USDA

**United States Department of Agriculture**

Office of the Secretary
Washington, D.C. 20250

DEC 24 2009

The Honorable Herbert Kohl
Chairman
Subcommittee on Agriculture, Rural Development,
Food and Drug Administration, and Related Agencies
Committee on Appropriations
United States Senate
129 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

The joint explanatory statement accompanying the Omnibus Appropriations Act, 2009 (Public Law 111-8) included a request from the Appropriations Committees for information regarding the efficacy of the Multi-Family Housing Revitalization Program.

The enclosed report is submitted in response to that request.

A similar letter is being sent to Senator Brownback, Congresswoman DeLauro, and Congressman Kingston.

Sincerely,

Thomas J. Vilsack
Secretary

Enclosure

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The Honorable Sam Brownback
Ranking Member
Subcommittee on Agriculture, Rural Development,
Food and Drug Administration, and Related Agencies
Committee on Appropriations
United States Senate
190 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Congressman Brownback:

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The Honorable Rosa L. DeLauro
Chairwoman
Subcommittee on Agriculture, Rural Development,
Food and Drug Administration, and Related Agencies
Committee on Appropriations
U.S. House of Representatives
2362A Rayburn House Office Building
Washington, D.C. 20515

Dear Madam Chairwoman:

The joint explanatory statement accompanying the Omnibus Appropriations Act, 2009 (Public Law 111-8) included a request from the Appropriations Committees for information regarding the efficacy of the Multi-Family Housing Revitalization Program.

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DEC 24 2009

The Honorable Jack Kingston
Ranking Member
Subcommittee on Agriculture, Rural Development,
Food and Drug Administration, and Related Agencies
Committee on Appropriations
U.S. House of Representatives
1016 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Kingston:

The joint explanatory statement accompanying the Omnibus Appropriations Act, 2009 (Public Law 111-8) included a request from the Appropriations Committees for information regarding the efficacy of the Multi-Family Housing Revitalization Program.

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## Multi-Family Housing (MFH) Portfolio Revitalization Demonstration Program (MPR) The Efficacy of Efforts and Recommendations for Permanent Status

### BACKGROUND:

The $11.5 billion Direct MFH Portfolio financed by the Department of Agriculture (USDA) Rural Development (RD) has over 16,500 Section 515 rural rental housing properties financed by 50 year 1 percent loans and Section 514/516 farm labor housing properties financed by 1 percent loans and grants. The two programs have been providing decent, safe and sanitary affordable rental housing since the 1960's to millions of rural residents. The programs were established because credit was not available from private lenders to finance quality affordable rental units to serve the needs of very low income renters who wished to live and work in their rural communities.

Congress has funded the MPR demonstration program through the USDA Appropriation bills since fiscal year (FY) 2006 in an effort to determine if the revitalization strategy initially proposed by USDA in draft legislation would be effective in rehabilitating this increasingly vulnerable, but strategically important portfolio to serve the affordable rental needs of rural communities.

**Key portfolio facts** – Only 3 of every 4 tenant households receive a deep tenant subsidy, the properties are small with an average size of 28 units and most are located in rural towns with modest market rents.

### CONCEPTUAL FRAMEWORK OF MPR DEMO FROM FY 2005 STUDY

**Comprehensive Property Assessment (CPA)** –RD contracted with an independent group of affordable rental housing experts to review the MFH portfolio and draw conclusions about how best to preserve it. The experts reviewed the physical status and market position of the portfolio and made recommendations on how to best address the revitalization needs of the portfolio.

- The CPA found the portfolio in good shape, but rapidly aging. It concluded a cash infusion was needed now to assure that the portfolio could continue to deliver a quality product and to avoid higher costs later.
- The CPA Study is available for review at : http://www.rurdev.usda.gov/rhs/mfh/Property%20Assessment/Property%20Assessment.htm

**CPA recommended that the Agency adopt a new approach**

- Old strategy - Take on more debt and raise rents. Problems - too expensive ($3 to 4 billion in increased rental assistance), slow (limited funds and accelerating needs), random (properties in poor markets funded or sophisticated developers pursued third party funding only where most profitable), and haphazard (immediate repair needs addressed, but no disciplined review of all current or future capital needs).

- New approach – Comprehensive rehabilitation efforts with new inexpensive tools (debt deferrals and soft loans) and disciplined underwriting and approvals (solid market and owner, capital needs assessment (CNA), sustainable underwriting, centralized review). The deal would be sealed with a new restrictive use agreement with the owner.

- The new approach was adopted and implemented by RD. Current MPR program requirements can be found in the FY 2009 MPR Notice of Solicitation of Applications (NOSA) available at: http://edocket.access.gpo.gov/2009/pdf/E9-9831.pdf

## MPR DEMO RESULTS

**New approach a success** – The MPR demonstration is now in its fourth year of existence. To date, RD has obligated over 300 MPR transactions that will affect close to 10,000 tenant households. The vast majority of these transactions are now closed, although the recent depletion of investors due to market instability has reduced low income housing tax credit resources and slowed the rate of closing for MPR transactions obligated during FY 2008. RD currently has an 80 project funding pipeline awaiting the availability of FY 2009 MPR money.

**Quick summary of MPR demonstration status –** Demonstration process, forms, automation, and procedures are in place, Agency skills are sharpened, work is balanced between simple and complex transactions, and the Agency is developing experience to unlock the processing efficiencies of portfolio level transactions. A 44 property transaction approved during FY 2008 is the largest transaction in the history of the Section 515 program, and will build on the success of a similar 22 property transaction approved during FY 2007. Key FY 2008 MPR statistics include: funded 134 deals, average 20 year CNA $30,000, and average per month rent change is a reduction of $17 per unit.

A summary of FY 2008 statistical results can be found at the end of this report.

**Key finding** – By allowing for a variety of transactions to come forward during the demo, a clear pattern emerged of a two tier response. More sophisticated borrowers typically combine the MPR with tax credit financed transfers. This allows the seller to use tax credit resources to buy out old limited partners, conduct a large scale upfront rehabilitation and provide the purchaser with developer fees. Smaller "mom and pop" borrowers typically elect to retain ownership and address capital needs on an ongoing repair schedule identified by the CNA. This limited rehabilitation transaction does not include a payment to the seller or developer fees.

As a consequence of the two tier response, RD has adopted two strategies to protect and expand the use of the MPR. First, RD adopted a two step approval process for MPR transactions with transfers. Step one is to assure that a market based transfer is sized to assure capital needs are addressed before profits are taken. Step two applies long term rent reduction to the transaction, primarily by using MPR debt deferral. The second strategy is to encourage participation by stay in owners. Most notably, changes have been made to the FY 2009 NOSA process to encourage "stay in" owners to participate in a larger scale than before to encourage low cost MPR transactions.

**Continual feedback used to improve performance** - Continual internal and external communications and stakeholder meetings have resulted in a strongly coordinated MPR implementation effort. Our most recent internal stakeholder meeting was conducted during April 2009. Key topics included: funds distribution strategies, technical program support issues, ongoing underwriting issues surfaced through loan review committees, construction policies for both rehabilitation and long term repair, reducing closing gap, and tightening post closing monitoring and servicing. Notes from our latest stakeholder meeting are available upon request.

**Current key challenges** - Internal – Building capabilities of inexperienced underwriters and CNA reviewers and increasing the level of coordinated post transactional servicing. External – Acquiring sufficient resources to build long term relationships with third party funders, building stronger incentives to encourage participation of stay in owners.

**Build on success** – In recognition of the success of the processing principles that have driven the MPR demonstration, the Agency is taking steps to implement those concepts into all direct MFH loan making and ownership transactions. For example, improved transfer processing requirements have been implemented, underwriting principals have been clarified and RD anticipates revising handbook and regulatory guidance on all new future construction efforts as well.

**Staff reorganized and refocused** - The MPR demonstration has prompted the MFH Headquarters program staff to reorganize internally twice. First, in FY 2005 we formed a highly focused team to lead efforts to break away from the old processing strategy and implement the MPR demonstration program. The second was implemented at the beginning of FY 2009 to take the successful MPR processing approach and apply it to all direct MFH loan making and preservation actions. This activity level during FY 2008 included 22 Section 515 new construction loans, 234 transfer approvals, 16 Section 514/516 new construction projects, 9 Section 514/516 rehabilitation loans and grants, and 49 prepayment prevention incentives or sales to non-profits.

**BOTTOM LINE:**

RD is poised to transition from a demonstration program to permanent legislation to fully implement and deliver long delayed and much needed MFH portfolio revitalization permanent program. Our long term goals, strategy and issues are summarized:

**LONG TERM GOAL:** Revitalize 1,000 properties a year.

**STRATEGY:**

- Increase third party participation - make better use of State and local partnerships
- Increase the size of transactions – increase processing efficiencies
- Reduce pressure on RA – most MPR transactions reduce rents

- More benefits for stay in owners – less expensive, no exit taxes, no developer fees

**ISSUES:**

- Reduce the cost of tools – fund tools from the Rural Housing Insurance Fund or no budget authority for deferrals
- More portfolios require a pool of available revitalization funds – all 12 months
- Permanent legislation – tools are the top priority
- Solve staffing concerns – quality and quantity

**LEGISLATIVE RECOMMENDATION:**

The MPR demonstration program has been a success. It provided RD with the time needed to gain experience to establish a format that works, identify strengths, address weaknesses in the process, and adopt strategies to protect and advance the Government's interest in preserving the MFH portfolio.

RD strongly supports the passage of permanent legislation to incorporate the process and tools being used in the MPR Demonstration Program. While additional program features and requirements incorporated in previous proposed legislation may be useful to accomplish additional worthy objectives and goals, it is our assessment that with sufficient funding the work of revitalization may continue to be accomplished within current requirements.

One possible addition to the MPR legislative tool kit would be the inclusion of an "advance" to be provided to small scale owners to allow them to meet the "soft costs" associated with preparing for and completing rehabilitation construction efforts.

**FY 2008 MPR SUMMARY** — January 7th 2009

| | | | | |
|---|---|---|---|---|
| | | | | % Total |
| Total Projects | 135 | Existing Owners Staying in Program | 70 | 51.9% |
| Total Revenue Units | 4,476 | Ownership Transferring | 61 | 45.2% |
| Average Units Per Project | 33 | | | |
| Total RA Units | 2,288 | | | |
| Percentage RA Units | 51.1% | | | |

| | Program Total | Average Per Project | Average Per Unit | Total BA | Avg BA Per Project | Avg BA Per Unit |
|---|---|---|---|---|---|---|
| Deferred Loan | $100,456,993 | $744,126 | $24,816 | $11,703,240 | $86,691 | $2,615 |
| 0% Interest Loans* | $12,649,885 | $843,326 | $20,143 | $6,484,331 | $48,032 | $1,449 |
| Grants * | $443,057 | $36,921 | $1,691 | $443,057 | $3,282 | $99 |
| Soft Second Loans* | $13,055,926 | $271,998 | $8,450 | $11,250,291 | $83,335 | $2,513 |
| 515 Loans* | $28,260,442 | $376,806 | $12,098 | $12,041,774 | $89,198 | $2,690 |
| Total New Agency Funding | $54,409,310 | $403,032 | $12,156 | $30,219,454 | $223,848 | $6,751 |
| Total Budget Authority | | | | $41,922,694 | $310,538 | $9,366 |
| Third-Party Funding* | $101,472,748 | $1,429,194 | $39,809 | | | |
| Rehab Not Included in CNA* | $64,684,530 | $710,819 | $20,176 | | | |
| CNA - Immediate Needs | $5,607,555 | $41,537 | $1,253 | | | |
| CNA - 20 Years | $67,062,349 | $496,758 | $14,983 | | | |
| Rehab plus CNA Immediate Needs | $70,292,085 | $520,682 | $15,704 | | | |
| Rehab plus CNA 20 Years | $131,746,880 | $975,903 | $29,434 | | | |
| CNA Per Year | $3,353,117 | $24,838 | $749 | | | |
| CNA plus Rehab Per Year | $6,587,344 | $48,795 | $1,472 | | | |

**Per property and per unit numbers based on properties with funding.*

| Impact of Transactions | Annual Impact | NPV 20 Years @ 5% (millions) | NPV per Unit |
|---|---|---|---|
| Impact on RA | ($243,982) | ($3.0) | ($1,329) |
| Impact on Tenants | ($27,715) | ($12.7) | ($309,379) |

**Negative impact represents a decrease in the rent, a savings to the tenant.*

| | Average Pre | Average Post | Average % Change |
|---|---|---|---|
| Rents PUPM | $461 | $444 | -2.0% |
| Reserve Deposits PUPA | $384 | $651 | 107.8% |