



C H A P A

**Citizens' Housing and
Planning Association**

**Testimony of Vincent F. O'Donnell
Housing Preservation and Tenant Protection Act of 2009
Submitted to the House Financial Services Subcommittee on Housing and
Community Opportunity
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Introduction

Good afternoon Chairwoman Waters, Ranking Member Capito, Chairman Frank, and distinguished members of the Subcommittee. Thank you for the opportunity to testify regarding the Housing Preservation and Tenant Protection Act of 2009. My name is Vincent O'Donnell, and I wish to speak in favor of this timely and important legislation.

I am testifying today in my capacity as president of the Citizens' Housing and Planning Association in Massachusetts. Established in 1967, CHAPA is a statewide non-profit organization whose mission is to expand housing opportunities for low and moderate income residents in Massachusetts. CHAPA works extensively on a number of important affordable housing and community development issues, including: the revitalization of state public housing; improving rental assistance programs; preventing homelessness; expanding homeownership education and counseling; increasing housing options for people with disabilities and seniors; spurring neighborhood revitalization; promoting smart growth and sustainable development policies; providing technical assistance and support to municipalities and local housing partnerships; and many other issues.

I also serve as Vice President for Affordable Housing Preservation at the Local Initiatives Support Corporation (LISC), a national community development intermediary dedicated to helping community residents transform distressed neighborhoods into healthy and sustainable communities of choice and opportunity. In that position, I lead LISC's national efforts to support nonprofit preservation transactions; to provide capacity building for CDCs, residents, and state and local government; and to coordinate a variety of preservation policy activities, including helping to facilitate the National Preservation Working Group, a broad coalition of nonprofit, tenant and governmental preservation stakeholders.

CHAPA's engagement in affordable housing preservation dates back to the mid-seventies. In 1978, I co-directed a three year demonstration program conducted by CHAPA with support from HUD and several foundations. The purpose of this project was to assist HUD in implementing new Congressional mandates and authority for the

preservation of foreclosed affordable multifamily properties. At that time, HUD was the one of the largest and most problematic landlords of affordable rental units in the City of Boston, and the goal of the CHAPA project was to redevelop these properties with the active participation of the tenants. With the active support of HUD, we succeeded in supporting the creation of several low-income tenant cooperatives, all of which are still operating successfully, and in establishing competitive procedures designed to facilitate the disposition of these properties to high-capacity owners committed to providing high-quality affordable housing. Once again, with the help of new legislative tools, we look forward to working with HUD as a constructive partner in implementing new approaches to our affordable housing problems, including the preservation of assisted multifamily housing.

Over the past thirty five years, I have worked with tenant organizations, nonprofit and cooperative purchasers and owners of assisted multifamily housing, and state and local government. This work began with distressed housing in Boston's poorest minority areas and later addressed prepayment of subsidized mortgages and expiration of Section 8 contracts, just when those same neighborhoods became gentrified years later. More recently, I have worked from the perspective of statewide and national intermediaries, providing financial and technical support to preservation entities, and continuing to work with the government to improve the toolkit with which we approach preservation.

I mention this experience to bring perspective and context to this urgently needed legislation. Affordable housing preservation has a long history: it began with the Housing and Community Development Amendments of 1978 and continued through the Emergency Low Income Housing Preservation Act of 1987 (ELIHPA), the Low Income Housing Preservation and Resident Homeownership Act of 1990 (LIHPRHA) and the Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA), and subsequent amendments. The priority of this early phase was defending the housing stock and its resources, and development of new preservation tools to address new risks as they emerged: prepayment of subsidized mortgages, Section 8 opt-out and renewal, and distressed HUD-foreclosed housing.

The proposed preservation legislation represents an urgently needed next phase: a consolidated package of reforms that will clarify HUD's preservation mandate, address new regulatory issues such as subsidized mortgage maturity; simplify and consolidate tools and resources; integrate needed resident services and resident participation; address obsolescence and the need for reconfiguration; and respond to changes in the populations served and changing markets. We need finally to make our current system work, and to end the distractions of putting out fires and spending valuable human resources on solving unnecessary problems with program operations.

As its history shows, affordable housing preservation policy is dynamic. If we are serious about making this housing sustainable, we must also expect that, when this package of reforms is in place, new challenges will emerge: integrating preservation with cross-cutting community transformation initiatives that involve education, workforce development, health care, transportation and environment. The 21st Century brings new

challenges for preservation, including: truly sustainable affordable housing in truly sustainable and diverse communities; working with the changing diversity of the communities served by affordable housing; addressing the concentration of poverty while respecting the vitality of existing communities; and ensuring equity of opportunity within our new revitalization strategies.

As an overall comment, I am pleased to say that the proposed legislation is highly responsive to the comprehensive recommendations produced in 2007 by the National Preservation Working Group. I would now like to discuss the specifics of this bill.

Types of Risk

The structure of the proposed legislation reflects the variety of reasons that federally-assisted affordable multifamily housing is at risk, including: conversion to market rate after the maturity or prepayment of a subsidized mortgage or an owner's decision not to renew a Section 8 contract; physical deterioration and obsolescence – including environmental obsolescence; and ineffective management to name a few. Preserving the affordable housing stock requires tools specifically targeted to these different risks.

Title I of the draft bill primarily addresses the first risk – the risk of conversion to market rate housing. The Title includes some new preservation tools, such as the right to purchase, which I will discuss shortly. First I would like to discuss several important provisions that apply existing preservation tools to an expanded universe of affordable housing programs: the early subsidized mortgage and rental assistance programs, and state agency assisted housing.

The first privately-owned multifamily subsidized housing was produced through a number of predecessor programs that existed before Section 8 came into the picture in 1974. This “older assisted stock” includes properties developed under mortgage programs such as the Section 202 direct loan program for seniors created in 1959, the Section 221(d)(3) Below Market Interest Rate loan program from 1961, and the Section 236 Interest Reduction Payments program created in 1968. These mortgage subsidy programs provided a “shallow subsidy” which effected a reduction in the rent level, but did not guarantee affordability to very low income families. The Leased Housing Program, the Rental Assistance Payment (“RAP”) and Rent Supplement programs were the pre-cursors to the deep subsidy of project-based Section 8 assistance, providing income-based subsidies enabling the very poor to afford this housing. Finally, some state housing agencies – including Massachusetts – have provided subsidies and financed affordable housing over the years that is now at risk of loss. This bill includes several provisions that will align the treatment of these programs with more common subsidy programs such as Section 8, an important step toward simplifying the preservation process.

The “Year 40” Problem

Tenants in older assisted properties are protected by Enhanced Vouchers if owners exercise their right to prepay and terminate use restrictions. No such protection exists when the property's mortgage fully matures, typically after forty years. Many of these older assisted properties also have ongoing Section 8 assistance contracts (through the

Loan Management Setaside program) for some or all of the units. To the extent that the units are covered by Section 8, they are subject to the provision of MAHRA that allows – but does not require – owners to renew the contracts to maintain affordability at “year 40”, and if the owner chooses not to maintain the LMSA assistance, the Section 8 tenants will receive Enhanced Vouchers.

However, there is currently no policy tool in place to preserve affordability at year 40 in entire properties or portions of these older properties that are not covered by a Section 8 contract. Once one of these subsidized mortgages matures, its regulatory agreement dissolves, and the tenants will be subject to immediate rent increases to market levels. Over the next ten years, this exposes over 100,000 households to possible displacement. This number is relatively small when compared to the total number of subsidized households and units at risk, which makes the problem one that is manageable with the right tools in place. We support the provision in the proposed bill that would open up the eligibility for Enhanced Voucher protection to these households to prevent large-scale involuntary displacement. The ability to project-base these Enhanced Vouchers is also a valuable new tool in the proposed bill.

Rent Supplement/Section 236 RAP Conversion

Units with Section 236 Rental Assistance Program (RAP) and Rent Supplement assistance are currently not afforded the same preservation incentives or renewal authority as units with project-based section 8 assistance. Most notably, these contracts cannot be marked up to market, and when the associated mortgage matures, is prepaid or foreclosed, the rental assistance is terminated. In contrast, project-based Section 8 assistance is renewable, and in the case of a mortgage prepayment or maturity, the project based assistance will either remain or be converted to enhanced vouchers, which allows tenants to stay in their home. Section 101 of the proposed bill would permit conversion of RAP and Rent Supplement contracts to project-based section 8 assistance, saving thousands of units of affordable housing. Upon conversion, the new contracts will be considered renewal contracts, and will be eligible for the preservation tools provided by the Multifamily Assisted Housing Reform and Affordability Act, including “mark up to market.”

State Assisted Properties

This legislation contains two sections that are especially important to the preservation of state-financed and assisted housing.

Section 104, Enhanced Voucher Assistance and Preservation Project-Based Section 8 Assistance for State-Financed Affordable Housing, addresses an important gap in the coverage of the existing preservation toolkit. Some states, including Massachusetts, provided both rental assistance and mortgage interest subsidies for affordable multifamily housing. Just as with federally-assisted properties, there are now thousands of residents vulnerable to displacement in these properties as mortgages mature and there is no replacement subsidy. In Massachusetts alone, there are fifty five affordable multifamily properties that were assisted under the Commonwealth’s Section 13A program.

These state-assisted properties were eligible for preservation incentives under the LIHPRHA program, and when those mortgages were prepaid, residents were able to receive Enhanced Vouchers. Section 104 would extend Enhanced Voucher protections to tenants of these properties upon mortgage maturity as well, continuing the parity established under LIHPRHA with regard to similar provisions in Section 102 for tenants of federally-assisted properties.

Another important provision in Section 104 of the proposed bill would provide owners of these state-assisted properties with the option to accept project-based vouchers instead of tenant-based Enhanced Vouchers. As with Section 105, acceptance of project-based vouchers would allow for an extended contract term (subject to appropriations), enabling easier use with other preservation financing sources.

Section 106 also contains provisions to assist the Preservation of state-HFA financed properties. There are more than 150,000 affordable units whose financing is provided by state Housing Financing Agencies (HFAs), using long-term, project-based Section 8 contracts. This bill will assist the preservation of these properties by: ensuring continuation of the section 8 contract if an owner refinances prior to mortgage maturity; allowing owners of these properties to use the mark up to market option prior to contract expiration, provided they agree to an extended Section 8 commitment; and permitting the cancellation of fully funded, long-term Section 8 contracts and their replacement with new, 20-year contracts subject to annual appropriations in the case of refinancings by preservation owners or sales to preservation purchasers.

First Right of Purchase Before Conversion of Multifamily Housing

Section 103 of the draft bill provides a new preservation tool aimed at properties at risk of conversion to market rate, an important issue that will affect the total number of properties that eventually get preserved. The first right of purchase would require sale of a covered affordable housing property, at fair market value, to a qualified preservation purchaser who is willing to provide essentially permanent affordability.

It also would provide a safe harbor, both for good-faith sellers, and for owners who wish to preserve without a sale. For instance, a sale to a preservation owner, or a refinancing with extension of affordability, would not trigger the first right of purchase if the terms of the transaction meet the legislation's affordability targets.

In working for many years with stakeholders in Massachusetts to secure passage of similar state legislation, we have learned that, within this overall framework, there are many nuances and complexities. The bill properly recognizes some of these complexities by requiring the Secretaries to issue regulations, for example, on important details such as what constitutes a safe harbor transaction and how to choose between competing purchase offers for a property.

Based on my Massachusetts experience, however, I believe further discussion with stakeholders would help to identify and resolve several issues that are essential to the success of this provision.

For example:

- A twenty four month notice period, as in the proposed bill, will require owners to provide a notice triggering purchase rights even if, for legitimate reasons, they have not yet decided what their intentions are.
- For a purchaser to obtain financing, post-transaction rent increases may be needed, even in the absence of rental assistance, at least to cover often-deferred operating costs, and sometimes for capital costs. But protection against abuses should also be provided.
- Most commercially reasonable offers and purchase agreements contain contingencies such as assembly of financing, deposit amounts and refundability, time to perform, and other details beyond just a fair purchase price.
- In some assisted properties, existing tenants who do not have rental assistance are paying in excess of 30% of their income for housing. Some combination of guidance and authority to the Secretaries as to resolution of conflicting goals would be helpful.

In Massachusetts, a right of first refusal (i.e., the right of a designated purchaser entity to match an arms-length third party offer), was suggested as an alternative to the right to purchase. After a lengthy discussion initiated by the legislative leadership, CHAPA and a broad coalition of owners, tenants and nonprofits ultimately supported a right of first refusal bill, but only on the condition that strong tenant protections also be provided.

There are important differences, advantages and disadvantages to various parties in these two approaches. A right to purchase provides the greatest opportunity to intervene when an owner wants to terminate affordability, such as simply letting it expire without a sale. The National Housing Law Project has argued persuasively that a right to purchase based on fair market value is not a taking, and therefore I do not think it is vulnerable to that line of critique. On the other hand, because it is rooted in an arms-length negotiation to purchase, a right of first refusal can provide a highly market-based benchmark for the terms of sale, which can eliminate costly and time-consuming implementation challenges. Those terms may include, for example, the timing of delivery of the sales price, possible tax-deferred or bargain sales, transfer of reserves controlled by the seller, timing requirements for obtaining financing and subsidy commitments, or cancelling the purchase contract after due diligence, and deposit requirements. Whichever mechanism is included in the legislation, some practical and legitimate test of commercial reasonableness is necessary. Hopefully these lessons from the Massachusetts experience can help to inform whatever mechanism is ultimately enacted.

Other Title One Provisions

Other important provisions of Title I would establish and clarify HUD's proactive preservation mandate, to ensure quality asset management that prevents the emergence of crises. HUD would also be given the authority to modify the terms of existing Flexible Subsidy subordinate loans, and to make residual receipts available to facilitate preservation in a manner which reduces the need for new appropriated funds. Restructuring of existing HUD-held debt, project reserves and existing regulatory

agreements are important preservation tools, and require greater administrative discretion and flexibility, within reasonable guidelines to protect the government's interest. This legislation encourages HUD to view its discretionary decisions as the strategic investment of assets, with a requirement for a good return in terms of long-term affordable housing with a positive community impact.

Finally, Title I includes an important provision that would ensure that state and local laws requiring additional notice periods, right to purchase or right of first refusal would not be federally preempted, unless expressly provided under federal law.

Risk of Deterioration

The draft bill also addresses the risk of physical deterioration and obsolescence of the affordable housing stock. Even the best maintained housing needs periodic recapitalization to update building systems in need of replacement and perform upgrades of other building components.

When properties are denied the ability to perform this rehabilitation on a regular basis – either through owner neglect or lack of available financial resources – they can easily fall into disrepair and create an unsuitable living environment for residents. Over time, this neglect can mean that complete replacement of a building is more feasible than rehabilitation.

Title II of the proposed bill includes a provision that encourages HUD to use, and provides a funding source for, existing authority to pool recaptured Section 236 subsidy dollars for rehabilitation grants to preservation projects. Although modest in size, this pool of subsidy dollars can be leveraged with other resources to help perform high priority repairs for at-risk affordable housing, with no new appropriations.

Title II of the proposed bill also includes an important provision to allow the replacement of outdated, physically obsolete or economically non-viable projects with better quality housing. This provision encourages mixed-income communities by allowing project-based Section 8 contracts to be transferred from one project to multiple other projects. These transfers of assistance have been made available on a temporary basis in recent years, but the use of this authority has been limited due to restrictive provisions in existing authority. The proposed bill strengthens the existing authority and makes it a permanent preservation tool.

Troubled Projects Facing Foreclosure

HUD has in place an enforcement system to help ensure that publicly subsidized housing is meeting HUD's physical standards and that good quality management is in place. This is a critical element of the public-private partnership under which this housing was created. However, the current system is in need of reform. For example, HUD's pending enforcement actions are often known only to the existing ownership entity, and not to tenants, local governments and other preservation entities until it is too late for anyone to take actions to save the housing. Once a property is in crisis, HUD sees its options as

limited, even if a preservation-oriented group is attempting to intervene, often resulting in loss of the Section 8 contract.

Title IV of the proposed bill provides flexible and incremental enforcement tools and clear direction to HUD to ensure that troubled properties are brought up to HUD quality standards, rather than using permanent loss of subsidies as the primary enforcement tool. And, when HUD foreclosure is unavoidable, the bill helps ensure that properties will remain affordable with Section 8 contracts in place after HUD disposition. The bill also repeals a prohibition against certain rehabilitation grants to foreclosed properties being sold by HUD. These so-called Upfront Grants are available from the Mortgage Insurance Fund, enhancing redevelopment feasibility without the need for new appropriations.

Title IV also recognizes that state and local governments should be partners with HUD in the preservation of troubled projects. To this end, the bill facilitates the transfer of assisted mortgages to state and local government in order to improve resolution of troubled properties. It also requires an industry-standard valuation of distressed properties being sold by HUD to state and local governments for subsequent purchase by nonprofits and other preservation entities.

Section 8 Renewal Incentives

One of the biggest challenges in preservation today in terms of the volume of units at risk is the continuing short-term renewal of project-based Section 8 contracts. Each year, subsidy contracts for between 200,000 and 300,000 units of Section 8 housing come up for renewal, and the vast majority are renewed for between 1-5 years at a time. Each time the contract expires, the owner has the option of walking away from the relationship with HUD. The challenge is to provide these owners with the right incentives to continue to renew their contracts and keep the housing affordable. The Multifamily Assisted Housing Reform and Affordability Act of 1997, which provided owners with options such as the Mark to Market mortgage restructuring program, provides an important context for renewal incentives.

While MAHRA has been very successful, there are some elements that need updating to ensure the continued success of the programs it created and to expand the law's benefits to additional at-risk housing types, including properties preserved under previous preservation programs and properties financed under the Section 8 Mod Rehab program.

One of the more important elements of Title V of the proposed bill is the ability to allow owners to obtain longer-term Section 8 contracts at their discretion. This will provide these projects with the certainty that a lender would need in order to provide financing to the property, and because the contracts are funded based on annual appropriations, this approach does not cost the government any more than a shorter-term contract would.

There is one important issue that has emerged recently but is not addressed in this bill. When Section 8 rents are renewed in properties using other resources, it has been possible to mark Section 8 rents up to comparable market levels, either on an as-of-right basis, or on a discretionary basis taking legitimate costs into account. Recent HUD

policies have called this procedure into question, in properties that are using Low Income Housing Tax Credits in conjunction with a preservation transaction. Congress recently corrected a similar problem with regard to project-based voucher assistance, in the Housing and Economic Recovery Act of 2008. A similar correction is needed in this legislation for project-based Section 8 contracts that are subject to MAHRA.

Preservation of Section 202 Supportive Housing for the Elderly

Important progress in the preservation of Section 202 multifamily housing for the elderly was achieved in the passage of Section 811 of the American Homeownership and Economic Opportunity Act of 2000. Several years of experience in working with this authority have identified certain gaps in coverage and new ideas to improve the implementation of this tool and create predictability. Subtitle B of Title VII of this bill reflects these needed amendments.

Among other things, this subtitle increases the long-term affordability requirements in exchange for HUD's consent to a prepayment, and clarifies its applicability to "old law" Section 202 properties that are not covered by existing authority. It ensures that HUD's consent should be given in order to address the physical needs of the project and to promote long-term affordability. Total debt service is allowed to be increased, if required to meet rehabilitation needs. Greater flexibility is provided to permit use of refinancing proceeds and existing project reserves for funding of social services, reconfiguration of obsolete unit types and other needs of the properties.

In addition to these improvements to existing authority, new tools are provided. Rents on existing project-based Section 8 contracts are allowed to be marked up to budget, including the cost of rehabilitation. In addition, a new Senior Preservation Rental Assistance Contract is authorized to prevent displacement of residents in "old law" Section 202 properties that have never had any form of rental assistance. Finally, several other financing issues are addressed, including a mortgage sale demonstration, clarification of underwriting standards when FHA Risk Sharing is used, and clear authority to subordinate existing section 202 and Flexible Subsidy debt in order to facilitate preservation.

Other Provisions

In addition to those elements I've discussed in detail, CHAPA supports other provisions of the bill, including the tenant empowerment provisions in Title III, the preservation database in Title VI, and the rural housing provisions of Title VIII. I have not addressed other minor technical concerns in this testimony. Comments to this effect will be provided to committee staff.

This concludes my testimony. Thank you for the opportunity to speak to you today. CHAPA and LISC look forward to working with members and staff to pass this comprehensive package of program reforms to bring preservation of affordable rental housing into the next generation. I will be happy to address any questions that you may have.