

RHS Concedes Early Maturing RHS Loans Are Subject to ELIHPA Prepayment Restrictions

By Gideon Anders, NHLP Senior Staff Attorney

Responding to a preliminary injunction motion in *Brown v. Vilsack*,¹ Rural Housing Service (RHS)² Administrator Tony Gonzalez acknowledged that certain RHS loans scheduled to mature early are nevertheless subject to the prepayment restrictions of the Emergency Low-Income Housing Preservation Act (ELIHPA). Specifically, property owners cannot pay off these loans prior to the originally scheduled maturity date without first applying to prepay the loan and receiving RHS approval. This article briefly summarizes the *Brown v. Vilsack* litigation and the important ramifications it has for other early maturing RHS mortgages.

Background

Three Section 515 residents of Merrill Apartments, a 12-unit Oregon development³ in Merrill City, Oregon, sued RHS when they learned of their possible displacement due to the property's early maturing mortgage. The property's mortgage was originally scheduled to mature in August 2015. Because of a small calculation error in the original payment schedule, however, the mortgage would actually reach maturity six months earlier, in March 2015. When residents learned that the Merrill loan was going to mature earlier than scheduled and that they faced likely displacement upon loan maturation, they contacted Legal Aid Services of Oregon (LASO). Residents wanted to avoid displacement and explore whether the development could be preserved as affordable housing.

Working closely with the Oregon Law Center (OLC) and the National Housing Law Project (NHLP), LASO and the residents asked the property owner to apply to RD to prepay the Merrill loan prior to its original maturity date. Critically, this prepayment, as opposed to loan

maturation, would subject the development to ELIHPA's prepayment restrictions,⁴ rendering the residents eligible for RHS vouchers⁵ and allowing them to remain in their homes after the prepayment, or enabling them to move to other housing if they choose. At the same time, the residents asked RD to postpone the early loan maturation date back to its original date, to preserve the development through a sale to the managing housing authority.⁶

Because the partnership that owns the property is interested in selling, it agreed to the residents' request in the hopes that prepayment would facilitate an RD-financed sale of the development under the RHS ELIHPA prepayment process. Even if the property is not ultimately sold, prepayment approval would aid in the development's transition to a market-rate development because current residents could remain, using the RHS vouchers made possible by prepayment.

Current Litigation

The RD state office unfortunately rejected resident entreaties for preservation. Accordingly, LASO sent a formal demand letter to the RHS national administrator, asking him to postpone the early maturity date. The letter argued that RHS's acceptance of principal payments that accelerated loan maturation violated ELIHPA since the owner had not been approved for prepayment. The letter also asked RHS to speed up processing of the owner's prepayment request, which residents believed was being intentionally delayed because the RD state office did not want to preserve the development.

RHS responded that its Oregon state office was processing the prepayment request as quickly as staffing levels permitted. It also insisted that RHS could not alter the early maturity date: the loan's principal balance had been

¹*Brown v. Vilsack*, No. 1:14-cv-01739-PA (D. Or. Complaint filed Nov. 3, 2014).

²Legally, operating authority for the Section 515 rural rental housing program is vested in RHS. The program, however, is administered by the Rural Development (RD) mission area of the Department of Agriculture. The RD Housing Administrator is also the RHS Administrator and all agency regulations are published under RHS regulatory authority.

³Eleven of the development's 12 units are deeply subsidized under RHS's Rental Assistance program. The last unit is reserved for an on-site manager. The development is owned by a private partnership and is managed by the local Klamath Housing Authority.

⁴The ELIHPA provisions that apply to RHS housing are codified at 42 U.S.C.A. § 1472(c) (2015). They require that any owner seeking to prepay a Section 515 loan prior to its original maturity date apply to prepay the loan. Once a prepayment application is filed, RHS is required to offer incentives to the owner to remain in the program. If the owner rejects the incentives, RD must determine whether the prepayment will have an adverse impact on minority housing opportunities. If an adverse impact is found, the owner is required to offer the development for sale to a nonprofit or public entity for 180 days. RD must then finance the sale and continue to subsidize the residents in a manner that does not require them to pay more than 30% of income for housing.

⁵The RHS voucher program is technically authorized by Section 542 of the Housing Act of 1949. 42 U.S.C.A. § 1490r (2015). Funding for the program is, however, authorized in the annual agricultural appropriations acts. Since 2006, appropriations have limited the use of vouchers to residents of Section 515 developments whose owners have prepaid their loans.

⁶For more information on the issue of maturing RHS mortgages, see the article on page 12 of this *Bulletin*.

advanced by a calculation error made at loan origination and RHS cannot unilaterally modify this mutual error.⁷ The response did not address the residents' allegation that the early loan maturation violated RHS regulations and ELIHPA.

Residents then filed a complaint in federal district court,⁸ followed shortly by a preliminary injunction motion. The complaint sought: (1) to permanently enjoin RD's acceptance of principal payments that would allow the loan to mature early; (2) to force RD to process the owner's prepayment request in a timely fashion; (3) declaratory relief that RD had an affirmative obligation to finance the sale of the development to a nonprofit or public entity if the prepayment would have an adverse impact on minority housing opportunities; (4) declaratory relief that RD had a statutory obligation to continue to subsidize the residents once the development transferred to a new owner; (5) a declaration that RD violated the residents' due process rights by failing to provide an opportunity to appeal RD prepayment decisions; and (6) a declaration that RD's "method" for determining whether a prepayment has an adverse impact on minority housing opportunities is arbitrary and capricious, since no method exists.⁹ The preliminary injunction motion simply sought relief on the first two causes of action.

RD's response to the preliminary injunction motion attached a declaration from Tony Hernandez, the RHS Administrator, stating:

RHS will not allow the Merrill mortgage to mature prior to the [original] maturity date scheduled in the mortgage unless [the owner] accepts an incentive offer pursuant to 42 U.S.C. § 1472(c)(4)(A) or, if [the owner] rejects the offer, then if the prepayment requirements of 7 C.F.R. § 3560.658 are met.¹⁰

With this declaration, RHS effectively conceded the residents' claim that RD's acceptance of principal payments that advance a loan's maturity date violates ELIHPA unless the owner has filed, and RD has approved, a request for loan prepayment.

Plaintiffs withdrew their preliminary injunction motion after RHS filed Mr. Hernandez's declaration. The case is now proceeding in the hope that the major issues can be resolved in time to permit the preservation of the development as affordable housing.

Conclusion

Mr. Hernandez's concession is extremely significant. An estimated 70 Section 515 loans are currently ahead of their original principal payment schedules, nationwide. RD's continued acceptance of final payments that mature loans prior to their original maturity dates clearly violates ELIHPA. Advocates who become aware of any RHS loan maturing ahead of schedule should challenge RD's action and seek to postpone the loan's maturity date to coincide with the original maturity date.¹¹ ■

⁷Letter from Tony Hernandez, RHS Housing Administrator, to Ed Johnson, OLC (Oct. 17, 2014).

⁸Brown v. Vilsack, No. 1:14-cv-01739-PA (D. Or. Complaint filed Nov. 3, 2014).

⁹RD has never adopted criteria for determining if a prepayment will have an adverse impact on minority housing opportunities.

¹⁰Declaration of Tony Hernandez in Support of Defendants' Response to Plaintiffs' Motion for Preliminary Injunction (Dec. 5, 2014).

¹¹Advocates can discover the original maturity date by consulting the recorded deed of trust or mortgage. Approximate loan maturity dates are also available on the National Housing Preservation Database, <http://www.preservationdatabase.org>.