

Chairman Allard, Ranking Member Reed, members of the Subcommittee, thank you for inviting the National Housing Trust to participate in this hearing today. The National Housing Trust appreciates the opportunity to comment on the bill introduced by Senator Allard to extend the Mark to Market program of the Department of Housing and Urban Development.

My name is Scott Kline and I am Vice President of the National Housing Trust, a national nonprofit organization formed in 1986, dedicated exclusively to the preservation and improvement of affordable, federally assisted and insured housing. Our board of directors includes representatives of all major interests in the field, including owners and managers, state housing finance agencies, national and regional nonprofit intermediaries, housing scholars and other housing professionals who care deeply about protecting this irreplaceable resource. The Trust was deeply involved in the introduction of the Mark to Market legislation nearly a decade ago and continues to view the program as an essential tool in the ongoing efforts to preserve existing affordable housing for working families and elderly people in all parts of this country.

The National Housing Trust serves as an informational clearinghouse on developments for the public and private sector. In addition to its public policy and program monitoring role, the Trust provides technical assistance to nonprofits on sale transactions of federally assisted and insured developments.

I also serve as the head of NHT/Enterprise Preservation Corporation, a housing development corporation that has used the mark to market program to successfully save affordable housing. NHT/Enterprise Preservation Corporation owns and operates nearly 3000 affordable apartments in Illinois, Texas, Florida, South Carolina, North Carolina, Virginia, and the District of Columbia. NHT/Enterprise is a collaboration of the National

Housing Trust and Enterprise Community Partners. The John D. and Catherine T. MacArthur Foundation provides NHT/Enterprise and the Nation Housing Trust general operating support and low cost capital for housing development as part of its major national housing preservation initiative, *Window of Opportunity*.

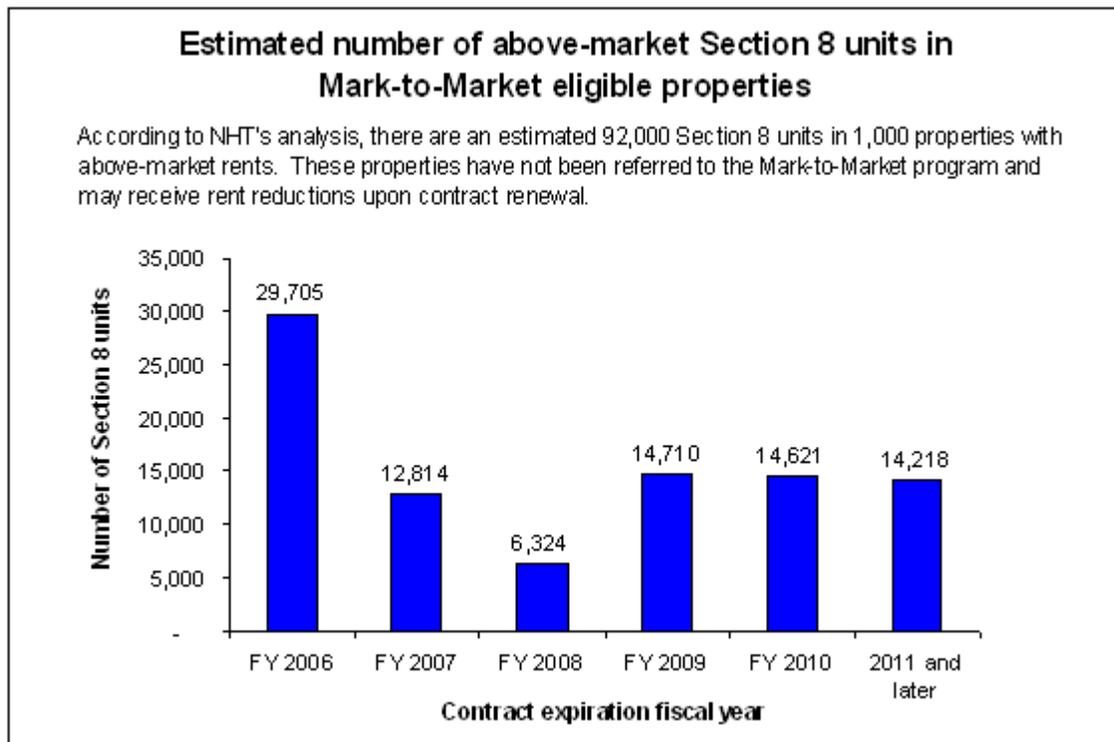
As you know, the Mark to Market program was somewhat slow to get off the ground but, as I will make clear today, the program is currently a viable, mature, federal housing preservation program-one that both saves housing and taxpayer dollars. According to the June, 2006 version of HUD Research Works, depending on how one calculates the savings, the net present value of savings from the program range up to \$883 million. See Exhibit A. For this reason alone, we strongly support the Senate bill.

Mark to Market Reauthorization is Urgently Needed

On September 30, 2006, legislative authority for HUD's Mark-to-Market (M2M) mortgage restructuring program expires. Without action by Congress to extend the program, apartments with HUD-approved rents that exceed comparable market rents face an uncertain fate. The National Housing Trust has joined more than a dozen housing groups in signing a letter supporting reauthorization (See Exhibit B).

The Mark to Market program preserves and improves affordable, HUD subsidized housing. Through a restructuring of debt and lowering of Section 8 contract rents, the Mark to Market program places HUD subsidized properties on a steadier financial platform from which they can be soundly operated with renewed, long-term affordability. Currently, an estimated 92,000 units in more than 1,000 FHA-insured properties have above-market rents.* Most of these properties, however, have contracts expiring after Mark to Market is scheduled to sunset. The problem: even if HUD's ability to restructure these properties' loans

to supportable levels is not extended, HUD is obligated by law to lower above-market Section 8 rents. If this comes to pass, many property owners won't have sufficient revenue to cover operating costs and mortgage payments after their rental assistance is cut. The result: loss of affordable housing due to property deterioration and foreclosures.



** Based on NHT's analysis of HUD data. Above-market status was determined by the FMR ratio (the ratio of the contract's rent gross amount to the FMR gross amount). For the purposes of this analysis, a contract with an FMR ratio greater than 105 was considered to have contract rents above-market.*

Why Preserve Federally Assisted Housing Stock?

The nation's market supply of affordable housing does not currently meet the demand for that product. There is virtually no dispute that affordable housing is a precious and endangered resource. According to a recent report by the Joint Center for Housing Studies at Harvard University, the national goal of decent and affordable housing for all Americans remains out of reach for certain Americans because poverty persists and the nation is losing low cost rental units from the conventional housing inventory. The nation's low cost housing

stock declined by 2 million units between 1993-2003.¹ Thus, how HUD handles restructuring and continued affordability for the people who reside in the hundreds of thousands of apartments subsidized by HUD is a key concern for those of us concerned about the well being of low income families.

No one disputes that the Mark to Market program has saved affordable subsidized housing. As of February, 2006, the program had saved over 220,000 affordable apartments. Moreover, the program lowers the ongoing cost of keeping that housing affordable. In April, 2006, the GAO issued a report titled “Policy Decisions and Market Factors Explain Changes in Cost of the Section 8 Programs.” The report describes Mark to Market as one of the steps Congress and HUD have taken to limit costs:: (GAO Report, April, 2006: “Policy Decisions and Market Factors Explain Changes in Cost of the Section 8 Programs”):

“Congress and HUD have taken steps to limit further growth in the budgetary costs of the Section 8 programs ... for the project-based program, Congress and HUD continued steps begun in 1997 to reduce above-market rents at some properties and to limit annual rent increases.” (See Exhibit C).

By already preserving over 220,000 affordable apartments, the Mark to Market program has helped save an otherwise irreplaceable housing resource at an acceptable cost to the American taxpayer.

¹**America’s Rental Housing: Homes for a Diverse Nation**, p. 2, Joint Center for Housing Studies (2006)

The Senate Bill Helps the Nation Resolve an Affordable Housing Dilemma at an Affordable Cost

According to a recent study conducted by HUD's Office of Policy, Development and Research, 220,000 affordable housing units have been preserved since the program was first authorized in 1997 and rent reductions have resulted in up to \$883 million in savings to the taxpayer. More than 2,800 properties have completed the Mark to Market process as of February 15, 2006. (Supra, Exhibit A).

The HUD finding is consistent with historical Mark to Market cost estimates. In 2001, the Government Accountability Office (GAO) conducted an analysis to determine if the Mark to Market program should be extended past an earlier expiration date. The GAO conclusion: extending the program was more advantageous to the federal government than ending it. The reasons: cost savings in the Section 8 program, minimized loss claims on the FHA insurance fund, and preservation of the affordable housing stock.² That same year, the CBO found that "the cost of restructuring mortgage debt is less expensive than the cost of default by about \$1 million per project, on average."³

Outline of the Proposed Bill

The Senate bill provides certainty to the marketplace that the Mark to Market program will continue. Extension of the program helps resolve a major housing dilemma for the households who live in properties where the Section 8 contract rent is higher than market. Moreover, the Senate legislation both identifies and helps resolve key issues of concern to those of us committed to affordable housing preservation:

² GAO Report: Issues Related to Mark to Market Program Reauthorization (July, 2001).

³ CBO Cost Estimate, HR2589, Office of Multifamily Housing Restructuring Act, 2001.

Specifically, the legislation:

- Continues the current program, which permits HUD properties to receive property based assistance, albeit at lower levels than the current assistance.
- Recognizes that some properties may not be able to meet operating expenses at the post restructured market rent and permits rents to be set at a budget based "exception rent" for up to 9% of the projects;
- Permits HUD, at its discretion, to use the Mark to Market restructuring authority on projects with at or below market rents;
- Provides for the preservation and rehabilitation of properties damaged by hurricanes or other natural disasters; and
- Extends the period during which a qualified nonprofit may purchase a Mark to Market property.

We support efforts in the Senate bill to address these important issues.

1. Exception Rents are a Vital Preservation Tool

Nationwide, no more than 5% of the properties in the Mark-to-Market program may have exception rents (defined as rents above 120% of Fair Market Rent). This authority may be exercised only if the loss of the project would seriously impact the tenants and community and the net operating income of the project is insufficient to support reasonable expenses and operating reserves. The Senate bill lifts this exception rent cap to up to 9% of the properties closed under the program in any given year. NHT/Enterprise was recently involved in a transaction that could not have occurred absent the provision of exception rents.

In June, 2005, NHT/Enterprise closed on the financing of a 67-unit, 100% Section 8, scattered site property located in the South Shore neighborhood of Chicago. The properties,

known as the “O’Keefe Portfolio,” were acquired and renovated using financing and pursuant to the program requirements of HUD’s Mark to Market Program. The South Shore neighborhood is in a working class community. One of the properties has 20 townhouses. Others are vintage 1920’s Chicago brick multifamily neighborhood buildings. There is a strong conversion market for these types of walk up buildings due to favorable real estate tax treatment that such buildings receive upon condominium conversion. Absent the Mark to Market Program and its allowed use of exception rents, these 67 affordable apartments could have been converted to market rate housing. The families occupying the housing all earn less than 30% of median income.



The O’Keefe Portfolio was preserved as affordable housing utilizing the Mark to Market program and exception rents.

Under the restructuring, the new marked down rents were sized at 110% of Fair Market Rent, an amount sufficient to pay operating expenses and service \$1.1 million in debt. Rehabilitation and repair work financed under Mark to Market restructuring includes new windows, new roofs, lead based paint remediation, new or enhanced furnaces, porch repairs, concrete and asphalt repairs, masonry repairs, addition of a management office and computer lab for use by residents, and numerous interior improvements such as new kitchen cabinets, new appliances, new carpet/tile, plaster repair and paint, and new tub surrounds.

Attached as Exhibit D is an example of how another national nonprofit organization, Volunteers of America, employed Exception Rents to save HUD assisted housing.

Permitting exception rents for up to 9% of the properties that are restructured permits organizations like VOA and NHT/Enterprise to save more Mark to Market properties. We thank the Chair for inserting this key provision on exception rents and urge the Senate to adopt it.

Separately, we recommend adding a provision to the Senate bill to give owners the right to request and receive budget-based rent increases. Such rent adjustments are authorized but discretionary with HUD. HUD has determined not to entertain any request for budget-based rent adjustments, relying instead solely on an annual Operating Cost Adjustment Factor (OCAF) adjustment. Over the 30-year life of the program, situations may arise where an OCAF adjustment is insufficient to meet rising operating costs, particularly for those properties that were underwritten before March of 2002 when HUD amended its underwriting criteria to allow a sufficient cushion for operating cost increases. In order to maintain project viability, owners should have the option of a budget-based review of rents in those situations.

2. The Senate Wisely Includes the Provision Providing HUD the Authority to Use the Restructuring Tool for Otherwise Eligible Projects with At or Below Market Rents

The Trust supports this provision. While the relationship of rents to debt is one factor in determining the need for a restructured mortgage, it is not the only factor. From time to time, the government could restructure debt to save a property where the rents were previously below market but where rehabilitation of the property would push the rents higher than market. Application of the MAHRA statute tools will support a property's extended viability and renewed affordability. In exchange, the property owner should commit to an extended affordability period.

3. The Senate Bill Properly Includes a Provision Providing HUD the Authority to Use the Restructuring Tool for Otherwise Eligible Projects with At or Below Market Rents

While the relationship of rents to debt is one factor in determining the need for a restructured mortgage, it is not the only factor. From time to time, the government could restructure debt to save a property where the rents were previously below market but where rehabilitation of the property would push the rents higher than market. Application of the MAHRA statute tools will support a property's extended viability and renewed affordability. In exchange, the property owner should commit to an extended affordability period.

This recommendation was first suggested to Congress by SAHF, Stewards of Affordable Housing for the Future (SAHF-say "SAFE"). SAHF's positions on Mark to Market are attached at Exhibit E. NHT/Enterprise is a member of SAHF. SAHF's remaining members include Mercy Housing, Inc., National Affordable Housing Trust, National Church Residences, Preservation of Affordable Housing, Inc., Retirement Housing Foundation, and Volunteers of America. Collectively, SAHF members own and operate over 800 affordable properties in 48 states, Puerto Rico, the U.S. Virgin Islands and the District of Columbia.

4. The Trust Supports Extending the Period of Eligibility for a Nonprofit to Receive Debt Relief or Assignment when Acquiring a Mark to Market Property.

The original Mark to Market bill encouraged transfers to qualified nonprofit organizations.⁴ There is mounting nonprofit interest and ability to purchase Mark to Market restructured properties. State and local governments have successfully utilized nonprofit organizations to preserve and produce housing with tax abatement and relief, tax exempt financing, HOME, CDBG and the low income housing tax credit. Nonprofit sponsors

annually produce or preserve over 30,000 units of affordable housing. Where local capacity isn't available, regional and national nonprofit organizations have acted as developers and purchasers.

HUD limits the time a nonprofit may secure debt relief or assignment of debt on a Mark to Market property to 3 years after the property closed under the program. However, the Mark to Market program is nearly 10 years old. With each passing year, qualified nonprofits are prevented from pursuing the elimination of debt in many properties that have previously passed through Mark to Market. Without nonprofit debt assignment or relief, these transactions are infeasible.

The 3 year rule significantly limits the options of private owners of these properties. Many owners are willing to transfer the properties. However, they are blocked from receiving a fair market bid by the arbitrary 3 year limit. The current three-year limit on these nonprofit purchase incentives is arbitrary, bearing no relation to when an owner ultimately decides to sell. If the best outcome at the time of sale is transfer to a nonprofit purchaser, then the Secretary should have maximum flexibility to support that outcome.

The Senate bill appropriately addresses this policy flaw, permitting nonprofits to purchase a Mark to Market property on or before the later of 5 years after recordation of the affordability agreement or 2 years after enactment of the bill.

Again, thank you for providing the National Housing Trust an opportunity to provide comments on the Senate bill concerning the reauthorization of authority for restructuring of HUD assisted and insured housing.

⁴ HUD strictly defined the term “qualified.” The Trust supports limiting debt relief to qualified organizations,

as defined. See Appendix C to M2M Operating Procedures Guide.