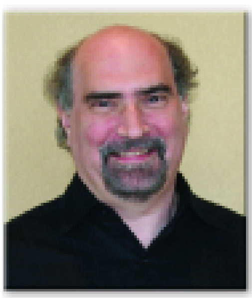
The MacArthur Foundation Supports Florida's Preservation Efforts

MacArthur Foundation President Jonathan Fanton (left) and Congressman Barney Frank, chairman of Financial Services Committee (right) congratulate Florida grantees Nancy Muller of the FHFC, Stan Fitterman and Jaimie Ross of the FHC, and Anne Ray of the Shimberg Center.

Photo by Dave Scavone



By Stan Fitterman

The John D and Catherine T. MacArthur Foundation has awarded the Florida Housing Coalition $475,000 under the Foundation's Window of Opportunity Initiative on Rental Housing Preservation. Under this three-year program, the Coalition will work to create more mission-driven organizations with the experience and capacity needed to preserve existing rental properties that provide housing for extremely low-income households and people with special needs. The Coalition will accomplish this through trainings in workshop settings as well as by providing a small number of nonprofit developers with substantial technical support on specific transactions through the pre-development, acquisition, and long-term financing phases of projects.

The focus of this effort will be on preserving the affordability of units that have project-based rental assistance. According to the Shimberg Center for Housing Studies, there are more than 58,000 such units in Florida. The Shimberg Center estimates that extremely low-income families, those earning less than 30 percent of median, live in over 76 percent of the HUD-funded project-based rental assistance units. Another 20 percent of these HUD units serve families earning between 30-50 percent of median. The Shimberg Center estimates also show that very low-income families, those earning

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less than 50 percent of median, occupy 89 percent of the units that have Rural Development funded project-based rental assistance.

The Need for Preservation

Assisted rental housing is built with public subsidy and comes with restrictions on the rents that can be charged and households that can be served. Eventually, however, these restrictions expire. According to the Shimberg Center's Assisted Housing Inventory, Florida has 272,025 units of privately owned rental housing with federal, state or local subsidies. By 2015, the subsidy will expire on 43,830 of these units. Of those that will expire by 2015, over 70 percent are units with HUD-funded project-based rental assistance. Therefore, the units serving the lowest income families are at the greatest risk of being lost the soonest.

How Did We Get Here

The origin of today's housing preservation problem dates back to programs created in the Kennedy and Johnson eras. These programs, Section 221(d)(3) and Section 236 of the National Housing Act represented the federal government's first attempt to stimulate private sector involvement in the production of low- and moderate-income housing. Under the Section 221(d)(3) program, the federal government offered below-market interest rate direct loans to developers at a rate of three percent. Developers of projects under the Section 236 program received a monthly interest reduction payment that reduced the interest rate to one percent. Tenant rent for Section 236 deals was set at an amount required to cover operating expenses plus the debt service at the one percent rate. The difference between the actual debt service, at 8 percent for instance, and the tenant's one percent payment was paid directly to the lender. This approach enabled both private owners and private lenders to directly participate in public sector housing programs.

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In addition to the mortgage subsidies, the federal government also insured the loans through the Federal Housing Administration (FHA), guaranteeing to lenders that the federal government would pay the outstanding loan in the event of default. Owners also received additional subsidies through substantial tax incentives including accelerated depreciation and mortgage interest deductions that were used to offset income tax liabilities. In effect owner and lender risk in most of these developments was virtually nonexistent. To sweeten the deal even further, while the subsidized mortgages were typically written for a 40-year term, in most cases owners were permitted to prepay the note, terminate the low- and moderate-income use restrictions, and convert the property to its highest and best use after just 20 years.

Fast forward 25 years. Housing markets heat up and owners begin to realize that, by invoking their right to prepay and convert their properties to market-rate housing, they could achieve substantial profits. For example, if a typical project cost $25,000 per unit to build, 20 years later it might have an outstanding mortgage debt of $20,000 and a market value of $45,000, leaving the owner with a residual equity value of $25,000. At the same time, due to the accelerated depreciation and other factors, the typical prepayment eligible project had become a tax liability for its owner: many owners found themselves paying taxes in excess of actual cash received from the allowable limited dividend. This so-called "phantom income" problem created an additional incentive to prepay, refinance, and convert the properties to market-rate housing.

The Response to the Early Conversions

As owners around the country began to prepay their mortgages and convert their units to market rate, a debate erupted over the future of privately owned, publicly subsidized housing with expiring use restrictions. Owners opposed any restrictions on their contractual right to prepay their loans and opt out of the rent restrictions. Housing advocates argued that the program's goal of providing affordable rental housing should take priority over the owner's windfall profits. By the late 1980's two federal laws were passed that prohibited mortgage prepayments while giving owners incentives to keep the housing affordable for another 20 to 50 years. These incentives included additional FHA mortgage insurance and project-based rental assistance. Owners could either retain ownership or sell to priority purchasers (nonprofits, tenant organizations, state or local governments) that would agree to the same rent restrictions. In 1996, however, Congress restored owners' prepayment rights and terminated all federal preservation funding. The goal of federal policy shifted dramatically from preserving the housing to protecting existing residents from displacement. Enhanced Vouchers became the cornerstone of the new federal preservation policy. Enhanced Vouchers were provided to eligible low-income tenants—and in some cases to moderate-income tenants—at the point of prepayment. Unlike regular vouchers, which are limited by the public housing authority's payment standard, Enhanced Vouchers are provided at the comparable market rent (as determined by the public housing authority) if the tenant chooses to stay in the housing.

Pictured from left to right at the press conference announcing the $1 million dollar award from the MacArthur Foundation, are Anne Ray, Steve Auger, and Jaimie Ross, respectively representing the Shimberg Center, the FHFC, and the Florida Housing Coalition.

Section 8 Housing Stock

In 1974, the Section 8 program was created by the federal government to provide a new incentive for private developers. This program requires the tenant to pay a portion of their income for rent and utilities, generally around 30 percent, and the property owner is paid the difference between the tenant's share and the fair market rent for that unit. These Section 8 subsidy contracts were either project-based (tied to the unit) or tenant-based (mobile subsidies, now called vouchers), which moved with the individual tenant. Section 8 provided a much deeper subsidy to the tenants than the earlier mortgage subsidy programs, enabling families with much lower incomes to benefit. For owners and lenders, it virtually guaranteed the rent needed to cover debt service, operating expenses and profit. The project-based Section 8 inventory is divided into two stocks: older assisted and newer assisted housing. The older assisted Section 8 inventory consists primarily of projects financed under Section 221(d)(3) and Section 236, including properties with expiring use restrictions. Section 8 contracts were added on top of the existing mortgage subsidies to protect very low-income families who could not afford the budget-based rents and to rescue failing projects from foreclosure. Newer assisted projects were originally developed with Section 8 in the late 1970s and 1980s, under the Section 8 New Construction/Substantial Rehabilitation programs. As noted above, many of these contracts between the owners and the federal government are set to expire. In strong rental markets, these units can be converted to market rate housing. In weak rental markets with

Ridgewood preservation project.

high vacancies, owners may find it difficult to generate sufficient operating revenue to maintain the property and keep it from deteriorating beyond repair. These properties may similarly be lost to the affordable stock due to deterioration or abandonment. An additional factor may also be at work in owners' decisions to sell. As Emily Acthenberg so eloquently put it in the LISC publication Stemming the Tide, "after 20 or more years of operations in a highly regulated environment, the cumulative experience with HUD can be a significant factor affecting the owner's decision-making process."

Preservation Options

Traditionally states have targeted preservation deals with a portion of their nine percent housing credits and sometimes a portion of their bonds with four percent credits. This financing is used for both acquisition and rehab of the units being preserved. HUD will also allow what is known as "236 decoupling," which enables the new purchasers to keep the interest reduction payments after the purchase and refinance. This, combined with the project-based rental assistance, makes the deals economically viable. Acquisition and rehab is of course a different business line than new construction. Florida, with its traditional focus on the production of new units, has very limited capacity with preservation deals, but a growing need to protect the affordability of these units that serve our state's lowest income residents.

On May 8, 2009, as part of the MacArthur Foundation initiative, Florida Housing Finance Corporation issued a Request for Qualifications (RFQ) to solicit a small group of nonprofit development organizations that are interested in taking on preservation of rental housing as part of their mission and want to receive direct, intensive technical assistance for this purpose from the Florida Housing Coalition over a three-year period. The RFQ targets nonprofits that have experience in affordable housing development (either homeownership or rental), but may have limited or no rental housing units that they manage in a portfolio. The RFQ is due June 19th, and the awards are to be announced at FHFC's July board meeting. After the awards are official, the Florida Housing Coalition will begin working with the selected nonprofits toward developing an effective preservation business line. HNN

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References:

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