RD Mortgage Maturities Threaten Hundreds of Thousands of Residents

By Gideon Anders, NHLP Senior Staff Attorney

In 10 years, three-quarters of Rural Development's (RD) current 440,000 rural rental and farm labor housing units[1] will become unavailable to low-income households.[2] The reason: maturing mortgages, a long-festering and recognized problem that RD has refused to focus on, let alone address. Hundreds of thousands of low-income residents of RD housing will soon be displaced, unable to afford the higher rents that will result when their apartments are removed from RD's housing stock. Most of the displaced will be seniors and people with disabilities, who together constitute over 61% of RD rental housing residents.[3] Unless RD and Congress act now, these residents will have no alternative affordable homes or rental subsidies available.

RD can change this bleak picture. After providing a brief background of the maturing mortgage crisis, this article outlines administrative solutions RD itself can take and policies RD should ask Congress to adopt to protect RD residents.[4] Advocates can facilitate some of the administrative actions and urge their congressional representatives to amend existing RD laws.

Background

The RD rural rental housing loan program started in 1963 as a senior housing program mirroring the Department of Housing and Urban Development's (HUD) Section 202 Elderly Housing program. In 1966, program eligibility was extended to non-senior families and the existing 3% flat loans available to property owners were replaced by an Interest Credit subsidy, which effectively lowered loan interest rates to 1%.[5] Under this framework, household rents were set at the higher of 20% of household income or the cost of operating the development and amortizing the loan at 1%. The rents, however, could not exceed the cost of operating the development and amortizing the RD loan at the rate the loan was actually made.

In 1976, RD began to make Rental Assistance available at its rental and farm labor housing developments.[6] Rental Assistance functioned like HUD's Project-Based Section 8 Program, with residents effectively paying 30% of their household income for housing.

The Mortgage Maturity Problem

RD's rental loan program remained relatively small in the 1960s, but then expanded rapidly, peaking in 1989. Loans were initially made for 50-year terms, a practice that continued for senior housing until sometime in the 1970s. Family housing loans were amortized over 40-year terms. Both 50-year loans made in the early 1960s and 40-year loans made in the late 1960s and early 1970s are now maturing.

Both the Interest Credit and Rental Assistance programs are project-based assistance programs. When these loans mature, their subsidies terminate and the owners must invariably raise rents to compensate for lost income, leading to widespread resident displacement.[7] Interest Credit and Rental Assistance differ from many current HUD subsidy programs, which are not tied to the underlying mortgage financing.

Both the lack of public access to RD data and accuracy problems with existing data exacerbate the displacement problem. Because RD both makes and holds the loans in its portfolio, it has always enjoyed access to loan maturity data. The agency has not, however, focused on the issue or data until very recently, when maturing mortgages were brought to its attention by advocacy groups. Unfortunately, the agency has yet to address the issue or to use the data in any meaningful way.

Finally, tenants receive no notice that their residence is facing loan maturation. They therefore lack a reasonable opportunity to relocate to other RD or HUD housing.[8] If RD and Congress do not act promptly to deal with these issues, many thousands of rural rental and farm labor housing residents face certain disaster.

Improve Maturing Mortgage Data

RD released its maturing mortgage data in November 2014.[9] While the overall data is sufficiently accurate to reveal and convey the magnitude of the mortgage maturity problem nationwide, a more detailed data listing of each loan[10] suggests that RD's records are not accurate with respect to the number and dates of maturing mortgages

[1]Tony Hernandez, Administrator, Hous. & Cmty. Facilities Programs, Results of the 2013 Multi-Family Housing Annual Fair Housing Occupancy Report, Attachment A, 1 (Feb. 21, 2014), *available at* http://www.ruralhome.org/storage/documents/rd_obligations/mfh-occupancy/usda-mfh-fy13-report.pdf [hereinafter Occupancy Report].

[2]Attachment to e-mail from David Howard, Legislative Analyst, Office of Congressional Relations—USDA, to United States Senator Jeff Merkley (Dec. 1, 2014).

[3]*See* Occupancy Report, *supra* note 1, at 10.

[4]NHLP recently prepared a memorandum on these options and presented it to RD Housing Administrator Tony Hernandez.

[5]*See* 42 U.S.C.A. § 1490a(a)(1)(B) (2015).

[6]*See* 42 U.S.C.A. § 1490a(a)(2)(A) (2015).

[7]As of 2013, the average yearly income of households receiving Rental Assistance was $10,024. The average yearly income of households only receiving Interest Credit assistance was $12,055. Occupancy Report, *supra* note 1, at 1.

[8]In addition, these residents are statutorily ineligible for RD vouchers.

[9]RD released the data only to congressional offices.

[10]RD released this more detailed data collection to the Housing Assistance Council.

in each state.[11] RD needs to update its database to ensure that developments with second mortgages, and developments with loans that were extended due to a national damage action against RD,[12] are accurately reflected in its database. To ensure further accuracy, RD should ask each RD state office to review the maturity dates and resolve any discrepancies. Finally, RD should make maturity dates public so advocates can more easily discover maturing mortgages in their geographical areas and work with residents, owners, and local public and private agencies to address the potential displacement problem.[13]

Mandate Meaningful Resident Notice

RD must immediately institute a policy requiring either its staff or development owners to provide a maturing mortgage notice to affected residents and housing agencies. Notice should be given at least two years prior to the loan maturity date, with reminder notices provided one year and six months before the date. A two-year notice is critical because it gives residents the opportunity to relocate to other RD and HUD developments, apply to local public housing, or apply for a voucher program. Most of these programs and developments maintain long waiting lists and suffer extremely slow unit turnover, so residents will likely require at least two years to relocate.

Urge Owners with Early Maturities to Delay Prepaying their Loans

Hundreds of RD loans are maturing significantly ahead of their original loan maturity dates. This is due to owners paying additional principal payments during the loan term, errors in calculating principal and interest made at loan origination, and/or the owner repaying loan principal when the full loan amount exceeded the cost to construct or rehabilitate the development. Whatever the reasons for early loan maturation, RD must approve an owner's early prepayment of the loan.[14] In many instances where a loan is maturing early, RD simply advises the owner that it must apply to prepay the loan and outlines application requirements. RD should stop this practice. If a loan is on pace to mature more than one or two months ahead of the original maturity date, RD should encourage owners to remain in the program as long as possible, and to then prepay the loan only one or two months early.

Delaying early prepayments allows residents to become eligible for RD vouchers.[15] Since principal loan balances will be very low only one or two months before loan maturity, owners could easily pay off their loans on this timeline. Indeed, owners should welcome the opportunity to prepay a loan one or two months early because it eliminates the problem of displacing residents who cannot pay the local market rent when the RD subsidies expire. The resulting reduced vacancy rate has a twofold benefit for owners. First, it has the immediate financial bonus of continued rent from the voucher holder, whom the owner can replace with a market-rate renter when the voucher holder moves out. Second, it should ease a development's transition from subsidized housing to market rate housing because it will make the development more attractive—much more attractive than it would be with massive vacancies.

Extend Current Loan Maturities

RD has authority to extend loan terms to coincide with the remaining useful life of a development. It should use this authority whenever possible to extend the availability of rent subsidies to residents.

RD also has authority to consolidate loans when owners own and operate more than one development in a geographic area. RD can then extend the maturity date of all the consolidated loans so they mature simultaneously. Where appropriate, RD should extend the maturity dates of loans scheduled to mature early to coincide with the loan scheduled to mature last.

Priority Admission

Currently, RD advises residents of developments where the owner has applied to prepay the loan that they are eligible to receive Letters of Priority Entitlement (LOPEs), which gives the residents the right to move to another RD development.[16] In the prepayment context, RD does not issue the LOPE until the owner has actually prepaid the loan. RD should abandon this practice and allow these residents to secure a LOPE as soon as RD notifies them that the loan will be prepaid. An earlier LOPE will give residents priority admission to RD and HUD housing so they can secure spots on waiting lists or relocate to other developments *before* the loan actually matures. The need for earlier LOPE procurement is particularly urgent in areas where alternative housing opportunities are not readily available or where the number of soon-to-be displaced residents exceeds the area's affordable housing stock.

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[11]Ohio and Oregon advocates discovered inaccuracies when they compared projects in the RD database against information available through their RD state offices.

[12]*See*, *e.g.*, Franconia Assocs. v. United States, 536 U.S. 129 (2002); Franconia Assocs. v. United States, 43 Fed. Cl. 702 (2004).

[13]For an example of successful local advocacy, see the article on page 15 of this *Bulletin*.

[14]*See* 7 C.F.R. § 3560.11 (2015) (defining prepayment as "payment in full of the outstanding balance on an Agency loan prior to the note's originally scheduled maturity date").

[15]Currently, RD vouchers are unavailable to residents displaced by prepayments.

[16]*See* 7 C.F.R. § 3560.660(b) (2015). Residents are also advised of their voucher eligibility.

To allow residents to take advantage of earlier LOPEs and to secure other housing, however, RD must make two administrative changes. First, it must allow residents to breach their annual leases by making relocation a good cause for lease termination.[17] Second, to eliminate a potential hardship to the owner and to prevent another low-income household from having to relocate when a loan matures, RD must authorize owners to admit higher-income residents, who are not in need of subsidies, for the balance of the loan term. These residents would not need to relocate when the loan matures. This exception will require regulatory change.

RD should also modify its regulations with respect to the priority given to LOPE holders. Under current regulations, LOPE holders are grouped with other applicants by income (extremely low income, low income, and moderate income)[18] and only receive admission priority within their income group. A regulatory revision should give LOPE holders the highest admission priority.

Finally, RD should also work with HUD to ensure that RD residents facing displacement are treated as displaced tenants under HUD programs and granted priority admission to HUD-financed housing and voucher waiting lists.

Statutory Changes

To better protect residents in developments with maturing mortgages, several statutory changes are necessary. First and foremost, residents must be made eligible for RD vouchers. This can be done simply by modifying the annual agricultural appropriations bill to classify residents of maturing mortgages as eligible for RD vouchers.[19]

There is a corresponding need to lift the statutory limitation that prohibits RD from contracting for more than 5,000 vouchers per year.[20] This could probably be accomplished by another amendment to the annual agricultural appropriations bill. Preferably, though, Congress would amend the authorizing statute. In the meantime, RD should seek an annual exception to the voucher limitation.

Finally, Rental Assistance subsidies should be decoupled from the Section 515 rental and Section 514/516 farm labor housing loan programs. This would enable RD to continue paying subsidies to owners whose loans are maturing and avoid or forestall resident displacement.

Conclusion

While RD can implement many of these suggestions administratively, the agency has yet to announce a single initiative to address the mortgage maturity problem. Advocates should urge RD and Congress to address mortgage maturity before it becomes a major crisis. In the meantime, advocates should determine which RD loans in their service areas are maturing, send notices to residents about the maturity dates, and work with owners and RD to ensure that owners prepay their loans shortly before they mature, rendering residents eligible for vouchers. ■

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[17]All leases must include: "[t]he terms under which a tenant may, for good cause, terminate their lease, with 30 days notice, prior to lease expiration." 7 C.F.R. § 3560.156(c)(18)(xx) (2015).
[18]*See* 7 C.F.R. § 3560.154(g)(1) (2015).
[19]Until this change is made, RD should encourage owners to prepay their mortgages only slightly early. *See supra* text accompanying note 15.
[20]42 U.S.C.A. § 1490r(b)(2) (2015).