The voucher program increased from $5 million to $16.4 million simply reflects the fact that vouchers that have been issued in the last several years are facing expiration. Additional funding is needed to keep assistance available to residents who were threatened with displacement when their landlords prepaid their Section 515 loans. The Rural Preservation Demonstration Program budget was increased from $20 million to $25 million. This increase reflects the substantial demand that exists for the revitalization of the Section 515 multifamily housing inventory.

Minor increases were made in the Section 504 very low-income senior home repair grant program, the Section 516 farm labor housing grant program, the Section 523 Self Help Technical Assistance Program, and the Section 533 Housing Preservation Grant Program. Funding remained level for the Preservation Rental Assistance Program, the Section 515 Rural Rental Housing Program for New Construction, and the Section 514/516 rental assistance programs.

**Recapitalizing the HUD-Assisted Housing Stock: Part Two**

The privately owned, federally supported housing inventory, like any other aging housing stock, requires additional capital to address growing physical needs, from wear and tear and for market and energy upgrades. Maintaining affordability in the face of these needs presents a tremendous challenge across the variety of Department of Housing and Urban Development (HUD) and Rural Development (RD) programs involved. Part One of this article in the January Bulletin reviewed the recapitalization dilemma under federal programs generally (including prior efforts and recommended principles), the Section 236 program, the Section 202 elderly housing program and the RD Section 515 rural housing programs. Part Two of this article covers the remaining restricted portion of the HUD-financed inventory, and properties with maturing federally supported mortgages.

**Section 250: Recapitalization Prior to Mortgage Maturity**

A cohort of properties facing significant recapitalization issues are those known generally as “Section 250 properties,” which are restricted from unilateral prepayment under Section 250 of the National Housing Act. In contrast to the general rule for properties with HUD-subsidized mortgages, where the owner may unilaterally prepay the mortgage after 20 years, owners of these properties must seek HUD approval throughout the entire mortgage term. This additional restriction exists because the project:

- was originally developed by a nonprofit;
- has a rent supplement contract;
- received flexible subsidy assistance; or
- participated in the Emergency Low Income Housing Preservation Act (ELIHPA) preservation program.

In the latter two cases, only those properties that agreed to a full mortgage term prepayment restriction in exchange for additional incentives would likely be considered bound by Section 250.

The recapitalization issue arises here where a project needs significant rehabilitation prior to mortgage maturity and, in order to finance the rehabilitation, the owner

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*This article (Parts One and Two) was co-authored by Brandon Weiss, Skadden Fellow at Public Counsel’s Community Development Project in Los Angeles, and NHLP Staff Attorney Navneet Grewal.


3. **42 U.S.C.A. §§ 1472 et seq. (Westlaw Nov. 10, 2009).**

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**FY 10 Budget Chart for Selected Rural Housing Programs**

(all numbers in millions)

<table>
<thead>
<tr>
<th>Program</th>
<th>FY 2009 Funding</th>
<th>FY 2010 Funding</th>
<th>Program</th>
<th>FY 2009 Funding</th>
<th>FY 2010 Funding</th>
</tr>
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<tr>
<td>502 Direct Home Loans</td>
<td>$1,121.5</td>
<td>$ 1,121</td>
<td>504 Repair Grants</td>
<td>$29.7</td>
<td>$31.6</td>
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<tr>
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<td>516 Farm Labor Grants</td>
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<td>9.9</td>
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<td>34.4</td>
<td>523 Self Help Grants</td>
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<tr>
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<td>533 Pres. Grants</td>
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<tr>
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<td>521 Rental Assistance</td>
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<tr>
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<td>542 Housing Vouchers</td>
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<td>1.8</td>
<td>Rental Pres. Demo.</td>
<td>20</td>
<td>25</td>
</tr>
</tbody>
</table>

As noted earlier, the only significant change in the entire RHS budget is an increase of nearly $6 billion in the Single Family Guaranteed Home Loan Program, which serves moderate-income households. The program is extremely popular with the financial institutions that benefit from the program’s loan guarantees. Unfortunately, the increased funding for the guaranteed loan program over the past several years has placed tremendous pressure on local Rural Development (RD) staff members, who are required to review and approve the guaranteed loans. Indeed, the workload has become so significant as a result of the program’s popularity that RD staff members are slowing down the processing and approval process for the direct loan program, which serves low-income households.
seeks to place new debt on the property. Given that HUD and private lenders are generally wary of being in a subordinate mortgagee position, the common practice is for the owner to seek HUD approval to pay off the HUD-insured mortgage and replace it with a new loan.

Prepaying the HUD-insured mortgage poses a problem because the affordability and eligibility limitations, the tenant protections and essentially all of the public benefit from the government’s prior investment of public funds are tied to the HUD-insured mortgage. The mortgage note or deed of trust note and the associated regulatory agreement, which contain many of the use restrictions, are only effective while the mortgage is in place. Similarly, the entire statutory and regulatory framework governing the property ordinarily ceases to apply upon an owner’s exit from the program through prepayment. Thus, there is a tension between the need for legitimate recapitalization and the need to ensure that residents are protected and that the public is not being short-changed on its investment in this housing. Unfortunately, the current legal regime mediating this tension is entirely unworkable.

The Statutory Framework: Section 250

Enacted in 1983, Section 250 of the National Housing Act states unequivocally that where HUD approval is required for prepayment, the Secretary shall not accept the offer unless “the Secretary has determined that such project is no longer meeting a need for rental housing for lower income families in the area.” This restriction makes no allowance for the need for recapitalization prior to maturity, even where the housing continues to meet a need. Given the pervasive housing affordability challenges across the United States and the dire need for subsidized housing, there are likely precious few areas where the statute could be satisfied.

HUD’s Implementation of Section 250

Despite the clear language of the law, HUD has essentially chosen to ignore the text of Section 250 and has instead established its own recapitalization process through HUD-issued guidance. Purporting to implement the statute, HUD issued Notice H 06-11 on August 8, 2006, “Prepayments Subject to Section 250(a) of the National Housing Act.” In this notice, HUD claims the authority to approve a prepayment request despite the fact that the housing continues to meet a need for lower-income families, arguably in direct violation of Section 250. The proffered justification is that HUD “will permit a prepayment in order to recapitalize the project,” but will do so “only if the owner agrees to execute a Use Agreement that ensures that the project will continue to be maintained as rental housing for lower income families in the area until at least the date the original mortgage would have terminated had it not been prepaid.” The rationale is thus that the former regulatory agreement is no longer needed because it will be replaced by a new Use Agreement. Such an interpretation directly contradicts the language of the statute.

Despite the clear language of the law, HUD has essentially chosen to ignore the text of Section 250 and has instead established its own recapitalization process through HUD-issued guidance.

Critique of HUD’s Implementation of Section 250

While clearly taking broad liberties with the mandate of Section 250, HUD’s attempt to establish a recapitalization procedure through Notice H 06-11 might be more justifiable if not for the manner by which HUD has chosen to execute it. The notice states that the Use Agreement must “require the same affordability and rental restrictions as those that were in place before the prepayment and minimize the threat of a negative impact on current and future low-income tenants.” HUD thus tried to ensure that tenants and the affordability of the property are similarly situated before and after the prepayment. However, the mechanism it has chosen to pursue this goal is flawed in a number of ways.

For example, the current model HUD Use Agreement used in the case of a Section 236 project prepayment, Form HUD-93142, falls well short of keeping tenants in the same position as they were under the Section 236 regulatory agreement. One potentially harmful difference is the allowance of rent increases to 30% of 80% of area median income, unadjusted for household size, which can be higher than many of the former budget-based rents. The end result is that a prepayment, justified on the basis of rehabilitation needs, results in an incremental loss of more deeply affordable housing. Other differences created by substituting the new Use Agreement include the following: good cause eviction protections are limited

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1The statute does not state that prepayment requests shall be denied unless the regulatory agreement is no longer serving a need, but that such requests shall be denied if the housing itself is no longer serving a need. Furthermore, the statute’s legislative history likewise argues against HUD’s interpretation. A prior version of Section 250 provided HUD the authority to grant a prepayment request where “the needs of lower income families in such project can more efficiently and effectively be met through other Federal housing assistance taking into account the remaining time the project could meet such needs.” Congress specifically deleted this provision in a 1988 amendment of Section 250 (Pub. L. No. 100-242, tit. II, § 261, 101 Stat. 1878, 1890 (1988)), thus explicitly stripping HUD of the very kind of authority it continues to claim in Notice H 06-11.

2Section 250 of the National Housing Act, supra note 2.

3Notice H06-11 replaced Notice H 2004-17, issued August 20, 2004, under the same title.
only to current, not future, tenants; tenants lose the right to organize, review and comment on owner policies; and residents lose maintenance assurances afforded by HUD inspection and enforcement under the REAC program.

Setting aside these specific problems related to the standard HUD Use Agreement, more global problems further hamper HUD’s implementation of Section 250. One such problem strikes at the core of the prepayment process. The entire justification for HUD’s strained interpretation of Section 250 is, according to Notice H 06-11, to “effectuate much needed rehabilitation of the project.” However, the decision as to whether a project is approved for prepayment has become untethered from actual project need. HUD requires owners to demonstrate that a “significant amount of repair” is needed in order to approve prepayment. However, HUD’s criteria only require proof of significant costs for repairs, not proof of actual need. This has given rise to anecdotal stories of residents who “get new sinks, when our old ones worked just fine.”

This situation may occur due to incentives that cause owners to attempt to prepay for reasons other than to effectuate much-needed rehabilitation. One such incentive relates to another more global problem with the current prepayment process: namely, the use of proceeds resulting from the prepayment. In some cases, a prepayment actually unlocks significant value, the beneficiary of which stands to profit handsomely, and thus the rehabilitation simply serves as window dressing for a payday to the owner. This problem would not exist if recapitalization proceeds were required to be reinvested in the project.

For example, in many instances, a project has built up significant “residual receipts,” funds over and above the distributions owners are allowed to take out of the buildings during the restricted term. At prepayment, however, HUD often simply releases these funds to the owners, without negotiating for any further public benefit. Aside from creating yet another way in which tenants are not similarly situated before and after prepayment (since the funds are no longer available for project needs), this practice also creates an incentive to prepay unrelated to the rehabilitation needs of the project.9

A final problem relates to the limited tenant involvement in the current recapitalization process. Section 250 merely requires that: (1) the tenants be notified of the prepayment request; (2) the tenants be provided an opportunity to comment on the owner’s request; and (3) the Secretary take any such comments into consideration. Notice H 06-11 does go farther than Section 250 by requiring the owner to make the proposed Use Agreement available during normal business hours.10 The owner must also offer the tenants 30 days to consider and comment upon the prepayment and Use Agreement, must forward all such comments and the owner’s response to HUD, and must consider the comments, “making any adjustments in the plan deemed appropriate by the owner.” Nothing requires the owner to provide tenants with an assessment of project needs or a proposed scope of work for the rehabilitation. Furthermore, there is little redress for a tenant who fails to submit comments during the 30-day window, nor is the owner required to take any action with respect to comments not “deemed appropriate.” An even broader problem is that tenants are given no rights to enforce the Use Agreements should the owner violate any of the obligations.

Towards a Balanced Recapitalization Policy for Section 250 Properties

While the current legal regime for recapitalizing the Section 250 stock is unworkable, it is possible to mediate the tension between legitimate rehabilitation needs and preservation of tenant protections and public investments. The policy solutions flow logically from the above-listed problems.

Section 250 should be amended to allow for legitimate recapitalizations. The current language allowing prepayment approval only where projects are “no longer meeting a need” fails to account for the often legitimate need for significant rehabilitation prior to mortgage maturity. The current system incentivizes HUD to ignore the statute to facilitate legitimate recapitalizations.11

Furthermore, Congress and HUD should ensure that tenants and housing affordability are not harmed by the prepayment. HUD should amend the standard Use Agreement to provide the protections listed above

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9See Department of Housing and Urban Development, Policy Clarification for Prepayments Subject to Section 250(a) of the National Housing Act (undated), http://www.hud.gov/offices/hsg/mfh/hto/clarifynoticeh0611.pdf (outlining three ways to satisfy the requisite standard for repair).

10 During the term of the mortgage, residual receipts are only allowed to be used with HUD approval for purposes fully consistent with the intent of the program, such as making repairs, providing additional project amenities, reducing operating deficits when legitimate cash flow deficits exist, making mortgage payments when default is actual or imminent, and paying the limited allowable distribution under restricted circumstances. See HUD Handbook 4350.1, Rev. 1, Ch. 25, § 25-9 (July 1993).

11 Other such potential incentives exist in the unlocked value that comes from the proceeds of any sale of the project at prepayment, or even simply the enhanced liquidity that comes from a refinancing. In some cases, HUD has required owners to deposit certain of these funds in a trust account to be used for public purposes, at least during the remaining years of the original mortgage term. Unfortunately, such practices are not uniform, the inconstistency resulting in instances of owners simply using the prepayment as the trigger to release a windfall above the deal that was originally negotiated with the federal government. In the overall net present value analysis, doing some cosmetic enhancements may be worthwhile to gain access to the value unlocked by prepayment.

12 However, experience has shown that often key terms of the Use Agreement are not filled in when made available to the tenants.

13 In some situations, litigation is the only tool available to address poorly conceived terms. Forcing HUD, owners, tenants and advocates into this realm wastes countless hours, muddies the governing rules and easily could be remedied by simply revising Section 250 to account for competing concerns.
that are currently lacking. Additional creative alternatives for recapitalization should be explored to obviate the need to remove the project from the relevant program through prepayment. For example, if a project has residual receipts funds sufficient to cover the proposed rehabilitation, the owner should be required to tap those monies prior to requesting to prepay the mortgage. Other ideas might involve HUD experimenting with providing capital or rental assistance funds to cover recapitalization in exchange for extended affordability commitments. Alternatively, HUD could explore tools such as mortgage insurance and/or a willingness to take a subordinate mortgagee position where HUD holds the mortgage in exchange for a private mortgagee lending against the property without requiring the prepayment of the HUD-insured mortgage.

Perhaps the greatest uncertainty about recapitalization concerns the situation now inexorably approaching for thousands of properties—mortgage maturity.

Another straightforward policy fix is to tie prepayment approval to actual project need. If the justification for the prepayment is to perform much-needed rehabilitation, there should be a comprehensive assessment of that need and of future needs in the process of approving any prepayment. Owners should be required to submit supporting documentation demonstrating a match between their proposed plans for rehabilitation and current project need.

In addition, Congress and HUD should provide uniform standards for dealing with prepayment proceeds. To the extent that prepayment unlocks significant value to which the owner would otherwise not have access, there should be a uniform policy dictating how those funds are to be used. Whether due to access to residual receipts, sales proceeds or simply new liquidity from refinancing, use of excess funds should reflect that they are being tapped early under the approval and are the result of significant federal investment. Placing such funds in a trust account, a percentage of which is allocated to investment in affordable housing, could be one promising method. While some have previously argued that nonprofit owners should bear even greater restrictions with respect to any such proceeds because their special status carries special responsibilities, certainly this is the case for all owners when additional public investment is part of the recapitalization package.

Finally, tenants must be afforded meaningful involvement in the process. This includes being provided with access to all documents necessary to make an informed judgment, including the needs assessment and rehabilitation plans. Owners are generally already required to give at least 150 days’ notice for other prepayments, yet tenants only have 30 days to comment on complex proposals. This window should be extended to provide time for tenants to obtain assistance to review the Use Agreement and other relevant documents. Owners should be required to meet with tenants and respond in writing to submitted questions. HUD should also be required to respond in a timely fashion to tenants’ written questions and comments.

The Year-40 Problem: Recapitalization at Maturity

Perhaps the greatest uncertainty about recapitalization concerns the situation now inexorably approaching for thousands of properties—mortgage maturity. Unlike the issues surrounding certain prepayments, no HUD approval is needed where the mortgage term is ending on its own accord, and tenants face the unwelcome proposition of being left unprotected when the associated restrictions expire.

A 2004 report by the General Accounting Office (GAO) evaluated the scope of this problem and determined that 21%, or 2,328 of the 11,267 subsidized properties with HUD mortgages, are scheduled to reach maturity by 2013, with three-quarters of these occurring between 2011 and 2013. These 2,328 properties contain 236,650 units—102,563 of these units lack any form of rental assistance, and many more have project-based Section 8 contracts which themselves are set to expire. Hundreds of thousands of families thus face a dire housing situation if Congress fails to remedy the situation.
In 2004, Congressman Barney Frank introduced H.R. 4679, the Displacement Prevention Act, in the 108th Congress. The bill contained a number of measures aimed at this impending problem. While hearings were held on the bill, it was never acted upon.

Like the rest of the HUD stock, many of these buildings reaching mortgage maturity are in great need of significant rehabilitation. The problem is often termed the “Year-40 problem” because many Section 221(d)(3) Below Market Interest Rate and Section 236 projects financed in the late 1960s and early 1970s are reaching the end of 40-year mortgage terms. Rural properties financed by United States Department of Agriculture RD loans face a similar situation. Without significant infusion of capital to address physical needs that accrued over the course of four decades, many of the buildings are in desperate need of repair. Again, interrelated issues of long-term affordability and recapitalization arise.

The Housing Preservation and Tenant Protection Act of 2009

In the 111th Congress, Congressman Frank has once again authored a draft housing preservation bill, various sections of which address the issue of mortgage maturity.\(^\text{17}\) From a broad perspective, there are a number of ways such legislation might approach the issue. Providing various “qualified entities” an option to purchase the building in exchange for committing to preserving long-term affordability is one of the more potent tools included in versions of the draft bill. Another approach might mirror that of the Low-Income Housing Preservation and Resident Homeownership Act,\(^\text{18}\) containing mandatory extension of affordability provisions in exchange for guaranteed government incentives. A third approach, also included in versions of the draft bill, is two-pronged: government-provided voluntary incentives to preserve affordability, coupled with direct tenant rental assistance where an owner rejects the incentives.

While the purchase option is certainly the most attractive from a preservation perspective, even the third approach hinging on voluntary incentives would be an improvement over the current situation. Contained in Section 102, “Displacement Prevention for Federally Assisted Multifamily Housing,” of the current draft bill, this concept would authorize appropriations necessary to make grants and loans to owners and purchasers to be used for capital improvements in exchange for the long-term extension of the currently applicable affordability restrictions. Section 102 also authorizes new project-based assistance to currently unassisted units in exchange for additional affordability restrictions.

For owners who reject these incentives, Section 102 would also make families living in properties with maturing mortgages eligible for tenant-based rental assistance in the form of enhanced vouchers. These vouchers are currently provided to tenants in situations involving certain prepayments or Section 8 opt-outs, but not at mortgage maturity.\(^\text{19}\) With these vouchers, tenants would be entitled to remain in their current apartment and receive rental assistance to offset a potential increase in rents to market rate. Providing tenants with enhanced vouchers is not inherently a preservation recapitalization tool, and thus fails to address issues of long-term physical or financial need, extended affordability for future tenants or reinvestment of proceeds. However, by coupling voluntary incentives with the provision of enhanced vouchers, the draft bill, if enacted, would at least provide some degree of security for those current tenants headed toward the cliff of mortgage maturity.

Section 102 additionally requires provision of a 12-month notice to tenants and to relevant government officials of an owner’s decision not to extend the affordability restrictions. While such notice is a necessary component, the bill could go further in ensuring tenant participation and endorsement of the preservation planning process, as well as granting tenants the right to enforce affordability restrictions and subsidy requirements.

Furthermore, in issuing implementing regulations, HUD should establish sufficient standards for rehabilitation, adequately taking into account future project needs. These standards should go well beyond merely bringing the buildings into code compliance, but instead should ensure the long-term physical soundness of the property. Likewise, the HUD grants or loans should be allocated in sufficient amounts, calibrated to consider factors including the potential loss of any interest-reduction subsidies, the necessary rehabilitation, other available funding resources and the market-rate returns required to encourage owner participation. Ideally, HUD’s implementation of the program would not unnecessarily add to the complexity of the process or result in the need for cumbersome layering of subsidies.

**Conclusion**

The HUD-assisted housing stock remains a vital asset to communities and low-income households across the nation. However, it continues to physically depreciate over time, and efforts to recapitalize and rehabilitate are inevitably necessary. Such efforts must mediate the tension between tapping new capital while not sacrificing


\(^\text{19}\)This has spurred some owners to prepay shortly before mortgage maturity to ensure that tenants receive enhanced vouchers.
the affordability protections that implement the governing housing program.

An evaluation of five such approaches in this two-part article demonstrates that successful efforts must observe six key principles:

- meeting short-term and long-term physical and financial needs;
- reinvesting excess proceeds back into affordable housing;
- guaranteeing affordability for current and future tenants;
- weeding out poorly performing owners and managers;
- providing for tenant participation in the decision-making process; and
- ensuring clarity in the governing law and regulations.

Passage of Congressman Frank’s draft omnibus preservation bill would be a significant step in the right direction for several of the types of properties reviewed here. Other innovative long-term measures should be explored as well, such as providing stronger incentives to transfer these projects to mission-driven nonprofits or to local land trusts, in order to provide greater assurances of long-term public benefit from responsible recapitalization.20 By combining the lessons learned from prior approaches with new innovative proposals, this important housing stock can remain a viable and valuable asset long into the future.

The Importance of Stable Housing for Formerly Incarcerated Individuals

Each year more than 725,000 people leave state and federal prisons.1 An additional 230,000 people leave county jails every week.2 Formerly incarcerated individuals struggle to secure employment, obtain medical care and avoid substance abuse. According to criminal justice officials, however, finding housing is the biggest challenge faced by individuals returning to the community.3 This article will identify the barriers to accessing stable housing, describes the housing arrangements of individuals returning to the community and explore the relationship between residential instability and recidivism.

Obstacles to Stable Housing

A number of institutional and legal barriers prevent formerly incarcerated individuals from finding stable housing after release. Private housing represents 97% of the total housing stock in the United States.4 Due to soaring prices, however, private housing is simply out of reach for many formerly incarcerated individuals living in urban areas.5 Moreover, most landlords conduct criminal background checks on prospective tenants.6 Given the short supply of affordable housing, landlords can afford to deny housing to applicants with criminal records. Screening for sex offenders is especially prevalent.

Federally assisted housing is the only option for many people leaving correctional facilities. Harsh admission

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5See NAT’L LOW INCOME HOUS. COALITION, OUT OF REACH 2009, http://www.nlhcc.org/oro/oro2009/data.cfm?getstate=one&geotmmsa=on&msa=2243&state=CA. For example, the fair market rent for a one-bedroom apartment in Oakland, California, is $1,093.