Rural Rental Housing Preservation:

Purchase Processes

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Nonprofit organizations, public housing agencies, and other mission-driven entities may wish to consider purchasing rural rental housing developments financed under the U.S. Department of Agriculture (USDA) Rural Development's Section 515 or 514 programs, as a way of preserving them for long-term occupancy by low-income tenants. Two separate purchase processes exist. Both methods are complicated, so this information sheet provides only a basic introduction to the general requirements and important steps for each.

Preservation Through the Prepayment Process

The Emergency Low-Income Housing Preservation Act (ELIHPA) restricts the prepayment of loans made before December 15, 1989 for Section 515 Rural Rental Housing and Section 514 Farm Labor Housing. Loans made on or after this date may not be prepaid. Loans made before this date may be prepaid only after following the multi-step process created by ELIHPA and the regulations that implement it. As described below, in certain situations that process includes an offer of sale to nonprofits and public agencies.

Step 1. Public Notice – An owner wishing to prepay the mortgage on an eligible Section 515 or Section 514 rental development must apply to the USDA Rural Development (RD) State Office in the state in which the development is located. This office must then provide public notice of the owner's intention to interested public or nonprofit organizations that have asked in advance to receive this type of notification. Potentially interested purchasers can receive RD notices by registering on its Preservation Information Exchange (PIX) website at https://pix.sc.egov.usda.gov. Some state governments have additional notice requirements.

Step 2. Incentives Offer – RD must offer the owner incentives to keep the development in the 515 or 514 program with "restrictive use provisions that keep it affordable to low-income tenants for at least 20 years. These incentives may include an equity loan, an increased return on investment, additional Section 521 Rental Assistance, an interest rate reduction, or a release of excess reserves. If the owner accepts the incentives, the prepayment process ends.

Step 3. Incentives Rejected – An owner can reject RD's incentive offer and prepay without offering the project for sale if:

- the owner agrees to keep the property affordable for low- and very-low income tenants for 10 years and then offer it for sale to a nonprofit or public agency;
- RD determines that prepayment would not adversely affect housing opportunities for minorities and there is an adequate supply of alternative housing in the community; or
- RD determines that prepayment would not adversely affect housing opportunities for minorities and that there is not an adequate supply of alternative housing, but the owner agrees to restrictive use provisions that will protect the current tenants.

Step 4. Offer of Sale – If none of these three situations exists, the property must be offered for sale to an eligible nonprofit or public agency for 180 days. If RD determines that no local nonprofit or public agency is available, regional and national groups may be considered. (Under the governing statute, for-profit entities are not eligible purchasers even if they are willing to restrict project use to low-income tenants. To sell the property to a for-profit purchaser at this stage, the owner would have to withdraw the prepayment request and then pursue the sale under the transfer regulations described below.)

A buyer must show that it is fiscally responsible and capable of managing the property itself or through an agent. It must commit to keep the development as affordable housing for low- and very low-income tenants for the property's remaining useful life. A nonprofit buyer's principal purposes must include low-income housing development or management. A local nonprofit must have a broad board of directors reflecting various interests in the community.

If a sale occurs, the sales price is the property's current appraised value as unsubsidized, conventional rental housing (separate independent appraisals are provided by RD and the owner). RD has the authority to do a number of things to help the purchaser, though it is not required to do any of them. It can help finance the sale through a transfer and assumption of the existing Section 514 or 515 loan, make an equity loan, or subordinate its loan to a third party equity loan. It may also provide an interest rate reduction and/or additional Section 521 Rental Assistance.

RD also has the authority to make a grant to the buyer to cover the costs of due diligence and packaging the loan. (In recent years grant amounts have been either $20,000 or $50,000, depending on congressional authorization.)

Step 5. After Offer of Sale – After offering a property to nonprofits and public agencies, the owner may prepay without restrictions if:

- no feasible offer is received within 180 days;
- a nonprofit or public agency makes a purchase offer but is unable to fulfill the offer's terms within 24 months; or
- the loan was made under Section 514 for farm labor housing on a farm, the housing is no longer needed, and the land cannot be separated from the farm.

Preservation Through Transfer and Assumption

Rural Development offers owners an alternative that is generally less cumbersome than the prepayment process. Section 515(h) permits a transfer of ownership to a new owner who also assumes the loan, if this action will further the provision of housing for low-income tenants and is considered to be in the best interests of the tenants and the government.

Ownership transfers are governed by §3560.406 of RD's regulations and must be approved by RD. Many transfer requirements are the same as requirements for a Section 515-funded acquisition of an existing property. For example, the same entities are eligible for both transfers and new Section 515 loans: individuals, partnerships, limited partnerships, for-profit corporations operating on a limited-profit basis, nonprofit organizations, limited equity cooperatives, Native American tribes, and public agencies.

RD has the authority to write down its loan so the purchaser assumes a smaller amount of debt. It can provide the seller with an equity payment, in the form of either a loan or cash. It may extend the term of the existing loan to 30 years or the remaining economic life of the housing, whichever is less. It may amortize a new loan over 50 years or the remaining economic life of the housing, whichever is less. A new loan can be in the form of a senior or junior loan, a parity lien, or a soft second.

RD is willing to subordinate its debt to debt from another source. Such sources may include state programs and private loans. The most likely possibilities, which are accessed through state or local agencies, are Low Income Housing Tax Credits, tax exempt bonds, and HUD's HOME program. The property's value must be high enough to provide security for the RD loan being assumed and any new loans being made as part of the transfer. If the value of the loans totals over $100,000, an RD appraisal is required.

The transfer agreement must include provisions for addressing the property's capital needs, as identified in a capital needs assessment. An environmental review, a civil rights compliance review, and a review of compliance with federal accessibility requirements are required.

A purchaser must accept a restrictive use agreement requiring the property to be used for program purposes for a specified period of time. When an equity loan is made at transfer, the use restriction must be for 30 years.

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A national nonprofit corporation headquartered in Washington, DC, and founded in 1971, the Housing Assistance Council helps local organizations build affordable homes in rural America by providing below-market financing, technical assistance, research, training, and information services to the organizations. HAC's programs focus on local solutions, empowerment of the poor, reduced dependency, and self-help strategies. HAC is an equal opportunity lender.

More information about rural rental housing preservation is available on HAC's website at www.ruralhome.org. Details about the prepayment purchase process and the transfer of ownership process are available from RD offices or in USDA's handbook HB-3-3560, available at www.rurdev.usda.gov/regs/hblist.html. Chapter 15 covers prepayment, Chapter 7 addresses transfers, and Appendix 1 contains the multifamily regulations, 7 CFR part 3560.

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