

**TESTIMONY OF ROBERT L. RICE, JR. ON H.R. 5039 ON BEHALF OF THE  
COUNCIL FOR AFFORDABLE AND RURAL HOUSING  
BEFORE THE SUBCOMMITTEE ON HOUSING AND COMMUNITY  
OPPORTUNITY, HOUSE COMMITTEE ON FINANCIAL SERVICES**

**APRIL 25, 2006**

Mr. Chairman and members of the Subcommittee:

I am Robert Rice, president of Crest Realty of Frankenmuth, Michigan. I have been involved in the rural housing industry for over 30 years. My company is a full service real estate company with an emphasis on the management of affordable multifamily housing. I am appearing here in my capacity as President of the Council for Affordable and Rural Housing (“CARH”).

CARH is a national organization headquartered in Alexandria Virginia. Our membership is comprised of for-profit and non-profit developers, managers, owners, syndicators, public agencies and others interested and involved in providing affordable housing to low-income families in rural areas. Thank you, Mr. Chairman, for holding hearings today on H.R. 5039, “Saving America’s Rural Housing Act of 2006.”

The major federal program to subsidize rental housing in rural areas, Section 515 of the Housing Act of 1949, has been operational for over 40 years, back to the early 1960’s. The program reduces the cost of operating a project by providing construction loans with an interest rate as low as one percent. It became apparent, however, that families at the lowest income levels could not reasonably afford to pay the rent needed to cover the full operating costs of the project, including the build-up of reserves, and

repayment of the principal of the loan plus interest at one percent. In the mid-1970's a program of rental assistance was authorized which provides subsidy to keep rental and utility costs to very low income tenants at 30 percent of their adjusted income.

Approximately 57 percent of the roughly 460,000 units in the 515 program are occupied by tenants with rental assistance

Rents for 515 units must be approved by the Rural Housing Service ("RHS"). Over the years, RHS has tried to balance the need for adequate rents to support a project with the reality that the 515 subsidy is often too shallow to serve the lowest income ranges. Although rental assistance, where it is available, is very helpful, RHS has attempted to stretch limited budget resources for that program by keeping rents lower than prudent for the long-term viability of projects. Rents and rental assistance, system wide, have been held down too far for too long, creating a crisis in resources. Coupled with the fact that owners, by and large, have not been allowed out of the program to recapitalize, a situation has been created often referred to as a "toll road with no exits".

We are gratified, therefore, that RHS two years ago conducted a comprehensive review of the condition of the 515 housing stock and proposed remedial legislation to correct the imbalance between income and expenses for many projects and to facilitate the injection of new capital and equity into the projects. The "revitalization" program will involve budget authority for the reduction, elimination or deferral of debt service on a 515 loan and for grants in some cases. The assistance is in the form of a deferred loan, repayable by the owner at the end of the 515 loan term. To process efficiently a large volume of projects, RHS should use the services of private entities and state and local

agencies to develop project financial plans, particularly those entities that gained experience by participating in HUD's mark-to-market restructuring program, and we are pleased that H.R. 5039 authorizes the use of outside contractors.

The success of this revitalization program, as contained in H.R. 5039, depends on how well it is administered by RHS, and whether rents are established and periodically adjusted at adequate levels to meet operating costs and to maintain reserves to pay for future capital needs.

In this regard, a provision in H.R. 5039 would lessen the effectiveness of the revitalization program by creating a new, unfunded cost to the program. H.R. 5039 imposes a maximum rent for all tenants in revitalized projects of 30 percent of adjusted income. The 515 program does not now provide this benefit, and while we agree that such a benefit is desirable, providing an unfunded cost requirement is not reasonable or workable. The rent limitation has to be accompanied by a subsidy component to be workable, such as rental assistance. Otherwise, such a requirement will negate the positive impact of the revitalization assistance provided in H.R. 5039.

Two other parts of H.R. 5039 revise existing loan prepayment restrictions on 515 owners and authorize tenant protection vouchers for low-income tenants in projects whose loans are prepaid. Upon prepayment, not only is the 515 loan subsidy eliminated but any rental assistance is also terminated, thus necessitating a new form of subsidy for tenants.

Legislation enacted in the late 1980's and early 1990's imposed on owners of certain HUD projects and 515 projects restrictions on prepaying their loans and terminating subsidies even through their contracts with the government permitted unrestricted prepayment. Congress ended its restriction on prepayments for HUD project owners ten year ago, in 1996, and authorized enhanced section 8 vouchers to enable tenants either to remain in a project or to move elsewhere. The restrictions on 515 loan prepayments, however, continue to this day. We are pleased that RHS and this Committee are receptive to ending these restrictions. Extensive litigation over these restrictions on 515 and HUD projects have led to numerous court decisions holding that the statutes were a breach of contract or a Fifth Amendment Taking of contract and property rights, and ordering damages to be paid by the government and in some jurisdictions also requiring prepayment to be accepted by RHS.

The new statutory prepayment framework in H.R. 5039, however, raises several issues. First, it is essential that a notice be given to tenants, RHS and other interested parties sufficiently in advance of the prepayment date to permit processing of tenant protection vouchers, which involves determining whether the units in the project meet housing quality standards and whether a tenant is eligible for the voucher.

However, H.R. 5039 requires a notice to be given, not 90 days before prepayment, but 90 days before "any action" to prepay is taken. This provision is ambiguous and could lead to disputes and litigation, as well as to a spate of premature notices. "Any action" could apply to any number of preliminary steps an owner might take before deciding whether to prepay, such as conducting a market study, inquiring about a

refinancing loan, applying for a tax credit, or even making an inquiry at RHS about prepayment. Until these preliminaries have been completed and a decision to prepay has been made by the owner, tenants should not be told there will be a prepayment nor should the voucher process be started. Experience with HUD programs indicates that many tenants, particularly the elderly, experience anxiety when told their subsidies will expire, even if informed about vouchers. Some tenants leave their projects prior to prepayment, even though that action disqualifies them for a tenant protection voucher. Therefore, we suggest that notice be given at least 90 days prior to prepayment, a point at which a firm decision to prepay should have been made by an owner.

Second, H.R. 5039 directs RHS to establish a procedure to administer prepayments and requires RHS to “encourage and facilitate” an owner who has decided to prepay its loan to maintain its project as affordable housing to low-income residents or to sell the project to another owner who will maintain affordability. What this language will entail is unclear but we are concerned that it could lead to delays and roadblocks to prepayment rights which may constitute new breaches of contracts that provide unrestricted prepayment rights. Indeed, current RHS guidance provides a similar standard and it has led to delays in processing as RHS and program participants have struggled to give this sort of phrase meaning.

Third, H.R. 5039 prohibits an owner who has decided to prepay its loan from selling the project to any purchaser other than a purchaser who will extend use restrictions for 20 years. This prohibition extends for 75 days, all or a part of which could occur before prepayment, with the owner having control over when the 75-day

period starts. We do not know what the point of this prohibition is other than to set a precedent for later expansion. Congress has not imposed such a restriction on the exercise of property rights in any of the HUD programs involving loan prepayment or non-renewal of section 8 contracts. Should this prohibition or a similar one become law, additional litigation could be expected.

Fourth, H.R. 5039 contains unclear provisions that could constitute additional breaches of contract prepayment rights. Owners who in the past accepted incentives from RHS, such as an equity loan, not to prepay, agreed to new or extended use restrictions. When these restrictions expire, the owners have a contractual right to prepay the loan but H.R. 5039 appears to prohibit prepayment even after the expiration of the restrictive use period. A similar prohibition appears to apply after the expiration of restrictive use agreements entered into by an owner in return for RHS approval of a transfer of the project or other assistance to the project.

Finally, H.R. 5039 changes current law by prohibiting prepayment during a period in which there is a restrictive use agreement. Under current law, prepayment may be approved by RHS under several circumstances while a use restriction is in effect, such as where RHS finds there no longer is a need for the housing in the area, with the use restriction either terminated or continued after prepayment, depending on the circumstances.

We would appreciate the opportunity to work with the Committee to resolve these issues in a manner that does not create new uncertainties and legal disputes, and that carries out one of the stated purposes of H.R. 5039 “to avoid further costly litigation”.

With respect to tenant protection, we would only note that the language of H.R. 5039 should be clearer as to whether the amount of assistance remains fixed at the year one level or rises as comparable market and project rents rise. We support the latter as providing a better measure of protection, particularly for elderly or disabled tenants, who may want to remain in the same project for several years but would find it difficult to do so if the voucher assistance did not increase as rents increased.

In summary, while we have some issues, which we hope can be addressed, overall H.R. 5039 is promising legislation, and we thank the Administration, the sponsors of H.R. 5039 and this Subcommittee for moving forward the important initiatives contained in this bill.

Thank you very much and I will be happy to answer any of your questions.