Mortgage Maturity Problem Still Awaits Congressional Action

The continued affordability of a number of privately owned developments is once again at risk due to time-limited use restrictions. In the 1980s and early 1990s, mortgage prepayments presented a major threat. In the late 1990s, the expiration of rental assistance contracts followed. Now, thousands of properties with HUD- and RD-subsidized mortgages face the threat of mortgage maturity, as development loans inexorably approach their 40-year terms. At maturity, the rent and affordability restrictions contained in the applicable federal regulations and regulatory agreements are terminated, threatening many low-income tenant households with rent increases.

Background

Initially explored by the General Accounting Office (GAO) in a 2004 report requested by Congressman Barney Frank, the problem of mortgage maturity has changed in scope as properties have continued to prepay or suffer foreclosure and data has been refined.[1] That report found that 2,328 properties would reach maturity during the 10-year period between 2004 and 2013, predominantly between 2010 and 2012.[2] Back in 2004, the GAO projected the number of maturing mortgages to reach 100 for the first time in 2009, increasing to more than 200 in 2010, to about 500 in 2011 and 700 in 2012.[3]

Based on more current information, HUD now estimates that the problem will impact about 190,000 units in roughly 1,900 properties during the period 2012 through 2020.[4] Of these units, about 72,000 are unassisted by other federal housing subsidies,[5] thus posing a special risk to resident households. After 2020, HUD forecasts that another 110,000 units with subsidized mortgages will face mortgage maturity, with an additional 18,000 unassisted households at risk.[6] Although no similar information has been provided by Rural Development (RD), the number of affected unassisted units in subsidized properties located in rural and suburban areas likely adds tens of thousands of units to the scope of the problem.

Affected properties are those with budget-based rent restrictions under the Section 221(d)(3) Below Market Interest Rate, Section 236, and Section 202 programs developed in the late 1960s and early 1970s, as well as rural properties financed by the United States Department of Agriculture under the Section 515 Rural Rental Housing program. These budget-based rent restrictions required under the regulatory agreement limited rent increases to those approved by the agency to cover demonstrated increases in operating costs. In many markets, where actual market rents in the area have gone up faster than project operating costs, these restrictions have provided a measure of affordability for tenants. For example, the restricted rents for a two-bedroom unit might be $700 in a market where similar unsubsidized units rent for $900.

Since 1995, when Congress revised the laws applicable to many rent-restricted properties to permit prepayment after expiration of the project's 20-year lock-in period, owners of hundreds of thousands of units already have converted to market-rate use. These owners were able to obtain higher market rents, or, where restricted and market rents were comparable, to be free from regulatory requirements. As a response to these prepayments, Congress has provided enhanced vouchers to protect eligible, unassisted tenants residing in these units at the time of the conversion.[7] Since the GAO report was issued in 2004, these conversions have dramatically reduced the scope of the threat presented by mortgage maturity.

In addition, the presence of rental assistance reduces the scope of the problem. Many residents in these properties are currently assisted by project-based rent subsidies, provided under the Section 8 Loan Management Set-Aside program, the RD Rental Assistance program, or the HUD Rent Supplement program. For properties with an assistance contract, the subsidies may cover all or just some of the units at a property. HUD estimates that 23% of the affected properties receive rental assistance for all of their units, whereas about 65% are partially assisted.[8] Fifteen percent of the affected properties receive no rental assistance.[9] During the period from 2012 through 2020, HUD estimates that about 118,000 (62%) of the nearly 190,000 units facing mortgage maturity have rental assistance, leaving about 72,000 (38%) unassisted households.[10]

Assisted tenants pay 30% of adjusted income for rent, with rental assistance covering the remaining portion up to the approved federally restricted level. In most cases, assistance for these tenants continues until the assistance

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[1] GAO, Multifamily Housing: More Accessible HUD Data Could Help Efforts to Preserve Housing for Low-Income Tenants, No. GAO-04-20, at 3 (Jan. 2004), *available at* www.gao.gov/cgi-bin/getrpt?GAO-04-20. For more on the GAO report, *see* NHLP, *GAO Report Warns of Maturing HUD Multifamily Mortgages*, 34 Hous. L. Bull. 85, 92 (May 2004).
[2] GAO, Multifamily Housing, *supra* note 1, at 9-10.
[3] *Id.* at 8 and Fig. 2.
[4] HUD, Impact of Provision of Enhanced Vouchers at Mortgage Maturity (undated document prepared by HUD in late 2010 during congressional deliberations) [hereinafter Enhanced Voucher Policy Impact] (on file with the National Housing Law Project).
[5] *Id.* at 2.
[6] *Id.*

[7] 42 U.S.C.A. § 1437f(t) (Westlaw June 16, 2011). Generally, these vouchers provide assistance to cover the rent between the former restricted rent and the new higher market rent, and they carry a statutory right to remain in the property.
[8] HUD, Enhanced Voucher Policy Impact, *supra* note 4.
[9] *Id.*
[10] *Id.*

contract expires and is not renewed, and replacement enhanced vouchers are provided.[11]

However, for a variety of reasons, many owners have yet to prepay their maturing mortgages and convert their units to market rate. One reason is that some owners are restricted from prepaying for the full mortgage term. For example, properties receiving payments under a Rent Supplement contract or that were originally developed by a nonprofit cannot prepay the mortgage without HUD approval for the full 40-year term. Another explanation is that some properties are operating under use agreements regulating rents and operations that were executed as part of additional public incentives, such as those provided under the Emergency Low-Income Housing Preservation Act.[12] These agreements are coterminous with the original mortgage. Yet another rationale is that, for some owners in "soft markets," where market rents are comparable to the current regulated rents, conversion simply does not pay. Still other limited partnership owners have not yet prepaid because of difficulties in obtaining the requisite approval from the partners.

At maturity, both properties and tenants, especially those unassisted by project-based rental assistance, face an uncertain future. Unlike the situation posed by mortgage prepayments, most unassisted tenants are unprotected when the associated restrictions expire. Advance notice and replacement subsidies are not required by current laws, and no special tools have yet been created to preserve affordability for any of these properties where owners or communities seek to do so.

Like the rest of the aging federally supported stock, many of these buildings reaching mortgage maturity require significant rehabilitation to address physical needs that have accrued over their mortgage terms and reposition them as strong affordable housing assets. Absent other federal resources and policies, tax-exempt bonds and 4% tax credits provide the most readily available preservation resources, with many transactions raising specific affordability challenges. Even if tenant protections are provided, preservation strategies will be critical to ensuring that these resources remain available to future low-income tenants in need. Authority to project-base any tenant protection resources provided may offer an important piece of the solution.

Scope of the Near-Term Problem

For fiscal year (FY) 2011, HUD estimates that approximately 9,000 unassisted households will face mortgage maturity, of which 1,000 households are elderly.[13] Of these 9,000 households, approximately 3,300 reside in units that the owners can prepay without HUD approval, and, thus, are already eligible for enhanced vouchers under current law, if the owner exercises that right in a timely fashion before maturity.

In FY 2012, the number of unassisted households will jump to 16,756. The impact gradually will decline to 14,406 in FY 2013, 13,689 in FY 2014, and 11,572 in FY 2015.

HUD-Subsidized Units and Maturing Mortgages, 2012-2020		
Fiscal Year	**Total Units**	**Unassisted Units**
2012	39,893	16,756
2013	32,818	14,406
2014	34,901	13,689
2015	29,198	11,572
2016	13,852	5,040
2017	11,842	4,534
2018	5,739	1,894
2019	7,205	2,225
2020	14,216	1,596
TOTAL	189,664	71,712

The National Housing Trust has developed slightly different estimates of the unassisted households affected, based on unverified HUD data, preliminarily projecting the following figures: FY 2011, 9,498 households; FY 2012, 12,968 households; FY 2013, 9,769 households; FY 2014, 11,142 households; and FY 2015, 9,490 households.[14]

For FY 2011 maturities, HUD found that the affected properties are located in many states, with California at the top with 30 properties (751 unassisted units), followed by Michigan with 15 (526 unassisted units), Maryland with 11 (505 unassisted units), and New York and Indiana with 9 (416 and 708 units, respectively).[15] Several properties in Massachusetts and Illinois recently have matured, threatening substantial rent increases to tenants. At some properties, these increases have been mitigated by owner forbearance while Congress makes a policy decision on replacement subsidies.

Legislative Proposals

In the wake of the 2004 GAO report, Congressman Frank introduced the Displacement Prevention Act,[16]

[11]§ 1437f(t); Section 524(d) of the Multifamily Assisted Housing Reform and Affordability Act (codified at 42 U.S.C. § 1437f note (Multifamily Housing Assistance)) (Westlaw June 16, 2011).

[12]Pub. L. No. 100-242, §§ 201-235, 101 Stat. 1877 (1988), *amended by* Pub. L. No. 100-628, §§ 1021-1027, 102 Stat. 3270 (1988) (codified at 12 U.S.C.A. § 1715*l* note (Preservation of Low Income Housing) (Westlaw June 16, 2011)).

[13]HUD, Enhanced Voucher Policy Impact, *supra* note 4.

[14]National Housing Trust, Unassisted Units in Subsidized Properties Maturing In [Year] (Oct. 2010).

[15]HUD, Enhanced Voucher Policy Impact, *supra* note 4. The California Housing Partnership Corporation (CHPC) estimates a higher figure for FY 2011 of 899 unassisted units out of a total of 3,283 subsidized units with maturing mortgages. CHPC, The Next Housing Crisis: Expiring Mortgages (June 2010) (on file with NHLP).

[16]H.R. 4679, 108th Cong., 1st Sess. (introduced June 24, 2010).

which was never acted upon. The bill would have required one-year's advance notice of mortgage maturity, while providing financial incentives for preservation and tenant protections in the form of enhanced vouchers where an owner declined incentives.

More recently, Congressman Frank included similar provisions in the comprehensive preservation bill, H.R. 4868, introduced in the 111th Congress.[17] Section 102 of the bill proposed a two-pronged approach whereby owners with maturing units would have access to voluntary financial incentives to preserve affordability, including grants, loans and project-based assistance for unassisted tenants, or tenants could receive direct rental assistance if an owner declined the incentives. In addition, H.R. 4868 would have required owners to provide at least a 12-month notice to tenants prior to mortgage maturity. This legislation was voted out of Committee, but received no further floor action.

In addition, as reported to the floor in the 111th Congress, the Section 8 Voucher Reform Act (SEVRA) proposed to extend enhanced voucher protections to unassisted tenants in properties with maturing mortgages.[18] This bill also received no further floor action, and it is unclear whether versions to be introduced in the current 112th Congress will include a similar provision.

Last fall, in the deliberations surrounding the FY 2011 appropriations process, congressional appropriations staff, with the support of HUD, advocates and owners, considered protections for unassisted tenants facing mortgage maturity. In response to policymakers' concerns about costs, the National Preservation Working Group developed a refined policy proposal limiting protections to those households that would experience a rent increase of 10% or more, producing a cost estimate of $11 million for FY 2011.[19] A provision was then included in the full-year appropriations bill advanced by Senate Appropriations Committee Chair Daniel K. Inouye (D-Hawaii) in early December.[20] This provision proposed $25 million in tenant protection assistance via vouchers for tenants residing in low-vacancy areas under guidelines developed by HUD.

However, the congressional leadership eventually chose to enact a series of short-term continuing resolutions to keep the federal government running. By March 2011, when a final compromise on FY 2011 funding was reached, no protection for tenants facing mortgage maturity was included.[21]

The failure to enact any protections for tenants facing a loss of federal affordability protections represents an ignoble first in federal housing policy. Thousands of low-income tenants nationwide still await a reasonable policy response. ■

[17]H.R. 4868, 111th Cong., 2d Sess. (2010). *See* NHLP, *House Considers Long-Awaited Multifamily Preservation Legislation*, 40 Hous. L. Bull. 159, 159 (Jul. 2010).

[18]H. Rep. No. 111-277, 111th Cong., 1st Sess. (June 25, 2009) (reporting H.R. 3045, Section 16 of which proposed to extend enhanced voucher protections to unassisted residents of maturing mortgage properties).

[19]Letter from National Preservation Working Group to Senators Murray and Bond (Oct. 22, 2010) (on file with NHLP). Advocates also have sought authority to permit tenant protection and enhanced voucher assistance to be project-based, so that the resources provided could be used to preserve affordable housing for both current and future tenants, but such authority has not yet been enacted.

[20]Discussion Draft dated December 8, 2010, § 3213 (on file with NHLP).

[21]Pub. L. No. 112-10, 125 Stat. 38 (Apr. 15, 2011).