



**TESTIMONY OF SHEILA MALYNOWSKI,
PRESIDENT, PRESERVATION MANAGEMENT
ON BEHALF OF
THE NATIONAL LEASED HOUSING ASSOCIATION**

**ON H.R. 647 THE MARK-TO-MARKET
EXTENSION ACT OF 2007**

**BEFORE THE SUBCOMMITTEE ON
HOUSING AND COMMUNITY OPPORTUNITY
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES**

OCTOBER 23, 2007

Madame Chairperson and members of the Subcommittee, my name is Sheila Malynowski and I am President of Preservation Management in Portland, Maine. Our company manages over 6,000 units of assisted housing in 11 different states. I am appearing before you on behalf of the National Leased Housing Association, which for over 35 years has represented owners, managers, investors, lenders and public agencies involved in developing and preserving affordable multifamily housing under Section 8 and other housing programs. I currently serve as President of NLHA.

The Multifamily Assisted Housing Reform and Affordability Act, or MAHRA for short, which was enacted in 1997 and substantially amended in 1999, provides a comprehensive framework for the renewal of section 8 project-based contracts. Prior to MAHRA, only temporary, stop-gap legislation permitted 20-year section 8 new construction and substantial rehabilitation contracts to be renewed, as well as 15-year moderate rehabilitation contracts to be renewed.

MAHRA has two main divisions. The first is a temporary renewal program that has been extended twice by Congress (most recently in the FY07 HUD appropriations bill). This temporary program applies to a specific class of projects when their original Section 8 contracts expire and provides the authority to restructure the debt on Section 8 projects with FHA insured mortgages and with Section 8 rents **in excess of market levels**. This part of the statute is called the mark-to-market or mortgage restructuring program. The authority for HUD to restructure mortgages on these properties expires in September 2011.

The second part of the statute is permanent, in the sense that there is no expiration date, and applies to the renewal of all Section 8 contracts that are not eligible for or in need of mortgage restructuring. This section is referred to as Section 524 renewals and provides the framework for renewing Section 8 contracts.

In both parts of MAHRA, Section 8 renewal rents are set at rents not exceeding market levels or on a budget basis. In the mark to market program, (or debt restructuring program) a reduction in rents is made feasible, in general, by the payment by HUD of a nondefault insurance claim on the FHA-insured mortgage and the replacement of that mortgage with another mortgage with lower debt service requirements. In the course of this process some funds are generated for any needed project repairs and any necessary replenishment of reserves. The amount of rehabilitation accomplished is modest, averaging about \$1800 per unit. An owner's obligation to repay the cost to HUD of mark-to-market is secured by a second and sometimes a deferred payment third mortgage on the property, with potential repayment from a portion of surplus cash income to the project and from any refinancing or sale proceeds.

MAHRA, which reaches its tenth anniversary later this month, expresses to us, the users of the Section 8 program, a congressional policy to preserve Section 8 projects into the indefinite future, and to do so in a manner that provides stability, and therefore predictability, to the renewal and preservation process.

Nevertheless, experience with the renewal program and perhaps changing conditions may warrant modifications to MAHRA, such as some of those to the mark-to-market program contained in H.R. 647. In addition, in an exhibit to our testimony we describe additional suggested statutory changes to the mark to market program and to the Section 8 renewal process in general, that will help preserve Section 8 projects for the long-term. These changes were formulated in consultation and cooperation with other national housing organizations.

With respect to the provisions in H.R. 647, as we mentioned, the extension (the main purpose of this bill) has already been accomplished. However, there are other provisions in the bill that would benefit the mortgage restructuring program and should be considered.

We support Section 5 of the bill that would increase from 5 percent to 9 percent of all restructured units the number of units that can have exception rents in excess of 120 percent of the fair market rent for the area. Exception rents are budget-based, that is they are the rents needed to operate the project. Such rents are used as part of mortgage restructuring when a reduction of debt to zero will not be enough to yield economically viable rents at market. The 5 percent limit was basically an educated guess when it was enacted in 1997 and HUD's experience with that limit should be acknowledged. This amendment is important to ensuring that properties with rents above market that need substantial debt relief can continue to provide safe and decent housing to very low income households.

In addition, NLHA strongly supports Section 8 of the bill which extends from 3 years to 5 years after mortgage restructuring the period during which a tenant-based or community-based nonprofit organization can purchase a mark-to-market project and obtain a modification or forgiveness of secondary debt on the project held by HUD. A longer time frame will facilitate more of these transfers to nonprofit purchasers, which often are accompanied by a low-income housing tax credit to finance substantial rehabilitation needed for the long-term viability of a project.

H.R. 647 also authorizes the mark-to-market program to be used for the repair of certain disaster related damages to section 8 projects. It appears that this provision expands MAHRA, and mark-to-market, beyond its current scope of establishing rules for the renewal of expiring Section 8 contracts, and into disaster relief assistance. NLHA has no position on this amendment but would be concerned if this provision replaced other potential forms of disaster assistance that might be more expeditiously provided than what the mark-to-market program can accomplish.

The provision that NLHA's members have expressed concern with is section 6 which would move some properties from the Section 524 renewal universe into the mark-to-market (debt restructuring) program. These are Section 8 projects with FHA-insured mortgages but with rents **at or below market**. This is a major alteration in the structure of MAHRA and has owners concerned about the future course of Section 8 renewal policy. NLHA and HUD negotiated changes to HUD's original proposal to provide

safeguards to owners, including a requirement that owners consent to being put into the debt restructuring program. This negotiated language is included in H.R. 624. However, NLHA members remain concerned that expanding the mark to market program to properties with below market rents is a major departure from the framework of MAHRA. HUD's Office of Assisted Housing Preservation has the ability to use outside contractors (Participating Administrative Entities (PAEs)) to accomplish mortgage restructurings under the Mark to Market program. We believe the ability to utilize such contractors is the genesis of HUD's request to expand the universe of eligible projects. A more appropriate solution would be for Congress to permit HUD to utilize its PAEs for other transactions outside of mark to market. Such transactions could include Section 236 decouplings, partial payment of claims, property disposition and other mortgage workouts.

Finally, we are very concerned that certain administrative actions taken by HUD, and particularly the recent severe funding problems highlighted by this committee at last week's hearing, will destabilize the Section 8 renewal process, leading more owners to consider not renewing their contracts. We are proposing a package of amendments to H.R. 647 that is designed to encourage continued participation in the program, as well as to facilitate transactions that will maintain these projects as affordable housing for a long time.

Thank you for the opportunity to testify on this important subject and I will be pleased to answer any of your questions.

NLHA PROPOSED AMENDMENTS TO MAHRA TO PRESERVE SECTION 8 PROJECTS

1. Ensure implementation of budget-based rent increases for mark-to-market projects.

Give owners of properties that have undergone debt restructuring the right to request and receive budget-based rent increases. Such rent adjustments are authorized in the mark to market regulations but discretionary and HUD has determined not to entertain any request for budget-based rent adjustments, relying instead solely on an annual Operating Cost Adjustment Factor (OCAF). Over the 30-year life of the program, it is possible that for some properties the OCAF adjustment will be insufficient to meet rising operating cost since it is based on generalized data and is uniform for an entire state. This flexibility is also particularly important as it relates to properties that were underwritten before March of 2002 when HUD amended its underwriting criteria to allow a more realistic 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 circumstances.

2. Subsequent mark-to-market restructuring.

Give owners whose projects went through mark-to-market in its earlier stages and whose rehabilitation needs may not have been adequately met the opportunity for a second restructuring of their debt to generate funds for rehabilitation.

3. Technical amendment regarding purchase of restructured projects by nonprofits.

Make a technical correction that will facilitate transfer of restructured projects to nonprofit owners. The amendment would clarify that in addition to acquiring title to a restructured project, a qualified nonprofit organization may qualify for forgiveness or

modification of secondary debt held by HUD if it acquires control over the limited partnership owning the project by becoming the sole general partner of the partnership. HUD currently recognizes that either the acquisition of title or acquisition of control of a property constitutes a transfer of physical assets (TPA), but HUD's General Counsel's office has expressed uncertainty whether the term "acquired" as used in section 517(a)(5) of MAHRA, applies to the acquisition of control over the ownership of the project.

4. Preservation projects clarification

Provide more flexibility in the renewal of section 8 contracts on preservation projects. Specifically, we seek clarification that owners of ELIHPA/LIHPRHA properties may renew Section 8 contracts under any renewal option that the project is eligible for under MAHRA. The tenant occupancy and affordability restrictions in the Plan of Action would continue to apply for the duration of those restrictions. Our amendment would also facilitate the sale of projects initially preserved under the Emergency Low Income Housing Preservation Act (ELIHPA) to purchasers who agree to extend the affordability term for at least 20 more years. The provision would clarify that owners can renew their Section 8 HAP contracts for terms that exceed the term of the Plan of Action. The new owner would operate at rents pursuant to the terms of the Plan of Action until its original expiration date, at which time the rents would be established at rents levels equal to comparable market rents.

5. Renewal of moderate rehabilitation contracts.

Encourage continued participation in assisted housing programs by providing comparable treatment of Section 8 moderate rehabilitation project renewals with other section 8 renewals under MAHRA.

6. Subsequent Section 8 renewals clarification.

Propose three technical corrections to MAHRA to clarify the original congressional intent of the statute, and to stabilize vacillating interpretations by HUD. The first would make it clear that an owner that initially renewed its section 8 contract under one provision of Section 524 may subsequently renew its contract pursuant to any other provision of section 524 for which it is eligible. NLHA's proposed amendment would also clarify that subsequent renewals of exception project contracts will be renewed using OCAF or, at the request of the owner and approval of HUD, budget-based rent adjustments. The third change would reinstate HUD's original interpretation of MAHRA that eligibility for mark-to-market debt restructuring is determined at initial contract renewal but would allow HUD and the owner to agree, after an initial renewal, under section 524, to process a subsequent renewal under mark-to-market.

7. Comparable rent studies.

Ensure a fair assessment of rent comparability in relation to a rent increase request and/or a contract renewal under MAHRA. NLHA's amendment would provide that where there is a 15 percent or greater differential between the owner's rent study and HUD's rent study, a third appraiser would be hired by HUD and the owner to make a comparable rent determination that would be binding. This mechanism is similar to one provided by statute that was used in determining compensation in return for limits on prepayment of HUD mortgages and the one still being used for determining market value of rural housing properties being sold to nonprofit buyers during the prepayment process. This amendment should enhance both HUD's commitment to objectivity and owners' confidence in the process.

