TESTIMONY OF HECTOR PINERO

RELATED MANAGEMENT COMPANY, LLC

ON BEHALF OF THE

NATIONAL LEASED HOUSING ASSOCIATION

NATIONAL MULTI HOUSING COUNCIL

NATIONAL APARTMENT ASSOCIATION

BEFORE THE

SENATE COMMITTEE

ON BANKING, HOUSING AND URBAN AFFAIRS

March 12, 2008

Chairman Dodd, Senator Shelby and distinguished members of this committee, my name is Hector Pinero and I am Senior Vice President of Related Management Company. My firm manages 26,000 apartments of affordable and market-rate housing in 135 locations in 13 states from New York to California. I am responsible for the affordable housing portfolio in the New York metropolitan area. Today I am representing the National Leased Housing Association (NLHA) the National Multi Housing Council (NMHC) and the National Apartment Association (NAA).

NLHA represents the interests of 600 member organizations involved in federally assisted rental housing including developers, owners, lenders, housing agencies and nonprofits. NLHA's members provide affordable rental housing for over three million families.

NMHC represents the interests of the larger and most prominent firms in the multifamily rental housing industry. NMHC's members are the principal officers of these organizations and are engaged in all aspects of the development and operation of rental housing, including the ownership, construction, finance and management of such properties.

NAA is the largest national federation of state and local apartment associations, with nearly 200 affiliates representing more than 51,000 professionals who own and manage more than six million apartments.

We commend you, Chairman Dodd, for your leadership, and we thank the members of the committee for your valuable work addressing the important issue of housing and the federal budget.

Fiscal Year 2009 Proposed Budget

On February 4, the President unveiled his Fiscal Year 2009 budget. The President's plan would fund the U.S. Department of Housing and Urban Development (HUD) at $38.7 billion, which according to the Center on Budget and Policy Priorities, is $330 million above current levels, but insufficient in light of the housing affordability issues plaguing this country. The HUD budget continues to strain efforts to provide decent and safe affordable housing. Over the years, HUD spending has declined significantly, illustrated by the fact that HUD's budget in 1974 was nearly $70 billion (in today's dollars) as compared to the $38.7 billion being proposed for FY09. Clearly, such cuts are indicative of the reduced commitment of the Federal Government to affordable rental housing in favor of failed homeownership policies.

We would like to focus our testimony on two programs that are the cornerstone of federally assisted housing, the Section 8 tenant-based rental assistance program, also known as the Housing Choice Voucher program and the Section 8 project-based programs.

Project-based Section 8

The project-based Section 8 programs, enacted more than 30 years ago, have provided effective and enduring shelter for millions of low-income families. In addition to making possible the construction or rehabilitation of housing units dedicated to low-income occupancy for extended periods, the program reduces the rent burden for low-income residents living in those properties.

My company, Related Management, has its headquarters in New York City and owns and manages about 26,000 units of multifamily housing in 13 states from New York to California. Our Section 8 project-based inventory totals 11,287 units in 64 projects.

In our opinion, the Section 8 subsidy mechanism is the most effective housing subsidy ever devised by Congress. It is an elastic subsidy that can reach the very poorest families and keep their rent burden proportionately the same as the rent burden of families with more income.

However, for Section 8 to be an effective program, HUD must comply with its contractual promise to housing providers to make timely monthly assistance payments. These assistance payments cover the difference between tenant rent contributions, generally set at 30 percent of a tenant's adjusted income, and the HUD-approved rents for the property. The tenant rent contribution generally pays for only a small portion of the costs of running a property, including debt service payments. Without assistance payments from HUD a building cannot continue to operate and serve its residents.

While HUD has been late sporadically in making payments over the past several years due to its antiquated computer systems, it was not until last summer that a major disruption in payments occurred. From June through September, late payments were widespread over most of the country. The negative impact of HUD being delayed in meeting its contractual obligations has both short- and long-term consequences, which we will discuss along with our recommendations to the committee for addressing the problem.

In the case of our company, for example, we billed HUD in June of 2007 for $9.8 million in assistance payments for the month of July. Almost one-third of our bill, or $3.1 million, was not paid by July 31, and about 20 percent or $2 million remained unpaid until November. One of our properties, in San Diego, received no funds for the period of July through November, for a total of $875,000. No doubt many other owners have been hit harder than us, but any late payment at any time is indefensible.

Owners do what they can to cope during these periods of nonpayment, such as drawing funds from a replacement reserve and other reserves if they exist, borrowing funds, delaying payments to vendors, and making personal contributions. However, not all properties have the ability to make ends meet when HUD fails to make timely payments, resulting in notices of default, inability to pay operating expenses, deferred maintenance, etc.

Late Housing Assistance Payments (HAP) not only affect the operations of a project but also make more difficult the preservation of these aging projects through sales, often to nonprofit or other preservation purchasers that commit to long affordability periods, and through rehabilitation, usually with proceeds from the low-income housing tax credit.

Purchasers, lenders, and tax credit investors have been put on alert that the government may not perform under its contracts, and they will act accordingly to protect their interests, assuming they continue to participate at all. We have attached to our testimony a list of 19 adverse consequences of delayed or insufficient HAP funding. We think it will be helpful to explain the circumstances that resulted in the late HAP debacle.

In the mid-to-late 1970s and early 1980s, when the Section 8 project-based programs were first developed, the monies for the HAP contract (be it 20, 30 or 40 years) were funded up front. For example, the costs of a 20-year contract were appropriated during the first year of the contract. Further, the subsidy amounts were based on the total rental costs at the time and did not consider the tenant contribution, which left wiggle room for rent increases during the contract term. When the first of the 20-year contracts started to expire around 1994, it was the first time in twenty years that Congress needed to make an appropriation to subsidize the properties. Congress agreed to fund the renewals, but only at rents not to exceed comparable market rents (hence the Multifamily Assisted Housing Restructuring Act (MAHRA), which provided the Mark-to-Market program and ultimately the Mark-Up-to-Market program).

As the number of HAP contracts renewing under MAHRA continued to increase and more appropriations were needed, instead of HUD requesting additional funds in its budget request, the Department chose to ask for less funding than was actually required to renew the contracts. This approach masked the true costs of contract renewals, but it was successful for a number of years because HUD was able to recapture previously appropriated funds remaining in HAP contracts that were about to expire. When most of the 20-year contracts expired around 2001 and 2002, the availability of recaptured funds diminished. HUD's need for increased funding for Section 8 renewals should have been reflected in its budget proposals around that time, but again HUD chose to mask the true costs.

To enable the renewal of contracts without sufficient appropriations, HUD chose to renew the HAP contracts with less than one year of funding. For example, if a contract expired in December of 2005, HUD would provide 9 months of funding until September 30 (the end of the fiscal year) instead of providing the full 12 months of funding up front. Essentially, it was bifurcating the 12 months of funding over two fiscal years. In this example the remaining funding for the contract would have been provided after October 1 (the new fiscal year) at which time 3 months of funding would be added to the contract for a total of 12 months. Until last year, this practice was invisible to the owners. However, in the fall of 2006, HUD's Chief Financial Officer (CFO) determined that such partial funding of contracts could not continue as the CFO believed this approach to be a violation of the Antideficiency Act (ADA), a law that is intended to ensure that appropriated funds are not mishandled. This new interpretation of the law by the CFO (which, incidentally, was not put into writing until requested by Members of Congress more than a year later) resulted in HUD reverting to funding renewals for the full twelve months in advance and not in increments.

Because the HUD FY07 budget request was based on its previous practice of partially funding contracts, there were insufficient funds appropriated by Congress, thus creating a large shortfall. The result of the shortfall was a delay in funding to thousands of Section 8 properties. When HUD realized in May of 2007 that it would not have sufficient funding to renew all of the contracts expiring in FY07, HUD's Office of Housing eventually reached a compromise with its CFO office to revert to partial or incremental funding of renewal contracts as long as the renewal HAP contract was amended to reflect the fact that partial (and not 12-month) funding was being provided at the time the renewal contract is executed. In other words, if HUD disclosed to the owner that only partial funding was being provided, the CFO deemed that HUD was not in violation of the ADA.

HUD's policy of incrementally funding (or funding for less than 12 months) continues in the current fiscal year (FY08) because of insufficient appropriations. Further, the President's FY09 request does not include sufficient monies to put Section 8 contract renewals back on a 12-month funding track. Insufficient funding coupled with HUD's inefficient payment process and questionable disbursement systems is likely to create financial disruptions to Section 8 properties for the foreseeable future.

The perception a partially-funded contract creates is devastating. It is of a government struggling to keep its financial house in order. Until recently, several years of predictability and stability in the Section 8 renewal process have led purchasers, lenders and investors in Section 8 properties to rely on long-term Section 8 renewal contracts, even though they are subject to annual appropriations, as sufficient backing for their investment. They assumed the appropriations risk in these contracts because they thought the risk was minuscule. They are not so sure anymore.

There are other more technical, but serious, concerns with short funding commitments. These contracts purport to bind an owner to providing Section 8 housing for one year. If HUD funding stops after 4 months, is the owner bound to continue to comply with Section 8 rent and other rules without receiving assistance payments? If the owner can get out of the contract will it be bound by the one-year tenant notice statute, which will prevent the owner from raising rents for one year after an opt-out notice to the tenants? Will the tenants be eligible for enhanced vouchers if the contract is abrogated? Will HUD wait until the one-year notice period has elapsed before awarding enhanced vouchers to the tenants, as has been its recent policy? Will there be sufficient funding for all enhanced vouchers?

All of these concerns will influence an owner's decision to remain in the program or to opt out, as well as decisions about whether to purchase and rehabilitate Section 8 projects. At a minimum, owners will more likely give routine notices to tenants that they intend not to renew a Section 8 contract, in order to reduce their exposure period during which they do not receive assistance payments but cannot raise rents. These opt-out notices will cause anxiety among tenants who will be placed in a continual state of uncertainty as to whether they will lose their homes or not.

Unless the industry has confidence that the government is committed to adequate and timely funding, the Section 8 inventory is likely to shrink in size. Nor will it get the new investment needed to preserve these properties as affordable housing and to keep them affordable far into the future.

What can this Committee do to help rectify the damage done to the Section 8 inventory? First, it can exercise close oversight over the process HUD uses to make Section 8 assistance payments, as well as how budgetary needs are calculated. The Secretary should be directed to use a portion of the appropriated working capital funds for this purpose. Second, legislation should be enacted to: impose a penalty on HUD when its payments are more than thirty days late; remove any requirements that owners receive HUD permission to use reserves to pay their mortgages and employees when HAP payments are late; and require HUD to notify owners when late payments are anticipated. Third, the Committee should urge that sufficient appropriations be provided for fiscal year 2009 to avert the use of a succession of short-term funding obligations by HUD.

Housing Choice Vouchers

We would also like to express our strong support for the Section 8 Voucher Program. Housing Choice Vouchers enable nearly two million households of low- and very-low-income families and the elderly to achieve decent, safe and affordable housing. The program has been successful because it provides choice to families, allowing them to rent decent and safe apartments in the communities that are near their schools, churches and workplaces. It also has the benefit of reducing the concentration of poverty. Vouchers also enable the private sector to partner with housing agencies to improve the housing stock in communities as well as protect tenants during market rate conversions. Vouchers are an essential tool for the provision of housing assistance and are supported by the owner community. Related Management is a strong supporter of this program and currently leases to 1,600 voucher holders.

We are concerned about the future of the program because HUD's budget proposes to reduce funding for the voucher program by nearly half a billion dollars, offsetting the reduction by relying on unused reserves, a move that the Center on Budget and Policy Priorities (CBPP) believes will result in the loss of at least 100,000 vouchers. Further, the proposed budget recommends using a funding formula that would base FY09 funding on the costs per voucher (plus inflation) from FY07 instead of the previous 12 months. This is unacceptable to our members because such an approach will result in additional shortfalls, jeopardizing housing assistance currently in use by tens of thousands of low-income families. It is imperative that the 2009 funding cycle be based on leasing and cost data for the most recent federal fiscal year as provided for FY08 by the Omnibus Appropriations Act (H.R. 2764) that President Bush signed into law on December 26, 2007. This is a fair formula that maximizes the amount of dollars provided by the appropriations process and ensures program stability.

The Broader National Housing Crisis

The current situation in the for-sale housing market is an unfortunate turn of events that is made even more unfortunate by the fact that it was completely foreseeable and preventable. For decades the government has pursued a "homeownership at any cost" housing policy. Many government officials, like other participants in the housing sector, mistakenly assumed that house prices would always go up. So they enticed people into houses they could not afford, and they forgot the rarely spoken truth that there is such a thing as too much homeownership.

Now we are seeing the consequences of that misguided policy. For years, we and others have been predicting this meltdown. We have been warning policymakers that pushing homeownership so aggressively could be disastrous not only for the hard-working Americans lured into unsustainable homeownership, but also for our local communities and our national economy.

That is exactly what is happening now. People are losing their homes, local communities are struggling with blight and crime, and our national economic growth is at risk. We understand that policymakers are worried that this situation might spill over into the broader economy, and we support efforts to help our country avoid a housing-induced recession.

The mortgage market meltdown represents a failure of government oversight and regulation. Despite repeated warnings, nothing was done to prevent it. On the contrary, the federal government gave a “green light” to this bubble by trying to push homeownership without limits and even trying to create a federally insured no-downpayment mortgage.

Unfortunately, while there was much the government could have done to prevent this crisis, there isn't much it can reasonably do now to alleviate it. What it can do, however, is recognize its own mistakes and ensure that this doesn't happen again. And that means, among other things, recognizing that homeownership isn't the right housing choice for all households at all points in their lives. Housing our diverse nation well means having a vibrant rental market along with a functioning ownership market. It's time we adopt a balanced housing policy that doesn’t measure success solely by how much homeownership there is.

Conclusion

I thank you for the opportunity to testify on behalf of the National Leased Housing Association, the National Multi Housing Council and the National Apartment Association, and wish to offer our assistance to the committee as you continue your important work.

SOME IMPLICATIONS OF INADEQUATE FUNDING OF PROJECT-BASED SECTION 8 CONTRACTS

NLHA

If Congress fails to appropriate sufficient funds for FY 2008 to make all contractual Section 8 payments, in original and renewal contracts, this failure will be regarded by participants in the Section 8 program, other housing programs, other federal programs, and the capital markets as a default by the United States in its perceived moral obligation. The Section 8 contract has already been devalued even without a default by sustained talk of inadequate funds, widespread late payments in 2007, and the inability of HUD to provide one-year extension contracts because of insufficient funds. A quick and decisive fix may salvage some of the damage.

The following are several specific adverse consequences:

(1) Lenders will be less willing to make long-term loans for refinancings or purchases of Section 8 projects, transactions that help in the rehabilitation and preservation of the projects.

(2) Investors and syndicators will be less willing to purchase low-income housing tax credits, which are key to the sale and rehabilitation of those projects.

(3) To the extent the above players continue to participate, it will be on more onerous terms and with a more rigorous selection process to assist only projects that would be viable if Section 8 payments terminated.

(4) Owners who economically can opt out of the Section 8 program will plan to do so and will do so at the first opportunity.

(5) Owners can also stop providing Section 8 housing even prior to contract expiration if HUD fails to provide assistance payments.

(6) Tenants will become anxious about the potential loss of their subsidy and homes. The elderly are particularly susceptible to those concerns. Some will move out and live with their families, thus losing their eligibility for tenant protection vouchers when an owner opts out.

(7) Owners will select the highest-income tenants they legally can select in order to mitigate the impact of missed or reduced assistance payments.

(8) The cost of enhanced vouchers and other tenant protection vouchers will soar, or, alternatively, all tenants will not be protected if there is an opt-out.

(9) There may be an increase in defaults on FHA-insured mortgages covering Section 8 projects.

(10) Affordability use restrictions for projects that have been restructured in the mark-to-market program, which run 30 years, would be converted to permit higher-income tenants to be served.

(11) Fifty-year affordability use restrictions for LIHPRH projects and existing use restrictions for ELIPHA projects would be terminated and the projects rented to market tenants if HUD cannot provide all the contractual Section 8 payments.

(12) For those projects remaining in the program, there will be an increase in deferred maintenance, depletion of replacement reserves, and little likelihood of obtaining tax credits for rehabilitation.

(13) Prices realized by HUD in selling foreclosed properties with Section 8 subsidies would decline.

(14) If Congress authorizes the conversion of rent supplement and RAP contracts to Section 8, there will be few takers.

(15) Participation and continued participation in other housing programs involving multi-year subsidies, such as project-based vouchers, tenant-based vouchers, and participation in the 202/811 programs would decline, or the quality of participants would decline.

(16) The lack of sufficient Section 8 funds will also thwart the refinancing of older Section 202 projects for the elderly and disabled that have section 8 subsidies. Many of these projects are 20 to 30 years old and can be preserved for another long period with recapitalization and rehabilitation, but lenders and investors would be wary of participating.

(17) The ability of public housing agencies (PHA) to borrow funds for capital improvements, secured by future appropriations to the capital fund, would be made more difficult and costly.

(18) Participation in non-housing federal programs, dependant on ongoing federal subsidies, would be compromised if participants felt the United States defaulted in the major Section 8 program.

(19) There are broader implications in the capital markets. A default by the United States in any area could send further shock waves to the already shocked markets. Would this be the end of the perceived federal backing of Fannie Mae and Freddie Mac obligations, and if so, would that increase borrowing costs for home purchases and refinancing? Would the hint of default by the United States raise borrowing costs for Treasury?