NLHA

NATIONAL LEASED HOUSING ASSOCIATION

TESTIMONY OF LAWRENCE J. LIPTON

CHIEF FINANCIAL OFFICER, RELATED MANAGEMENT

ON BEHALF OF
THE NATIONAL LEASED HOUSING ASSOCIATION

ON LATE PAYMENTS UNDER

SECTION 8 PROJECT-BASED CONTRACTS

BEFORE THE SUBCOMMITTEE ON
HOUSING AND COMMUNITY OPPORTUNITY
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

OCTOBER 17, 2007

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Madam Chairperson and Members of the Subcommittee, my name is Larry Lipton and I am Chief Financial Officer of Related Management. I am appearing before you on behalf of the National Leased Housing Association, which for over 35 years has represented owners, managers, lenders, investors, public officials and others involved with Section 8 and other affordable housing programs. NLHA played a major role as Section 8 programs were being formulated and our member organizations were the original developers and owners of this critical housing resource.

Related Management is also an active member of the National Multi Housing Council (NMHC) and the National Apartment Association (NAA). Both organizations have joined with NLHA in submitting this testimony. NMHC represents the apartment industry's largest and most prominent firms and NAA is the largest national federation of state and local apartment associations, with 190 affiliates representing nearly 50,000 professionals who own and manage more than six million apartments. NMHC and NAA jointly operate a federal legislative program and provide a unified voice for the private apartment industry
.

Other national housing organizations are also deeply concerned about this issue and have weighed in with Members of Congress; a copy of their letter is attached.

My company, Related Management, has its headquarters in New York City and owns and manages about 26,000 units of multifamily housing in 12 states, spread from New York to California. Our Section 8 project-based inventory totals 11,287 units in 64 projects.

The Section 8 project-based programs, enacted more than 30 years ago, have provided effective and enduring shelter for millions of low-income families. In addition to making possible the construction or rehabilitation of housing units dedicated to low-income occupancy for extended periods, Section 8 has been used in several hundred thousand units in projects financed under other HUD programs to preserve those projects from financial problems or to ease the rent burden on low-income tenants in those projects.

In our opinion, the Section 8 subsidy mechanism is the most effective housing subsidy ever devised by Congress. It is an elastic subsidy that can reach the very poorest families and keep their rent burden proportionately the same as the rent burden on families with more income.

However, for Section 8 to be an effective program, HUD must comply with its contractual promise to housing providers to make timely monthly assistance payments. These assistance payments cover the difference between tenant rent contributions, generally set at 30 percent of a tenant's adjusted income, and the HUD-approved rents for the project. The tenant rent contribution generally pays for only a small portion of the costs of running a project, including debt service payments. Without assistance payments from HUD a project cannot continue to operate and serve its tenants.

While HUD has been late sporadically in making payments over the past several years, this year late payments have been widespread over most parts of the country, with nonpayment often persisting for several months.

In the case of our company, for example, we billed HUD in June of this year for $9.8 million in assistance payments for the month of July. Almost one-third of our bill, or $3.1 million, was not paid by July 31, and about 20 percent or $2 million remained unpaid as of September 30. One of our projects, in San Diego, received no funds for the three-month period of July through September, for a total of $525,000. No doubt many other owners have been hit harder than us, but any late payment at any time is indefensible. We support legislation to charge HUD interest on payments not received within 30 days of the due date, a penalty payment available to most contractors doing business with the government, and that might also be an incentive to HUD to make timely payments.

Owners do what they can to cope during these periods of nonpayment, such as drawing funds from a replacement reserve, and other reserves if they exist, borrowing funds, delaying payments to vendors, and making personal contributions.

It is not exactly clear how these payment problems occurred and owners have no assurances that the problem will not recur in the future. To protect themselves from future late payments, some owners may consider taking several actions, including not making needed project repairs from funds in a replacement reserve in order to preserve these funds to offset late payments; selection of the highest income tenants legally possible in order to reduce the deficit between tenant rent contributions and the cost of operating the project; and, perhaps most significantly, planning to opt out of their contracts.

The late payment problem not only affects the operations of a project, but also makes difficult the preservation of these aging projects through sales, often to nonprofit purchasers that commit to long affordability periods, and rehabilitation, usually with proceeds from the low-income housing tax credit. Purchasers, lenders, and tax credit investors have been put on alert that the government may not perform under its contracts, and they will act accordingly to protect their interests, assuming they continue to participate at all. We have attached to our testimony a list of 19 adverse consequences of delayed or insufficient HAP funding.

The damage of the late HAP payments is being compounded by concerns that Congress will not provide sufficient appropriations for the Section 8 project-based program in fiscal year 2008. HUD is responding to this potential shortfall by entering into renewal contracts that no longer purport to make a commitment for one year of funding, but rather obligate HUD for only a period of a few months with the promise to extend the short period for an indeterminate further period when and if sufficient appropriations become available.

The perception this kind of contract creates is devastating. Until recently, several years of predictability and stability in the Section 8 renewal process have led purchasers, lenders and investors in Section 8 properties to rely on long-term Section 8 renewal contracts, even though subject to annual appropriations, as sufficient backing for their investment. They assumed the appropriations risk in these contracts because they thought the risk was minuscule. They are not so sure anymore.

There are other more technical, but serious, concerns with short funding commitments. These contracts purport to bind an owner to providing section 8 housing for one year. If HUD funding stops after 4 months is the owner bound to continue to comply with Section 8 rent and other rules without receiving assistance payments? If the owner can get out of the contract will it be bound by the one-year tenant notice statute which will prevent the owner from raising rents for one year after an opt-out notice to the tenants? Will the tenants be eligible for enhanced vouchers if the contract is abrogated? Will HUD wait until the one-year notice period has elapsed before awarding enhanced vouchers, as has been its recent policy? Will there be sufficient funding for all enhanced vouchers?

These concerns will influence an owner's decision to remain in the program or to opt out, as well as decisions whether to purchase and rehabilitate Section 8 projects. At a minimum, owners will more likely give routine notices to tenants that they intend not to renew a Section 8 contract, in order to reduce their exposure period during which they do not receive assistance payments but cannot raise rents. These opt-out notices will cause anxiety among tenants who will be placed in a continual state of uncertainty as to whether they will lose their homes or not.

Unless the industry has confidence that the government is committed to adequate and timely funding, the Section 8 inventory is likely to shrink in size. Nor will it get the new investment needed to preserve these projects as affordable housing and to keep them affordable far into the future.

What can this Committee do to help rectify the damage done to the Section 8 inventory? First, it can exercise close oversight over the process HUD uses to make Section 8 assistance payments, as well as how budgetary needs are calculated. Second, a package of amendments submitted to the Committee by NLHA to remove statutory and administrative impediments to preserving affordable housing will help facilitate Section 8 renewals and the sale, rehabilitation, and long-term affordability of Section 8 and other HUD-assisted housing projects. Third, the Committee should urge that sufficient appropriations be provided for fiscal year 2008 to avert the use of a succession of short term funding obligations by HUD.

Thank you for the opportunity to testify on this important subject and I will be pleased to answer any of your questions.

NATIONAL
LEASED HOUSING
ASSOCIATION

SOME IMPLICATIONS OF INADEQUATE FUNDING OF PROJECT-BASED SECTION 8 CONTRACTS

If Congress fails to appropriate sufficient funds for FY 2008 to make all contractual section 8 payments, in original and renewal contracts, this failure will be regarded by participants in the Section 8 program, other housing programs, other federal programs, and the capital markets as a default by the United States in its perceived moral obligation. The section 8 contract has already been devalued even without a default by sustained talk of inadequate funds, widespread late payments in 2007, and the inability of HUD to provide one-year extension contracts because of insufficient funds. A quick and decisive fix may salvage some of the damage.

The following are several specific adverse consequences:

(1) Lenders will be less willing to make long-term loans for refinancings or purchases of section 8 projects, transactions which help in the rehabilitation and preservation of the projects.

(2) Investors and syndicators will be less willing to purchase low income housing tax credits, which are key to the sale and rehabilitation of those projects.

(3) To the extent the above players continue to participate, it will be on more onerous terms and with a more rigorous selection process to assist only projects that would be viable if section 8 payments terminated.

(4) Owners who economically can opt out of the section 8 program will plan to do so and will do so at the first opportunity.

(5) Owners can also stop providing section 8 housing even prior to contract expiration if HUD fails to provide assistance payments.

(6) Tenants will become anxious about the potential loss of their subsidy and homes. The elderly are particularly susceptible to those concerns. Some will move out and live with their families, thus losing their eligibility for tenant protection vouchers when an owner opts out.

(7) Owners will select the highest income tenants they legally can select in order to mitigate the impact of missed or reduced assistance payments.

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(8) The cost of enhanced vouchers and other tenant protection vouchers will soar, or alternatively, all tenants will not be protected if there is an opt-out.

(9) There may be an increase in defaults on FHA-insured mortgages covering section 8 projects.

(10) Affordability use restrictions for projects that have been restructured in the mark-to-market program, which run 30 years, would be converted to permit higher income tenants to be served.

(11) Fifty-year affordability use restrictions for LIHPRHA projects and existing use restrictions for ELIPHA projects would be terminated and the projects rented to market tenants if HUD cannot provide all the contractual section 8 payments.

(12) For those projects remaining in the program, there will be an increase in deferred maintenance, depletion of replacement reserves, and little likelihood of obtaining tax credits for rehabilitation.

(13) Prices realized by HUD in selling foreclosed properties with section 8 subsidies would decline.

(14) If Congress authorizes the conversion of rent supplement and RAP contracts to section 8, there will be few takers.

(15) Participation and continued participation in other housing programs involving multi-year subsidies, such as project-based vouchers, regular vouchers, 202/811 would decline, or the quality of participants would decline.

(16) The lack of sufficient section 8 funds will also thwart the refinancing of older section 202 projects for the elderly and disabled that have section 8 subsidies. Many of these projects are 20 to 30 years old and can be preserved for another long period with recapitalization and rehabilitation, but lenders and investors would be wary of participating.

(17) The ability of public-housing agencies to borrow funds for capital improvements, secured by future appropriations to the capital fund, would be made more difficult and costly.

(18) Participation in non-housing federal programs, dependant on ongoing federal subsidies, would be compromised if participants felt the United States defaulted in the major section 8 programs.

(19) There are broader implications in the capital markets. A default by the United States in any area could send further shock waves to the already shocked markets. Would this be the end of the perceived federal backing of Fannie and Freddie obligations, and if so, increasing borrowing costs for home purchases and refinancing? Would the odor of default by the United States raise borrowing costs for Treasury?

October 5, 2007

The Honorable Dave Obey
Chair
Committee on Appropriations
2314 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Obey:

The undersigned organizations are writing to alert you to a desperate situation currently affecting federal government contracts on thousands of affordable housing properties subsidized through the U.S. Department of Housing and Urban Development (HUD).

Owners and developers of low income housing properties throughout the country that have entered into Section 8 project-based housing assistance payment (HAP) contracts with HUD are experiencing major funding shortfalls due to insufficient FY07 appropriations to renew such contracts. Without these funds, properties are not able to pay debt service, utility costs (including utility allowance payments to residents) or other operating expenses. If the property is unable to operate, the low income residents, many of them elderly and disabled, will be displaced and a scarce housing resource will be lost.

This crisis is a direct result of HUD and particularly the Office of Management and Budget (OMB) underestimating the funding renewal needs of such contracts and requesting less than is necessary in the Administration's budget request. From what we can gather, a number of "creative" accounting maneuvers have been used over the last ten years, including the Congressional practice of including "rescissions" in appropriations bills. These actions have distorted the actual funding needs for project-based Section 8 renewals, causing the current crisis.

HUD's budget request for FY08 is **less** than what was appropriated in FY07 even though the $5.829 billion appropriated for Section 8 project-based contract renewals in FY07 has proved to be nearly $1.2 billion less than what was needed. We believe the shortfall for FY08 to be $2.2 bllion.

It is not appropriate to continue HUD's band-aid solution of providing partial funding by bifurcating payments between fiscal years. Such an approach distorts the actual funding need, but does not reduce the amount of the shortfall. Further, the continued delay in making payment undermines the confidence of owners, resulting in owners' terminating such contracts. It is simply not acceptable that the nation's most vulnerable people, many of them elderly and disabled will be put out on the street because the Administration did not request sufficient funds to meet its contract obligations

We can ill afford to lose this scarce housing resource. Please support the appropriation of sufficient funds to renew for 12 months all Section 8 project-based contracts in FY08.

Sincerely,

American Association of Homes and Services for the Aging (AAHSA)
Council for Affordable and Rural Housing (CARH)
Institute of Real Estate Management (IREM)
Institute for Responsible Housing Preservation (IRHP)
Mortgage Bankers Association (MBA)
National Apartment Association (NAA)
National Association of Affordable Housing Lenders (NAAHL)
National Association of Homebuilders (NAHB)
National Affordable Housing Management Association (NAHMA)
National Leased Housing Association (NLHA)
National Multi Housing Council (NMHC)