

MAINE STATE LEGISLATURE

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MAINE STATE
HOUSING
AUTHORITY

PRESERVING LOW INCOME HOUSING:
AN INTERIM STRATEGY
FOR MAINE

MAINE STATE HOUSING AUTHORITY
ELIZABETH H. MITCHELL, DIRECTOR

APRIL, 1989



— Elizabeth H. Mitchell, Chairman/Director —

To: Governor McKernan, Members of the Maine Legislature
From: Elizabeth H. Mitchell, Director
Date: April 18, 1989
Subject: Preserving Low Income Housing: An Interim Strategy for Maine

In September of 1988 Governor McKernan's Task Force on Affordable Housing reported that "the State of Maine... faces a crisis as the federally subsidized rental units within the state are at risk of loss." The Task force requested that the Maine State Housing Authority evaluate the situation, and make recommendations about how to proceed.

In response to this request, in December of 1988 we published the report Preserving Low Income Housing in Maine -- An Inventory of Assisted Housing. That report listed all assisted housing projects in Maine, and established the earliest possible date that each would be "at risk" of conversion or loss.

This report takes the analysis a step further, and recommends an "interim strategy" for Maine in the next three years to protect tenants and communities from sudden disruption. This ultimate responsibility for solving this crisis is with the Federal Government; the State does not begin to have the resources necessary to replace the Federal subsidy. However, in the meantime, as we wait for Federal action, we must take several essential and minimal steps to protect Maine's low income renters. Those steps are laid out in this report.

I would like to thank the members of the Preservation Committee, listed on the inside cover, for their invaluable advice and guidance in preparing this report. Under Diana Hout's leadership, they helped us analyze and understand an extremely complex problem in just three short months, and made this report possible.

We hope these recommendations prove useful, and help stimulate debate and discussion of what Maine can do to insure that decent and affordable housing for low income renters can be preserved.





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Introduction

There are 18,000 apartments in Maine for low-income tenants in Federally-assisted projects. There are an additional 10,000 low-income Mainers in private apartments receiving Federal rental assistance through the Section 8 Existing Program. In all, nearly a quarter of Maine renters receive Federal rent assistance. They are subsidized by both the Federal Department of Housing and Urban Development (HUD) and the Farmer's Home Administration (FMHA) under a variety of program, financial, and contractual arrangements.

Both types of housing -- project-based and private apartment assistance -- are endangered by the potential loss of Federal subsidies in the near future. This report addresses primarily the problems of Federally-assisted rental projects (for a short description of the problem facing private apartment-based subsidies, see the letter in Appendix A). However many of the same issues are present in both. The solutions proposed, will, in most cases, be applicable to both types of situations.

Why is there a problem?

Most assisted projects were built in the 1970's and early 1980's, at a time of expanding Federal commitment to housing, and at a time when the Maine private housing market was less robust than today. Many were constructed by private owners with twenty year commitments for Federal rental subsidies. At the time it was generally assumed that these commitments would be renewed in the future, given the steadily expanding Federal housing role.

Today this assumption is called into question. The Federal Government has cut its new housing expenditures by 70% in the 1980's. The Federal deficit nonetheless persists, making significant new housing commitments unlikely. In addition the private housing market in Maine has boomed, and alternative uses for subsidized housing now are more financially feasible for private owners. As contractual commitments expire in the coming years, the question is raised: what is going to happen to Maine's low-income housing stock, and Maine's low-income renters?

Consequences of the Loss of Low-Income Units

In a rental-assisted unit, the low-income tenant pays 30% of his income for rent and utilities. The average tenant household income in Maine State Housing Authority (MSHA) projects is \$6,000 per year, or \$500 a month. That means that, on average, the tenant is paying \$150 a month for rent.

If an assisted project loses its subsidies, the tenant is placed in a bind. If he can afford at all to stay in his apartment, the monthly cost (at say \$400) will consume 80% of his income. Most will be unable to stay, unable to find new housing, and may become homeless. Most will at some point turn to local General Assistance for help -- 20 tenants from a given project could cost a town \$60,000 a year in General Assistance.

Of course the consequences go far beyond immediate dollars. Children's educations will be disrupted. Phones will be disconnected. Jobs lost. Family stress will increase. The human consequences of the loss of affordable, decent housing are, ultimately, unmeasurable.

Housing Preservation Defined

There are three ways in which Federally assisted housing can be "lost:"

- 1) Expiring subsidies. Rental assistance contracts between housing owners and the Federal Government are in effect for a specified term, usually between fifteen and fifty years. In most subsidized projects, the largest share of rental income is paid by the Federal Government. Once these subsidies are removed, tenants must bear the full rent burden. Low income tenants cannot begin to afford the market rent levels necessary to operate the projects without the government subsidy.
- 2) Prepayment of mortgages. When the mortgage is paid off on some projects, government controls over the project cease, including the requirement to rent to low income tenants. An increasing number of owners in Maine will become eligible to prepay their mortgages and opt out of low-income residency requirements in the coming years.
- 3) Deterioration. The subsidized housing stock is aging. The cash flow from subsidies, tenant rents, and tax breaks is not adequate in all cases to cover essential rehabilitation and even maintenance. This situation can lead to default or mortgage prepayment and conversion.

The goal of preservation activities is to prevent the loss of low-income housing stock due to any of the above causes. Therefore, preservation can be defined as follows:

Housing preservation actions are those which extend the life of existing low-income assisted housing through the extension of existing subsidies or through new subsidy and contractual arrangements.

Scope of the Preservation Issue in Maine

There are 18,000 Federally-assisted low-income apartments in Maine. Should these units be lost, the cost of building replacement housing would exceed \$1 billion.

Of the 18,000 units, 4,500 may be lost between now and the year 2000. The cost to the State of replacing the Federal subsidy in these units would be approximately \$25 million a year.

The Federal Responsibility

The primary responsibility for dealing with this problem lies with the Federal Government. Federal subsidies created these apartments, and only the Federal Government has the financial resources to sustain them.

In fact, Federal actions in recent years have only made the problem more critical. New allocations for Federal rent subsidies, an essential tool for maintaining low-income occupancy, have been cut back drastically. Federal tax law changes have made investments in low-income apartments less profitable. Finally, Federal restrictions on the use of capital and operating reserves limit the possibilities for nonprofit housing corporations to purchase threatened housing.

In 1987 Congress took initial steps to deal with the issue. The Housing and Community Development Act of that year limited conversions in the following ways.

- 1) Owners of HUD Section 236 and 221-d-3 projects are forbidden from mortgage prepayments unless they can show the sale will not affect the availability of low-income housing, and they prepare a displacement and relocation plan which meets the approval of the Secretary of HUD and the state housing agency; financial incentives to forestall prepayment were also authorized (but not funded completely).
- 2) Owners of Farmer's Home 515 projects are also eligible for financial incentives for maintenance of low-income occupancy; and if the owners decide to sell, they must first offer their project to a nonprofit corporation or a public agency at a fair price.
- 3) Owners of HUD Section 8 projects must provide a one year notice before sale; incentives for retaining the units are also available.

However in the absence of major new commitments of rental subsidies, the proposed financial incentives are inadequate. The law itself expires in February of 1990, leaving no protection in the years to follow.

There is no evidence that the Federal Government will move quickly to address the issue. The much awaited National Affordable Housing Act (Cranston, D'Amato) only proposes that HUD set up a new "Office of Affordable Housing Preservation" that would work to develop "strategies" with state and local governments. No other major legislation to address the problem exists at the Federal level. But the day of reckoning is coming, and cannot be postponed by new offices and commissions.

State Lobbying of the Federal Government

The first obligation of the State of Maine in this situation is to pressure the Federal Government to create a serious national program for housing preservation.

RECOMMENDATION #1 -- THE STATE OF MAINE SHOULD LOBBY THE FEDERAL GOVERNMENT TO CREATE A NATIONAL HOUSING PRESERVATION PROGRAM.

The elements of such a program should include:

- * immediate extension of housing assistance contracts under the Section 8 Existing and Voucher programs (note: these subsidies are scheduled to be cut drastically in the next few years);
- * authorization for HUD and FMHA to extend project-based rent subsidies in public and subsidized housing;
- * expansion of the Low Income Housing Tax Credit by creating a set-aside for preservation investments;
- * additional tax code changes to make low-income rental investment profitable again;
- * capital gains tax exemptions to private owners who sell subsidized projects at below-market costs to nonprofit owners;
- * and regulatory changes which allow nonprofits to use capital and operating reserves from existing projects to help finance the purchase of at-risk, privately owned, projects.

Current or proposed initiatives in Congress which can serve as vehicles for preservation programs include:

- * Senator Sanford's bill which would increase FMHA rural housing assistance by \$200 million;
- * the Cranston-D'Amato bill in the Senate (mentioned above), which should be amended to deal affirmatively with preservation;
- * the Gonzalez bill in the House (H.R. 1180 -- The Housing and Community Development Act of 1989) which has no provisions for preservation;
- * and the Mitchell-Danforth Low-Income Housing Tax Credit Task Force Report, which recommends the creation of a "special pool of Credits and other subsidies directed toward preservation of the low-income housing inventory."

Because of the importance of this issue, and the importance of close Federal-State cooperation in dealing with it, representatives of the Legislature, the Congressional delegation, the Governor's Office, and the Maine State Housing Authority should meet periodically in the coming months to create a unified Federal and State strategy for addressing preservation in Maine.

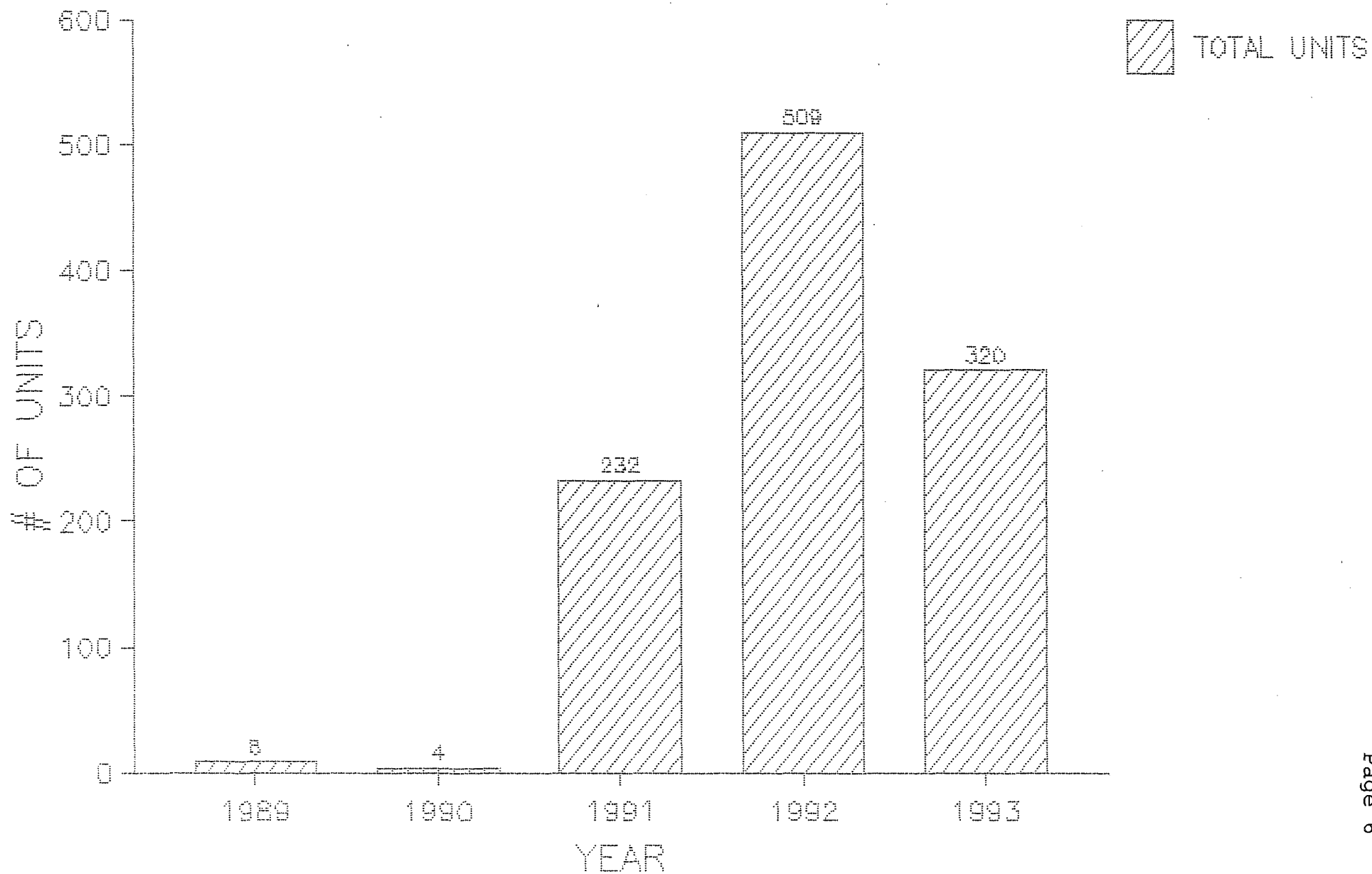
Maine's Short Term Exposure

Given the current inaction in Washington, a serious national strategy cannot be expected for several years. Meanwhile, there are low income apartments already at risk of being lost in Maine. An interim strategy needs to be prepared to deal with those projects which face the loss of Federal subsidies in the next several years.

How many projects and units are involved? Forty-seven projects, with 1,073 subsidized units, located in 30 Maine cities and towns, will face the loss of Federal subsidies before January 1, 1994. In 1992 alone, 23 projects, with 509 subsidized units, will be at risk. Thereafter the numbers will remain high until about the year 2005. These figures do not include the thousands of rental certificates in private housing (the Section 8 Existing Program) which will expire in the near future.

See Chart on following page

UNITS WHERE LOW INCOME USE RESTRICTIONS MAY EXPIRE



Existing Maine Safeguards

A Maine law was enacted in 1988 which gives the Maine State Housing Authority and the municipal housing authority (if one exists in the area) the right of "first refusal" for projects considering sale and conversion. Under the terms of the law (30-A MRSA #4971 et seq.), owners of low income property must notify the MSHA and the local housing authority if they are considering a sale or change of use. The authorities then have 30 days to notify the owner if they are interested in a purchase; and 60 days thereafter to arrange the financing. In the event of no interest, or the inability to find a buyer, on the part of the state and local housing authorities, the owner is free to dispose of the project however he wishes. This law expires on August 1, 1989.

This law is a stopgap, and was clearly intended as such, as the sunset date indicates. There are no funds for authority or nonprofit purchase, no financial incentives for owners to continue low income occupancy, and only vague notice and relocation benefits for tenants. These are necessary tools for making a preservation strategy work. In the following pages there are recommendations for creating these tools, as part of a proposed Maine Interim Preservation Strategy.

An Interim Preservation Strategy for Maine

The goal of this strategy is to create an effective Maine response to conversion proposals in the next three years, before a national strategy is developed. It involves generating funds for project refinancing, spelling out legal protections for low income tenants, and creating a short term rental assistance fund.

RECOMMENDATION #2 -- LEGISLATION SHOULD BE PASSED WHICH INSURES PROTECTION FOR TENANTS, AND ORDERLY NEGOTIATIONS FOR PURCHASE.

State legislation should be passed to supersede the existing "first refusal" law. Elements of this legislation should include:

- * a one year notice to low-income tenants, the State Housing Authority, and applicable local housing authorities and nonprofits, of an owner's intention to sell or change the use of a subsidized project;

- * the continued right of "first refusal" to MSHA and the local housing authority, which would extend through the one year notice period;
- * a mechanism for insuring that the sales price offered to the State and local nonprofits is a "fair market price;" and
- * in the event that the State or local nonprofits cannot purchase the units, the requirement of a displacement and relocation program prepared by the owner and approved by the Maine State Housing Authority prior to sale.

RECOMMENDATION #3 -- A STATE PRESERVATION FUND OF \$10 MILLION SHOULD BE CREATED THROUGH A BOND ISSUE.

The fund could be used in a variety of ways: to lessen a project's financial burden through refinancing or secondary financing, or even by a grant to write down excessive debt, thereby making it possible for rents to be kept affordable; to provide all or part of the acquisition financing for a new owner; to finance needed rehabilitation; or some combination of the above.

The uses of the fund must be flexible, because the individual financial condition and options of each project will be unique. While clearly \$10 million is insufficient to solve the entire problem, the fund will provide a needed and currently unavailable resource to address the most critical situations which arise.

RECOMMENDATION #4 -- A \$1.2 MILLION SHORT-TERM RENTAL ASSISTANCE FUND SHOULD BE CREATED WITH GENERAL FUND SUPPORT.

In the case of projects receiving direct rental assistance, the withdrawal of subsidies by the Federal Government will make rent increases and displacement inevitable. Even if these projects are already owned by nonprofits or local authorities -- and many are -- the lost subsidies will be nearly impossible to replace.

In the cases of other projects, there may be a need for temporary rental assistance to be part of a larger package of financial incentives to retain low income housing.

The average income of tenants in MSHA-financed rental assistance projects is about \$500 a month. This means that they can afford (at 30% of their income) monthly rent and utility expenses of no more than \$150. In a subsidized unit, the Federal Government currently picks up the difference between what the tenant can afford, and what the project needs to operate -- often between \$300 and \$400 a month.

A temporary State rental subsidy, to be effective, must approach in size the Federal subsidy. At \$250 a month, this means that it takes \$6,000 of State funds to subsidize one average low income rental unit for two years. An appropriation of \$1.2 million would therefore provide enough funds to support 200 low income units for two years.

This fund would allow the State to "buy time" as the Federal Government comes up with a longer range solution.

RECOMMENDATION #5 -- STATE TAX INCENTIVES SHOULD BE CONSIDERED WHICH WOULD PROMOTE PRIVATE INVESTMENT IN LOW INCOME RENTAL HOUSING.

The Federal Low Income Housing Tax Credit is proving to be a viable financial incentive for private investment in low income housing: The State should consider providing an equivalent Tax Credit on Maine income to enhance the effectiveness of the Federal credit.

Likewise, the State should consider providing capital gains tax exemptions to private owners who sell subsidized projects at below-market costs to nonprofit owners.

Finally, property taxes are a burden on operating expenses in many assisted projects. Partly this is because subsidized projects are assessed on their replacement cost, rather than their income experience (as is, say, a parking garage or other commercial structure). And partly it is simply because property taxes are increasing. The State should consider changing assessment practices for subsidized projects; and providing targeted property tax relief for subsidized projects (when it can be shown that such relief provides direct benefits to tenants), perhaps through a mechanism similar to that already in place for low income homeowners and renters in private housing.

Further legislative study is required to identify the actual costs of these alternatives, and to judge their potential effectiveness.

RECOMMENDATION #6 -- PRESERVATION MUST BE A CONSIDERATION
IN EVERY POLICY AND PROGRAM AFFECTING LOW-INCOME
HOUSING.

Many privately owned subsidized projects are sold and re-sold over their life. As the projects get refinanced, new debt is added for the new owner. When it comes time to make a decision about conversion, the size of the existing debt can make preservation either expensive or impossible. Under existing contracts, the Maine State Housing Authority, the Farmer's Home Administration, and in some cases HUD have the power to approve or disapprove ownership transfers of their projects. In cases where state and federal agencies approve such transfers, they should use their leverage to exact commitments from the new owner to extend housing assistance contracts, to provide a level of low income benefit beyond the term of federal subsidies, and to pay assumption fees which the Authority can use to replace units lost when subsidies on other projects expire.

There are many other ways that MSHA, as project financier and administrator of contract subsidies, can affect the balance sheet of existing projects and use its influence to extend the life of rental subsidies. Such techniques include the control of project rent increases, the refinancing for older projects, the encouragement of cooperative forms of project ownership, and the development of new creative financial tools. Preservation should continue to influence decisions in all of these areas.

Conclusion

The problem of the potential loss of the existing low income housing stock is critical. The potential victims are Mainers -- low-income tenants who have no other place to go to find affordable and decent housing.

We cannot afford to wait and see what the Federal Government will do. We have our own responsibilities -- to press the Federal Government to create a long-term solution, and to act in the present to insure the continued availability of assisted rental housing to Mainers who need it. The recommendations in this report are intended to strike a balance. Maine cannot replace the Federal Government commitment -- the costs are simply too high -- but Maine can take necessary steps in the short term to insure that an orderly process of evaluation and action is triggered every time a project comes up for conversion. That balance is the essence of the Maine Interim Preservation Policy outlined above.



MAINE STATE
HOUSING
AUTHORITY

March 31, 1989

The Honorable George H. Mitchell
176 Russell Office Building
Washington, DC 20510

Dear Senator Mitchell:

I am writing to alert you to a very urgent problem that could have a devastating impact on Maine's low and very-low income renters. Without federal action, funding for rental assistance through HUD's Section 8 Existing Annual Contributions Contracts will expire.

Currently the Maine State Housing Authority administers rental assistance payments for over 2,200 Maine households. These funds help cover rental costs in housing chosen by the subsidy recipient.

Over 2,000 applicants are on waiting lists to receive such rental assistance. Of those on waiting lists, at least half are involuntarily displaced, living in substandard housing, or paying more than 50 percent of family income for rent. Those families fortunate enough to receive rental assistance have a lengthy wait, averaging three years or more.

Of the 2,200 rental certificates or vouchers currently assisting Maine households, approximately 1500 will expire by 12/31/90. This represents over \$4,500,000 in federal subsidies in jeopardy of being lost to Maine if no action is taken, causing the loss of affordable housing for over 1500 Maine households.

We need your assistance to at least maintain the current levels of assistance being provided. Our record of over 95 percent successful lease-up of more than 2,200 units and our lengthy waiting lists indicate the overwhelming need for the assistance to continue.

Thank you for your leadership in housing. The needs are great, and we cannot afford to lose more ground. Please call me if I can provide additional information.

Sincerely,

Elizabeth H. Mitchell
Director

EHM:np

