NATIONAL AFFORDABLE HOUSING MANAGEMENT ASSOCIATION

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RURAL MULTIFAMILY HOUSING POLICY PRIORITIES 2012

In the last 18 months, the Department of Agriculture (USDA)—Rural Development (RD) office made a number of policy changes that NAHMA believes will negatively impact the Agency's ability to achieve its mission. These policies include:

1. Freezing the RD Management Fees in FY 2013;
2. Retiring Rental Assistance When an RD Property is Foreclosed Upon or an Owner Prepays the Mortgage; and
3. Ending Prepayment Incentives to Properties with RD Loans After the Transfer of the Property Has Closed.

We believe that RD should reconsider these policies, as they hurt RD's efforts to preserve affordable multifamily housing and provide quality, affordable housing to very-low income households in rural areas.

Furthermore, we encourage RD to continue pursuing policies that:

4. Provide Adequate Funding for RD Multifamily Housing Programs in FY 2014.

Please find more detailed descriptions of each NAHMA priority attached.

1. Freezing RD Management Fees in FY 2013.

On August 1, RD announced to the Field Offices that it would not be increasing management fees for rural housing properties in 2013. This is the second year in a row that RD has not increased the management fees. RD believes the freeze is justified because there was an increase in the improper payments audit error rate from FY 2011[1] to FY 2012[2] and the number of findings in the Multi-Family Integrated System (MFIS) from May 2011 to May 2012.

The improper payments audit rate in the Section 521 rental assistance program increased almost 2 percentage points between FY 2011 (1.48 percent) and FY 2012 (3.44 percent). RD attributed the majority of the errors to incomplete paperwork, including:

- No verification documents to support the amount of income reported;
- Tenant certifications were not signed or dated; and
- Incorrect tenant certification was provided to RD for review.

The number of MFIS findings also increased by 696 between May 2011 (6,113 findings) and May 2012 (6,809 findings). RD directly attributed the increase to management agents' submissions and responsibilities.

However, NAHMA strongly disagrees with RHS's rationalization for freezing management fees in 2013. It is both illogical and unfair to punish all management agents for the errors of a few. According to RD's Improper Payments Information Act (IPIA) audit, over 96 percent of all RD management agents are performing well. Only 3.44 percent of the materials examined had errors. We are unpersuaded that RD will achieve greater compliance by punishing the 96 percent of well performing agents rather than address the actual problems observed in the audit.

Moreover, RD has not provided information on the MFIS findings related to management agent submissions to the industry or O/As. We urge RD to share more information on the MFIS findings—such as the most common findings and the number of findings from previous years—so that industry stakeholders can work with RD to help reduce findings in the future.

Freezing management fees for the second year in a row will effectively reduce the funding available for management agents to ensure properties are in compliance with RD's regulations. Attachment 3-D of RD's Multifamily Housing Asset Management Handbook HB-2-3560 specifies the "Costs and Services To Be Paid from the Management Fee." Under Item L, overhead to the management agent includes:

- "Direct costs of insurance (fidelity bonds covering central office staff, computer and data coverage, general liability, etc.), directly related to protection of the funds and records of the borrower;"
- "Insurance coverage for Agents office and operations (Property, Auto, Liability, Errors and Omissions (E&O), Casualty, Workers' Compensation, etc.);" and
- "Travel of Agent staff to properties for onsite inspection, training, or supervision activities."

Attachment 3-D also directs O/As to use management fees to pay for "Attendance at meetings (including travel) with tenants, borrowers, investors, and/or RHS, HUD, HFA, or other governmental agency." Both travel and insurance costs have grown exponentially in the last several years. In fact, one NAHMA member stated that their travel costs associated with managing RD properties had increased

[1] The FY 2011 error rate reflects RD's review of the audit for 2010.
[2] The FY 2012 error rate reflects RD's review of the audit for 2011.

30 to 50 percent over the last three years due to the rising cost of oil. Therefore, freezing management fees is counterproductive to RD's goals of improving compliance.

Likewise, freezing the management fees creates an additional disincentive for good management agents to participate in RD programs. It is already incredibly difficult to operate RD properties effectively due to the growing costs, regulatory, and administrative burdens. The costs of items and services that must be paid from the RD management fees continue to grow each year. Now, competent managers will be even more reluctant to take on new properties and even fewer new management companies will want to participate in the RD programs. According to another NAHMA member, some O/As are considering leaving the RD programs altogether because of these difficulties. If they do opt-out of RD programs, it will hurt the Agency's efforts to preserve the existing portfolio and to house the very-low income families living in these properties.

In closing, NAHMA members are committed to working with RD to achieve regulatory compliance. Penalizing an entire industry for the errors made by less than 4 percent of its participants damages the public-private partnership between RD and the management agent community.

O/As cannot provide quality affordable housing without adequate resources. We hope that RD will engage O/As in the future to develop more practical policy approaches to address compliance issues. To that end, NAHMA encourages RD to further examine implementing a financial incentive policy—which rewards management companies that exceed minimum performance standards—in order to increase management agents' compliance and ensure the quality of the portfolio is maintained.

Therefore, NAHMA strongly urges RD to:

- **Reconsider its position on management fees, revise its policy materials, and provide an adequate increase in management fees for 2013 and beyond;**
- **Provide additional data on common MFIS findings;**
- **Engage stakeholders prior to implementing RD policy changes in order to find mutually agreeable solutions that improve O/A compliance; and**
- **Work with the industry to create a successful incentive-based system for management fees.**

2. Retiring Rental Assistance When an RD Property is Foreclosed Upon or an Owner Prepays the Mortgage.

In a May 18, 2011 unnumbered letter (UL) titled "Dynamic Servicing Strategies for the Multi-Family Housing Direct Loan Portfolio," RD announced that it would begin "retiring" rental assistance (RA) instead of reusing it when a property with RA is foreclosed on or the owner prepays the RD mortgage.[3] In the UL, RD specifically states, "Recapturing RA will reduce the budgetary expense of the program."

NAHMA is extremely concerned that, as of March 15, 2012, RD has "retired" 743 RA units.[4] We strongly believe that it is inappropriate for RD to "retire" RA in order to decrease the outlays for the Section 521 program. By taking RA away from properties, RD is effectively reducing the number of affordable housing units available to low-income families, which is contrary to the Agency's mission.

While existing tenants will still have access to vouchers or the option to transfer their RA[5], there are still several other families who are income-qualified for RD properties but cannot afford the rents without assistance. In fact, many NAHMA members have reported an increase in the number of long-term vacancies at unassisted RD properties because prospective tenants could not afford the rents.[6] These vacancies reduce the potential income to RD properties and make it very difficult to efficiently operate and preserve older projects.

In order to address this issue, NAHMA formed the Rural Housing Occupancy Working Group in April 2011. The group determined that transferring RA to or using tenant vouchers with unassisted RD units would help low-income households afford the rent and fill the vacancies at these properties. As a result, retiring RA not only reduces the overall number of affordable rental units available to low-income households, but it also takes away a valuable resource that the Agency could use to address the vacancy problems within its portfolio. In addition, recycling—instead of "retiring" the RA—would not only help very-low income households afford a safe place to live, but it would also help recapitalize and, thereby, preserve some of the older buildings in RD's portfolio. Therefore, retiring RA works against the Agency's efforts to preserve its portfolio.

Finally, existing tenants may also have difficulty finding affordable housing under this policy. If a tenant with RA cannot find a suitable RD property within or close to their community within four months of the mortgage prepayment, foreclosure, or disaster, they will lose their assistance. Furthermore, the number of tenant vouchers available is subject to appropriations. This means that there is a possibility that some eligible tenants may not receive a voucher. We are gravely concerned that this policy may ultimately lead to unintended consequences, which could result in more families being displaced and struggling to afford their housing.

NAHMA understands that RD is reviewing the May 18, 2012 UL "Dynamic Servicing Strategies for the Multi-Family Housing Direct Loan Portfolio." During this assessment, we strongly urge the Agency to reconsider this policy and reuse RA at other RD properties, in order to assist additional low-income households, instead of "retiring" it.

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[3] Rural Development, *Unnumbered Letter "Dynamic Servicing Strategies for the Multi-Family Housing Direct Loan Portfolio,"* Washington, DC: Department of Agriculture, May 18, 2011, 12-13.
[4] Provided by RD staff on a quarterly call with industry stakeholders.
[5]Tenants will still have the ability to take their RA with them if they move to another RD property within four months of the mortgage prepayment, foreclosure, or disaster situations. RD also notes that the voucher program is available to assist all low-income residents of Section 515 properties that are removed from RD's portfolio through foreclosure or prepayment, whether or not the tenants were receiving RA (Rural Development,13).
[6] Due to reduced income, job loss, and/or—particularly for the elderly and disabled—fixed income status.

3. Ending Prepayment Incentives to Properties with RD Loans After the Transfer of the Property Has Closed.

When owners decide to prepay an RD mortgage, RD is authorized to offer them incentives to keep these properties in the program. Often, RD offers owners incentives that will help them preserve the property and keep it affordable, including, but not limited to: rental assistance (RA), low-interest RD loans to recapitalize the property, increased returns to the owner, or the release of reserve accounts to the property. Because rents tend to go up after an owner prepays an RD mortgage, RD offers incentive RA to many properties for all of the units that have income-qualified households at the time of prepayment. This ensures that low-income tenants are not displaced and can still afford to live in the property.

However, RD has been slow to obligate prepayment incentives, particularly RA, and the waiting list for these incentives is long. During the waiting period, some owners have decided to sell or "transfer" their properties to new owners. Both the sellers and purchasers in these transactions heavily rely on the promise of incentives in order to make the transfer deals work.

Recently, RD changed its policy for issuing prepayment incentives in the May 14, 2012 unnumbered letter (UL) titled "Prepayment Clarifications and Related Issues." On page 3 of the UL, RD stated that it will no longer obligate prepayment incentives to a buyer/transferee of a project with USDA loans[7] when the project transfer has closed and the seller/transferor is the borrower who accepted the prepayment incentives for the project. RD explained that prepayment incentives are prohibited from being obligated to a property that contains restrictions because the buyer who assumes an Agency loan is required to execute a restrictive use agreement and properties with restrictive use agreements are not eligible for preservation incentives under Section 502 (c)(4)(C) of the Housing Act of 1949. Nevertheless, this new policy should not impact any prepayment incentives that are obligated to the property prior to the close of the property transfer.

NAHMA has been advised that the statute and regulations do not prohibit these types of transactions. Yet, we are concerned that many property transfers cannot wait until the incentives are obligated before closing the transaction. These transfer deals are typically accompanied by the receipt of low-income housing tax credits (LIHTCs) in order to recapitalize and preserve older properties. Tax credit deals have tight deadlines and often close before RD obligates the prepayment incentives. These deals are carefully crafted and the new buyers are assuming that they will receive the prepayment incentives as part of these deals. Without the prepayment incentives, many of these preservation-minded transfers could fall apart. We are concerned that RD's policy may jeopardize such transfers due to circumstances beyond the buyers' and sellers' control, such as obligation delays by the Agency or the lack of appropriations from Congress.

NAHMA is also concerned that the unintended consequences of this policy may harm the very low-income residents that RA is intended to help. Because of the restrictions signed by a borrower when a transfer is closed, there are no tenant protections available to help income-qualified families afford increased rents. Consequently, tenants must decide whether to struggle to pay the higher rents without any RA or to move out.

Nevertheless, we were interested to learn that RD will be using Section 515 appropriations to fund prepayment incentives, such as rental assistance (RA) and equity loans, instead of issuing a new construction NOFA for FY 2012. The decision was made in accordance with the June 2012 Supreme Court verdict for ***Salazar vs. Ramah***, which stated that if agencies had outstanding contracts and sufficient appropriations, they must fund those contracts. NAHMA agrees that it is imperative for RD to fulfill its prepayment contract obligations. These contracts keep RD properties in the program, help preserve older properties, and ensure that existing low-income tenants can afford to continue living in their homes.

Still, NAHMA does not believe these activities should be undertaken at the expense of the Section 515's primary purpose—new construction and rehabilitation. After funding the prepayment incentives, we

[7] Including, but not limited to, Section 515 and Section 538 loans.

understand that RD plans to use the leftover funding to rehabilitate older 515 properties or facilitate the sale of Agency properties to preservation-minded owners. While NAHMA strongly supports RD's efforts to preserve older Section 515 properties, we are concerned that any preservation efforts RD takes with these funds will be extremely limited in scope once the Agency fulfills its prepayment contract obligations. NAHMA is also very disappointed that RD will not be using any of the Section 515 funding for new construction in FY 2012. New construction helps provide critical housing to areas that have high concentrations of low-income families with worst case housing needs.[8]

Our members are very concerned that the new prepayment incentive policy may hurt RD's preservation efforts and will reduce resources available to assist low-income households. Therefore, NAHMA urges RD to:

- **Rescind the UL's guidance for prepayment incentives after the close of a transfer;**
- **Specify that prepayment incentives may continue to be allocated for all preservation-related transactions;**
- **Work with industry partners before implementing policies that could inadvertently harm preservation efforts;**
- **Inform the public of how the Agency will:**
  - **Distribute the FY 2012 Section 515 appropriations to fund existing prepayment incentive agreements and portfolio preservation efforts; and**
  - **Issue new prepayment incentive offers; and**
- **Consider requesting additional appropriations from Congress to fund the prepayment incentives going forward.**

[8] HUD defines "worst case housing needs" as very low-income renters with incomes below 50 percent of area median income who do not receive government housing assistance and who either paid more than one-half of their income for rent or lived in severely inadequate conditions.

4. Provide Adequate Funding for RD Multifamily Housing Programs in FY 2014.

RD's portfolio is in dire need of preservation, and it is extremely difficult to find private equity in rural areas to make these critical upgrades. Likewise, more families are finding it difficult to make ends meet and are struggling to afford rents in rural areas without some sort of rental assistance (RA). For these reasons, it is now more important than ever for the Obama Administration and Congress to support adequate funding for multifamily rural housing programs.

Section 515 Appropriations

NAHMA is very concerned by the proposed cuts to the Section 515 program for FY 2013 and the possibility of additional cuts in future fiscal years. The Obama Administration has already proposed zeroing out funding for the Section 515 program in its FY 2013 budget. The House and Senate have also suggested providing $31.2 million and $28.4 million for the Section 515 program in their respective FY 2013 Agriculture Appropriations bills. Each of these figures represent a significant cut to the program when compared to the FY 2012 appropriations level ($69.5 million). If Congress does reach an agreement on appropriations,[9] Section 515 funding will likely be limited in FY 2013.

In addition, the federal government will be under even tighter budget constraints in FY 2014 due to the discretionary spending caps in the Budget Control Act and the required sequestration beginning in January 2013. Because new construction and rehabilitation programs are easy targets for reductions, we worry that the Section 515 program will receive additional cuts in FY 2014 and beyond.

New construction of affordable rural housing decreased significantly due to the economic downturn and has not recovered, unlike other sectors of the housing market. The Section 515 program is one of the few resources available to help developers and owners finance new low-income rental housing and to preserve older buildings in rural areas. It is extremely important to use the program for its primary purpose—providing grants and loans for new construction and rehabilitation—in order to help these areas recover. Not only does this funding produce additional units and preserve existing housing in rural markets, it also creates much-needed jobs and investment opportunities in rural areas.

As a result, NAHMA strongly urges RD to:

- **Support sufficient funding for the Section 515 program in FY 2013;**
- **Request adequate funding for the program in the FY 2014 budget; and**
- **Issue a Section 515 NOFA in FY 2013.**

Funding for Other Rural Multifamily Programs in FY 2013

NAHMA was particularly pleased to see that the Obama Administration requested the full 12-months of funding for all Section 521 RA contracts at renewal ($907 million). We were also heartened to see that RD requested increased funding for the Section 538 loan guarantee ($150 million) and the Multifamily Housing Revitalization ($46.9 million) programs in the FY 2013 budget. These are critical programs that help preserve and recapitalize existing affordable housing, help very low-income residents in rural areas afford their rents, and provide jobs in local communities.

We understand that all of the $907 million in rental assistance requested by RD is for renewal and would urge RD to consider including in future budget requests RA for incentives.

However, the House and the Senate proposed cuts to some of these programs in FY 2013. Although the Senate's FY 2013 Agriculture Bill contained $907 million to renewal all rural RA contracts for their 12-month terms, the House proposed short-funding the program. The House provided only $889 million for the

[9] Congress has agreed on a six month continuing resolution, which will fund all government programs at FY 2012 levels through March 2013. This will give Congress additional time to consider its 12 appropriations bills for FY 2013, including the Agriculture appropriations.

Section 521 RA program in FY 2013, $16 million below the FY 2012 appropriation. However, short-funding impedes housing providers' ability to operate their rural properties. It also hurts properties' ability to meet their obligations for other federal programs—such as RD's Section 515 and Section 538 programs, Treasury's Low-Income Housing Tax Credit, and HUD's project-based Section 8 program—if they receive mixed-financing.

NAHMA was also disappointed to see both the House and Senate provided less than RD's budget request for the Multifamily Housing Revitalization program in their FY 2013 Agriculture Appropriations bills, $12.7 million and $27.8 million respectively. As discussed above, the RD portfolio is in desperate need of rehabilitation. Without adequate funding for the Section 515 and Multifamily Housing Revitalization programs, more properties will fall into disrepair and some will have to be taken offline, reducing the number of units available for the low-income households that need it most.

Nevertheless, we were pleased to see that both the House and Senate's FY 2013 Agriculture Appropriations bill contained $150 million for the Section 538 program. This program will allow RD to guarantee loans made by private lenders to develop new and rehabilitate existing affordable rural rental housing. These loans will help ensure that tenants who need affordable housing in rural areas have access to it and those currently living in older rural properties are not displaced.

NAHMA encourages RD to continue:

- **Urging Congress to fully fund the Obama Administration's budget requests for the Section 521 RA, Section 538, and Multifamily Housing Revitalization programs in FY 2013;**
- **Requesting full 12-month funding for all Section 521 RA contracts at renewal in FY 2014; and**
- **Requesting adequate funding for the Section 538 and Multifamily Housing Revitalization programs in FY 2014.**