



# **Council for Affordable and Rural Housing**

*Serving the Affordable Housing Needs of Rural America*

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**TESTIMONY OF WILLIAM C. SHUMAKER  
ON BEHALF OF THE  
COUNCIL FOR AFFORDABLE AND RURAL HOUSING  
BEFORE THE SUBCOMMITTEE ON HOUSING AND COMMUNITY  
DEVELOPMENT, HOUSE COMMITTEE ON FINANCIAL SERVICES**

**H.R. 4868, HOUSING PRESERVATION AND TENANT PROTECTION ACT OF 2010**

**March 24, 2010**

Madam Chairman and members of the Subcommittee, I am Bill Shumaker, the President of the Council for Affordable and Rural Housing. I am also Vice President of Provident Management, a full service real estate company that develops, owns and manages close to 80 affordable housing complexes with over 2000 units throughout Ohio and West Virginia.

I want to thank you and the Committee for the opportunity today to address issues surrounding federal rural housing programs, rural housing opportunities, and rural housing legislation under discussion. We appreciate your efforts, Chairman Frank's efforts and the efforts of the co-sponsors and the Committee for the introduction of H.R.4868, Housing Preservation and Tenant Protection Act of 2010. We believe that many of its provisions will help address issues faced by rural affordable housing providers. We believe several provisions could be made more effective, and we share general concerns voiced by other housing advocates.

CARH members house hundreds of thousands of low-income, elderly and disabled residents in rural America. CARH has sought to promote the development and preservation of affordable rural housing throughout its 30 year history as the association of for-profit, non-profit and public agencies that build, own, manage and invest in rural affordable housing.

The condition of our nation's housing stock, in general, has improved over the last thirty years, but affordability of that stock is a growing problem. In rural areas throughout the country, there continues to be an overwhelming need for both affordable and decent housing. The need for rental housing is even more acute. With lower median incomes and higher poverty rates than homeowners, many renters are simply unable to find decent housing that is also affordable. While the demand for rental housing in rural areas remains high, the supply, particularly of new RURAL housing, has decreased. This is in large part due to a reduction in federal housing assistance. Neither the private nor the public sector can produce affordable rural housing independently of the other. **It has been and should be a partnership.**

As any property ages, it requires more attention and periodic rehabilitation. Building systems begin to fail and need replacing at or after the fifteenth anniversary from construction or substantial rehabilitation. In some cases this has already begun to happen as the United States Department of Agriculture's (USDA's) Rural Development (RD) Section 515 rural multifamily housing and Section 514 farm labor multifamily properties are typically 30 years old and the vast majority have not been rehabilitated. These properties have suffered from federal funding shortages and statutory and regulatory barriers that exist and make preservation difficult. The portfolio is more exposed today due to the economic conditions that permeated this country in the later part of 2008. The portfolio for many years has relied on the Low Income Housing Tax Credit (LIHTC) program. Lack of investors in the LIHTC, particularly in rural housing has put this important segment of the affordable housing market even more at risk.

The Section 514 and 515 Programs, funded by private capital and government under Section 514 and 515 of the Housing Act of 1949, operates through a successful

public-private partnership. The 514 and 515 portfolio consists of 15,977 apartment complexes containing 452,610 units<sup>i</sup>, and comprises 50% or more of subsidized properties outside of many metropolitan counties and 9% inside metropolitan areas.<sup>ii</sup>

Past studies conclude that there are nearly 14 million families and elderly persons with critical housing needs, a significant proportion of which are rural residents.<sup>iii</sup> The burden of this need falls disproportionately on non-metropolitan areas.<sup>iv</sup> Consequently, federal housing programs must address non-metropolitan and rural housing needs more effectively. Any failure to do so will exclude a significant number of Americans from our national economy. Unfortunately, prior gains in addressing these housing needs through the Section 515 program are eroding, due in large part to an overall shrinking of the rental housing supply.

Funding shortages and regulatory barriers threaten the ability to operate, maintain and rehabilitate older buildings. Real estate of all types is periodically updated and rehabilitated as an essential and typical part of property operation and maintenance.<sup>v</sup> This is especially true of the subject multifamily and seniors housing apartment complexes, which are in constant use, and which successfully provide homes to hundreds of thousands Americans.

In 2002, RD, through its Housing and Community Facilities agency, estimated that 4,250 Section 515 properties with 85,000 units “will physically deteriorate to the point of being unsafe or unsanitary within the next 5 years.” At that time, RD estimated it would need \$850 million to maintain just this portion of the portfolio, and that as much as \$3.2 billion will be required for portfolio-wide rehabilitation.<sup>vi</sup> Little preservation progress has been made since 2002. Adjusted for inflation, the 2002 \$3.2 billion estimate is now approximately \$3.8 billion.

We believe that streamlining current procedures and creating flexibility in existing programs are the best ways to address existing properties. We categorically believe that maintaining the existing housing stock is more cost effective, and less expensive, than allowing that stock to deteriorate and be replaced with new housing. The prospect of a new housing program to replace these affordable units is highly remote; no comparable program has been created in over 30 years. Moreover, this portfolio constitutes a multi-billion dollar government investment. These properties are the government’s mortgage security, and the government has a strong interest in their continued maintenance and good repair. Most importantly, these units constitute a vital social resource by providing a decent home in which the elderly and families can live with dignity.

Prepayment and conversion to market-rate rents is not a realistic option for most of the Section 515 portfolio. Prepayment has been estimated to only reach about 3,900 of the more than 16,000 properties in the total portfolio. Only those properties have both (a) enough equity to make prepayment feasible and (b) the original right to prepay.<sup>vii</sup> Congress removed the prepayment right for the pre-1989 properties and replaced it with the Emergency Low Income Housing Preservation Act of 1987 (“ELIHPA”), which, as the title suggests, was supposed to be a short term solution. The process was intended to

swap owner equity for “incentive” payments and, in the process, extend low-income restrictions. However, Congress slashed funding for incentives, and never restored owner’s prepayment rights, leaving owners remaining in the program without the ability to receive a financial return on investments in the 515 program, creating a barrier to raising new capital.

Many properties are most needed as affordable housing, and do not have an independent economic purpose. In other words, even though a property is in good condition and otherwise marketable, its available market is limited to low-income persons by economic conditions, regardless of government regulation. But for government funding sources, either through loans, tax incentives and/or guarantees, such properties would not have access to enough capital to continue fulfilling their mission. Many other properties do have a highest and best economic use as other than affordable housing, but the contractual and regulatory restrictions close off the possibility of a commercial refinancing, and again, they need access to such government funding sources. In both instances we have been able to leverage public financing with private resources. That ability to leverage is now greatly diminished. Since the fall of 2008, lending and private equity investment in affordable rural housing has virtually ceased from the fallout of the credit shortage in the wider economy. We have seen the Administration’s policies bear fruit and affordable housing providers appear to have sustained their ability to preserve housing and provide jobs through different government programs provided in last year’s stimulus legislation, the American Recovery and Reinvestment Act of 2009. Early indicators for 2010 appear to indicate re-entry of private equity sources into the market place. However, that appears to be correlated with Community Reinvestment Act (CRA) needs. This appears to be creating a recovery for urban and suburban areas, but rural areas are not seeing even this recovery, our members report. This compounds the pre-existing hurdles rural housing faces in attracting commercial financing, namely the small size, community specific focus and remoteness of rural housing..

More importantly, the recession created turmoil among residents and applicants. CARH members report a material change where residents are moving to find work or moving into Section 515 properties as a last resort after losing jobs. We are greatly concerned that some current or former residents are at a tipping point towards homelessness.

We believe that any analysis of the Section 515 portfolio and its ability to provide residents with housing is driven by the financial status of the properties themselves, and options have been declining. RD has kept rents down to artificially low levels, even for affordable housing, about half of comparative HUD programs, and created processing barriers to rent increases. Rent processing problems have also resulted in owner returns not being paid or even budgeted. The owner’s return is never assured, but when budgeted, creates a minimal compensation for their efforts and serves as prudent underwriting to provide a contingency for successful operations. Owners have also found most of the original investment basis and tax benefits taken away through the Tax Reform Act of 1986. Finally, many investors also need to sell for estate planning or other reasons. This is particularly applicable to this portfolio, which has many properties with

individuals as general partners. After 20 years or so of operations, these people seek to retire or, increasingly, pass on.

Additionally, CARH members estimate that immediate and near term modernization needs for most of the portfolio range from \$15,000 per unit to as much as \$60,000 per unit, depending on location and area of the country. For example, members in Florida estimate immediate and near term needs at \$15,866 per unit, while members in New York and Ohio estimate needs at \$30,000 to \$60,000 per unit. These needs represent costs to properties currently performing but have not had capital to replace components for 30 years.

CARH believes that a great and financial commitment is needed for affordable housing preservation. While CARH and our members understand the budget constraints facing all government programs, we cannot support further reductions in the multifamily programs at the U.S. Department of Agriculture when the impact of reductions threatens the housing for low and moderate income families throughout the country.

For instance, the Administration's Fiscal Year 2011 budget request does not request funding for what has been RD's primary preservation program during the last several years. Madam Chairman, we know that this Committee has attempted to make the Multi-Family Housing Revitalization Program (MPR) permanent since it has operated as a demonstration program through the Appropriations Committees. However, one of the reasons for the agency's justification for not requesting funding is that the program is not permanent. We recognize that Title VIII of H.R. 4868 would do just that. We do however have major concerns that the agency in its budget notes that "the most cost effective and justified repairs have been achieved." This is plainly false. In fact, the Administration's budget statement is contradicted by RD's own conclusions in proposing and supporting the MPR program each year over the past four years when the agency set its goals at restructuring over 7,000 transactions. To date, more than 8,000 applications have been submitted. However, RD only obligated 400 transactions over four years, and it is unclear as to the exact number of transactions that have actually closed. The elimination of the MPR program would essentially eliminate any organized preservation program at RD. The Administration's budget also stated that the MPR program benefits owners, which is also false. The MPR program, while a good effort that CARH supports, is far from perfect. One defect is the failure to recognize or compensate owners for their efforts. Another defect are the potential tax affects of a mortgage restructuring.

From repairing aged roofs to providing units with air conditioning, improvements made to this vital resource greatly enhances residents' lives and creates jobs all over the country.<sup>viii</sup> Notwithstanding the significant cost of such rehabilitation, CARH members estimate that replacing this housing could cost five times rehabilitation, if not more. RD has advised CARH that it values this portfolio at \$11.5 billion. Without funds for needed rehabilitation and repair, these projects will not be able to maintain the required level of financial feasibility and meet resident needs. We believe that \$5 billion, or \$1 billion a year for five years is a reasonable investment to save this important housing stock in rural America.

USDA's funding commitment does not adequately reflect that MPR is RD's priority. Indeed, USDA could take advantage of credit reform rules, and has not done so. Most of the Section 515 mortgages that could be restructured under MPR were originated before credit reform. As such, RD should not need new budget authority to restructure most loans, but USDA has not allowed RD to proceed under existing budget authority.

One way we may be able to pay for a portion of the needed funds is with a new revolving loan program. We propose utilizing deposits in the Rural Housing Insurance Fund, not needed in the current fiscal year, to loan to eligible properties at the applicable federal rate of interest, currently floating around 4.5%. Half of the interest would be used to cover RD salaries and expenses to administer the program, and/or for a contractor to assist RD with asset management. The funds would be backed by a voluntary guaranty or pledge of Section 515 reserve funds from owners of participating properties. In exchange, the reserve accounts would receive the other half of the interest charged, providing additional reserves for 515 repairs. This proposal would more fully utilize the Rural Housing Insurance Fund, provide security for the Fund, and additional repair funds for Section 515 properties

The Section 521 Rental Assistance (RA) Program is an essential component of the Section 514/515 program. RA provides deep subsidy to very low-income residents by paying the difference between 30% of a resident's income and the basic rent required to operate the property. Sixty-three percent of 515 units are subsidized with RA. The RA Program must continue to provide sufficient funds for both current levels of RA and sufficient additional RA to support increasing program costs. Also, there needs to be a "first in line" for RA and override the administrative requirement giving preference to the most rent-burdened over otherwise eligible, needy residents who have waited for a longer period. More importantly, there needs to be additional RA to remove rent overburden, the condition of tenants paying more than 30% of income in rent, without reducing project operating income. Some Section 515 projects also utilize HUD Section 8 Rental Assistance. An alternative to additional RA would be expanded Section 8 for rural properties.

RD has been reluctant to commit resources to fund identified project capital improvements necessary to provide decent, safe and sanitary housing. That historical reluctance has depressed operating budgets below current project needs and forced owners to defer needed maintenance in some cases. As this reluctance stems in large part from 1490 USC(a)(1)(C)(i), which allows RD to require budgets that do not fully fund project needs, we propose amending 1490 USC(a)(1)(C)(i) to insert "capital needs" after "utilities" to read:

"the amount determined by the Secretary to be necessary to pay the principal indebtedness, interest, taxes, insurance, utilities, capital needs and maintenance. . . ."

One quick fix to make RA more efficient is to provide 20 year contracts, subject to annual appropriations. Not only would this reduce the costs associated with reprocessing contracts on an annual basis without increased appropriations, it would also

create more reliable subsidy. This will help attract potential investors and lenders to Section 514 and 515 projects. The 20 year approach is consistent with that taken by U.S. Department of Housing and Urban Development (“HUD”) on project based Section 8 contracts, which has created greater investor and lender interest in project Section 8 projects.

The Section 538 program was enacted in 1996 as Section 538 of the Housing act of 1949 to build new affordable rural housing as well as preserve the existing Section 515 portfolio. Each year most Section 538 loans completed carried interest subsidy, which reduces the interest rate and makes low-income affordability possible. Congress’s removal of the interest subsidy has made the 538 program all but irrelevant, as it now effectively addresses only moderate income needs. CARH strongly recommends that the interest subsidy be restored.

A long neglected tool in Section 515 is 515(t), where USDA is authorized to guarantee equity loans to provide a fair return and further preservation resource for properties that are 20 years old or older. This program should be funded and implemented. It will provide owners a further incentive to remain in the 515 program and provide further resources to recapitalize properties.

Another barrier to preservation and tenant protection is an unintended one, resulting from a conflict between the tax code and market forces. Almost all Section 515 properties were constructed through limited partnership arrangements whose structure makes it exceedingly difficult to introduce new capital into these properties, either through additional capital contributions from current owners or through the transfer of such properties to new owners. Most were also created before the 1986 Tax Reform Act. Because rent restrictions limit cash flow, new capital contributions would only generate additional passive losses that cannot be utilized by current investors. Yet, if the current owners sell a property it is almost impossible to generate sufficient cash to pay off the steep recapture taxes that would be owed. The best alternative for current limited partners is to hold the investment until death, enabling their heirs to acquire the property with a stepped up basis that avoids any recapture taxes. While that is a perfectly rational decision at the partner level, it is not consistent with sound housing policy and risks imposing far higher costs on the federal government as these capital-starved properties either continue to deteriorate as affordable housing or are sold off as market rate housing as a means of generating cash on the sale to pay off exit taxes for investors.

A modest change in the tax rules must be adopted to preserve the stock of Section 515 affordable housing. This could be accomplished by waiving the depreciation recapture tax liability where investors sell their property to new owners who agree to invest new capital in the property and to preserve the property as affordable housing for another 30 years. Since very few investors subject themselves to recapture taxes today, opting instead to pass on the property to their heirs at a stepped-up basis, the cost of this proposal should be modest while the benefit to the federal government of extending the affordability restrictions will be far-reaching. This concept is embodied in H.R. 2887, the Affordable Housing Tax Relief Act of 2009.

Congress should extend the Section 1602 Low Income Housing Tax Credit (LIHTC) exchange program as established in the American Recovery and Reinvestment Act of 2009 through 2010. It appears that Congress has endorsed this proposal in that, H.R. 4213 the American Workers State and Business Relief Act or “Tax Extenders Act of 2009” as passed by both the House and Senate and awaiting conference, would give a one year extension. Congress should also modify it to include four percent LIHTCs for multifamily housing tax-exempt bonds. This will allow some 515 properties to apply for needed resources. While rural properties must have specialized financial tools that will address rural needs, some rural properties will also benefit from a general, active affordable housing financing program.

Extending the current LIHTC carryback period from one year to five years will stimulate investment interest in LIHTCs in general. In the short term, LIHTC investors should be permitted to carryback for up to five years LIHTCs from their 2008-2010 income tax returns, but only to the extent they immediately reinvest LIHTC amounts carried back in new affordable rental housing. The alternative minimum tax relief provided under the Housing and Economic Recovery Act of 2008 (“HERA”) should be extended to LIHTCs carried back.

The Federal Internal Revenue Code restricts potential LIHTC investors through passive loss limitations, limiting the ability of associations that are not real estate professionals from investing. LIHTCs should be available to S Corporations, Limited Liability Companies, and closely-held C Corporations to the same degree LIHTCs are currently available to widely held C Corporations, to offset revenue with LIHTCs that would otherwise be taxable when passed through to the owners of these businesses. To ensure high standards of oversight, such entities should have at least \$10 million in annual gross receipts, be formed for reasons other than just avoidance of Federal income tax, and have an expectation of reasonable asset management. This proposal is aimed at accessing substantial investment capital available from sophisticated financial institutions and businesses that happen not to be widely-held Schedule C corporations. Indeed, this change would allow the 1,954 commercial banks and 55 savings institutions to invest in low-income housing tax credits in the communities in which they operate.

Congress should also permit taxpayers to carryback LIHTCs claimed after 2008, generated by new developments up to five years during the ten-year period that LIHTCs are generally taken. This will enable new investors to participate where they might otherwise be uncertain if they will have ten straight years of positive taxable income.

As noted above, we appreciate introduction of H.R.4868 and Title VIII of the legislation. As you know, this title follows several other house bills introduced in previous Congresses. We believe this title is a better means for preservation than previous bills. However, we continue to be concerned over a couple of items:

Title VIII requires a 30 year capital needs assessment, but provides no funding for this requirement. Real estate industry standard are to project capital needs over 10 to 20 years, and the longer term requires more up front budgeting and escrowing, raising costs above market when the program operates with below-market resources. This provision

should be changed to remove the 30 year requirement and require a commercially reasonable capital needs assessment. Thirty years is beyond any reasonable real estate standard, and will doom Title VIII to failure because it will require resources beyond anything that a 515 property could be expected to finance. We also believe that owners who have exited the program under law should not be required to take a tenant voucher where that voucher does not provide for a reasonable rent at least equivalent to market rents or where the housing is being converted to for-sale housing. CARH strongly supports the additional vouchers and the ability to provide enhanced vouchers. We are concerned that there is too much complexity in the current voucher provisions and we ask that the committee review those provisions and make certain they are as administratively simple as possible.

As stated earlier, CARH supports continuation of RD's Multifamily Preservation and Revitalization (MPR) program. MPR has funded some properties, but of equal importance, are even larger number of properties owners and RD have preserved on an ad hoc basis, with just a few regulatory tools. Unfortunately, RD authority today is not enough to translate these ad hoc efforts into broader preservation and the demonstration program has not had the impact we had hoped, notwithstanding RD's substantial efforts and we believe it is for two reasons. RD needs the permanent legislation contemplated in Title VIII, and we must recognize that Title VIII will only achieve RD's goal of 7000 refinancings where 514/515 properties have access to Low Income Housing Tax Credit program, exchange and other programs.

On behalf of CARH, we again thank the Committee for this opportunity to highlight the important issue of rural housing preservation. With a few relatively minor changes Congress can provide the tools needed to continue the successful public/private partnership for affordable rural housing.

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<sup>i</sup> "RHS Multifamily Inventory Shows Small Decline in Housing Projects, Units," Housing and Development Reporter, at 523 (August 31, 2009); July 14, 2009 unnumbered letter from Tammye H. Trevino, Administrator, Housing and Community Facilities Program, USDA ("July 2009 Letter").

<sup>ii</sup> Connecting The Dots: A Location Analysis of USDA's Section 515 Rental Housing and Other Federally Subsidized Rental Properties in Rural Areas, (May 2008).

<sup>iii</sup> Stegman, Quercia, McCarthy "Housing America's Working Families," New Century Housing (June, 2000).

<sup>iv</sup> General Accounting Office's September 2000 report entitled "Rural Housing Options for Optimizing the Federal Role in Rural Housing Development."

<sup>v</sup> "What We Have Learned About Properties, Owners, And Tenants from the 1995 Property Owners and Managers Survey", by Howard Savage, U.S. Census Bureau. "Homeowner Remodeling Trends Affect Contractor Workloads," Housing Economics, April 1990.

<sup>vi</sup> See GAO Report "Multifamily Rural Housing, Prepayment Potential And Long-Term Rehabilitation Needs For Section 515 Properties," May 10, 2002 ("2002 GAO Report"), p.3.

<sup>vii</sup> 2002 GAO Report

<sup>viii</sup> "The Local Impact of Multifamily Construction in a Typical Metro Area, Income, Jobs and Taxes Generated" National Association of Home Builders (June 2009). For every 100 units of rental housing, it is estimated 122 local jobs are created, with 32 recurring local jobs also created.