

# CHAPTER 2

## IMPROVING THE PRIVATE MULTI-FAMILY PROGRAMS

Retooling HUD  
for a Catalytic Federal Government:  
A Report to Secretary Shaun Donovan

Penn Institute for Urban Research  
University of Pennsylvania

---

### EXECUTIVE SUMMARY

The Federal Government has long played an integral role in the creation and preservation of multi-family housing – particularly for those not served by private-market forces. The U.S Department of Housing and Urban Development (HUD) has had varying degrees of success during its 40-year history and its visibility has fluctuated dramatically under different Administrations. Never has the role of the Department been more critical than it is today.

We stand at the brink of a new era. The Secretary has the opportunity to undertake an aggressive strategy to drive fundamental changes to private multi-family housing programs. The changes, discussed as recommendations in this report, will enable HUD to increase home production in a weakened capital market, expand its role as a thought leader in critical areas of policy, and improve HUD’s internal culture to an entrepreneurial one that embraces the new possibilities for impact the new Administration brings.

For HUD to reaffirm its traditional crucial role as the leader of the private multi-family housing industry, it must act quickly and aggressively with its internal team and other federal and state agencies to develop the necessary capacity and resources.

#### A. Strategic Premise

Certain actions taken by the Secretary of HUD will have the impact of opening up the development of affordable housing in the current market, enhancing the delivery of essential HUD financing products and programs, and improving the interface between HUD and its partners.

#### B. Vision

The recommendations discussed in this report are guided by a shared vision for HUD as the policy leader for housing and urban affairs by becoming:

- A key collaborator with the White House, Treasury, Health and Human Services (HHS), Environmental Protection Agency (EPA), Department of Energy, and others in developing policies and programs that break through traditional departmental boundaries;
- A catalyst for and disseminator of successful models;
- A partner with states and cities in using its financing and policy tools effectively; and
- A partner with its private sector program participants.

#### C. Recommendations

The purpose of this report is to identify policies, programs, and systems that, if employed, would enable HUD to more effectively administer its multi-family housing programs.

Recommendations address both immediate turn-key actions, which would open up markets for affordable housing development in the first 100 days as well as actions that could be taken during the first year or two of the Administration that would enable the Department to become a consistent, proactive partner. Recommendations fall into four categories:

- **Reform Federal Housing Administration (FHA):** Enhance the effectiveness of HUD’s multi-family products by injecting liquidity in the multi-family construction market and improving current multi-family insurance programs;
- **Motivate Investment in Multi-Family Affordable Housing:** Create the National Housing Trust Fund, retool and reform financing programs (including the Low Income Housing Tax Credit [LIHTC]) to enhance liquidity for multi-family housing, and fund multi-family properties stalled in the current capital market;
- **Preserve Affordable Housing:** Take steps to preserve existing affordable housing through a series of administrative, programmatic, and statutory modifications to existing practice, improvement of the Section 8 program, and facilitation of the financing of preservation transactions; and
- **Transform HUD’s Culture:** Inspire transformative change in internal approach and external interface with stakeholders. Dynamic, new leadership and a dramatic process of change at HUD will enable the agency to reassert its appropriate role.

## REFORM FHA's PROGRAMS

The housing crisis we are experiencing and the weakened state of Fannie Mae and Freddie Mac in this crisis point directly to the substantially missing and critically important leadership role of FHA in housing finance including both single- and multi-family housing. HUD insurance programs could be the backbone of multi-family finance in the United States in this time of economic stress.

### A. First 100 Day Strategy – FHA

Steps must be taken in the short- and medium-term to assure that the Federal Housing Administration can immediately activate its products to facilitate the work of its frequent users and attract participation by new users.

*FHA Topic 1: Government National Mortgage Association (GNMA or Ginnie Mae) Construction Loan Securities Purchase Program*

**Recommendation 1: The Secretary should encourage the Federal Reserve Bank (“the Fed”) to purchase Ginnie Mae Construction Loan (CL) securities at the same rate as the private market is paying for Ginnie Mae Permanent Loan (PL) securities.**

As part of the Troubled Assets Relief Program (TARP) and the Fed’s program to buy Fannie Mae, Freddie Mac and Ginnie Mae securities, the Fed could inject liquidity into the multi-family markets, create construction jobs and provide capital for acquiring supplies, materials and equipment by purchasing Ginnie Mae CL securities at the same rate as the private market is paying for Ginnie Mae PL securities.

The ready market for PL securities would set a benchmark for the Fed’s pricing and would allow a private market for CL securities to reemerge when investors’ balance sheets allow their reentry into this credit risk-free market. Once the construction/rehabilitation is completed on these projects (usually 18 to 24 months), the Fed could sell the PL securities and, unless interest rates increase significantly, could make money on the transaction.

*Background:* The interest rate on Ginnie Mae construction loan securities is significantly higher than on permanent loan securities and the high rates are making most FHA-insured new construction and substantial rehabilitation developments infeasible. Generally, the rate on Ginnie Mae CL securities has been the same as on project loan securities because both are backed by the full faith and credit of the U.S. government and both have been very liquid investments with a ready market of investors. However, in the current market, there are few investors willing to buy and hold the CLs until they convert to a PL security. Most of the previous investors are experiencing balance sheet problems and do not want to accumulate and hold the CLs during the construction period until they convert and can be placed in a Real Estate Mortgage Investment Conduit for sale to permanent investors. This issue has led to price differences of approximately 100 basis points, rendering many projects infeasible.

In a recent survey of mortgage lenders by the Mortgage Bankers Association of America (MBAA), 26 lenders reported that there are currently more than 200 applications in process for FHA insurance for more than \$3.2 billion in mortgage amount (representing approximately 29,000 units) that could go into construction in the next six months if this program were implemented. This would provide much-needed affordable rental housing and healthcare facilities—both preservation of current properties as well as new construction in certain markets. The program would also provide strong economic stimulus in markets across the country as almost 34,000 jobs would be generated quickly and efficiently. The National Association of Home Builders estimates that the development of a typical 100-unit multi-family apartment complex generates 116 new jobs in the construction trades and in companies that supply goods and services integral to the development of this housing.

## **B. Mid-Term Strategy – FHA**

### *FHA Topic 2: Reenergize Multi-family Insurance Programs*

There are a number of administrative and legislative actions that the Task Force strongly recommends the Secretary and FHA Commissioner implement in 2009 that will enable it to more effectively administer the multi-family insurance program. These adjustments are intended to address inefficiencies and minor imperfections in current insurance programs.

Addendum 2.1 details a list of recommended adjustments to current FHA practices and regulations. Enacting these adjustments, all of which have broad support in the industry, would enable the incoming HUD leadership team to make FHA products much more efficient and productive for the lending and development industries.

Recommendations are divided into administrative and legislative changes that, individually and collectively, will improve HUD programs, which, in our view, are stronger in their design than execution. The fundamental premise behind the recommendations is that HUD can be a far more effective player in the multi-family housing industry without burdening the federal budget and without taking inappropriate insurance risks.

We encourage the incoming leadership team to review each of the changes to multi-family insurance programs by reviewing each of the recommended changes in Addendum 2.1. In brief these administrative and legislative recommendations are:

#### *Administrative Recommendations*

**Recommendation 2.1: Make it a Federal responsibility to produce a Federal housing program.**

**Recommendation 2.2: Correct Davis-Bacon wages.**

**Recommendation 2.3: Restore project-based Section 8 contracts.**

**Recommendation 2.4: Authorize automatic prior participation clearance, after application and approval, for frequent participants in HUD programs.**

**Recommendation 2.5: Encourage preservation of affordable housing.**

**Recommendation 2.6: Assure quality of buyers of HUD troubled properties.**

**Recommendation 2.7: Allow contingencies for new construction.**

**Recommendation 2.8: Allow the option of balloon mortgages and lower floaters.**

**Recommendation 2.9: Correct the annual contribution to reserves for replacement to \$250 per unit per year.**

**Recommendation 2.10: Keep to the Multifamily Accelerated Processing (MAP) time frames.**

**Recommendation 2.11: Release cash flow monthly.**

**Recommendation 2.12: Allow more retail/commercial space in Section 221d properties.**

**Recommendation 2.13: Define elderly as age 55.**

**Recommendation 2.14: Correct Section 231 underwriting.**

**Recommendation 2.15: Modernize ground leases.**

**Recommendation 2.16: Correct Master Lease underwriting requirements.**

**Recommendation 2.17: Allow Firm Commitment applications with less than 100% plans, specs, and costs.**

**Recommendation 2.18: Correct mortgage insurance premium (MIP) for Section 223f.**

**Recommendation 2.19: Allow MAP underwriting for Section 241 loans.**

**Recommendation 2.20: Allow meal service in Section 231 properties.**

**Recommendation 2.21: Allow construction on sites deemed residentially safe by the States.**

**Recommendation 2.22: Allow non-profits to benefit from payment in lieu of taxes (PILOTS).**

### *Legislative Recommendations*

**Recommendation 3.1: Set aside mortgage insurance premiums as a Housing Trust Fund.**

**Recommendation 3.3: Increase per unit statutory limits by a construction inflation factor.**

## **MOTIVATE INVESTMENT IN MULTI-FAMILY AFFORDABLE HOUSING**

### **A. First 100 Day Strategy – Motivate Investment**

#### *Motivate Investment Topic 1: Allocate Federal Funds to Fund Stalled LIHTC Properties*

**Recommendation 4: Advocate the allocation of \$5 billion in specially-appropriated Home Investment Partnerships (HOME) or TARP funds as gap financing to State LIHTC-allocated agencies for stalled projects.**

*Background:* The credit crunch has made the financing of tax credit-financed multi-family housing extremely difficult in the current environment. Developers who have been allocated LIHTCs have been unable to raise sufficient debt and equity for their properties. In the past year, the value of tax credits has decreased by 25% or more, construction costs and operating costs have increased, incomes have stagnated or decreased, and interest rates remain high. All of these factors taken together have contributed to many tax credit allocations being returned or developments simply not moving forward, awaiting additional subsidy, lower interest rates or some other method of bridging the gap.

Gap funds invested through state allocation agencies could fill financing gaps and start LIHTC projects immediately before the investment industry recovers. In the event HOME funds are unused, matching fund requirements should be waived and LIHTC rules (e.g., rent and income) should be followed.<sup>26</sup>

#### *Motivate Investment Topic 2: Facilitate the Availability of Financing for LIHTC Properties*

**Recommendation 5: Pursue one of the following two options to address debt service costs:**

- As part of TARP and the Treasury's proposed rate buy-down program for single-family loans, Treasury could purchase multi-family loans where the property is assisted through low income housing tax credits at an interest rate. Treasury could issue 15-year debt at current rates and purchase Fannie Mae, Freddie Mac or Ginnie Mae securities backed by the loans, earning the interest rate spread for 15 years and then selling any remaining loans that have not refinanced at the end of the 15-year period. There would be some cost to the government, depending on the number of loans not refinanced during the 15 years and the level of interest rates at the end of 15 years.

---

<sup>26</sup> This Task Force is supportive of Representative Frank's call for an additional \$5 billion of Treasury funds to be invested in the purchase of low income housing tax credits that have no current marketability.

**OR**

- HUD could launch a new Ginnie Mae Tandem program whereby Ginnie Mae would purchase FHA-insured loans at a 4.5% interest rate and hold them until maturity or until the market is such that they could sell them at a reasonable price.

*Background:* To make these loans feasible, new tax credit investors are being cultivated, additional soft debt or grants are being sought, construction cost savings are being explored, and all operating costs are being closely scrutinized.

In a recent survey of mortgage lenders by the MBAA, the 26 lenders responding reported that there are currently more than 25 applications in process for FHA insurance with low income housing tax credits for more than \$125 million in mortgage amount (representing approximately 4100 units) that could go into construction in the next 6 months, if a 4.5% interest rate could be assured. This would provide much needed affordable rental housing; the National Association of Home Builders estimates it would produce more than 4,700 jobs.

### *Motivate Investment Topic 3: Unlock the Housing Bond Program.<sup>27</sup>*

In the current market, there has been limited demand for Housing Bonds. The lack of liquidity has frozen the utilization of state and federal products. The following steps must be taken by the incoming HUD leadership to encourage associated entities within the federal government to support the improvement of Housing Bond Programs.

**Recommendation 6.1: Encourage Treasury to use TARP funds or other resources available to purchase long-term fixed-rate Housing Bonds at reasonable rates, which will establish the market and draw in other investors.**

**Recommendation 6.2: Encourage Treasury and the Federal Reserve to establish liquidity facilities for:** Housing Finance Agency (HFA) Variable Rate Demand (VRD) loans, to attract buyers for this short-term debt by pledging to step in and purchase it if there are no other buyers when its terms call for it to be remarketed; and for HFA long-term, fixed-rate Housing Bonds, to attract investors by making funds available to them to purchase these bonds.

**Recommendation 6.3: Encourage the Federal Reserve to condition its GSE debt and mortgage-backed securities (MBS) purchases on GSE commitments to use a portion of the funds they receive to buy HFA Housing Bonds and provide liquidity to HFAs to support their lending programs.<sup>28</sup>**

**Recommendation 6.4: Engage Fannie Mae and Freddie Mac to advance their affordable housing mission by supporting HFAs by buying their Housing Bonds and providing them liquidity through loan purchases, including FHA-insured loans, on reasonable terms and other means.** Support these activities by increasing the GSEs' debt ceilings, relaxing the limit on the amount of their assets they can invest in tax-exempt bonds (the so-called 2 percent De Minimis Rule), and awarding them affordable housing goal credit for these activities.

**Recommendation 6.5: Encourage the Federal Home Loan Banks to advance their affordable housing mission by providing HFAs liquidity on reasonable terms.**

**Recommendation 6.6: Change the Housing Bond law<sup>29</sup>, so as not to require issuers to designate housing purposes when they carry forward unused bond authority from one year to another, and extend HERA's**

---

<sup>27</sup> From NCSHA Economic Recovery Priorities White Paper.

<sup>28</sup> Traditionally, Fannie Mae was the primary purchaser of 40-year tax-exempt bonds from the HFA's, but no longer need tax-exempt income. This recommendation would bring purchasers back into the 40-year tax-exempt bond market. The GSEs could hold the bonds and resell them when the market is more stable as with tax credits.

<sup>29</sup> Section 142(d) of the Internal Revenue Code of 1986 (Code) as amended allows for the issuance of tax-exempt multi-family housing bonds to be bought by private parties. These bonds may be accompanied by 4% LIHTCs under Section 42 of the Code. Section 145 of the Code permits issuance of tax-exempt bonds to finance multi-family housing owned by qualified non-profit corporations.

**AMT exemption to prior-year Housing Bond authority carried forward to 2009 or future years and to bonds issued to refund prior-year Housing Bonds.**

**Recommendation 6.7: Utilize the HFA delivery system to ensure that any forthcoming Treasury and Federal Reserve mortgage rate buy-down initiative reaches lower-income families HFAs to successfully serve and provide a further interest rate advantage to those families.**

**Recommendation 6.8: Eliminate the so-called Mortgage Revenue Bond (MRB) Ten-Year Rule that requires payments on mortgages financed with Housing Bonds outstanding for more than ten years to be used to redeem bonds rather than to make new mortgages.**

**Recommendation 6.9: Expand bank interest in municipal bonds by increasing the bank qualified issuance limit.**

*Motivate Investment Topic 4: Structural Changes to the LIHTC Program*<sup>30</sup>

The Low-Income Housing Tax Credit program has been the most important driver for affordable rental housing over the past twenty years. Discussed below are targeted adjustments, recommended by nearly all within the industry, that would open streams of equity and capital into new development by encouraging former and new investors back into the market.

**Recommendation 7: HUD should support efforts to include provisions in a stimulus package that would revive the LIHTC equity market. Proposals currently under discussion include:**

1. *Make LIHTCs refundable to arms-length investors (for a two- or three-year period).* Make the LIHTC refundable for arm's length investments made by publicly traded, widely held C-corporations in projects placed in service starting January 1, 2009 and receiving tax credit allocations from states by December 31, 2010. Investors in qualifying projects that do not have sufficient tax liability in any year of the tax credit period would receive a cash refund. Sophisticated corporate investors provide business discipline essential to the LIHTC's success. Refundability should not be available to developers or individual investors.
2. *Extend "carrybacks" from one to five years.* Allow LIHTCs to be "carried back" so investors can offset taxable income from prior years. Under Section 39 of the Code, most business credits, including LIHTCs, may be carried back for one year and carried forward for 20 years except for the marginal oil and gas well production credit, which may be carried back for five years. Until the Taxpayer Relief Act of 1997, the Code permitted a three-year carryback for business credits. A lengthened carryback rule would contribute to increased investment activity in two ways.

First, investors would know that if their tax liability were to decrease and they were unable to use future year credits, they could be used in any of five prior tax years. Profitable companies, uncertain about their tax liability in coming years, would find this far more attractive.

Second, in the current environment companies without current tax liability may begin to sell their existing portfolios at substantially discounted prices. Active investors, sensing the opportunity to purchase these credits at below-market prices, have declined making new investments, further exacerbating an already depressed market. The Federal Housing Finance Agency, which oversees Fannie Mae and Freddie Mac, has stated publicly that the GSEs will not make "wholesale" dispositions of their portfolios, but even a partial sale of their very substantial holdings would interfere with raising new capital for new properties. A five-year carryback for these companies and others without current tax liability would encourage such taxpayers to use their credits in prior years when they had tax liability. Presumably, they would choose to use credits where they would receive a dollar-for-dollar return from Treasury rather than sell their credits for a far lesser amount.

---

<sup>30</sup> Proposals 1 and 2 under Recommendation 7 provided by Affordable Housing Tax Credit Coalition (December 2008).

Housing and Economic Recovery Act of 2008 (HERA) permits LIHTCs to be used against alternative minimum tax (AMT) liability, effective for properties placed in service after 2007. The revised carryback rule should permit these LIHTCs to be used in the prior five-year period. In addition, we propose that LIHTCs arising from properties placed in service before 2008 also be allowed against AMT liability during this period.

3. *Extend Special Gulf Opportunity Zone (GO Zone) Incentives through 2012* HUD should join each of the State's in the GO Zone and support the extension by Congress of the completion deadline for GO Zone LIHTC and bonus depreciation until December 31, 2012. Stalled LIHTC developments in the GO Zone depend on special incentives that require project completion by 2010. This deadline is not realistic under current market conditions.

## B. Mid-Term Strategy – Motivate Investment

### *Motivate Investment Topic 5: The National Housing Trust Fund (NHTF)*

*Background:* An important part of restoring HUD's leadership of the U.S multi-family housing sector is for HUD to expand housing options for those with the fewest choices. In the last 20 years, HUD's role has diminished to oversight of the dwindling supply of federally assisted housing, having relinquished responsibility for new development to the LIHTC program, administered by the Department of Treasury. Even while HUD periodically examines "worst case housing needs," thus documenting the shortage of rental homes for the lowest income households, HUD's role in solving the most serious housing needs is limited to the 202 and 811 programs and 30% of the McKinney Homeless Assistance programs. Extremely low income households (30% area median income [AMI] or less) are the only income group for whom there is an absolute shortage of rental homes they can afford (9 million households and 6.2 million rental homes).

The state of low income housing today is a classic example of policy, not demand, driving practice. Since the primary resource for low income housing development is the LIHTC with its specific income targeting requirements, housing developers have gained expertise in building housing that serves the people at the 50-60% AMI level. Only when coupled with operating cost resources, do new LIHTC properties help fill the gap. LIHTC developers have established a model that works and in the absence of new policy that incentivizes them to create new models, this is what they will continue to do.

The NHTF was established to meet the demand for rental homes affordable for extremely low-income households, to incentivize new models. The NHTF is a new program to be administered by HUD. Funding will be distributed to states by formula based on need. The states will make grants to capable developers, who will submit applications to the designated state agency. At least 90% of the funds must be used for rental homes and at least 75% of the rental homes must be affordable to extremely low-income households. Most NHTF grants are expected to be used in conjunction with LIHTCs and other production resources so that a portion of units in new development will be more deeply targeted.

NHTF grants can also be used for preservation and rehabilitation of rental homes that meet the income targeting criteria.

**Recommendation 8.1: Expedite the completion of the NHTF regulations.** The NHTF statute requires that HUD complete the regulations for the distribution formula by July 30, 2009. HUD staff expects to have all regulations ready by that date. Earlier issuing of the regulations may be possible.

**Recommendation 8.2: Require that regulations mandate that all homes produced or preserved using NHTF dollars meet all "green" standards.**

**Recommendation 8.3: Assure that the economic recovery package includes the requested initial capitalization amount for the NHTF of \$10 billion, which has been requested to be included in the economic recovery package.** The challenge will be to solidify sufficient funding for the NHTF for it to produce on the scale that is necessary to fill the gap. The goal is 1.5 million units produced or preserved over 10 years.

**Recommendation 8.4: Make 100,000 new project-based vouchers available to be a part of the package to be distributed by the states for use with NHTF units that need additional operating subsidy.**

**Recommendation 8.5: Initial funding for the NHTF was to have come from contributions from Fannie Mae and Freddie Mac, but has been temporarily suspended due to the current financial crisis at the government-sponsored enterprises (GSEs).** Other potential dedicated sources of revenue are various FHA revenue streams. Several others are in development. Securing dedicated sources of funding necessary to produce, preserve, or rehabilitate 1.5 million rental homes affordable to extremely low-income households should be a top priority for the new HUD Secretary in his first two years.

#### *Motivate Investment Topic 6: Improved Coordination Between HUD and LIHTC Program*

For over two decades, the LIHTC program has had a remarkably successful track record in combining private and public investment in the creation and preservation of approximately 2,000,000 units of affordable, rental housing.

Nevertheless, users of the program are often daunted by its complexity. Others observe that the tax credit program, absent additional government subsidies, does not provide sufficient capital to fund the production or preservation of housing for households earning less than 30% of income. Still others are concerned that the low-income housing tax credit, as currently structured, is difficult to use in mixed-finance or middle-income housing.

The Department should, over time, become more conversant with the existing tax credit program and request that current stakeholders be consulted on how to make the program less complex. In particular, HUD should consider how its own subsidy and insurance programs can make the credit become more useful in the creation and/or preservation of very low- and middle-income housing.

**Recommendation 9: Consider how HUD's programs can make the LIHTC more efficient and useful for low- and middle-income households and for mixed-finance properties.**

## **PRESERVATION OF AFFORDABLE HOUSING**

The large and critical stock of existing affordable properties is controlled by long-term stewards from the non-profit and for-profit industry who keep the housing affordable and, to the extent of financial support, maximize the supportive services. Policies that support these owners and encourage the preservation of this housing build a stronger capital base and allow them to deploy their resources flexibly. This introduction would be more helpful if it were extended to include a description of what your recommendations are trying to fix and how generally they will ameliorate any existing inadequacies.

### **A. First 100 Days Strategy – Preservation**

#### *Preservation Topic 1: Strengthen Project-Based Section 8 Contracts*

*Background:* Project-based Section 8 is an important tool for borrowers, tenants, and local jurisdictions to provide quality affordable housing. The affordable housing investment community is unable to make investments in rural communities or in severely distressed communities without rental subsidy, even in the absence of must-pay debt in the transaction.

The current program needs significant improvements. It should be easier to move project-based contracts from failing projects to new, better located projects. Payments, of course, need to be paid reliably without months-long gaps. Section 8 contracts should be extended at least 20 years or to the affordability period for tax credit projects. Even with 20-year contracts subject to annual appropriation, HUD actions over recent years in curtailing Section 8 funding necessitate more to enable lenders and investors to finance Section 8 assisted housing. Current market constraints could be met by a commitment upon signing of a Section 8 contract – and not subject to annual appropriation – for a

funding of two times the annual contract amount to a project to enable its transition to tax credit rents at any point prior to the 20-year life of the contract should HUD cease to provide continuing funding.

Revised Section 15.8 of the Section 8 renewal guide should be rescinded. It requires that non-profit general partners in a tax credit transaction be limited to the lower of market or tax credit rents, which thus reduces any insured mortgage.

**Recommendation 10: Make 20-year project-based Section 8 contracts available again and reliably funded.**

## **B. Mid-Term Strategy – Preservation**

### *Preservation Topic 2: Facilitate Financing of Preservation Transactions*

*Background:* One reason that HUD 202 refinances and other preservation deals are often not viable is that, when financed with 4% LIHTCs and tax-exempt bonds, there is not enough capital for the comprehensive rehabilitation needed to fully recapitalize the deals. Too much of the refinance is dedicated to paying off the existing HUD mortgage

**Recommendation 11: Make soft sources available to preservation transactions and make it easier to subordinate existing HUD debt to improve viability of such projects refinances.**

### *Preservation Topic 3: Administrative Actions to Encourage Preservation of Affordable Housing*

There are a number of administrative and legislative actions that the working group strongly recommends the incoming Administration consider in its first year that will strongly encourage the preservation of affordable housing. We have included an extended list of important recommendations in Addendum 2.2 to further advise the incoming HUD leadership team.

The recommendation, considered together, will bring a department-wide focus to the preservation of affordable housing. The detailed discussion in Addendum 2.2 of the recommendations outlines the steps the new leadership must take to set this priority. In brief, these administration and legislation recommendations are:

#### *Administrative Recommendations:*

**Recommendation 12.1: Model leadership on preservation at every level of HUD.**

**Recommendation 12.2: Solicit input on policy changes and opportunities to improve preservation practices.**

**Recommendation 12.3: Approve rent increases for owners of Section 221(d), Section 236, and Section 202 elderly properties.**

**Recommendation 12.4: Revise regulations and HUD handbook to allow project income distributions to non-profit owners on the same basis as limited distribution for-profit owners.**

**Recommendation 12.5: Use existing discretion to provide rent increases, when authorized and justified by the market, to encourage recapitalization and continued owner participation, and the transfer to non-profits of at-risk properties.**

**Recommendation 12.6: Honor the non-profit incentives in the Mark to Market program and end the practice of requiring repayment of mortgage restructuring notes as a percentage of the developer fee earned by a non-profit purchaser.**

**Recommendation 12.7: By general policy, provide tenant protection vouchers on a one-for-one replacement basis for all lost or converted affordable units, not just occupied units.**

**Recommendation 12.8:** By general policy, make 20 year Housing Assistance Payment (HAP) contracts, subject to appropriations, available in preservation sales and refinancings, regardless of when the current contract will expire.

**Recommendation 12.9:** By general policy, provide the tools to preserve state-HFA financed projects.

**Recommendation 12.10:** By general policy, permit the assumption and subordination of Section 202 loans, Flexible Subsidy loans, and other loans where warranted by the needs of the property or residents and reverse the discredited OGC opinion limiting assumption of Section 202 loans by a non-profit.

**Recommendation 12.11:** Revise the Section 202 Use Agreement required in preservation sales or refinancing, which now bars the owner from charging rents above 30% of income even when Section 8 is not renewed or funds are not appropriated.

**Recommendation 12.12:** By general policy, but on a case-by-case basis in field offices, allow affiliated owners in the same state to merge or cross-collateralize loans in preservation sales or refinancings of small properties and Section 202 properties.

**Recommendation 12.13:** By general policy, but on a case-by-case basis, empower field offices to determine that there are chronic vacancies in the efficiencies of a particular property and allow the units to be combined and reduced and any excess Section 8 project-based assistance be transferred.

**Recommendation 12.14:** Remove the 7.5% ceiling on secondary seller financing in a preservation sale or refinancing using Section 223(f) insurance.

**Recommendation 12.15:** Revive cities' right of first refusal for disposition sales by interpreting the Deficit Reduction Act of 2005 to allow consideration of repair or rehabilitation costs in determining market values for HUD-owned buildings and HUD-held loans.

**Recommendation 12.16:** By general policy, but subject to case-by-case review in field offices, allow the use of residual receipts for rehabilitation projects in cases where residual receipts are held.

**Recommendation 12.17:** By general policy, but on a case-by-case basis in field offices, allow owners to transfer residual receipts and replacement reserves from one property to another property owned by an affiliate where necessary.

**Recommendation 12.18:** By general policy, implemented by the field offices, exercise its affirmative obligation under Section 250(a) to make sure that prepayments are not allowed where it will result in the loss of necessary affordable housing.

**Recommendation 12.19:** Use the authority conferred by Section 215 of the FY 2008 HUD Appropriations Act and Section 8bb to allow owners to transfer Section 8 authority to other properties when a property is obsolete.

**Recommendation 12.20:** By general policy, but on case-by-case basis in field offices, in the context of a preservation transaction, continue paying Interest Reduction Payments in their entirety, notwithstanding a reduction in total units, if such a reduction is warranted.

**Recommendation 12.21:** By general policy, direct field offices to encourage and support preservation purchasers willing to take over distressed properties by allowing them time to seek capital for rehabilitation rather than attempt to force immediate repairs and by providing appropriate accommodation in the Real Estate Assessment Center (REAC) and Transfer of Physical Assets (TPA) processes.

**Recommendation 12.22:** Ensure that rent increase requests are processed at or near the time of recapitalization, whether or not related to recapitalization, in the manner provided under HUD's current handbooks and procedures.

**Recommendation 12.23:** Regularly provide updated information on HUD’s public website about recent REAC scores, opt-out notices, and mortgage prepayment requests, and link this information to the existing database on HUD-assisted rental properties.

*Legislative Recommendations:*

**Recommendation 13.1:** Seek legislation to create a special type of project-based assistance intended specifically to promote the acquisition/rehab or refinancing by qualified preservation owners of properties with maturing mortgages and no or partial rental assistance.

**Recommendation 13.2:** Seek legislation to permit the Secretary, at an owner’s request, to authorize project-based assistance when an “eligibility event” would otherwise make the tenants eligible for enhanced voucher assistance.

**Recommendation 13.3:** Seek legislation to permit an owner to convert such assistance, which is not renewable, to Section 8 assistance, which is renewable.

**Recommendation 13.4:** Permit the Secretary, at an owner’s request, to authorize project-based assistance when an “eligibility event” would otherwise make the tenants eligible for enhanced voucher assistance.

**Recommendation 13.5:** Seek legislation to make 20-year, Sec. 8 contracts (subject to annual appropriations) available upon request to qualified preservation owners who wish to acquire/rehab or refinance these properties.

*Preservation Topic 4: Supportive Housing*

*Background:* Based on existing successful models that combine affordable housing with extended services for low- and middle-income families generally and populations with specific needs (e.g. veterans, the homeless), it is time the new Congress and Federal Administration take the next step and explore opportunities to scale-up existing, successful programs to include a much larger population. Successful models have not only increased family stability and reduced poverty by working with families and individuals to build human capital and increase their financial assets but have, as is well documented, reduced costs to public systems including emergency and long term health care, the penitentiary and welfare system. Further, affordable housing providers have documented decreases in tenant turnover rates and vandalism to properties, thus reducing the overall operating costs to affordable housing providers and HUD.

Key services may include financial literacy to improve credit scores and savings; adult education attainment, jobs skills training and job placement to increase income as well as education enrichment programs for children to ensure school success and completion. Yet, in order for a range and diversity of programs to be made available to residents with varying interest and degrees of need, it is time to reconceptualize how services are provided and explore moving toward strategic partnerships working among the federal agencies who define the scope of various programs, the local agencies who administer the programs and the housing providers who provide the platform from which residents can access services.

The Obama Administration has emphasized the Promise Neighborhood model to provide comprehensive and integrated supports to poor families, especially children. It can reshape large scale affordable housing efforts by funding a series of new developments co-located with strong neighborhood-based organizations with highly developed and effective human development programs. HUD’s leadership in an effort grounded in HUD-assisted communities could be complimented by efforts initiated from other focal points – whether they be educational environments supported through the Department of Education or human service providers support through the Department of Health and Human Services.

**Recommendation 14.1:** Create incentives for affordable housing providers by creating the funding necessary to provide expanded services through an enhanced LIHTC program and/or expand the Section 8 Housing Grant and Rental Assistance Contract.

**Recommendation 14.2: Incentivize service agencies, local government and affordable housing providers to partner with one another, through federal legislation and appropriations targeted specifically at housing providers and local agencies who work together to meet resident needs, reduce resident deprivation and demonstrate clear outcomes.**

**Recommendation 14.3: Make necessary changes to and increase funding resources for veterans generally and homeless veterans specifically in addition to similar changes to the HUD 811 program for the disabled.**

**Recommendation 14.4: Explore the possibilities for “charter housing,” designed for specific populations that face common issues and have common opportunities. Engage social entrepreneurs to bring to that housing their transformative ideas about education, health care, microenterprise and the like and secure the commitment and active participation of residents.**

**Recommendation 14.5: HUD would run a competition and select for funding up to 10 recently completed HUD-assisted affordable and mixed-income communities to participate in the Promise Neighborhood initiative.** One promising focal point could be some of the several hundred HOPE VI properties. A second effort would involve selecting ten communities for funding where there is a strong Harlem Children’s Zone-like program mix and capacity and where a residential platform could add a critical component to achieving long-term success.

## **CULTURE OF HOUSING AND URBAN DEVELOPMENT TERMS**

HUD has a proud history. However, over recent decades, the Department has become an inconsistent and unpredictable partner. Despite the dedication of many long-time HUD employees, it has become commonplace for its one-time stalwart supporters – non-profit and mission-driven for-profit developers, state and local governments, advocates, etc. – to blame HUD for blocking innovative affordable housing solutions. Further, decision-making at the 51 Hubs is often pushed up the chain of command to unusually high levels inside the Department. The resulting delay frustrates HUD’s key constituents and makes it difficult, if not impossible, for the FHA Commissioner and Assistant Secretaries to do their real jobs.

The common result of this dynamic is once-motivated staff losing the ability and, in some cases, impulse to be effective and efficient partners. The incoming leadership of HUD must take immediate steps to improve morale and encourage positive decision-making in the Field Offices. It must also develop a means of gathering feedback on performance and suggestions for process improvement to develop a culture of continuous learning.

There is a critical role for HUD to design the vehicles to meet the needs of the multi-family affordable housing development industry, allocating the resources to fund the programs and overseeing their implementation. Delegating all of these roles to state and local governments represents a major abdication of the federal role in assuring decent housing for all Americans. HUD staff must be empowered to lead this effort.

### **A. Mid-Term Strategy – HUD Culture**

#### *Culture Topic 1: Field Office Staff Outlook and Attitude*

*Background:* HUD has many bright, dedicated, and talented field-office staff. Some are already active readers of the MAP Guide and other HUD handbooks and believe that the production of rental housing for all income levels and urban revitalization are critical responsibilities of the federal government. If a transaction involves sensible risk, they will allow underwriting that encourages the development unless some handbook, regulation, or statute prohibits some modest change to standard underwriting. Or, they will find a sensible way to approve a handbook waiver. If the handbook doesn't say you can't, then you can.

Others only follow underwriting procedures that are specifically permitted in the handbooks, regulations, and statute. If the handbook doesn't say you can, then you can't. Staff needs to be encouraged to have a sense of reasonable real estate risk, or reasonable mitigation of risk, and be encouraged to support development. If they are shown that taking

risks, encouraging urban and suburban development, and providing rental housing are as important to their personal careers as protecting themselves from negative feedback, if those who take risks are professionally rewarded or publicly congratulated, morale will improve and production will follow.

In addition, a team from HUD Central, willing to meet in the field offices with stakeholders and staff (separately and together), could help promote resolution of industry problems.

If all handbook sections were marked to show which provisions are statutory (changed only by Congress), regulatory (waived by the Federal Housing Commissioner), or handbook guidance (waived at the field office level or HUD Central level), field-office staff would know how far their decision-making authority extended.

**Recommendation 15: Address staff morale and positive decision-making among field office staff.**

*Culture Topic 2: Continuous Feedback and Commitment to Improvement*

*Background:* The healthcare underwriters at HUD have been grouped into a new program called Section 232 LEAN which is modeled after the Toyota model of continuous improvement. They encourage regular, specific feedback, and questions from lenders and borrowers.

Multi-family production and asset management would benefit from a similar approach. The ability to email or post suggestions that would be rapidly answered by a responsive decision-maker on how to improve the process, would be very helpful. A feedback system works now, with industry meetings and visits back and forth between HUD staff and stakeholders, but a commitment to rapid continuous improvement is missing at HUD Central for the multi-family programs. The clearance process for minor improvements takes months and years.

**Recommendation 16: Solicit continuous feedback from stakeholders and reinforce commitment from HUD central to improvement.**

## ADDENDUM 2.1

### MID-TERM STRATEGY – Reform the Federal Housing Administration (FHA) Recommendations

#### *FHA Topic 2: Reenergize Multi-Family Insurance Programs*

##### *Administrative Recommendations*

#### **Recommendation 2.1: Make it a Federal responsibility to produce a Federal housing program.**

The industry occasionally speculates about devolving all the U.S. Department of Housing and Urban Development (HUD) multi-family insurance programs down to the states for implementation. The assumption is that State agencies are less encumbered by a large bureaucracy and can deliver housing more quickly. Experience with the low-income housing tax credit program indicates that, for many States, neither of these assumptions is true. The country has 50 different ways to allocate tax credits and tax-exempt bonds. The programs are frequently slow, cumbersome, and fraught with political considerations. Developers, lenders, and syndicators who work in more than one state have multiple application requirements to learn. Some states require that their allocation of federal tax credits or federal tax-exempt bonds be given to borrowers who also use their State debt programs, thus becoming expensive sole-source providers. States should be prohibited from restricting the use of federal resources to projects using State debt or credit enhancement. The country needs one, consistent federal multi-family housing delivery system, housed at HUD. HUD's field offices are in place and should be improved not abandoned. The mortgage bankers who specialize in HUD-insured mortgages represent a large, well-informed industry already at work promoting the HUD programs and should be viewed as an important asset.

#### **Recommendation 2.2: Correct Davis-Bacon wages.**

All HUD insurance programs for new construction or substantial rehabilitation require payment of Davis-Bacon wages. Davis-Bacon wages are supposed to be the prevailing wages paid in the market. The Labor Department's method of collecting data relies on paper surveys frequently completed by union representatives. The results tend to skew wages rates toward union scale and do not accurately reflect wages paid in the wider market. Nevertheless, residential wage rates paid for buildings for four or fewer stories frequently do reflect actual wages paid in the market. The problem arises at the Labor Department's definition of commercial buildings at five or more stories. Local jurisdictions in the Mid-Atlantic region, for example, now define residential buildings, allowing less expensive stick-built construction, as five or fewer stories. Residential wage rates should apply to all new construction of five or fewer stories and to all substantial rehabilitation of buildings of any height. In addition, ancillary facilities including residential parking garages of any cost and retail/commercial space costing less than 20% of total project cost should be allowed at the wage rates of the residential part of the project.

#### **Recommendation 2.3: Restore project-based Section 8 contracts.**

Project-based Section 8 contracts need to be available again and reliably funded. Project-based Section 8 is an important tool for borrowers, tenants, and local jurisdictions to provide quality affordable housing. The current program also needs a few improvements. It should be easier to move project-based contracts from failing projects to new, better located projects. Payments, of course, need to be paid reliably without months-long gaps. Section 8 contracts should be extended at least 20 years or to the affordability period for tax credit projects. With confidence that Section 8 will be available, subject only to annual appropriations, syndicators for tax credit transactions would probably be confident enough to allow underwriting at the market rent allowed by Section 8, even if market rent is higher than tax credit rents. This “overhang” is used to underwrite FHA-insured mortgages and is an important source for tax credit transactions. Revised Section 15.8 of the Section 8 renewal guide should be rescinded. It requires that non-profit general partners in a tax credit transaction be limited to the lower of market or tax credit rents, which thus reduces any insured mortgage.

#### **Recommendation 2.4: Authorize automatic prior participation clearance, after application and approval, for frequent participants in HUD programs.**

The project inspection and participation clearance processes at HUD have become enormously bureaucratic and cumbersome and have had the effect of making participation in HUD financing programs much more difficult for all firms and particularly those with substantial holdings and experience with the department. The “gotcha” mentality that often raises a field office staff disagreement to a delay in processing further transactions for a HUD user is totally dysfunctional. HUD should establish a procedure for annual authorization of frequent participants in HUD programs and automatic clearance for each transaction after approval of that annual application for the following year. This process should be carried out in Washington. HUD should also set a 3-tier limit to the number of organizational tiers that must complete the Form 2530, establish a set of timelines to streamline the 2530 process and assign to each local 2530 application one field agent who is responsible for processing that application through both the field office and the headquarters review.

**Recommendation 2.5: Encourage preservation of affordable housing.**

By general policy, implemented by the field offices, HUD should use its regulatory and financial authority over properties and owners with chronic deficiencies to promote preservation, rather than to terminate Section 8 and make preservation impossible. HUD should use its existing authority to require management improvements, changes in management companies, encourage transfers or deeds in lieu of foreclosure, and ensure that foreclosed properties are sold with project-based assistance intact to maximize the opportunity for preservation. Make foreclosure the last alternative rather than the first.

**Recommendation 2.6: Assure quality of buyers of HUD troubled properties.**

By general policy, implemented by field offices, HUD should comply with the intent of Section 219 of P.L. 108-199 and other preservation laws by ensuring that potential buyers of HUD troubled properties are qualified preservation buyers with track records of preserving affordable rental housing, a commitment to preservation for the benefit of low- and middle-income tenants, feasible business plans for the housing they are purchasing, and a record of substantial compliance with housing regulations and codes.

**Recommendation 2.7: Allow contingencies for new construction.**

HUD currently allows a contingency for substantial rehabilitation projects, but not new construction. Contractors increase their trade payment breakdown line items to cover unforeseens on new construction. Underwriting would be clearer if HUD allowed a new construction contingency of 5% of the construction contract amount.

**Recommendation 2.8: Allow the option of balloon mortgages and lower floaters.**

HUD now permits only long-term, fixed rate mortgages. Shorter term mortgages (for example, 18 years or the shortest term of the affordable use restrictions, at the option of the borrower) would bring the obtainable interest rate down the yield curve and facilitate new transactions. Lower floaters for tax-exempt bond projects are also very helpful right now for the same reason; the interest rate is lower down the yield curve.

**Recommendation 2.9: Correct the annual contribution to reserves for replacement to \$250 per unit per year.**

HUD uses .6% of structures (which can now reach more than \$1,000 per unit per year for new construction with structured parking) to calculate the annual contribution to reserves, which is included in operating expenses for underwriting. Substantial rehabilitation requires .4% of the mortgage (which is often a very low amount). The multi-family industry and most lenders recognize that it is really too expensive to reserve enough money annually through the operating budget to replace all building components when they reach the end of their useful lives. Most properties refinance in 15 years to obtain funds for repairs. The industry standard contribution is \$250 per unit per year. HUD should correct the required annual contribution to \$250 per unit per year for both new construction and substantial rehabilitation projects. Market rate properties spend more than this sum anyway to remain competitive in the market.

**Recommendation 2.10: Keep to the Multifamily Accelerated Processing (MAP) time frames.**

Some field offices keep to the 45 or 60 day review periods but many do not. Those that do not complain of being overwhelmed and understaffed. Nevertheless, HUD will become an increasingly important source of debt in the next 2-3 years and has an important role to play in helping the country out of the current recession. The program needs to be predictable, reliable, and timely. Even shorter underwriting reviews would be better.

**Recommendation 2.11: Release cash flow monthly.**

HUD has a long-standing policy of allowing owners to take cash flow once a year following the annual audit. This system is an old-fashioned and cumbersome attempt to keep properties from defaulting, but does not actually achieve

that goal. Properties default whenever they cannot continue to pay their debt service. Monthly release of cash flow makes HUD-insured mortgages more attractive to equity providers.

**Recommendation 2.12: Allow more retail/commercial space in Section 221d properties.**

HUD now allows retail/commercial space of 10% of gross square footage and 15% of gross income in Section 221d properties. For projects located in areas of concentrated revitalization, Section 220 allows 20% of gross square footage and 30% of gross income. If Section 221d allowed larger retail/commercial areas, important urban mixed-use properties could be developed, even if they are not located in areas of concentrated revitalization.

**Recommendation 2.13: Define elderly as age 55.**

The Fair Housing Act and the Housing for Older Persons Act (HOPA) both define “elderly” as age 55 or older. The National Housing Act defines “elderly” as age 62. HUD has two multi-family insurance programs for providing elderly housing. Section 221d allows elderly families (one person in the household is age 62 and everyone else can be of any age, including grandchildren). Section 231 allows 50-100% of the residents to be age 62, thus allowing elderly-only properties. Most zoning requirements follow the Fair Housing Act and HOPA. The National Housing Act should be conformed to Fair Housing and HOPA.

**Recommendation 2.14: Correct Section 231 underwriting.**

Section 231 works fine for new construction, but not for substantial rehabilitation. The Section 231 program for substantial rehabilitation should be corrected to allow “as is” value in the replacement cost mortgage. It now allows the lesser of “as is” value or outstanding indebtedness, thus discriminating against current owners who have paid down their debt. The 221d programs were corrected about 20 years ago to allow “as is” value in the replacement cost mortgage for all owners. The Section 231 program should follow suit.

**Recommendation 2.15: Modernize ground leases.**

HUD accepts ground leases as acceptable site control for insured mortgages. The underwriting should be modernized to recognize value for a borrower's leasehold interest. In a perfect ground lease, the landlord would be paid over time sums which, when presented valued, would exactly equal the “as is” value of the ground. Ground leases are seldom this perfect. While no borrower should pay more for a ground lease than the “as is” value of the ground, landlords are frequently willing to take less. Value thus accrues to the leasehold interest of the borrower. HUD should correct Section 7.16 of the MAP guide to recognize leasehold value in the replacement cost mortgage. HUD should also not require conversion to fee simple at a sum specified at construction loan closing in the event of default for for-profit landlords (a waiver of this conversion requirement is available for public landlords).

**Recommendation 2.16: Correct Master Lease underwriting requirements.**

Properties that qualify for a variety of tax credits are more economic if a master landlord takes the tax credits and is a separate entity from the Mortgagor. HUD issued guidance for master leases on March 3 and March 5 which opened HUD underwriting to allow for Master Leases. The guidance, however, contains a few onerous provisions including withholding the developer fee and surplus cash until the project has achieved sustaining occupancy for 2 consecutive years. We understand that HUD is working on and needs to complete industry-acceptable revisions.

**Recommendation 2.17: Allow Firm Commitment applications with less than 100% plans, specs, and costs.**

HUD will not accept an application for Firm Commitment for new construction or substantial rehabilitation without 100% plans, specs, bid costs, and a thorough review by a third party. This requirement adds months to the application process. If HUD would accept 75-80% plans, specs, and reasonable costs for the Firm Commitment application, a reasonable cost-limited mortgage could be determined. 100% plans, specs, costs, and a third party review would become a closing requirement. Mortgage calculations are reprocessed anyway when the final interest rate is known. This reprocessing could include both the debt service calculation and the final cost calculations.

**Recommendation 2.18: Correct mortgage insurance premium (MIP) for Section 223f.**

The current statutory requirement of 1% initial MIP for Section 223f properties is too high and the rate should be adjusted to closer to .5%.

**Recommendation 2.19: Allow MAP underwriting for Section 241 loans.**

Section 241 allows secondary loans for repairs to be insured by HUD as long as the first mortgage is also insured by HUD or if the proceeds are to be used for energy improvements. This loan program should follow MAP underwriting requirements and be added to the MAP Guide.

**Recommendation 2.20: Allow meal service in Section 231 properties.**

A new trend in housing the independent elderly includes simple meal service with a rental apartment. HUD does not currently permit meal service. HUD should allow mandatory meal service without requiring State licensing as an assisted living facility.

**Recommendation 2.21: Allow construction on sites deemed residentially safe by the States.**

HUD has many environmental restrictions that prevent construction in older urban areas. These restrictions prohibit construction on sites that have active monitoring wells, nearby cell phone or TV towers, or propose to cap contaminated soil. These environmental conditions should be allowed if the State or local regulatory agency, delegated the responsibility by EPA, deems the site safe for residential construction.

**Recommendation 2.22: Allow non-profits to benefit from payment in lieu of taxes (PILOTS).**

HUD requires that tax abatements run with the land, not the non-profit legal status of the sponsor, in order to take tax abatements into account in underwriting. The two exceptions are tax credit projects which receive tax abatements by virtue of a non-profit general partner or Section 202 refinances that already have tax abatements by virtue of a non-profit ownership. All tax abatements given to non-profits should be recognized in the underwriting. HUD prohibits non-profit tax abatements from being recognized because, in the event of default, HUD wants a project that could be sold to either non-profit or for-profit borrowers with the same economics (i.e. underwritten with full real estate taxes). There are enough non-profit borrowers in the market to find borrowers for these properties. Non-profit buyers are also more likely to keep the properties affordable.

*Legislative Recommendations*

**Recommendation 3.1: Set aside mortgage insurance premiums as a Housing Trust Fund.**

The Trust Fund would be administered by HUD and allocated through the field offices rather than using them to keep the mortgage insurance fund solvent, which should not be refunded to Congress.

**Recommendation 3.3: Increase per unit statutory limits by a construction inflation factor.**

Construction costs have increased dramatically in the last five years, particularly in urban infill areas, so that many otherwise financially feasible rental mortgages are artificially increased to the maximum per unit dollar amount allowed by the statute and made financially infeasible. Statutory limits mortgages are first derived from dollar limits published by Congress, inflated by the consumer price index annually, multiplied by a high cost factor, and complicated by complex addition of “costs not attributable to the dwelling unit,” which cause many additional calculations and still do not support projects in urban or high-cost areas. Statutory limits were designed to keep HUD's lending in the affordable housing arena, but many important high-end, mixed-use, mixed-income urban development projects in emerging areas are prevented by low statutory limits mortgages. The dollar limits published by Congress should inflate by a construction cost inflation factor, not the consumer price index.

## ADDENDUM 2.2

### MID-TERM STRATEGY – Preservation Recommendations

#### *Preservation Topic 3: Administrative Actions to Encourage Preservation of Affordable Housing*

##### *Administrative Recommendations*

**Recommendation 12.1: Model leadership on preservation.**

Provide guidance from Washington through top-down, explicit leadership on preservation, so that all U.S. Department of Housing and Urban Development (HUD) offices understand that they have a mandate from the Secretary to preserve affordable housing, know the available tools, are encouraged to use them, and have discretion to adapt them to the needs of specific properties and preservation transactions.

**Recommendation 12.2: Solicit input on policy changes and opportunities to improve preservation practices.**

Reach out to residents, managers, owners, and developers of affordable rental housing to develop best practices.

**Recommendation 12.3: Approve rent increases for owners of Section 221(d), Section 236, and Section 202 elderly properties.**

Approve 100% Section 8 rents when authorized and justified by the market, to encourage recapitalization and to provide for needed property improvements and continued owner participation.

**Recommendation 12.4: Revise regulations 24 C.F.R. §§ 236.10, 880.205(a), 881.205(a), 883.306(a), and HUD handbook 4560.1 § 3–6(E) to allow project income distributions to non-profit owners on the same basis as limited distribution for-profit owners.**

By general policy, allow non-profit owners to receive distribution of proceeds from sale or financing of assisted multi-family housing projects.

**Recommendation 12.5: Use existing discretion to provide rent increases, when authorized and justified by the market, to encourage recapitalization, continued owner participation, and the transfer of at-risk properties to non-profits.**

One simple and effective example: rescind the recently promulgated counter-productive changes to Chapter 15 of the Section 8 Handbook (which discouraged the use of tax credits on HUD assisted properties and raised uncertainties about HUD's available resources) and expand on the original concept of promoting non-profit preservation-based transfers by a) reducing uncertainty about potential HUD resources and b) allowing access to market rents on both to-be-improved properties and Housing Finance Agency financed properties.

**Recommendation 12.6: Honor the non-profit incentives in the Mark to Market program and end the practice of requiring repayment of mortgage restructuring notes as a percentage of the developer fee earned by a non-profit purchaser.**

HUD should also extend its self-imposed limit on the period to assign or forgive second and third mortgages for properties restructured under Mark to Market from the current three years to five years in order to facilitate the long-term preservation of more of these properties.

**Recommendation 12.7: By general policy, provide tenant protection vouchers on a one-for-one replacement basis for all lost or converted affordable units, not just occupied units (rescinding limitations such as those contained in PIH 2006-5).**

**Recommendation 12.8: By general policy, make 20-year Housing Assistance Payment (HAP) contracts, subject to appropriations, available in preservation sales and refinancings, regardless of when the current contract will expire.**

**Recommendation 12.9: By general policy, provide the tools to preserve state-Housing Finance Agency (HFA) financed projects.**

- Clarify that HUD will continue to provide project-based Section 8 upon prepayment of such a property.
- Rescind the generally discredited 2002 HUD Office of General Council (OGC) opinion stating that Section 8 contracts on state-HFA financed properties terminate upon HFA mortgage prepayments.
- Allow owners of state-HFA financed properties the right to mark up to market prior to contract expiration in exchange for an extended Section 8 commitment subject to appropriations.

**Recommendation 12.10: By general policy, permit the assumption and subordination of Section 202 loans, Flexible Subsidy loans, and other loans where warranted by the needs of the property or residents in order to facilitate preservation and rehabilitation and reverse the discredited OGC opinion limiting assumption of Section 202 loans by a non-profit controlled limited partnership.**

**Recommendation 12.11: Revise the Section 202 Use Agreement required in preservation sales or refinancing, which now bars the owner from charging rents above 30% of income even when Section 8 is not renewed or funds are not appropriated.**

**Recommendation 12.12: By general policy, but subject to case by case review in field offices, allow affiliated owners in the same state to merge or cross-collateralize loans in preservation sales or refinancings of small properties and Section 202 properties.**

**Recommendation 12.13: By general policy, but subject to a case by case determination, empower field offices to determine that there are chronic vacancies in the efficiencies in a particular property and allow the units to be combined and reduced and any excess Section 8 project-based assistance to be transferred.**

**Recommendation 12.14: Remove the 7.5% ceiling on secondary seller financing in a preservation sale or refinancing using Section 223(f) insurance.**

**Recommendation 12.15: Revive cities' right of first refusal for disposition sales by interpreting the Deficit Reduction Act of 2005 to allow consideration of repair or rehabilitation costs in determining market values for HUD-owned buildings and HUD-held loans.**

**Recommendation 12.16: By general policy, but subject to case-by-case review in field offices, allow the use of residual receipts for rehabilitation projects in cases where residual receipts are held.**

**Recommendation 12.17: By general policy, but subject to case by case review in field offices, allow owners to transfer residual receipts and replacement reserves from one property to another property owned by an affiliate where necessary to meet the physical or financial needs of the second property.**

**Recommendation 12.18: By general policy, implemented by the field offices, exercise its affirmative obligation under Section 250(a) to make sure that prepayments are not allowed where the prepayment will result in the loss of necessary affordable housing.**

**Recommendation 12.19: Use the authority conferred by Section 215 of the FY 2008 HUD Appropriations Act and section 8bb to allow owners to transfer Section 8 authority to other properties when a property is obsolete.**

**Recommendation 12.20: By general policy, but subject to case by case review in field offices, in the context of a preservation transaction continue paying Interest Reduction Payments in their entirety, notwithstanding a reduction in total units if such a reduction is warranted by changing market conditions, physical obsolescence, and other factors.**

**Recommendation 12.21: By general policy, direct field offices to encourage and support preservation purchasers willing to take over distressed properties by allowing them time to seek capital for rehabilitation**

rather than attempt to force immediate repairs and by appropriate accommodation in the Real Estate Assessment Center (REAC) and Transfer of Physical Assets (TPA) processes.

**Recommendation 12.22:** Ensure that rent increase requests are processed at or near the time of recapitalization, whether or not related to recapitalization, in the manner provided under HUD’s current handbooks and procedures.

**Recommendation 12.23:** Regularly provide updated information on its public website about recent REAC scores, opt-out notices, and mortgage prepayment requests, and link this information to the existing database on HUD-assisted rental properties. Protect enhanced voucher holders by clarifying that owners must accept enhanced vouchers and evict only for good cause, and by clearly prohibiting Public Housing Authority (PHA) re-screening of income-eligible tenants.

Please note that this recommendation has essentially been accomplished by HUD at present. The working group recommends that the Department maintain diligent updating.

### *Legislative Recommendations*

**Recommendation 13.1:** Seek legislation to create a special type of project-based assistance intended specifically to promote the acquisition/rehab or refinancing by qualified preservation owners of properties with maturing mortgages and no or partial rental assistance.

This action will protect tenants from rent increases and support a qualified preservation owner’s ability to leverage non-HUD resources to support the acquisition/rehabilitation or refinancing with renewed affordability of properties with maturing mortgages and no or partial rental assistance.

**Recommendation 13.2:** Seek legislation to permit the Secretary, at an owner’s request, to authorize project-based assistance when an “eligibility event” would otherwise make the tenants eligible for enhanced voucher assistance.

This action would enhance a qualified preservation owner’s ability to leverage non-HUD resources to support the acquisition/rehabilitation with renewed affordability of properties that would otherwise leave the affordable inventory.

**Recommendation 13.3:** Seek legislation to permit an owner to convert such assistance, which is not renewable, to Section 8 assistance, which is renewable.

This action would facilitate a qualified preservation owner’s ability to acquire/rehab or refinance a property with Rent Supplement/Rental Assistance Payment (RAP) assistance.

**Recommendation 13.4:** Permit the Secretary, at an owner’s request, to authorize project-based assistance when an “eligibility event” would otherwise make the tenants eligible for enhanced voucher assistance.

This action would enhance a qualified preservation owner’s ability to leverage non-HUD resources to support the acquisition/rehabilitation with renewed affordability of properties that would otherwise leave the affordable inventory.

**Recommendation 13.5:** Seek legislation to make 20-year, Sec. 8 contracts (subject to annual appropriations) available upon request to qualified preservation owners who wish to acquire/rehab or refinance these properties.

This action would facilitate the recapitalization or acquisition/rehabilitation by qualified preservation owners of properties with long-term (typically 40-year), fully funded Sec. 8 contracts that are set to expire within the coming years. Absent the ability to cancel the current HAP contracts, which have but a few years remaining, qualified preservation owners will be unable to maximize the leveraging potential of Low Income Housing Tax Credit (LIHTC)/bond resources. The current debt holder (mostly states but also some local agencies) would need to agree to cancel the current HAP contract.