Rural Development Section 515 Maturing Mortgages
Minnesota as a Canary in the Coal Mine

A Report from the Housing Justice Center
And HOME Line

The Problem Prompting This Survey

The Section 515 Rural Rental Housing Program, administered by Rural Development (RD) is facing a looming threat. Over the next ten years, three quarters of RD's 440,000 apartments under the Section 515 program will reach the point where the RD mortgage matures.[1] With mortgage maturity comes the end of program involvement and most importantly, the end of Rental Assistance (RA). The RA subsidy is the lifeline that makes rents affordable for the many extremely low income households residing in Section 515 projects. Approximately 60% of residents rely on RA to make ends meet.

This problem starts slowly and builds rapidly. Nationally, 60 projects mature this year, but by 2019 that number increases to 1,152 projects with 33,574 units. Tenants in nearly half those units (14,924) rely on RA payments.[2]

When the Section 515 mortgage ends and RA terminates, there is no subsidy to replace the RA.[3] The resulting gap, often quite large, would have to be met through huge rent increases to tenants, project owners absorbing the lost rental income, or some combination of the two. In many cases, the gap will be large enough that neither approach will be financially feasible. Without some safety net, low income tenants, many of them elderly and disabled, will be displaced from their homes into communities with few alternatives. Many owners will face the prospect of project default on non-RD financing because their communities will lack tenants who can afford to pay an unsubsidized rent.

Minnesota was one of the first states to construct Section 515 projects in significant numbers, and is one of the first states now facing mortgage maturity. In fact, it has already started, with the first maturing mortgages occurring in 2015. We felt it would be instructive to know what plans owners of early maturing mortgage projects had to address the loss of RA (if any).

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[1] "RD Mortgage Maturities Threaten Hundreds of Thousands of Residents," National Housing Law Bulletin, Volume 45 (1-1-15), p. 12. These numbers continue to evolve as RD refines its data.

[2] Attachment to email from David Howard, Office of Congressional Relations—USDA, to US Senator Jeff Merkley (Dec. 1, 2014).

[3] Loss of RA is only the largest of several adverse consequences when mortgages mature. Interest credit subsidies and utility allowances also end.

Minnesota projects surveyed

According to data obtained from a Freedom of Information Act (FOIA) request, twenty RD projects in Minnesota were scheduled to reach mortgage maturity in 2015 and 2016. Those 20 projects cover 320 units, 161 of which have been covered by RA subsidies. A few of these projects have been preserved, by means of re-amortizing or extending the RD mortgage, thus extending the RA as well.[4]

This left 16 projects, of which 13 owners or managers responded through the survey. The list of projects is attached at the end. The survey was conducted by HPP and HOME Line in late 2014/early 2015.

Survey results

Generally speaking, the owners or managers we talked to were aware of the impending maturity of their mortgages, and that it would mean the end of RA. Knowledge about options to address the loss of RA varied widely however. Not surprisingly, the more sophisticated owners and the professional management companies had a good sense of options available to them to mitigate the loss of RA (though not in all cases). Knowledge was much more lacking in the case of several elderly owners of single, often small projects, including elderly widows who had reluctantly inherited responsibility for a Section 515 project. There was also a lack of knowledge, and resources, in the case of several community based nonprofit boards composed of very elderly board members who were generally not very engaged with these projects anymore.

Virtually all the respondents were quite alarmed about the impending loss of RA. Owners (or Managers) thought that some of the tenants could probably handle the increased rent because their RA subsidy was shallow, but most of the projects had many tenants relying on large RA payments. In those cases the loss of RA would mean either huge rent increases which would likely displace many tenants or a loss of project revenue that would threaten the financial viability of the project. Many of the at-risk tenants are elderly, even in general occupancy buildings. It is not clear at this point how well this threat is understood by the tenants who will be affected. It is only very recently that the agency has put in place a process to inform tenants of impending mortgage maturity, and the consequences.

The two most common responses owners were planning on were getting their residents on waitlists for section 8 vouchers, and prepaying mortgages prior to maturity in order to access RD vouchers. Both strategies have drawbacks.

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[4] This has generally only been possible where the project was deemed a high priority for preservation and was receiving third party funds. The good news is that the RD has recently broadened the use of this tool—see last page of this report.

Accessing Section 8 vouchers

Of the survey respondents, almost half were hoping to rely on accessing Section 8 vouchers for their residents. The appeal of this strategy is obvious; a Section 8 voucher subsidy is comparable to that provided by RA (the key difference being the Section 8 voucher is portable). However, replacing RA with section 8 vouchers is far from an ideal solution. First, the ability to obtain a Section 8 voucher in a timely fashion will vary greatly by locality. The length of waiting lists will vary greatly, as will local priorities for placement on the waitlist. In the case of two of the projects involved in the survey, there was no Section 8 voucher program serving their county. Second, as the number of mortgage maturing properties begins to escalate in coming years, accessing Section 8 vouchers will become more and more difficult. The number of available vouchers in rural areas is unlikely to significantly increase, while owners will urge more and more RD residents to crowd onto these ever growing waiting lists. Finally, and most importantly, this solution simply means cannibalizing precious housing subsidies intended to serve other needy low income households. There are already not enough Section 8 vouchers to serve the needs of low income households in rural areas, and asking the Section 8 voucher program to solve the loss of RD's Rental Assistance will only compound that shortfall.

Prepaying Mortgages Prior to Maturity

Some of the owners were planning on another strategy to replace the anticipated loss of RA: prepaying their mortgages just prior to the point the mortgage would mature. The reason to do this is that the residents then become eligible for RD vouchers. This strategy also has its limitations, however.

First, not all owners are eligible to prepay their mortgages. For example, owners who sued USDA in the Court of Claims over prepayment restrictions obtained monetary settlements but in the process gave up their right to prepay. Minnesota has a large share of such owners, including two of the respondents in the survey. Second, the significant number of "paid ahead" loans has confounded the use of this strategy. Paid ahead loans involve a variety of situations where RD loan payments end up being completed prior to the original maturity date of the loan. One of the survey respondents was quite surprised to recently learn, on very short notice, that her loan payments had been completed and RA payments were terminating almost immediately, and well over a year before the mortgage would reach its maturity date. RD has announced recent efforts to fix this problem by re-amoritizing paid ahead loans so payments are not completed prior to the original maturity date, but ambiguities in RD's new guidance raise questions over whether this problem is fully solved.

Third, not all eligible owners will be able to take advantage of this option. Over half the respondents we talked to were unaware of prepayment as an option to access RD vouchers. RD is willing to explain the process to owners who inquire, but the agency has been reluctant to reach out and offer this option as a solution to the loss of RA. In addition, many of the smaller and less sophisticated owners view the prepayment process as way too daunting in its complexity and administrative burden. Finally, on an ironic note, some of the protections states enacted to protect against the loss of RD projects through the prepayment process are now becoming hurdles to accessing RD vouchers. In Minnesota, RD owners must provide a one year notice of intent to prepay their mortgage under state law. Since RD has a regulation requiring that owners applying to prepay the mortgage comply with all relevant provisions of state law, RD will not approve a prepayment without a year having passed following issuance of the notice. This timing problem effectively rules out compliance with the one year notice for about half the surveyed properties. The State RD Office has received no guidance from the National Office on whether it could waive this year notice requirement in this situation.

Fourth, RD vouchers are not an adequate replacement for RA. Among other drawbacks, and unlike RA, the voucher subsidy will not increase if the rent is increased or if the tenant household's income drops. Over time, these RD vouchers will provide significantly less protection than continued RA would have provided.

Next Wave of Maturing Mortgages in MN

Data recently obtained through a FOIA request documents mortgages scheduled to mature in Minnesota between 2017 and 2019. The results are as follows:

2017	25 projects	365 units	235 units of RA	
2018	8 projects	123 units	53 units of RA	
2019	5 projects	52 units	5 units of RA	
Totals 2015-2019		64 projects	979 units	476 units of RA[5]

These totals peak in 2017 and then decline dramatically over the next two years, but long term the trend will continue to escalate both in Minnesota and around the country. A separate analysis conducted by the Minnesota Housing Finance Agency finds that by 2020, 75 Minnesota projects with 1097 units will reach maturity, or 13% of RD mortgages. The other striking fact from the 2017-2019 data is that of the 38 projects in that group, in 26 cases the loan was scheduled to be paid off prior to the original maturity date due to early payoffs, meaning that it will be critical for the agency to move those termination dates back to the original maturity date.

Recent RD Actions

Recently, RD took administrative action to address the mortgage maturity problem.[6] Borrowers facing maturity will now be encouraged to either re-amortize and extend their loan up to 20 years, apply for debt deferral under the Multi-Family Preservation and Restructuring program (MPR), or apply to prepay the mortgage prior to maturity, in order to access RD Vouchers. If implemented successfully, these actions could effectively extend RA in many cases. There will

[5] Minor discrepancies between the data provided in the 2 FOIA requests accounts for some changes in the totals.
[6] "Management of Loan Payoffs in Multi-Family Housing Properties," Unnumbered letter, 4-28-15.

still be owners, however, who will be unable or unwilling to take any of these actions. In those cases, it will be important that Congress extend eligibility for RD vouchers to mortgage maturities. RD is reportedly seeking this change in the 2016 Appropriations Act.

Conclusion

The early Minnesota experience suggests that the impending loss of RA has project owners quite concerned. No doubt tenants will be also, once they are fully informed of the problem. The two main strategies owners are currently looking to, getting their tenants on Section 8 voucher waitlists and prepaying mortgages prior to maturity to access RD vouchers, both have numerous and serious drawbacks. Given the fact that the number of mortgages maturing will rapidly escalate in coming years, the drawbacks to these strategies will become even more apparent. Recent administrative initiatives by RD to extend mortgages and RA are promising, but will require close watching. It is not yet clear that the scale of these initiatives will match the scale of the mortgage maturity trends.

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