Preserving the 13A Portfolio in Massachusetts

MassHousing

Rental Housing: Preservation and Rehabilitation

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OVERVIEW

As the state's affordable housing bank for the last 53 years, MassHousing is no stranger to the challenges of preserving expiring use properties. However, it faced what many would argue is the most serious preservation challenge that has ever confronted the Commonwealth – in the form of a housing program known as Chapter 13A. To address this challenge – the Agency partnered with other state agencies and stakeholders – assembling a significant investment both from the Agency and the Commonwealth. Most important though was the strategy that MassHousing developed which helped to produce individualized preservation offers and tenant protection strategies to meet the unique housing needs of over the people in over 2,200 units of housing and which will protect these extremely vulnerable low-income renters whose housing future was most dire.

BACKGROUND

In the 1970s, the Commonwealth created the Section 13A Program, a state rental development initiative modeled after the federal Section 236 Program, which initially resulted in the creation of more than 8,600 units of affordable housing in 67 developments. The 13A Program functioned as a debt service subsidy, reducing the interest rate on the mortgage to 1% for the owner. Income-eligible households pay the greater of 30% of adjusted income or a budget-based rent.

The debt subsidy payments were originally funded by a state line-item, but the funding for the 13A Program was reduced and then eliminated in 2009, at which time MassHousing stepped in to make up this funding gap – investing nearly $80 million. This financial support protected units that have been housing families with an average household income of $25,000. Close to 90% of the households in 13A properties earn below 60% of area median income and beyond that – nearly 25% of households earn below 30% of area median income.

THE CHALLENGE

By 1999, the Commonwealth was using Section 8 Enhanced Vouchers as part of its preservation efforts for expiring 13A properties. This was a solid and reliable strategy which was made possible in large part because of the work of then-Congressman Barney Frank who had language adopted in Congress which directed HUD to make Enhanced Vouchers available to 13A projects in Massachusetts and other state-assisted projects in other states that were eligible for assistance under two federal preservation programs known as LIHPRHA and ELIPHA. Unfortunately, by 2012, HUD unexpectedly reversed its long-standing practice of using these Enhanced Vouchers for the preservation of state-assisted properties.

Over the last several years and continuing through 2020, the majority of the 13A properties have reached or are nearing the end of their 40-year mortgage terms without the option to utilize Enhanced Section 8 Vouchers to help protect existing tenants. MassHousing estimates that the loss of access to Enhanced Vouchers represents a $300 million loss over time.

It is important to note that when the mortgages for these properties mature, the owner – which may be a private owner or a non-profit owner – can decide to refinance the property with an Agency like MassHousing and continue to maintain the property as affordable – or the owner can choose to leave any public subsidy behind and convert all of the units to market rate rents, subject to the provisions of Chapter 40T. Chapter 40T is an expiring use law in Massachusetts. The statute was designed to help preserve the stock of affordable housing in Massachusetts that is at risk of loss due to expiring affordability restrictions and subsidy contracts, and to protect tenants in these developments from displacement. Specifically, it establishes the right of first refusal for the sale of property to an entity committed to preservation. It also requires tenant notification one year in advance of affordability terminations and provides protections for tenants from significant increases for up to three years. However, after that the protections terminate.

While MassHousing is working with the state's Department of Housing and Community Development (DHCD) to try to preserve as many 13A properties as possible over the long term, this may not always be an option. To be clear, the decision to convert a property to market lies entirely with the owner and MassHousing acknowledges this reality. Nevertheless, the Agency has sought to meet with every owner of a 13A property to understand their intentions for the property after the 13A mortgage expires.

ADDRESSING THE PROBLEM

By 2016, it became clear that despite MassHousing and DHCD's repeated efforts to reverse HUD's decision, federal resources would not be available to assist in preserving the remaining 13A developments. At that time, MassHousing and DHCD each committed $50 million to support the preservation efforts of the 13A properties – for a total of $100 million. While this was far less than the value of the Enhanced Vouchers, because the preservation of affordability in the 13A developments is a priority for the Commonwealth, additional resources were designated to assist with preservation efforts. This included a priority for the use of tax-exempt volume cap as well as an increase to the payment standard for subsidies in the Massachusetts Rental Voucher Program (MRVP), which includes tenant and project-based vouchers.

With regard to the increased resources that were made available through MRVP, this opportunity was created for owners of 13A properties who also have project-based MRVP contracts, to increase the rents on these units to 100% of the 60% Low-Income Housing Tax Credit (LIHTC) rent. This represented an increase to the MRVP account of more than $6 million annually. A letter was sent to each owner in October of 2016 with this offer. The intent was to provide owners with an opportunity to realize rental income above 13A Program standards as a way of jumpstarting conversations around preservation.

Each property that received this offer was asked to indicate whether they would like to accept it by February 1, 2017. As part of that acceptance, DHCD asked for a confirmation that the owner was actively engaged in a preservation conversation with MassHousing prior to the Agency's approving the rent increase request. This offer for increased MRVP funds would help to increase Net Operating Income (NOI) at the property. The owner could retain 25% of this increased NOI with the remaining 75% remitted to MassHousing to be used as a source of the property's future preservation transaction. Candidly, this strategy was also employed to serve as a so-called "canary in the coal mine" indication. That is, if an owner didn't respond to this offer then this might indicate that they were not contemplating a preservation outcome for the property. As such, owners who did not commit to at least engaging in a preliminary conversation were not eligible for these funds so that they might be used at properties where there was an active preservation dialogue in play.

At the same time, MassHousing also developed a valuation-based approach for resource allocation that relied on market-based third-party data. For the majority of developments, the state offered a "formula" amount of subordinate debt as part of an initial preservation offer.

As part of its preservation work for this program, MassHousing has created a Section 13A preservation database that tracks all of the properties and captures preservation offers and funds allocated for each deal, highlights opportunities and challenges of various approaches, and tracks results. Reports generated from this database have been useful for coordinating negotiating efforts and communicating progress with all stakeholders involved.

Offers of resources out of the preservation fund are based on a model developed at MassHousing that accounts for size, market, and operations at each property. This has provided a way for MassHousing and DHCD to use limited resources more effectively.

OUTCOMES

In addition to the tenants protected and the units preserved, the Initiative has also had financial benefits for the Commonwealth. The per-unit subsidy required for tenant protection and/or preservation has been substantial but remains lower than the cost to create replacement units.

At present, of the 13A developments where affordability was at risk, well over two-thirds of the households will be able to remain in place with manageable rents well into the future.

As of April 2019:

- 13 properties (835 units) have closed preservation transactions or are executing tenant protection plans using $46.1 million in 13A funds.
- 6 properties (665 units) have identified transaction structures and are on track to close preservation transactions using $36.6 million in 13A funds.
- 6 properties (415 units) have received resource offers – including MRVP support and 13A funds – and are working to structure preservation transactions or tenant protection strategies.
- 4 properties (245 units) are uncertain about their ultimate outcomes or have made it clear to stakeholders that preservation is unlikely – but tenants are insulated by other factors.
- 6 properties (1045 units) are uncertain about their ultimate outcomes or have made it clear to stakeholders that preservation is unlikely – and tenants are at risk.

One of the most important aspects of this effort is that it has required the commitment of all actors – MassHousing, DHCD, state entities, elected officials, and municipal leaders – to protect the tenants and preserve the units whenever possible using all available resources. These individualized responses to each Section 13A property have also required continuous negotiations with owners and a coordinated effort by all.

Presented with significant challenges to preserve units and protect tenants, MassHousing has swiftly and deftly responded to the challenge. Partnering with DHCD, and working with other state and municipal stakeholders, MassHousing has actively confronted the displacement of vulnerable residents and the conversion of units to market with its Section 13A Preservation Initiative. In particular, this initiative has been successful in large part because of MassHousing's ability to develop property-specific, case-by-case approaches to addressing the preservation challenge for each of the developments remaining in the portfolio.