A Review of Federal Rural Rental Housing Programs, Policy and Practices

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This report was prepared by Rapoza Associates on behalf of the National Rural Housing Coalition (NRHC). Audrey Johnston served as the principle author.

NRHC is a national membership organization comprised of rural community activists, public officials, and nonprofit developers that fights for better housing and community services for low-income, rural families. NRHC is managed by Rapoza Associates, a public interest lobbying, policy analysis, and government relations firm located in Washington, D.C. that specializes in providing comprehensive legislative and support services to community development organizations, associations, and public agencies.

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Executive Summary

In late 2015, the National Rural Housing Coalition (NRHC) convened for its annual business meeting. At the meeting, members of the NRHC Board of Directors (Board) engaged in a lengthy discussion on the U.S. Department of Agriculture’s (USDA) rental housing programs. Members of the Board, many of whom are leaders in rural housing and community development, determined that NRHC should further explore USDA’s multifamily housing portfolio. The purpose of this effort would be to inform the Board, and the public in general, about preservation issues, as well as to present the business opportunities for nonprofit involvement in the solution.

On October 4, 2016, NRHC held a first-of-its kind gathering that brought together experienced industry members for a daylong session devoted to exploring federal and state rural housing programs and policies and the examination of examples of successful preservation strategies for USDA’s rural rental properties. Presenters and attendees included nonprofit housing developers, state housing finance agencies and federal officials charged with administering rural multifamily housing programs.¹

The meeting came at an important moment. A 2016 report commissioned by USDA estimated that the 20-year cost to maintain the existing portfolio of rural rental developments topped $5 billion.² In addition, an increasing number of Section 515 mortgages are maturing, which threatens the availability of affordable housing in many rural communities. USDA has made a number of improvements in policies and procedures for the preservation of rural rental housing. Yet, the most significant challenges remain for owners and operators trying to maintain rural rental housing.

While NRHC released a whitepaper that summarizes the conference proceedings and findings, the purpose of this report is to serve as a detailed review of the programs, policies and practices discussed at that one-day meeting, and provide additional information on barriers to improving rental housing in rural America in era of limited federal resources.³ This paper includes an overview of federal policy, programs and problems related to preserving the existing approximately 400,000 units of rental housing financed by the USDA Rural Development (RD) and its Rural Housing Service (RHS).

There are several key federal programs that support the development and preservation of affordable rental housing in small towns and rural communities: (1) USDA’s Section 515 Rural Rental Housing Direct Loans (Section 515), (2) Farm Labor Housing Loans and Grants (Section 514/516), (3) Rural Rental Housing Assistance (Section 521), (4) the Multifamily Preservation and Revitalization (MPR) Demonstration Program, (5) the Low-Income Housing Tax Credit (LIHTC), and the Department of Housing and Urban Development (HUD) Section 8 program. While each of these programs play a critical role in overcoming the unique barriers to affordable rental housing, funding shortfalls have hindered their impact.

There remains a measurable demand for rental apartments in rural places across the United States. There is not, however, an adequate supply. Section 515 Rural Rental Housing Loan program was once the principle source of financing for new rural rental housing development. Since its peak in the mid-1980’s, program levels have been cut by more than 97 percent from $954 million to just $28.4 million today. Private for-profit and non-profit owners used the program to finance the construction of 30,616 units of affordable housing each year at its peak. Since 2012, the program has halted financing the construction new rental housing.

In this era of limited resources, Congress and successive Administrations have focused policy and the limited available resources on preserving the existing Section 515 portfolio. This policy choice leaves many rural communities without a viable option for financing new housing, as they often lack access to public resources and private financing necessary for new rental housing.
Preservation of the public’s rural rental housing stock has faced significant funding challenges. Congress has never provided sufficient funding to address the preservation needs of the portfolio. According to the 2016 USDA Comprehensive Assessment, meeting the $5.596 billion need to preserve the existing multifamily housing portfolio will require Congress to increase funding by approximately $290 million per year (uninflated) for the next 20 years, through Sections 515, 514, and 538, from direct appropriations, tax credit equity, or other sources.4

In addition to these funding issues, the portfolio is also maturing. Although, as reported by the Housing Assistance Council (HAC), the tidal wave of maturing mortgages is not estimated to begin until 2028, additional resources and new policies are needed now to ensure that this important source of affordable rental housing in rural communities is not lost.5

Background

Introduction

Central to the discussion of the specific programs that make up USDA’s multifamily housing portfolio and practices used to preserve the portfolio is an appreciation for why these programs are essential to families in rural communities across the country. In order to effectively identify preservation strategies that can be successful in rural areas, developers and policy makers must have an understanding of the economic and demographic characteristics of the people living in these communities.

Overcoming Barriers to Affordable Rental Housing in Rural America

For several decades, rural America has faced an affordable housing crisis. Although housing costs are generally lower in rural communities, lower incomes and higher poverty rates make many housing options simply unaffordable for many rural residents. This is especially true for rural renters, who typically earn even lower incomes and are more likely to live in poverty than other rural families.

The poverty rate in rural America (17.7 percent) is generally higher than in urban areas (14.5 percent) and the nation as a whole (15 percent).6 It is also a persistent problem according to the Economic Research Service (ERS) at USDA. ERS defines counties as being persistently poor if 20 percent or more of their population was poor over the last 30 years (measured by the 1980, 1990, 2000 censuses and the 2007-2011 American Community Survey).7 Of the 353 persistently poor counties, 301, or an astounding 85.3 percent, are rural counties.8 More than 15 percent of all non-metropolitan counties are persistently poor – including more than 20 percent of all southern counties.9 This is particularly true in the nation’s highest need regions: central Appalachia, the Lower Mississippi Delta, the southern Black Belt, border colonias areas, and Native American lands.10 Thus, any discussion of affordable housing must take into account that rural places carry a disproportionately high share of nation’s poverty.11

<table>
<thead>
<tr>
<th>Comparing Rural and Urban Poverty Rates12</th>
<th>At-Risk Poverty Rates, 2014 (in percent)</th>
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<tbody>
<tr>
<td>Rate/Ethnicity</td>
<td>Age</td>
</tr>
<tr>
<td>White</td>
<td>Black</td>
</tr>
<tr>
<td>Non-metro</td>
<td>15.5</td>
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<tr>
<td>Metro</td>
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Estimates from the 2010 – 2014 American Community Survey show that 15 percent of rural (i.e. non-metro) households earn less than $15,000 per year, and that around 36 percent of non-metro households earn less than
$30,000 annually. Rural renters tend to have even lower incomes than their home owning-neighbors. The Results of the 2015 Multi-family Housing Annual Fair Housing Occupancy Report revealed that the average household living in USDA’s multifamily property with rental assistance lives on $10,554 per year of income and $12,729 for tenants that do not receive rental assistance.

High poverty rates and low incomes mean that families living in rural areas often struggle to afford their housing needs. Nearly five million rural households are “cost burdened,” meaning they spend 30 percent or more of their monthly income on housing costs. Notably, the number of cost-burdened households has been increasing in rural areas. Rural renters are particularly at risk for being cost-burdened. In fact, 41 percent of all rural renters fall into this category. Moreover, 21 percent of cost-burdened rural renters, or 2.1 million households, are considered to be severely cost-burdened, which means they pay more than 50 percent of their monthly income on housing costs.

**Poor Quality Housing**

Poor rural families are also more likely than their urban counterparts to live in substandard housing. One reason for this is that a disproportionately high proportion of the housing stock in rural places is substandard. Homes are more likely to need extensive repair or improvements to just meet basic health and safety levels. In fact, more than five percent of the occupied units in rural or small communities are considered to be either moderately or severely substandard - equivalent to 1.5 million rural families living in poor quality housing.

A 2011 American Housing Survey found that extremely low-income households earning less than 30 percent of the Area Median Income were more than three times as likely to live in inadequate housing. Inadequate housing means that the home either lacks complete plumbing facilities, has inadequate or no heat, has no or sporadic electricity or exposed wiring, and/or has maintenance and upkeep issues (for example, leaky roofs, holes in floors or walls and rodents).

The rate of substandard housing is more prevalent in rural and tribal areas. For example, tribal census tracts are five times more likely to lack or have incomplete plumbing and non-metro tracts are more than two times as likely compared to metro tracts. Although most Americans take indoor plumbing and potable water at the tap for granted, it is unavailable to the 4 percent of rural occupied units with inadequate plumbing. Over 10 percent (10.3 percent) of these units also have more than one occupant per room which suggests that inadequate units in rural areas are also likely to be overcrowded.

<table>
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<tr>
<th>Substandard Housing</th>
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<tr>
<td><strong>According to the U.S. Census Bureau, substandard housing may have inadequate:</strong></td>
</tr>
<tr>
<td><strong>Plumbing:</strong> Substandard housing may lack piped water, an indoor flush toilet, or both a shower or bathtub;</td>
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<td><strong>Heating:</strong> Substandard housing may lack a safe and reliable heating source;</td>
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<tr>
<td><strong>Electricity:</strong> Substandard housing may lack electricity, or have exposed wiring or inadequate illumination;</td>
</tr>
<tr>
<td><strong>Structure or Materials:</strong> Substandard housing may have a leaking roof, windows, basement, or plumbing, holes in the walls or ceilings, peeling paint or plaster, rodent infestation, or lead-based paint; or</td>
</tr>
<tr>
<td><strong>Access:</strong> Substandard housing may have public areas without working lights, loose or missing steps or railings, or no working elevators.</td>
</tr>
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**Lack of Access to Financing**

Low-cost capital is essential to the preservation and development of affordable rental housing. It is almost impossible to maintain below-market rents when paying market-rate debt service. Rural rental developments often lack the economies of scale that help keep rents low. The housing tends to be smaller, and have fewer
units over which to spread operational costs. A lack of population density also means there will be fewer borrowers and lenders in that community with the experience and expertise to make these deals work.

There are several federal programs designed to generate lower-cost capital for housing in high-need areas. The Community Reinvestment Act (CRA) and the Low Income Housing Tax Credit (LIHTC) are two of the most prominent. CRA encourages private financial institutions to make investments in certain low-income communities as a condition of their overall ratings. LIHTC provides tax incentives for investments in affordable housing. However, not all rural communities are served by banks that have CRA regulatory requirements, and LIHTC, while an important resource, is not by itself a deep enough subsidy to finance affordable housing in small communities. Thus, rural communities, not uniformly covered by CRA and lacking other subsidies, particularly since the demise of section 515, do not receive a proportional share of LIHTC investments.

As a result, many rural communities—and especially smaller, more remote communities—struggle to piece together the low-cost financing needed to develop affordable rental housing. Former USDA Assistant Deputy Administrator of Multifamily Housing Patrick Sheridan noted, “when there is a choice between new construction of a larger development in a metropolitan area or a small project in a rural area, the large development wins nearly every time.”

**Rural Rental Housing Programs and Challenges**

**Introduction**

For more than 50 years, federal rural rental housing programs, through Section 515 Rural Rental Housing Loans, Sections 514 and 516 Farm Labor Housing Loans and Grants, and Section 521 Rental Assistance, have served as an important source of financing for affordable housing. While these programs received robust support and funding in their early years, financing hundreds of thousands of units, recent funding trends have led to a reduction in resources that has hindered preservation and rehabilitation of existing properties and all but halted new construction.

The decreased funding and lack of new construction have created two confounding issues for USDA. The portfolio is aging and the there is a substantial, $5.5 billion, cost estimated just to maintain and preserve existing developments over the next 20 years. Many of the loans made to finance these rental housing properties are maturing. Under current law, rural Rental Assistance is limited to developments that are financed under Section 515, and farm labor units financed under Section 514. As these loans mature, the developments and their tenants are no longer eligible for Rental Assistance (RA.) Without RA, the property is no longer required (and often not able) to maintain affordable rents. In 2015 alone, private owners of 2,646 affordable units in 205 properties left USDA’s portfolio. When these properties leave the portfolio, the tenants are frequently left with limited affordable housing options. Although USDA and Congress have, in recent years, taken action to address these issues, new strategies are needed to provide adequate financing and stem the loss of affordable housing.

**Section 515 Rural Rental Housing Loans**

**Introduction**

Since 1963, Section 515 Rural Rental Housing Loans have improved the quality of affordable rental housing in rural America. Section 515 is authorized under Title V of the Housing Act of 1949. As of June 2016, there are 417,511 units of affordable rental housing in 13,877 properties financed by Section 515, making it the principal source of rental housing in rural communities.
Through the Section 515 program, for-profit and non-profit developers are eligible for low cost long term direct loans for the construction or rehabilitation of rural rental housing. In return for low interest loans, tenant rents are set at 30 percent of the family’s income and eligibility is limited to low-income households, with incomes not exceeding 50 percent of the median. Section 515 loans are 50 year loans or 30 year loans amortized for up to 50 years and feature interest rates subsidized to as low as 1 percent.

All rental housing units financed with Section 515 are exclusively targeted to those with the greatest needs, including lower-income families, the elderly and persons with disabilities. A vast majority (92.25 percent as of 2015) of Section 515 tenants have very low incomes, earning no more than 50 percent of the Area Median Income (AMI). The average Section 515 tenant earns just $12,377 each year. In addition, 62 percent all Section 515 households are elderly or disabled tenants, 31.2 percent are headed by persons of color and 71.1 percent are headed by women. Because the Section 515 Loan Program can be combined with other rental subsidy programs, including the Section 521 Rural Rental Assistance program, rents are more affordable to these at-risk populations. In fact, the average rent for a one-bedroom, Section 515-financed housing unit is just $488 per month. For many Section 515 tenants with limited means, the lower rents under the Section 515 program can mean the difference between being able to afford basic needs, such as nutrition and healthcare, and foregoing those needs to pay for rent.

**Section 515 Funding Decline, LIHTC and Initial Preservation Policy**

Despite the program’s success, funding for Section 515 loans has been cut dramatically over the past 30 years. Since its peak in 1982, the program’s funding has been cut by more than 97 percent from $954 million to just $28.4 million today. While the program financed the construction of 30,616 units of affordable housing annually at its peak, it has effectively halted financing the construction new rental housing altogether.

Initially, Section 515 properties were not under any use restrictions. Owners were allowed to prepay their mortgages without any restrictions. Because of this, developers used Section 515 financing for rental housing development and prepaid the loan absent protections for future affordability. When prepayment occurred, the owner was no longer obligated to comply with USDA regulations and could increase rents to market rates.

In an effort to address this issue, and ensure the sustainability of affordable rental housing in rural communities, in 1979, Congress passed legislation which created 20 year use restrictions on all USDA multifamily developments that were financed from that point on. Any loan obligated prior to 1979 can be prepaid at any time.
In 1987, Congress passed the Emergency Low Income Housing Preservation Act of 1987 (ELIHPA). The ELIHPA was designed to promote long-term affordability. The Act established prepayment restrictions on all Section 515 developments that were financed prior to the law’s enactment. These restrictions are not a total prohibition on prepayment of Section 515 mortgages. Rather, the law required USDA to offer incentives to property owners seeking to prepay their loans and to encourage the owners to remain in the program for 20 years. Incentives include equity loans made through Section 515, increased rates in the return on investment, reduced interest rates for the loans and Rental Assistance. If a property owner rejects the incentives (and still decides to prepay), the owner is required to offer to sell the development to a nonprofit organization or public housing authority to maintain affordability when prepayment would have a negative impact on the minority housing community.

In 1989, Congress expanded use and prepayment restrictions to cover all properties financed after 1989 for the life of the Section 515 mortgage. In 1992, the ELIHPA was expanded to include loans financed between 1987 and 1989. However, even with these new restrictions, because funding for Section 515 continued to decline many rural communities were still faced with a major setback in building new affordable rural rental properties.

This decline in funding for Section 515 has had a broader impact than just the loss of USDA’s affordable rental housing portfolio. Section 515 played an important role attracting other housing resources to rural America. With little new rental real estate growth, it is difficult for rural communities to ensure access to affordable housing.

For example, rural communities frequently used Section 515 to leverage LIHTC investments. LIHTC, which was created in 1986 and made permanent in 1993, is the primary tool for financing the development and preservation of affordable rental housing in communities across the United States. Through LIHTC, investors receive a dollar-for-dollar federal tax liability reduction for 10 years, in the form of annual tax credits, in exchange for providing financing for the development of affordable rental housing. Properties financed through LIHTC must remain in compliance with the LIHTC eligibility requirements (including restrictions in rent and availability to low-income tenants) for 15 years.

LIHTC is administered by the states, typically through state housing finance agencies. Developers submit applications to the state housing finance agencies, which review the application and award the credits based on the state Qualified Allocation Plans (QAPs). After a developer receives a LIHTC allocation, they use the credit to leverage the financial resources needed for the project. Developers can apply for two types of LIHTCs: the...
nine percent credit and the four percent credit. The nine percent credit covers 70 percent of the low income unit cost without additional federal subsidies. The four percent credit is roughly equal to 30 percent of the low income unit cost for new construction with additional subsidies or acquisition of an existing building. Because it supplies a lower level of subsidy, the four percent credit is typically used with tax exempt bonds and other additional funding sources from HUD – HOME and CDBG; USDA – Section 538, Section 515 and MPR and the Federal Home Loan Bank Affordable Housing Program. Because the nine-percent credit offers a higher subsidy rate, it typically has a more competitive allocation process. Although the four-percent credit is less competitive, it can be difficult for organizations – particularly smaller organizations – to meet the necessary funding gap that is necessary due to the smaller subsidy amount.

Between 1987 and 1994, 31 percent of all affordable housing properties financed with LIHTC also leveraged Section 515 Rural Rental Housing Loans. As funding for Section 515 has been cut, however, rural communities find it more difficult to attract LIHTC investments. In fact, between 1995 and 2009, only nine percent of LIHTC-financed rental properties leveraged Section 515 funds.

**2004 USDA Comprehensive Report Findings, Response and the MPR Program**

In 2004, USDA published a Comprehensive Property Assessment and Portfolio Analysis, which examined the various challenges to preserving the Section 515 portfolio, including prepayment options, rapidly aging properties, and recapitalization needs.

The report found that 10 percent of all Section 515 properties are located in markets where they could serve uses other than affordable housing. As discussed above, under current law, Section 515 loans obligated before December 15, 1989 may be prepaid by the development’s owner, granted that certain conditions are met. The vast majority of projects are located in markets where their only use was as affordable housing.

The 2004 Comprehensive Property Assessment and Portfolio Analysis found that none of the Section 515 properties had the financial reserves to meet their projected capital needs for ongoing maintenance and repairs. At the time, it was estimated that $2.6 billion in additional funding was needed over the next 20 years—in the form of rental assistance or other financing tools—in order to preserve the portfolio.

In response to the findings from the 2004 report, in 2006, Congress established a Multifamily Housing Preservation and Revitalization (MPR) demonstration program, which authorized USDA to employ a variety of financing options in order to preserve the Section 515 and Farmworker housing properties in its portfolio. The
goal of the MPR program is to recapitalize properties by restructuring USDA multifamily housing loans and leveraging resources for other federal and state programs. This includes both Section 515 and Section 514 mortgages, and is often done in conjunction with grants, private debt guaranteed under Section 538, tax credits and other sources in order to revitalize the properties and extend their affordable use. Thus far, the MPR effectively attracts three times its funds in investments from LIHTC and other sources, though it remains a demonstration program subject to annual appropriations.

The MPR has financed an estimated 26,459 units in 1,218 properties between 2006 and 2014.43

2016 USDA Comprehensive Report

The 2016 USDA Comprehensive Property Assessment and Portfolio Analysis looked at USDA’s Section 515 properties, as well as their farm labor housing properties, Section 538 financed developments and projects refinanced under the MPR program.44

The USDA report analyzed the per unit per annum (PUPA) net reserves. PUPA is the estimated reserves for replacement that a property must set aside for each unit annually in order to maintain the unit’s functionality. The PUPA reserves deficit refers to the PUPA net of reserves for replacement. Where the PUPA is greater than available reserves, additional funding is required to maintain the property. Thus, reducing the PUPA deficit is important for continuing the useful life of the property.45 The report found that average PUPA reserves deficit for the Section 515 portfolio increased. In the 2004 study, the PUPA reserves deficit was $647 (average per property). By 2015, the PUPA deficit was $964 (average per property).

The average age of rental housing in the Section 515 portfolio is 34 years old. The 2004 report USDA estimated that an additional $2.6 billion was needed over the next 20 years to preserve the portfolio. However, the 2016 report found that the need has more than doubled in the past 12 years, and it is now estimated that $5.596 billion will be needed over the next 20 years just to preserve USDA’s rental housing stock. Of that amount, $4.7 billion relates to Section 515 developments.

The 2016 report looked at the quality of the USDA multifamily portfolio. Over 50 percent of both rural rental and farmworker projects had major capital needs that should be addressed within 10 years. Yet, careful operations and differing needed renovations and repairs has allowed 83 percent of the Section 515 and 77 percent of Section 514 property to stay at or above the minimum standards for decent and safe housing. A total of 17 percent of the current Section 515 properties, and 23 percent of Section 514, projects were deemed below average.46

In the 2016 Comprehensive Property Assessment and Portfolio Analysis USDA found that the MPR has been a successful tool in reducing PUPA reserve deficits.47 For example, projects built before 1979 that did not participate in MPR have an average deficit of $1,296. Compare this to PUPA deficits of $450 for those properties built before 1979 that were in the MPR. For properties constructed between 1990 and 1999, the difference was $885 to just $122 for those in the MPR. The 2016 report thus concluded that the “MPR was considered ‘successful’ in terms of its meeting its objectives as a program.” The 2016 report further stated that the MPR could effectively decrease the PUPA reserves on Section 515 properties.

Housing Assistance Council August 2016 Report

The Housing Assistance Council (HAC) reports that Section 515 has been used throughout its history to finance around 28,000 rental properties, with a total of 533,000 units.48 HAC also found that reduced program funding, corresponding to reductions in LIHTC investments and a lack of resources dedicated to preservation, has reduced USDA’s current portfolio to less than 14,000 properties.49
More and more properties, and the affordable rental units within them, are expected to exit the portfolio due to prepayment or mortgage maturity, meaning the loans are reaching their payoff dates, every year. According to the Housing Assistance Council’s analysis of USDA data, rate of maturation and prepayment between 2016 and 2027 averages around 74 properties per year.\textsuperscript{50} However, the number of properties exiting the USDA portfolio sky rockets in 2028 to 407, and averages 556 properties per year for the next five years (2028 through 2032).\textsuperscript{51} Between 2032 and 2050, an estimated 12,530 properties will mature or be prepaid, with the greatest loss, 927 properties, with some 30,831 units, exiting in 2040.\textsuperscript{52}

**Section 514/516 Farm Labor Housing Loans and Grants**

**Introduction**

Today, America’s farmworkers face extremely high levels of poverty and have the worst housing needs of all rural people. According to the USDA Economic Research Service, nearly 60 percent of the 3 million farmworkers across the nation live in poverty—a rate more than five times the national average. As a result, farmworkers face extremely powerful barriers to decent, safe, and affordable housing, forcing many to live in substandard, crowded, and unsanitary conditions.

The USDA Section 514 and 516 Farm Labor Housing Loan and Grant programs are the only federal program designed to increase access to affordable housing for America’s farmworkers.\textsuperscript{53} Authorized in Title V of the Housing Act of 1949, these programs have provided low-cost loans and grants to help acquire, build, improve, and repair housing for farm workers for more than 40 years.\textsuperscript{54} Demand for farmworker housing has far outstripped the supply. And for the housing that has been built, USDA’s 2016 Comprehensive Property Assessment found it lacks the funds to address $15 million of the repairs and renovations necessary just to keep the property operating and habitable. This is a shortfall of $187 million over 20 years to maintain the 15,839 units of Section 514 off-farm housing.

In fact, a 2013 survey conducted by the Housing Assistance Council found that about one-third of farmworkers pay more than 30 percent of their monthly incomes on housing and are considered “cost-burdened.” In addition, more than 23 percent of farmworker housing is either moderately or severely substandard. This is much greater than the 5 percent substandard housing rate for all rural communities. A report from the Government Accountability Office (GAO) found that demand for affordable housing is so high among farmworkers that an increasing number have been forced to live in informal dwellings such as garages, sheds, and trailers because they lack other options.\textsuperscript{55}

With such high need, all Section 514/516-financed housing is exclusively targeted to very low-, low-, and moderate-income farmworkers. Residents of USDA’s Farm Labor Housing properties have an average income of $22,429 per year.\textsuperscript{56} Slightly more than 20 percent of Farm Labor Households are elderly or disabled and 94.9 percent of residents are persons of color.\textsuperscript{57} All must be U.S. citizenship or have permanent residency status.

Under the program, farmers, nonprofit organizations, and local governments are eligible to receive low-interest loans—subsidized to as low as one percent—with terms of up to 33 years. Public bodies—typically housing authorities—and nonprofit organizations may also receive grants to cover up to 90 percent of development costs. Nearly 70 of the developments also receive on-going rental housing subsidies provided under the USDA Section 521 program. In exchange for the low-interest loans and on-going rental subsidy, owners agree to limit the rent collected from farm workers to 30 percent of the workers’ income. On average, each Section 514/516 tenant that receive rental assistance earns $16,460 a year.\textsuperscript{58}
Chronic Underfunding of Farmworker Housing

Despite significant need for Section 514/516 financing, the program has been chronically underfunded. On average, the Section 514/516 program finances the construction of about 600 housing units each year. Compare that to California, where more than 800 families are currently on the wait list for a single farm worker housing project.

Section 521 Rental Assistance

USDA’s Section 521 Rental Assistance (RA) program serves some of rural America’s most vulnerable residents, including aging seniors, individuals and families with very low incomes, persons with disabilities and farmworkers. Without assistance from the Section 521 program, these individuals would not be able to access clean, decent and affordable housing. RA is often granted to property owners in conjunction with Section 514 and Section 515 loans. This allows rent charges to be no more than 30 percent of the tenant’s monthly income.

As of September 2015 the average annual income for a tenant receiving Rental Assistance in a Section 515 development was $10,554. Over 62 percent of RA households are elderly or disabled tenants, 31.5 percent are headed by persons of color, and 73 percent are headed by women. Rental assistance is essential for many rural families, even with the lower rents in Section 515 and Section 514. Of the total 407,240 households in Section 515 and 514 properties, 54,171 are considered cost-overburdened, paying more than 30 percent of their income for rent and utilities.
The FY 2017 House (H.R. 5054) and Senate (S. 2956) Agriculture Appropriations Bills included funding for Rental Assistance at $1.4 billion, making it the single largest program in the Rural Development discretionary budget. According to the USDA FY 2017 budget justification, the estimated average annual per unit cost of rental assistance is $4,911.

Budget Authority for the Section 521 Rental Assistance program has grown from 72 percent of the Rural Housing budget in 2010 to 89 percent in 2014. The enacted funding level of Section 521 was $1,110 billion in FY 2014. In FY 2015, funding decreased slightly to $1.089 billion. The FY 2016 Omnibus included $1.390 billion for Section 521 – an increase of over $300 million. The increase ensures current Section 521 units continue to receive rental assistance, and not at expanding the program.

Of the total 687,869 residents (not households) in USDA’s multifamily housing portfolio, 447,783, or 65 percent, receive Section 521 RA. The FY 2017 budget estimates 286,000 households will receive rental assistance if the funding level in the House and Senate bills are met.

### USDA and Congressional Action

#### USDA Unnumbered Letter

On September 16, 2016, in an unnumbered letter USDA RHS announced a new pilot program designed to incentivize the participation of nonprofit organizations in the Section 515 program. The program, which has an effective date of March 1, 2017, applies to transfer applications of Section 515 properties that are expected to mature or be prepaid on or before December 31, 2030, where a nonprofit organization is the purchasing entity. The incentives provided in the UL are:

- Return on Investment (ROI) for Nonprofit Entities;
- Change in the calculation of Security Value; and
- Allowance for hard cost contingency.

Currently, nonprofit organizations are not eligible to earn an ROI in USDA’s multifamily housing properties. However, because multiple funding resources, including a nonprofit’s own resources as well as third party funds, are often required to finance the transfer of a Section 515 property, the prohibition of ROI is
limiting and prevents nonprofit involvement. In recognition of this, RHS in the UL permits nonprofit organizations to earn an ROI on initial investments for properties maturing or being prepaid before December 31, 2030.\textsuperscript{68}

However, the UL specifies that nonprofit entities must choose to receive the allowable ROI or the Asset Management Fee (which is a reimbursable fee of up to $7,500 per entity for certain expenses). A nonprofit will not be able to earn both the ROI and the Asset Management Fee.\textsuperscript{69}

In addition, USDA will also recognize grant dollars as the applicant’s own resources for the purposes of determining the ROI, as long as the grant is from a Federal, state or local government entity, or other approved source.\textsuperscript{70} The grant dollars must also be used for hard costs of construction. A developer loan is a loan made by one nonprofit organization, which received a grant for capital improvements, to a new eligible non-profit entity. In certain conditions, through the pilot program, the developer loan may be included in the calculation of the ROI. Under a previous unnumbered letter dated October 26, 2015, the only nontangible assets included in the Security Value were Federal direct or Federal intermediary lending programs. The UL specifies that state or local loans provided at favorable rates will also be included in the Security Value calculation, provided an agency accepted appraisal documents the value of these loans.

Hard cost contingency is used to address unforeseen hard costs, such as additional labor and materials, required during construction. Under the UL, when a Section 515 loan is being used for rehabilitation, it will be considered an eligible loan cost. As an eligible loan cost, it will be included in the ROI calculation.\textsuperscript{71}

**Fiscal Year 2017 Senate Appropriation Provisions**

The FY 2017 House and Senate Agriculture Appropriations bills (H.R. 5054 and S. 2956) included increased funding for Section 521 at $1.405 billion, an increase of around $16 million over the FY 2016 enacted level.\textsuperscript{72}

The Senate bill also included provisions aimed at improving multifamily housing programs overall.\textsuperscript{73} The Senate bill provided increased funding for Section 515, over the FY 2016 enacted amount as well as the House request. Specifically, the Senate bill funds Section 515 rural rental housing at $40 million for FY 2017, which is an increase of five million dollars over the House bill ($35 million) and over $11 million more than the enacted level for FY 2016.\textsuperscript{74}
The Senate bill also includes several other notable changes to the Section 515 program in an effort to develop solutions to address the issues created by maturing 515 mortgages. The Senate bill directs the Secretary to implement provisions and provide incentives to facilitate the transfer of USDA multifamily properties to nonprofit organization and public housing authorities, including to allow such entities to earn a ROI and an Asset Management Fee of up to $7,500 per property. The report includes language directing the Secretary of USDA to engage affordable housing advocates, property owners, tenants, and other interested parties, to find long-term solutions to maintaining affordable housing properties in rural America.

The Senate bill further recommends $1 million for a new pilot program for grants to qualified non-profit organizations and public housing authorities to provide technical assistance to USDA multifamily housing borrowers to facilitate the acquisition of RHS multifamily properties by non-profit housing organizations and public housing authorities that commit to keeping the properties in the USDA multifamily housing program for a set period of time. This proposal could be particularly important to the smallest private owners who do not currently have access to the technical expertise needed for the increasingly complex nature of affordable housing finance.

The provisions in the Senate bill reflect an important step to meeting the affordability and quality demands for improving rental housing in rural communities.

Case Studies

Preserving rental housing in an era of declining resources is challenging and there is not one source of capital that can finance a transfer or rehabilitation of rural rental housing on its own. The process of assembling the necessary capital stock often runs into policies and procedures that impede, rather than expedite, the effort. As discussed above, there are resources available for rural rental housing transfer and preservation at the federal level, through USDA multifamily programs, and at the state, through LIHTC, the HOME program and other state resources. Despite the challenges facing USDA’s multifamily housing portfolio, with these resources and the innovation of rural development leaders, there are number of success stories for rural rental housing preservation.
Greystone Affordable Housing Initiatives LLC (Greystone) recently orchestrated a complex financial transaction to preserve 1,058 affordable housing units deemed at risk of exiting the U.S. Department of Agriculture’s (USDA’s) Rural Development Section 515 program. The company bundled 24 separate multifamily properties serving low-income households in 12 different counties scattered across rural Florida into a single bond issue and transferred them to new ownerships (an affiliate of The Hallmark Companies, Inc.), which extended the affordability restrictions for another 30 years.

Although the primarily garden-style communities maintained an average vacancy rate of less than 10 percent, all were built in the late 1970s and early ‘90s and were showing their age. “The buildings were approaching the end of their lives,” said Tanya Eastwood, President of Greystone’s affordable housing group. “They had minimum built-up capital reserves for extensive rehabilitation, and there were little viable resources within Rural Development to assist with large-scale preservation. Many of the properties were also at the end of their restricted-use agreements; therefore, the owners were ready to sell and exit the program.”

Greystone is a real estate finance and transaction management firm with a deep passionate focus on meeting the challenges frequently experienced by both non-profit and for profit owners with the recapitalization and preservation of affordable housing properties. The company assists with the acquisition, and rehabilitation of properties, including performing due diligence, securing financing, and managing the rehab process.

The Florida preservation initiative began in the fall of 2015, and was certainly no easy feat. Preserving these units required a highly complex $130 million effort, combining both public and private funding. It included a single issuance of $42 million in multifamily private activity tax-exempt bonds by Osceola County Housing Authority, and a purchase of 4 percent Federal Low Income Housing Tax Credits by Boston Financial Investment Management, generating $28 million in capital contributions. The financing plan also included the assumption and subordination of $27 million of original USDA Section 515 debt, which is a direct loan program designed to provide subsidized loans to owners of affordable housing in rural markets. Final funding included senior debt of $30 million and other funding sources totaling $3 million.

The complexity came from not only the sheer volume but also all the different parties involved - with some having different or competing agendas. “We were dealing with 24 different sellers who we had to get to the table at the same time and numerous deadlines related to tax credits, bonds, financing applications and approvals, and third party reports with varying expiration dates,” said Campbell Brown, Senior Vice President of Greystone.

“One of the most unique elements that Greystone brings to the table as a transaction manager is that we are investing in the deal from day one,” continues Eastwood. “When you try to close on 24 properties at the same
time, it takes a tremendous amount of money to complete appraisals, market studies, capital needs assessments, rehab scopes of work and drawings, legal due diligence, etc. That is often a real stumbling block for many of the current Rural Development property owners, as most do not have that kind of ‘at-risk’ money lying around. And chances are that, if one never closed, the costs are never recouped.” In this particular transaction, Greystone invested close to $1.4 million in due-diligence costs, with an exposure of more than $2 million if the deal did not close.

Substantial renovations, averaging $32,000 per unit, will include both interior and exterior improvements. Particular emphasis will be placed on bringing the properties up to modern standards, addressing accessibility, functional obsolescence and deterioration. The rehabilitation plan includes a fast-paced construction process, estimated to be completed within 12 months, during which time no residents will be permanently displaced.

A National Model

Greystone believes this initiative can serve as a valuable model for preserving other aging Rural Development properties. There are approximately 14,500 remaining Rural Development properties across the country, representing close to half a million units with over $5 billion of estimated capital needs. However, preservation done one at a time would be economically impractical. Furthermore, the learning curve for such complex financings for most owners and operators (whose daily focus is typically property management) would be frustratingly steep – not to mention the necessary time commitment would cripple most organizations.

Greystone continues to provide both the creative solutions and crucial financing needed to satisfy the often conflicting needs of multiple parties, and the disciplined transaction management to get deals done. Greystone is dedicated to sustaining and expanding affordable housing throughout the United States, particularly in rural markets.

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**Southwest Minnesota Housing Partnership**

Why Housing Matters

Victoria Thorp was born and raised in Crookston, MN. Vicki had the opportunity when she was sixteen to live for a year with her sister in New Orleans and fell in love with Louisiana. After graduating from Crookston High School, Vicki moved to the French Quarter and lived and worked there for over 40 years until August 28, 2005. Vicki fled from the French Quarter with a small suitcase and her cat in a three car caravan the afternoon before Katrina’s landfall. Having no car she left with a former boyfriend, his current girlfriend, his
parents and sister with four cats and two dogs for Baton Rouge. A friend took all of them in as well as other travelers, until there was no more floor space for sleeping bags. This included twelve pets as well. Vicki stayed ten days in Baton Rouge until her brother, William who was the caretaker at Nimens-Espegard Apartments secured an apartment for Vicki and arranged a flight to Grand Forks, North Dakota where William gave her a ride to Crookston. Vicki lost everything in Katerina. Her apartment was destroyed, all of her possessions were lost and her place of employment was severely damaged and never re-opened for business.

She found a very welcoming community upon her return. Community members made donations, provided furnishings and helped her to feel welcome in Crookston. The residents and manager helped her to make a new home at Nimens-Espegard Apartments where she has lived for the past 10 years since fleeing Katrina. Vicki’s story is a remarkable commentary on kindness exhibited by friends, family and in particular complete strangers in a time of crisis.

The Nimens-Espegard Project

Nimens-Espegard is a 98 unit Section 515 development located in Crookston, MN. Constructed in 1977, Nimens became at-risk of loss due to pre-payment eligibility and the owner’s desire to exit the Rural Development program. As the largest property in RD’s Minnesota portfolio with significant rental assistance, keeping the property in the program and rents affordable for the low income residents was a priority.

The property was identified by the Minnesota Preservation Plus Initiative (MPPI), which is a 10 year partnership to pro-actively preserve Minnesota’s existing affordable housing. Nimens was at risk of converting to market-rate housing because of its good condition and a strong local market. The MPPI partners contacted the Southwest Minnesota Housing Partnership (SWMHP) to consider acquiring and preserving the property, even though the property was located well north of SWMHP’s traditional operating area. The partners were seeking an experienced, preservation-oriented buyer who has previous Rural Development acquisition experience and capacity to rehabilitate, own and manage the property long-term.

The co-funders and members of MPPI, including USDA Rural Development, the Greater Minnesota Housing Fund, and Minnesota Housing Finance Agency, each contributed equity loans, new below-market debt and subsidy with twenty (20) new rental assisted units being obtained. The property was acquired and rehabilitated in 2015.

Total financing for this project was $5,566,307 and included:

- USDA Rural Development (1st lien): $1,728,986
- Greater MN Housing Fund /USDA RD Multifamily Housing Preservation Revolving Loan Fund (2nd lien): $1,500,000
- Minnesota Housing Finance Agency: (soft second): $1,987,321
- City of Crookston (Small Cities/CDBG): $350,000

There were many challenges to this project, including the multi-year transfer approval process with USDA Rural Development; existing disincentives for Non-profit ownership including lack of return to owner and/or asset management fees, and, due to the urgent need to quickly preserve the project, it fell out of the nine percent
LIHTC funding cycle. In the end, this was the largest existing USDA property in Minnesota, and it was successful due to the pro-active effort with contributions from all funders.

*Southwest Minnesota Housing Partnership*

The Southwest Minnesota Housing Partnership is a non-profit community development corporation serving communities throughout southwest and South Central Minnesota. The Mission of the Partnership is to “Create thriving places to live, grow, and work through partnerships with communities.” SWMHP aims to build strong and healthy places to live so that the communities in the region thrive.

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**Findings and Conclusion**

Sections 515 and 514 have played a critical role in financing rental housing in rural communities. In many small towns, the rental housing financed by USDA is the only affordable housing available. For that reason preservation of these properties is essential.

Recent efforts by USDA to share data for the multifamily housing portfolio have allowed policy makers and advocates to have a clearer picture of the status and need of the portfolio. There are two major challenges facing USDA in simply maintaining its current portfolio:

1. There is a massive shortfall in the funds needed to maintain the habitability of existing properties. The average age of the rural rental housing portfolio is 34 years. As the 2016 USDA Comprehensive Report indicated, there is a 20 year, $5.5 billion cost for maintaining and preserving existing rural rental housing developments and the approximately 470,000 units of existing rural rental housing (Section 515 and 514). Revitalization efforts must expand in order to fully address the scale of the issue. In FY 2015 USDA financed the revitalization of 3,544 units of rental housing, bringing the total number of units revitalized through the MPR to over 30,000.

2. There is a rising tide of maturing mortgages, which will result in increasing affordability issues for low- and very-low-income rural renters. As Sections 515 and 514 loans have matured, those developments and their tenants are no longer eligible for rental assistance. USDA has already lost a substantial number of units, losing 2,646 units from 205 properties in 2015 alone, and this trend is expected to continue over the next several decades. If existing refinancing programs are not expanded and new preservation policies and practices are not explored, rural communities across the country will lose this essential source of affordable housing.

Section 515 and 514 funding alone are insufficient to finance the necessary rehabilitation and preservation of USDA’s multifamily housing portfolio. Without LIHTC, nonprofit housing developers, who are essential to this effort, will be unable to afford the purchase and improvement costs associated with these properties. Due to the competitive nature of the nine percent credits, which offer a higher subsidy rate, the four percent credit, which use tax exempt bonds and require more outside financing, is more accessible to nonprofit housing developers in rural communities. However, modifications to state LIHTC application processes to prioritize the preservation of rural rental properties, potentially through creating a set-aside for nine percent credits for this type of project, would allow for more nonprofit organizations to be able to finance revitalization projects.

Given the vast number of properties and units, the preservation strategy employed by Greystone is particularly attractive. By grouping multiple properties together under one transaction, this method makes the preservation effort more economically viable, lowers development costs and impacts a larger number of rental units at one
time. However, because the transactions are larger, they typically involve increased up-front costs, increased workloads and the cooperation and coordination between multiple property owners, lenders and regulators.

Generally, states prefer to use the nine percent credit on new construction properties and the four percent credit on rehabilitation projects. As explained above, the four percent credit can be difficult to use in smaller projects, like the Nimens-Espegard project. That means that organizations like Southwest Minnesota Housing Partnership must then secure financing from many different sources in order to preserve a property.

While the actions taken by USDA in the September 16, 2016 UL are a step in the right direction, and an indication that RD is taking the preservation of its multifamily housing portfolio seriously, there is more that USDA could do to alleviate burdens and hurdles that prevent nonprofit housing developers from purchasing Section 515 and 514 properties. The provisions from the FY 2017 Senate Agriculture Appropriations Bill and the report would encourage more nonprofit involvement. The key differences between the UL and the Senate bill are:

- The UL is a two year pilot program. After two years, USDA will review the results of the program to determine if the incentives provided in the UL should be revised, discontinued or made permanent.

- The UL pilot program only applies to properties with mortgages that will mature or prepay by December 31, 2030. The Senate Bill’s language is broader, and is designed to incentivize the transfer of all rural housing service multifamily housing properties to nonprofit organizations that commit to maintaining the properties in USDA multifamily housing programs.

- The ROI calculation does not include proceeds from LIHTC synchronization.

- The UL does not expand the Asset Management Fee from per-entity to per-property. The UL also limits the Asset Management Fee by allowing nonprofits to either earn an ROI or the Asset Management Fee, but not both.

- The UL does not include the $1 million in the form of a technical assistance pilot program to facilitate transfers of Section 515 properties to nonprofits.

Thus, while the UL includes important program changes USDA’s multifamily housing programs, in light of the current need of the USDA portfolio, the provisions in the Senate bill are needed to preserve these essential properties. Specifically, as the above case studies indicates, the preservation of multifamily housing in rural areas are typically not financially possible without the use of LIHTC. The program changes included in the Senate provisions will be more effective in encouraging the involvement of nonprofit housing developers in the preservation of USDA’s multifamily housing portfolio.

In light of the above research, NRHC makes the following recommendations to address the issues facing the USDA multifamily housing portfolio:

1. Continue progress in revamping Section 515 rules to accommodate other partners, including state housing agencies and other federal agencies.

2. Mission driven organizations are an important resource for preserving and maintaining affordable rental housing is rural America. USDA should revamp rules to encourage participation by nonprofit organizations and public housing agencies. This should include encouraging these organizations to use LIHTC in funding the acquisition and preservation of Section 515 and Section 514 developments. Under current regulations, nonprofit agencies cannot include LIHTC proceeds in calculating return on investment.
3. Affordable housing finance is a complex business. Property owners need additional technical assistance to acquire and preserve Section 515 and Section 514 developments. Many current owners are small business people who started working with Sections 515 and Section 514 in the mid-1970’s. As a group they are nearing retirement and many are anxious to sell or transfer their properties. USDA assistance in understanding the relevant rules, regulations and resources could help these owners make the right decisions in preserving housing.

4. The availability of rural rental assistance is contingent on a property having a Section 515 or Section 514 mortgage. USDA should address the emerging increase of maturing mortgages by encouraging owners to take advantage of MPR and other tools for refinancing developments with Section 515. With the extended financing in place, rental assistance will continue through the term of the new loan.

5. While LIHTC is a key ingredient, it is increasingly difficult for rural properties to get the nine percent credits; and especially challenging for rural properties to accumulate the additional subsidy necessary to effectively employ the four percent credits. Policy makers at the state level should consider providing additional nine percent credits to rural areas or, failing that, encourage the greater allocation of HOME and CDBG to accommodate the four percent credit in rural areas.

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8 Id.
9 Id.
10 Id.
11 Id.
16 Id.
17 Id.
20. 42 U.S.C. 1490(c).
23. Id.
24. Id. This is the average rent for both Section 515 and Section 514 properties.
26. Id.
27. Id.
28. Id.
29. Id.
30. Id.
33. Id.
34. Id.
36. Id.
37. Id.
38. Id.
39. Id.
41. Id.
43. Id.
45. Id.
46. “Below average” means that the property “exhibits pervasive wear and tear, some limits in functionality and deferred maintenance issues. Life safety/code issues are significant and/or numerous and involve substantial costs. High reserves are required” for properties that are “below average.” Properties that are “poor” quality are characterized by “inferior/deteriorating conditions and some limits functionality. Deferred maintenance is pervasive and will [be] costly to cure. Multiple life safety/code issues are identified and involve significant cost. Extensive repairs are required.”
47. Id.
49. Id.
50. Id.
51. Id.
52. Id.
53. 42 U.S.C., Chapter 8A, Subchapter III, 1484 and 1486.


These case studies are also included in the whitepaper summarizing the conference proceedings.

The recommendations listed below are the same recommendations included in the whitepaper summarizing the conference proceedings.