STATEMENT OF
GIDEON ANDERS, EXECUTIVE DIRECTOR
NATIONAL HOUSING LAW PROJECT
BEFORE THE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY
U.S. HOUSE OF REPRESENTATIVES
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I am Gideon Anders, Executive Director of the National Housing Law Project (NHLP), a 35-year old nonprofit corporation that seeks to advance housing justice for low income persons by, among other things, preserving and increasing the supply of decent affordable housing throughout the United States. NHLP has worked on the preservation of Department of Housing and Urban Development (HUD) assisted and Rural Housing Service (RHS) financed housing for more than 25 years. Personally, I have worked on Rural Housing Service housing issues for more than 30 years, and on rural housing preservation issues for more than 25 of those years.

The statutory requirement that requires owners of Section 515 housing to maintain their developments as affordable housing for 20 years was enacted in 1979 at NHLP's suggestion when we discovered that the Section 515 program imposed no use restrictions on owners and that some were converting their developments to other uses by displacing elderly and other households at will. Our staff also assisted in drafting the rural provisions of the Emergency Low Income Housing Preservation Act of 1987 (ELIHPA), which was enacted after an increasing number of owners of developments that were financed before 1979 were prepaying their loans and displacing elderly and other households from homes they had expected to occupy for the rest of their lives. NHLP served as staff for the National Rural Housing Preservation Task Force, which reviewed RHS' implementation and administration of ELIHPA between 1987 and 1990. One of the recommendations of that task force was the creation of a National Office of Rural Housing Preservation within RHS that would ensure that the rural housing provisions of ELIHPA are administered and enforced uniformly throughout the states and territories. Congress enacted that recommendation in 1992, and RHS finally implemented it in 1998.

In 1991, NHLP assisted Mid-Minnesota Legal Services in litigating *Lifgrin v. Yeutter,* the first post ELIHPA prepayment case that challenged an owner's failure to maintain affordable rents after prepaying a Section 515 loan. The residents prevailed in that case and the development was returned to the Section 515 program. NHLP has participated and assisted other legal services programs litigate cases that successfully challenged illegal prepayments of Section 515 loans. We are currently representing residents in two RHS prepayment cases. The first is *Hines v. United States*, in the Eastern District of Missouri, in which residents of a Section 515

development are challenging a public housing authority's decision to prepay its loan and demolish a habitable 50 unit development that serves as a critical housing resource to African Americans in a small Missouri bootheel community. We also represent residents in *Kimberly v. United States*, a case that involves a 24 unit senior housing development in Kimberly, Idaho, whose owner has sought to prepay its loan and circumvent ELIHPA by bringing a quiet title action against RHS under Idaho law. While we have criticized RHS frequently for its administration of the ELIHPA preservation program, we have also worked closely with its staff to improve its understanding of the law and enhance its efforts to protect residents against displacement and to preserve the critical, and dwindling, supply of affordable rural rental housing. We have also worked and continue to work with owners and their representatives to streamline and improve the operation of the preservation program.

We are testifying here today because we are concerned about several trends that we are observing with respect to RHS' administration of the ELIHPA program. Our observations lead us to believe that the agency is not adequately enforcing ELIHPA, not preserving units that can and should be preserved and failing to protect residents against displacement. Before addressing these concerns specifically, we want to affirm our fundamental belief that there is an absolute and continuing need to maintain an effective rural rental housing preservation program that protects residents against displacement. Rural communities continue to have a greater need for affordable, decent, safe, and sanitary housing than their urban counterparts because housing conditions in rural areas have historically been and continue to be worse than in urban areas. The over 450,000 units of Section 515 housing that have been constructed in rural areas continue to serve a critical need in those communities. Frequently, those developments are the only available affordable rental housing that is decent, safe and sanitary. The conversion of Section 515 housing to uses other than low income housing deprives communities of a critical resource and forces elderly, disabled and working households to relocate to other communities that are tens of miles away from their current homes, jobs and families. Conversion of Section 515 housing is a particularly critical issue in the Central Region of this country where over 47 percent of the projects financed under the program prior to 1989 are located and in the South where another 30 percent of the developments are located.

We also believe that the ELIHPA rural housing preservation mechanism is a sound and effective means of preserving the nearly 300,000 units of housing that is covered by the legislation. In that context, it is important to remember that the ELIHPA preservation framework was a product of negotiations between builders, owners and residents and represents a compromise of the various positions that each group was seeking to advance. ELIHPA treats all parties fairly. It authorizes prepayments where housing is no longer needed and residents can be relocated within the same market areas. It permits prepayments when minority housing opportunities are not affected and residents will not be displaced. When minority housing opportunities are affected, it authorizes RHS to extend substantial incentives to owners to remain in the program and, if they choose not to accept those incentives, to sell their developments, with RHS financing, at fair market value to a nonprofit or public agency. If no bona fide offer is made to purchase the housing, the owners are allowed to prepay their loans and convert the housing to whatever uses they choose. The only element that is missing from the ELIHPA framework is a mechanism that enables RHS to provide financial assistance to those families that are actually threatened with displacement by prepayments and are unable to relocate into other

federally assisted housing. RHS should be authorized to assist these household with rental assistance vouchers that will enable them to continue to rent the converted units or rent other market rate housing that they can afford within their existing rural communities. We urge that the subcommittee consider such authorization and champion its funding. HUD has this type of assistance for residents threatened with displacement from HUD assisted housing. There is no reason that RHS should not have the same.

We have four concerns with RHS' administration of the rural preservation program. First and foremost is program funding. RHS does not have enough funding to meet current preservation needs, has been unwilling to ask Congress for additional funding to meet that need, and has itself been unwilling to devote more funding to a growing preservation need. Second, RHS is failing to preserve all the units that it can and should preserve and has created, and continues to create, loopholes that allow more owners to prepay their loans without protecting residents from displacement or preserving critically needed housing. Third, RHS is not affirmatively enforcing owners' obligations to operate Section 515 housing for its intended purposes either before or after a loan is prepaid. Fourth, RHS is not effectively directing and controlling litigation that is challenging ELIHPA's prepayment restrictions or seeking damages for its imposition. We will detail each of our concerns separately.

1. RHS Does Not Have Sufficient Funding to Operate an Effective Preservation Program

RHS has represented to this and other congressional committees that it has sufficient funds to meet existing preservation needs. This is not true. For at least the past nine years RHS has not had sufficient money to fund equity loan commitments that it has made to owners who have agreed to remain in the Section 515 program if they were provided with an equity loan. RHS repeatedly enters into preservation agreements knowing that it will not fund those agreements for several years. The backlog on equity loans has been as high as $12-18 million and as long as eight or nine years. While that amount is truly not a significant expenditure of funds, for owners who have to wait nine years to get their incentive loans, it is unacceptable. No wonder that they have been disappointed and have sought to end the preservation program as it exists today.

While advising Congress that it has adequate funds to meet current preservation needs, RHS states otherwise in the recent Federal Register publication of proposed regulations seeking to alter the preservation program. There the agency acknowledges that it does not have sufficient funds to meet all the equity loans that it has agreed to fund and claims to have unfunded agreements that were entered into as early as 1996. To address this problem, RHS does not offer the use of more funds, but instead proposes to allow owners, whose agreements are not funded within 15 months, to exit the program by selling the housing to a nonprofit or public agency. Aside from the fact that there is no statutory basis for the RHS proposal, RHS does not disclose that it may not have the funding to finance such sales or to increase the Rental Assistance subsidies that will be necessary to maintain the units' affordability after the sale.

The fact that RHS has been encouraging nonprofit and public agencies to use third party financing, such as bond financing or even private loans, to finance transfers is clear evidence that

RHS does not have the money to fully fund its preservation efforts. Typically, these funding sources have higher interest rates than RHS loans and, to reach low income households, require additional subsidies. However, because the agency has not allocated sufficient funds to finance the transfers, it is encouraging owners to use these third party funding sources.

Further evidence that the agency does not have sufficient preservation funding comes from RHS' proposed settlement of an Idaho lawsuit that will require the agency to finance the transfer of 17 Section 515 developments, containing approximately 660 units of housing, to nonprofit or public entities. The commitment to finance the transfer of these units, which we will discuss later, was ill advised, and is limiting the agency's capacity to preserve and subsidize Section 515 housing in other states.

What is troubling about this picture is that RHS has not only not disclosed the funding issue to Congress in the appropriations process or otherwise, but also that it is a self-created problem. The RHS Section 515 appropriations do not specify how much money RHS should be using for preservation, maintenance or new construction. Those decisions are made administratively by the agency after it receives its appropriations. For at least the last 8 years, RHS has consistently not allocated sufficient funds for preservation. Otherwise, it would not have the equity loan backlog that it does.

We understand that RHS has made its funding decisions based on the premise that the Section 515 new construction program should be continued, albeit on an extremely limited basis. However, we question that decision when the cost of maintaining a new production program limits the agency's capacity to preserve a greater number of existing units at a fraction of the cost of producing new units. What is particularly disturbing is the fact that RHS is now proposing to use the shortage of available preservation funding as a basis for allowing owners, who have already agreed to accept equity loans and remain in the program, to abandon their preservation agreements if RHS cannot fund them within 15 months.

Importantly, we believe that the funding issue will become more significant over the next several years and that inadequate preservation funding may cripple the program. Although we have no hard statistics to support our position, we are observing a substantial increase in the number of owners who are willing to either remain in the program in return for incentives or, as an alternative, are prepared to sell their developments to nonprofit or public agencies. We suspect that this is due to the fact that many post-1979 projects are beginning to reach the end of their 20-year use restriction. If so, we believe that the demand on RHS preservation funding will increase substantially and that RHS will not be able to respond to that increase. We urge that the subcommittee take a closer look at RHS rural rental housing needs, increase the Section 515 program's authorization and urge the budget committees to specify how RHS should allocate its funding between program components.

2. RHS Is Not Preserving All the Developments that It Can.

Our second concern is that RHS is simply not preserving all the developments that it can and that it has created several loopholes by which owners can and will circumvent the prepayment and preservation process. The most glaring example is RHS' unwillingness to

extend use restrictions through the acceleration and foreclosure process. With one exception, RHS takes the position that an owner who pays the balance due on a loan in response to an acceleration of the promissory note is not prepaying the loan and is free to use the property as it chooses after the loan is paid. A recent decision in *Albany Apartments Tenants' Ass'n v. Veneman* upheld RHS's discretion to manage the program in this fashion primarily because there is nothing in ELIHPA or its legislative history that requires the agency to do otherwise.

Unfortunately, now that the agency practice is public and having been upheld by at least one court, we can expect that owners will take advantage of the situation to circumvent the prepayment process by simply defaulting on their loans and waiting for RHS to accelerate their notes. At that point the owners will pay the amount owed in full and free themselves of any RHS prepayment restrictions.

While we are aware that RHS has cautioned the Rural Development staff that it should not accelerate loans in cases where it appears that owners are trying to circumvent the prepayment process, and that RHS regulations place continued use obligations on owners who default on their loans within a year of their having sought to prepay, we do not believe that either process will deter owners from using this loophole to prepay their loans. First, owners can easily avoid the regulatory provision by simply defaulting on their loans without first applying to RHS to prepay. In the alternative, they can wait twelve months after they have been denied the right to prepay and then default on their loan. More critically, the fact that an owner may seek to avoid the prepayment restrictions by defaulting on a loan and prepaying in response to an acceleration does not appear to be of concern to RD or RHS staff. In the Minnesota case that upheld RHS' position, the RD file disclosed that the owner may indeed be trying to avoid the prepayment process by defaulting on the loan. RHS did nothing in response.

RHS is also using the acceleration process to avoid dealing with troubled projects. We are aware of several instances where Section 515 projects have had maintenance and or occupancy issues that have caused owners to default on their loans. Rather than work with those owners in resolving the issues and making the developments viable, RHS has used the acceleration and foreclosure process to simply wash its hands of the troubled properties.

Currently, RHS is refusing to allow an owner of a Section 515 development that has defaulted on its loan due to an occupancy issues to sell the development to a nonprofit or public agency at a loss. The nonprofit could preserve the housing by reconfiguring some of the units and protect the residents living in the development from displacement. It appears that RHS will instead foreclose on the property, take it into inventory, displace any remaining residents and sell it at a loss without any use restrictions as nonprogram real estate. Because RHS does not have vouchers or rental assistance that it can offer to the existing residents, their displacement is inevitable. This will cause severe hardships to the residents and remove from the market housing that can be made to serve the community.

We do not believe that RHS position is justified. The agency should change its regulations to impose long term use restrictions on all loans that are accelerated and paid off by the owner prior to or at foreclosure.

3. RHS Does Not Affirmatively Enforce Owners' Obligations to Rent Units to Low-Income Residents.

NHLP is counsel to tenants in a 50 unit Missouri development that the owner, a public housing authority, is seeking to demolish. The development serves a critical housing need because it contains 4 and 5 bedroom units in single story cement block development that includes 19 single family detached units. The housing authority has been prepaying the loan incrementally so that by the 19th year of a 40 year loan it had almost fully paid the RHS loan. In order to avoid displacing a large number of households at one time, the authority began to relocate the Section 515 residents into its public housing development and kept the vacated Section 515 units empty. While RD was aware of the authority's prepayment and demolition plans and offered it incentives to maintain the housing in the Section 515 program, it did nothing when the authority began to systematically relocate residents and leave the units vacant. When the relocation process was almost complete, the housing authority initiated a lawsuit challenging RHS's authority to enforce ELIHPA when no use restrictions were incorporated in the original loan documents. In the two years that the housing authority took to vacate the development and in the two more years that the case has been pending, RHS has not taken any action to force the housing authority to rent up the facility by compelling it to comply with its contractual agreement to operate an affordable development or by imposing substantial fines for failing to use the housing as required by law. As a consequence, 48 units of affordable housing have been standing empty for nearly four years.

In another instance, RHS approved the prepayment of a Section 515 development in South Carolina after the owner agreed not to displace the residents of the development, directly or indirectly, for as long as they chose to remain in the development. Shortly after the owner prepaid the RHS loan, the owner converted the development to a condominium and displaced all the residents protected by the RHS use restrictions. Although RHS was aware of the fact that the residents were being displaced, it took no action to protect the residents by stopping the displacement. Indeed, we are not aware of any case where RHS has sought to enforce use restrictions against an owner who has prepaid its loan.

4. RHS Does Not Control or Adequately Coordinate Litigation Challenging the ELIHPA Prepayment Restrictions or Seeking Damages for Their Imposition.

Our fourth concern relates to RHS' capacity to coordinate and control lawsuits in which owners are challenging the validity of ELIHPA prepayment restrictions or seeking damages for their imposition. Currently, there appears to be no concerted effort on the part of RHS, or its counsel, to ensure that ELIHPA, a federal law, is properly enforced. Basic arguments, such as the supremacy of federal laws over state laws, are not being advanced and cases are being settled instead of appealed because certain legal arguments have not been made in the federal district courts where these cases are first heard. Moreover, RHS, or at least its counsel, appear intent on settling cases even before the agency's liability has been established. Potentially, these settlements may cost the government hundreds of millions of dollars that could have been better spent on preserving the housing in the first place.

NHLP is representing a resident living in what is now a former Section 515 development in Kimberly, Idaho. The owners of the development have sought to challenge the ELIHPA restrictions by tendering the balance that was due on the loan and, when RHS did not accept the prepayment, suing the agency under Idaho's quiet title law. While RHS succeeded in having the case dismissed in the federal district court by asserting the unmistakeability doctrine, a contract defense available only to the federal government, the United States Court of Appeals for the Ninth Circuit reversed the decision. It held that the unmistakeability doctrine should not have been considered by the district court because its availability was dependent on another doctrine, known as the sovereign acts doctrine, which it held was inapplicable to the case. In its opinion, the 9th Circuit panel suggested, but did not hold, that Idaho law may grant the owner the right to quiet title to the property and, accordingly, remanded the case to the district court for further proceedings.

Upon remand, RHS made only one argument to the district court, namely that its rejection of the owner's tender of payment was justified under Idaho law because ELIHPA precluded its staff from accepting prepayments. RHS did not argue a more fundamental legal principle that Idaho law does not apply to the case because the Section 515 contract was a federal contract controlled by federal and not state law. In other words, it failed to simply argue that federal law in this case, namely ELIHPA, superseded state law. Thus, when the district court issued a totally unprecedented decision granting the owner's motion to quiet title to the property under Idaho law--in which the court stated that it did not have consider ELIHPA because it was not a sovereign act-- RHS did not appeal the decision. Instead, it settled the case by accepting the owner's prepayment, thus allowing the owner to remove the development from the Section 515 program and to sell it to another organization at a sizeable profit.

Residents in the development did not agree with the district court decision, which also denied the residents the right to intervene in the case in the first place. To preserve their rights, the residents have appealed the denial of intervention to the 9th Circuit, sought and secured a stay of the district court decision and sought and secured an injunction against the owner's selling the development or terminating the tenants' RHS rights pending resolution of the case by the 9th Circuit. It is indeed ironic that residents of a development and not RHS are appealing this case.

Unfortunately, the *Kimberly* case is not the only case in which RHS is letting owners out of the 515 program. As part of the *Kimberly* settlement, RHS unexplainedly also settled an Oregon case, brought by the same owners. In the settlement, RHS allowed the owners to prepay the Oregon loan and to remove the Oregon development from the Section 515 program without any restrictions. What is shocking about this settlement is that RHS did not even litigate the Oregon case. It apparently decided to allow the Idaho decision to dictate the Oregon result and simply accepted the owner's prepayment. It now appears that RHS is also allowing the same owners to sell four additional Oregon developments to public housing agencies without ever determining whether the owners are entitled or capable of prepaying the loans.

Even more disturbing is a yet another case brought by the same owners in Idaho. In that case, another Idaho district judged ruled, contrary to the 9th Circuit's *Kimberly* decision, that RHS had given up its right to assert the unmistakeability doctrine as a contract defense in the case. Consequently, it held that the owners were entitled to quiet title to 17 properties if they

paid RHS the balance that was due on the loans. RHS decided not to appeal that decision either and instead is working on a settlement whereby the developments, totaling over 600 units of housing, would be sold to nonprofit or public agencies.

While the settlement in this case may be consistent with the purposes of ELIHPA and should protect the residents of the 17 developments from displacement, the precedent set by the case is disturbing. First, it suggests that RHS is unwilling to appeal any prepayment case brought by owners in the 9th Circuit. Second, RHS appears to be settling cases without any showing that the owners of the developments would have, in fact, been able to prepay their loans and operate the developments without federal subsidies. In other words, we suspect that many of the Idaho and Oregon properties that are being sold to nonprofit or public agencies are located in soft housing markets and that the owners would not be able to operate the developments profitably on the private market. Put bluntly, RHS is expending substantial sums of money for the preservation of developments that do not need to be preserved because the owners cannot operate them as anything other than subsidized housing.

Third, as we already noted, these settlements are putting severe strains on RHS's self established preservation budget and hence its capacity to preserve other developments in other parts of the country. Given that they could have litigated the Oregon case and appealed the Idaho decision, their action is simply not justified.

Lastly, we are concerned about the position RHS appears to be taking with respect to a series of law suits pending in the Federal Court of Claims where as many as 600 owners of Section 515 developments are pursuing damage claims against the agency on the premise that the ELIHPA restrictions constitute a taking of their property without just compensation, entitling them to damages under the Fifth Amendment to the Constitution. Last year, the Supreme Court decided that the RHS is not immune from liability in these cases by virtue of the six-year statute of limitations, which the lower courts had held began to run when ELIHPA was enacted. The Supreme Court, in a very narrow opinion, held that the statute of limitations does not begin to run until an owner seeks to prepay its loan, effectively subjecting RHS to many lawsuits, however, not necessarily to damages.

Indeed, as of today, none of the pending damage lawsuits have gone to trial and no court has determined that the owners are entitled to damages. In our view, RHS continues to have several valid defenses to the damage claims. Moreover, even if its defenses are rejected by the courts, the owners of many of the developments that are involved in these law suits may not be eligible for damages. This is because they have not sought to prepay their loans, they may be required to sell their developments to a nonprofit or public agency at fair market value--which makes them ineligible for any other damages--or because the housing is in areas where the operation of the developments as federally assisted housing may be the best and highest economic use of the property.

Notwithstanding the fact that RHS may not be liable for any damages, it is our understanding that RHS has exchanged settlement offers with the owners in the first damage case that is set for trial. While we are not aware of the scope of the owner's offer or RHS counter offer, we are extremely concerned that any settlement will be sizeable, that it will serve as a basis

for settling other currently pending cases, and is likely to encourage other owners to sue RHS in order to secure similar settlements. In short, we fear that RHS may be agreeing unnecessarily to a settlement that, by some estimates, may reach several hundred million dollars.

Moreover, we are also concerned that while these settlements will obligate the owners to comply with ELIHPA's prepayment restrictions, they will ultimately also obligate RHS to finance the transfer of thousands of units to nonprofit and public agencies. These transfers will again cost the agency hundreds of millions of dollars. Given the current appropriations levels, the agency will not be able to finance those transfers.

In our dealings with RHS about several of these cases and in our observation of the developments and results in others, we are convinced that neither RHS nor the Department of Agriculture's National Office of General Counsel has managed or controlled these cases to ensure that cogent and uniform positions are advanced in each case. Instead, it appears that Regional Offices of General Counsel together with local Assistant United States Attorneys are developing and making haphazard arguments and decisions that are detrimental to the continued viability of the preservation program. We believe that the manner in which the United States Department of Agriculture Office of General Counsel is organized, as an independent entity responsible directly to the Secretary, hinders RHS' capacity to fully understand and control litigation that involves agency programs. To better control and coordinate litigation, RHS should have its own legal staff that is authorized to coordinate and direct litigation on behalf of the agency.

5. RHS' New Prepayment Regulations

Before we close our testimony, we want to take this opportunity to comment on two provisions of the recently proposed RHS revisions of the Section 515 regulations that affect prepayments. 68 Fed. Reg. 32872 (June 2, 2003). The first provision is an RHS proposal to finance future Section 515 developments with loans that are amortized over a 50-year term but which become due at the end of 30-years. In other words, the proposal would finance Section 515 loans over 50 years but create a balloon payment at the end of 30 years, leaving to RHS and the owners to decide whether and under what circumstances to continue the loan for an additional 20 years. In our view this proposal violates ELIHPA and we urge the sub-committee to direct RHS not to implement the provision and, if necessary, prohibit it from doing so.

In 1989, Congress amended the Housing Act of 1949 to prohibit RHS from accepting prepayments or requiring owners to refinance Section 515 loans made after that date prior to the end of the loan term. RHS's new regulatory proposal violates that provision by establishing, at the beginning of the loan term, a date, which precedes the end of the loan amortization period, on which owners must refinance their loans. If the statute precludes RHS from forcing an owner who has a 50-year loan to refinance that loan at the end of 30 years, RHS cannot circumvent that statute by initially amortizing a new loan over a 50 year term but requiring the owner to refinance the loan at the end of 30 years. There simply is no fiscally sensible reason for the proposal. The longer amortization period provides owners deeper subsidies without also requiring them to maintain the housing as affordable housing for the longer term.

Moreover, we are concerned that if this administration is allowed to implement this proposal, what is to prevent future administrations from amortizing loans over 50 years but terminating the loan through a balloon payment at 20, 10 or even 5 years. The purpose of the 1989 amendment was to ensure that RHS financed developments remain affordable for the entire term of the loan. This proposal is a blatant violation of the law and should be stopped.

The second provision about which we have significant concerns is one that we referenced earlier, which proposes to allow an owner to terminate its equity loan agreements with RHS if RHS does not fund the agreement within 15 months of the time that it was entered into. ELIHPA requires RHS to make incentive offers to owners who seek to prepay their loans in order to encourage them to remain in the program. It also allows owners to prepay their loans if Congress does not provide preservation funding for a term of 15 months. It does not allow, and should not allow, RHS to rescind incentive agreements and give owners new prepayment options because RHS chooses not to allocate sufficient Section 515 funding for preservation purposes. As long as RHS, and not Congress, determines the amount of funding that is made available for preservation, the choice of whether to fund incentive agreements lies with the agency and no one else. It must not, therefore, be allowed to make incentive offers to owners that it later chooses not to honor. Both owners and residents should not be required to go through the prepayment process multiple times when RHS decides that its Section 515 funding should be used for purposes other than preservation. This is particularly true when there is a strong likelihood that RHS may also not be able to finance or subsidize one of the new options it proposes to provide owners, the sale of the development to a nonprofit or public agency. If RHS does not have money for equity loans, how will it have money to finance transfers? The RHS proposal is simply another mechanism that would allow owners to avoid prepayment restrictions. It should not be allowed.