

My name is Robert Rapoza and I am Executive Secretary of the National Rural Housing Coalition. The Coalition is a national membership organization that advocates for federal policies which improve housing and community facilities in rural America. We have previously appeared before this subcommittee, and we greatly appreciate the opportunity to testify today on behalf of H.R. 5039, The Saving America's Rural Housing Act, which would strengthen the U.S. Department of Agriculture's Section 515 loan program for the future.

Before I discuss the merits of the legislation, I would like to provide a brief overview of the Section 515 program, its appropriations history, as well as describe some of the challenges it currently faces.

### **Background and Section 515 Appropriations**

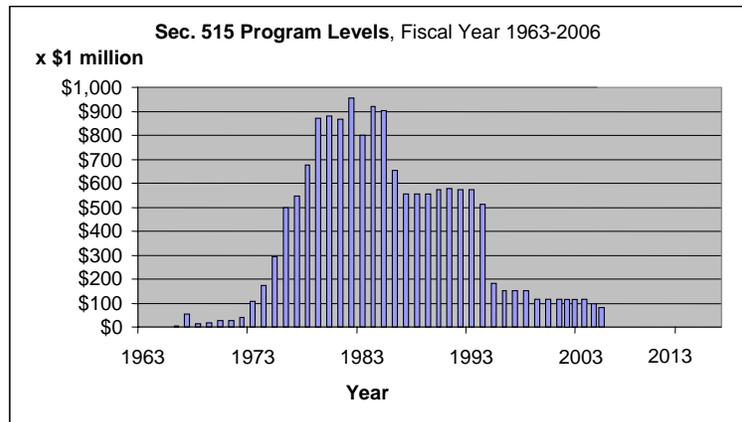
The Coalition has long supported the Section 515 program as the best and most affordable way to provide affordable housing to low income families and senior citizens in rural areas. In these communities, the only affordable rental housing is through the Section 515 program. It is therefore a very important resource for rural America.

Congress established the Section 515 program in 1962 by amending Title V of the Housing Act of 1949. Its purpose was to provide loans for the construction, rehabilitation, acquisition, and operation of rental or cooperative housing for low and moderate income rural elderly people. The U.S. Department of Agriculture was to serve as the lender of last resort – that is, borrowers had to prove that they could not access comparable private financing. The Agriculture Department set their 515 loan terms between 33 and 50 years, and they were expected to “graduate” from the program by repaying their loans as soon as they had the financial means.<sup>1</sup>

The program began making loans in 1963 and has since financed more than 526,000 units. As a result, it has helped alleviate acute shortages of safe and affordable rental housing in rural areas across the United States. Today, the Section 515 loan portfolio serves approximately 475,000 households.

---

<sup>1</sup> The preceding discussion and Exhibit 2: Evolution of the Section 515 Program are based on histories provided in: National Task Force on Rural Housing Preservation, *Preserving Rural Housing* (Washington, D.C.: Housing Assistance Council, 1992), 6-8; and U.S. Department of Agriculture, Farmers Home Administration, *A Brief History of Farmers Home Administration* (Washington, D.C.: U.S. Department of Agriculture, 1990), 6-8.



As the chart above indicates, funding for the Section 515 program peaked between 1979 and 1985. During this period, annual budgets exceeded \$864,000,000 and the Agriculture Department’s Rural Housing Service made a total of 9,622 loans. The program then underwent steep cuts in the mid-1990s when Congress, seeking opportunities to balance the budget, found that some property owners had defrauded the program. Although RHS eliminated these abuses and made the regulatory changes that Congress suggested, Congress never fully restored the program’s funding. In Fiscal Year 2006, Congress provided only \$99,000,000 for Section 515 loans.

In the current budget climate then, the Coalition believes that it is vital to preserve the current portfolio of Section 515 developments. The Administration’s Fiscal Year 2007 budget, however, proposes to eliminate this program and replace it with a \$74,000,000 voucher initiative. The budget promises to submit legislation authorizing the use of these funds for restructuring assistance as well.

### **Preserving Rural Rental Housing**

The current funding situation demonstrates the need for the Rural Housing Service to preserve the assets it has already developed. There are now approximately 15,000 Section 515 properties throughout the United States. The developments constitute a priceless asset for rural America where more than 900,000 renters live in moderately or severely inadequate housing, and 1,900,000 people are rent-overburdened.<sup>2</sup>

In 2003, the average annual tenant income in these properties was \$9,168. Seventy-five percent of tenants received a rental assistance subsidy, either through project-based rental assistance, the Section 8 program, or through vouchers. Although rents were extremely low, averaging \$314 per unit per month, 20% of tenants were nevertheless rent-overburdened and 7% paid more than half their income toward rent.

<sup>2</sup> These tenants pay more than 30 percent of their incomes toward rent.

In many rural communities then, Section 515 housing is the only affordable option. It is an essential resource for elderly people, single-parent families, the disabled, and other less mobile residents. It provides them with an alternative to living alone in housing they cannot maintain; residing in overcrowded or other substandard conditions; living in their cars; or moving to a nursing home.

Section 515 housing also is generally well managed. Property managers often invest much of their own free time and creativity in providing tenants with a safe and cohesive community. They organize social get-togethers and, at some elderly properties, they arrange for services such as health screenings and grocery and pharmaceutical delivery.<sup>3</sup> The Section 515 portfolio is also financially sound, with a loan delinquency rate of just 1.6% and only eight properties in inventory.<sup>4</sup>

Nevertheless, the Section 515 program faces some major challenges. For example, numerous owners wish to prepay their loans but statutory restrictions impede their ability to do so, despite the fact that they are also eligible for Rural Housing Service-funded monetary incentives to remain in the Section 515 program. In addition, 89% of Section 515 properties are ten years old or older and in need of significant rehabilitation. The Rural Housing Service lacks sufficient funding to meet the need for the incentives as well as for rehabilitation. Its preservation efforts rehabilitate only 3% all units in the portfolio each year, and it now faces lawsuits from owners who want compensation and/or the right to prepay. It is vital then that these concerns are addressed so that the Section 515 program can continue to provide these vital services to rural America.

## **Overview of Prepayment Issues**

It is also important to trace the evolution of the Section 515 program and the prepayment process in order to show how the Rural Housing Service's lack of funding for incentives and rent subsidy vouchers has hurt both owners and tenants.

The Rural Housing Service faces approximately many lawsuits for prepayment-related lawsuits and cannot meet the demand for preservation incentives. At the same time, it is losing more units to prepayment than it is building.

Starting in 1968, six years after the Section 515 program was established, non-profit organizations and consumer cooperatives could qualify for "interest credit," which reduced the interest rate on their loans to as low as 1%. The interest credit resulted in rents lower than at properties developed by for-profit entities, which received market-rate loans and offered market-rate rents. In the first decade of the Section 515 program, most

---

<sup>3</sup> U.S. Department of Agriculture, Rural Development, Rural Housing Service, *Rural Housing Service 1997 Progress Report* (Washington, D.C.: U.S. Department of Agriculture, 1998), 12, 24.

<sup>4</sup> Rural Housing Service, Office of Rural Housing Preservation, untitled PowerPoint presentation, January 2004.

borrowers were locally-based non-profit organizations and small “mom and pop” for-profit investors.

In the late 1970s, however, the Rural Housing Service found itself balancing competing pressures. Rising property values in rural areas enabled a growing number of owners to prepay their loans. Given the agency’s history of enforcing the requirement that they “graduate” from the program by repaying their loans as soon as they had the financial means, the owners expected they could do so. As a result, there was a sharp increase in prepayment activity, with 55% of all prepayments since the program’s occurring between 1977 and 1979.<sup>5</sup>

At the same time, tenant advocates began mobilizing to halt this trend, since prepayments often led to dramatically increased rents and the eviction of very low income tenants. Advocates argued that owners had reaped tax and other benefits at the taxpayers’ expense, and that they should not be allowed to profit even more by converting their properties to market use.

Congress responded by passing the Housing and Community Development Amendments of 1979 (P.L. 96-153). This law requires that properties with Section 515 loans made on or after December 21, 1979 serve low income residents for 15 or 20 years, depending on the level of the Section 515 interest rate subsidy. Congress also placed prepayment restrictions on existing, pre-1979 loans but repealed these restrictions in 1980.

As the federal tax benefits to those participating in the Section 515 program began to expire during the 1980s, more owners prepaid. The resulting displacement of large numbers of tenants, many of which were elderly, generated much publicity and controversy. In response, Congress mandated a moratorium on prepayments in October 1986, which remained in effect until the Emergency Low-Income Housing Preservation Act (ELIHPA, P.L. 100-242) became law in 1988. While creating financial incentives for borrowers with pre-1979 loans not to prepay, ELIHPA also restricted their prepayment rights, a provision that directly contradicted the Rural Housing Service’s mandate that these owners graduate from the Section 515 program as soon as they were financially feasible.<sup>6</sup>

In order to eliminate the prepayment issue for all new housing, Congress then passed the Department of Housing and Urban Development Reform Act of 1989 (P.L. 101-235), precluding prepayment for all Section 515 loans made on or after December 15, 1989. Congress then extended prepayment prevention incentives to borrowers with loans made between December 21, 1979 and December 14, 1989 through the Community Development Act of 1992 (P.L. 102-550).

The Rural Housing Service’s framework to process prepayment requests combines statutory and regulatory requirements then. What this process means for

---

<sup>5</sup> National Task Force on Rural Housing Preservation, p. 8.

<sup>6</sup> Ibid., p. 9.

owners qualified to prepay is that (a) they may be able to receive financial incentives to stay in the program; (b) they may be able to prepay without any further obligations; (c) they may be required to carry out the remainder of their restrictive use provisions or protect the existing tenants, after which they can do what they want with the properties; and (d) they may be required to sell at fair market value to a non-profit or public agency. Eventually, owners who do not accept incentives and are not required to sell may therefore convert their properties to market-rate use.

### **Lack of Funding for Preservation Incentives**

Preservation incentives include equity loans; increased return on investments; Section 8 rents in excess of the amount needed to meet annual operating, maintenance, debt service, and reserve expenses; increased rental assistance; and interest rate write-downs to 1% and/or loan reamortization over the remaining life of the property. Demand for incentives always exceeds supply.

From 1989 to 1994, the Rural Housing Service's total equity loans ranged between \$11,000,000 and \$27,000,000 annually. In 1995, however, when appropriations for the Section 515 program dropped from \$512,000,000 to \$183,000,000, the amount of funding for prepayment equity fell as well. Since this time, the Agency has made approximately \$5,400,000 in prepayment prevention equity loans each year, thereby preserving approximately 1,000 units annually.<sup>7</sup>

For Fiscal Year 2006, the Rural Housing Service has allocated \$4,950,000 to equity loans. Of that amount \$950,000 is available for transfers to non-profits or public bodies. The current backlog of demand for equity loans is about \$20 million. Approximately \$44,000,000 is allocated for repair and restoration of Section 515 developments.

Supply is also uncertain because the amount of rental assistance that Congress appropriates varies from year to year. For example, the current rate for debt forgiveness is \$8 million. In the Fiscal Year 2007 budget, the amount of "debt forgiveness" rental assistance was eliminated. The Rural Housing Service uses debt forgiveness rental assistance also to supplement equity loans. It is therefore vital to making prepayment prevention incentives work for properties that do not have full rental assistance coverage.

The fundamental issue regarding Section 515 prepayment, however, is the lack of resources to provide incentives for long-term use, the financing of the repair and rehabilitation of developments, and rental subsidies for tenants that may be displaced.

### **Comments on HR 5039**

---

<sup>7</sup> In Fiscal Year 2003, RHS provided a total of \$21.5 million in equity loans. However, only \$5.8 million was for prepayment prevention incentives. RHS also made \$10.5 million in equity loans to transfer 20 Idaho properties to a new owner, per the settlement agreement of *Atwood-Liesman v. United States*. Finally, RHS made \$5.2 million in equity loans to support innovative transfers outside of the prepayment process.

In 2004, the Department of Agriculture released an assessment of the Section 515 program. It also noted that over 10% of the portfolio is located in hot markets and that owners in those areas may be financially able to convert the projects to other uses. The report correctly recognized that capital is needed to repair and revitalize its portfolio. The Department's report also indicated that the vast majority of the remaining projects are in markets where their best use is as affordable housing. The report projects the cost to repair and restore the developments at \$2.6 billion over 20 years.

The policy recommendation stemming from this report is that the government should allow these hot market projects, and presumably others the right to prepay. The report contends that the vast majority of projects are in markets where their only use is as low income housing so with some revitalization they may be preserved for use under section 515 or similar programs. This is more or less the policy framework for HR 5039.

We appreciate the work of the sponsors in attempting to craft legislation to solve these difficult issues. H.R. 5039 is a substantial improvement over previous drafts that were circulated. The bill narrows the number of projects eligible for prepayment and establishes a much needed restructuring program with a favorable maximum rent requirement. We also support the right of first refusal provision and would like to work with the Committee to strengthen the legislative language. In addition, we appreciate the tenant notification provisions but believe that they may be improved, particularly with respect to providing more notice to tenants. Therefore, in the details of the legislation, there is much to support, and we believe that we can work with the Committee to improve the other provisions.

The Coalition has concerns, however, with the overall framework for the legislation. H.R. 5039 repeals provisions of current law – particularly 502(c) of the Housing Act of 1949 -- that regulates prepayment of Section 515 developments and establishes incentives for their long term use. If this bill becomes law, it is possible that families living in Section 515 units will be displaced without assistance and without alternative housing.

As we have noted, the population in Section 515 developments is low income and mostly elderly persons with disabilities. It is not a very, mobile population either. In many rural communities, the only decent affordable housing in town is the Section 515 developments. If those units disappear, many families may have no place to go.

In 2004, the Committee considered H.R. 3995 which proposed changes to the Section 515 prepayment process. The Committee agreed to make prepayment contingent on tenants having a voucher and the owner agreeing to take the voucher. H.R. 5039 does not contain this provision, which means that low income and elderly tenants could be displaced without vouchers and without a place to live.

In cases of prepayment it is possible that the Rural Housing Service will move quickly, as they recently did in Georgia, to get vouchers to families. It is also possible that an owner may decide to convert the Section 515 financed housing to some other use

and not accept vouchers. In that case, how likely is it that displaced families will receive a voucher and find alternative affordable housing in the community?

We support preserving Section 515 projects. The Coalition therefore believes that it is far more preferable to continue current law under Section 502(c) of the Housing Act and provide adequate incentives to owners for long term use.

While we know a lot about the current status of the portfolio, we do not know how owners and tenants will react to prepayment, displacement, and restructuring. There may be some answers in the Fiscal Year 2006 Agriculture Appropriations Act though. In that bill, Congress included \$16,000,000 for vouchers for displaced families designed along the lines of the Section 8 program. The appropriations legislation also included \$9,000,000 for a portfolio restructuring demonstration. The Rural Housing Service has recently released a Notice of Funding Availability (NOFA) for those funds. A total of \$173,000,000 of assistance in the form of deferred mortgages, revitalization grants, subordinated debt subsequent loans, transfer and consolidations as also included in the bill. We urge the Committee to monitor the implementation of the restructuring and the voucher program funded in this year's appropriations process.

As some contend, it may that owners would rather have assistance for restructuring and stay in the program. As a result, there will be fewer prepayments and displacements than originally predicted. However, we do not know if that will be the case. The Coalition therefore believes it would be useful for Congress to see the Fiscal Year 2006 voucher and restructuring work before enacting such far reaching legislation as H.R. 5039.

#### Comments and Recommendations on HR 5039

##### A. Prepayment

The legislation allows prepayments of section 515 loans made prior to December 15, 1989 provided that these projects have met their 20 year restrictions and have not received not received preservation incentives and have not had any servicing actions. Loans made after the December, 1989 date did not include the right to prepay. The legislation requires a 75 day right of first refusal for buyers willing to maintain the project as affordable housing for at least 20 years. Owners are required to give 90 days notice to tenants of the prepayment.

NRHC recommends that the right of first refusal language be strengthen and the 90 day notice period be extended to at least 180 days. ( section 544 (j) (B)

##### B. Vouchers

The bill authorizes vouchers, along the lines of section 8. The tenant contribution on the vouchers is in most cases 30% of income. An owner who prepays may not refuse a voucher for a household living in the project. For communities with a lack of affordable housing, USDA can provide an enhanced voucher as authorized under the section 8 statute.

NRHC Recommendation: The bill does not contain a dollar authorization for vouchers and that is obviously necessary to provide future appropriations.

C. Restructuring:

The bill authorizes a restructuring assistance program. In return for such assistance, the owner must agree to a use restriction of an additional 20 years or the balance of the loan term whichever is longer. The legislation establishes a planning process for the owner and USDA to determine the need of the physical and financial needs of the project, future rents (that are affordable to eligible households under section 515) and projects a rate of return to the owner that is comparable to other, similar properties. Restructuring assistance can include reduction or elimination of interest on the loans, deferral of loan payments, loan forgiveness, subordination of the loan, re-amortization of the loan, grants payments of project cost for the long term plan of the project, third party investments and a direct loan or guarantee. At the end of the use restriction term USDA and the owner divide the proceeds. Maximum rents for restructured projects are 30% of income. Minimum rents are set at the lower of 30% of income of \$25.

NRHC strongly supports that maximum rent provision as a way to ensure that restructured projects continue to be affordable to low income families.

D. Section 544 (j)(1)(B) authorizes the Secretary of Agriculture to process any request for section 515 prepayment regardless of implementation of other provisions of this legislation. We urge the Committee to revise this provision. If the intent of this legislation is to preserve as many units as possible within section 515 and to protect tenants by having vouchers available, then RHS should have those resources authorized in this bill available before prepayments are processed.

Thank you for this opportunity to testify.. I would be happy to answer any questions the Committee might have.