Rural Rental Housing Preservation Legislation Introduced

Congressmen Lincoln Davis (D-TN) and Geoff Davis (R-KY) have recently introduced H.R. 4002, the Rural Housing Preservation Act of 2007.[1] The bill has three main purposes: to restructure, revitalize and preserve as decent and affordable housing the 465,000 units of rural rental housing financed under Section 515 of the Housing Act of 1949[2]; provide vouchers to residents of assisted projects to ensure that their rents after revitalization do not exceed 30% of adjusted income; and protect residents who are threatened with displacement due to authorized prepayments or foreclosures by providing them with rural vouchers that allow them to stay in the prepaid project, or, if forced to move, to relocate to other housing.

H.R. 4002 replaces H.R. 5039,[3] which was passed by the House Committee on Financial Services in the 109th Congress and was intended to accomplish some of the same purposes that H.R. 4002 seeks to achieve. Significantly, however, H.R. 4002, unlike H.R. 5039, does not propose to lift the prepayment restrictions that were enacted in the Emergency Low Income Housing Preservation Act of 1987 (ELIHPA).[4] It is also generally much more protective of the interests of residents in Section 515 housing. The balance of this article will review the major provisions of H.R. 4002.

Background

The Rural Rental Housing stock financed under the Section 515 program is aging and in need of physical preservation. Many of the developments financed under the program are more than thirty years old and the stock is generally deteriorating because of inadequate reserves or other financing with which to undertake physical revitalization. Due to the fact that funding for the 515 program has been dramatically reduced since the early 1990s, the need for affordable rental housing in rural areas has been increasing, particularly for very low-income households served by the program. The average annual income of households living in Section 515 housing is about $10,000 and nearly 60% of the households served are elderly or headed by a person with a disability. In most rural areas, Section 515 housing is the only decent and affordable housing in the community.

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[1]H.R. 4002, 110th Cong. 1st Sess. (2007) (Hereinafter all citations to this bill will be to the specific sections of the bill).
[2]42 U.S.C. § 1485.
[3]H.R. 5039, 109th Cong. 1st Sess. (2006).
[4]The rural prepayment restriction enacted by ELIHPA are codified at 42 U.S.C. § 1472(c).

For the past two years the Rural Housing Service (RHS) has operated a demonstration revitalization program that is intended to identify the means and methods by which the agency can revitalize and preserve the Section 515 stock. This demonstration program has been carried out under authority and financing granted to the agency under the Fiscal Year 2006 and 2007 agricultural appropriations acts.[5] Unfortunately, little is known about the achievements or success of the program because the RHS has not released any information about its use of special statutory authorities included in the appropriations acts to refinance or restructure existing loans or of the successes that it has achieved in revitalizing the developments that have been chosen to participate in the demonstration program. Generally, it is believed that the agency is subordinating its existing mortgages to third party financing, such as Low Income Housing Tax Credits or bond financing, that enables owners to rehabilitate their developments. The agency may also be extending or deferring its mortgages to maintain rents in developments and avoid the displacement of residents who are not receiving deep rental assistance subsidies.[6] The agency does not, however, have authority to extend additional subsidies to residents of revitalized developments and may be limiting participation in the demonstration program to developments that have RHS rental assistance or Section 8 subsidies available to most, if not all, the units.

H.R. 4002 is intended to provide RHS with a broad set of tools that expands on the agency's existing revitalization and restructuring authorities and protects residents against displacement through rent increases by proposing to create three new rural voucher programs.

Revitalization and Restructuring Authorities

The bill will authorize RHS to extend to owners of Section 515 housing who wish to revitalize their developments a variety of financial incentives. This includes: reduction or elimination of interest on the existing Section 515 loan; partial or full deferral of payments; outright loan forgiveness; subordination of the Section 515 loan to third party financing; reamortization and extension of the loan; grants (subject to appropriations); payment of the costs associated with the development of a long-term viability plan; and additional direct or guaranteed subsidized loans that are not limited by the value of the project.[7]

To secure one or more of these incentives, an owner will have to file a request with RHS to participate in the revitalization and restructuring program. In response, RHS will have to develop a long-term project viability plan that includes two elements. The first is a physical needs assessment that identifies the repairs, improvements and other changes that need to be made in order to preserve the development together with the cost of those repairs and changes. The second is a financial plan that reviews the financial stability of the project; takes into account the loan restructuring elements, including rent increases, that are needed to preserve the project; provides the owner with a rate of return comparable to that received by other owners under the Low Income Housing Tax Credit program; takes into account the repairs that will be made and the costs, if any, of relocating residents during the repairs; and ensures that the rents in the development, after revitalization, are affordable to the residents of the development.[8]

H.R. 4002 is intended to provide RHS with a broad set of tools that expands on the agency's existing revitalization and restructuring authorities and protects residents.

The bill would authorize RHS to use public or private administrative agencies to develop the long-term viability plans. This includes state housing finance agencies, nonprofit organizations or private contractors.[9]

Based on the long-term viability plan, RHS may offer an owner any incentives for which it has legislative authority and funding. However, before doing so, it will have to give the owner an opportunity to review the viability plan and to discuss it with someone from the agency. In addition, a copy of the viability plan will have to be provided to the residents of the development and they must be given thirty days in which to comment on the plan. RHS must respond in writing to the resident comments.[10]

When an owner and RHS agree on the long-term viability plan and the incentives necessary to put it into place, they will enter into a long-term use agreement. That agreement will incorporate the financial restructuring plan for the development, obligate the owner to maintain the housing as affordable housing for thirty years or the remaining term of the project loan, whichever is longer, require the owner to comply with the viability plan, and comply with certain rent restrictions that are set out in the bill. The agreement also obligates the owner to warrant the provision of safe, healthy and clean buildings, and sets out the project rent terms and any voucher assistance that may be provided to the owner. The agreement will be evidenced with a recordable covenant that runs with the

[5] See, e.g., Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act, 2006, Pub. L. 109-97 (Nov. 10, 2005).

[6] Approximately 39% of the residents of Section 515 housing are not receiving Rental Assistance or Section 8 subsidies that ensure that their monthly rent payments, including utilities, do not exceed 30% of adjusted household income.

[7] § 3(a).

[8] *Id.*

[9] *Id.*

[10] *Id.*

land. It may only be terminated if some material preservation incentives that were extended to the owner are no longer available and RHS determines that their unavailability was not due to the owner's fault.[11]

RHS may be able to deny revitalization or restructuring assistance to any owner who has a history of poor management or maintenance of rental properties, is in default on a Section 515 loan, does not enter into a long-term use agreement within a reasonable amount of time, is suspended or debarred from further participation in a government contracting program, or for other good cause as determined by RHS.[12]

A very interesting provision of the bill will deny owners the right to participate in the revitalization and restructuring program if they are a party to an action against RHS that either seeks to allow the prepayment of a Section 515 loan in contravention of the ELIHPA prepayment restrictions or seeks damages for the imposition of the prepayment restrictions. An owner who has previously secured damages against RHS will be able to participate in the program if the owner contributes 50% of the damage recovery, or $100,000, whichever is less, to the revitalization plan.[13]

Rents Under the Long-term Use Agreement

The bill provides that rents, which include the cost of utilities, in restructured and revitalized developments may not exceed 30% of household adjusted monthly income. This rent limitation applies regardless of whether or not additional rent subsidies, such as rental assistance or rural vouchers, are available to the residents of the development. Rents may not be increased in the developments more than once per year and only in accordance with standards set out in the long-term use agreement.

Rural Earned Income Disregard Program

The bill proposes an Earned Income Disregard program identical to that applicable to residents of public housing and voucher holders. While it appears that the income disregard program is extended to all new rural voucher holders and Section 515 households—as opposed to households residing in revitalized and restructured developments—it is not absolutely clear that this is the intent of the bill because the income disregard provisions are not codified in any specific section of the Housing Act of 1949. Effectively, the program requires owners of Section 515 housing to disregard, for purposes of determining household rent, increased household earned income for a period of twelve months when a household member who has been unemployed for a year or received public assistance within the last six months secures employment or participates in a training or self-sufficiency program. At the end of twelve months, owners are required to disregard 50% of the household member's income for an additional twelve months.[14]

Rural Preservation and Rural Tenant Protection Vouchers

The bill proposes three new rural voucher programs, all subject to future appropriations.[15] The first is a rural preservation voucher that can be made available to residents of Section 515 housing whose developments are restructured or revitalized. These vouchers will make restructuring and revitalization of a development easier because they will subsidize the rent of residents who are not receiving rental or Section 8 assistance. Effectively, this voucher program will relieve owners who are participating in the revitalization and restructuring program of having to maintain the rents for residents who are not receiving deep subsidies at 30% of household income. These preservation vouchers will be project-based and will remain in the development as long as it remains subject to the long-term use agreement.

The other two proposed voucher programs are enhanced rural vouchers, which are intended to protect residents of Section 515 developments whose owners prepay their RHS loans, and rural relocation vouchers, which would allow residents to move from a development whenever an owner prepays or RHS forecloses on the loan.[16] These two voucher programs mirror vouchers available to residents of HUD developments whose owners opt-out of the project-based Section 8 program. The enhanced vouchers subsidize the rents of households who live in the Section 515 program when an owner converts a development to the private market. Effectively, they maintain the residents' rent at 30% of adjusted income and subsidize the difference between the residents' rent payment and the new market rent charged at the development. The bill will require the owners of the converted development to accept the vouchers.

The relocation vouchers would allow residents to move from a Section 515 development to other decent and sanitary housing when an owner seeks to prepay the loan or when RHS forecloses on the loan. Unlike H.R. 5039, these rural vouchers are fully portable and can be used to move anywhere in the country. Moreover, these vouchers remain available to the community in which the development was located as long as appropriations are available for the program.

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[11] *Id.*
[12] *Id.*
[13] *Id.*
[14] *Id.*
[15] § 4.
[16] As drafted, H.R. 4002 does not appear to authorize the extension of these vouchers to residents assisted under either the RHS Rental Assistance or HUD Section 8 voucher programs. This does not appear to have been intended by the bill's sponsors and is expected to be clarified as the bill moves through the committee.

Conclusion

H.R. 4002 will not be considered by the Financial Services Committee until at least February of 2008, at which time it is expected that it will be incorporated into a yet-to-be-drafted larger preservation bill addressing HUD housing preservation issues. It is expected that minor amendments will be made to the bill in the process to eliminate some ambiguities that are in the current version. No comparable bill has yet been introduced in the Senate although the House bill is likely to be considered favorably in the Senate.

The Administration has yet to voice its support or opposition to the bill. With respect to revitalization and restructuring authorities, the bill mirrors H.R. 5039, which was introduced at the Administration's request last year. Moreover, the provision that rents in restructured developments not exceed 30% of residents' income is one that the Administration agreed to last year as H.R. 5039 was moving through the Financial Services Committee. The most significant differences between H.R. 5039 and H.R. 4002 lie in the fact that H.R. 5039 does not lift the prepayment restrictions that were authorized by ELIHPA and in the proposed voucher programs, which are more favorable to residents and the communities where prepaid or foreclosed developments are located.

Notwithstanding, the Administration may be willing to accept the bill because the lifting of the prepayment restriction is not as critical this year as it may have been last year. When H.R. 5039 was first introduced, RHS estimated that owners of nearly 45,000 units of Section 515 housing were interested in applying to prepay their loans and it believed that the preservation of these units in accordance with the ELIHPA incentive program would, in this Administration's view, be too expensive. Accordingly, it proposed to lift the prepayment restrictions, allow the owners to prepay their loans and allow RHS to expend its resources on preserving and restructuring the remaining RHS Section 515 stock. The Administration's view may have shifted however, because there are reports that it recently entered into a settlement agreement with owners of about 20,000 Section 515 units who sued the agency for damages caused to them by the imposition of the ELIHPA prepayment restrictions. Under that settlement agreement, owners who receive damage awards will be required to maintain their developments in the Section 515 program for at least an additional twenty years. Thus, the number of units whose owners may seek ELIHPA prepayments has almost been halved and RHS may now be willing to accept the cost of preserving the remaining units.

With respect to the rural voucher programs proposed in H.R. 4002, the Administration may also be willing to accept them notwithstanding the fact that they are more favorable to residents and local communities than the vouchers proposed in H.R. 5039. This is because these programs require new appropriations. It is quite possible that the Administration is willing to accept the authorization for the voucher programs in order to secure the revitalization and restructuring authorities and oppose financing for the voucher programs when they are considered as part of the appropriations process.

NHLP will report on the progress of H.R. 4002 as the bill moves forward. ■

Federal Circuit Issues Yet Another Significant Cienega Gardens Decision

The Court of Appeals for the Federal Circuit has issued another significant ruling on the issue of whether Congressional restrictions on mortgage prepayments for privately owned, federally subsidized properties constitute a regulatory taking. In *Cienega Gardens v. United States*, acting with an enlarged panel on a consolidated appeal, the Federal Circuit reversed and remanded a lower court decision that the Low-Income Housing Preservation and Resident Homeownership Act (LIHPRHA) restrictions on prepayment of mortgages amounted to a regulatory taking and awarded damages to the owner plaintiffs.[1] The Federal Circuit's analysis examined the factors that must be taken into account when assessing whether a regulatory taking occurred, and may prove important for determining the fate of similar restrictions.

Background

Relevant Statutes

In the late 1960s, Congress enacted first Section 221[2] and then Section 236[3] of the National Housing Act. Section 221 provided below market-rate mortgages for private owners, while Section 236 provided market-rate mortgages with interest subsidies. In exchange for these and other benefits, the private owner had to agree to HUD rent and occupancy restrictions. Owners also benefited financially from significant tax benefits.[4] For both programs,

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[1]*Cienega Gardens v. United States*, __ F.3d___, 2007 WL 2778687 (Fed. Cir. 2007) (hereafter, "Cienega X").

[2]Housing Act of 1954, Pub. L. No. 83-560, 68 Stat. 590, 597 (1954), amended by Housing Act of 1961, Pub. L. No. 97-70, 75 Stat. 149 (1961), *codified as amended at* 12 U.S.C. §§ 1715l(d)(3)(2007).

[3]Housing and Urban Development Act of 1968, Pub. L. No. 90-448, § 201(a), 82 Stat. 476, 498, 499 (1969), codified at 12 U.S.C. § 1715z-l (2007).

[4]Though most of these tax benefits were available to all types of properties, owners of Section 221 and 236 were able to maximize their value because of related mortgage insurance and imputed equity provisions.