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Testimony

Before the Subcommittee on Housing Opportunity and Community Development, Committee on Banking, Housing, and Urban Affairs, United States Senate

Statement Submitted on October 17, 1995

# MULTIFAMILY HOUSING

# Issues and Options to Consider in Revising HUD's Low-Income Housing Preservation Program

Statement for the Record by Judy A. England-Joseph, Director, Housing and Community Development Issues, Resources, Community, and Economic Development Division

Mr. Chairman and Members of the Subcommittee:

In conjunction with the Subcommittee's October 17, 1995, hearing on the Department of Housing and Urban Development's (HUD) program for preserving low-income housing, we are pleased to submit this statement for the record. The preservation program, created by legislation initially enacted in 1987 and revised in 1990, is aimed at maintaining the affordable low-income housing that was created primarily under two federal housing programs during the 1960s and 1970s. Under these programs, when owners received HUD-insured mortgages with 40-year repayment periods, they entered into agreements with HUD that imposed affordability restrictions, such as limits on the income levels of tenants and on the rents that could be charged at the properties. However, after 20 years, owners had the right to prepay (pay off) their mortgages in full without prior HUD approval and terminate the affordability restrictions. The preservation program has proven to be complex and costly, resulting in recommendations by HUD, HUD's Office of the Inspector General (OIG), and others to change or repeal the program.

Our statement is based primarily on work that we have carried out during the past several years on HUD's preservation program and on work that we have performed in preparation for this hearing. This statement focuses on (1) how the current preservation program works, (2) the status of preservation eligible projects, (3) concerns that have been raised about the program, and (4) options for revising the program.

In summary, we have found the following:

- To help maintain affordable housing, the current preservation program restricts owners' previously unlimited right to prepay mortgages but provides them with incentives to continue the affordability restrictions. HUD can approve a plan for prepayment only after finding, among other things, that the supply of comparable vacant housing is adequate in the relevant housing market. Those owners who agree to extend the affordability restrictions for the remaining useful life of their properties, may receive, subject to the availability of appropriated funds, various financial incentives, such as increases in federal rental assistance, financing of capital improvements, and federally insured equity take-out loans. Alternatively, the owners can sell their properties to purchasers who will maintain the affordability restrictions. The purchasers are eligible for incentives similar to those received by owners who extend restrictions.

- As of September 30, 1995, the owners of 1,122 projects had notices of intent to extend affordability restrictions or to sell the property to qualified purchasers in process at HUD. In addition, HUD had approved 736 projects for preservation; about

70 percent of these had completed the process. As of September 30, 1995, 223 were awaiting funding. If appropriations are not available to finance the preservation incentives, according to HUD, the owners of at least 127 of the 223 projects approved for preservation will have the right to prepay the mortgage and end the affordability restrictions in fiscal year 1996.

- While housing industry officials believe the preservation program is achieving the goal of preserving affordable housing, HUD, HUD's OIG, the House and Senate Committees on Appropriations, and the National Alliance of HUD Tenants have all expressed concerns about the program's high cost--over $1.2 billion or an average of $19,152 per unit for projects that have completed the preservation process. Specific concerns center on the size of incentives provided and the funding of incentives through increased federal rental assistance, thus creating an expensive, long-term commitment to government funding. HUD has also argued that the program is inconsistent with its efforts to reinvent the Department because, for example, the program promotes above-market rent structures and imposes "complex bureaucratic requirements" on private owners, residents, and state and local governments.

- Several options have been suggested for revising the current program to address these concerns. H.R. 2099, as approved by the Senate Committee on Appropriations in September 1995, proposes to replace the current program with an approach that restores owners' unlimited right to prepay mortgages and uses "capital grants/loans" in lieu of federal rental assistance payments to finance preservation incentives. Two alternative options that HUD has examined are (1) restoring owners' right to prepay and repealing the preservation incentives and (2) restoring owners' right to prepay and continuing preservation incentives, but on a more targeted basis and at a reduced level. Under each of these three options, low-income residents displaced as a result of owners' prepayment of the mortgage would be provided with some form of assistance. Some of the key questions to be assessed in comparing the merits of these options are: (1) Which option is the least costly method of providing housing assistance to those in need? (2) To what extent will eliminating or reducing the preservation incentives result in loss of valuable housing stock, create housing shortages, and cause displacement of residents? and (3) Can HUD effectively carry out whichever alternative is selected, considering its other responsibilities and capacity limitations?

Before discussing these issues in more detail, we would like to provide some background on the preservation program.

## BACKGROUND

The owners of several thousand multifamily housing projects are, or over the next few years will be, eligible for federal financial incentives designed to compensate them for preserving their properties as affordable rental housing for low-income households. These properties were developed during the 1960s and 1970s with government assistance, mostly under the section 221(d)(3) mortgage insurance program authorized by the Housing Act of 1961 and the section 236 mortgage insurance program created by the Housing and Urban Development Act of 1968.[1]

In return for the federal assistance, the property owners agreed to rent units only to individuals and families meeting specific income limits. They also agreed to restrictions on the rents they could charge and the rates of return they could receive. Although mortgages under the programs were generally for a 40-year period, owners could elect to prepay the balance of their loans after 20 years. After prepaying the loan, an owner would no longer be subject to the affordability restrictions and would be free to charge market rate rents or convert the property to some other purpose, potentially displacing the low-income tenants.

As the 20-year anniversary of many of the mortgages approached, the Congress became concerned that the prepayment option could trigger a mass exodus from the program, the displacement of thousands of low-income families, and the permanent loss from the rental market of a significant quantity of affordable low-income housing. As a temporary measure to prevent these outcomes, the Congress enacted the Emergency Low-Income Housing Preservation Act of 1987 (also known as title II or ELIHPA),[2] which placed limitations on owners' prepayment rights but provided a number of incentives for owners to maintain their properties for low-income tenants. This was replaced by the current preservation program, authorized by the Low-Income Housing Preservation and Resident Homeownership Act of 1990, as amended (also known as title VI or LIHPRHA).

## HOW THE PRESERVATION PROGRAM WORKS

The current program is designed to ensure that most units remain available and affordable to low-income families, while limiting but

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[1]Certain projects that are not FHA insured may also participate in the preservation program, including projects developed by state housing finance agencies for which mortgages can be prepaid. According to a HUD multifamily official, about 30 uninsured projects have been approved by HUD and another 33 have applications in process.

[2]Title II of the Housing and Community Development Act of 1987 (P.L. 100-242).

not precluding prepayment of the mortgage by the owner. It offers various financial incentives to those owners who agree to extend the current affordability restrictions for the remaining useful life of the property and to those who are willing to purchase the properties at a fair price and maintain the restrictions. The latter are called "qualified purchasers." Although the owners may elect to forgo the financial incentives and prepay, as a practical matter it is difficult to do so. Before allowing an owner to prepay, HUD must first determine that the action would not, among other things, (1) materially increase the economic hardship for current tenants, (2) cause these tenants to pay more than 30 percent of their income for rent, (3) cause involuntary displacement when comparable affordable housing is not available, and (4) materially affect the availability of affordable housing in the relevant housing market area. If the owner does prepay, however, the property is no longer subject to the affordability restrictions.

Owners seeking to extend the affordability restrictions, sell to a qualified purchaser, or prepay must file a notice of intent with HUD, the appropriate state or local jurisdiction, and the mortgagee, and must inform their tenants of the filing. Two independent appraisers, one selected by HUD and another by the owner, then appraise the property to establish its "preservation value." In general, the preservation value is based on the property's highest and best use.

The appraisal and the preservation value it establishes are key to the financial calculations made during the remainder of the preservation process and to the financial benefits that the owner ultimately receives. The preservation value represents the ceiling price for the sale of the property to a qualified purchaser. The preservation value, less the remaining debt on the property, also determines the "preservation equity," which is used in calculating some of the financial incentives for owners electing to extend affordability restrictions.

Once an owner files a notice of intent, HUD has 9 months to provide the owner with the appraisal results and certain other information the owner needs to proceed.[3] Within 6 months after receiving this information, the owner must file a "plan of action" with HUD for the desired option (i.e., either extension of the affordability restrictions and receipt of incentives; sale to a qualified purchaser who will maintain the restrictions; or prepayment and termination of the restrictions).

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[3]HUD has 9 months to respond to notices from owners who wish to extend affordability restrictions or sell to qualified purchasers and 6 months to respond to notices of intent to prepay the mortgages.

A plan of action for continuing the affordability restrictions must include, among other things, a description of the federal incentives the owner will need and an analysis of how the owner will address any financial or physical deficiencies connected with the property and maintain the low-income use restrictions. After approving the plan, HUD can enter into the agreements that are necessary to ensure that the owner (1) receives the authorized annual rate of return on investment (i.e., 8 percent of the preservation equity), (2) pays the debt service on the federally insured mortgage and any additional loan taken out to rehabilitate the property, (3) meets the projected operating expenses, and (4) establishes adequate cash reserves.

Subject to availability of funds, HUD is authorized to provide the owner with a number of incentives to ensure that these outcomes occur. Permissible incentives include (1) increases in federal Section 8 rental assistance,[4] (2) rent increases for current tenants, (3) financing of capital improvements under other HUD programs, and (4) access to project equity through an FHA-insured loan. Qualified purchasers are eligible for similar incentives. However, purchasers receive a larger percentage of the preservation equity (up to 95 percent compared with up to 70 percent for owners who extend the restrictions), and "priority purchasers" (i.e., resident councils, state and local agencies, or nonprofit organizations) are eligible for grants to help with the acquisition.

The owners who accept the incentives must enter into binding agreements with HUD to retain the affordability of the housing throughout the property's remaining useful life. They must also commit to adequately maintain and operate the property according to HUD's standards, not to displace the current tenants except for good cause, and to comply with certain rules governing future rent increases.

STATUS OF PROJECTS IN THE PROGRAM

As of the beginning of fiscal year 1996, 3,691 projects consisting of 472,854 housing units are or will be eligible to participate in the preservation program. Of this total, the owners of 1,122 projects consisting of 126,529 units had notices of intent to extend the affordability restrictions or to sell the property to a qualified purchaser in process at HUD.

In addition, as of September 30, 1995, HUD had approved owners' plans of action for 736 projects to continue preserving the properties for low-income use. Nearly 69 percent of these projects

[4]Section 8 rental assistance is provided by HUD's Housing Assistance Payments Program, authorized by the Housing and Community Development Act of 1974.

(506 projects containing 63,201 units) had completed the process, received funding under the program, and agreed to extend the affordability restrictions for the projects' remaining useful life or to sell the property to a qualified purchaser.[5]

However, another 223 projects containing 26,521 units remained in the queue awaiting funding. HUD estimates that more than $644 million will be needed to fund the incentives for the remaining 223 projects. Under current law, owners with approved plans of action under LIHPRHA to sell may prepay their mortgages 6 months after the plan of action is approved or 60 days after the start of the subsequent fiscal year if federal funding for preservation incentives is unavailable. Owners with approved plans of action under LIHPRHA to extend the affordability restrictions may prepay their mortgages 15 months after the plan of action is approved. Of the 223 projects awaiting funding, HUD estimates that at least 127 could meet this criterion and be eligible to prepay their mortgages in fiscal year 1996 if funding for the program is not provided.

## CONCERNS ABOUT THE PRESERVATION PROGRAM

While housing industry officials believe that the preservation program has generally been consistent with the legislation's goal of preserving affordable housing, various parties, including both HUD and HUD's OIG, have raised concerns about the program. HUD's multifamily housing officials believe that the primary problem with the existing program is that it creates a system under which property owners are effectively precluded from prepaying their mortgages and instead are given substantial incentives as compensation for continuing to preserve their properties as low-income housing.

While property owners are not specifically precluded from prepaying their mortgages and terminating the affordablility restrictions, the current program establishes limitations that significantly restrict their ability to prepay. Specifically, the low-income restrictions can be terminated through prepayment only if HUD finds that the effects on existing tenants and the low-income housing market would be minimal. As of October 1, 1995, HUD staff told us that only five projects had been approved for prepayment. Some owners have sued the government for, among other things, breach of contract because the preservation laws placed restrictions on mortgage prepayments that would have otherwise been unrestricted after 20 years. On March 27, 1995, the United States Court of Federal Claims ruled in favor of owners who brought suit on this

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[5]According to a HUD multifamily official, there are 7 projects that have been approved and for which funding is available that have not yet completed processing.

issue and sent the case back to trial to determine damages with respect to the breach of contract claim.[6]

While the program limits owners' ability to prepay their mortgages, it provides substantial incentives to owners or purchasers to preserve the properties as affordable housing. Since the program was enacted, it has cost over $1.2 billion to preserve 63,201 units in the 506 projects that have completed the process.[7] This amount represents an average cost of $19,152 per unit to preserve the properties.

HUD, HUD's OIG, the House and Senate Committees on Appropriations, and the National Alliance of HUD Tenants have all expressed concerns about the cost of the preservation program. Among the factors cited as contributing to the high cost of the program are the following:

- The incentives provided to owners and purchasers are based on a substantial portion of a project's preservation equity--up to 70 percent of equity for owners who agree to extend low-income affordability restrictions and 95 percent of equity for purchasers of properties who agree to preserve the affordable housing. The National Alliance of HUD Tenants has argued that these incentives are excessive since, in its view, (1) taxpayers created most of the equity in the properties through housing subsidies and insurance funded at taxpayers' expense and (2) property owners had typically made large profits when the properties were constructed.

- Compensation provided to owners for preserving their projects is typically funded through increased rents, part of which are paid by HUD through increased Section 8 rental assistance. According to HUD's multifamily officials, using Section 8 subsidies to fund incentives and requiring owners to preserve their property for its remaining useful life has created an expensive, long-term commitment to government funding. In addition, as HUD's OIG has noted, HUD expends significant staff time and costs in processing and monitoring the preservation program, as well as in overseeing federal rental assistance contracts under Section 8 and FHA-insured loans.

- Incentives are provided to some projects whose owners are, for various reasons, unlikely to prepay their mortgages. This

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[6]Cienega Gardens v. the United States, 33 Fed. Cl. 196, United States Court of Federal Claims.

[7]According to HUD's OIG's July 14, 1995, report, HUD's Multifamily Preservation Program, the program's costs include Section 8 funding for the initial 5-year contract period, but not for the remaining terms of the mortgage.

concern is compounded by the fact that no minimum amount of preservation equity is needed to participate in the program.

- The program has, in some cases, caused HUD to pay excessive amounts toward repair of properties that have been approved for preservation.

The housing industry officials that we contacted acknowledged that there were concerns about the cost of the program but believed that the program has basically been consistent with the legislation's goal of preserving low-income properties.

In addition to expressing concern about the cost of the program, HUD has also expressed the view that for several reasons the preservation program is inconsistent with efforts to reinvent the Department. First, the program continues to link long-term, project-based assistance with HUD mortgage insurance which can result in losses to HUD from loan defaults unless the project-based assistance is continued. HUD believes this linkage is a fundamental cause of the problems that currently affect the health of a substantial portion of HUD's multifamily loan portfolio. Second, the program promotes artificial, above-market rent structures as opposed to market-driven rents. Third, the program imposes "complex bureaucratic requirements" on private owners, residents, and state and local governments.

HUD's OIG has also expressed concern that under the program, the tenants in projects that have been preserved are no longer mixed-income but rather are predominantly subsidized under Section 8--a situation that runs counter to HUD's philosophy that mixed-income neighborhoods create healthier and more stable environments. Along these lines, the OIG's July 14, 1995, report on the preservation program found--based on an analysis of 296 projects approved as of December 31, 1994--that the percentage of units receiving Section 8 assistance had increased from 32 percent to 76 percent for title II projects and from 45 percent to 87 percent for title VI projects. Housing industry officials we contacted agreed that the program has increased the number of housing units receiving Section 8 assistance, but believed that the program had not caused any widespread change in tenant income profiles.

## OPTIONS FOR REVISING THE PRESERVATION PROGRAM

Various parties have suggested revising the program to address the concerns discussed above. Under one option, the current program would be replaced with an approach that restores the owners' unlimited right to prepay mortgages and uses capital grants and loans in lieu of Section 8 subsidies to finance the preservation incentives. Such an approach is included in H.R. 2099, as approved by the Senate Committee on Appropriations on September 13, 1995. Two alternative options that HUD has examined are (1) restoring the owners' right to prepay and repealing preservation incentives and

(2) restoring the owners' right to prepay and continuing preservation incentives, but on a more targeted basis and at a reduced level. Under all three options, low-income residents displaced as a result of prepayment would be provided some form of assistance.

Capital grants/loans

The capital grants/loans proposal, as specified in H.R. 2099, would restore the owners' unlimited right to prepay their mortgages, while providing owners (or purchasers) with a different set of financial incentives if they choose instead to continue affordability restrictions. The principal change in incentives would be the addition of two new forms of incentives--capital loans and grants, which would provide the owners with access to a portion of the preservation equity and also directly cover the costs of necessary rehabilitation. The incentives involving (1) increased Section 8 rental assistance, (2) equity loans insured by HUD, and (3) second mortgages for capital improvements would be eliminated.

The capital loans would be provided to owners who agree to extend affordability restrictions. As with the current equity loans, these loans could be for amounts up to 70 percent of the preservation equity. However, no interest would be charged and repayment would not start until the original mortgage was paid in full. The owners of such projects would also be allowed an annual return of 8 percent on the remaining 30 percent of equity in the project. According to housing industry officials, this return would be included in the project's operating budget, which is used as a basis for determining the project's rents.[8]

If the owners elect to sell their property to a qualified purchaser, the purchaser would be eligible for a capital grant in an amount up to 100 percent of the preservation equity, or at their option, a capital loan for the same amount. (Currently, purchasers can get equity loans for up to 95 percent of preservation equity.) Unlike the capital loans to owners who extend the affordability restrictions, the loans to purchasers would carry interest at no less than the going federal rate. Repayment, however, would be deferred until the property was resold or refinanced, whichever comes first (or until such later date as may be required to maintain the affordability restrictions for the property's remaining useful life). HUD would be permitted to provide the capital loans in five annual installments, but, if it does so, would have to pay the owner interest on the unpaid amount. Qualified purchasers are also entitled to an 8-percent return on

[8]Officials stated that rent increases resulting from the inclusion of this return on equity would be offset to some degree by the fact that some return on owner equity is already included in project budgets.

the actual cash they invest in the projects from sources other than the federal preservation assistance.

The capital grants/loans proposal also would establish minimum equity amounts that an owner or purchaser would need to qualify for the incentives. To qualify for incentives, owners would need a preservation equity at least equal to the lesser of three amounts: $500,000 per property, $5,000 per unit, or eight times the appropriate HUD fair market rent for all the eligible units.

The proposal would also to some degree change the protection for displaced tenants. HUD would no longer guarantee Section 8 rental assistance to low-income tenants (i.e., those earning between 50 and 80 percent of the area's median income) but would continue the guarantee for very-low-income tenants (i.e., those earning less than 50 percent of the area's median income). HUD could, however, provide Section 8 assistance to the low-income group if appropriations were available. In lieu of a current requirement that owners pay half of the displaced tenants' relocation expenses, the capital loans/grants proposal would require HUD to pay relocation expenses, up to $1,500 per family, for low-income displaced tenants who are paying more than 30 percent of their adjusted income for rent and utilities.

This proposal would eliminate requirements in the current law that, in general, restrict increases in tenants' rent contributions to levels that do not exceed 30 percent of tenants' adjusted income and require that rent increases above certain levels be phased in. It would also revise the existing law's requirement that to the extent practicable new tenants in preservation projects be at the same proportion of very-low, low, and moderate incomes as the tenants who resided in the project when the project's plan of action was approved or on January 1, 1987, (whichever results in the greater proportion of very-low-income families). Instead, maintaining the same income mix among tenants as on the date of the plan of action would only be required to the extent that federal assistance is available. Housing industry officials believe that these changes in the program are needed to ensure the project's viability since Section 8 assistance would no longer be used to fund preservation incentives.

The proposal also makes a variety of other changes in the existing program including (1) revising the maximum federal cost limits for the program, (2) revising the definition of priority purchasers to facilitate the use of low-income housing tax credits in connection with the program, and (3) eliminating the requirement that excess income received under the Section 236 program be remitted to HUD.

According to housing industry officials that we contacted, the capital grants/loans program keeps those aspects of the current preservation program that are working and adjusts various other features to address concerns about the existing program. These officials believe that the capital grants/loans proposal would improve the current preservation program in a number of respects. These include the following: first, owners' unrestricted right to prepay which was taken away under the current program would be restored. Second, costs would be lower than they are under the current program. Third, properties could be preserved without additional Section 8 assistance, thus addressing the concern about linking preservation incentives with Section 8 assistance. Finally, a minimum level of preservation equity would be established, thus addressing concerns that the current program provides preservation incentives to property owners that are unlikely to prepay in any case.

On the basis of our discussions with HUD and housing industry officials and our review of reports by HUD's OIG and other documents, there are also a number of concerns regarding the capital grants/loans proposal. These include the following: (1) the incentives provided to owners and purchasers under the capital grants proposal may actually be higher than those in the current program; (2) because owners would receive most of their equity up front, their commitment to maintaining quality housing over the life of the property is questionable, potentially necessitating additional federal assistance in the future; (3) projects preserved as affordable housing will remain in HUD's inventory of insured properties, requiring continued HUD monitoring and exposing the government to future costs in the event of loan default; (4) the level of protection for tenants in projects whose owners prepay is less than it is under the existing program; (5) even if a minimum threshold of preservation equity is established for participants, owners who are unlikely to prepay may continue to receive preservation incentives; (6) because the appraisal process and estimates of repair costs are subjective, guarding against overestimated preservation values will still be difficult; (7) changes in the affordability requirements could reduce some of the public policy benefits of the current preservation program; (8) elimination of the requirement that excess Section 236 income be returned to HUD could lessen HUD's ability to use such funds to assist needier projects; and (9) depending upon how the capital grants/loans proposal is handled, there could be a variety of tax implications for owners, and if applicable, purchasers. Furthermore, as discussed in the next section, there are concerns as to whether the capital grants proposal is less costly than other options for revising the preservation program.

<u>Eliminate Preservation Incentives and Provide Tenant-Based Assistance</u>

Under an alternative option that HUD has considered, the owners' prepayment right would be restored but preservation incentives would be eliminated. Owners would be allowed to prepay their mortgages after 20 years, or they could continue to operate under the terms of their current mortgage. However, they would not receive incentives for forgoing their right to prepay.

If the owners prepay, certain displaced tenants would be provided with housing assistance. HUD has examined various options for providing such assistance. For example, in addition to assisting persons already receiving Section 8 assistance, options include (1) providing tenant-based assistance to unassisted very-low-income tenants, (2) providing tenant-based assistance to low- and very-low income tenants not currently receiving assistance, or (3) providing tenant-based assistance to very-low-income tenants and covering a portion of low-income tenants' relocation costs.

HUD's multifamily officials believe that a "prepayment/tenant protection" approach that focuses on allowing owners to prepay while protecting tenants is consistent with the Department's proposals to reinvent itself and restructure the multifamily portfolio. These proposals include moving from project-based housing assistance linked to properties to tenant-based assistance, which the tenants take with them wherever they live. Two advantages of tenant-based assistance cited by HUD are that such assistance (1) can provide tenants with greater housing choice, whereas with project-based assistance tenants lose their assistance if they move from the assisted property, and (2) breaks the interdependence between housing assistance and federal payments for defaults on FHA-insured loans which HUD's management believes has undermined the Department's ability to effectively manage the multifamily portfolio. Allowing owners to prepay would also be consistent with the view that rents in projects are better set by the marketplace than through HUD's regulation. In this regard, HUD's OIG has stated that returning projects eligible for preservation to the discipline of the private sector will result in projects that are better maintained and less costly to the federal government.

In addition, this option could help the Department overcome the lack of capacity to adequately manage the multifamily portfolio that it has been trying to address for a number of years.[9] To the extent that restoring the owners' prepayment right results in loans leaving FHA's insured loan portfolio, oversight responsibilities and potential federal liability for defaults of those loans would be eliminated.

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[9]HUD has been unable to provide adequate oversight and management of its existing multifamily loan inventory. See HUD Management: FHA's Multifamily Loan Loss Reserves and Default Prevention Efforts (GAO/RCED/AIMD-95-100, June 5, 1995) and HUD Management: Greater Oversight Needed of FHA's Nursing Home Insurance Program (GAO/RCED-95-214, Aug. 25, 1995).

A primary risk of or uncertainty about the prepayment/tenant protection option centers on its impact on low-income tenants. For example, HUD's OIG has reported that tenants believe that tenant-based assistance will not prevent displacement of all the affected families. There are also concerns that all the displaced low-income residents may not be able to find alternate housing using tenant-based assistance because (1) in some tight housing markets, an adequate supply of alternate housing is not available and (2) some property owners may not accept tenants with such assistance. As a result, some displaced tenants may have to move out of some communities to other areas to seek affordable housing. To help mitigate such concerns, HUD is examining an option under which elderly, disabled, and possibly family tenants living in properties whose owners prepay, would be eligible to receive tenant-based assistance at levels exceeding the normal maximum limits for such assistance if the new rent for their unit exceeds such limits. This approach is aimed at allowing such residents to continue to remain in their units.

There are also concerns that eliminating preservation incentives will result in the permanent loss of good-quality housing stock for low- and moderate-income tenants. After prepayment, these properties may be converted to other uses, such as condominiums, or upgraded to serve middle- and upper-income families. However, several housing industry officials told us that, if projects are again allowed to prepay their mortgages, owners' access to conventional refinancing could be contingent on a number of factors surrounding the project, such as location and condition. Such contingencies, depending on the degree they affect the projects' value and the associated risk, could limit the number of projects that could qualify for this type of financing.

Yet another issue is whether this option is more or less costly than the capital grants/loans option. A recent analysis prepared by HUD staff compared the costs of the capital grants proposal to the costs of an alternative under which preservation incentives would no longer be funded, owners would be allowed to prepay, and tenants would be protected by receiving Section 8 assistance. The analysis indicated that the prepayment/protection option would be cheaper for the first 15 years but that capital grants would subsequently be less costly.[10] HUD staff also noted, however, that

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[10]HUD's analysis compares the costs under the two options for projects in its preservation pipeline, which includes about 150,000 units. HUD assumes that 75 percent of the owners would prepay if preservation funding were discontinued and 20 percent of owners would prepay if capital grants/loans were available. HUD assumed that for projects whose owners prepay, Section 8 assistance would be provided to those households that already receive Section 8 assistance as well as to very-low-income and low-income households that are not currently receiving such assistance. HUD also assumed

the two options are not directly comparable in that the level of assistance provided to tenants differs under the two options--that is, considerably more tenants receive Section 8 assistance under the prepayment/protection option than under the capital grants/loans option. Section 8 assistance limits tenants' contribution to rent to 30 percent of the household's income, while unassisted tenants may be required to pay more than 30 percent of their income for rent under the capital grants/loans proposal. Industry representatives told us that they had not seen HUD's analysis but believe that the capital grants/loans option would be less costly than the prepayment/protection option after a much shorter period of time. We have not performed a detailed assessment of HUD's analysis.

A More Targeted Preservation Program

HUD's multifamily housing officials told us that another option that HUD is currently considering is establishing a more-targeted, scaled-down preservation program. As in the other two options, the owners' unlimited right to prepay their mortgages would be restored. While some incentives would be authorized for owners or purchasers who wished to extend the affordability restrictions, the incentives would be reduced and/or more targeted than under the current program or the capital grants/loans proposal.

While the specific provisions of such a proposal are still being formulated, HUD officials said that the following approaches are being considered: (1) restoring owners unrestricted right to prepay their mortgages, (2) using capital grants or loans in place of existing preservation incentives but, perhaps, at lower levels than those in the existing program and under the capital grants/loans proposal, (3) targeting the program to emphasize selling the properties to entities controlled by tenants and to public agencies, and focusing on the projects whose owners are highly likely to prepay and where local involvement and support are high, and (4) limiting the amount of repair costs that HUD is responsible for covering.

Under this option, tenants in projects whose owners prepay would receive tenant-based assistance. The approaches for providing such assistance are the same as those described for the second option.

Because this option is not fully formulated, it is difficult to assess its benefits and costs. However, HUD's multifamily officials believe that a highly targeted preservation program is likely to be less costly than the capital grants/loans option and would allow HUD to promote the preservation of selected properties

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that under the prepayment/protection option, about 20 percent of households would be provided with assistance at levels that exceed the normal limits for such assistance.

through sales of those projects. Potential concerns about this option relate to (1) how HUD would target projects for preservation and (2) whether the projects could be preserved at reduced preservation incentive levels. In addition, to the extent that the proposal would result in a significant number of prepayments, many of the same concerns that exist regarding the prepayment/tenant protection option would apply.

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This concludes our statement. We hope that the information we have provided will assist you and the other members of the Subcommittee in your deliberations.

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Penalty for Private Use $300

Address Correction Requested

Bulk Rate
Postage & Fees Paid
GAO
Permit No. G100