



Rural Rental Housing Prepayment and Preservation

Housing Assistance Council

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The Section 515 Rural Rental Housing program run by the U.S. Department of Agriculture (USDA) has proven extremely successful at providing decent, affordable housing for the lowest income rural Americans. The majority of Section 515 apartments were built before 1995, however, and many of these older buildings need major physical repairs or updates. At the same time, significant numbers of Section 515 loans are in danger of being paid off, potentially enabling their owners to convert the units to market rents and displace current tenants.

Rural Rental Housing Need

Nearly 5 million rural households (about one-quarter of the total) rent their homes. They suffer some of the worst housing problems in the United States.

- Housing costs are the most significant problem facing rural renter households. More than one-third of them are cost burdened (i.e., they pay over 30 percent of their income for housing). There is no county in the country where the prevailing minimum wage is enough to afford the standard rent level established for a modest one-bedroom apartment by the federal Department of Housing and Urban Development (HUD).
- Worst case needs, as defined by HUD, afflict one in every four very low-income renter households in nonmetropolitan areas. That is, they are extremely cost burdened and/or inadequately housed, and they do not receive federal housing assistance. The vast majority of these households are severely cost burdened, paying more than half of their income for their housing costs.
- Rural renters are twice as likely as owners to live in physically substandard housing. Approximately 12 percent of nonmetro renters live in either moderately or severely inadequate housing; for minorities, the rate rises to 18 percent.
- Elderly people often face some of the worst housing conditions. In many rural areas, if a low-

income senior cannot find an affordable apartment, her choices are likely to be a nursing home or relocation to an unfamiliar urban area.

- Rent subsidies alone cannot end rural America's rental housing problems. Too often there simply are not enough rental units. In some rural places, HUD's Section 8 vouchers are not available because there is no administering agency.

The Section 515 Program

The Section 515 Rural Rental Housing program provides mortgage loans to develop rental housing for very low-, low- and moderate-income tenants. Section 515 loans are often used in conjunction with Low Income Housing Tax Credits and other financing. Section 515 funds may also be used to provide equity to certain owners of existing Section 515-financed properties as an incentive to avoid prepayment and preserve affordable housing.

Section 515 is administered by the USDA's Rural Development (RD) Housing and Community Facilities office. RD is the successor to the former Farmers Home Administration.

Section 515 has been the mainstay of RD's efforts to serve the poorest of the rural poor. From 1963 (when Section 515 began operating) through 2008, the program committed financing for housing developments containing a total of 531,341 units – more than half a million rental homes that are affordable for low-income rural residents. As of April 2009, RD's Section 515 portfolio contained 15,263 properties providing homes for 403,335 households with an average annual income of \$10,978. People who were elderly or had disabilities occupied 60 percent of the units.

Over the years, Section 515 has suffered severe funding cuts. New unit production peaked at 38,650 in 1979 and dwindled to a low of 486 in FY 2006.

USDA's Section 521 Rental Assistance (RA) adds further help for tenants, such as elderly and disabled people on fixed incomes. RA is available only for tenants of developments financed under Section 515 or the Section 514/516 farmworker housing program. Units produced with Section 538 or tax credit funding do not qualify for

Rental Assistance and are not affordable to the lowest income tenants unless they obtain further aid from another source.

Prepayment and Preservation in Section 515

The term “preservation” can refer to (1) maintaining or improving the physical condition of Section 515 properties, or (2) keeping Section 515 properties available and affordable for the kinds of tenants the program currently serves.

The need for attention to physical preservation was demonstrated by a Comprehensive Property Assessment conducted for RD in 2003-2004, which found that the average age of properties in the Section 515 portfolio was 23 years. Researchers reported that the physical conditions of the properties did not pose any serious immediate health and safety problems, but warned that many properties would face significant physical needs in the immediate future.

None of the properties has enough money in reserve to address its physical needs over time. Researchers calculated the total cost to prevent physical deterioration of Section 515 properties would be \$2.6 billion over 20 years.

In addition to the physical challenges identified, USDA’s Comprehensive Property Assessment reported that owners of 9,698 of the properties (61 percent) had the right to prepay their mortgages. (Section 515 mortgages made after December 15, 1989 cannot be prepaid.) Researchers calculated that it would be economically viable for owners to prepay mortgages on 1,648 of the properties (10.4 percent), accounting for about 46,000 apartments.

Owners seek to prepay for varying reasons, including the expiration of tax benefits, the burden of increased servicing requirements, the desire of some small project owners to retire and, in some rural areas, an increase in vacancies due to out-migration. As is the case for owners of HUD multifamily projects, Section 515 owners’ ability to prepay is restricted by federal law. The details vary depending when a loan was approved, but in all cases RD is either permitted or required to offer owners incentives not to prepay, and in exchange the property continues to be restricted to low-income occupancy for 20 years. These incentives include equity loans, increases in the rate of return on investment, reduced interest rates, and additional rental assistance. In some cases, an owner that rejects the offered incentive(s) must offer the project for sale to a nonprofit or public agency. When a subsidized loan is prepaid the apartments may continue to be available to low-income tenants, or they

may be converted to market rents or to condominiums. In the latter cases, tenants can no longer afford their homes.

The Section 515 stock is losing units to prepayment faster than new ones are being built. In fiscal year 2007, more than three times as many units were prepaid (1,810) as were produced (557); in FY 2008, 1,877 were prepaid and 805 were produced. Most of the prepayments include rent protections for current tenants. The rent protections seldom apply to future tenants, however, and when current tenants want or need to move, the rent protections do not move with them.

In many situations, to address both physical and affordability preservation the owner who wishes to leave the Section 515 program can sell the property to a new owner, whether nonprofit or for-profit, that is dedicated to keeping the units affordable for low-income renters. These buyers are sometimes called “preservation purchasers” or “mission-driven entities.”

Preservation Resources

Any rural rental preservation effort is likely to involve numerous sources of financing to cover the costs of acquisition and rehabilitation. Simple preservation deals may involve only two or three sources, but most require more.

Financing sources available for rural rental preservation include commonly known programs such as Low Income Housing Tax Credits, as well as others that are devoted exclusively to preservation.

Section 538 guaranteed rental housing loans can be used by purchasers or stay-in owners of Section 515 properties, alone or in conjunction with tax credits or other financing. USDA provides a 90 percent guarantee and interest credit on \$1.5 million of the loan amount down to the long-term monthly applicable federal rate at the date of loan closing. Program terms include a minimum 1.15 debt service coverage ratio and 40-year amortization. Eligible lenders are those approved by and active with Fannie Mae, Freddie Mac, or the Federal Housing Administration, or those approved by USDA.

The Multi-Family Housing Preservation and Revitalization Restructuring Program, known as MPR, was created in fiscal year 2006. USDA selects a limited number of properties for help restructuring their Section 515 loans in order to revitalize them while keeping them affordable, with or without a change in ownership. USDA’s preferred form of assistance is deferral of existing Section 515 debt, enabling the cash flow to be used instead for physical revitalization. Other possibilities include new financing from third party

sources, rehabilitation loans, soft mortgage loans, debt forgiveness, and (for nonprofit owners or purchasers only) revitalization grants.

USDA's Preservation Revolving Loan Fund (PRLF) program, first funded in 2005, makes loans of up to 30 years to nonprofit intermediary organizations that, in turn, lend the funds to owners or purchasers of Section 515 developments. One of the intermediaries funded by the USDA PRLF program is the Housing Assistance Council. HAC's PRLF provides low-interest loans for refinancing and costs incorporated into long-term financing such as options, downpayments, purchase, site development, architectural and engineering fees, construction financing, rehabilitation, and more. The interest rate is 8 percent for for-profit entities and 5 percent for others, with the amount and term of each loan varying according to the project's needs.

Rental assistance for tenants may be available to increase the viability of some preservation deals. Some current Section 515 tenants receive Section 8 vouchers from HUD or Section 521 Rental Assistance from USDA. New RA is not available for MPR participants, but USDA sometimes provides new RA units as incentives to owners to stay in the program rather than prepaying their mortgages. In addition, since FY 2006, USDA has been able to provide its own vouchers to enable current tenants to remain in prepaid properties.

Additional Information

Those who wish to preserve Section 515 homes for their tenants can help avoid loss of units by monitoring prepayment activity, intervening when necessary, and/or by purchasing projects when they are offered for sale. It is easier to purchase a property before an owner asks for USDA permission to prepay than after the owner has initiated such a request, because the request sets in motion a statutory process involving a variety of requirements.

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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.

For more information about rural preservation, please visit the Housing Assistance Council's website at www.ruralhome.org and USDA's MPR page at www.rurdev.usda.gov/rhs/mfh/MPR/MPRHome.htm. Examples showing how the resources mentioned above have been used for rural preservation are highlighted in the Summer 2007 issue of HAC's Rural Voices magazine, available at www.ruralhome.org.



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