distinguished its earlier *Kimberly* decision as a contractual case between a borrower and RD, noting that it did not address whether a decision to accept a prepayment was subject to an APA review.[10]

On remand, the Oregon district court ruled in favor of the Seacrest residents by holding that the prepayment violated ELIHPA.[11] However, it did not enter an order providing relief to the residents. Instead, it asked the parties to consider settling the case and offered the court's assistance in the process. Over the next 29 months, the parties engaged in protracted settlement discussions and pursued various financing alternatives that ultimately resulted in the settlement agreement.

Conclusion

The plaintiff residents will now be returned to the RD Rental Assistance Program, as will all other eligible residents living at Seacrest. They will also be entitled to all RD resident protections, which include a tenant grievance and appeals process. The one ineligible Seacrest household will be required to move from the development, and only low-income, RD-eligible residents will be admitted to the development for the next 30 years. Seacrest will undergo major rehabilitation, which will require residents to be relocated for a short time. The settlement agreement ensures that the residents will receive relocation and other assistance during that period.

Significantly, in the Ninth Circuit, *Goldammer* has laid to rest RD owners' claims that they can circumvent ELIHPA by making an offer to prepay their loans and, when RD does not accept their offer, that they can pursue a quiet title action that removes the RD security and regulatory lien from the property.[12]

The Seacrest residents were represented by Art Schmidt of the Oregon Law Center, who was assisted by the staff of the National Housing Law Project. The Oregon Law Center and NHLP also settled their Equal Access to Justice Act attorney's fees claim as part of the settlement agreement with RD. ■

[10]For a more detailed discussion of the *Goldammer* decision, *see* NHLP, *Victory: Ninth Circuit Allows Residents to Challenge RD Prepayment*, 36 Hous. L. Bull. 206 (Oct. 2006).

[11]No. 03-1749 (D. Or. June 14, 2007).

[12]*See* Schroeder v. United States, 569 F.3d 956 (9th Cir. 2009).

Recapitalizing the HUD-Assisted Housing Stock: Part One

Beginning in 1959, Congress created several programs designed to motivate private owners to develop affordable housing in exchange for government incentives. The owners agreed to certain affordability restrictions that usually ran with the mortgage, almost always for at least a certain period. To effectuate this minimum restricted use period, Congress also frequently restricted the owners' ability to prepay the mortgages. Unfortunately, these financing restrictions have often led to situations where owners are not able to obtain capital with which to make necessary repairs to the buildings. This has become an increasingly serious problem as the HUD-assisted stock ages and capital components wear out over time.

The past decade has witnessed many policies and proposals to address this problem for various segments of the HUD-assisted stock. This two-part article will analyze five examples of such recent efforts to address recapitalization in several of the HUD housing programs, focusing on:

- Section 236 Decoupling;
- Section 202 Supportive Housing for the Elderly;
- Section 515 Rural Rental Housing;
- properties subject to Section 250 of the National Housing Act; and
- properties with naturally maturing mortgages (commonly referred to as "The Year-40 Problem").

These examples are not intended to be comprehensive, as other recapitalization efforts have been adopted. However, the five examples discussed here are illustrative of common issues that frequently arise in and recurring principles that should govern recapitalization efforts. Part One of this article will address the first three examples. Part Two, which will be published in the next issue of the *Bulletin*, will address the final two.

A number of common impediments to responsible recapitalization exist across the HUD-assisted housing stock. Many programs operate under a rigid statutory scheme that may not allow for project owners both to engage in transactions that access capital for reinvestment into the property, while at the same time continuing in the program and protecting affordability for current and future tenants. This results in a tension between the need for recapitalization and the need to maintain long-term affordability for tenants. Owners often seek release from the use restrictions that protect long-term affordability, achieving recapitalization at the expense of affordability. Even where the existing affordability restrictions are maintained, in situations where public approvals or additional public investment is required, it is necessary to ensure that the conferral of further public support results in an extended term of affordability.

Principles of Recapitalization Policy

To address these issues, recapitalization policy should follow specific principles that enable satisfaction of a property's long-term physical needs while preserving affordability to protect both current and future tenants. Specifically, any legislative or administrative recapitalization policy should be consistent with the following six principles, to the greatest extent possible. First, the recapitalization must meet the properties' short- and long-term physical and financial needs. Second, proceeds that exceed those needed for revitalizing the property should be retained for affordable housing needs to the extent that they are made possible by added public benefits or approvals. This has been a point of contention, especially for nonprofit owners who may want to use the proceeds for non-housing related portions of their broader charitable mission. However, given the scope of the affordable housing crisis and the long-term federal budget outlook, it is vital that excess proceeds be used for affordable housing and related social services. Third, any policy must also protect current tenants and ensure future affordability for tenants and the project. Often, legislation only considers current tenants, but does not make provisions for future tenants who will also need the same protections. Many properties have only a short period of time left on their use restrictions. If they receive recapitalization incentives, Congress must require extended use restrictions that ensure preservation of the affordable units for the long term. Fourth, the policy should weed out poorly performing owners and managers who lack the capacity or the will to provide high-quality, responsive stewardship for the property and its tenants. Fifth, the policy must provide mechanisms for tenants to participate in the decision-making process. This participation must be meaningful—tenants should be given proper notice, provided all relevant documentation, and be afforded a chance to comment, and the owner and HUD must respond to such comments within a defined timeframe. Finally, the policy should be clear to minimize confusion as to the requirements and protections, and should attempt to minimize unnecessary complexity.

Prior Recapitalization Efforts

In addition to the five examples discussed in this article, Congress has previously addressed these issues with other segments of HUD-subsidized and assisted housing. First, with respect to troubled properties experiencing mortgage default and foreclosure, Congress passed the Housing and Community Development Amendments of 1978, which was later strengthened in 1988 and revised again in 1994.[1] This law established a framework for preserving such properties, including both planning requirements and resources to fund property rehabilitation and preservation. Second, for certain properties with HUD-subsidized mortgages that could otherwise unilaterally prepay their loans, Congress adopted the Low-Income Housing Preservation and Resident Homeownership Act of 1990 (LIHPRHA).[2] LIHPRHA generally required such properties to be preserved for their useful lives, either by owners staying in the program or selling to nonprofit preservation purchasers, in exchange for federal financial incentives. However, Congress reduced funding in 1995 and completely withdrew it in 1998. Another policy designed to address this issue is called the Mark-to-Market mortgage restructuring program, which Congress passed in 1997. Mark-to-Market allows properties with expiring project-based Section 8 assistance and above-market rate Section 8 contract rents to bifurcate their debt in a manner that allows HUD to reduce the necessary rental assistance while renewing the Section 8 contracts and extending the term of affordability.[3] Two years later, Congress and HUD adopted the Mark-up-to-Market program for properties with below-market rate Section 8 rents, and a similar Mark-up-to-Budget program for nonprofit owners.[4] In contrast to Mark-to-Market, these programs offered a mechanism for Section 8 properties with below-market rents to increase the contract rents in exchange for extended affordability restrictions. All of these efforts contained certain elements of a responsible recapitalization policy, including ownership capacity requirements, physical needs assessments and rehabilitation requirements, extended use restrictions, planning processes involving affected tenants and communities, as well as the necessary financial resources.

Section 236 Decoupling

Over the past decade, HUD has utilized Interest Reduction Payment (IRP) decoupling as a recapitalization tool for Section 236 properties. Under Section 236, HUD provided an IRP directly to the lender, thus effectively reducing the interest rate on the underlying loan to 1%. In exchange, owners agreed to various restrictions on the property, including budget-based rent limitations and low-income occupancy, so long as the mortgage and regulatory agreement remain in effect.

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[1]Now codified at 12 U.S.C.A. § 1701z-11 (Westlaw Nov. 10, 2009).

[2]Pub. L. No. 101-625, tit. VI, 104 Stat. 4079, 4275 (Nov. 28, 1990) (codified at 12 U.S.C.A. §§ 4101 *et seq.*) [hereinafter LIHPRHA]. LIHPRHA was passed after Congress initially enacted a temporary program restricting prepayments.

[3]Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRAA), Pub. L. No. 105-65, Title V, 111 Stat. 1343, 1384 (Oct. 27, 1997) (codified at 42 U.S.C.A. § 1437f note (Historical and Statutory Notes, "Multifamily Housing Assistance")), *amended by* Pub. L. No. 106-74, § 531 (Oct. 20, 1999).

[4]Pub. L. No. 106-74, § 531 (Oct. 20, 1999) (amending Section 524 of MAHRAA); HUD Section 8 Renewal Policy Guide (as rev. Apr. 17, 2009), *available at* http://www.hud.gov/offices/hsg/mfh /exp/guide/s8renew.pdf.

Congress enacted the decoupling provisions for Section 236 properties in 1999 as Section 236(e)(2) of the National Housing Act.[5] Decoupling severs the IRP stream from the underlying mortgage and thus allows for the complete refinancing of the project, while still retaining the already appropriated IRP subsidy. Thus, funds necessary for rehabilitation can be accessed through tapping new debt, without sacrificing the existing subsidies.[6]

As Section 236 mortgages near maturity of their 40-year terms, the decoupling tool becomes less useful, because the total amount of remaining IRP available diminishes as the remaining mortgage term decreases.

Section 236 decoupling serves as a useful early example for recapitalizing a particular segment of the HUD-assisted stock. However, the decoupling tool falls short in a number of ways.

Nuts and Bolts of IRP Decoupling

Section 236(e) authorizes the retention of IRPs upon refinancing, but only where "the project owner enters into such binding commitments as the Secretary may require…to ensure that the owner will continue to operate the project in accordance with all low-income affordability restrictions"[7] for not less than the original IRP term, *plus an additional five years*.

In 2000, HUD issued Notice H 00-8, implementing Section 236(e)(2).[8] This Notice has since been reinstated and extended a number of times,[9] and continues to set forth the guidelines governing IRP decoupling transactions.

Notice H 00-8 requires owners who engage in decoupling to enter into new IRP Agreements and Use Agreements that govern the IRP payments and extend the use restrictions (including the regulation of rents, occupancy and habitability standards, income limits and financial reporting requirements) on the project. Although project rents may be increased to include reasonable debt coverage,[10] rent increases on units not also receiving project-based Section 8 assistance are limited to 10% above current rents.[11]

In exchange for these restrictions, the owner is allowed to decouple the IRP subsidy and apply it to service the new debt. The continued IRP subsidy may not exceed the original IRP budget authority allocated to the project.[12] However, the term of the new IRP agreement may exceed the length of the original if the owner opts to receive lower monthly payments.[13] Whatever the new term, the owner must extend the use restrictions for five years beyond the IRP expiration.

Notice H 00-8 also requires the application to include a "[d]iscussion of the physical condition of the project and the cost and nature of any physical improvements that will be undertaken to address all repair needs and place [the] project in good condition for the foreseeable future."[14] The decoupling is also prohibited from causing any involuntary displacement, and the application must provide a narrative describing how tenants will be protected from any rent increases, such as through the use of other subsidies.[15]

Deconstructing Decoupling

Section 236 decoupling serves as a useful early example for recapitalizing a particular segment of the HUD-assisted stock. It does a good job of maintaining affordability limits and protections for tenants through extended affordability agreements and limits on increases in tenant rent burdens and involuntary displacement. Specifically requiring the owner to renew any existing project-based assistance during the extended restricted term is another plus. Likewise, the requirement that applications assess overall project need at least in theory compels owners to provide for responsible and sufficient recapitalization.

However, the decoupling tool falls short in a number of ways. It only provides for a five-year extension of the use restrictions, and thus cannot serve as a model for long-term preservation. Where properties lack rental assistance, the limited amount of new debt service that can be placed on the property remains a limitation. The

[5] Codified at 12 U.S.C.A. § 1715z-1(e)(2) (Westlaw Nov. 10, 2009).

[6] Prior to developing the decoupling scheme, Section 236(b) of the National Housing Act, 12 U.S.C. § 1715z-1(b), provided another tool, which allowed an approved public agency to purchase the 236 mortgage and retain the IRP payments, while issuing additional debt secured by the original 236 mortgage. Use of Section 236(b), however, requires consent from the original note-holder, which is often difficult to obtain. Use of this provision has significantly diminished since 1999, when decoupling was enacted.

[7] Departments of Veterans Affairs and Housing and Urban Development, Independent Agencies Appropriations Act, 2000, § 532(a), Pub. L. No. 106-74, 113 Stat. 1047 (Oct. 20, 1999).

[8] Guidelines for Continuation of Interest Reduction Payments after Refinancing: "Decoupling", HUD Notice H 00-8 (May 16, 2000).

[9] *See* HUD Notice H 07-02 (Mar. 13, 2007); Notice H 05-19 (Nov. 9, 2005); Notice H 04-20 (Nov. 9, 2004); Notice H 03-17 (Aug. 20, 2003); Notice H 02-15 (July 17, 2002); Notice H 01-05 (June 6, 2001).

[10] *See* HUD Notice H 00-8, *supra* note 8, at ¶12, stating, "Based on careful analysis, appropriate added debt service resulting from the restructuring may be included in the Basic and Market Rent calculation, if it is treated as an operating expense of the project subject to the rent increase limitations." *See also* Emily Achtenberg, Local Initiatives Support Corporation, Section 236 Decoupling 2 (2009) ("Reasonable debt coverage may also be included in the budget-based rent.") (citing Memorandum from Shaun Donovan, "Revisions, Questions, and Answers Regarding HUD Notice H 00-8" (Nov. 6, 2000)).

[11] HUD Notice H 00-8, *supra* note 8, at ¶12.

[12] *Id*. at ¶14.

[13] *Id*.

[14] *Id*. at ¶10.

[15] *Id*.

extensive amount of rehabilitation needed by many of the old Section 236 projects will not be supported by a modest increase in debt service and rents, in conjunction with principal paydown. Increased rental assistance is usually critical,[16] and successful decoupling transactions generally require leveraging of significant other public subsidies, such as state or local bond financing, Low-Income Housing Tax Credit (LIHTC) syndication proceeds, federal HOME or CDBG funds or other state or local subsidies. Not only does this layering of subsidies significantly increase the complexity of these transactions, but it also drastically limits the use of decoupling to projects where other such subsidies can actually be tapped.

Furthermore, Notice H 00-8 lacks specific requirements for tenant notice or involvement in the decision-making process about the recapitalization plan, though it does maintain the tenant participation requirements of 24 C.F.R Part 245 for input on rent increases.[17] Finally, the program does not specifically require that recapitalization proceeds be reinvested in the property, though that may well be the practical result of maintaining the same limitations on surplus cash distributions and the assessments and approvals required to use decoupling.[18]

Section 202 Supportive Housing for the Elderly

In 1959, Congress created what is now known as the Section 202 Supportive Housing Program to provide affordable housing for elderly persons.[19] By 2005, the program maintained an estimated 268,000 units designated for the elderly,[20] with approximately 4,500 new residential units created each year.[21] Owned by nonprofit organizations, the properties provide features to assist older Americans age in place, such as grab bars, ramps or emergency call systems that are not frequently available in the general market.[22] Much of this stock is aging and needs repair.

The Section 202 program has operated under different financing schemes and use restrictions over the course of its existence.[23] Initially, the program operated through direct loans with 50-year use restrictions ensuring affordability for low-income elderly families. Since 1974, the program has required only a 40-year use restriction, but has included some type of project-based rental assistance in order to make the units affordable to very low-income elderly families. Most of the Section 202 inventory now has project-based rental assistance. Between 2001 and 2009, funding for the 202 program has remained relatively stable, although only at levels sufficient to produce a small portion of the units needed. The current funding level for fiscal year 2009 is $765 million.[24]

Current Practice

In recent years, nonprofit owners of Section 202 properties have sought more responsive HUD approvals to permit prepayment of loans for refinancing. Until the FY 2009 Appropriations Act was passed, owners could only prepay a loan and refinance if it would result in lower debt service, not to raise capital to address the physical needs of the property.[25] Congress has recently responded by considering legislation amending Section 811 of the American Homeownership and Economic Opportunity Act of 2000 (the Act),[26] which provides the framework for refinancing Section 202 properties.

In 2007, H.R. 2930, a bill proposing changes to Section 811 of the Act, was introduced and eventually passed in the House.[27] H.R. 2930 laid much of the initial groundwork for creating an effective recapitalization program, but lacked some necessary tenant protections. Most importantly, the bill would have authorized project owners to refinance to address physical needs, so long as the rents for current unassisted tenants would not increase.[28] This would allow project owners to obtain the necessary capital to reinvest in the property. However, the bill failed to ensure future affordability for tenants and the project, provide mechanisms for tenants to participate in the decision-making process or adequately restrict the use of proceeds for affordable housing needs. Although the Senate version of the bill included important revisions addressing such concerns, it never left committee.

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[16]Given the current 10% cap on non-Section 8 units, commentators have noted the limited usefulness of decoupling transactions to projects without a high proportion of project-based Section 8 contracts. *See, e.g.*, Achtenberg, *supra* note 10.

[17]HUD Notice H 00-8, *supra* note 8, at 12.

[18]*Id*.

[19]Housing Act of 1959, Pub. L. No. 86-372, 73 Stat. 667 (1959) (codified at 12 U.S.C.A. §§ 1701q *et seq*. (Westlaw Nov. 10, 2009)). At the time, the 202 program was also designated for persons with disabilities.

[20]U.S. GAO, Elderly Housing: Federal Housing Programs that Offer Assistance for the Elderly 10 (2005), *available at* http://www.gao.gov/new.items/d05174.pdf.

[21]AARP Public Policy Institute, Developing Appropriate Rental Housing for Low-Income Older Persons: A Survey of Section 202 and LIHTC Property Managers 2 (2006).

[22]*Id*. at 4.

[23]U.S. GAO, *supra* note 20. Because each project must follow the rules in existence at the time it was developed, understanding each property's financing is helpful to understand its recapitalization issues. When the 202 program began in 1959, developers received direct 50-year loans from HUD that held a 3% interest rate. For those 202 projects built between 1974 and 1990, interest rates increased to Treasury's cost of borrowing and the term of use restrictions dropped to 40 years. These projects used project-based Section 8 in conjunction with 202, making the units affordable to very low-income households, as the subsidy filled the gap between the tenant's share of rent and the approved contract rent. Finally, 202 properties built since 1990 are financed through forgivable capital advances instead of loans, and thus have no debt service so long as the 40-year use restrictions are adhered to. The program no longer uses Section 8 rental subsidy, but instead has rental assistance based on operating costs.

[24]FY 2009 Appropriations Act, Pub. L. No. 111-8, 123 Stat. 524 (2009) [hereinafter FY '09 Appropriations Act].

[25]FY '09 Appropriations Act § 234.

[26]Pub. L. 106-569, 114 Stat. 3109 (Dec. 27, 2000).

[27]Section 202 Supportive Housing for the Elderly Act of 2007, H.R. 2930, 110th Cong. (2007).

[28]H.R. 2930, tit. II.

In February 2009, several items regarding Section 202 prepayments involving refinancing made their way into the final FY '09 Appropriations Act, as enacted.[29] Under this Act, HUD may approve prepayments of Section 202 loans that involve refinancing to address the physical needs of the property after a cost-benefit analysis that includes assessing whether tenant rents will increase.[30] Additionally, the FY '09 Appropriations Act allocates $150 million for tenant protection assistance, including tenant-based or project-based assistance that could help preserve the long-term affordability of any Section 202 properties refinanced under the Act's provisions.[31] However, these provisions do not fully address all preservation concerns. Thus, the current authorizing legislation introduced in the Senate as S. 118 and now included in the draft omnibus preservation bill authored by Congressman Barney Frank is vital for a comprehensive revision of rules regarding prepayments that involve refinancing.[32]

Proposed Legislation

The Section 202 Supportive Housing for the Elderly Act of 2009, S.118 and Title VII of the omnibus House preservation legislation address many concerns raised by advocates.[33] First, the proposed bills address the need to preserve affordability in the long term, by adding a 20-year use restriction following the original maturity date of the original loan in order to receive prepayment approval.[34] This is vital, especially as an estimated 40,000 to 45,000 units of the pre-1974 Section 202 stock near the end of their use restrictions.[35] Further, the bill allows refinancing by a nonprofit owner to increase the overall cost of Section 8 rental assistance in order to mark-up-to-budget.[36] This ensures that the owner will be able to cover the recapitalization costs without increasing tenant rent burdens. Title VII also includes provisions attempting to ensure tenant participation in the prepayment decision-making process, though they fall short of providing meaningful opportunities for participation.[37] Finally, the proposed bill increases restrictions on the use of proceeds from refinancing so that they will only be used for housing or service-related purposes.[38] These new refinancing provisions are vital to protect tenants and to secure long-term affordability.

Looking forward, to fully address concerns regarding tenant protections and long-term affordability, the rules regarding refinancing must still address a number of issues. While the proposed revisions to Section 811(a)(2) of the Act would allow a requested prepayment to involve refinancing to address physical needs so long as rent charges do not increase for current unassisted residents, there is no protection for future tenants. Language must be included to ensure that future tenants are not faced with unregulated rents. Because Section 202 property owners are nonprofits and will have little opportunity to recapitalize without federal assistance, future legislation should require the maximum term of use restrictions possible in exchange for allowing prepayments with refinancing.

Looking forward, to fully address concerns regarding tenant protections and long-term affordability, the rules regarding refinancing must still address a number of issues.

Other aspects of the proposed bill which need to be improved include the fact that while Title VII would allow a project owner to refinance for the physical needs of the project, it does not create any restrictions noting that those needs must be related to the overall viability of the project and benefit the tenants. These two criteria, overall viability and benefit to the tenants, are necessary to ensure that refinancing leads to rehabilitation that will maximize the use of the building for affordable housing purposes. Additionally, the section regarding the use of proceeds should be clarified to ensure that any proceeds are used for housing and service-related needs of the project. The bill may also need to address the fact that allowing proceeds from refinancing to be used to support equity take-outs may be extremely costly. Further, if HUD agrees to subordinate current debt rather than permit prepayment and refinancing, the bill is unclear on whether the additional rental assistance or restrictions attached to such refinancing would apply. Finally, the new section on tenant participation does not provide any timeline in which such tenant participation must occur. This section should explicitly state when notice should be given, the length of the comment period and the manner in which the project owner must respond to tenant concerns. Such provisions are necessary for ensuring long-term affordability for tenants and the project.

[29] FY '09 Appropriations Act.
[30] FY '09 Appropriations Act § 234(a)(2).
[31] FY '09 Appropriations Act at General Provisions.
[32] Section 202 Supportive Housing for the Elderly Act of 2009, S.118, 111th Cong. (2009) (introduced in Senate); Housing Preservation and Tenant Protection Act of 2009, Title VII of H.R. ___, 111th Cong. (2009) (discussion draft). A June 23, 2009, version of the draft bill is available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/Flhr_061809.shtml. The draft bill incorporates a number of the suggestions contained in a package of proposals developed by the National Preservation Working Group. For a summary of these proposals, see NHLP, *Congress Considers Overdue Preservation Agenda*, 38 Hous. L. Bull. 72 (Mar. 2008).
[33] Housing Preservation and Tenant Protection Act of 2009, *supra* note 32, tit. VII.
[34] Housing Preservation and Tenant Protection Act of 2009, § 721.
[35] *The Section 202 Supportive Housing for the Elderly Act of 2007: Hearings on H.R. 2930 Before the Subcomm. on Hous. and Cmty. Opportunity of the House Comm. on Fin. Serv.*, 110th Cong. (2007).
[36] Housing Preservation and Tenant Protection Act of 2009, § 721.
[37] § 725.
[38] § 723.

Section 515 Rural Rental Housing

The United States Department of Agriculture (USDA), through its Rural Development (RD) agency, administers subsidized housing programs for rural families.[39] One such program is the Section 515 program that provides rural rental housing to low-income families. Like many of the HUD-subsidized programs, the Section 515 stock is aging and in need of physical preservation. Research conducted by the National Housing Law Project found that in 2006, 6,262 of the approximately 15,800 properties in the Section 515 program were considered troubled.[40] That figure equals 41% of the program's inventory.

Created in 1962, the Section 515 program authorized USDA to make direct loans to nonprofit organizations, government entities and private individuals or partnerships for the purpose of constructing rental housing. Over 500,000 units of Section 515 housing have been constructed since the program's inception. The average annual income of households living in Section 515 housing is approximately $10,000, and nearly 60% of the households served are elderly or headed by a person with a disability.[41]

Current Practice

Since 2006, the Rural Housing Service (RHS) has operated a demonstration revitalization program intended to identify the means and methods by which the agency can revitalize and preserve the Section 515 stock. No clear information exists regarding the details of the program. Generally, it is believed that the agency is subordinating its existing mortgages to third-party financing that enables owners to rehabilitate their developments. The agency may also be extending or deferring its mortgages to maintain rents in developments and avoid the displacement of residents who are not receiving deep rental assistance subsidies. The agency does not, however, have authority to extend additional subsidies to residents of revitalized developments and may be limiting participation in the demonstration program to developments that have RHS rental assistance or Section 8 subsidies available to most, if not all, the units.

Proposed Legislation

The proposed omnibus preservation legislation includes the Rural Housing Preservation Act of 2009. This Act would authorize RHS to offer financial incentives to owners of Section 515 housing who wish to revitalize their properties. These incentives include: reduction or elimination of interest on the existing Section 515 loan; partial or full deferral of payments; outright loan forgiveness; subordination of the Section 515 loan to third-party financing; reamortization and extension of the loan; grants (subject to appropriations); payment of the costs associated with the development of a long-term viability plan; and additional direct or guaranteed subsidized loans that are not limited by the value of the project.[42]

To secure one or more of these incentives, an owner would have to file a request with RHS to participate in the revitalization and restructuring program. In response, RHS would have to develop a long-term project viability plan that includes two elements. The first is a physical needs assessment that identifies the repairs, improvements and other changes required to preserve the development together with the cost of those repairs and changes. The second is a financial plan that reviews the financial stability of the project, takes into account the loan restructuring elements needed to preserve the project (including rent increases), provides the owner with a rate of return comparable to that received by owners under the LIHTC program, takes into account the repairs that will be made and the costs of relocating residents during the repairs, and ensures that the rents in the development, after revitalization, are affordable to the residents.[43] These provisions help ensure long-term affordability and viability for tenants and the project. Before RHS could offer the incentives to a project owner, it would have to give the owner an opportunity to review the viability plan and to discuss it with someone from the agency. In addition, the bill would ensure tenant participation by requiring RHS to provide a copy of the viability plan to the residents, with 30 days to comment. RHS would be required to respond in writing to the resident comments.[44]

If an owner and RHS were to agree on the long-term viability plan and the necessary incentives, the proposed bill sets forth provisions that would ensure affordability and tenant protections. First, RHS and the owner would enter into a long-term Use Agreement, which would obligate the owner to maintain the housing as affordable for 30 years or the remaining term of the project loan, whichever is longer. Most importantly, the Use Agreement would set the maximum household contribution to monthly rent and utilities at 30% of the family's adjusted income. This would necessarily require rental assistance, even if other funding sources, such as tax credits or publicly provided soft debt, are utilized for recapitalization. The agreement would also obligate the owner to warrant the provision of safe, healthy and clean buildings, and set out the project rent terms and any voucher assistance that might be provided to the owner. The Use Agreement could be terminated only if some material preservation incentives that were extended to the owner are no longer available,

[39] Note that while this stock of housing is not technically HUD-assisted, we include it in this article due to the overlap of shared issues, as well as the great importance of preserving this housing stock.

[40] NHLP, *New Data on Troubled Section 515 Properties: Information Obtained by NHLP Reveals Widespread Program Violations*, 36 Hous. L. Bull. 129 (June-July 2006).

[41] *Id.*

[42] Housing Preservation and Tenant Protection Act of 2009, tit. VIII.

[43] *Id.*

[44] *Id.*

and RHS determines that their unavailability was not due to the owner's fault.[45] As an additional affordability tool, unassisted tenants may be afforded vouchers, either attached to the unit or tenant-based, which would provide an additional subsidy to ensure that residents would not pay more than 30% of their income toward rent.[46] However, tenant-based vouchers would do nothing to preserve the affordability of the units for future tenants.

Under the draft House bill, RHS would be able to deny revitalization or restructuring assistance to any owner who has a history of poor management or maintenance of rental properties, is in default on a Section 515 loan, does not enter into a long-term Use Agreement within a reasonable amount of time, is suspended or debarred from further participation in a government contracting program, or for other good cause, as determined by RHS.[47] Additionally, an owner could not participate in the program if the owner is a party to an action against RHS that either seeks to allow the prepayment of a Section 515 loan in contravention of the ELIHPA[48] prepayment restrictions or seeks damages for the imposition of the prepayment restrictions. An owner who has previously secured damages against RHS would be able to participate in the program if the owner agreed to contribute 50% of the damage recovery, or $100,000, whichever is less, to the revitalization plan.[49]

Conclusion

The three examples of recapitalization efforts reviewed in Part One of this article represent different strategies to preserve the federally assisted housing stock, each with its own set of benefits, strengths and weaknesses. As preservation legislation moves forward in Congress, each of these schemes provides pertinent lessons for other programs facing similar impediments. Advocates must seek effective recapitalization policies that maintain properties while preserving long-term affordability for tenants. ■

[Ed. Note: Part Two of this article, covering so-called Section 250 prepayments and the Year-40 mortgage maturity problem, will appear in the next issue.]

[45]*Id.*
[46]*Id.*
[47]*Id.*
[48]42 U.S.C.A. §§ 1472 *et seq.* (Westlaw, Nov. 10, 2009).
[49]§§ 1472 *et seq.*

Hope for HAMP: One Step Back, But Two Steps Forward?*

Homeowners across the country breathed a sigh of relief when the Obama administration announced the Home Affordable Modification Program (HAMP) in February 2009.[1] The program is intended to make homeowners' monthly mortgage payments no more than 31% of gross monthly income. If a loan servicer approves an application for a trial loan modification, the servicer must perform a "waterfall" calculation to decrease the payment until it is no more than 31% of gross monthly income.[2] Unfortunately, many homeowners have encountered a variety of obstacles in seeking HAMP relief.

This article offers some hope that HAMP modifications will move forward and servicers will be more accountable for their actions. This article first revisits the Minnesota HAMP case filed in federal court, *Williams v. Geithner*.[3] It then turns to recently released federal directives and describes how these directives may ease homeowners' application processes. Lastly, it discusses a recent Michigan case where a state appellate court, relying on the language of federal statutes establishing HAMP, reversed summary judgment against the homeowners.

Williams v. Geithner: A Step Back

Homeowners have encountered a number of problems during the HAMP application process.[4] For example, many servicers have failed to notify homeowners when their modification applications are denied. When servicers do notify homeowners of a denial, many neglect to provide any explanation as to why the application was denied.[5] As a result, many homeowners assume that their applications are still under consideration and are helpless as their foreclosure cases advance toward sale.

To seek recourse for HAMP-eligible homeowners, the Housing Preservation Project in Minnesota filed a class action lawsuit against federal agencies responsible for implementing HAMP. In *Williams v. Geithner*, the plaintiffs alleged that HAMP is a federal entitlement program, and

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[1]*See* Dep't of the Treasury, Supplemental Directive 09-01, https://www.hmpadmin.com/portal/docs/hamp_servicer/sd0901.pdf.
[2]*Id.* This waterfall includes reduction of interest rate, extension of mortgage term and principal forbearance.
[3]No. 09-1959 (D. Minn. filed July 28, 2009). The complaint filed in the *Williams* case is available at http://www.hppinc.org/projects/index.php?strWebAction=resource_detail&intResourceID=112. *See also* NHLP, *Home Affordable Modification Program: Help for Homeowners or Another Dead End?*, 39 Hous. L. Bull. 221, 230-33 (Sept. 2009).
[4]*See supra* note 3.
[5]*Id.*