

**Statement of Russell T. Davis, Administrator of USDA Rural Housing and Community Programs, before the Subcommittee on Housing and Community Opportunity.**

Mr. Chairman and members of the Subcommittee, thank you for the opportunity to present the Bush Administration's initial comments on H.R. 5039, the "Saving America's Rural Housing Act of 2006."

Let me begin by acknowledging and thanking the sponsors and cosponsors of H.R. 5039 for their leadership on this important issue. Mr. Chairman, we appreciate the fact that you have been personally interested in this bill, as well as Congressman Geoff Davis and Congressman Barney Frank. The quality of thought and effort are evident throughout. We also thank everyone involved with this legislation for their work and the experience they have brought to the process.

There is an urgent need to address long-standing and severe issues of deferred maintenance and economic imbalances in the rural multi-family housing portfolio. This initiative will ensure continued viability of thousands of multi-family housing properties

and hundreds of thousands of units for years to come. I am grateful that we have stepped up to that challenge.

We believe the basic strategy outlined by this legislation will work. The two new housing mechanisms in this bill – rural vouchers and debt restructuring – are in fact already being implemented on a demonstration basis with a promising response.

First, let me mention our voucher demonstration program. On April 7, 2006, USDA Under Secretary for Rural Development, Thomas Dorr, issued the first Rural Development vouchers to tenants of Wedgewood Apartments in Hinesville, Georgia, in a property where the borrower had just prepaid its multi-family housing loans. These vouchers provided roughly \$240 per tenant per month and allowed those tenants to remain in their apartments, despite a post prepayment rent increase of about 45 percent. USDA is issuing vouchers both through its field offices and through HUD under an interagency agreement.

Second, the early results of our Restructuring demonstration are also extremely encouraging. As of the close of the application window on April 17, 2006, approximately 4,000 Section 515 property owners have applied to undergo debt restructuring. This represents 25 percent of the total portfolio. These results indicate a tremendous interest among the ownership community in seeking a resolution to the revitalization challenge. I look forward to working with Congress to develop and pass legislation that protects these assets for the low-income rural housing tenant population.

H.R. 5039 is the product of extensive and ongoing discussions among members of Congress, the Administration, and USDA Rural Development. It is heartening that these discussions have been bipartisan and that H.R. 5039 is broadly compatible in approach with the Administration's proposed legislation. The Administration therefore supports this bill, with certain clarifications which I will describe shortly.

### **Administration's Proposal**

The Administration's revitalization proposal was circulated on the Hill in August of 2005. That draft legislation addressed three critical needs faced by USDA's Rural Housing Programs' Section 515 multi-family housing program: (1) enhancing tenant protections through vouchers when a property owner leaves the program by pre-paying a loan; (2) creating an equitable new agreement with property owners electing to stay with the Section 515 program; and (3) using debt relief as the primary tool to stabilize properties at risk of physical deterioration.

To revitalize properties in the program, the Administration's legislation proposed to restructure the owners' current loan. The restructurings are targeted to the properties that need rehabilitation in the near future, and would be limited to properties placed in service before 1992.

The restructurings would be accomplished through a negotiated process in which USDA would employ a "toolbox" of financial incentives and disincentives to secure another twenty years of decent, safe, and affordable housing for low-income rural tenants, at the

lowest cost to the Federal government. By utilizing a variety of restructuring tools we can ensure that post-restructuring rents are as close to pre-restructuring rents as possible. A fundamental principle of our revitalization study was that restructuring tools are more cost effective in the long run rather than extensive, open-ended tenant subsidies.

One way to look at this restructuring process is to view it as a “fix-up vs. build” decision: it costs \$85,000 on average to build a new affordable housing unit, but only \$20,000 per unit to rehabilitate what we currently have. The vision, then, is to secure the valuable national asset of a large affordable rural rental housing portfolio, for the longest period, at the lowest cost to the government, at the greatest benefit to tenants, owners, and communities.

To provide for the property’s physical rehabilitation, the Administration’s proposed legislation provided the owners with greater flexibility in operating their properties and managing their capital contributions. Deterioration is causing unnecessary increases in costs, and a new capital structure is needed to attract private sector investment.

Loans older than 15 years could go through a financial restructuring. The properties’ budgets reserve requirements, and possibly Section 515 debt levels, would be adjusted to provide more cash flow for rehabilitation. In addition, the securing of outside capital from owners, third parties, housing tax credits, etc. would be encouraged. In return, owners would enter into a “Long-term Use Agreement” with USDA to maintain affordable rents and housing for up to 20 additional years.

Ultimately, the Administration's proposed legislation would help shore up the multi-family housing portfolio so that we continue to provide decent, safe, affordable tenant based housing to the current residents within the portfolio.

The 2007 Budget supports these changes by requesting \$74 million for vouchers and debt restructuring.

### **H.R. 5039**

We are pleased that H.R. 5039 reflects the Administration's vision for addressing multi-family housing program concerns. Like the Administration's proposed legislation, H.R. 5039 would protect rural residents from rent overburden when borrowers prepay their loan. The bill would also allow property owners to restructure their loans to provide cash for rehabilitation; in return rural America keeps a valuable multi-family housing property affordable for rural residents.

The differences between the Administration's proposal and H.R. 5039 are, in the main, minor, and we look forward to working with the Subcommittee to address these issues. One such item is that H.R. 5039 would set a maximum tenant contribution of 30 percent for restructured properties. We recognize that this is an understandable policy goal as an attempt to address the 'overburdened' tenant. This approach recognizes that the Section 515 program as currently structured protects some tenants more than others: some low-income tenants receive rental assistance while others do not; and some pay higher percentages of their incomes than do others. As a matter of what social scientists call

'horizontal equity,' many supporters of the Section 515 program desire to broaden the income subsidy nature of the program.

There are, however, significant countervailing considerations. Because the Administration places its highest policy priority on protecting tenants, we have given serious attention to both sides of the equation. We cannot, however, support the bill's 30 percent maximum rent provision.

First, by imposing a lower, and across-the-board, maximum rent cap, H.R. 5039 is likely to greatly expand the cost of preserving these properties. The initial cost of this provision understates its financial impact, because the legislation does not limit the number of beneficiaries of the rent cap to just those residents overburdened at the time of restructuring, but would require that Rural Development provide Rental Assistance to an unknown number of future overburdened residents as well.

Second, the Administration places a high premium on a market-based restructuring in which owners have an economic incentive to respond to market forces. This is also consistent with the policy goal of maintaining a mixed-income tenant population. These yield important social benefits and allow for a more inclusive representation of the rural communities in which these properties are located. A completely tenant subsidy-based property undermines these objectives.

Third, by preserving some degree of market constraints on property owners, the Administration's approach creates a long-term incentive for holding down costs and maintaining property quality. It also eliminates the incentive for owners or managers to seek windfall returns by under funding maintenance and repairs while recruiting tenants willing to accept substandard conditions.

Finally, the Administration's approach recognizes that current overburdened tenants did, in fact, enter willingly into their current rental arrangements with their landlords and are paying their rent. Additionally, existing law already provides the authority to extend rental assistance to the overburdened, and that the matter of doing so should be left to the appropriation process. Particularly in an austere budget environment, there is no reason to extend an unsolicited subsidy to people who are successfully meeting their obligations.

If the maximum rent provision remains in H.R. 5039, at a minimum, we strongly recommend that certain controls be put in place, such as:

(a) Limiting additional Rental Assistance (RA) funds to only residents in units that are overburdened at the time of restructuring. As written, H.R. 5039 contains no such limits. For example, under the bill, should an overburdened resident making \$10,000 per year move out of a property and be replaced by a tenant with \$1,000 income, the cost of RA (to be incurred by Rural Development) would rise dramatically. Under this scenario, it would be impossible to provide accurate predictions of the future amounts of RA that would be needed. Alternatively, if

the RA were limited to the amount present at the time of restructuring, everyone would be able anticipate annual costs, both present and future.

(b) Limiting potential beneficiaries to tenants or applicants without current HUD assistance, either tenant or project-based. We believe that the Section 515 program will in the long run be on a stronger footing by preserving multiple sources of tenant assistance.

### **Conclusion**

The Administration applauds members of Congress for taking this very important first step. We remain committed to protecting tenants, while also focusing the remaining resources on the essential long-term purpose of the legislation, the revitalization initiative. The modest changes to H.R. 5039 – very reasonable controls – would achieve this goal. We believe that these modifications would significantly enhance the efficiency and effectiveness of the revitalization initiative. USDA Rural Development looks forward to working expeditiously with Congress on this important legislation.