Rental Housing: Preservation & Rehabilitation
MassHousing – Section 8 Proactive Preservation Program

The issue of preserving existing affordable housing units is one with which every housing finance agency in the country struggles.

MassHousing was one of the very first housing agencies in Massachusetts to recognize the threat of "expiring use" properties over 20 years ago and the scope of the problem that this could create. Given the current cost of developing affordable rental housing in Massachusetts, preserving the existing affordable housing stock where possible will always be more cost-effective than creating new rental units. Additionally, given the current shortage of affordable housing in Massachusetts, the state must maintain as many of the affordable units as possible now in addition to developing new units if a level of supply is to be created that can ever serve to meet the current demand.

All of this makes sense in concept – but the prospect of actually developing preservation programs that work in practice is much more difficult. But MassHousing has risen to this challenge over many years with preservation programs that are tailored to varied portfolios of loans that share unique characteristics.

Maturing Section 8 Properties: The Coming Tidal Wave
MassHousing's most recent endeavor on the preservation front has been in the area of Section 8 properties. On December 10, 2002, the U.S. House Committee on Financial Services asked the U.S. General Accounting Office (GAO) to respond to ten questions related to the imminent, unresolved status of maturing mortgages for subsidized properties. In response, the GAO issued a report, "Multifamily Housing: More Accessible HUD Data Could Help Efforts to Preserve Housing for Low-Income Tenants" (GAO-04-20).

The GAO report identified 2,328 HUD-assisted properties that will mature before 2013. All of the affordability covenants will end at maturity. The GAO report concluded that, "HUD does not offer incentives to owners to keep properties affordable upon mortgage maturity. While many state and local agencies GAO surveyed offer incentives to preserve affordable housing, they have not directed them specifically at properties where HUD mortgages mature."

In the wake of this report, MassHousing took a closer look at its current preservation efforts. While the Agency had some very successful preservation programs in place, it did not have any programs that specifically targeted HUD-assisted properties with maturing mortgages. Within its own portfolio, the Agency identified 61 mortgages that mature between the years 2009 and 2013.

These mortgages were originally financed by the Agency as 30-year mortgages supported by co-terminus Section 8 HAP contracts, which are administered by MassHousing, and each mortgage is precluded from prepayment through maturity.

Proactive Preservation – Addressing the Crisis before it Develops
In searching for ways to address this specific preservation challenge, the Agency devised the Section 8 Proactive Preservation Program. This Program was designed to accomplish three main objectives:

- to preserve the affordability of the Section 8 HAP developments in the Agency's portfolio;

- to retain these properties as assets in the Agency's mortgage portfolio;
- and to maintain MassHousing's Section 8 Contract Administration for each of these developments.

Under the Section 8 Proactive Preservation Program, owners are allowed to extract equity from their properties at competitive interest rates immediately in exchange for extended affordability and a commitment to pursue the renewal of the expiring HAP contract for the longest duration possible. Prior to this program, owners were precluded from accessing equity from their developments due to a combination of the lock-out provisions in their mortgages and the inability to use HUD's HFA "Risk-Share" insurance for equity take-out subordinate financing.

One of the most important elements in this program's design is the effort to approach owners of these properties as many as five years prior to the end of their mortgage terms and work with them to develop financing packages that are attractive enough to entice them to retain the developments as affordable. It is equally important to the Agency to ensure that the financing that MassHousing offers is both reasonable and fiscally prudent.

Candidly, this approach appeals to an owner's desire to be paid now for the value of the asset that they hold and at the same time allows the Agency to negotiate these deals in a somewhat calmer environment than usually exists when a property has already reached the end of its mortgage term. At that time, it is not uncommon for legislators and other housing advocates to raise concerns over the potential loss of affordable units which can raise the profile of an individual property but at the same time change the dynamics of a negotiation and not always for the better.

Eligibility and Approach

MassHousing originally allocated $100 million of uninsured financing for the Proactive Preservation Program. Any MassHousing-financed development supported by a project-based Section 8 HAP contract is eligible to participate in the Section 8 Proactive Preservation Program. However, the existing Section 8 HAP contract must be within five years of expiration before the new loan can be closed. The new loan is locked from prepayment for 15 years after the maturity of the existing MassHousing mortgage.

Property owners are permitted to use the proceeds from this refinancing for the following purposes: to pay off other outstanding MassHousing obligations, if any; to fund a Debt Service escrow equal to the total outstanding debt service payments remaining until maturity of the original MassHousing loan; to fund replacement reserve escrows or repair/construction escrows; to pay for any reasonable transaction costs; and lastly, for an owner equity take-out.

In June 2006, MassHousing closed its first transaction under the Section 8 Proactive Preservation Program with the owners of Canton Village. Located in an affluent suburb south of Boston, Canton Village consists of 56 units of elderly housing and is scheduled to reach the maturity of its mortgage in February 2010. As part of an acquisition, MassHousing financed a new 40-year taxable permanent loan of approximately $4.4 million, in addition to the $500,000 balance on the existing loan. After deducting a repair escrow, as well as capitalized reserves and soft costs of approximately $1.2 million, the owners of Canton Village realized take-out equity in excess of $3 million. In turn, the new owner entity will be obligated to renew the project-based Section 8 contract at maturity for the longest available term and to commit to a 20-year prepayment lock-out and use restriction.

Following this initial transaction, MassHousing closed a total of $98 million in uninsured loans for 10 developments representing 1,270 units. The Agency considered this effort to be a great success – but the next issue loomed large: how to accomplish the next round of refinancings.

After having completed its initial $100 million allocation of uninsured Agency financing – MassHousing needed credit enhancement to cover the risks for additional financings beyond the initial uninsured allocation. This was problematic because HUD regulations only permit equity take-outs as part of a sale/acquisition. For the purposes of MassHousing's Section 8 Proactive Preservation Program, most existing owners do not wish to sell. In this way, it was critical that MassHousing offer a loan product that could continue to provide equity take-out incentives in exchange for long-term preservation.

On January 17, 2008, MassHousing applied in writing to HUD with a request to permit equity take-out in Risk Share transactions to be refinanced under MassHousing's Section 8 Proactive Preservation Program.

What followed was a carefully orchestrated strategy directed by MassHousing's Manager of Portfolio Preservation and which included the involvement of MassHousing's Washington counsel, NCSHA, AAHSA and John Garvin, HUD's Deputy Assistant Secretary for Multifamily Housing, and his deputy, Janet Golrick. MassHousing also employed the help of CHAPA, a large affordable housing advocacy group in Massachusetts and letters of support sent by a well-known owner of affordable housing to various Congressional representatives.

What was remarkable was how fast MassHousing received its approval from HUD. On June 5, 2008, MassHousing received the most far-reaching waiver of HUD regulations in MassHousing's history, when HUD approved the Risk Share credit enhancement for equity take-out financing for up to 30 Section 8 developments in MassHousing's portfolio of loans maturing between 2009 – 2013. MassHousing may select which projects receive the waiver from the list of the 61 Section 8 mortgages in the Agency's portfolio. Given HUD's need to internal policy, legal and programmatic review, as well as the competing internal demands brought on by the transition to a new HUD Secretary and the issues involved in the subprime mortgage crisis, it was a tremendous achievement to receive the waiver approval in less than five months.

MassHousing believes that the HUD waiver will enable the Agency to close up to an additional $250 million of Preservation transactions for the 30 developments over the next two years. What is perhaps equally important is the fact that this waiver can potentially be duplicated by other HFAs with similar facts and circumstances for maturing Section 8 mortgages. In fact, MassHousing has already received calls on its program from the California and the Connecticut HFAs.

As well, MassHousing hopes that this waiver will help the Agency to awaken public decision makers to the need for proactive preservation for expiring use properties and help to fill the void in federal programs depicted by the GAO report and in turn to preserve thousands of highly needed affordable rental housing units across the country.