

ADDRESSING THE NEED FOR AFFORDABLE HOUSING IN RURAL AMERICA

The Contributions and Challenges Facing the Rural Housing Industry and the Federal Government

The condition of our nation's housing stock has improved over the last thirty years. However, in rural areas throughout the country, there continues to be an overwhelming need for affordable and decent housing. The need for rental housing is even more acute. Recent statistics suggest that rural renters are more than twice as likely to live in substandard housing as people who own their own homes. 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 housing, has decreased. This is in large part due to a reduction in federal housing assistance.

During this crucial time period, the Council for Affordable and Rural Housing (CARH) and its members continue in their commitment to provide safe, decent and affordable housing for individuals who live in rural areas. CARH believes that certain programs must be continued, albeit in some instances, modified. In addition, both the public and private sectors must work together on developing new programs that will put less strain on the federal government and yet continue to produce an ample supply of affordable rural housing.

Neither the private nor the public sector can produce affordable rural housing on its own. It has been and should be a partnership. Therefore, CARH believes that the following legislative issues should be addressed by the Congress during 2004:

Department of Agriculture:

Section 515 Program -

The Section 515, multifamily rural rental housing program administered by the Rural Housing Service (RHS), is one of the few resources that enables the very low-income and low-income renters in rural America to access decent, safe and affordable housing. The Section 515 program also reduces homelessness and overcrowding. The demographics of the residents in these complexes are as follows: the average annual tenant income is \$7,900; 73% of the households in the complexes are headed by women; 41% are headed by an elderly person; and 26% of the households are headed by a minority. Approximately, 86,000 residents pay more than 30% of their income toward rent, and 29,000 pay more than 50%, yet these families remain in RHS housing. Although they are heavily rent burdened, these families see RHS housing as their best alternative. In many

of America's rural communities, there have not been other safe and sanitary alternatives for very low-income residents.

Since the program's inception, in 1963, over 526,187 affordable rental housing units in 27,505 apartment complexes across the country have been selected for funding. This represents an investment, in affordable rental housing for rural America of \$14,961,124,085. The current outstanding portfolio, as of December 31, 2003, is in excess of \$11.5 billion dollars with 16,352 apartment complexes that contain 451,191 affordable rental housing units. The typical new property consists of 24 units with an agency per-unit cost of \$37,000 for a total loan of approximately \$900,000. There are additional leveraging partners to provide the additional funds to develop the property.

Over the last several years, funding for the Section 515 program went from \$540 million in Fiscal Year 1994 to \$115 for Fiscal Year 2004. The Administration's request for Fiscal Year 2005 is \$60 million. This drastic reduction in funding in the last eight years has had a negative effect on current residents who live in existing housing. Lack of funding has also prevented the construction of new rural rental housing in the communities where residents continue to need additional affordable housing. In fact, the Fiscal Year 2005 budget request would eliminate any new construction.

Recommendations:

CARH recommends that the Congress should, at a minimum, vote to provide the Fiscal Year 2004 level of funding of \$115 million. At the same time, CARH believes that the program should be increased to at least \$350 million so that new construction needs can be met and the existing portfolio can also be serviced. The age of the housing stock in many rural areas is such that needed rehab work should take place. Without adequate rehab loans, owners can not afford to rehab their properties. Congress needs to take a serious look at rural housing and provide funding that will give developers, management companies and owners the resources to provide decent and affordable housing for rural Americans through out the country.

In addition, RHS does not currently permit owners to use funds to pay for special resident events or programs. However, elderly and disabled residents located in relatively remote areas frequently need additional services, ranging from transportation to physical therapy and medical related-services. CARH strongly believes that this policy should be changed. Affordable housing can better attract, retain and provide for elderly and disabled residents if it can provide or coordinate services.

Section 521 Rental Assistance-

The Section 521 Rental Assistance (RA) program is an important component of the Section 515 program in that it provides an additional deep subsidy to very low-income residents by providing a 5-year renewable contract to make up the difference between 30% of a resident's income and the basic rent required to operate the property ("basic" rent is that which is required to cover general operating expenses, pay the mortgage on a

1% interest rate note, and provide an 8% return on the owner's equity, which is currently 3% or 5% of the project cost.) Some Section 515 projects also utilize the Department of Housing and Urban Development's (HUD) Section 8 Rental Assistance, which then enables additional very low-income families to be served. The Administration's budget request for Fiscal Year 2005 would provide \$592 million for RA.

Recommendations:

- CARH does not support the Administration's request for RA for Fiscal Year 2005. An additional \$100 million should be provided for the program so that new as well as existing units can receive RA.
- CARH urges Congress to examine the issue of how to better target RA money so that RHS can provide RA for new construction as well as servicing RA.
- A minimum rent should be established for those persons receiving rental assistance of between \$25 and \$50. The establishment of a minimum rent will help stretch scarce rental assistance dollars.
- Another way to stretch dollars in the program is to override the administrative rule that gives rental assistance preference to the most rent-burdened residents over **otherwise** eligible, **needy** residents who have occupied a complex for a longer period. In addition, very low-income applicants would not be given priority for admission over eligible low-income applicants who have been on a waiting list for a longer period. These existing requirements are similar to the preferences that were applicable to HUD programs until suspended by Congress.

Section 538 Rural Rental Housing Loan Guarantee Program-

The Section 538 Rural Rental Housing Loan Guarantee Program authorizes guarantees of privately made loans for the development of new multifamily housing for low and moderate income persons and shows great promise in providing financing to serve persons in rural areas at very little cost to the federal government. Any cost involved comes from the statutory requirement that at least 20% of the loans be given a thin subsidy to lower the interest rate to the applicable federal rate. The rate is based on the 30-year Treasury bond rate on the day of closing. The guarantee program is intended to operate, in many situations, in conjunction with other assistance programs, such as HOME, the low income housing tax credit (LIHC) and tax-exempt bonds. The Administration's Fiscal Year 2005 budget recommends a program level of \$100 million.

Recommendations:

- CARH supports the Administration's request of \$100 million.
- The program should also be expanded to communities with populations not in excess of 50,000 and not adjacent to an urbanized area over 50,000 in population.

CARH believes this expansion will benefit all areas by leading to a stronger Section 538 program, with more lenders, more volume, and more industry acceptance. However, with respect to the thinly subsidized portion of the program, where the interest rate is lowered to the applicable federal rate, a preference would be provided for communities with less than 20,000 inhabitants.

- CARH also recommends that the House Financial Services Committee and the Senate Banking, Housing and Urban Affairs Committee hold oversight hearings on the program to determine whether the program is being administered as was envisioned when it was first created.

Section 502 Single Family Guarantee Rural Housing Loan Program-

The purpose of the Guaranteed Rural Housing loan program is to enable eligible low- and moderate-income (up to 115% of median income) rural residents to acquire modestly priced housing for their own use as a primary residence. Qualified applicants should be without adequate housing and related facilities, and unable to obtain mortgage credit through conventional financing without a guarantee from Rural Development. Interested parties can apply for assistance for financing from any participating lender. Loan terms are for 30 years and interest rates are negotiated with the lender.

Guaranteed loans provide for 100% loan-to-value financing, and no private mortgage insurance is required. The program is available for the purchase and repair of existing and newly constructed dwellings. The cost of Section 502 guarantee loans is 0.17% versus 14.18% for Section 502 direct loans. The Fiscal Year 2004 authorization level for the 502 program is \$4.091 billion. The Administration's request for Fiscal Year 2005 is \$3.6 billion, with \$1.1 billion for the Section 502 direct loans and \$2.5 billion for Section 502 guarantee loans.

Recommendations:

- CARH recommends that the Congress consider alternative delivery mechanisms to provide for a regular source of loan guarantee funding with the same authorization level.
- CARH does not support the Administration's request. CARH believes that Congress should approve at least the Fiscal Year 2004 level of \$4.091 billion.

Prepayment of Rural Housing Loans-

Section 515 loans are subject to a complex set of rules with respect to the prepayment of the loan. Different rules apply depending on whether the loan was approved before December 22, 1979, between December 22, 1979 and December 14, 1989 or after December 14, 1989. Post 1989 loans cannot be prepaid and loans prior to 1989 can be prepaid only under limited circumstances. Incentives are authorized to discourage prepayment, including equity loans, an increase in the rate of return, additional rental

assistance, and a decrease in the interest rate on the loan through the use of interest credits.

Funding for incentives is virtually nonexistent, particularly for equity loans. For those borrowers who wish to prepay and who either never had low-income use restrictions or whose use restrictions have expired, RHS is requiring the imposition of new use restrictions, thus making prepayment impractical in many situations.

The changes in restrictions on the prepayment of Section 515 loans have paralleled a similar development of restrictions on the prepayment of mortgages insured by HUD under some of its subsidy programs. In 1996, however, legislation was enacted allowing all such mortgages to be prepaid (after the end of a 20-year use restriction period), subject to some resident protection with full compensation to the owner at market rent.

Recommendations:

CARH believes the latest congressional policy expressed in the HUD legislation (Public Law 104-204) should be followed for the Section 515 properties. Prepayment should be permitted in all cases where the owner's original contract with the RHS permitted prepayment or did not prohibit prepayment.

Specifically, CARH supports reintroduction of legislation that would allow the following:

- All pre-December 22, 1979 loans should be allowed to be prepaid at any time.
- Loans between December 22, 1979 and December 14, 1989 should be allowed to be prepaid if any of the three conditions are met: a.) the loan is at least 20 years old (or 15 years old if no rental assistance was provided); b.) the Secretary of Agriculture determines that the housing is no longer needed or the residents lose other financial assistance; or c.) the loan is not 20 or 15 years old, but the owner agrees to use restrictions until the end of that period.
- Post-December 14, 1989 loans could not be prepaid, as these loans were made with that understanding. However, the 1997 change in the Section 515-loan term from 50 to 30 years, with a 50-year amortization, would be available retroactively if the borrower agrees. Under this condition, the owner will not have to finance the balloon payment with a further 20-year Section 515 loan. Thus, prepayment would be permitted for this class of loans after 30 years.
- There has been significant confusion between mortgage prepayment and market-rate conversion, with a generalized fear that one automatically leads to the other. Prepayment can, but does not necessarily, lead to market-rate conversion. CARH supports restoring owners' prepayment rights, but even if those rights are not restored, RHS should institute a streamlined prepayment process for owners maintaining affordability in order to avoid unnecessary waste and delay.

- Congress should permit prepayment funds received by USDA to be used as new funding. This would help USDA recycle funds and maintain affordable housing in needed areas.

Preservation:

Make the Rural Housing Service (RHS) Structure More Rational-

The RHS is administered on a state-by-state basis with State Directors reporting to the Under Secretary for Rural Development instead of the Administrator. This creates a jumble of interpretations for what should be a uniform set of standards.

Recommendations:

CARH recommends that RHS have uniform national standards and lines of authority, similar to current HUD operations. RHS already has a Preservation Office, but that office suffers from the same balkanized implementation as the rest of the Agency. CARH also recommends elevating the authority of the Preservation Office and authorizing it to centralize preservation processing. By "preservation" we mean maintaining both the physical repair and the low-income character of the housing at issue. The main goal of the Preservation Office should include reviewing and restructuring financing on aging properties. RHS should administratively adopt a recovery program that will expedite transfers, prepayments and loan workouts within the Preservation Office.

Streamline Transfer Rules-

Owners that seek to maintain low-income restrictions through a transfer face a complicated and daunting process. Since State Directors administer the program, the exact interpretations of the rules vary generally from state to state. This also creates a Catch-22 situation because owners cannot readily prepay out of the program or transfer and refinance within the program.

Recommendations:

CARH believes that the only solution is to have a firm processing deadline and informal appeal rights to the RHS National Office.

Enact a New Cost Effective Program-

In light of funding shortages, we have analyzed various ways to utilize federal funds to achieve maximum financial leverage. We recommend a new interest credit program to leverage federal funds.

Provide Vouchers-

RHS properties would benefit greatly from an allotment of Section 8 vouchers.

Currently, rural properties cannot easily access HUD Section 8 vouchers. CARH recommends a set aside of Section 8 vouchers for Section 515 properties that prepay.

Convert Certain Rental Assistance-

Presently, RA terminates when the Section 515 loan is prepaid. CARH recommends converting RA to Section 8 so subsidy continues after prepayment.

Department of Housing and Urban Development:

HOME Investment Partnership Program-

The HOME Investment Partnership Program (HOME), enacted by the National Affordable Housing Act of 1990, has been a successful program for the acquisition, construction and rehabilitation of affordable housing. This federal program is implemented through state or local governments designated as participating jurisdictions (PJ). Funding for this program has continued to increase. CARH supports HOME and believes that the federal government should increase funding to rural areas under this program.

Recommendations:

HOME faces certain inefficiencies and artificial restrictions that prevent smooth interaction with other programs. CARH, like the Millennial Housing Commission, specifically supports the following program and statutory changes so that HOME can operate more efficiently:

- CARH supports the Administration's request of \$2.084 billion for Fiscal Year 2005. However, CARH also supports continued efforts to provide additional funding so that more money can be allocated to rural areas.
- CARH believes that PJs should be given the option to use HOME funds for long-term reserves. HOME funds may be used to capitalize an initial operating deficit reserve. However, a developer must secure private debt for long-term reserves.
- PJs should be allowed to use HOME funds to refinance certain subsidized rental properties in jeopardy of loss, regardless of whether there is a rehabilitation.
- When rental housing is financed with both HOME and Community Development Block Grant (CDBG) funds, HOME rules should govern to create consistent requirements.
- Make both new construction and substantial rehabilitation expenditures eligible for the 9% tax credit, even when the development is federally assisted. Under current law, developments that use loans funded out of federal appropriations are, with some exceptions, eligible only for 4% credits.

- CARH supports the use of HOME funds on LIHC properties that are awarded the 30% increase in basis for being located in difficult development areas and qualified census tracts. This would eliminate a barrier to using the credit for new development or substantial rehabilitation in high-poverty areas.

Taxes:

Low Income Housing Tax Credit

Income Limits-

Under existing law, low income housing tax credit (LIHC) residents can earn no more than 60% of their median income. Apartments financed by the credit can have rents at no more than 30% of 60% of the area median income. In many areas across the country, particularly rural areas, the median income is simply too low to support the development of new multifamily complexes therefore, making development in those areas very difficult or infeasible. Recent data from HUD demonstrates that current income limits inhibit housing credit development in as many as 1,700 of the 2,364 non-metropolitan counties across the country.

Recommendations:

CARH supports H.R. 284, introduced by Representatives Amory Houghton (R-NY) and Richard Neal (D-MA) and S. 595, introduced by Senators Orrin Hatch (R-UT) John Breaux (D-LA). These bills would amend the Internal Revenue Code to allow states to use the higher of the area median income (AMI) or the statewide median income for the purpose of calculating application income limits. This technical change to the LIHC program would greatly enhance the tax incentive's ability to help low-income renters who live in the nation's rural areas.

Development Costs In Basis-

The Internal Revenue Service (IRS) issued five Technical Advice Memoranda (TAMs) in the later part of 2000. The TAMs essentially provide an analysis of whether certain costs are included in eligible basis for the low income housing tax credit. For example, the TAMs take the position that certain expenditures were related to building development versus land cost, with building related costs included in basis. The result largely prohibits developers from including in basis many of the costs related to site preparation, such as: land grading and clearing; local impact fees; boundary and environmental surveys; and certain engineering and architectural services. The net effect is a fictional and illogical distinction among necessary development costs.

Recommendation:

CARH supports H.R. 1928, legislation introduced by Representatives Nancy Johnson (RCT) and Charles Rangel (D-NY), which would clarify that certain development costs typically included in tax credit eligible basis as generally accepted industry practice. “Development cost basis” would be added to existing law and would include the following: site preparation costs; state and local “impact” fees; certain development fees; certain professional fees and construction financing costs. The concept of “development cost basis” would be substituted for “eligible basis” as currently exists in Section 42 (d) (1) of the Internal Revenue Code. This new development cost basis standard should resolve the Service’s concerns about site preparation costs.

Nine Percent Credit and Rural Housing Set-Aside-

Properties that are financed through the RHS receive a mix of direct loans and interest credit and rental assistance. RHS subsidies are often regarded as below-market federal finance, disqualifying RHS properties from the 9% LIHC. The current tax code should be changed to permit the 9% credit for RHS programs, similar to the treatment of HUD properties. Such a change would allow for deeper subsidy, where the state housing finance agencies believe it is warranted and to provide for the development of new rural housing of the rehabilitation of existing rural housing.

The volume cap for the LIHC has been increased. However, competition in many states for the credit continues and proposals for rural complexes are competing with proposals from urban markets. A small statutory set aside for properties located in rural areas will help open credit to many rural areas that, at this point in time, have been unsuccessful in building new or rehabilitating existing housing.

Recommendations:

CARH recommends that the tax code be changed to allow for 9% credit for RHS properties. In the past, Congress has approved the inclusion of below-market finance as eligible for the 9% tax credit. For example, HUD's HOME program, public housing and Section 8 programs can receive the 9% tax credit when developers agree to set aside at least 40% of the units in a complex for individuals who are at no more than 50% of median income. Similarly, CARH recommends that the LIHC program be amended to provide a statutory 10% set aside for rural properties. This set aside would be consistent with previous set asides, such as those directed toward non-profit entities.

Casualty Losses-

Last year, the Internal Revenue Service (IRS) issued a memorandum ruling regarding the treatment of casualty losses under Section 42, the LIHC program. Memorandum 200134006 held: 1.) that the term “casualty loss” should have the same meaning as set forth in generally accepted tax principles and that a period of up to two years after the casualty to restore the property is acceptable; 2.) that the state housing credit agencies should report to the IRS, as noncompliance with Section 42, any casualty loss that takes

LIHC property out of service and results in a reduction of qualified basis; and 3.) that property owners may not continue to claim low-income housing credits during the period that the units are not in service because of the casualty event, although no recapture of previously claimed credits is required provided that the property is restored in a timely manner.

The IRS had previously advised state housing credit agencies on an informal basis that they did not need to report noncompliance in the event of a casualty and that owners could continue to claim credits while the property was being restored. The informal advice previously provided is consistent with Revenue Procedure 95-28, in which the IRS provided relief for projects affected by a major disaster. In Section 7.01 of this procedure, the IRS stated that the owners of projects in such areas are not subject to loss of credits and that agencies do not report noncompliance, provided that the project's qualified basis was restored within a reasonable period (24 months after the end of the year in which the disaster area declaration occurred).

Recommendations:

CARH supports the efforts of Representatives Johnson and Rangel to have this revenue ruling reversed. There is absolutely no justification for a different set of rules depending on whether the casualty is caused by a major disaster or by a "regular" casualty, such as a localized fire or thunderstorm. In reviewing the conference committee report that accompanied the Tax Reform Act of 1986, it is apparent that it was Congress' intent that owners should not be penalized because of casualty events either with respect to prior credits or with respect to credits claimed during the restoration period.

Units damaged by a casualty and which must be taken out of service are "vacant;" owners go through the process of restoration in order to rent the unit following completion of the work. It is the opinion of Representatives Johnson and Rangel that it was not Congress' intent to punish owners when their units are vacant, regardless of the reason, as long as owners are making reasonable attempts to do whatever is necessary to have the units occupied, whether those attempts involve restoration or marketing. Should the IRS not reverse the latest memorandum ruling, legislation should be introduced.

Exit Tax Relief-

Owners of affordable rural housing are "locked-in" by exit tax liability, which prevents transfer and refurbishment. This barrier is particularly intractable because many of these owners invested in properties for tax benefits contained in the pre-1986 tax code, which were deleted with the 1986 Tax Reform Act.

Recommendations:

CARH supports the introduction of exit tax relief legislation. Legislation providing tax relief through the elimination of exit taxes could result in tax revenues by encouraging sales and taxing the distributors. This exit tax relief legislation should be crafted in the

form of an exclusion from income on the recapture portion of the gain on the transfer of qualifying property rather than an allocated credit.

National Housing Trust Fund-

Housing trust funds are distinct funds established by cities, counties and states that permanently dedicate a source of public revenue to support the production and preservation of affordable housing throughout the country. A national housing trust fund would build and preserve 1.5 million units of rental housing for the lowest income families over the next 10 years. The fund would be financed with profits from housing programs operated by the Federal Housing Administration and Ginnie Mae. State and local agencies would match the federal money with their own funds and undertake new construction programs.

Recommendations:

CARH supports H.R. 1102, legislation introduced by Representatives Bernard Sanders (IVT) and Barbara Lee (D-CA). The legislation would establish a national affordable housing trust fund that would provide for the development, rehabilitation and preservation of affordable housing throughout the country. CARH would urge introduction of similar legislation in the Senate.

Non-elderly Occupancy in Projects Designed for the Elderly-

In the Housing and Community Development Act of 1992, a solution to the problem of projects for the elderly being overrun by non-elderly disabled residents was forged. While the problem was more acute in Section 8 housing than in Section 515 housing, the problem does exist in rural areas, and is quite severe in certain areas of the country.

Recommendations:

- CARH has recommended to the House Financial Services Committee and the Senate Banking, Housing and Urban Affairs Committees that the provisions enacted for Section 8 housing be extended to Section 515 properties. Under the legislation, owners could elect to limit non-elderly disabled occupancy to at most 10% of the units, through attrition rather than eviction if the current percentage is higher than the statutory elective maximum.
- CARH also supports changing the definition of elderly to 55 or older to harmonize with the Fair Housing Act and to make the program more flexible. Housing choices in rural areas can be very limited and it is important to allow maximum flexibility to what may often be the only available affordable housing in a rural town.

Miscellaneous:

Association Health Plans-

According to the U.S. Census Bureau, more than 43 million Americans currently have no health insurance, and approximately 60 percent of those people are in families that are headed by an employee of a small business, such as those found in the rural housing industry. Association health plans can help alleviate the rising number of uninsured and the high cost of health care in this country.

Recommendations:

CARH supports passage of S. 545 and H.R. 660 the Small Business Health Fairness Act of 2003. S. 545 has been introduced by Senators Olympia Snow (R-ME) and Christopher Bond (R-MO) and has been referred to the Senate Health, Education, Labor and Pensions Committee and H.R. 660 was passed by the House on June 20, 2003. This legislation would allow small business owners to band together across state lines by virtue of their membership in a bona fide local, state or national trade association, and negotiate lower health insurance packages for their employees. Unlike large businesses, corporations and unions, many small businesses today can not offer their employees favorable health insurance and employee benefit packages. CARH strongly supports passage of S. 545 and H.R. 660. Passage of this legislation would allow CARH and therefore rural housing providers that are members of CARH to offer competitive health insurance packages for their employees.