

Preserving Affordable Housing

By: Warren A. Kirshenbaum, Esq. (December 5, 2009)

The Boston Globe, on November 26, 2009 reported that Governor Deval Patrick had signed into law a recently enacted statute dubbed the “expiring use” bill. This new law will have the effect of preserving as affordable, thousands of units of housing in Massachusetts intended to be used by low-income residents. In a November 30, 2009 press release announcing the new law, the Patrick Administration stated that the bill “creates a regulatory framework to keep affordable rents in properties where long-term publicly subsidized mortgages are paid off and affordability restrictions can then expire.” The press release also claims that as many as 90,000 housing units in Massachusetts could be affected by expiring affordability restrictions, with about 17,000” of those units at risk of losing their affordability through expiring use over the next three years.” These numbers are simply staggering, so, understandably, this new law, if it does what they say it does, could be a very significant arrow in our quiver of affordable housing preservation tools, and may even present distressed asset investment opportunities.

The Patrick Administration went even further in establishing this “regulatory framework”, also announcing a \$150 million preservation loan fund. This fund pools public and private funds to help secure rental developments that are about to lose their expiring use restrictions. The preservation loan fund, which mirrors what we in the private sector are doing to raise funds and acquire distressed assets is capitalized as follows: \$3.5 million in grant funding from the John and Catherine T. MacArthur Foundation, Private Lenders are making \$40 million available, MHIC (a non-profit entity founded by a consortium of banks) is providing \$100 million, and the Commonwealth of Massachusetts will fund \$6.5 million via State Bond Funds.

So far this sounds like a good piece of legislation coupled with a practical mechanism to get the deal done. Nevertheless, let’s analyze the new statute to determine how this all of this will work.

It appears that the “expiring use” bill will operate as a new Chapter to the permitting section of the General Laws, i.e. M.G.L. Ch. 40T, enacted as Senate Bill No. 2190. DHCD, the Commonwealth’s Department of Housing and Community Development plans to release regulations within 150 days to clarify the way the law will operate. My sense is that these regulations will be important, as Chapter 40 of the General Laws is a complex area of the law with many intricate moving parts, so the new bill’s practical interaction with existing laws and rules will be instrumental in ensuring its successful operation.

What is publicly-assisted affordable housing?

Although many such projects are government-owned and operated, all publicly-assisted affordable housing is not owned and operated by government, municipal or local public entities. Basically, publicly-assisted affordable housing includes privately owned developments that have used various governmental tools as sources of equity to build the project (low-income housing tax credits), or publicly subsidized debt, such as tax-exempt bond financing (multi-family housing revenue bonds), or FHA insured below-market interest rate mortgages to provide the

debt financing, or other forms of government subsidy that assist the project's cash flow, such as a section 8 project-based voucher, or a HAP contract. Much publicly-assisted affordable housing is, therefore, owned and operated by private entities. This is a smart government theory that outsources a public obligation to the private sector, allowing the private sector to profit by performing this function. Of course, there are limitations to using public subsidies as the housing units must be made available, at least in part, to residents of lower economic strata, and may not realize market rate values. Legally, these limitations are achieved by recording affordability restrictions against the property, usually in a Regulatory Agreement or a Land Use Restriction Agreement, which prevents the project from renting to market rate tenants, and limits the project to rent to tenants that fit within certain affordability parameters, such as 80% of the area's median income. These restrictions need to be complied with over the period of time that they are in place, and this time period will eventually end, hence the period of expiring affordability use that this new law intends to combat.

Accordingly, developments that you had no idea or inkling could be publicly-assisted affordable housing are in fact such. They could be market-rate properties that have an affordable component, workforce housing or tax credit properties, or simply buildings that have a FHA insured mortgage, and may, therefore, qualify for the generous state incentives and the procedure that the "expiring use" bill has put into place.

So – what does this new law do?

As alluded to above, the affordability restrictions that encumber these properties burn off over time, and have different life spans, whether it is the 15 year compliance period for low-income housing tax credits, or the 40 year periods that certain HUD programs impose. Therefore, once the period of affordability restriction ends, or when the publicly subsidized loans are paid off, the affordable housing can be converted to market rate use, i.e. its affordability use "expires". The new "expiring use" law obligates owners of these properties to provide additional notices to particular parties, including tenants and DHCD when these properties are nearing the end of their affordability period. Usually, if a property is nearing the expiration of its affordability use, the owner will have a plan for that post-affordable life, whether it be to increase the subsidized rents to market rate, or to sell the property. In a sale, the new owner will inevitably reposition the property as a market rate property. In either scenario, low-income tenants are going to face a rent increase, and most likely will no longer be able to afford to live in their homes. Although, that is a societal disaster, particularly in grueling economic times, denying a property owner the ability to receive the market rate value of his property is also problematic. The new law's additional notice requirements serve to remedy this natural conflict in that they obligate the owner to notify the Commonwealth of its post expiring use plans, and if those plans include an elimination of the rent subsidy, there are tenant protections inserted into the law to protect tenants from rent increases, but most importantly there is a *right of first refusal for DHCD to purchase the property if the owner was intending to sell, and the owner has a legitimate buyer willing to purchase on market rate terms.* The law, however, also states that DHCD may designate its right to purchase the property. The DHCD designee may be a for-profit entity capable of operating publicly assisted housing as safe, decent, and sanitary affordable housing, so long as DHCD, or its designee, sign a Regulatory Agreement ensuring that the property remains affordable. Interestingly, therefore, in addition to

DHCD, municipalities, and other governmental entities, there is the possibility that the ***DHCD could designate its rights to the private sector***, which could present a stack of opportunities for well-managed developers, management companies, and, of course, distressed asset investment funds.

The purchase right.

The right of first refusal operates as such a provision usually does, in that DHCD would be obligated to purchase the property at its market rate value, and on terms embodied in an arms-length agreement that the owner struck with a legitimate third-party buyer. The only significant variations from the purchase agreement that DHCD can make is to (a) limit the earnest money to a maximum of \$250,000, (b) make the earnest money non-refundable after a 90 day due-diligence period, and (c) to give DHCD or its designee at least 240 days to close.

The Loan Fund

The new law appears to provide a framework, and a procedure that can help sellers receive a market rate value for their publicly subsidized affordable housing, which was clearly a stumbling block to prior affordable housing preservation efforts. The \$150 million preservation loan fund will then act as the pool of money that DHCD, or its designee, can use to purchase these properties. Seemingly, this statute is well thought out, and the practical application of the procedure, which even includes financing, has now been made available to preserve thousands of units of housing that might have been lost to the affordable stock and become part of an already bloated, overpriced, and overburdened supply of market-rate housing, while creating the possibility of profit generation for the private sector.

This is the type of legislation that excites me, because I am sure we can engineer and structure some socially positive and profitable deals using these tools.

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