

HOUSE COMMITTEE ON FINANCIAL SERVICES

WRITTEN TESTIMONY OF REVEREND LAVERNE R. JOSEPH

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STEWARDS OF AFFORDABLE HOUSING FOR THE FUTURE (SAHF)

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Chairman Frank, Ranking Member Bachus, and members of the Committee, thank you for the opportunity to submit this testimony on preservation of affordable rental housing.

My name is Laverne Joseph. I am President and CEO of Retirement Housing Foundation, a nonprofit housing provider based in Long Beach California. RHF owns and operates about 15,000 affordable rental homes, assisted living units, and nursing beds in twenty-four states. I am testifying today on behalf of Stewards of Affordable Housing for the Future (SAHF). RHF and SAHF's seven other members together provide high-quality, affordable housing to more than 100,000 Americans in forty-eight states, the District of Columbia, Puerto Rico, and the Virgin Islands. SAHF members include: NHT/Enterprise Preservation Corporation, Mercy Housing, NHP Foundation, Preservation of Affordable Housing (POAH), National Church Residences (NCR), Retirement Housing Foundation (RHF), Volunteers of America, and National Affordable Housing Trust.

SAHF's members came together in 2004 to promote their shared ownership objective, which embraces the notion that stable, affordable housing is critically important in the lives of our citizens. Stable housing can enable working families to retain jobs, grow earnings, and build a better future for their children. Affordable rental homes with services enable low-income seniors to age in place with dignity rather than face disruptive and costly institutionalization. Well designed and operated housing also makes it possible for Americans with disabilities to enjoy a high level of independence. SAHF's members develop, acquire and own affordable multifamily rental homes with these beliefs in mind, and SAHF seeks to bring the full weight of its members' expertise, experience, and entrepreneurial spirit to bear on the task of taking not-for-profit housing preservation to scale.

SAHF's members undertake acquisitions ranging from individual properties to multistate portfolios. They have extensive experience with the Department of Housing and Urban Development (HUD) and USDA programs, housing bonds, tax credits, 501(c)(3) bonds, Federal Home Loan Bank affordable housing program loans and grants, and a wide array of state and local government funding sources. A large portion of our members' units receive project-based Section 8 housing assistance.

RHF is also an active member of AAHSA, the trade association of nonprofit senior housing and health care providers. I am a member of AAHSA's Affordable Housing Finance Cabinet. SAHF and AAHSA work closely together on public policy issues, including preservation, that affect low-income seniors.

The Problem

The need for affordable housing in our society is a pressing one, and yet we are losing much of what we have. The first order of business is to keep affordable the housing we have already built at great expense to the taxpayer. The loss of project-based Section 8 assisted housing is particularly grievous, since tax credit housing without Section 8 cannot serve the very poor.

Our nation is currently embroiled in a housing crisis. Given the weak and slow income growth among households at the bottom half of the distribution, together with the ever increasing cost of housing, housing in America is consuming an increasingly large share of household budgets. In 2005 for example, 37.3 million American households' housing costs were in excess of 30% of their income.¹

For low- and very-low-income Americans fortunate to receive project-based housing vouchers, the increasing insecurity of losing the subsidy due to the conversion of affordable multifamily units to market rate rentals is all too real. Indeed, Housing Assistance Payment (HAP) contracts that were established in the 1970s and 1980s are expiring at an astonishing rate, resulting in the loss of precious affordable housing. The need for preservation of affordable housing is clear. Further, we are moving towards a world in which housing nonprofit and for-profit developers are increasingly taking on the role of serving not just as developers and owners with a short-term horizon, but as long-term stewards of our affordable housing resources.

Yet the increasing role of non-profit housing providers in developing, providing and preserving affordable housing is too often derailed or made much more difficult by restrictions placed on them by the Department of Housing and Urban Development (HUD). Instead of enabling non-profit preservation owners to bring to scale the development of affordable housing, HUD has created obstacles which prevent non-profits from developing, renovating and properly maintaining affordable housing.

Despite about \$38 billion in annual appropriations for housing and community development coupled with the addition, for example in 2005, of roughly 78,000 new and 55,000 renovated units through the federal Low-Income Housing Tax Credit program² or in starker terms² the \$4.7 billion in annual expenditures from federal tax credits to build and rehabilitate affordable housing, the government has made little progress in stopping the loss of low-cost rentals from the nation's housing stock.² Furthermore, the combination of higher construction and operating costs, along with stagnant or even declining rents tied to household income limits and the fact that non-profits do not have access to distributions of excess cash flow and to equity to invest in properties ultimately undermines the fundamental viability of affordable housing projects.

But the numbers tell the real story:

¹ Joint Center for Housing Studies of Harvard University, "The State of the Nation's Housing," (2007), available at <http://www.jchs.harvard.edu/publications/markets/son2007/son2007.pdf>.

² Less and less of the federal nondefense discretionary budget² which is itself shrinking² is being devoted to housing programs. Housing assistance as a share of total nondefense discretionary spending dropped from 10.2% in 1998 to 7.7% in 2006. In the past year, spending on housing assistance also failed to keep up with inflation, amounting to a 2.3% cut in real terms. *Id.*

- According to the National Housing Trust, the total number of apartments on which project-based Section 8 rental assistance will expire before 2012 is 857,253 nationwide.
- According to HUD, between 2007 and 2029, the Rent Supplement/Rental Assistance Payment contracts will expire on more than 32,000 units nationwide. Contracts on more than 7,100 units are set to expire from FY 2007 through FY 2011.
- According to HUD, from August 2007 through July 2017, mortgages on 2,044 properties will mature.
 - Of these properties, 636 (51,523 units) have 100% rental assistance. Within the 1,408 properties with partial rental assistance, there are 102,321 assisted apartments and 179,099 apartments overall. Forty-one properties with a combined total of 7,062 units are completely unassisted.³
 - A U.S. Government Accountability Office study published in April 2007 found that owners of properties with rental assistance on fewer than 50% of units were more likely to opt out.⁴ Of the 2,044 properties with maturing mortgages sited, 592 fall into this category. Combined, these properties have 20,447 assisted units and 79,343 overall units.⁵

Although new units will be produced, the number is not nearly enough to keep up with the pace of lost affordable apartments over the next few years to come. Moreover, even the replacement of Section 8 housing with tax credit housing fails to meet the need to house the very poor, who cannot afford rents that pay even operating expenses. We have lost these apartments even though, as a rule, preservation is cheaper, faster, and greener than new construction.

The importance to our society of preserving affordable rental homes is underlined by the decision of the John D. and Catherine T. MacArthur Foundation to invest \$150 million in a decade-long initiative entitled “Window of Opportunity: Preserving Affordable Rental Housing.” MacArthur has provided essential grants and program related investment loans to SAHF and its members.

MacArthur is seeking to make a difference in several ways: (1) strengthening social enterprise nonprofits, (2) supporting policy analysis, (3) conducting research into the impact of affordable housing on its residents and the community, and (4) recognizing and encouraging the preservation efforts of state and local government. Details of the initiative can be found at www.macfound.org.

Legislation is Needed to Stem the Loss of Affordable Housing

No amount of private effort or foundation support, though, can preserve federally assisted housing without the active support of Congress and the Administration. If we are to preserve the

³ HUD Website, www.hudclips.org

⁴ GAO, “Project-Based Rental Assistance: HUD Should Update Its Policies and Procedures to Keep Pace with the Changing Housing Market,” GAO-07-290 (April 2007), available at <http://www.gao.gov/new.items/d07290.pdf>.

⁵ HUD website, www.hudclips.org

affordability of these apartments, we must take affirmative steps well in advance by giving preservation-minded owners and purchasers the key tools they need to recapitalize properties and position them for long-term affordability.

Legislation to encourage the preserving of the affordable housing inventory is necessarily complicated, because the federal assistance and regulatory structures under which our properties operate are themselves complex and have evolved over time. Absent a massive new program, the solution involves a mind-numbing level of detailed revisions in statutes and regulatory policy. The draft Housing Preservation and Tenant Protection Act of 2008, circulated informally, is a very good start at addressing those details and generally reflects our priorities.

Today, I would like to identify nine tools that SAHF considers priorities within the preservation agenda generally.

First, tenant protection vouchers should be available to residents in a much wider range of properties.

When, despite all our efforts, a federally assisted or insured property is lost to affordability, it is the moral obligation of our country to give the former residents access to affordable housing. Current law falls well short of meeting that obligation. Section 302 of the draft bill would expand the range of properties with respect to which tenants would receive enhanced vouchers to include projects without project-based Section 8 assistance.

Second, long-term project-based assistance should be made available under more circumstances.

At RHF, we have had direct experience with the need for twenty-year project based assistance to preserve affordable housing in tight markets. For example, we have used twenty-year HAP contracts, subject to appropriations, to raise the debt and tax credit equity we needed to buy and preserve a ten-property portfolio of affordable housing in and around Boston. Without these contracts, we simply cannot compete with purchasers who would convert affordable apartments to condominiums or market rate apartments. With twenty-year project-based assistance, we believe we could preserve another eleven properties by acquiring them from the same seller group.

Enhanced vouchers are provided to protect existing tenants from displacement upon the occurrence of an "eligibility event" in a multifamily housing project—generally prepayment of the subsidized mortgage or termination of an insurance or rental assistance contract. Upon turnover, these vouchers move with the tenant, and the housing is lost as a resource for future low-income families.

Section 104 of the draft bill would permit the use of project-based assistance in place of enhanced vouchers. Project-basing the assistance will provide a financeable revenue stream for preservation-oriented owners and purchasers, without which many worthwhile projects, especially in strong markets, have been forced to exit the affordable program. The assistance would be provided at the request of the owner, subject to the approval of the PHA, and would cover all existing tenants in the project who would otherwise receive enhanced vouchers.

In that connection, we note that section 205 of H.R. 2930 (the bill to reform Section 202), as passed by the House and as introduced in the Senate, would create a "Senior Preservation Contract" for Section 202 projects without project based assistance. The contract would be for twenty years, subject to annual appropriations.

We also note that the Senate version of SEVRA (S. 2684), introduced in March by Sens. Dodd and Schumer, would create project-based preservation vouchers at the election of the owner and subject to PHA determinations of economic viability and demand. The vouchers would not count against various limits otherwise imposed on project-based vouchers, such as the cap on the share of a PHA's vouchers that may be project-based and the limit on the share of units in any project that may be project-based.

A second important need is to provide long-term, renewable rental assistance for properties with Rent Supplement (Rent Supp) or Rental Assistance Payment (RAP) contracts. There are approximately 35,000 apartments with Rent Supp or RAP contracts. Over the next ten years, the contracts on 21,433 of these apartments will expire. By 2029, all of the apartments will have been lost to contract expiration. These contracts exist in thirty-five states, but the majority of them are located in California, Illinois, Massachusetts, Michigan, New Jersey, New York, Virginia, and Washington State. Under current law, at the expiration of a contract issued with Rent Supp (Section 101 of the Housing and Urban Development Act of 1965 (12 U.S.C. § 1701s)) or RAP (Section 236(f)(2) of the National Housing Act (12 U.S.C. § 1715z-1)), an owner has no right to renew the contract, and tenants are eligible for enhanced vouchers only in limited circumstances. Not only are all of the assisted apartments at risk of loss, but tenants are inadequately protected against potential rent increases.

To forestall this risk, SAHF supports section 101 of the draft bill, which provides that if the owner submits a request within a twelve-month period beginning on the date of enactment, HUD must convert the contract to Section 8 project-based rental assistance. This action would protect low-income tenants in danger of losing their homes, save valuable rental housing, and in some cases make it possible to mark rents up to market rate to facilitate rehabilitation.

This approach would resolve an impending bad outcome by converting the assistance to a renewable resource. Any authority that is recaptured as a result of conversion of Rent Supp and RAP program contracts should be used by the Secretary for the purpose of making assistance payments with respect to the initial twelve-month term of the new Section 8 contract, and the balance should be used to fund other preservation initiatives under this Act.

Third, Congress should recognize the key role played by the new generation of social enterprise nonprofits in preserving affordable housing.

Many housing nonprofits have evolved from small, local entities to regional and national mission-driven businesses. As they have evolved, they have moved from a reliance on 100% financing to participation in the same programs used by other developers. In addition, there is substantial embedded equity in their properties, in large part because of their stewardship of the properties as the mortgages have amortized.

SAHF's members strive to operate efficiently and at scale in the pursuit of their nonprofit missions, including preservation. They have invested heavily in professional staff, in technology, and in training. Yet HUD sometimes continues to treat them as if they were fledgling organizations somehow unaffected by the market.

HUD's regulatory structure has failed to keep pace with the evolution of these high-capacity, nonprofit organizations and therefore constrains their ability to address the needs of their portfolios and to unlock this equity. For example, HUD regulations generally prohibit distributions of excess cash flow from single-purpose nonprofit organizations to their parent nonprofits, even in circumstances where a for-profit could distribute cash to its owners for their personal use. Similarly, when a nonprofit organization recapitalizes a property using state-allocated bonds and tax credits, it often is not permitted to use sales proceeds for affordable housing, even though a for-profit could distribute its proceeds to its investors. The net effect of these regulations is to lock up the embedded equity in these properties that could be a significant resource for housing development and preservation.

In addition, many smaller-scale, nonprofit owners have found that the needs of their projects have outstripped their capacities. The inability of these smaller nonprofit organizations to receive some proceeds from a sale causes them instead to retain ownership. At the end of their required affordability period, these organizations will be able to sell the properties and retain any proceeds, bringing about a net loss of apartments from the affordable inventory. Instead, these smaller-scale owners should be permitted to receive some proceeds from the sale for their charitable missions, in return for selling to organizations that commit to meeting the properties' rehabilitation needs and renewing their long-term affordability.

Social enterprises such as SAHF members can only extend their impact if successful stewardship of affordable housing produces cash flow to support their missions. Importantly, section 503(b) of the draft bill would remove restrictions on the distribution of cash flow from successful properties when distributions are permitted under similar circumstances to for-profit organizations and make clear that nonprofits may reuse for mission purposes any proceeds of recapitalization. Although the draft bill contemplates limiting this protection to certain events such as preservation transactions, mortgage prepayment, sale, or refinancing, SAHF recommends against the imposition of any such limitation. The purpose of removing limitations on cash distribution is to facilitate the development of a capital base by social enterprise nonprofits so that they can be more effective in providing and preserving affordable housing.

We note that section 401 of H.R. 2930 (the Section 202 bill), as passed by the House, prohibits the Secretary from imposing any condition that restricts the amount or use of sale or refinancing proceeds unless expressly authorized by existing contract. The provision extends beyond 202s and is retroactive to January 1, 2005, reportedly to overturn a restriction imposed on Jewish Community Housing for the Elderly in Massachusetts in connection with its recapitalization of a Section 236 project.

Fourth, HUD properties should be sold with Section 8 assistance attached or the properties' project-based assistance should be re-deployed.

Since properties with rents set at tax credit limits cannot serve very-low-income people without rental assistance, any loss of project-based Section 8 authority causes a permanent loss of affordability. In 2000, for example, 10 percent of seniors ages 65 and older, or 3.4 million, had incomes at or below the federal poverty line. In other words, in 1999, the income year for the 2000 census, the poverty threshold for a person 65 or over living alone was \$7,990 and \$10,075 for a two-person household with one person in the household 65 or older. Currently there are more than 300,000 units of Section 202 affordable senior housing available in the United States. This means, for each Section 202 affordable senior housing unit that is available, there are ten eligible seniors on waiting lists for a unit. The average time an eligible senior is on the waiting list is 13.4 months.⁶ These figures only reinforce the need to ensure that Section 8 assistance is not lost through the sale of a property.

Fifth, HUD's authority to approve transfers of project-based rental assistance as a means of preserving affordability should be extended permanently and be made more flexible.

Transfer of Section 8 authority is, in many circumstances, the only way to avoid the Hobson's choice of (1) rehabilitating a property as is despite the need for changes, or (2) losing precious project-based Section 8 authority. However, the overly tight constraints of existing law have hampered SAHF members' ability to make use of the transfer authority.

SAHF supports giving HUD the permanent authority to approve partial transfers, following the direction of FY 2008 TTHUD Appropriations Act (Pub. L. No. 110-161, Title II, section 215), and beyond that, recommends adding some additional flexibility where existing law has defeated sensible transfers.

Partial transfers serve important policy goals, and the authority for partial transfers should be made permanent.

- *Reconfiguring the unit mix.* Much of the assisted housing (particularly senior housing) built decades ago included a significant number of efficiency apartments. In many areas, especially outside the hottest urban markets, those efficiencies are unmarketable, resulting in persistent vacancies. Obsolescence in a few units can put whole developments in jeopardy. To prevent a net loss of project-based rental assistance, the HUD Secretary should be authorized to permit the partial transfer of such assistance from properties undergoing a unit reconfiguration to properties that have unassisted apartments.
- *Creating mixed-income communities.* Many of the early siting decisions for assisted housing led to the geographic concentration of poor families. Most of these older assisted properties now require significant rehabilitation. While simply rehabilitating the properties would perpetuate the concentration of poverty, permitting the owners instead to transfer project-based rental assistance to other properties would enable them to provide housing for poor families in areas better served by employment, educational, and

⁶ http://www.aahsa.org/aging_services/default.asp

other opportunities. This same practice has been employed successfully under the Moving to Work program with regard to (project-based) public housing assistance.

Other conditions on the transfer of Section 8 authority reflected in a series of appropriations acts should be simplified. The ten conditions required by those acts and narrow administrative interpretations stemmed from a concern over possible misuse of transfer authority to allow developers to sell buildings in prime locations and transfer the Section 8 authority to poor locations. For example, Section 318 requires that the transferring property be physically obsolete or economically nonviable. In some conditions, a property that does not quite meet these conditions may still be in a socially distressed area in which using new resources for rehabilitation at the same scale in the same location would be unwise. Another provision contains mandates regarding subordination of new debt to transferred debt that are unworkable in most situations. These conditions can be relaxed somewhat without serious risk of abuse.

Sixth, extend the period in which Mark-to-Market (M2M) debt may be assigned to nonprofit purchasers or forgiven and clarify that HUD may not require repayment of any portion of junior M2M debt in transactions with additional resources allocated by state or local government.

When the Mark-to-Market (M2M) program was reauthorized for five years in 2002, the program was amended to permit the HUD Secretary to assign junior M2M debt to not-for-profit purchasers or to forgive that debt entirely. These not-for-profit "purchase incentives" recognize the value of not-for-profit stewardship, the stifling effect of this otherwise burdensome debt, and fact that the incentives would enable not-for-profit purchasers to raise funds to buy out old owners and to leverage significant outside resources for rehabilitation, primarily Low Income Housing Tax Credits (assigned debt can be counted in acquisition basis). Two policies at HUD undermine the value of the not-for-profit purchase incentives and are addressed by this section:

- HUD has limited to three years (after the initial restructuring) the period of time during which the HUD Secretary may assign or forgive M2M junior debt. In reality, sellers often require more than three years to decide to sell. Thus, HUD's limit undermines the utility of the incentives. According to HUD, as of February 1, 2007, 65% of the closed portfolio is already beyond the eligibility window, and the number will increase to 75% by the end of FY 2007.
- In July of 2007, HUD issued a policy requiring nonprofit purchasers to pay HUD a portion of the assigned/forgiven debt, prior to its being assigned or forgiven, if the transfer in question involved seller proceeds or a developer fee for the purchaser. This policy directly undermines the not-for-profit purchase incentives put in place by Congress in 2002. Most nonprofit purchasers are utilizing state or local resources to effectuate the transfers. HUD's policy of requiring repayments in connection with these transfers is doubly problematic, in that it ultimately results in the absorption of these state and local resources by HUD. The public entities overseeing the allocation of these resources will be less inclined to support committing resources to these projects if HUD is the ultimate beneficiary of a portion of that allocation.

For this reason, SAHF supports section 105(b) of the draft bill, which would modify the Mark-to-Market statute to extend the period of eligibility for nonprofit purchase incentives and to clarify that HUD may not require a repayment of any portion of junior M2M debt in cases of acquisitions by nonprofit purchasers using purchase incentives and state or locally allocated housing resources.

Seventh, HUD should be authorized to assign or forgive Flexible Subsidy loans.

The Flexible Subsidy Program was created in Sec. 201 of the Housing and Community Development Amendments of 1978, and, until its discontinuance in 1996, provided financial assistance to prevent financial and regulatory defaults (and foreclosures that would have resulted in claims on the FHA mortgage insurance funds) to certain HUD assisted properties. The loans evidencing this assistance are in many cases impeding the ability of projects to be sold to preservation-minded owners and/or recapitalized and rehabilitated. In order for a project to be eligible for a Flexible Subsidy loan, HUD was required to determine, among other things, that the assistance was necessary to maintain the financial or physical soundness of the project and that the assistance was less costly to the government than other available measures. As a result, most properties that received Flexible Subsidy assistance are located in economically challenged neighborhoods, and the existence of Flexible Subsidy debt is often an impediment to employing typically available recapitalization strategies.

SAHF supports using this debt as a tool to promote the sale of properties to nonprofits and to attract state and local resources to support preservation by authorizing HUD to forgive such debt or transfer it to nonprofits in connection with a transfer of the property to a nonprofit, just as the HUD Secretary is authorized to forgive or assign subordinate mark-to-market debt. HUD should also be prohibited from requiring any repayment in connection with that forgiveness or assignment if the purchaser is utilizing any state or locally allocated resources in connection with the transfer.

By making the debt forgivable and/or assignable in connection with nonprofit transfers, Congress will encourage state and local governments to allocate their resources to help preserve and protect these properties for the long term. SAHF supports section 109 of the draft bill, which authorizes HUD to assign flexible subsidy loans to qualified preservation owners.

Eighth, with the approval of the state housing agency or local authority lender, an owner should be permitted to replace the stub portion of a Section 8 contract with a long-term contract, subject to appropriations.

In the 1970s, HUD entered into contracts to provide thirty to forty years of project-based assistance to nearly 173,000 affordable apartments in connection with properties on which state or local instrumentalities provided debt financing, of which approximately 150,000 remain. These contracts expire with respect to approximately 47,000 apartments by 2012 alone. At that point, the first mortgage debt will have been fully amortized. Although owners have the right to renew their Section 8 contracts at expiration, they will be equally free to convert their properties to market-rate apartments or condominiums, further depleting the supply of affordable rental housing.

If we are to preserve the affordability of these apartments, we must take affirmative steps well in advance by giving preservation-minded owners and purchasers the key tools to recapitalize properties and position them for long-term affordability. To attract lenders and equity investors, an owner or purchaser seeking to preserve the long-term affordability of the housing typically must have a Section 8 contract of sufficient duration to amortize most of the mortgage debt and to assure that a property will have Section 8 support through at least the fifteen-year tax credit compliance period. Typically lenders and equity investors require a twenty-year contract and are willing to accept contracts that are subject to appropriations. As a result, replacing funded thirty- or forty-year contracts with twenty-year contracts subject to appropriations would preserve the affordability of the properties well beyond the initial term of affordability.

SAHF supports section 201 of the draft bill, which amends section 523 of MAHRA to provide that, with the approval of a State Housing Agency or local authority, a property owner with a Section 8 project-based contract that has debt financing from a State Housing Agency or local authority may terminate the contract and enter into a new project-based contract for a term of twenty years, subject to appropriations and provided the owner agrees to preserve the affordability of the project for forty years.

Importantly, granting this authorization would generate budget authority savings. Funds for the existing project-based contracts were fully appropriated when the contracts were entered into and in many cases have several years to run. Terminating the remaining appropriated amount of the existing contracts would recapture several years of budget authority. Any authority that is recaptured as a result of termination should be utilized by the Secretary for the purpose of making assistance payments with respect to the initial twelve-month term of the new Section 8 contract, and the balance should be used to fund other preservation initiatives under this Act. Since termination and substitution would be voluntary and require lender approval, not all owners would convert.

Finally, legislation providing new incentives should insist on long-term preservation.

In the 1960s and 1970s, when America first began to try to attract developers to the affordable housing field, Congress concluded that offering a big upside on eventual conversion of the housing to market rate housing was the only way to attract the necessary capital. Today, we are forced to use our scarce tax credit resources to buy out huge appreciation in some markets.

In any case, there is now a large established industry—nonprofit and for-profit—interested in owning and preserving the affordable housing inventory, and we no longer need to offer windfall rewards to attract investors. To conserve tomorrow's resources, SAHF recommends that Congress create a new category—“preservation owner”—that would be entitled to preservation incentives. In return, preservation owners would be expected to keep the properties affordable for at least forty years, subject to the continued availability of rental assistance.

Thank you again for the invitation to testify this morning. SAHF looks forward to the opportunity to continue to work with the Committee and its staff on preservation.