Curbing the Loss of Affordable Rental Housing in Florida: A Risk Assessment Approach

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Abstract

Thousands of Floridian families in need of affordable housing rely on privately-owned multifamily rental apartments that were constructed under federal government programs in the 1960s through 1980s. The terms of the subsidy programs and the age of the structures now cause many units to be faced with a high risk of loss to the affordable housing stock. Units are lost as a result of conversion to market-rate housing upon the prepayment or maturity of a subsidized mortgage, or the expiration of a rental assistance contract or use restriction. Units are also lost through physical deterioration and mortgage default. Preservation of affordable housing has been hampered by a lack of multifamily housing research and data. This paper describes the creation of an assisted housing inventory and the analysis of property characteristics as an approach to identify properties most at risk of loss and to steer preservation policy and funding. This risk assessment approach is applied to Florida's assisted housing stock. For units at risk by 2015, it found that the majority receives project-based rental assistance, that all population groups are impacted by the potential loss, that almost half have non-profit ownership, and that only four counties house almost 50 percent of at-risk units. Rent restructuring, debt restructuring, additional funding programs and property tax relief are described as preservation strategies.

Florida's Housing Market and the Concept of Affordability

Demographic Shifts and Housing Demand

The state of Florida has experienced a steady increase in population that is expected to keep pace in the decades ahead. The most significant reason for Florida's growth in population has been migration from other states in the country, especially the northeastern states, and increasingly from foreign countries (Smith 2005). Many retirees that settled in the state came with financial resources in hand from savings and home equity. But younger immigrants and working families do not tend to share in this financial prosperity. Instead, a large part of Florida's workforce relies on low paying jobs. Nissen and Zhang (2006) call Florida a low wage state with the median wages below the national level and an overrepresentation of construction jobs and services jobs in leisure, hospitality and retail. Florida has been faced with the challenge of stagnating incomes and increasing prices of homes, as illustrated by Figure 1. As a result, even essential services personnel such as teachers, nurses, firefighters and policemen are confronted with an inability to afford to live in the community that they serve. Especially in southern Florida, companies are finding it increasingly difficult to attract and retain employees (Rawls 2006). While home prices have now stabilized or dropped in Florida's submarkets, this is not resolving the housing affordability challenge. Many families that own a home are saddled with increased payments for property insurance and property taxes, and some even face foreclosure. The gap between house prices and incomes continues to be large enough to make homeownership unattainable for many households, especially those in lower income brackets and on fixed income.

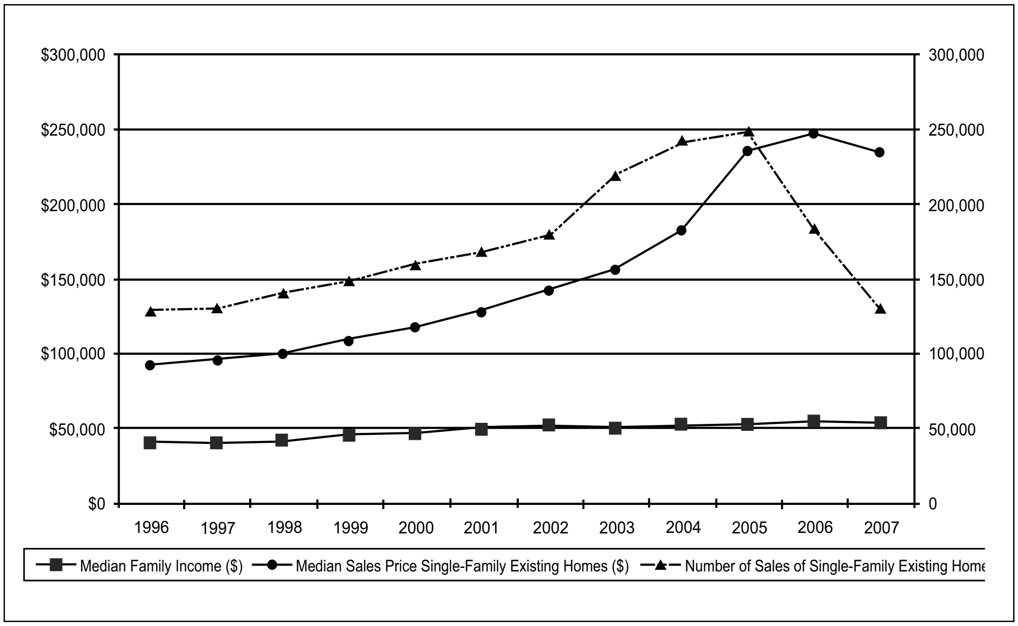

figure 1

Median Family Income, Median Sales Price and Number of Sales of Existing Single-Family Homes in Florida, 1996-2007

Source: U.S. Department of Housing and Urban Development (1996-2007); Florida Association of REALTORS® (1996-2007).

Affordability and Cost Burden

When discussing housing affordability, it is important to define the term. From a simplistic perspective, housing affordability means that a household can afford to pay for the cost of housing from income, while still financially able to meet other basic needs such as food, clothing and health care. Economists generally take another view. They believe that if a household is paying a given amount for housing, it implies that the household can afford to do so (Green and Malpezzi 2003). From a government policy and programmatic perspective, housing affordability in the United States usually means that a household pays no more than 30 percent of its annual gross income for housing. For renters, the cost of housing is considered the rental payments and utilities; for homeowners, it includes principal, interest, property taxes and insurance. When a household spends more than 30 percent of its gross income on housing, it is considered cost burdened; when spending more than 50 percent, a household is deemed severely cost burdened. The 30 percent benchmark is generally applied in housing programs to limit a tenant's rent and calculate the rental subsidy provided by the government. Belsky and Bogardus Drew (2006, 10) noted that "there is no clear history of why that standard was selected but it is clear that it began at 25 percent of income but was boosted to 30 percent in the early 1980s in a bid to reduce housing outlays in the federal budget." According to Schwartz (2006, 23), "These thresholds have no intrinsic meaning… ; nevertheless, they are widely used."

The proportion of all cost burdened Floridian households was estimated at 35.4 percent for 2005. Over 50 percent of renters were cost burdened and almost a quarter were severely cost burdened. In the same year, more than 91 percent of renter households with an annual income of less than $20,000 experienced cost burden. Although cost burden affects people of all ages, most noticeable was the impact on the youngest and oldest generation of renters. Over 58 percent of renter households in the 15 to 24 age group was cost burdened. Cost burden also affected 58 percent of the renter households in the 65 and older cohort (U.S. Bureau of the Census 2005).

Federal Rental Housing Programs

Interest Rate Subsidy Programs: HUD Section 221(d)(3) BMIR and Section 236

Starting in the 1930s, housing built by government agencies was the approach to address the need for affordable rental housing. The federal attitude to public housing shifted in a fundamental way when President Kennedy took office in 1961. Kennedy was in support of housing the poor and wanted to stimulate the economy through construction, based on the principle of public-private cooperation (Hays 1995). Kennedy introduced the concept of affordable housing development by the private sector with government funding, referred to as assisted or subsidized housing. His Administration enacted the Section 221(d)(3) Below Market Interest Rate (BMIR) program under the National Housing Act in 1961. This was replaced by the Section 236 program under the Housing Act of 1968 enacted by the Johnson Administration. Both programs enabled non-profit and for-profit developers to obtain subsidized construction loans at below-market interest rates. The loans were also insured by the Federal Housing Administration (FHA) to lower the risk to lenders. The premise of these housing programs was to reduce a property's debt service and thereby to achieve financial feasibility while offering affordable rents for an extensive time period. The amortization term of the mortgages issued under these programs was 40 years. Properties also had to maintain a 40-year use restriction that generally reserved the units for households at or below 80 percent of the area median income. Most non-profit owners had no option to prepay the mortgage prior to maturity or to terminate affordability early. But many for-profit owners could prepay any time after 20 years and subsequently end the restriction that kept units affordable (Pedone 1991). Tax benefits were also provided to property owners as additional incentives to construct affordable rental housing. Owners were allowed to deduct mortgage interest payments and calculate accelerated depreciation, although a limited dividend restriction on their cash flow distribution was imposed (Achtenberg 2002). The U.S. Department of Housing and Urban Development (HUD) continues to administer the properties built with funding under these programs.

HUD Section 8 Project-based Rental Assistance

In 1973, President Nixon's government placed a moratorium on all housing programs in reaction to rising costs and subsidy commitments, cash flow problems of public housing developments, program scandals and public criticism (Mitchell 1985). The Section 236 program was abandoned and a new program was introduced to stimulate construction and rehabilitation of affordable rental housing by the private sector. The new housing program was called Section 8 and continues to be administered by HUD. It encompassed several rental assistance initiatives that provide subsidies to property owners (project-based assistance that is fixed to the units) as well as directly to households in the form of vouchers to be used in the private rental market (tenant-based assistance that is portable, now called Housing Choice Vouchers). Section 8 initially restricted a household's rent to 25 percent of gross income, later increased to 30 percent. The property owner receives a subsidy to cover the gap between collected rent and the HUD-determined Fair Market Rent (FMR) for the area. While project-based assistance was provided for new construction and substantial rehabilitation, it was also used to supplement rents in properties built under the HUD Section 221(d)(3) and Section 236 programs, which were experiencing difficulty in meeting their mortgage obligations due to shortcomings in rents (Kochera, Redfoot and Citro 2001). The original term of the project-based rental assistance ranged from five to forty years, depending on the type of subprogram (National Low Income Housing Coalition 2007; HUD 1999). At the end of the term, a property owner can either opt-out of the rental assistance contract or, in most cases, renew it. Many rental assistance contracts are currently renewed with one-year terms only and are subject to annual appropriations by Congress.

By the 1980s, federal housing policy had shifted from a supply-side production approach to a demand-side subsidy system when housing affordability had become a much greater concern than substandard conditions and overcrowding (Schwartz 2006; Vidal 1997). After a substantial increase in the supply of affordable rental housing units during the previous two decades, the Section 8 New Construction and Substantial Rehabilitation program was repealed during the 1980s and new construction slowed down steadily under President Reagan's "antiproduction, voucher-only housing policy" (Orlebeke 2000).

Low Income Housing Tax Credit Program

The 1980s also marked the start of devolution, the shift in responsibility to state and local governments for developing and implementing housing policies (Schwartz 2006). A new housing program was created under the Tax Reform Act of 1986, the Low Income Housing Tax Credit (LIHTC) program. "[It] has been the major federal program for producing affordable rental housing since its creation" (Cummings and DiPasquale 1999, 251). In line with the devolution movement, tax credits were made the responsibility of state governments. The program received bipartisan support, because it is based on a tax expenditure instead of a federal budget spending item. The premise of the tax credit program is that federal tax credits are offered to private investors. These tax credits provide a dollar-for-dollar reduction in federal tax liability over ten years. In exchange, the private investors supply equity that is infused by the developer to realize affordable rental housing that generally targets households that make less than 60 percent of the area median income. Upon inception of the tax credit program, the restricted period of affordability was established at fifteen years. But long-term housing concerns led to a statutory change that added a fifteen year extended affordability period in 1989 (Collignon 1999). The state of Florida changed the mandatory affordability period of tax credit properties to 50 years.

Today, more than 1,300 properties with over 176,000 units built under the programs discussed above continue to operate with subsidies and/or use restrictions, providing affordable housing to Florida's residents (Shimberg Center for Affordable Housing 2007).

Understanding Loss of Affordable Units and Need for Data

How Units Lose Affordability

As discussed in the previous section, assisted multifamily properties have finite periods of affordability under the terms of their subsidies and use restrictions. Both prior to and upon expiration of these subsidies and use restrictions, properties can be at risk of loss to the affordable housing stock. A property is either lost as a result of conversion to market-rate housing or as a result of deterioration and default.

Conversion to market-rate rentals or condominiums can be a financially attractive option in a strong local housing market. An owner has this option when a subsidized property reaches a "discontinuity event," a term phrased by Recapitalization Advisors, Inc. (2002, 6). A discontinuity event is a point in time at which the terms of the funding allow the owner to make a choice about the future of a property's affordability. Discontinuity events include:

- **Mortgage prepayment eligibility:** A for-profit property owner with a mortgage under Section 221(d)(3) BMIR or 236 may be eligible to prepay the loan after twenty years from the origination of the loan and any time prior to maturity.
- **Mortgage maturity:** When the loan obligations are met at the end of the term, all affordability restrictions are lifted if no other funding programs or agreements are in place to keep the development affordable for a longer term.
- **Expiration of rental assistance:** Each rental assistance contract has a limited timeframe. Upon expiration of the contract, an owner has the choice to opt-out of the contract or to extend the contract and continue to receive rental assistance (although not all contracts provide the option to extend).
- **Expiration of use restriction:** At the end of the use restriction, the owner is allowed to terminate affordability if no other funding programs or agreements are in place to keep the development affordable for a longer term.

Since the mid-1990s, more than 100 properties with over 9,000 units have already been lost to Florida's subsidized housing stock as a result of HUD mortgage prepayment, HUD mortgage maturity, HUD rental assistance opt-out or affordability termination upon the expiration of a tax credit use restriction (Shimberg Center for Affordable Housing 2008).

The risk of loss of affordable units as a result of deterioration stems from the age of the structures. As buildings have aged, replacement of such items as roofs, plumbing fixtures and heating-cooling equipment has become necessary. However, many subsidized multifamily properties have none or limited capital reserves or have depleted these reserves to supplement cash flow (Wilkins 2002). Physical deterioration and deferred capital improvements negatively impact the quality of life of residents. Furthermore, an owner may default on a mortgage if it is no longer able to meet its mortgage obligation. Dilapidation and loan default lead to foreclosure if the government agency such as HUD cannot restore financial viability of a property in cooperation with the owner (Pedone 1991). Foreclosure can result in displacement of tenants if a new property owner cannot be found. The risk that a property is not maintained is highest in financially and socially distressed neighborhoods.

Preservation and Need for Data

> "It is difficult to know just where to apply resources and which category of housing has the greatest need and will be the most responsive to cost-effective preservation."

Preservation of assisted multifamily housing means both maintaining affordability for low-income households for an extended period, and keeping these properties in good physical and financial condition (MacArthur Foundation 2007). The 1980s marked the start of the preservation debate as subsidized mortgages issued under the earliest federal programs (HUD Section 221(d)(3) BMIR and Section 236) reached their 20th anniversary, and several private developers prepaid and converted to market rate housing. But preservation efforts have been hindered by a limited knowledge about the subsidized housing stock and a lack of understanding of the motivations of property owners. This could explain why the country has seen "only piecemeal preservation efforts" (Joint Center for Housing Studies of Harvard University 2006, 29). Throughout the 1990s, several research papers identified the gap in information on multifamily housing and the weak multifamily housing data sets that lacked breadth and depth, especially compared to the research available on the single-family housing market (Follain 1994; Bogdon and Follain 1996). Follain (1994, 536, 564) stated that "the combination of a growing demand for information and a literature that has not placed great emphasis on multifamily housing has produced an information gap.... The study of multifamily housing is severely hampered by inadequate data." Researchers expressed the need for study of multifamily housing to address policy concerns such as loss of affordability (Galster, Tatian and Wilson 1999). Recapitalization Advisors, Inc. (2002, 3) echoed the need for data for policy purposes, claiming that "this lack of fundamental data handicaps the efforts of non-profit practitioners, governmental agencies and lenders who wish to assist in the effort to preserve the housing. It is difficult to know just where to apply resources and which category of housing has the greatest need and will be the most responsive to cost-effective preservation. Policy therefore tends to be driven by anecdote and headline rather than by a thoughtful strategy." Michael Bodaken, President of the National Housing Trust, also recognized the knowledge gap. He identified expanded funding for research, education and data gathering as one of the critical steps to address the preservation issue (Bodaken 2002).

Preservation Approach: The Housing Inventory and Risk Assessment

One approach to proactively pursue preservation efforts and effectively target resources is to create a development-level database of the affordable housing stock and to assess which developments are most likely to lose affordability. At-risk properties can be flagged before their situation becomes critical in order to prevent their exit from the affordable housing stock. This approach has two steps: Create an inventory and assess properties for risk of loss.

The Housing Inventory

Several national, state and local entities throughout the country have made an inventory of subsidized properties as a way to take stock of the affordable housing supply and the number of properties at risk of loss. Such an inventory generally takes the shape of a development-level database that is populated with property data collected from the funding sources such as HUD, U.S. Department of Agriculture Rural Development (RD), state housing finance agencies and local governments. Entities that manage their own portfolio of subsidized apartments have started to use the data about their properties to build an inventory and can expand the database with information on other multifamily units in the community. An example of a state-wide organization that has built an inventory is the California Housing Partnership Corporation (CHPC). The inventory reports on the number of properties and units funded by HUD and RD programs by county, and identifies the number of properties and units at risk of loss. CHPC's purpose for creating this inventory and risk assessment is derived from its mission, which is "to assist nonprofit and government housing agencies to create, acquire and preserve housing affordable to lower income households, while providing leadership on housing preservation policy and funding" (California Housing Partnership Corporation 2006, 1). As another example, the Governor's Task Force for Housing Preservation in Wisconsin built an inventory of multifamily properties funded by HUD, RD and the Wisconsin Housing and Economic Development Authority with the mission "to identify and preserve those affordable rental housing units at greatest risk of loss where the tenant's residency is most threatened in order to maintain a positive impact on the stability of Wisconsin's residents and the continued sustained growth of Wisconsin's economy and to make recommendations on how to best preserve those units" (Governor's Task Force for Housing Preservation 2004, 3).

In order to make an inventory of subsidized properties a valuable tool for risk assessment, it is essential to collect and report on two types of data variables: Basic property data variables and preservation-specific variables that are indicators of risk of loss. Basic property data variables include data fields such as development name, address, number of units, funding program(s) and target population (e.g., family, elderly). Preservation-specific variables that are commonly included in databases created for preservation purposes include the following:

- **Expiration dates:** These are the dates of subsidized mortgage prepayment eligibility, subsidized mortgage maturity, rental assistance contract expiration and expiration of use restriction. If an expiration date is imminent, the risk of loss to the affordable housing stock is higher, because a property owner will soon have the option to terminate affordability.
- **Ownership type:** The type of ownership and an organization's mission can drive the decision about termination of affordability. The mandate of a non-profit owner is generally to serve lower income families in the community. A study prepared for HUD found that non-profits were less likely to opt out of a rental assistance contract compared to for-profits, because "nonprofit owners are often mission-driven to continue to provide affordable housing" (Finkel et al. 2006, ix). For-profit owners have a strong focus on the financial bottom line and aim for maximization of returns (Wallace 1995; Pedone 1991). A for-profit is more likely to exit the funding program and sell the property or convert to market-rate housing if it makes financial sense to do so.
- **Physical condition:** The physical state of a property can impact its fate. A structure may be deteriorating and in need of capital improvements due to owners' neglect or lack of capital reserves. Deterioration can make a property into an unlivable habitat and can result in mortgage default and loss to the affordable stock. Since limited public data tend to be available on physical condition, two proxies are often used: Age of the structure and HUD Real Estate Assessment Center (REAC) score for physical condition. If a property is older or has a relatively low REAC score, the risk of loss due to deterioration and default is assumed to be higher.
- **Financial condition:** If a property suffers from poor cash flow and low reserves, it may be difficult for the owner to meet its mortgage obligations, thereby increasing the risk

of default. In a strong housing market or gentrifying neighborhood, poor cash flow can motivate the owner to sell or convert to market-rate housing in order to increase rent revenue and improve financial feasibility. The risk indicators include the loan to value ratio, debt coverage ratio and financial reserves. However, these data are often only available to project administrators and not made public.

- **Strength of the market:** The conditions in the local housing market can impact the level of risk that a property will convert to market-rate housing. Conversion risk is considered higher if the ratio of project rents to market rents is weak (Finkel et al. 2006; Southern California Association of Government 2000), if the area has relatively low vacancy and low poverty rates, or if the median home sales price has increased over the past years (Recapitalization Advisors, Inc. 2002). If a property is located in a distressed area with high poverty, the risk of deterioration and default is generally higher.

Risk Assessment

The next step is to use the data for each property to assess the risk that it will disappear from the affordable housing stock. Two major risk assessment methods can be distinguished: Risk rating and multiple regression analysis.

The most common approach to risk assessment of a subsidized housing inventory is to use a limited number of key risk indicators to categorize each property by level of risk of loss. The key risk indicators tend to be the expiration dates, type of ownership and strength of the market. This approach is most common, because it is relatively simplistic and because the data variables are most easily obtainable. As an example, the Chicago Rehab Network (CRN) has developed an opt-out risk assessment for properties with Section 8 project-based rental assistance. It measures all properties in the Section 8 inventory against four risk factors: Contract expiration, level of demand and gentrification in the local real estate market, ownership type, and geography (in Illinois, outside of Chicago, Chicago proper). CRN considers a property most at risk if it has a rental assistance contract that is due to expire within the year, if it is located in a booming or gentrifying area, and if the owner is a for-profit entity (Chicago Rehab Network 2003). The California Housing Partnership Corporation considers a property at risk if the funding expires or can be terminated within five years. If this property has non-profit ownership, it is placed in the next risk category and classified as lower risk (California Housing Partnership Corporation 2006).

Multiple regression analysis is another method that can be applied to a housing inventory to explain the correlation between an owner's decision and characteristics of a development, its ownership, funding program and location. The purpose of the analysis is to find which variables are statistically significant. This method requires access to data on properties that have been lost to the inventory and those that remain affordable. In a recent nation-wide study prepared for HUD, a multivariate regression model was constructed to analyze close to 9,000 Section 8 project-based properties of which 763 were opt-outs. It found that the major predicted variable was the project rent to the Fair Market Rent ratio: "The lower the rent-to-FMR ratio, the higher the likelihood of opting out" (Finkel et al. 2006, 33). Another key variable was type of ownership; non-profit owners were significantly less likely to opt-out compared to other owners. Other findings included that properties with the following characteristics were more likely to opt-out (holding each other variable constant): 100 percent rental assistance; family-occupied; fewer than 50 units; unit mix with three or less bedrooms; older assisted properties; low-poverty rate census tracts; and central city or non-metropolitan locations (Finkel et al. 2006). The research team was able to achieve a relatively large sample size and conduct this regression analysis thanks to access to numerous HUD internal data sources with detailed property-level information, which are not publicly available. Regression analysis of the inventory is not widely performed, because of the data availability issue and the higher complexity of this method.

The outcome of the risk assessment approach is both a shortlist of properties and an aggregate number of properties at risk. The shortlist can be used as a target list for preservation. The aggregate number of properties can be used for policy and program development and the allocation of funding for preservation.

Properties at Risk in Florida

Florida's Assisted Housing Inventory

Through primary and secondary data collection, the Shimberg Center for Affordable Housing at the University of Florida developed a state-wide Assisted Housing Inventory (AHI) for Florida. AHI was created in 2003 as a tool for policy-makers, planners, developers and housing advocates. It is a development-level database of multifamily rental properties that are funded under housing programs by the U.S. Department of Housing and Urban Development, U.S. Department of Agriculture Rural Development, Florida Housing Finance Corporation, and local housing finance authorities. The 2007 database contained over 2,200 properties with more than 272,000 units. More than 60 percent of the properties were funded by more than one housing program in order to achieve financial feasibility of the construction and operation.

The Assisted Housing Inventory reports on general data variables such as development name and address, unit count, target population and housing programs. Since 2005, the following preservation-specific data fields have been added: Funding or affordability expiration dates, type of ownership and year built. Data on the financial and physical condition of assisted properties have not been made available by the funding sources, nor is extensive data available on properties that have already been lost due to mortgage prepayment, rental assistance contract opt-out or affordability termination after the expiration of a use restriction. Therefore, the risk assessment of the Assisted Housing Inventory for Florida is currently limited to a descriptive analysis, as performed for this paper.

Characteristics of At-Risk Properties

Properties that are most at risk of loss due to conversion or deterioration are those developed under HUD programs Section 221(d)(3) BMIR, Section 236 and Section 8 project-based assistance. Many of these properties are now faced with prepayment eligibility, rental assistance contract expiration and physical deterioration. Also at risk for conversion and deterioration are properties funded under the Low Income Housing Tax Credit program before 1990, which have now reached the end of the compliance period and also may require attention to deferred maintenance and capital needs.

In 2007, the Assisted Housing Inventory reported a total of 1,381 properties with more than 176,000 units that provide affordable housing under at least one of these subsidy programs. The immediate concern is for those units that are at imminent risk of loss. A total of 380 properties with more than 32,000 units are estimated to be at risk by 2015, as measured by the affordability expiration date. Of these units, 60 percent have HUD rental assistance, 38 percent are built under the HUD Section 221(d)(3) BMIR or Section 236 programs, and 2 percent are Low Income Housing Tax Credit units (Figure 2). It is important to note that many rental assistance contracts now only have one year terms and are subject to annual appropriations from the federal government. Although many are renewed annually, properties with rental assistance are still at risk, because an owner has the option to opt-out of the contract each year and because the government may decide to discontinue funding.

As illustrated by Figure 2, HUD is the funding source for almost all units that are estimated to be at risk by 2015. This implies that many extremely low-income households are at a high risk of displacement, since a median of 76 percent of households in HUD-assisted multifamily properties are reported to have an income below 30 percent of the area median family income (HUD 2006a). These households will be challenged to find alternative affordable housing options in the community.

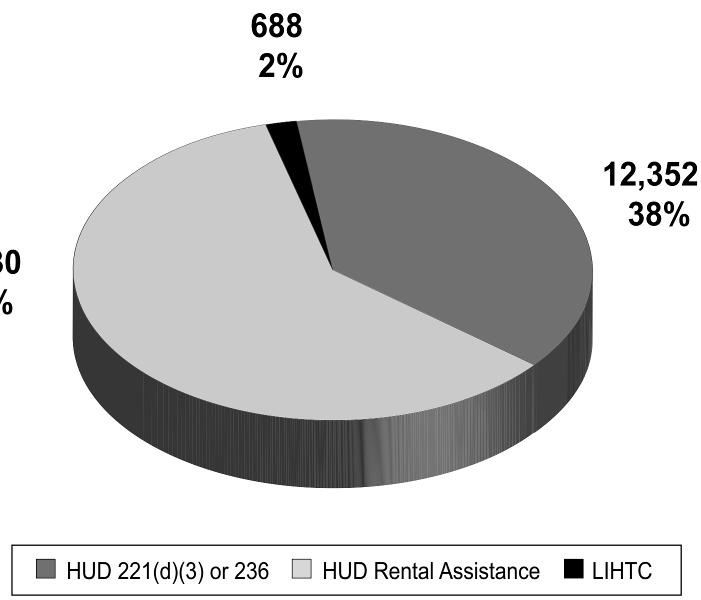

figure 2

Funding Program for Federally Assisted Units at Risk by 2015

Source: Shimberg Center for Affordable Housing, University of Florida (2007).

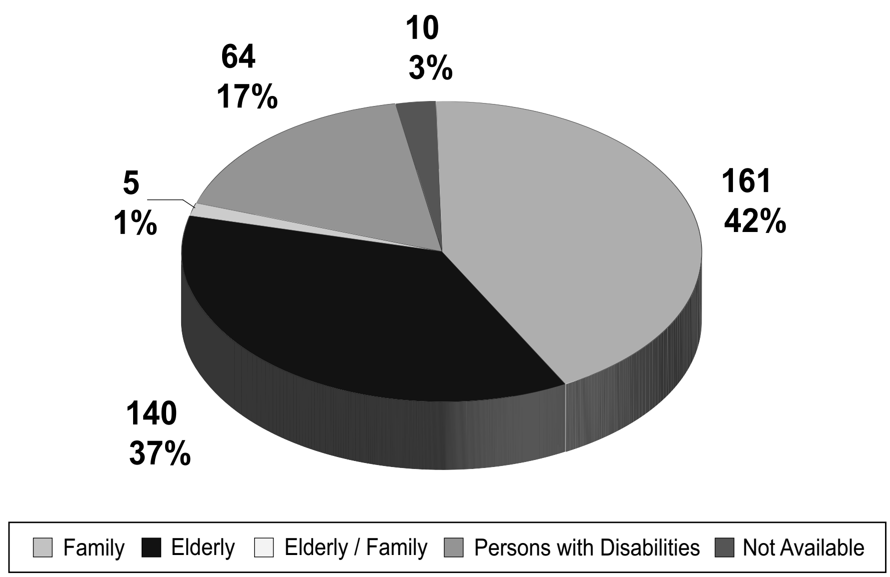

figure 3

Target Population of Federally Assisted Properties at Risk by 2015

Source: Shimberg Center for Affordable Housing, University of Florida (2007).

In terms of target population, all groups are impacted by loss of affordability. More than 40 percent of the properties at risk by 2015 serve families. Properties that target the elderly (37%) and persons with disabilities (17%) are also at risk of loss, resulting in potential displacement of these vulnerable types of tenants (Figure 3).

Further analysis of the units at risk by 2015 concludes that almost 50 percent of the units are owned by non-profit entities. These units are not in much jeopardy for conversion to market rate housing thanks to a non-profit's social mission. However, they can be in danger of dilapidation due to the lack of capital reserves or the limited property management expertise and capacity of non-profits (Bratt et al. 1998). The units that are in hands of profit motivated organizations (26%) and limited dividend owners (15%) have a larger risk of affordability termination and conversion if financial gain can be achieved (Figure 4).

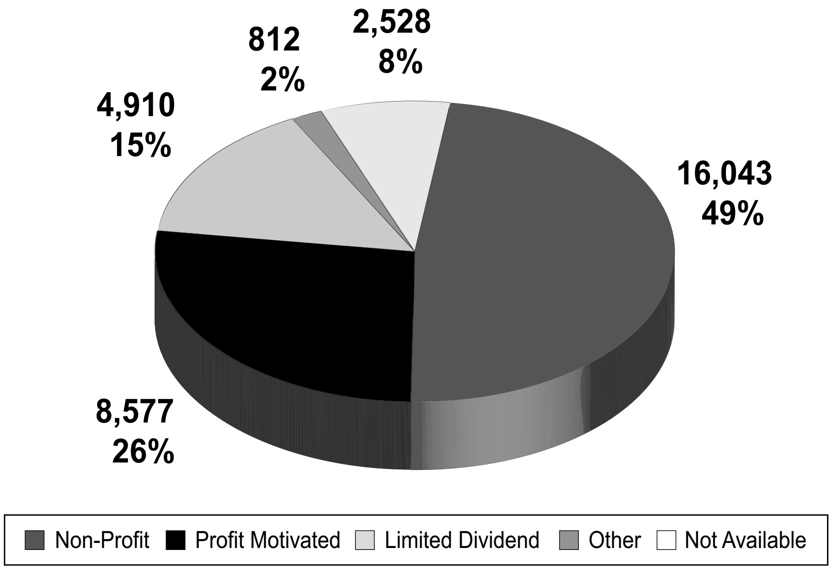

figure 4

Type of Ownership of Federally Assisted Units at Risk by 2015

Source: Shimberg Center for Affordable Housing, University of Florida (2007).

More than three quarters of Florida's 67 counties are faced with at least one property that will likely lose its funding program by 2015. But the location of the at-risk units is not evenly distributed among all those counties. More than 90 percent of all units that face potential loss of affordability by 2015 are located in 30 percent of the counties (Figure 5). Almost half of all units are located in four counties: Miami-Dade, Duval, Hillsborough and Pinellas. These are all urbanized and coastal counties with relatively strong local housing markets. These markets provide the greatest opportunity for property owners to seek higher rents or convert to condominiums (GAO 2007). But within these urbanized areas, subsidized units could be located in poverty neighborhoods where the market potential is limited and where the risk of deterioration is greater than the risk of conversion.

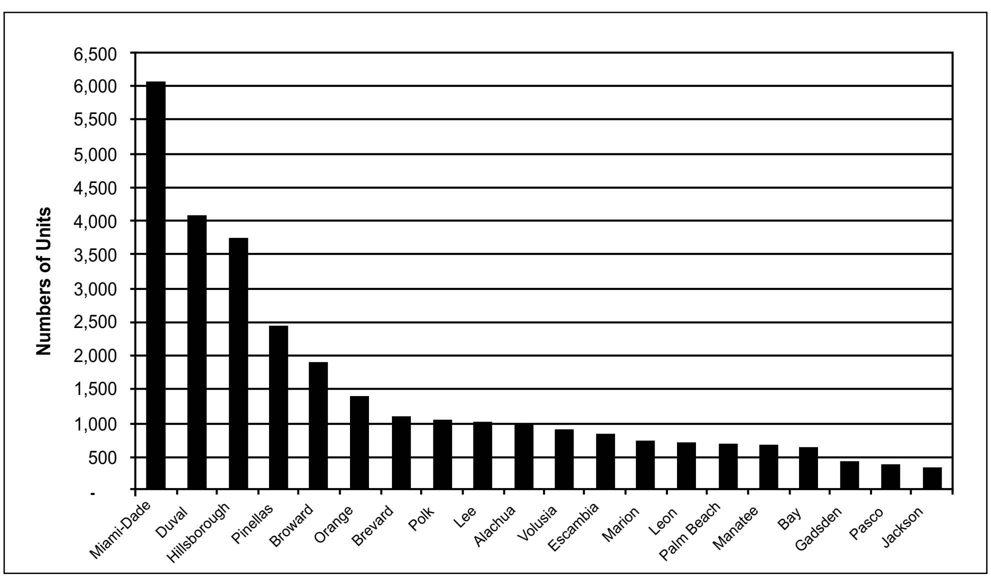

figure 5

Geographic Concentration of Federally Assisted Units at Risk by 2015

Source: Shimberg Center for Affordable Housing, University of Florida (2007).

This analysis demonstrates that thousands of low-income households could be displaced within the next decade. Policy-makers can use the general analysis for the advancement of preservation policy and programming. Local governments, housing advocates and developers can use the shortlist of properties to identify those that are most at risk and to pursue preservation at the property level.

Limitations of Risk Assessment

Risk assessment is only possible if extensive data are available about the properties that make up the affordable housing stock. But even when data can be accessed, risk assessment has two major limitations. First, not every property that is identified to be at risk is a target for preservation. It may not be feasible or desirable to preserve a property. Second, although risk assessment models can be developed to identify properties at risk, it is not possible to precisely predict an owner's decision. "Armchair assessment can never be highly reliable as a predictor of owner behavior. Interacting with the owner and the property is, ultimately, the way to gauge the operative dynamics of the owner's decision making. Even then, predicting actual outcomes is difficult" (Recapitalization Advisors, Inc. 2002, 36).

Despite the limitations, risk analysis of the assisted housing inventory can be a valuable tool to assess the need for preservation policy and funding, and to identify opportunities for preservation as a way to protect housing for the growing number of families in need of affordable living in the state of Florida.

Preservation Strategies

This section outlines four major preservation strategies that can be applied to properties that are identified to be at a higher risk of loss. Preservation strategies were initiated by the federal government in the late 1980s when it introduced legislation that restricted prepayment of HUD-subsidized mortgages. Prepayment rights were restored in 1996 and federal preservation initiatives that have since been introduced were not designed or funded to reach all at-risk units. As a result, the responsibility for preservation has shifted to state and local governments (National Housing Trust 2007; Achtenberg 2002).

Rent Restructuring

Rent restructuring to improve a property's operating income is one of two approaches that the federal government has taken in its preservation programs. As was found in a study for HUD, "The lower the [project] rent-to-FMR ratio, the higher the likelihood of opting out" (Finkel et al. 2006, 33), because the owner has a great opportunity to increase the rental income if conversion is pursued. Below-market project rents have been most common in properties with both a subsidized mortgage under the HUD Section 221(d)(3) or Section 236 program and a project-based rental subsidy through the Section 8 Loan Management Set Aside (LMSA) program. The country experienced a wave of opt-outs during the late 1990s when many rental assistance contracts reached the end of their original term and housing markets were experiencing escalating market rents (Achtenberg 2002). In response, the federal government created the following two programs for below-market rent properties: Mark-Up-to-Market program for for-profit or limited dividend owners and the Mark-Up-to-Budget program for non-profit owners. To prevent properties from opting out, these programs allow for the renewal of a rental assistance contract at comparable market rent levels up to 150 percent of the Fair Market Rent. The contract term is at least five years for for-profit and limited dividend owners and at least 20 years for non-profits. The increased cash flow can be used to fund acquisition, repairs or rehabilitation, or to obtain additional debt.

Debt Restructuring

Debt restructuring to lower a property's debt service and improve cash flow has been the other federal approach to preservation. The federal Mark-to-Market (M2M) program targets properties with above-market rents that were built under the HUD Section 8 New Construction and Substantial Rehabilitation program during the mid-1970s to early 1980s and that had a FHA-insured mortgage. These properties had rental assistance contracts with 20 to 40 year terms. The original project rents were often set at above market levels to compensate for such items as higher construction costs (HUD 2006b). Over the years, project rents continued to rise above market rents because of an annual rent adjustment factor. The federal government identified the following preservation challenge: How to renew expiring rental assistance contracts without incurring a tremendous budgetary burden caused by high project rents and without forcing properties into foreclosure (Schwartz 2006). In response to this challenge, Congress introduced the Mark-to-Market program in 1997. It had two major components: Restructuring of project rents down to the local rent level in order to reduce the budgetary burden, and restructuring of the debt in order to prevent mortgage default. A transaction that includes both rent and debt restructuring is referred to as a full restructuring and requires owners to renew the rental assistance contract for a 30 year term. In addition to a reduced first mortgage that can be serviced by market rents, the M2M program offers other incentives such as new funds for capital improvements and payment by HUD of 80 percent of the rehabilitation and transaction costs (HUD 2002). Table 1 presents an example of a cash flow proforma for a property that undergoes a full Mark-to-Market restructuring, which illustrates the impact on the financial bottom line.

table 1

Cash Flow Proforma Before and After Full Mark-to-Market Restructuring (in $000)

	Before M2M	After M2M
Gross Potential Rent	*Above Market Rent:* $700	*At Market Rent:* $625
Vacancy Loss @ 2.5%	-$18	-$16
Operating Expenses	-$475	-$409
Replacement Reserves	-$20	-$44
Capital Recovery Payment to Owner	-$0	-$6
Adjusted Net Operating Income	$187	$150
First Mortgage Debt Service	-$160	-$70
Incentive Performance Fee to Owner	-$0	-$18
Surplus Cash Flow	$27	$62
75% to Second Mortgage	-$0	-$47
25% to Owner	-$0	-$15
Total to Owner	$27	$39

Source: HUD 2002

The federal government also created preservation assistance for properties built with a HUD Section 236 subsidized mortgage. These properties have an Interest Reduction Payment (IRP) subsidy that covers the difference between the actual debt service and a hypothetical debt service at a one-percent interest rate. To prevent the loss of Section 236 properties through mortgage prepayment, the government allows for these properties to retain the IRP subsidy if the mortgage is refinanced by the current or new owners. This is referred to as IRP Retention/Decoupling, which requires no new budgetary outlays, because the IRP subsidy was already appropriated at origination of the original mortgage (National Low Income Housing Coalition 2007). The subsidy is in place for the remaining term of the original Section 236 mortgage and can be utilized for any purpose such as capital improvements (Schwartz 2006).

Additional Funding Programs

State and local governments are dedicating resources for the preservation of the assisted rental stock. Most commonly, the Low Income Housing Tax Credit program is used to provide funding for acquisition and rehabilitation of properties that otherwise could have been lost through conversion or deterioration. The National Housing Trust (2007) reported that 46 states prioritized preservation in their LIHTC allocation plans, either by awarding extra points on the funding application for preservation deals or by setting aside a percentage of the total tax credits allocated to the state for the explicit purpose of preservation (e.g., 12 percent set-aside in Florida, 40 percent set-aside in Wisconsin, 10 percent set-aside in New York State). Many states also dedicate 4% tax credits to preservation in combination with tax-exempt bonds. The following example illustrates the use of tax credits for preservation. A 100-unit property located in Gainesville, Florida was built under the HUD Section 236 program in 1971 and also received Section 8 project-based rental assistance. The subsidized mortgage was prepaid in 2003. The property remained part of the assisted housing stock when a new owner acquired and rehabilitated it using 4% tax credits and local tax-exempt bonds. The rental assistance contract was also renewed with a 20 year term (subject to annual appropriations by Congress) (HUD 2008; HUD 2007; Florida Housing Finance Corporation 2003).

Many state and local governments also have other programs available that provide funding for acquisition and rehabilitation. As an example, Florida's State Apartment Incentive Loan program provides gap financing that can be used for substantial rehabilitation of multifamily housing. It is funded by the State's housing trust fund. Acquisition and rehabilitation are also funded by local governments from resources that they receive under the federal Community Development Block Grant program and HOME Investment Partnership program.

Preservation incentives such as Mark-to-Market, tax credits and bonds are commonly combined in order to generate sufficient funds for capital improvements and rehabilitation (GAO 2007; LISC 2005). Government incentives can also be combined with equity financing and other support from banks, foundations and intermediaries such as Enterprise Community Partners, Inc. (Cisneros et al. 2007).

Property Tax Relief

Reducing operating expenses is another approach to improve the cash flow of a property that has capped rents. The expense item that is most commonly targeted in state and local preservation strategies is property taxes. According to Cisneros et al. (2007, 78), "A major impediment to sustained affordability, particularly in gentrifying neighborhoods, is the property tax rate. A sudden hike in assessments often triggers the sale of subsidized rental housing to market-rate developers." Both state and local governments throughout the country are providing property tax relief for affordable rental housing. State laws in Florida, California and Wisconsin allow property tax exemptions for non-profit owners (Cisneros et al. 2007). This gives owners not only a reduction in operating expenses, but also provides predictability for this expense item (Achtenberg 2002).

In addition to these four major strategies, federal, state and local governments have developed other preservation tools that can be effective in preventing the loss of units. Among these other tools are rent and eviction control, notice requirements for mortgage prepayments and rental assistance opt-outs, conversion ordinances, and technical assistance to non-profit entities. Most importantly, preservation strategies need to respond to the characteristics of the properties that have been identified at risk of loss to the assisted housing inventory.

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