



Housing Law Bulletin

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PRESERVING FEDERALLY ASSISTED HOUSING AT THE STATE AND LOCAL LEVEL: A LEGISLATIVE TOOL KIT

By Brian Galle¹

Over the past few years, the nation has lost more than 100,000 units from its privately owned federally assisted affordable housing stock through prepayments and Section 8 opt-outs and terminations.² These units, originally supported with federally subsidized mortgages under programs

like Section 236 or with project-based rental assistance contracts under programs like Section 8, have historically provided affordability through federal mortgage insurance and interest subsidies, combined with contractual rent controls and use restrictions, or through rental assistance payments to cover the difference between housing costs and tenants' income-based contributions for a multi-year term. Faced with

¹NHLP and the author, a second-year law student, wish to thank the Columbia Human Rights Internship program for funding the author's work at NHLP.

²See *Preservation Crisis Mounts: HUD and Congress Respond*, 29 HOUS. L. BULL. 67 (April 1999). See also *National Housing Trust Data Clearinghouse*, summary available online at <<http://www.nhtinc.org/data.asp>>.

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The National Housing Law Project has been selected as one of 50 groups to appear on the 1999 Working Assets donation ballots and share in the company's distribution of approximately \$4 million. Working Assets is a socially responsible long distance carrier and credit card company. The money is divided according to the votes of Working Assets members, participants in its ShopForChange Program and, as of November, persons who have donated funds under its GiveForChange Program.

If you are a Working Assets member, you should have received your ballot with your October invoice. Please cast your ballot for the National Housing Law Project. If you donated to NHLP through GiveForChange (see page 185 for more details), or if you did not cast your paper ballot, you can now vote electronically for NHLP to receive more funds from the Working Assets distribution. To vote for NHLP, go to the Working Assets webpage at www.workingassets.com and follow the instructions on voting for the nonprofit of your choice. You can find NHLP under the Economic and Social Justice group or by searching for National Housing Law Project. Your vote will help NHLP significantly!

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the growing need for affordable rental housing, many state and local governments, as well as housing advocates, have begun to take a variety of actions to preserve this housing stock, just as they did when the conversion crisis first loomed large in the late 1980s.³ The abdication of federal responsibility has taken root as evidenced by the inadequate funding of the federal preservation program, the restoration of the owner's right to prepay beginning in 1996, and the adoption of an "owner choice" policy to govern expiring Section 8 contracts. Therefore, these state and local initiatives have become increasingly important in preserving these critical affordable housing resources.

This article provides information about many current and pending efforts on the part of non-federal actors to curb the exodus of some of the highest-quality housing now available to low-income renters.⁴ Other states, municipalities, and local advocates can replicate or build on these initiatives to create a more consistent and effective set of protections for tenants and the housing stock affected by recent federal budget and policy changes.

Uncertainty About Preemption

Many prospective state or local preservation measures potentially share a common obstacle: the prospect of federal preemption posed by Section 232 of the Low-Income Housing Preservation and Resident Homeownership Act ("LIHPRHA").⁵ That section purports to preempt state or local laws to the extent that they restrict owners' ability to

³See, *State and Local Initiatives to Preserve Subsidized Rental Housing*, 19 HOUS. L. BULL. 1 (Jan. 1989) and *Update on State and Local Initiatives to Preserve At-Risk Housing*, 23 HOUS. L. BULL. 59 (Sept. 1993). One important action that state and local governments can take is to formally express their concern about federal budget and policy actions that threaten to diminish the stock. For example, in 1999, the California legislature adopted a resolution urging the President, Congress and HUD to take appropriate funding and policy actions to preserve California's existing federally assisted stock. S. Jt. Res. 12 (1999).

⁴The research for this article was completed in July of 1999. The legislative picture at the federal, state and local levels affecting this housing stock is constantly changing, and subsequent developments may affect the applicability or utility of any of the initiatives reviewed herein. *As we plan to update this article, please provide us with information about errors, omissions, and additional related developments by e-mail to: jgrow@nhlp.org*

Information for this article was drawn from diverse sources, including state legislative websites and websites of local advocacy organizations. A great deal of helpful material also came from responses to a survey of interested parties. We are particularly grateful to Sean Spear, Debra Gardner, Peter Iskin, Sandy Rollins, Jill Russ, Laura Hewitt, Irene Basloe Saraf, Jon Gould, Janet Byrd, Ian Slingerland, Martha McLennan, Jack McCullough, Craig Castellanet, Bill Rumpf, and Michael Bodaken for their valuable assistance. Lastly, some information came from previous NHLP publications, especially *State and Local Initiatives to Preserve Subsidized Rental Housing*, 19 HOUS. L. BULL. 1 (Jan. 1989) and *Update on State and Local Initiatives to Preserve At-Risk Housing*, 23 HOUS. L. BULL. 59 (Sept. 1993). Much useful information about pre-1993 initiatives, many of which are still law, can be obtained from those articles.

⁵LIHPRHA was established by Pub. L. No. 101-625, Title VI (1990), codified at 12 U.S.C. §§ 4101 (1999) *et seq.*, and Section 232 is codified at 12 U.S.C. § 4122. (1999).

prepay or receive incentives authorized by the statute, are incompatible with the terms of LIHPRHA, or are otherwise targeted exclusively at "eligible low-income housing"⁶ under LIHPRHA.⁷ However, laws of "general applicability," like zoning, are not preempted. Although Congress is no longer funding LIHPRHA, it has not been repealed and the preemption provision arguably remains effective. To avoid the cloud of preemption, proponents of local preservation initiatives therefore must ensure that the initiative's language affects a wider array of projects than simply "eligible low-income housing." Additional uncertainty stems from the fact that owners have also argued, although not yet successfully, that Section 232's language "restricts or inhibits the prepayment of any mortgage..."⁸, and thus requires preemption of any legislation that has the effect of reducing the profitability or ease of prepayment.⁸

The abdication of federal responsibility has taken root as evidenced by the inadequate funding of the federal preservation program.

Limiting Owner Returns

Since the primary purpose of market-rate conversions via prepayment or opt-out is to increase the owner's income and profits, one obvious approach to preventing a conversion is to reduce the profitability of the transaction. This can be done either through direct regulation of rent levels or through any requirement that increases an owner's conversion costs. Limits on owner returns, in addition to providing a general deterrent effect, can often lower sale prices below unrestricted levels, possibly increasing the number of units that can be permanently preserved with increasingly limited federal, state or local housing funds.

continued on page 186

⁶Generally, "eligible low-income housing" includes Section 221(d)(3)BMIR or 236 projects that were or became eligible to prepay without the Secretary's approval. See 12 U.S.C. § 4119 (1999) (establishing a revised § 229). These properties are almost always owned by for-profit or limited-dividend sponsors and have reached the end of their 20-year restricted use period. Note that because LIHPRHA's eligibility definition is generally restricted to properties with HUD-subsidized mortgages, those HUD properties with only Section 8 project-based rental assistance contracts are wholly unaffected by the preemption cloud of LIHPRHA's Section 232.

⁷12 U.S.C. § 4122 (1999).

⁸In one case, the Federal Claims Court had accepted that argument, ruling that Los Angeles' rent control ordinance cannot apply to "eligible" prepayment properties, although the decision was reversed on other grounds. See *Cienega Gardens v. United States*, 38 Fed. Cl. 64 (1997), *rev'd* 162 F.3d 1123 (Fed. Cir. 1998). See *Court of Appeals Reverses Damage Award to Owners of HUD Rental Housing Whose Prepayment Rights Had Been Restricted*, 28 Hous. L. Bull. 218 (Dec. 1998). A copy of an amicus brief on appeal in the Federal Circuit in support of the United States, addressing the issue of preemption that the Appellate Court failed to reach, submitted on behalf of numerous tenant organizations, is available from NHLP.

Over the past few years, Massachusetts is the only state that has considered regulation of rents in projects exiting the federal subsidy programs. The state legislature has considered several proposals to enable localities to do so, but none has yet succeeded. The final version of the most recent proposed bill would have given municipalities the right to establish administrative boards with the power to set rent levels in any "former governmentally involved housing."⁹ Localities would also have been able to require project owners to renew their Section 8 contracts. Although the bill passed both houses unanimously, it was vetoed by the Governor. At the time of passage, several cities had already lined up to use their new powers.¹⁰ Another version of the state-wide enabling law is pending in this legislative session and has passed the Massachusetts Senate unanimously.¹¹

Over the past few years, Massachusetts is the only state that has considered regulation of rents in projects exiting the federal subsidy programs.

The greatest advantage of this approach is complete protection for tenants and affordability of the housing. Since prepayments generally require recapitalization at significantly higher unrestricted market values, the prospect of purely cost-based rent adjustments usually discourages all future prepayments. If subsidies are maintained, the property is still governed by HUD's rent and use restrictions and the owner cannot raise rents to market rates. Also, tenants with enhanced vouchers in properties that have already prepaid could be protected from subsequent rent increases not covered by their vouchers. Massachusetts advocates minimized the preemption problem by drafting the statute to apply to all projects that terminated their government "involvement," either insurance, interest subsidy or rental as-

sistance, so that the law is arguably of "general applicability," avoiding the LIHPRHA preemption cloud.¹²

Similar results have been achieved by applying already existing rent control laws to formerly subsidized or assisted properties, although the net effect depends upon the nature of the local rent regulation being extended. Typically, this approach involves setting the "base rent" for any property exiting the federal subsidy or assistance program at the last rent level in effect under that program, and then subsequently applying the generally applicable rent regulations on general and individual rent adjustments, or perhaps vacancy decontrol. San Francisco,¹³ New York City, San Jose, and Berkeley have all reportedly taken this route, either in their original ordinances or through amendments. Los Angeles has a comparable restriction,¹⁴ but reportedly has not enforced its rules strictly against prepayment properties. The major advantage of this approach is that it is simple and usually extremely cost-effective. Owners assessing the economic benefits of conversion may simply view a conversion that would yield only restricted rents as not worth the time and expense, and remain under the federal program.

Another alternative involves so-called "statutory leases," in which tenants in converted buildings get mandatory temporary lease renewals under terms specified by law, at rent levels roughly equal to those in effect under the federal program before a conversion. Rhode Island¹⁵ and Maryland¹⁶ both have statutes employing this concept, which can protect tenants while limiting the ability of owners to realize gains from higher rents. Both statutes provide for one-year renewals for all tenants, and certain classes of tenants, generally the elderly or disabled, are guaranteed two (Rhode Island) or three (Maryland) years of renewals. Maryland allows for good cause evictions during the statutory renewal period, while Rhode Island permits termination only for death or non-payment. Rhode Island's efforts appear to have been effective, as there have been no prepayments as of the end of 1998. Unfortunately, according to public officials in Maryland, administrative decisions have left the tenant protection statute there almost completely un-enforced, and thousands of units have converted to market-rate. A similar

⁹The original version of the proposed Massachusetts State-Wide Enabling Act (House No. 1709, 1996-98 Session) would have allowed any municipality in the state to choose to regulate rents, evictions and removals in prepayment and expiring Section 8 developments. A later version, House No. 5778, authorized municipalities to regulate pursuant to local referendum, rather than city or town council action. This bill passed unanimously at the end of the session, but was then vetoed by Governor Cellucci 10 days later, and died when the legislature did not return to formal session.

¹⁰"Home rule" petitions were filed in the 1996-98 Session for the cities of Boston (House No. 2113), Cambridge (House No. 4257), Amherst (House No. 4150) and Northampton (unavailable) that would have authorized each of those municipalities, respectively, to regulate rents, evictions and removals in prepayment or expiring Section 8 developments. None of these bills got out of committee, and none were refiled by the deadline in 1998 for the current two-year legislative session ending July, 2000.

¹¹*An Act Authorizing Localities to Adopt Protections for Tenants and Units of Governmentally-Involved Housing*, S. 1946 (1999). As of October 25, no bill has yet been voted on in the House.

¹²Advocates relied on HUD's claim that "rent control laws are not preempted if they are consistent with LIHPRHA and are of general applicability." 57 Fed. Reg. 19977 (1992). Cf. HUD Directive CIM-0105, *Applicability Of Boston Rent Control Laws on LIHPRHA Appraisal* (Oct. 27, 1994).

¹³For example, in 1998, San Francisco amended its Rent Stabilization Ordinance, San Francisco, Ca., Code § 37, to explicitly extend general local rent controls to any formerly HUD-assisted property occupied before 1979 that emerges from the federal program and any associated explicit local rent control preemption. For example, prior Section 8 contract rent levels or Section 236 HUD-controlled rents become the new rent levels controlled by local law, which provides for annual CPI-based rent increases set by a board.

¹⁴Los Angeles City Code Ch. 15, §151.02, ¶ 18(5).

¹⁵Rhode Island Gen. Laws § 34-45-11.

¹⁶Maryland Ann. Code Article 83B §§ 9-101- 9-114.

statute in Maine requires owners to "allow tenants to remain" for up to six months at rent levels equal to those at conversion.¹⁷

Several other legislatures have enacted measures imposing certain costs on owners who prepay or opt-out. These provisions generally take the form of payments for services or reimbursements to affected tenants. For example, San Francisco charges owners a relocation fee of \$5,250 per household for displaced tenants.¹⁸ Rhode Island¹⁹ and Maryland²⁰ statutes require coverage of reasonable moving costs up to a certain limit. In 1990, Seattle enacted a local relocation ordinance that applies to any displacement caused by demolition, change of use, substantial rehabilitation, or removal of use restrictions on federally assisted housing developments.²¹

A recent Portland, Oregon ordinance would have required a housing replacement fee of \$30,000 per unit where owners opt-out of their Section 8 contracts and refuse a market-based purchase offer from the city or its designee.²² However, after passage at the local level the probable enactment of an explicit preemption bill at the state level²³ reportedly caused the city to withdraw the ordinance, substitute a longer notice requirement and authorize local government eminent domain power.

Procedural Requirements

One of the most popular restrictions on conversion involves the imposition of a time-consuming process that must be completed before conversion, usually in the form of a required notice to tenants or local governments. Minnesota has also adopted a mandatory "tenant impact statement," requiring owners of HUD-subsidized and assisted developments to provide, at least 12 months prior to termination, a statement of the impact of any proposed termination on residents to the state housing agency, local government and the residents themselves.²⁴ These laws have won passage relatively easily, perhaps because they resemble existing federal statutes and provide limited protection. However, it has been more difficult to obtain express statutory remedies for

violations.²⁵ Advocates have reported several instances in which a required notice prompted and provided sufficient time for arranging a transfer of the project to a nonprofit owner, using funding sources described *infra*. It is also possible that very long notice requirements might deter some owners from prepaying.

Current federal law, as revised in October of 1998, requires any owner who anticipates a termination of the Section 8 contract to provide a one-year notice to tenants and to HUD.²⁶ Until recently, HUD interpreted this statute as allowing owners to provide ambiguous letters declaring the imminent expiration of a contract without any indication whether or not the owner planned to renew.²⁷ In May of 1999, HUD changed course, and owners must now declare at the time of the notice whether they intend to renew or not.²⁸ Another federal law also adopted in October of 1998 now requires owners to provide written notice of prepayment to tenants, HUD and local governments five to nine months in advance of the prepayment.²⁹

Some state and local notice laws pre-dated the latest federal requirements yet there is still a significant place for state and local notice laws under this most recent federal regime. Statutes requiring written prepayment notices of longer than five months³⁰ are of obvious use. Those more broadly requir-

²⁵At least one notable exception is the state of Washington, where the statute authorizes aggrieved tenants to seek injunctive relief and damages for violations, with attorney fees. Wash. Rev. Code § 59.28.

²⁶ Pub. L. No.105-276 § 549(a)(1) (1998), codified at 42 U.S.C. § 1437f(c)(8). Under this federal law, "termination" includes both ordinary expiration of a contract of limited duration, as well as an owner's decision not to renew the contract.

²⁷See, e.g., HUD Notice H 98-34 (Oct. 16, 1998).

²⁸HUD Notice H 99-8 (May 27, 1999). However, it remains unclear whether HUD will require owners who change their minds and decide to opt-out to serve a new one-year notice.

²⁹ Pub. L. No.105-276 § 219(b)(3), 112 Stat. 2488 (1998).

³⁰See California Gov't. Code 65863.10-11 (nine months); Connecticut P.A. No. 88-262 (one year); 1988 Rhode Island Pub. L. ch. 88-508 (two years); San Francisco Admin. Code § 60 (12 to 18 months); Hawaii SB 1519 (presented and vetoed, 1998) (one year). Over the past few years, Massachusetts has also considered bills that would require two-year notices for prepayments and opt-outs, barring any rent increases until two years after the later of a proper notice or the prepayment opt-out. Senate No. 547, House No. 4271 were filed in December, 1996 for the two-year legislative session ending July, 1998. These bills failed to pass the legislature.

¹⁷Maine Rev. Stat. Ann. tit.30-A, §4976.

¹⁸San Francisco Admin. Code § 60.

¹⁹Rhode Island Gen. Laws § 34-45-11.

²⁰Maryland Ann. Code Art. 83B § 9-105(a) (up to \$975).

²¹Seattle Municipal Code §22.210 (enacted 1990). Assisted housing developments include those listed in the state notification law (Wash. Rev. Code § 59.28), and include HUD-subsidized and Section 8 projects. A household is "displaced" by removal of use restrictions if its post-removal rent exceeds its pre-removal rent by 20 percent or more. The relocation payment level is \$2,000, half payable by the owner and half payable by the city. Households must be at or below 50 percent of local median income to be eligible for the \$2,000 payment.

²²Ordinance 172844 (Nov. 1998), Portland City Code Chapter 30.01; see <http://www.ci.portland.or.us/bhcd/what/housing/preserve.html>. This ordinance has since been revised.

²³Oregon House Bill 2636 (pending, May 1999).

²⁴Minn. 1998 Laws, Chap. 389, Art. 14, §6 (effective July 1, 1998).

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ing notice of any conversion (via prepayment or opt-out)³¹ can be helpful if they provide tenants and community housing advocates with more information than either the federal prepayment notice or the federally required one-year notice of Section 8 termination. In addition to the notice period, important considerations for additional notice requirements are the required recipients of notice (e.g., federal law does not require Section 8 termination notices to municipal governments, neighborhood organizations, tenant organizing projects, or legal services offices) and the required content of the notice.

Washington, California and Minnesota have all recently dedicated some general revenues to maintaining affordability in HUD-subsidized housing.

Transfer of Properties to Preservation Purchasers

If cost were no object, permanent preservation of at-risk properties via transfer to non-speculative ownership would probably be the best way to preserve at-risk housing. Moving projects into the hands of entities whose purpose is providing housing rather than generating profit—such as tenant-endorsed or controlled non-profits—is more likely to keep tenants in their homes and preserve the property as a future housing resource. Obtaining both the necessary funds for transfer and site control from private owners remain difficult challenges in the ever-changing policy and budget picture. In addition, local government activities that enable nonprofit purchasers to be competitive with other options available to owners interested in converting to market-rate use (e.g., identifying potential conversion candidates, contacting owners to explore transfer options, providing predevelopment support for purchasers) will continue to be especially important in preserving units.

Funds for Preservation

While there are some limited federal resources for this purpose, including HUD's new "Mark-up to Market" program for below-market Section 8 contracts and other federal financing tools, obtaining sufficient capital funds will usually require state or local financial contributions, which

may include formerly "federal" funds such as Low-Income Housing Tax Credits, HOME or CDBG funds. Although there are a wide variety of potential sources for housing dollars, very few of these are currently earmarked for preservation.

Washington, Minnesota, and California have all recently dedicated some general revenues to maintaining affordability in HUD-subsidized housing. For example, in California the enacted budget for FY 2000 includes \$6 million for a broad purpose multifamily acquisition and rehabilitation program, with the first priority for funding being the preservation of currently affordable units. These funds will apparently be distributed through a new consolidated program being developed for many state housing funds via 3 percent loans which are deferrable for nonprofits. California has also provided approximately \$2.5 million for FY 2000 for pre-development loans and technical assistance for preservation.

On the local level, San Francisco has established a more comprehensive "Affordable Housing Preservation Program" operated by the San Francisco Redevelopment Agency. This program will administer several million dollars of redevelopment agency tax increment funds over a multi-year period for a variety of uses, including grants and below-market loans for nonprofit purchasers, pre-development assistance, and tenant outreach, organizing, and technical assistance.³² In November of 1998, the Seattle City Council approved \$1 million in general revenue funds to be used for preservation in FY 1999.

Federal Low-Income Housing Tax Credits, a limited resource for every state, often provide an important source of "equity" funds for nonprofit acquisitions. California reserves 10 percent of its Low-Income Housing Tax Credits for preservation.³³ For several years in Massachusetts the Qualified Allocation Plan has contained a general priority for "projects that preserve valuable existing affordable units." More specifically, 60 percent of the state's credits are allocated to "large-scale projects with significant federal resources, such as the HOPE VI or expiring use restrictions projects, and other preservation projects."³⁴

Tax-exempt bond allocations can provide an important source of below-market debt financing for nonprofit acquisitions. For example, the California Debt Limit Allocation Committee has recognized the preservation of federal at-risk

³¹See California Gov't. Code 65863.10-11 (nine months); Maine Rev. Stat. Ann. tit. 30-A, §4973 (90 days); Maryland Ann. Code Art. 83B §9-103 (one to two years, plus detailed statement of reasons and tenant impact); Minnesota Stat. 566.17 (one year), and Minn. 1998 Laws, Chap. 389, Art. 14, §6 (effective July 1, 1998); Washington Rev. Code § 59.28 (one year); Oregon H.B. 2636 (pending) (allowing local governments to require owners to provide up to 210-day notice of conversion).

³²SFRA funds require a minimum 50 year affordability requirement, and specific transactions have included even longer restrictions of a minimum of 99 years via a ground lease. The SFRA Preservation Program has four staff assigned to it, an operating budget of \$1 million (about two-thirds of which provides grants to resident groups for capacity building and technical assistance), and a capital budget of \$5 million for preservation acquisitions.

³³Cal. Rev. & Tax. Code § 23610.5(j)(3)(c)(iii).

³⁴Under the Massachusetts preservation priority set-aside, "other preservation projects" include the purchase and rehabilitation of other existing housing that is *de facto* affordable housing, but at risk of loss from conversion or deterioration where new capital or new ownership is needed.

housing as a priority factor in its Qualified Allocation Plan. In March 1999, the committee allocated tax-exempt bond authority to finance the acquisition of approximately 2,000 units of HUD-assisted housing.³⁵

Other capital or debt subsidy measures are provided by both state³⁶ and municipal³⁷ governments. All of these typically require use and affordability restrictions in exchange for the benefits provided.

At least one local government has employed the power of eminent domain to acquire a property for preservation purposes.

Taxable bonds can also be a useful source of funds, especially for owners who want to stay in the program by renewing their contracts, depending on capital market alternatives. California's "Preservation Financing Program" has made available up to \$100 million annually in taxable bond allocation for FY 1999, with \$25 million increases annually through the year 2003. Because of the competitive private rates available, to date there have reportedly been few takers.

Also underway in California for FY1999, the state Department of Housing and Community Development has earmarked \$6 million of its federal HOME program funds for preservation of properties located in jurisdictions that do not receive a direct HOME allocation.

Beyond providing support for capital or operating costs, another approach is for government to reduce the costs of acquiring or operating the property, usually after it has been bought by a targeted purchaser. Cost reductions may be an important component of maintaining affordability after transfer, particularly where the HUD subsidy will cease or be limited, or where a property contains unassisted units. One cost relief measure already in effect is a property tax reduction or exemption.³⁸ Care must be taken to ensure that

³⁵The California Housing Finance Agency also has a below-market interest rate loan (currently 5 percent) program for qualified Section 501(c)(3) purchasers of governmentally-assisted projects, but this program cannot be used on a permanent basis in conjunction with tax-exempt bonds and tax credits.

³⁶Many state housing finance agencies, including those in Maine, Missouri, Pennsylvania, and Vermont, use their own budgets for low- or no-interest loans to promote preservation purchases. These funds are used for costs of purchase, to rehabilitate properties, to expand affordability, to cover predevelopment costs and shortfalls caused by rent increase phase-ins, or gaps in operating income between Section 8 subsidy levels and rents required to support new higher debt service expenses.

³⁷San Francisco Admin. Code § 60 (1999).

³⁸See e.g., California Rev. & Tax. Code § 214(g); Missouri H.B. 378, 85th Gen. Assembly (1989); 1989 Rhode Island Pub. Laws 89-51188 (enabling statute for local tax abatement laws); Washington — H.B. 1946 and S.B. 5532 (pending March 1999).

such cost reductions do not simply reduce the federal subsidy provided prior to the transaction. Similarly, a reduction in acquisition costs can be provided by forgiving state capital gains taxes (for profit-motivated sellers, who then pass along the benefit to purchasers in the form of a reduced sales price) where a property is sold to a specified type of preservation purchaser.³⁹ These benefits typically require additional local use and affordability restrictions as well.

Other cost reduction measures that have been considered or proposed include exemption from various state taxes and lower utility rates for nonprofit purchasers in exchange for affordability restrictions. Local governments could also provide additional operating subsidies directly to a project after purchase, but only as supplements to existing federal contributions.

Obtaining Site Control

At least one local government has employed the power of eminent domain to acquire a property for preservation purposes,⁴⁰ and the city of Portland has reportedly authorized use of the condemnation power to acquire at-risk properties.⁴¹

A number of state and local governments have enacted "rights of first refusal," providing nonprofits or public agencies with rights to purchase properties triggered by sale or transfer (rather than by the event of conversion itself), apparently on the assumption that conversion is often tied to sale.⁴² To the extent that this assumption is inaccurate, as many owners elect to retain ownership post-conversion, the utility of those laws is limited.

³⁹California Rev. & Tax. Code § 18035.5; Missouri H.B. 378, 85th Gen. Assembly (1989). Of course, the financial impact of these state tax measures is minimal compared to federal capital gains tax burdens.

⁴⁰*City of Pacifica v. Acosta*, No. (unavailable) (Cal. Super. Ct., County of San Mateo, filed July 30, 1999), pursuant to Resolution No. 34-99 (unanimously passed July 12, 1999). The property in question was not a project-based Section 8 development, but a property in which 70 of the 100 units were occupied by elderly Section 8 tenant-based subsidy recipients (pursuant to the requirements of a 1973 zoning variance that permitted smaller units and fewer parking spaces) who were threatened with rent increases beyond Section 8 FMRs and payment standards.

⁴¹Reportedly, this was in exchange for revising the local Housing Preservation Ordinance to remove the replacement housing fee levied when owners opt-out of Section 8 and refused market-based purchase offers from the City or its designee. See text accompanying note 22, *supra*.

⁴²California Gov't. Code § 65863.11; Maine H.P. 948-L.D. 2322, Pub. L. ch. 785 (1988), as amended by H.P. 948-L.D. 1316, Pub. L. ch. 380 (1989); Maryland Annotated Code Art. 83B § 9-104(a)(2) (1989). San Francisco's 1990 Preservation Ordinance (S.F. Admin. Code §60) provides for an exclusive negotiation period for the city or its designated representative, and a Fair Return Price calculation that the owner must accept as a sale price. This law assisted the San Francisco Redevelopment Agency in signing a purchase agreement with an owner who had issued a Notice of Prepayment to the city and the tenants, later assigned to a nonprofit organization. A right of first refusal bill introduced in the Texas legislature in 1999 failed to pass. H.B. 3607 (sponsored by Rep. Burnam, April 1999). The City of Seattle was considering a similar proposal during 1999.

To overcome this limitation, a more appropriate initiative would create "preemptive options," triggered by the act of prepayment or opt-out. Maine's preservation statute, for example, reportedly combines notice requirements with a right of first refusal for the state housing agency whenever the owner takes an action that would terminate a project's subsidies, not just upon a proposed sale that would do so.⁴³

In combination with mechanisms to obtain site control, some localities have also adopted or considered defining a formula specifying the sale price of preservation properties.⁴⁴

Some owners who might otherwise exit government programs can be enticed to stay with financial or other benefits.

Providing Additional Preservation Incentives to Current Owners

Some owners who might otherwise exit government programs can be enticed to stay with financial or other benefits. HUD's recent "Mark up to Market" initiative provides one important tool to encourage current owners to preserve expiring Section 8 contracts. But this federal initiative may not be sufficient to address the needs of other properties that lack an expiring Section 8 contract that is substantially below-market. Before HUD's initiative, and even to fill the gaps left in its wake, additional state incentives may be needed.

Even where incentives are useful, to the extent that they rely on relaxing rent, use or dividend restrictions or providing additional debt financing, care must be taken to ensure that tenants are not adversely affected by rent increases to cover the costs of the incentives. Some tenants in these properties do not receive income-based rental assistance and even for assisted tenants, federal assistance may be limited. Another downside to poorly implemented incentive programs is that they can serve only to enrich the owner without providing corresponding benefits to tenants or the property, or longer affordability commitments. Incentive programs targeted at rehabilitating and improving the project, if properly monitored for compliance, are generally superior to general "mark ups" and increased profit schemes. Incentives to current owners are often popular because they may look cheaper than the costs of a nonprofit purchase. While this may be

⁴³ Maine Rev. Stat. Ann. tit. 30-A, § 4973 (NHLP has been unable to currently verify this information).

⁴⁴ San Francisco Admin. Code § 60 sets a "Fair Return Price" based upon certain appraisal assumptions that the owner must accept as a sale price. This option was reportedly considered in Seattle, but no legislation was filed.

true in the short run, the cumulative costs of long-term preservation may mount as time-limited use restrictions imposed in exchange for stay-in incentives later expire.

Numerous state housing finance agencies have developed incentive programs aimed primarily at preserving projects within their own portfolio of state-financed properties. Some of these creative programs include:

- offering refinancing to decrease debt service or cash-out current equity⁴⁵
- equity takeout loans for other purposes⁴⁶
- allowing partial access to residual receipts or excess income accounts⁴⁷
- allowing increased dividends⁴⁸

These benefits are usually exchanged for new or extended use agreements.

Another possible incentive is streamlined regulatory burdens. Vermont reports that their concerted effort to reduce reporting requirements and to condense and simplify their program guidelines has reduced owner opt-outs. This could provide a cheap and simple complement to large financial investments. In Minnesota, the state housing agency is using part of the state's \$10 million annual appropriation for preservation to make zero-interest loans to owners of expiring Section 8 and prepayable HUD-subsidized properties in an amount up to the capitalized value of the difference between currently restricted rents and market rents.⁴⁹

Conclusion

Although HUD has reported a recent slow-down in the rate of owner opt-outs, possibly due to its "mark-up" initiative, there remains a substantial risk of conversion for the best subsidized properties. With federal contributions and policies incomplete, only expanded efforts by advocates on the state and local level will succeed in preserving more of this housing for the future. The Housing Law Bulletin will continue to chronicle those important efforts. ■

⁴⁵See National Council of State Housing Agencies National Preservation Survey 1998 (on file with NHLP) (citing the states of California, Colorado, Maine, Wisconsin).

⁴⁶*Id.* (Minnesota).

⁴⁷*Id.*, (Maryland, Massachusetts, Michigan, Pennsylvania).

⁴⁸*Id.*, (Maryland, Massachusetts, Michigan, Wisconsin).

⁴⁹It is currently unclear whether these funds are accurately targeted to properties at highest risk of conversion to market-rate use.