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NATIONAL
LEASED HOUSING
ASSOCIATION

Testimony of the National Leased Housing Association

Presented by Raymond K. James
Hearing on the "Housing Preservation and Tenant Protection Act of 2010"

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Subcommittee on Housing and Community Opportunity

My name is Raymond K. James, I am a partner with the law firm of Coan and Lyons in Washington, DC and specialize in HUD related housing issues. Prior to my work in private practice, I served as Chief Counsel to this subcommittee. I am an active member of the National Leased Housing Association (NLHA) on whose behalf I am presenting testimony today.

The National Leased Housing Association (NLHA) has for the last 38 years represented the interests of developers, lenders, housing managers, housing agencies and other involved in providing federally assisted rental housing. Our members are primarily involved in the Section 8 housing programs – both project-based and tenant based- as well as the Low Income Housing Tax Credit (LIHTC) program. NLHA's members provide or administer housing for over 3 million families.

Madame Chair and members of the subcommittee, thank you for the opportunity to testify. NLHA has been working over the last three years with you, Chairman Frank, and the committee staff along with our industry partners including the Institute for Responsible Housing Preservation (IRHP) to craft workable legislation that will facilitate the ability of our members to preserve the assisted housing stock. We appreciate everyone's hard work as we know that many of these issues are narrow and highly technical.

Preserving the scarce supply of federally assisted housing is important to our members and we have devoted significant effort over the last many years to promoting the preservation and recapitalization of the affordable housing stock through technical seminars and workshops as well as through our advocacy before HUD and on Capitol Hill. However, the ability for our members to rely on their agreements with the Federal Government is also important as these relationships are the basis on which we have developed or acquired the housing.

H.R. 4868, the "Housing Preservation and Tenant Protection Act of 2010" contains many widely supported provisions (several of which will be addressed later in this testimony) that will be helpful in preserving affordable housing and protecting tenants, but it also contains several provisions that would destabilize affordable housing programs, harm preservation efforts, lead to more opt-outs and prepayments, and generate breach of contract litigation.

The two most damaging provisions of the bill are section 107 (Federal right of first refusal) and section 108 (restricting preemption of state and local laws by federal law).

Provisions That Are Inimical To Preservation

NLHA must oppose H.R. 4868 as long as it includes Section 107 that restricts an owner's choice in selling its project at any time up to 15 years before its assistance contract is scheduled to expire. This provision, therefore, governs the transfer of properties for almost the entire current inventory of HUD assisted housing. It even covers small programs that were terminated decades ago, such as urban development action grants (UDAG) and housing development grants (HODAG) that may have involved thin subsidies for some units. Also covered are programs with their own preservation and sale provisions, such as rural housing programs administered by the Secretary of Agriculture and the low-income housing tax credit.

It is unclear why the Committee believes that a restricted sales process is necessary in today's environment. There is a viable and active community of preservation entities that have the resources, sophistication and desire to acquire assisted properties to preserve them for long term use. As a result, opt-outs are few and far between. HUD's own data show that the rate of Section 8 opt outs declined drastically with the passage and implementation of the Multifamily Assisted Housing Restructuring Act of 1998 (MAHRA) that set the framework for Section 8 renewals. By establishing a market based approach to renewals, Congress removed one of the main reasons for owners to leave the program. In the year 2000, when MAHRA was just beginning to be understood and implemented, 288 contracts were not renewed. In 2009 that number was down to 59.

Further, HUD Secretary Donovan indicated in his June 2009 testimony before the House Financial Services Committee that his experience in New York has solidified his opinion that incentives work much better than sanctions to preserve housing. Section 106 of this bill which we believe was based on Secretary Donovan's views includes a "preservation exchange" program that appears to be what the Secretary had in mind when advocating the carrot vs. stick approach. NLHA believes such an exchange program will be helpful to further facilitate preservation without impinging on owners' contract or property rights. However, Section 107, the Federal Right of First Refusal provision, effectively moots any benefits of an exchange program.

Specific problems with Section 107 include:

(1) Adds delay and uncertainty to the transfers of subsidized properties. These transfers are important to the rehabilitation and improvement of assisted projects and are particularly time sensitive when the low-income housing tax credit is used as a preservation tool.

The provision gives the Secretary of HUD up to four time-consuming opportunities to purchase an assisted property the owner wishes to sell. Further, if the owner misses certain deadlines in the process it must restart the process from the beginning.

The first opportunity for HUD (or more likely its assignee) to purchase a property is when the owner is required to submit a notice to HUD that it wishes to sell the property. If, within 90 days, HUD does not submit an offer or its offer to buy is unacceptable to the owner, HUD is given a second opportunity to buy after the owner has executed a binding purchase contract with a third party. The contract is required to be binding on the seller as well as the buyer but it really isn't because HUD could replace the third party buyer. Will a third party spend the time and money before committing to buy a property which it most likely will not be able to buy? If the owner cannot find a third party to execute a binding contract in about a nine-month period it must go back to Start and entertain again a purchase offer from HUD, whose sales price and terms and conditions might be unacceptable, or give up on the attempt to sell the project.

If the owner does find a bona fide third party to execute a binding purchase contract, the contract has to be submitted to HUD, which can submit its own contract containing the same material terms and conditions as the third party contract, except there would be a limit on the amount of an earnest money deposit. Of course, it is HUD that determines whether its offer is a match of the third party contract. The owner will have to sell to HUD or not at all.

The third opportunity for HUD is for it to make a counteroffer to the third party contract, presumably because it finds the terms unacceptable. If the owner rejects HUD's counteroffer, it has two years to complete a sale or go back to Start.

If within the two-year period, the owner finds a third party buyer, HUD will have a fourth opportunity to buy the property if HUD determines that the third party sale is upon economic terms and conditions that are the same or materially more favorable to the purchaser than HUD's counteroffer.

(2) Encourages owners to opt out of section 8 contracts or prepay subsidized mortgages. One option for owners who wish to sell their properties but do not want to take the risk of an unacceptable HUD purchase offer or replaying Groundhog Day over and over is not to renew their contracts or to prepay their mortgage. Another option is to find a buyer willing to commit to staying in the program forever, which would avoid the convoluted process. But such sales may not be feasible or in the best economic interests of an owner.

Even owners without immediate plans to sell their properties will chafe at this effort to dilute their property rights, which, when added to other HUD irritants known to drive owners out of the programs, will push more owners to opt out.

(3) Retroactively and materially changes the contractual agreements between owners and HUD. HUD assistance programs covered by this provision were designed to enlist private entities to use or develop their property for affordable housing under detailed terms specified in a contract. Nowhere in these contracts is there an indication that owners would be forced to submit to a cumbersome process when they wished to sell their properties, designed to steer the sales to the Secretary of HUD or its designee or to other favored purchasers.

While HUD has a contractual right to determine whether a purchaser of an assisted project is fit to operate the project, it is a breach of the contract with the owner for Congress to restrict the sales process to give a priority to the Secretary of HUD or its designee.

(4) Affects projects over which the Secretary of HUD has no regulatory authority. The Secretary of HUD does not have the regulatory authority to approve or disapprove purchasers that is necessary to efficiently implement this provision with respect to rural housing programs. Moreover, one of the major problems to preserving this housing stock has been the administrative barriers to transferring these rural projects from one owner to another. The addition of another administrative barrier to transfers is counterproductive to preservation.

The Secretary of HUD also cannot effectively enforce this provision with respect to projects with low-income housing tax credits. In addition, these projects are subject to a right of first purchase provision in the tax code. Any attempt to give the Secretary of HUD effective authority to restrict sales of these projects is within the jurisdiction of the tax writing committees of Congress.

While HUD might use the 2530 process to encourage compliance for some owners, in other situations it would need to engage in litigation with owners to attempt to enforce this provision.

(5) Interferes with preservation sales. While some of these sales may qualify for exemption from this provision, others will not but they still will be desirable preservation transactions. Trying to force every transaction into a rigid mold will do more to harm than to help preservation of affordable housing.

The 2nd undesirable provision in the bill is Section 108. This provision will permit states and localities to regulate owners of projects assisted under federal law with respect to preservation and tenant protection even if the regulation conflicts with federal law. The only way to avoid a conflict under this provision is for the federal law to explicitly preempt state and local laws. Most federal housing laws do not contain preemption provisions. Under judicial

precedents federal law can preempt a local law without express preemption provisions if the local law conflicts with federal law.

Since no effort is apparent in the preservation bill to identify provisions of federal law which should be given preemption protection, it is fair to assume that none of the hundreds or thousands of provisions in housing, tax and other laws that currently do not expressly preempt local laws are intended to have protection.

Thus owners of section 8 housing, for example, who have been dealing for some time with stable and predictable federal laws, as have their lenders and investors, will now be subject to the uncertainty and destabilization of being subject to rules from potentially hundreds of jurisdictions that conflict with federal laws and contracts.

In this provision, Congress would permit states and localities *to change federal law.* Contracts with HUD could be rendered meaningless. There is no point to this provision unless its authors want state and local laws that conflict with federal law to have supremacy, contrary to what normally happens under the U.S. Constitution.

Section 108 could be extremely harmful and therefore is opposed by NLHA.

Expanding Preservation Vouchers: Long Overdue

One of the most important and necessary legislative provisions in H.R. 4868 is one that will ensure that residents living in properties with expiring mortgages are not physically or economically displaced. In 1996, when Congress restored owners' rights to prepay Section 236 or Section 221(d)(3) mortgages, Congress amended the U.S. Housing Act of 1937 to provide tenant protection to families or elderly living in such properties. Eligible residents who were not receiving rental assistance at the time of the prepayment were now eligible to receive an enhanced voucher if/when the owner raised the rents on the units. In other words, the prepayment of the mortgage eliminated the use restrictions and subsidies related to the previous loan. Once the mortgage is paid off, the owner is free to raise the rents to the market rent resulting in tenants paying more. The receipt of vouchers by eligible residents, those with incomes generally at or below 80 percent of median or in tight rental markets 95 percent of median, enables the families to afford the rents and stay in their homes. The statute was amended again in the next few years to provide enhanced vouchers to families/elderly living in properties in which the owners opted out of their Section 8 contracts.

The current statute needs to be amended (as proposed in the bill) to address two situations that were not contemplated in 1996. Firstly, it was not necessary to address mortgage maturations in the context of enhanced vouchers as the Section 236 properties or Section 221(d)(3) BMIR properties were at least ten years from their mortgage maturation (original mortgage terms 40 years and owners in most cases had a right to prepay the mortgage after 20 years). When the mortgages mature, the accompanying affordability requirements expire

(including ELIHPA projects). In January 2004, the GAO issued a study on such mortgage maturations and projected that 11,267 mortgages will mature through 2013. The first such maturations have already occurred, and will peak in the next few years.

Secondly, the enhanced vouchers provisions did not address situations in which a nonprofit sponsor prepays such a mortgage (or the mortgage expires) because the original eligibility for enhanced vouchers was tied to the ability of owners to prepay their mortgages without HUD permission (nonprofits need HUD permission to prepay in most cases). However, in today's low interest environment, it is not unusual for a nonprofit to seek and receive permission to prepay its mortgage to allow a refinancing and recapitalization of properties that are on average 30 to 40 years old. This includes Section 202 loans that were made prior to 1975, which did not receive Section 8 assistance. We are appreciative that the bill will address this important issue and will permit owners to request project-based Section 8 assistance in lieu of enhanced vouchers. This choice will provide comfort to lenders thereby ensuring sufficient recapitalization and thereby long term viability

Conversion of Old Rental Subsidies

We are pleased that Section 101 of the bill would provide an opportunity to permit the conversion of Rental Assistance Payment (RAP) and Rent Supplement contracts to project-based Section 8. The RAP and Rent Supplement programs were a precursor to Section 8 and their conversion was mostly accomplished in the 1980's. However, there are a number of such properties that remain in the inventory. Their conversion at an owners' request would ensure preservation past the term of the property's mortgage.

Other Positive Provisions

The majority of the provisions in Section V of the bill would remove administrative barriers and clarify HUD policy on a number of issues that have delayed or otherwise hampered preservation transactions. While HUD is making progress administratively on removing its own barriers, several of the provisions are necessary to clarify congressional intent or to provide statutory authority. Such provisions include ensuring that a property may receive budget-based rents for underwriting purposes for preservation transactions, improving the chances of expiring ELIHPA properties to be preserved beyond their use restriction, clarifying a number of issues in the HUD Mortgage Restructuring Program including a requirement that HUD provide budget-rents for properties that were restructured before HUD amended its underwriting criteria to ensure continued viability, addressing properties in disaster areas and more.

Non Profit Proceeds

HUD approval is sometimes needed when an FHA insured project is being sold or refinanced. Without statute or regulation, HUD over the last few years has arbitrarily limited the use of sale or refinancing proceeds where the owner is a non-profit sponsor, proceeds which the

nonprofit could otherwise use for other subsidized properties or to further its mission. This requirement has stalled numerous preservation transactions where the nonprofit sought to sell its property a few years before the mortgage maturity to a preservation entity that agreed to renovate and recapitalize the property for long term preservation. Last month, HUD indicated that it will review its policies and allow waivers to current barriers to preservation which should address this situation. Section 504 of the bill, we believe attempts to deal with the proceeds issue, but falls short in that the language appears to contemplate the same ownership refinancing versus a new owner acquiring the project for preservation purposes. We believe the language should be amended to address sales as well as refinancing and that the proceeds of the nonprofit seller not be restricted as this will prevent the sale from occurring. We submitted language to the subcommittee that we believe meets the stated objectives and would apply retroactively to several transactions the closed in recent years.

Access to Information

The bill includes several provisions (Sections 303 and 304) to increase HUD's collection of data and make that data more accessible via HUD's website and to ensure proper HUD oversight of property conditions.

There is no disagreement that HUD's data systems leave a lot to be desired and that the information available on its website is often hard to find, however the bill appears to require information be made available on the web that should be protected under privacy laws (home address of investors, 2530 forms , financial information, etc.). We would oppose any attempt to provide the public with access to private information. We understand that the goal is to provide information to the residents and the public about the condition of the buildings. However that can be accomplished without exposing participants to identify theft or other harm caused by the release of private information.

Further, HUD has a myriad of enforcement tools which it employs should a project fall into disrepair obviating the need for tenants to seek judicial relief. In addition, HUD currently posts information about the physical condition of properties along with information concerning any enforcement actions resulting in suspension or debarment. In addition, residents have two other avenues to address their concerns: 1) a HUD hotline; and 2) contacting the project's Contract Administrator who will register the complaint, notify the owner and provide follow-up until resolution.

Additional Comments

Due to the length and breadth of the bill, NLHA is not able to comment on all of the provisions, but intends to provide additional comments and add to the comments above when our members have sufficient time to thoroughly review the bill.

Thank you for the opportunity to share our views. I am happy to answer any questions.