any, of use restrictions: a) the owner can prepay the loan and terminate any use restrictions, b) the owner can accept incentives from HUD and an extension of the use restrictions for the remaining term of the mortgage; after accepting the incentives, the owner may choose to sell the project, with use restrictions, c) the owner may not choose to accept incentives, but is offered a preemptive sale offer at fair market value by an entity which agrees to extend the use restrictions for the remaining useful life of the project, or d) after the prepayment eligibility date the owner chooses to sell the project to residents under a homeownership program. Under this program, the residents would be free to prepay the mortgage, convert the project to condominiums, and terminate all use restrictions.

Several cities, such as San Jose and San Francisco, have taken positions on various aspects of the proposed federal legislation. The federal government's response to this issue is critical. First, the legislation adopted will set the framework for any local or state approaches to addressing preservation of the affordable housing stock. Second, without a federal commitment, the financial burden of ensuring that the housing is preserved or replaced will be borne by local governments.

To sum, staff strongly supports the provisions in the Senate bill over those in the House bill. The Senate bill alone provides the mechanisms necessary to ensure that units remain affordable. The Senate bill takes an aggressive stance to discourage prepayment while also providing reasonable economic incentives to owners for continuing affordability.

The House bill, on the other hand, makes preservation of rent restrictions voluntary on the part of the owner. The House bill also preempts state and local preservation legislation, and appears to provide a less affordable rent structure on projects where the owner does in fact voluntarily decide to accept the preservation incentives.

Many advocate organizations and some local jurisdictions are supporting the Senate version of the bill, among them: Nonprofit Housing Association of Northern California, Coalition for Economic Survival, San Francisco Coalition for Low Income Housing, California Coalition for Rural Housing Project, Southern California Association of Nonprofit Housing, California Housing Partnership Corporation, the City of San Jose and the City of San Francisco.

State Legislation

At the State level, staff has been participating on the California Senate Working Group on Housing Preservation. Eleven preservation bills were passed by the Legislature last year, nine of which were subsequently vetoed by the Governor. As of the time of this writing, several additional bills have passed out of the Legislature and are awaiting the Governor's signature. Staff is supporting the following four:

* SB 1908 (Mello) - Creates a 6-month right-of-first-refusal process one year in advance of the anticipated subsidy termination date during which an owner seeking to sell a property must first offer it to a qualified tenant association, nonprofit, public agency or other purchaser who agrees to keep the units affordable.

* SB 1913 (Petris) - Extends from six months to one year the time period when an owner must notify affected tenants, local agencies and other of an anticipated termination of subsidy.

* SB 1286 (Seymour) - Provides for 100% nonrecognition of state captial gains for an owner who sells his/her property to a tenant association, nonprofit or public agency, if the gain is reinvested in two years.

* AB 3277 (Costa) - Clarifies that the State's Urban and Rural Predevelopment Loan Programs may be used for costs associated with preservation (acquisition and rehabilitation) of subsidized housing that might otherwise convert.

If passed, these bills would provide some means of action to preserve projects, although they by no means present a complete answer to the issue. If preemption language is adopted by Congress, the provisions of these bills would be rendered void.

Local Action

After federal and State legislation is enacted and assessed, staff will develop a local strategy to address the preservation issue. Strategy at the local level can take various tacts. Specifically, the legal and practical feasibility of the various possibilities will have to be evaluated.

To the extent legally feasible, Sacramento could implement by local ordinance (assuming Congress does not preempt local legislation) strategies not enacted at the State or federal level. Such strategies could include requiring that a public hearing be held on the proposed conversion, or that adequate notice be given to all parties involved, including the tenants and the City or County. Other local actions could include playing an active role in commenting on and negotiating Plans of Action, and facilitating tenant or non-profit acquisition of projects (or acquiring the projects ourselves).

On this last point, many believe the optimal solution to the conversion problem is sale of projects to public agencies, tenant or non-profit ownership. This strategy is viewed as different from simply inducing current for-profit owners (by financial or other means) into keeping the loans or Section 8 contracts for the remainder of the term. Depending on the final provisions of any federal legislation, non-profit ownership presumably will be more likely to allow projects to be kept affordable into perpetuity. Sacramento Mutual Housing Association may be a useful vehicle for non-profit acquisition that would also allow residents to have a strong voice in how the project is operated.

Buy-outs by non-profits (or any entity) may be costly, depending on the ultimate federal legislation. Any local preservation strategy will need to offer guidelines for prioritizing which projects merit preservation by this route. The study staff is undertaking on the preservation issue will enable the Agency to begin to assess the potential subsidy cost that could be incurred in implementing a preservation program.

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OPINION

A Housing 'Time Bomb'

The Editor's Desk

by Tim Holt

It's being called a housing "time bomb." It has already begun to detonate, and its impact will be felt gradually, over the next 5-20 years, quite possibly adding many thousands more to the numbers of homeless now wandering our streets.

At least 10,000 Sacramentans who currently live in federally subsidized rental housing could be out on the streets within the next two decades. Under federal programs set up in the 1960s, owners were given incentives to build and operate low-and moderate-rent housing. These incentives included mortgage insurance, low equity requirements and tax-sheltered depreciation benefits. But the main incentive was a low-interest construction loan, usually for a 40-year term. In exchange, the owner agreed to provide rent-subsidized housing for the life of the loan.

Since the subsidies were paid by the government, the owner/landlord was guaranteed rent payments at or near market rate levels, and the tenant got decent housing at a rent level he or she could afford (no more than 30 percent of their total income). It was a big step forward from the affordable housing solution of the 1950s—the sterile, government-run public housing projects that stigmatized and isolated the poor.

The time bomb that has been ticking away is a provision in the federal loan program that allows landlords to pay off their loans early, anytime after 20 years. Once that's done, the original agreement allowed them to do what they wanted with the property—go off the subsidy program, charge full market rents, convert to condos, whatever.

And that's starting to happen. Already thousands of apartments in Northern California have gone to market rental rates due to loan re-payments. The California Coalition for Rural Housing Project reports rent hikes as high as 300 and 400 percent.

Statewide, 117,000 apartment units are eligible for conversion to market rates within the next 20 years. According to a HUD study, 41 percent of these are occupied by the elderly. In Sacramento, affordable housing advocates estimate that 6000 apartment units are eligible for conversion.

That's not news for Irettia Shepard, 73, who got bounced out of her one-bedroom apartment off Folsom Boulevard when its owners paid off their loan a few years ago. The rent at Windward Village went from $385 to $485 a month. Not only that, but Shepard, widowed and living on Social Security, lost her rent subsidy at the same time. In her search for affordable housing she has lived in three different apartment complexes in the last four years. She's currently living in

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Time Bomb

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a $225-a-month one-bedroom near Town and Country Village.

At Shepard's apartment complex, when the big rent increase was announced, the tenants held meetings and unsuccessfully attempted to roll it back. In Rocklin, when over 100 tenants of the Sunset Apartments were faced with a conversion to market rates, big rent increases, and 30-day eviction notices, many of them simply moved out, but quite a few stayed on to fight the increase. They enlisted the help of the Auburn office of Legal Services of Northern California, and the result was an out-of-court settlement that had a ripple effect on the affordable housing effort throughout the country.

As a result of the Sunset Apartments case, new federal guidelines were drawn up that blocked loan payoffs and conversions to market rate if tenants would not be able to find affordable replacement housing in the community. Also, new incentives were provided owners to maintain subsidized housing, including greater returns on equity, equity loans, and bigger rent subsidies. If the owners still decide to go ahead and convert, they must give first right of refusal to purchase the property to non-profit organizations who are willing to continue to operate them as subsidized housing.

In their out-of-court settlement, the Sunset tenants received guarantees that their apartments would remain subsidized. The Farmers Home Administration stepped in and re-financed a loan to Sunset's owners, with renewed 20-year conversion restrictions. The Sunset tenants and their attorneys, Francesca Boxa and Ron Rogers, had won a major victory for themselves and for low-income tenants throughout the country.

Mike Bush, a veteran legal aid attorney who specializes in housing issues, says his initial fears over the displacement of tenants have been "somewhat lessened" over the last few years.

The bomb is exploding . . . in slow motion.

"As a result of the Sunset case and other lawsuits, the Farmers Home Administration has taken a pretty strong position to try to preserve (low-income) housing," he says.

Still, the struggle isn't over. The federal government's rent subsidy program, known as Section 8, is due to expire in 1994, and there is no guarantee that Congress or the President will renew it. During the Reagan administration, income tax writeoffs for builders of low-income housing were virtually eliminated, countering the income-boosting incentives adopted by the Farmers Home Administration.

And, most ominously, no new low-interest loans are being offered potential builders of low-income housing. The stock of such housing isn't being renewed, and what exists is gradually deteriorating. Waiting lists of those seeking affordable housing are growing.

So the bomb is exploding, as it were, in slow motion, its action slowed by the efforts of a relative handful of legal aid lawyers, housing advocates, and stubborn tenants. If we are not to see more homeless on our streets, however, we'll need new programs for building new housing and a stronger commitment from government at all levels to keep existing affordable housing in place.

(Credit where credit is due: This column was inspired by an article that appeared in the weekly *San Francisco Bay Guardian* February 7. They also deserve credit for the phrase "affordable housing time bomb." Readers wishing more information on this issue should contact the California Coalition for Rural Housing Project at 443-4448.)

Bee 4/2/90

The poor battle to stay in low-income housing

By Robert D. Davila
Bee Staff Writer

Marta Bustamante, Rosemary Cortez and Gabriela Gonzalez sat at a picnic table in Zapata Park next to their Washington Square apartments. They occasionally turned their heads to keep an eye on children clambering on the jungle gym.

But the three neighbors weren't just soaking up the sun in Alkali Flat. Not far from a statue of Mexican revolutionary and land reformer Emiliano Zapata, the women were planning strategy on the local front of a nationwide fight by poor people to stay in low-income housing like Washington Square.

In Sacramento and across the country, poor families have been forced out of affordable housing after owners bailed out of federal subsidy programs that keep rents low. Many of the units have been converted into high-rent apartments and condominiums.

Residents of the 143 units at Washington Square fear they will have to leave if the owners decide to stop participating in subsidy programs that come up for renewal next year. Led by 52-year-old Bustamante, the residents are exploring ways to stay in their homes, including forming a non-profit corporation to buy the apartments.

"I earned $1,800 last year and pay $30 a month for a two-bedroom apartment here," said Bustamante, who is disabled. "If we lose the subsidy, I'll be out of luck and on the street."

The tenants are heeding alarms sounded by advocates of affordable housing who warn that cities across the United States face a housing "time bomb" as the federal subsidy programs begin to expire.

"The potential magnitude of the problem is staggering," said Rob Wiener, co-director of the California Coalition for Ru-

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+ 21,000 paying 30-50%

Housing

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ral Housing Project in Sacramento.

But some government officials and housing owners say the problem is being distorted by housing advocates' predictions that poor families will be uprooted and forced into the ranks of the homeless on a massive, nationwide scale.

"That simply isn't happening," said Dirk Murphy, a spokesman for the U.S. Department of Housing and Urban Development.

The subsidy programs began in the 1960s, when the U.S. government provided low-interest mortgages to private developers to build housing for the poor and elderly. In return, the owners agreed to keep the rents low.

The mortgages were generally for 40 years – but they included an option allowing owners to pay off the loans after 20 years and "opt out" of the low-income housing program.

Nationwide, large numbers of the mortgages are reaching their 20th anniversary dates early this decade. Many owners are choosing to pay off their notes and get out of the low-income housing business.

Some landlords also are declining to renew Section 8 contracts, which generally have five-year terms. Under the program, HUD subsidizes apartments so that tenants don't have to pay more than 30 percent of their income for rent.

Freed from the government programs, owners can convert the units into expensive apartments and condos. Unable to afford rents that in some cases have quadrupled, many tenants have been forced out.

In California, owners of 34 apartment buildings opted out of HUD subsidy programs by 1988. Eight of those projects – about 300 apartments – were in the Sacramento area, said Wiener, whose organization tracks developments in low-income housing.

"Many go very quietly," he said. "No one follows the tenants to find out whether they stay or have to leave – and where they go."

Alarmed at the threat of a large influx into the ranks of the homeless, Congress has passed a moratorium on early mortgage payoffs through this September.

Meanwhile, the numbers of projects eligible for payoff and Section 8 contracts up for renewal are continuing to snowball. About 1.8 million affordable units – about 90 percent of all federally subsidized rentals in the country – could be removed by 2000, according to a U.S. General Accounting Office report cited by the Rural Housing Project.

Almost 95,000 low-income apartments in California – including 8,200 in Sacramento County – will be eligible for conversion into more expensive housing by 1995, according to data compiled by the Rural Housing Project.

For tenants forced out, the chances of finding other affordable housing in Sacramento County are not good: Names on waiting lists for other Section 8 housing number in the thousands.

Moreover, conversion of low-income apartments further depletes the already scarce inventory, said Laura Sobottka, an associate planner at the Sacramento Housing and Redevelopment Agency.)

More than 24,000 county households qualify for – but do not live in – subsidized housing. They qualify because they earn less than half of the $37,500 median income for the county and pay more than 50 percent of their income in rent, Sobottka said.

"If you take away 6,000 units, that puts us 30,000 behind what we need," she said, "and the number just keeps growing with the population."

At HUD's Region IX headquarters in San Francisco, however, Murphy said that the moratorium through September on early mortgage payoffs has halted the immediate conversion of low-income apartments. "Everyone expects Congress will provide some sort of extension in September," he said.

Federal legislation also has created profit and equity incentives for owners to remain in the low-income programs, Murphy said. Even tenants whose apartments are dropped from the Section 8 program may be eligible for rent-subsidy vouchers.

But the vouchers have strict income-eligibility requirements. "If you're poor – but not poor enough – you're out of luck," Wiener said.

Murphy acknowledged some families have been displaced and have had little luck finding affordable housing.

But he said the fears of massive dislocations have not come true, mainly because many low-income apartments are in areas where rents have remained stable.

At Washington Square, Don Gustin, president of Amphora Financial Corp., said the company plans to renew the Section 8 contract in June 1991 that covers 40 units in Washington Square III.

Richard Fisher, management representative for the owners of Washington Square I and II, said those units also would continue in the Section 8.

Both said it was too early to tell whether landlords would seek early payoffs for two HUD mortgages on the entire development when the 20th anniversary dates roll around in 1994 and 1995.

But Gustin said many low-income apartments in Sacramento – including Washington Square – are in areas where rents are not likely to rise much above the subsidized levels landlords receive from Section 8 tenants.

"Nobody wants to be labeled as someone that shuts the door on these people," Gustin said.

Bustamante isn't convinced. She began organizing her neighbors at Washington Square after learning of six Elk Grove families who were displaced when their landlord opted out of the federal programs.

The tenants and other residents of low-income housing are planning to rally at noon Tuesday at the Capitol, where the state Senate Housing Committee will hear four bills that would protect poor tenants whose buildings are converted.

"As far as we're concerned, we won't be happy until we see a HUD contract signed on the dotted line," she said, watching children abandon the jungle gym at Zapata Park and head toward waiting mothers.

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Neighbors March 15, 1990

Subsidized rents may end in '95

Alkali Flat tenants told to organize

By Patty Henetz
Neighbors staff writer

Residents of the Washington Square apartments in Alkali Flat could lose their homes in five years, and rather than wait for the sky to fall, they should organize to avert the threat, say area residents.

All of the Washington Square tenants receive rent subsidies through a federal 40-year mortgage program. Until the mortgage is 20 years old, those subsidies are locked in, and the tenants safe in their homes.

By 1995, the mortgages in Washington Square will have passed the 20-year milestone. At that time, the owner of the apartments will be allowed to take steps to pay off the federal loan early, which would end the subsidy.

The tenants shouldn't wait until then to face the problem, said Washington Square resident Marta Bustamante. "We believe that right now is the time to start to organize, to find alternatives," she said.

Bustamante, a member of the Alkali Flat Project Area Committee, said that if the apartment rents were to rise to market rate, none of the people who now live there would be able to stay.

"Where are the families going to go?" she asked.

Kathleen Williams, an attorney who lives in Alkali Flat, is helping the Project Area Committee find its way through the legal thicket surrounding the housing subsidy issue.

Though four years may seem like plenty of time, it's not when housing issues are at stake, she said.

"There will be a lot of pressure to return those (apartment units) to market value," she said. "We are organizing to head off a crisis. Maintaining subsidized housing downtown is very important. We have a lot of homeless people in our neighborhood already."

The Washington Square apartments flank Zapata Park between Eighth, 10th, D and E streets. The apartments, built for low-income tenants, were constructed in three phases with a total of 143 units.

Two of the apartment buildings were built with the help of a federal mortgage program that provides a subsidy to the apartment

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Rents

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owner. With the subsidy, the owner's rental income is at or near market level. The tenants in turn are guaranteed not to pay more than 30 percent of their total income for rent.

At Washington Square, the tenants also receive additional federal Section 8 rental subsidies. Pegged to their incomes, these extra subsidies bring their rents far below the regional market rate.

The owner of the apartments could at any time decide to end the Section 8 participation. Such "opt-outs" are usually only successful in rural areas or in smaller cities — such as Sacramento — where the tenants aren't organized, said Rob Weiner, co-director of the California Coalition for Rural Housing Project.

But until the 20-year mortgage mark is passed — 1994 for one building, and 1995 for the other — the owner of Washington Square may not move to raise the rents to market rate. If that happens, the tenants will lose their homes, Bustamante and Williams said.

'Maintaining subsidized housing downtown is very important. We have a lot of homeless people in our neighborhood already.'

— Kathleen Williams, Alkali Flat attorney

The situation at Washington Square is not an isolated one. In Sacramento alone, 3,500 apartments now subsidized under the mortgage program will pass the 20-year mark by 1995.

A national moratorium on the pre-payments has been in effect since 1987, and if it weren't for that, "we'd have untold displacements," Weiner said.

The moratorium will expire in September, and the issue has become a major priority with housing advocates as well as with federal and state legislators.

Some housing advocates are pushing to find a way to organize the tenants to resist the pre-payment efforts or to find ways to buy out the apartment owners.

Congress is working on legislation that would extend the moratorium, Weiner said.

On the state level, pending legislation would give non-profit groups the right of first refusal — the right to purchase the housing — before the owner can proceed with plans to convert it to market-rate rentals, said Laura Sebottka of the Sacramento Housing and Redevelopment Agency.

And housing activists have scheduled a series of rallies across the country for March 26, which is national Save our Homes Day. On March 28-30, a conference sponsored by the National Housing Law Project in Berkeley will focus on how non-profit agencies can buy these threatened housing developments.

Sebottka said that only one owner of Sacramento housing under the federal mortgage subsidy program has so far applied for pre-payment.

Federal law requires that the owner demonstrate that the tenants who would be displaced from the apartments would be able to find comparable housing at comparable rents, she said.

With Sacramento's booming housing market, that is not likely, she said.

So, the federal agencies administering the mortgage program will probably negotiate some kind of arrangement with the owner so he can get some kind of equity out of his investment.

The upshot would be tenant displacement, she said.

CALIFORNIA HOUSING PARTNERSHIP CORPORATION

Working With You to Preserve Affordable Housing

CHPC ISSUE PAPER:

Preservation of Federally Subsidized Housing "At-Risk" of Conversion

Introduction

Federally financed and/or subsidized housing units nationwide are in jeopardy of being converted to market-rate rentals or condominiums. Approximately 117,000 privately owned units in California are at risk of loan repayment and expiration of rent and occupancy restrictions or elimination of project-based subsidies in the next 20 years. These rental units serve primarily very low and low-income tenants at rents which are typically half of current market rates.

The bulk of these projects were built using the Section 221(d)3 Below Market Interest Rate (BMIR), Section 236 and Section 8 Programs. The Section 221(d)(3) and Section 236 programs provided for-profit and nonprofit owners very attractive financing between 1961 and 1983. The loans were typically at interest rates of 1 or 3 percent and provided borrowers with at least 90% of the cost of the development. Many for-profit borrowers were able to take tax benefits which provided them with a very attractive return on their 10 percent equity contribution. Many owners also received a restricted annual cash flow of up to 6 percent of original equity and also received compensation in the form of management and partnership fees. The mortgages were for terms of 40 years; however, at the time the programs were conceived, it was believed that new rental housing would continue to be built and that owners might wish to prepay the mortgages so as to seek other investment opportunities. It is a monumental understatement to say that owners, the government, tenants and communities in general did not perceive the housing crisis that exists today nor the astronomical increases in value that have occurred, particularly in states such as California. Therefore the original programs provided for loan repayment in year 20 and elimination of the regulatory restrictions on both rents and occupancy.

In addition to the problem of prepayment, many projects have rental subsidies attached to the units which enable very poor households to afford even the restricted rent. In many cases, these Section 8 subsidies were written to allow owners the option of renewing or opting out of the contract every five years. Further, many Section 8 contracts are also due to expire in the next few years, without an opportunity to renew the contract. There is concern that the federal government may not reauthorize the funds for these subsidies. These project-based Section 8 contracts are found in projects with low-interest HUD loans and restricted rents, as well as in projects that are otherwise unregulated.

This paper is a general discussion of some of the most critical aspects of this new housing crisis and provides a rationale for active pursuit of strategies at all levels of government and the community at large to develop resources and techniques to preserve these units as affordable for the longest feasible time. Many housing professionals are developing individual strategies to acquire these projects and, through nonprofit or future tenant ownership, insure their continued accessibility to low and very low-income families.

Typical At-Risk Developments

To fully appreciate the impact of conversion in high cost, tight rental markets such as much of California, it is important to understand the current rent structure, tenant mix and type of property which may be affected. Many of these projects were built between 1963 and 1974 in developing neighborhoods in suburban and urban areas. They are often well-maintained, mixed-income family projects. In many cases they are well-located close to job and transportation centers, since land was accessible at reasonable prices during that time and the government was providing 90 percent of all required financing. The developments have modest amenities and more open space than many newer housing projects. Many of the developments provide a significant portion of three-bedroom units, which is almost unheard of today because of land costs. The tenant population was initially below 80 percent of median income in most programs. In some developments, the income mix now includes families above median income, although the typical project continues to have over 50 percent of its tenants at or below 50 percent of median income. The rents in Section 221(d)(3) and Section 236 projects, which are based on the actual operating costs and debt plus a modest return, are typically half those of comparable market-rate units.

The Current Regulatory Environment

While most privately owned Section 221(d)(3) and Section 236 projects allow for mortgage prepayment in year 20, there are now temporary restrictions on prepayment. The current law governing these projects is the Emergency Low-Income Housing Preservation Act of 1987 (ELIHPA). Projects that are currently, or within one year will be, eligible to prepay their mortgages prior to September 30, 1990 may file a Plan of Action; however, ELIHPA is also scheduled to expire on that date.

Under ELIHPA, owners are virtually prohibited from prepaying their federally subsidized mortgages and converting the projects to market rate housing. In lieu of prepayment, HUD offers owners an incentive package in conjunction with the filing and approval of a Plan of Action. The most important incentives available under a Plan of Action include: 1) project-based Section 8 rental assistance for all very low-income tenants; 2) rent increases on current tenants to 30 percent of income following a phase-in period; 3) FHA insurance for second mortgages; 4) increased cash flow; and 5) access to reserve accounts. Under a Plan of Action, owners must commit to maintaining the affordability of the project for the remaining term of the mortgage, generally 20 more years.

A Plan of Action can be filed by the current owner, who remains free to retain or sell the property. A Plan of Action can also be filed in conjunction with a nonprofit buy-out.

ELIHPA generally preserves the project as affordable to the tenant profile in place either at the time the Plan of Action is executed, or on January 1, 1987, whichever profile results in the highest proportion of very low-income tenants. The disadvantages to a Plan of Action, however, include: 1) substantial rent increases facing lower, and occasionally very low-income, tenants; 2) the possibility of receiving no Section 8 appropriations after the first five-year contract expires; and 3) the lack of mechanisms to ensure permanent affordability, despite the continuing investment of substantial public resources.

Congress is now considering permanent replacement legislation for ELIHPA. Bills are pending in both the House and Senate, and the issue is also addressed in the Administration's HOPE proposal. Under HOPE, prepayments will be allowed, and the incentive package will be made available only to owners who voluntarily decide to stay under HUD restrictions for 20 more years. In order to prepay, however, owners must first provide a 2 1/2 year right of first refusal to tenant associations (which may include local nonprofit organizations) to purchase the project at market value. HUD will provide financial assistance for tenant buy-outs, but the amount of funding is not yet clear and unlikely to be adequate to meet owners' market-rate value expectations. If prepayment and conversion do occur, owners will be required to pay the costs of tenant relocation. This, however, assumes there are vacant units available for relocation.

Under the House and Senate proposals, prepayment is not allowed in areas where it would result in tenant hardship. Owners would instead be entitled to receive financial incentives, and there will be funding targeted to tenant and nonprofit buy-outs. Senate and House committee leaders, however, are currently involved in intense negotiations with parties on all sides of the issue, and the bills are likely to be revised. The major issues still being discussed are whether there will be voluntary prepayments, the value of projects and return to owners, and the level of HUD-insured equity loans that may be leveraged.

In most of California, where the market value of federally assisted housing is generally very high, owners are not likely to voluntarily remain in the HUD programs (unless the level of incentives is increased dramatically or the project has serious physical problems). Without adequate financial assistance from all levels of government, tenant or nonprofit buy-outs will not be feasible and widescale displacement will occur.

Why Preserve?

Some of the human reasons for pursuing preservation strategies are quite obvious; however, it is worth spending a moment reviewing why it is critical to struggle with preservation even if it requires use of local resources in conjunction with federal and state programs. It is easy and probably appropriate to say that prepayments and opt-outs are a federal problem and that the federal government should solve it. However, as with many federal problems, the impact of conversion is local, and therefore many localities, nonprofit housing developers, owners and tenant groups are exploring efforts which employ local and state, as well as federal, resources to insure that the problem is not only addressed, but addressed for the long term.

Currently, many communities are struggling with shortages of affordable rental housing which have resulted in homelessness, overcrowding, excessive commutes (resulting in intolerable levels of traffic and poor air quality), and, most frequently, families paying more than 50 percent of their income for housing. In light of these concerns, preservation of what we already have is paramount. Existing stock, even at its full market value, is typically 10 to 20 percent less expensive to acquire than building new replacement housing. This economic differential is even greater for the federal at-risk housing, since some federal support is still available and the underlying debt can be assumed at the attractive low interest rates.

Additional reasons to consider preservation include the following:

- Opportunities for new development are often scarce as land becomes both expensive and inaccessible;

- Existing assisted housing developments are often well-located and the sizes and types of units are simply not economically feasible today; and

- The timeframe for development is long and and the process is complex.

Of equal importance are the human impacts of displacement. These range from significant increases in housing costs to dislocation from jobs and community. Even if tenants are protected economically while being forced to relocate, the cost to the government is higher and/or the protection is time limited. Further, displacing tenants and providing tenant-based subsidies assumes that there alternative housing is available. Alternative housing, however, is often very scarce, particularly for larger and well-located units.

Acquisition as a Solution

Given the impacts of conversion, many communities are beginning to pursue acquisition of at-risk developments by nonprofit or other entities who are committed to insuring permanent affordability. While this approach has a potential cost that is higher today than shorter-term solutions, acquisition has significant long-term advantages. These include:

- Eliminating future uncertainty;
- Assurance that the problem is not simply being recycled at a higher future cost; and
- Providing an opportunity for tenants to be involved in the solution and potentially play a role in maintaining and stabilizing the management of the development.

Additionally nonprofit ownership enables the owner and the community to mitigate the need for future rental increases, since there is less motivation to raise rents above those required to cover actual costs. Further, nonprofit owners often strive to maintain and even increase the number of households served, and to integrate services such as childcare which enable households to increase their economic and social stability.

As each community struggles with the problem and assesses options and potential roles for itself and other key actors, such as the federal government, tenants, current and future owners, the most vital first step is to complete an assessment of the risk of conversion and opportunities to address the problem now. This assessment should include identifying potential resources, both financial and non-financial, such as capable nonprofit organizations, the cost of acquisition today and overtime, the potential federal legislative approaches and the current tenant mix. This information may then serve as the foundation of a strategy to acquire the developments, respond to tenant and owner inquiries, comment on HUD and legislative proposals and requirements, and consider allocation of staff and resources.

Briefing Paper on Senate and House Prepayment Bills

National Housing Trust
Washington, D.C.

August 16, 1990

This memorandum discusses four key public policy issues that distinguish the House and Senate preservation program for federally assisted housing at-risk of prepayment. The National Housing Trust has also prepared a detailed side-by-side comparison of the House and Senate prepayment provisions, which is available upon request.

I. Statement of the Problem

The Congressional Budget Office (CBO) has determined that during the 1990's, over 360,000 federally assisted low and moderate income housing units will become eligible for prepayment of the HUD-assisted mortgage and conversion to more profitable use. Prepayment of the mortgage terminates all federal regulation of the housing.

The CBO predicts that owners of at least 280,000 units will indeed exercise the prepayment/conversion option. If the CBO estimate is correct, prepayment could cause the displacement of over 560,000 people, many of whom are elderly according to recent studies. Most of the losses to the affordable housing supply will occur during the next four years (1990-1994).

In 1987, Congress enacted a stop-gap measure, the Emergency Low Income Housing Preservation Act (ELIHPA) to stem the loss of Section 221(d)(3)(BMIR) and 236 housing due to prepayment. Incentives were provided to the owner in exchange for continued low and moderate income use. ELIHPA expires on September 30, 1990 and Congress has been working on developing permanent legislation during the past two years.

II. Background on Evolution of House Position On Mandatory/Voluntary Preservation Program and Duration of Use Restrictions

The bills that have emerged from the House and Senate reflect significant differences on key public policy issues. Some of these differences have been narrowed as a result of the passage of the Carper-Price amendment, by a vote of 400-12, during House floor action on July 31st. However, a fundamental difference remains on whether Congress should regulate the circumstances under which federally assisted housing is withdrawn from low and moderate income use, notwithstanding the owners' contractual right to prepay their HUD-assisted mortgages after 20 years without the Secretary's prior approval. The two positions are as follows:

Senate: The owners' contractual right to prepay should be restricted by Congress, in exchange for a set of incentives that will yield a fair rate of return to the owner (or fund a transfer of the housing to a preservation purchaser) and infuse needed capital into the housing.

House: The owners' contractual right to prepay should be left intact subject only to the possibility of a forced sale of the project directly to a preservation purchaser or through HUD on a pass-through basis, in the event an owner rejects incentives or a voluntary transfer to a purchaser that would continue the affordability restrictions.

The Bartlett-Barnard amendment, which replaced the Chairman's mark and was adopted by the House committee on June 13, 1990, permits the owner to prepay after serving two notices. Displaced tenants will receive certificates or vouchers and a moving expense payment. An owner's acceptance of incentives, in exchange for continued low and moderate income use, is strictly voluntary. (However, it would in practice be significantly affected by the limitation of rental charges to 110% of the Section 8 Fair Market Rent.)

The Frank-Kennedy amendment, offered at the committee level and defeated, would have: (1) required owners to continue the use restrictions if provided with a fair and reasonable return and (2) conditioned the provision of incentives on a continuation of affordability restrictions for the remaining useful life of the housing.

While the House has not adopted a mandatory preservation scheme, in contrast to the Senate, certain House members attempted to forge a middle ground by offering an amendment on the floor. The Bartlett-Barnard amendment provided a "first look" option for nonprofit and other purchasers willing to continue the affordability restrictions, activated only when the owner's notice of intent indicated an intention to sell the property. The Carper-Price amendment replaced these provisions with "right of first refusal/mandatory sale" language. Specifically, the amendment provides that, if an owner refuses to accept the preservation incentives, and a nonprofit, public agency, resident council or other purchaser offers to buy the project for its full appraised fair market value (best and highest use), the Secretary can require the owner to sell to such purchaser. If the owner continues to refuse the bona fide offer, the Secretary will acquire the property through purchase, donation or condemnation, and then reconvey the property to this purchaser. At the end of this memorandum is a section discussing the "right of first refusal/mandatory sale" provision of the House bill, as amended, and comparing it to its precursor, the 1987 FmHA prepayment statute.

III. Review of Four Fundamental Differences In Senate and House Prepayment Bills:

1. Voluntary or Mandatory Federal Preservation Program:

The issue is whether Congress should limit the number of projects that are prepaid and converted by imposing certain standards on the exercise of the prepayment right, as part of an administrative review process. (The owners' 20 year prepayment right is not statutory but was included in the contracts signed by owners and HUD when the housing was built during the 1960's and 1970's.)

Current Law: Owners who wish to prepay and convert the housing must go through an administrative process ("plan of action") and prove that the housing is not needed for low and moderate income families in the community, that displaced tenants can find alternative affordable housing and that minority housing opportunities will not be adversely affected through a conversion of the housing to another use. If the owner can not meet these standards, HUD offers incentives for continued low income use designed to provide a fair and reasonable return on investment. The constitutionality of the temporary prepayment law has been upheld in federal court.

Senate: Continues current law (ELIHPA) standards for approval of prepayment and conversion. Defines a fair and reasonable return and a methodology for arriving at that number. Attempts to make the process for receiving incentives less discretionary and more streamlined. Makes a clear distinction between the content of a plan of action for owners who wish to terminate affordability restrictions and those who indicate a willingness to accept incentives or transfer to a purchaser who will continue the use restrictions.

House: No criteria or process for evaluating whether prepayment and conversion should be permitted. Owner may accept incentives voluntarily or prepay after serving two notices. An owner who refuses incentives may be forced to sell the property if a nonprofit, resident council, public agency or other purchaser makes an offer to purchase within 6 months after the owner's second notice of intent. Such purchaser must agree to maintain affordability restrictions for the remaining useful life of the housing and offer no less than the full appraised fair market value, based on "best and highest" use. (See section at the end entitled "Distinguishing Mandatory Sale Program in Carper Amendment From Its Model: The FmHA Prepayment Statute.")

2. **Preemption of State and Local Preservation Laws:**

The question before Congress is whether state and local preservation laws should either be preempted, in whole or in part, by the new federal preservation program. This issue has typically been discussed in the context of proposals for a mandatory federal incentive system (see point 1 above).

At least twelve states or municipalities have enacted laws to protect federally assisted housing at-risk of conversion out of the low income and moderate income housing supply. A preservation ordinance has been enacted in Boston, and major ordinances are pending in San Francisco and Seattle, among other cities. State preservation laws have been enacted in California, Maryland, Massachusetts, Rhode Island, Illinois, Maine, Minnesota, Missouri, New Jersey, Washington, and Connecticut.

Current Law: Silent on the preemption of state and local laws governing prepayment-eligible housing. Nothing stated in the legislative history would support an inference that Congress intended to preempt state and local preservation statutes.

Senate: The bill is silent on the issue of preemption of state and local laws governing prepayment-eligible housing, even though the Senate bill provides for a mandatory federal incentive program. The report lists states and localities that have enacted preservation laws and discusses them in a positive and supportive way.

House: Preemption language in committee bill was both scaled back and, with respect to post-conversion projects, expanded as a result of the Carper-Price amendment. House bill preempts state and local laws that (1) limit or prohibit prepayment (2) are inconsistent with the subtitle, including those that limit or impair the ability of an owner to receive federal preservation incentives. Further, any state or local law that is exclusively applicable to projects with prepaid mortgages or terminated insurance contracts is preempted. The construction clause states that state and local laws which are not inconsistent with the subtitle and relate to building standards, zoning limitations, health, safety or habitability standards or rent control are not preempted if such laws are of general applicability to federally assisted and nonassisted housing.

3. Rent Structure Under Preservation Incentive Program:

Background

Income Limits /Rent Levels: To qualify for residency in a 221(d)(3)(BMIR) project, a tenant's income must be below 95% of the area median income. Eligibility for Section 236 housing is limited to tenants with incomes below 80% of area median income, adjusted for family size. Some units in these projects are additionally assisted under the project-based Section 8 Loan Management program. Since 1981, access to Section 8 assistance has been generally restricted to tenants with incomes below 50% of area median income.

Notwithstanding the high income eligibility limits for the programs, the vast majority of residents are very low or lower income households because the rents are restricted and thus are affordable to them. Rents in 221(d)(3)(BMIR) and 236 projects are set by HUD and reflect the low interest financing provided by the government, operating expenses and a limited owner profit. In this cost-based rent structure, HUD authorizes rent increases when operating expenses increase.

Who Lives in At-Risk Housing: The income mix of projects threatened by prepayment varies widely, but HUD has found that, on average, 45% of the units are occupied by very low income tenants, regardless of whether or not Section 8 assistance is available. Most of the other tenants have incomes below 80% of median income, but it is not unusual for 5% to 10% of the units to be occupied by moderate income families.

Current Law: Owners who participate in the incentive program must limit rental charges for current tenants to 30% of income; rent increases are phased-in over a 3 year period. The upper limit on rental charges for assisted and nonassisted tenants is the Section 8 Existing Fair Market Rent. The rent structure for future tenants is different and becomes the mechanism by which the economic mix of the project is maintained. Rents are tiered to achieve income mix. Consistent with legislative history of ELIHPA, the new rents are set in a way that will not only maintain the same proportions of very low, lower and moderate income households in the future but also assure a range of affordable rents for units reserved for occupancy by lower income tenants (50%-80% of median income, adjusted for family size).

Senate Bill: Owners who participate in the incentive program must limit rental charges for current tenants to 30% of income; rent increases are phased-in over a 3 year period. With respect to future rental charges, the Senate's approach is to maintain the cost-based rent structure that has characterized the Section 221(d)(3) (BMIR) and Section 236 programs from their inception. The owner profit level, included as a "cost" in the rent structure today (a 6% return on original equity) is replaced with a new profit level (8% return on adjusted equity, in combination with other incentives) in the new rent structure. Similarly, if the project is sold, the new rent levels will include the cost of acquisition financing, if any.

House Bill: Owners who participate in the incentive program must limit rental charges for current tenants to 30% of income; rent increases are phased-in over a 3 year period. In the future, however, project rent levels are market-based but may not exceed 110% of the Section 8 Existing Fair Market Rent. The cost-based rent structure is eliminated as well as any limitation on cash flow distributions to the owner. (It is unclear whether future rent increases are tied to changes in the Section 8 FMR, or will only be approved by HUD based on increases in project operating expenses.) Rents are not skewed to achieve economic integration. Very low and lower income households are served only through the provision of rental subsidies.

4. Duration of Low and Moderate Income Use Restrictions Required In Exchange for Preservation Incentives:

Current Law: Restrictions on rents and incomes of tenants for remaining term of the mortgage (20 years) in exchange for incentives.

Senate Bill: Restrictions are for the "remaining useful life" of the property, a concept introduced in 1989 with the passage of the affordable housing programs in the savings and loan legislation (FIRREA).

House Bill: The duration of use restrictions under the House bill will depend entirely on the future disposition of the project and actions taken by the owner.. On one hand, the use restrictions on projects that receive preservation funding from HUD may be terminated (condominium conversion by the residents), yet in another scenario, they may be extended permanently ("mandatory sale" to a preservation purchaser).

• **Notice to Purchasers:** The FmHA prepayment statute specifies a procedure whereby the owner must affirmatively notify interested nonprofits of the project's availability for sale for a 180 day period. This has been further elaborated in FmHA's regulations and implementing instructions. In contrast, the House bill provides no procedure whereby HUD or the owner will inform any prospective purchaser that the owner has rejected the incentives and that the right of first refusal/mandatory sale provisions have been activated. Yet, under the House bill, the 6 month clock for submission of a bona fide offer begins on the date the owner submits the second notice of intent to HUD. While the tenants and the chief executive officer of the state or local housing agency will receive notice that the owner has filed a second notice of intent, this is the extent of the notice requirement.

While this memo describes five key distinctions between the FmHA buy-out program and the House bill, as amended, it should be emphasized that the rural housing statute and the House legislation differ markedly in other respects. The House has borrowed an idea for safeguarding HUD projects at-risk of prepayment from the rural housing prepayment statute, but has not adopted its operational features.

A. Owners Who Accept Incentives And Stay-In or Sell To Purchaser That Continues Affordability Restrictions:

To receive incentives on the prepayment eligibility date, the owner (or a purchaser) must extend affordability restrictions for the remaining term of the mortgage (20 years).

Use Restrictions At End of Mortgage Term: No later than 18 months prior to the end of the HUD mortgage term, HUD may notify the owner of its intention to provide for incentives or a sale of the housing. The owner must respond in 6 months, and either sell the project for a price equal to its then current appraised "best and highest" use value or accept incentives and continue regulated use for another 5 years, based on a new unrestricted rental use valuation, if offered by HUD. (While it is not clear, it appears that the owner can elect sale or continued receipt of incentives, rather having this decision made by the Secretary. It is also not clear whether HUD is required to offer additional incentives or to purchase the project at the end of the mortgage term, subject to the availability of appropriations, or just has the authority to do so.)

- Owner Accepts More Incentives: After the end of the 5 year period, where additional incentives were provided, the Secretary may extend the period of restricted use, at his discretion, and provide additional incentives for another 5 year period, based on a new appraisal of the property as rental housing, without federal use restrictions. After this 10 year period, the Secretary may again offer incentives which the owner may accept or decline. This third incentive renewal period must be for not less than 5 years.

- Owner Sells At End of Mortgage Term: Where the project is sold at the end of the mortgage term to the Secretary, or to a an approved purchaser, the Secretary decides the duration of the use restrictions. This issue is left open in the House bill.

B. Sales To Resident Councils (HOPE Initiative):

If, on the prepayment eligibility date, the owner sells the project to the residents under a homeownership program, and the residents convert the housing to condominium ownership, there are no future restrictions. The initial resident owner can resell the housing to any purchaser, regardless of income, and without any purchase price limitation. If, on the other hand, the residents buy the project as a cooperative and assume the mortgage, the use restrictions will be extended through the remainder of the mortgage.

C. Mandatory Sale to Nonprofits or Other Purchasers:

As a result of the Carper-Price amendment, the House bill now provides for one situation where use restrictions are extended for the remaining useful life of the housing. As discussed in the introduction, if the owner refuses preservation incentives, and a nonprofit, public agency or resident association or other purchaser agrees to permanent use restrictions and offers to buy the project for the full fair market value (best and highest use), then the owner must sell. The interplay between this new mandatory sale provision and the resident council purchase provisions discussed immediately above, which were added by Bartlett-Barnard at the committee level, is not clear.

IV. <u>Distinguishing Mandatory Sale Program In the Carper Amendment From Its Model: The FmHA Prepayment Statute</u>

The Bartlett-Barnard amendment provided for a 12 or 18 month period (following the receipt of appraisal information from HUD) for nonprofits or other purchasers who were willing to extend low income use to make an offer to the owner. This "first option" provision was only applicable when the owner was willing to sell. The Carper-Price amendment replaced the "first option" provision with "right of first refusal" and "mandatory sale" requirements that apply in a very different circumstance. Specifically, they are triggered by the owner's refusal to either accept incentives for itself or a purchaser of its choice that would continue the affordability restrictions. The House bill, as amended, incorporates an approach taken by Congress in 1987 for rural housing projects at-risk of prepayment and conversion. However, it is different from the rural housing statute in at least five critical respects.

- **Eligible Purchasers:** Under the FmHA prepayment statute, only nonprofits and public agencies can exercise the right to purchase option and in so doing, prevent a withdrawal of the housing from the affordable supply. In the House bill, a nonprofit, resident council, public agency or for-profit entity can invoke the mandatory sale option, provided the purchaser agrees to maintain the affordability restrictions for the remaining useful life of the project. (The nonprofit buyout provisions of the FmHA statute also require permanent use restrictions.)

- **Higher Purchase Price:** FmHA has interpreted the statute to authorize a maximum purchase price equal to the fair market value of the housing as residential rental housing, without federal use restrictions, for the nonprofit buyout program. In contrast, the House bill requires a preservation purchaser to offer the owner a price equal to the fair market value under a "highest and best use" valuation before the mandatory sale provision applies.

• **Incentives May Not Provide Sufficient Funding for Sale:** The rural housing statute authorizes funding for the transfer of 5,000 units of at-risk housing each fiscal year to nonprofit purchasers. If funding is depleted during the fiscal year, owners are required to wait until the next fiscal year. If, on the other hand, appropriations are insufficient, then owners must wait 15 months before prepaying the mortgage so that new appropriations can be secured. If new appropriations are not forthcoming, the owner can prepay and terminate low income use. The FmHA program offers 102% financing, and complete interest and rental subsidies to facilitate transfers to nonprofits and public agencies.

In contrast to the FmHA program, the House bill offers no assurance that a preservation purchaser, under a fully funded preservation program, will ever be able to pay the required purchase price (fair market value at "highest and best use"). While rent levels and subsidies, in the context of a sale to any purchaser willing to continue the affordability restrictions, are based on "best and highest use" valuation, they are still capped at 110% of the Section 8 Fair Market Rent. The $200 million in grant funds for nonprofit acquisitions, as well as the grants authorized for homeownership conversions, may make some transactions feasible where the maximum rents and rental subsidies will not support the full acquisition financing otherwise needed. If, however, federal grants and rental subsidies combined are insufficient to pay the purchase price, maintain the affordability of the housing and meet the physical needs of the housing, state or local funding may be required to make viable the only safeguard against the loss of prepayment-eligible housing authorized by the House. Another alternative would be to supplement available funds with equity raised through syndication of low income housing tax credits, if this program is extended.

• **Tax Relief for Owners:** The House bill is more favorable to the owner than the FmHA provisions because the owner can demand that the Secretary take the property through eminent domain proceedings. This action would qualify the owner for capital gains relief under Section 1033 of the Internal Revenue Code. (It is unclear to this author that the 1931 condemnation statute, cited in the House bill, provides an appropriate legal basis for the Secretary's acquisition of an at-risk project.)