

Project-Based Rental Assistance

By Staff of the National Housing Trust

Administering agency: HUD's Office of Multifamily Housing Programs and Office of Recapitalization

Years started: 1961 - Section 221(d)(3) Below Market Interest Rate (BMIR); 1963 – USDA Section 515; 1965 - Section 101 Rent Supplement; 1968 – Section 236; 1974 – Project-Based Section 8, and Rental Assistance Payments program; 1978 – Section 8 Moderate Rehabilitation program.

Number of persons/households served: 1.5 million

Population targeted: extremely low to moderate income households

FY14 funding: \$9.9 billion

See also: *USDA Rural Housing, Tenant Protection Vouchers, Project-Based Vouchers*

Project-based housing is a category of federally assisted housing produced through a public-private partnership to build and maintain affordable rental housing for low income households. HUD has provided private owners of multifamily housing either a long-term project-based rental assistance contract, a subsidized mortgage, or in some cases both, to make units affordable. Project-based assistance is fixed to a property.

This stock of affordable housing is in danger of being permanently lost as a result of owners opting out, physical deterioration of a property, or maturing mortgages ending use restrictions. When an owner “opts out” of the HUD project-based assistance program, they may convert the property to a market-rate rental building or condominiums. Recently, HUD has taken a number of actions to encourage the preservation of these properties.

HISTORY AND PROGRAM SUMMARY

From 1965 to the mid-1980s, HUD played an essential role in creating affordable rental homes by providing financial incentives such as below-market interest rate loans, interest rate subsidies, or project-based Section 8 contracts. Currently, no additional units are being produced through these programs.

Initially, project-based assistance was provided through FHA in the form of a mortgage subsidy. Mortgage subsidies reduced the cost of developing rental housing; in return, HUD required owners to agree to use restrictions that limit contract rents and limit occupancy to households meeting a program's income limits. These programs did not provide the direct rental assistance needed in order to be affordable to extremely low or very low income households.

The Section 221(d)(3) Below Market Interest Rate (BMIR) mortgage insurance program, created by the National Housing Act of 1961, enabled HUD to purchase below-market loans made by private lenders. In 1968, the Section 221(d)(3) BMIR program was replaced by the Section 236 program, which combined FHA mortgage insurance on private loans with an interest rate subsidy to effectively lower the mortgage interest rate to 1%. Owners of Section 221(d)(3) BMIR and Section 236 properties were required to make units available to low and moderate income families at HUD-approved rents for the term of their 40-year mortgages. More than 600,000 units of affordable housing were built under these two programs. Some, but not all, subsidized mortgage properties also have project-based rental assistance from the Section 8 program.

In 1974, Section 236 was replaced by the Section 8 New Construction and Substantial Rehabilitation program, now known as project-based Section 8. HUD entered into 20- to 40-year contracts with private owners to serve low income tenants. More than 800,000 units were developed between 1974 and 1983, when authorization for new construction was repealed.

There are three other smaller programs that still have units associated with them. These programs are sometimes referred to as the orphans. In addition to mortgage subsidies, HUD provided rental assistance payments to owners for some tenants of Section 221(d)(3) BMIR and Section 236 insured properties through several programs.

The Section 101 Rent Supplement program (Rent Supp) was authorized by the Housing and Urban Development Act of 1965. Many of these properties received Loan Management Set-Aside (LMSA) Section 8 contracts due to rapidly rising operating costs in the mid-1970s. Currently there are 176 active Rent Supp contracts covering 9,779 units.

Some Section 236 properties were provided additional rental assistance through the Rental Assistance Payments (RAP) program, authorized by the Housing and Community Development Act of 1974. RAP payments were made to owners on behalf of very low income tenants unable to afford the basic rent with 30% of their income. RAP reduces tenant payment for rent to 10% of gross income, 30% of adjusted income, or the designated portion of welfare assistance, whichever is greater. Most RAP contracts converted to Section 8 LMSA contracts. Currently there are 120 active RAP contracts covering 12,219 units.

Another form of rental assistance is the Section 8 Moderate Rehabilitation (Mod Rehab) program, designed in 1978 to stimulate moderate levels of rehabilitation to preserve affordable housing. Mod Rehab provides project-based rental assistance for low and very low income residents, but unlike other project-based Section 8, the agreement is between the owner and a local public housing agency (PHA). Like project-based Section 8, residents pay 30% of adjusted income for rent while rental assistance pays the balance. The program was repealed in 1991 and no new projects are authorized for development. There were 22,067 Mod Rehab units in 2008.

The Office of Rural Development at the U.S. Department of Agriculture (USDA) administers two rental housing programs, Section 515 and Section 521. The Section 515 program provided subsidized mortgage loans that developed more than 550,000 rental units for very low to moderate income households. Started in 1963, budget cuts reduced production dramatically after 1979. The stock of Section 515 units has been dwindling due to mortgage prepayment and deteriorating physical conditions. The Section 521 program is a project-based subsidy available for Section 515 projects (as well as Section 514/516 farm worker projects) that subsidizes the difference between the contract rent and a tenant rent payment of 30% of income.

ISSUE SUMMARY

Today, nearly 1.2 million households live in homes with project-based rental assistance. Fifty-six percent of these households have someone with a disability or who is elderly. The average household income is \$11,000. Another 300,000 households live in homes with one of the other forms of project-based assistance, but without rental assistance.

For project-based Section 8 rental assistance, HUD enters into Housing Assistance Payment (HAP) contracts with owners. These contracts can be renewed in one, five, or twenty year increments. However, funding for the contracts is provided 12 months at a time. Tenants pay 30% of their monthly adjusted income for rent and utilities, and HUD pays the owner the difference between the contract rent and the tenant's portion. The average monthly subsidy per unit in 2011 was \$665. New residents in project-based Section 8 units can have income of no more than 80% of the area median income (AMI), with 40% of new admissions required to have incomes below 30% of AMI.

New residents of Section 221(d)(3) BMIR properties can have incomes up to 95% of AMI, while those in Section 236 properties can have incomes up to 80% of AMI, though the median annual household income for residents of these properties is between \$11,000 and \$12,000.

Although no new units are being constructed, the challenge today is ensuring federally assisted affordable housing is not permanently lost, either through physical deterioration, or as a result of properties being converted to non-affordable uses, such as high-rent units or condominiums, when a HUD-subsidized mortgage is either prepaid or matures, or when an owner decides not to renew an expiring project-based Section 8 contract.

There are several specific conversion risks for rental housing with project-based assistance.

Mortgage prepayment. Although Section 236 and Section 221(d)(3) BMIR mortgages originally had 40-year terms, program regulations allowed most for-profit owners to prepay their mortgages after 20 years. By pre-paying, in most cases owners may terminate income and rent restrictions and any Section 8 rent subsidy. Owners must give tenants at least 150 days advance notice of an intention to prepay. Upon pre-payment, tenants are eligible for a tenant protection voucher, or in some cases an enhanced voucher, that allows a tenant to either remain in the property or find new affordable rental housing with the voucher assistance.

Maturing mortgages. Tens of thousands of low income families face escalating rents if affordability protections are not extended for properties with maturing Section 236 and Section 221(d)(3) BMIR mortgages. Residents living in apartments with affordability protections but without project-based Section 8 contracts do not currently qualify for enhanced vouchers or other rental assistance when the HUD-subsidized mortgage expires. The National Housing Trust estimates that over the next five years, 69,000 households are at risk of rent increases or displacement because HUD-subsidized mortgages have recently matured or are due to mature.

Expiring project-based Section 8 assistance contracts. When project-based Section 8 contracts expire, owners may choose to opt out of their contracts, enabling them to increase rents to market levels or to convert units to market-rate condominiums, thereby rendering apartments unaffordable to lower income tenants. Owners must give tenants one year advance notice of an intent to opt out. Most tenants will receive enhanced vouchers to enable them to remain in their homes. The National Housing Trust estimates that over the next five years 650,000 units covered by project-based Section 8 contracts will expire.

Enhanced vouchers. Special voucher assistance is provided to tenants who would otherwise be displaced due to rising rents or condo conversion if an owner prepays a Section 221(d)(3) BMIR or Section 236 mortgage, or if an owner opts out of a project-based Section 8 contract. HUD is required by statute to provide enhanced tenant-based vouchers to tenants in such properties in order to enable them to afford to remain in their homes. Enhanced vouchers pay the difference between 30% of the tenant's income and the new rent, even if that rent is higher than the PHA's payment standard. Tenants have a right to remain in their apartments after conversion to market rents. Owners must accept enhanced vouchers. If a tenant with an enhanced voucher moves to another property, the enhanced voucher converts to a regular voucher and the unit they occupied is no longer affordable to any lower income household. HUD Notice H 2012-3 is a useful reference regarding instances when enhanced vouchers can be issued to residents.

Mark-to-Market and Mark-Up-to-Market. Some FHA-insured properties with expiring project-based Section 8 contracts have rents that exceed market rents. Upon contract renewal HUD is required to reduce rents to market level, creating a cash crunch for these properties and potentially putting their FHA-insured mortgages at risk of default. To address this problem, Congress enacted the Mark-to-Market program in 1997. Owners of eligible properties must either go through the Mark-to-Market program, or opt out. In the Mark-to-Market program, an owner has two options:

- To choose to have the mortgage restructured in order to be able to afford to operate and maintain the property with lower, market rents. In exchange for this mortgage restructuring, an owner agrees to accept Section 8 rent subsidies for an additional 30 years.
- To choose to renew the Section 8 contract for one year with Section 8 rents reduced to market without undergoing a mortgage restructuring.

HUD is also able to raise contract rents to market levels upon contract renewal for properties in high-cost areas through the Mark-Up-to-Market program. Contract renewals of at least five years are required in Mark-Up-to-Market. This provides a needed incentive for owners to renew their participation in the Section 8 program when private-sector rents are high. This also provides a source of revenue for capital improvements.

Troubled properties. HUD multifamily properties may be at risk when a property is in poor financial or physical condition. An owner in default on a HUD-assisted mortgage could result in termination of the Section 8 subsidy through HUD's foreclosure and property disposition process. Since 2005, however, Congress has used appropriations acts to renew the so-called Schumer Amendment. The provision requires HUD to maintain a project-based Section 8 contract at foreclosure or disposition sale as long as the property is in viable condition. If not viable, HUD can, after consulting tenants, transfer the Section 8 subsidy to another property.

Another risk is that of HUD terminating a Section 8 contract mid-term or refusing to renew the Section 8 contract if there is a serious violation of the terms of the Section 8 Housing Assistance Payment contract. Appropriations act provisions since FY06 have allowed HUD to transfer project-based assistance, debt, and use restrictions from properties that are physically obsolete or not financially viable to another project. Residents must be notified and consulted.

Rental Assistance Demonstration. Through the Rental Assistance Demonstration (RAD) program, HUD may convert expiring Rent Supp or RAP contracts to a long-term project-based voucher contract (PBV). Currently, Rent Supp and RAP contracts can only be extended for a one-year term, making it difficult to finance a rehabilitation project. By allowing owners to convert to a longer-term PBV contract, the affordability of the apartments will be maintained and owners will be able to finance recapitalization projects.

Provisions of FY14 Appropriations Act. The FY14 Appropriations Act had five key provisions affecting project-based programs:

1. Tenant protection vouchers issued since October 1, 2006 for expiring Rent Supp, RAP, and Mod Rehab properties, or for contracts that will expire, can be project-based through December 31, 2014. Project-basing of Housing Choice Vouchers means converting vouchers tied to a tenant household and instead fixing the voucher to a specific project or units in a project. This will not count against a PHA's limit of using no more than 20% of its total Housing Choice Voucher dollar allocation for project-basing.
2. \$5 million was set aside within the public housing Tenant Protection Voucher account to provide tenant protection vouchers or enhanced vouchers to at-risk tenants living in buildings with expiring HUD-insured mortgages (e.g., Rent Supp) or expiring RAP contracts that do not qualify tenants for enhanced vouchers. Tenants would have to be in jeopardy of paying more than 30% of income for rent in properties located in low-vacancy areas. These vouchers could also be project-based.
3. The Schumer Amendment was renewed for FY14. The FY14 version now applies to all project-based contracts, not just those that are HUD-insured or HUD-held properties. The FY14 version also requires HUD to notify tenants and obtain their consent before HUD abates a contract and relocates tenants for imminent health and safety threats.
4. Section 8 transfer authority is renewed, allowing HUD to transfer a Section 8 contract, debt, and use restrictions from a financially troubled or physically obsolete building to another building or buildings. The FY14 version adds that transfers can be completed in phases, and it also allows the number of units in the receiving property to be fewer than in the original if those units were unoccupied and the reconfiguration is justified by current market conditions.
5. HUD is required to take affirmative steps to address physically troubled properties. For properties that fail required inspections multiple times, HUD is required to take an action that could result in a new owner of the property, new property management, or transfer of the project-based rental assistance contract to another property or site. The language encourages HUD to preserve the rental assistance contract while also removing non-responsive owners from the program.

November 22, 2011 Memorandum. Given budget constraints, HUD issued a memorandum on November 22, 2011 announcing three policy changes to save money. These policy changes are still in effect, along with short-funding of project-based Section 8 contracts.

1. Funds currently held in project residual receipts accounts will be used to reduce assistance payments.
2. Renewals and annual rent adjustments for certain projects will be limited to Operating Cost Adjustment Factor (OCAF) increases if proposed rents exceed the market.
3. All rent comparability studies will be required to justify proposed rent increases exceeding 110% of Small Area Fair Market Rents.

FUNDING

Congress appropriated \$9.9 billion to renew all project-based Section 8 contracts in FY14. The Administration's budget request for FY14 was \$10.2 billion, which was \$1.2 billion short of what was needed to renew all contracts for 12 months. HUD admitted this was not sufficient to give full, 12-month contracts to all properties. HUD has been short-funding contracts since FY12. It provided almost 8,000 contracts only 9 months of funding, instead of 12 months of funding, in order to make rental assistance payments to all owners on time. Advocates are concerned that with continued short-funding, investors will question the stability of the program.

The FY14 Omnibus Appropriations Act provided an increase of \$1.1 billion for the project-based Section 8 program and extended RAD conversions through December 31, 2014.

FORECAST FOR 2014

HUD will be increasing its efforts in 2014 and 2015 to encourage the preservation of the existing multifamily housing stock. For example, HUD will be issuing guidance that will implement rental assistance contract transfer authority provided in Section 8(bb) of the Housing Act and Section 214 of the HUD title of the FY14 appropriations act. This authority is a critical preservation tool that will help owners and communities retain affordable housing units. In addition, HUD is encouraging owners to pre-pay Section 236 mortgages in order to ensure that residents receive tenant protection vouchers or enter a Section 236 preservation transaction that involves refinancing of the mortgage. Finally, HUD will be issuing a notice to implement the \$5 million Tenant Protection Voucher Set Aside for Residents in Maturing Mortgage provision that was included in the FY14 Omnibus. This provision requires HUD to write guidance within 120 days.

For FY15, HUD has requested \$9.7 billion for renewals. HUD's request includes a proposal to adjust all project-based rental assistance contracts to align with the calendar year starting in January 2016. The change would possibly allow HUD to more accurately predict the cost of renewing contracts and streamline its contract administration practices. The proposed shift to calendar year funding, if enacted, would result in a low level of funding needed for FY15, setting up the need for a large increase in funding for FY16, estimated at over \$1.5 billion. Advocates are concerned that it will be quite difficult for HUD to achieve this increased level of funding for project-based rental assistance in FY16. Advocates are meeting with HUD officials and appropriators to weigh alternatives to the proposed low level of funding for project-based rental assistance in FY15.

TIPS FOR LOCAL SUCCESS

Preservation of affordable rental housing is usually undertaken by preservation-mission developers, often regional or national nonprofits. The most successful local efforts include early identification of properties at risk of conversion, as well as active partnerships with tenants, local HUD officials, state and local housing officials, and lenders and investors with a shared commitment to preserving affordable rental housing.

Subsidized multifamily rental housing can be at risk of leaving the affordable housing stock for any number of reasons, such as an owner's intent to prepay a subsidized mortgage or not renew a project-based rental subsidy contract, or uninhabitable living conditions prompting a HUD foreclosure.

Having a local database of subsidized multifamily rental housing is an essential tool for preserving assisted housing in a community because it provides an inventory of properties available to low income households, their location, and factors threatening the affordability of each project.

Many projects benefit from multiple layers of subsidy. HUD makes data on specific affordable housing programs available to the public, but nowhere does HUD combine these files into one database that counts each subsidized project only once and associates it with all of the subsidies that make it affordable to low income households. NLIHC has a publication that spells out how to create an easy-to-use database. See Chapter 5 of *The Preservation Guide*, located at: <http://nlihc.org/library/other/preservation/guides/2010>

NLIHC and the Public and Affordable Housing Research Corporation (PAHRC) created the National Housing Preservation Database, a tool for preserving the nation's affordable rental housing. It provides integrated information on all housing subsidies for each federally subsidized project. It enables advocates and researchers to easily quantify the supply of federally assisted affordable housing in any geographic area, while at the same time establishing a baseline of subsidized affordable units against which future levels can be measured. The database is at: www.preservationdatabase.org

WHAT TO SAY TO LEGISLATORS

Advocates should urge legislators to provide sufficient funding to renew all project-based Section 8 contracts for a full 12 months in FY15 and FY16.

Members of Congress should be asked to support preservation features of the RAD program and improvements to the project-based voucher program to allow housing authorities, developers, and owners to preserve the existing housing stock. In addition, advocates should urge reintroduction of broad legislation to preserve assisted housing that would:

- Provide grants and loans to for-profit and nonprofit housing sponsors to help ensure that properties can be recapitalized and kept affordable;
- Allow owners to request project-based assistance in lieu of enhanced vouchers;
- Protect the rights of states to enact preservation and tenant protection laws that will not be preempted by federal law;
- Ensure data needed to preserve housing are publicly available and regularly updated, and allow for the creation of a single database for all federally assisted properties based on a unique identifier for each property; and,
- Authorize rural housing preservation program for Rural Development Section 515 properties.

FOR MORE INFORMATION

National Low Income Housing Coalition, 202-662-1530, www.nlihc.org

National Housing Trust, 202-333-8931, www.nhtinc.org

National Housing Law Project, 415-546-7000, www.nhlp.org

National Alliance of HUD Tenants, 617-267-9564, www.saveourhomes.org

HUD Notice H 2013-3, <http://1.usa.gov/VAXMZ6>