

# **AFFORDABLE HOUSING IN THE RURAL SOUTH: NORTH CAROLINA STRUGGLES WITH RISING POVERTY**

Report of a Workshop<sup>?</sup> Sponsored by  
National Affordable Housing Preservation Associates, Inc.  
Raleigh, North Carolina  
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Preservation of federally-assisted affordable housing in rural North Carolina is confronted by a series of profound economic and institutional challenges: a rural workforce strapped with rising and in many cases chronic unemployment, an aging multi-

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<sup>?</sup> On Tuesday, June, 24, 2003, in Raleigh, North Carolina, in cooperation with the North Carolina state office of the U. S. Department of Agriculture's Rural Housing Service, the North Carolina Housing Finance Agency (NCHFA), and the North Carolina Rural Economic Development Center (NCREDC), National Affordable Housing Preservation Associates, Inc., (NAHPA) hosted a one-day workshop to examine the present state of USDA/RHS affordable housing in North Carolina and elsewhere in rural and small town America and explore various alternative financing strategies for preserving this housing.

The workshop was funded by a grant from the U.S. Department of Housing and Urban Development, through the auspices of the NHT/Enterprise Corporation, a non-profit joint venture of the National Housing Trust of Washington, DC, and the Enterprise Foundation of Columbia, MD.

Awarded pursuant to Section 4 of the HUD Demonstration Act of 1993, the NHT/Enterprise grant will build NAHPA's capacity to promote various alternative financing strategies to preserve rural affordable housing. In addition to exploring numerous financing alternatives, the Raleigh workshop provided an opportunity for owners of USDA Section 515 properties to meet with prospective for-profit and non-profit purchasers of rural affordable housing and with NAHPA officials and other local third-party intermediaries providing assistance in facilitating these property transfers.

Attendees at the workshop included senior USDA/RHS, NCHFA, and NCREDC officials, USDA Section 515 affordable housing property owners, and representatives of several North Carolina organizations actively involved in rural affordable housing finance and preservation.

Workshop panelists included USDA/RHS officials from the Washington national headquarters and the Raleigh, North Carolina-based state office, senior NCHFA and NCREDC representatives, a tax accountant experienced in affordable housing finance, officials with several local North Carolina organizations involved with affordable housing preservation, a NAHPA board member and official with a national affordable housing intermediary, and a representative of a national faith-based affordable housing preservation group. The workshop was moderated by a local North Carolina affordable housing consultant.

This report is based on presentations at the workshop and discussions (including post-workshop conversations) with participants, attendees, and other USDA Section 515 affordable housing professionals. See Attachments A and B, respectively, for a list of workshop participants and attendees.

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family housing portfolio which federal and state officials predict will spawn a torrent of pre-payment requests by property owners eager to leave the federally-assisted housing marketplace, the lack of an active private-sector non-profit community with the financial muscle and institutional wherewithal to acquire and manage low-income properties, persistent local government opposition to affordable housing, and, most critically, the nation's second-lowest level of federal rural rental assistance.

Against this backdrop, federal and state officials are working creatively to preserve North Carolina's large USDA Section 515 multi-family housing stock. State officials are exploring options to use the state's untapped economic development bonding authority to finance the acquisition by non-profit organizations of large Section 515 housing portfolios, while federal and state USDA managers are countering a growing pre-payment trend by offering Section 515 property owners greater rates of return and new equity loans and calling their counterparts in other states in search of excess rural rental assistance which can be transferred to North Carolina.

## **History**

Since the early 1960s, the U.S. Department of Agriculture's Section 515 housing program has been the federal government's principal financial assistance program for rural and small town multi-family housing serving low-income individuals and families. Property owners participating in the Section 515 program are eligible for below-market mortgage financing and ongoing rental assistance in exchange for long-term commitments to retain units for lower-income residents. According to the most recent USDA data, nearly 460,000 apartment units in more than 16,500 multi-family housing properties currently participate in the Section 515 mortgage program. Combined, these properties have an outstanding loan principal of nearly \$12 billion.

Of these roughly 16,500 properties, most are small, averaging about 27 units per property. Residents are generally elderly and predominantly female. Many are handicapped or otherwise disabled. More than a quarter are minorities, an unusually high percentage for rural areas. Average income per household is roughly \$8,100, about 30 percent of national rural median income.

Approximately three-fourths of all Section 515 tenants receive some type of federal rental assistance, principally under USDA's Section 521 rental assistance program, although some Section 515 property owners also participate in the U.S. Department of Housing and Urban Development's Section 8 rent subsidy program. In addition to federal rental assistance, more than 70 percent of Section 515 tenants receive some other form of regular federal or state income supplement.

## **Current Status of USDA Section 515 Program**

Properties participating in the USDA Section 515 affordable housing program are aging, often deteriorating, and generally lack the financial reserves necessary to ensure long-term maintenance and rehabilitation. Most Section 515 buildings are approaching

old age; certainly most have passed their prime. More than a quarter of all properties are 20 or more years old; nearly three-fourths are more than 15 years old and at the stage of their lives where owners are beginning to encounter significant renovation expenses. Although most properties are structurally sound, they are increasingly in need of new roofs, updated heating and cooling systems, upgrades to meet new building code requirements, and other life-cycle replacements and improvements.

Like many of the properties it finances, USDA's Section 515 program also is past its prime. The peak funding decades of the 1970s and 80s – what USDA managers call the “boom years” – are history, and Congress has shown little inclination to provide the type of rehabilitation financing or rental assistance necessary to allow property owners to properly maintain the Section 515 affordable housing portfolio. Of roughly \$150 to \$200 million in estimated annual rehabilitation needs, USDA has only about \$50 million available.

Similarly, although USDA offers Section 515 property owners new low-interest equity loans in exchange for their agreement to remain in the program for a designated term of years, appropriations for new equity financing also have declined in recent years. At the present time, USDA officials estimate that private for-profit and non-profit developers supply the rural affordable housing marketplace with between \$10 and \$15 million in new equity capital annually, double or triple the roughly \$5 million available from USDA in the current federal budget.

What remains are thousands of under-financed, poorly maintained low-income properties owned by investors no longer willing or able to properly care for them. In many cases, distant third-party investors have exhausted the once-attractive tax benefits of Section 515 property ownership and are now faced with paying taxes on phantom income. In other instances, owners are eligible to pre-pay their USDA mortgages and leave the low-income rental marketplace.

Nationally, about 100 Section 515 properties leave the USDA program each year. Of these, USDA estimates that half no longer serve a low-income tenant market or are not considered sufficiently economically viable to justify continued USDA funding. Owners of the other half, those affordable housing properties USDA managers are most eager to retain, generally leave for economic reasons, either through sale of their buildings to non-Section 515 participating owners or because they believe they can rent units at market rates. In some cases, USDA managers convince these property owners to accept financial inducements in exchange for a commitment to remain in the program until their current low-income tenants leave, either voluntarily or through death. Overall, because USDA is not writing 100 new Section 515 contracts per year, the program continues to shrink.

Agency officials estimate that roughly 11,000 separate multi-family housing properties – developments totaling about 300,000 apartment units – currently are at risk of sale or removal from the Section 515 program. In some cases, these properties may be converted to market-rate housing, making them unaffordable to most low-income tenants.

In other instances, owners without for-profit sales opportunities – and no longer benefiting from lucrative federal tax advantages – may allow properties to further fall into disrepair. Either outcome threatens the nation’s low-income rural rental housing stock.

### **Plummeting Federal Outlays**

Declining federal funding poses the most significant threat to the future of the USDA Section 515 affordable housing program. Indeed, USDA officials consider themselves fortunate to stay even budget year to budget year, and senior managers continue to worry about rescissions, especially given mounting budget pressures and a ballooning federal deficit. Currently, only one-quarter to one-third of average annual Section 515 housing rehabilitation needs are met by USDA lending, and private lenders generally make two to three times as much equity capital available every year as the federal government.

Rental assistance is by far the largest USDA Rural Housing Service budget item, totaling about \$740 million in the most recently submitted federal budget. Overall, three-fourths of all Section 515 property owners receive some form of federal rental assistance, including a few who participate in HUD’s Section 8 program. Owners participating in USDA’s Section 521 rental assistance program sign renewable five-year commitments, while those with HUD Section 8 contracts depend on annual funding. Of the total available USDA rental assistance, about 98 percent covers current contracts, leaving very few dollars for new rental assistance agreements with either existing Section 515 property owners currently not participating in the program or for newly constructed rural rental housing.

### **The Looming Pre-Payment Crisis**

The most challenging quandary facing rural affordable housing administrators is how to stem what is expected to become a growing tide of pre-payment requests in the face of this steep decline in federal outlays for rural rental assistance and other financial incentives needed to keep property owners in the Section 515 program. Although the pre-payment problem is exacerbated by several additional factors, including a growing number of owners considering property sales as they near their own retirement or undertake estate planning, at its core the crisis stems from sharply declining federal support for rural housing programs.

Owners’ decisions to pre-pay their Section 515 mortgages and withdraw from the USDA affordable housing program also are commonly motivated by rising land values, particularly along both coasts. There, unlike in the country’s heartland, land values have created significant equity for property owners, often compelling pre-payment by those owners keen on serving a higher-income tenant base or converting properties to non-housing uses. For USDA managers eager to retain low-income Section 515 properties in the midst of an overall rising rental marketplace, higher land values translate into the need to finance larger equity mortgages. Overall, USDA equity loans – all of which come

with new minimum 20 year program restrictions – average about \$450,000 per property (roughly \$17,000 per unit), although along the coasts and in certain recreational areas of the country these mortgages are significantly higher.

USDA had few requests for pre-payment during years when it had adequate rental assistance available to support tenant rents. Similarly, the agency believes many owners could be enticed to remain in the Section 515 program if Congress appropriated sufficient funds for new equity mortgages and rehabilitation loans. In most cases, USDA managers believe that leveraging federal dollars by encouraging owners to stay in the Section 515 program in exchange for take-out equity and rehabilitation financing is the preferred solution to the potential loss of low-income rural rental housing.

### **Franconia Associates, et al. v. United States**

A recent U.S. Supreme Court decision may accelerate an already escalating pre-payment trend. Prior to 1979, Section 515 borrowers were permitted to pre-pay their USDA mortgages without limitation. In 1988, in an effort to stem the loss of low-income rural housing caused in part by a growing number of Section 515 loan pre-payments, Congress imposed restrictions on pre-payments by pre-1979 borrowers. Several hundred Section 515 borrowers sued the federal government in 1997 for breach of contract under terms of their pre-1979 loans. Plaintiffs alleged that the promissory notes governing their Section 515 loans guaranteed them an unfettered right to pre-pay at any time and thereby gain release from the USDA program and the restrictions it places on a participating owner's rental housing property.

Relying on a federal statute requiring claims against the United States to be filed “within six years after such claim first accrues” (in this case by 1994), lower courts dismissed the actions as untimely filed. On June 10, 2002, the Supreme Court ruled unanimously that Congress's 1988 action limiting Section 515 property owner's pre-payment rights constituted a repudiation of the parties' bargain, not a present breach of the loan agreement. Thus, breach will occur – and the six-year statutory limitation period will commence to run – only after a borrower tenders pre-payment and the federal government dishonors its obligation to accept the pre-payment and release its control over use of the property that secured the loan. The Court's ruling in *Franconia Associates, et al. v. United States* also permits those Section 515 borrowers whose previous attempts at pre-payment were rebuffed by USDA to sue for damages, which plaintiffs predict could exceed \$800,000 per effected property.

### **Exit Strategies**

In many cases, owners of Section 515 properties – particularly limited partner investors looking to escape tax liabilities on phantom income – enjoy few attractive exit strategies. Sale to a property's general partner commonly triggers both capital gains and recapture taxes on previous depreciation deductions. Moreover, since many Section 515 properties have little or no equity – either due to declining property values, excessive deferred maintenance, or both – property sales generally produce little or no free cash to cover these various exit taxes. Nonetheless, the prospect of paying taxes on phantom

income often forces limited partner investors to sell and suffer a one-time tax hit on the property's negative capital account.

Resyndication poses similar obstacles. Internal Revenue Service rules restrict ownership changes during a syndicate's early years and impose additional limitations on relative ownership percentages which can effect the ability of some limited partners to either remain in or leave the ownership group. Although application of the various syndication rules is at times excruciatingly complex, in general, no more than ten percent of a previous investment syndicate may participate in a new, restructured affordable housing ownership group.

Internal disputes between a syndicate's general partner and its many limited partners also may arise over the parties' competing financial interests. Limited partners, who typically own 95 percent or more of an investment group, are attracted by the tax advantages associated with Section 515 property ownership. Once these advantages are exhausted and individual investors face the prospect of paying taxes on phantom income, many limited partners seek a way out. For their part, general partners collect substantial up-front fees for putting syndicates together and, importantly, ongoing payments for administering the investment group and managing its various properties. Even in cases where limited partners are angling to leave, general partners may resist property sales and the attendant loss of this lucrative management income.

At other times, motivations may be inverted; general partners may face an uphill battle convincing far-flung limited partners to sell. Often, these limited partners are unfamiliar with the USDA Section 515 program and have inflated notions of a particular property's value. Brought into these limited partnerships – principally for the tax advantages – by investment advisors years ago, they resist selling their interests for less than what they believe they are worth, regardless of current market valuations and other constraints imposed on them by the USDA program.

Another exit strategy considered by some investment syndicates involves gifting a Section 515 property to a non-profit organization. In these cases, the non-profit assumes the outstanding debt on the property. Although the investment group realizes a capital gain on the difference between the property's appraised value and its investment basis, the taxable amount, if any, will be reduced by the excess of the property's fair market value above the debt assumed by the non-profit receiver since IRS qualifies this excess as a charitable contribution.

### **North Carolina's Section 515 Program**

On a population-adjusted basis, North Carolina is by far the nation's leading participant in the USDA Section 515 affordable housing program; only California, a state with more than four-times North Carolina's population, exceeds (and even then only slightly) the Tar Heel state's more than \$600 million in outstanding Section 515 mortgage debt. With 617 Section 515 properties – accounting for nearly 25,000 affordable housing units – North Carolina places at or near the top of every USDA

Section 515 statistical category except one – rural rental assistance – and here the state ranks second to last.

In large measure, it is this scarcity of rural rental assistance that puts the squeeze on North Carolina's Section 515 program. Not only does the lack of sufficient rental assistance prevent many owners from earning adequate rates of return on their investments, it discourages them from incurring additional debt to rehabilitate existing low-income properties, and, most adversely, leads many to seek an early exit from the USDA program.

Moreover, the lack of adequate rural rental assistance – the life blood of the Section 515 program – cripples the state's Section 515 acquisition market; few organizations, including leading national non-profit groups active in the affordable housing preservation marketplace, are willing to invest their increasingly scarce resources in Section 515 acquisitions unless they are assured of a revenue stream sufficient to service the increased mortgage debt. Although USDA officials say they were able to adequately fund all current rental assistance recipients this year – in some cases by “borrowing” rental assistance credits from other states – they concede that the long-term preservation of North Carolina's existing Section 515 housing stock will require significantly increased federal rental subsidies.

Faced with declining federal support for rural affordable housing programs, North Carolina's USDA office is preparing for an expected onslaught of Section 515 mortgage pre-payment requests in the next several years. The average North Carolina Section 515 property is 17-plus years old. Although USDA officials have only ten pre-payment applications in hand at the current time, they anticipate seeing ten times that number annually in three to five years. Overall, owners of more than two-thirds of all Section 515 properties – roughly 400 developments containing about 16,000 low-income apartment units – are expected to apply for pre-payment by the end of the decade.

### **Growing Population of Rural Poor**

North Carolina faces a mini-population boom; statewide, the number of residents has increased by more than twenty percent in the last decade. And, unlike the experience of many states whose rural population has declined during this period, North Carolina's rural areas have experienced an almost eighteen percent population increase. According to the North Carolina Rural Economic Development Center, a Raleigh-based research and information clearinghouse, these increases are driven principally by an influx of out-of-state retirees and a surge among Hispanic immigrants.

In a worrisome trend, statewide poverty rates have kept pace with these population increases. While much of the nation – including North Carolina's three major metropolitan areas – experienced strong economic growth during the decade of the 1990's, the number of North Carolina residents living in poverty fell by only about one percent during this period and remains at a stubbornly high statewide rate of more than twelve percent. Poverty rates are particularly acute in the state's rural areas, where nearly

140,000 workers were unemployed as of mid-2003 and several rural counties currently experience unemployment rates in excess of ten percent.

The continuing loss of thousands of high-paying manufacturing jobs – many of them in rural areas – is likely to push many additional thousands of families below the poverty line, a new economic reality for tens of thousands of displaced factory workers who have seen their wages decline by almost fifty percent in the last three years. Overall, state officials say the North Carolina economy is the weakest it has been in more than three decades, a statewide crisis which imposes particular hardships on residents of the state's eighty-two rural counties.

### **Local Opposition to Affordable Housing**

North Carolina faces another obstacle in efforts to preserve rural affordable housing: opposition by local governments to increased rural rental assistance based on a fear of unwanted low-income residents in their communities. During the peak period of Section 515 affordable housing development in the 1970's and 80's, many local governments successfully opposed applications by property owners for USDA rental assistance. Even today, preservation activists often encounter stiff opposition from local leaders when they apply for new or increased rental assistance to cover costs associated with the acquisition and rehabilitation of Section 515 housing.

Federal and North Carolina state housing officials are in a quandary. Although they concede that it makes little sense for local governments to oppose applications for federal rural rental assistance – especially given the state's large and growing number of rural poor families – they also know that any successful affordable housing preservation strategy will require increased revenue to cover increased property expenses. And, with real wages in rural North Carolina continuing to decline – and with them the ability of tenants to pay higher rents – the only commonsense source of additional cash flow is from increased rental assistance.

### **Few Homegrown Non-Profits**

State housing finance agency officials also admit to some unease over the ability of the state's non-profit community to fill the void created by the continuing exit of for-profit developers and syndicators from the Section 515 marketplace. North Carolina has not followed the lead of several states which have created and funded separate non-profit housing entities to acquire and manage low-income properties; and state officials readily acknowledge that more needs to be done to educate local non-profits about the growing need – and the exceptional opportunities – for preservation of the state's USDA Section 515 housing stock. Interestingly, the state's much-acclaimed university system recently created a separate non-profit entity to manage revenue generated from the sale of state-wide education bonds to build new and rehabilitate old university dormitories.

Efforts by local North Carolina-based non-profits to preserve rural affordable housing are likely to be augmented by well-funded out-of-state organizations committed

to the preservation of USDA-mortgaged low-income properties, including such large national faith-based groups as Mercy Housing, Volunteers of America, and National Church Residences. While North Carolina officials concede that smaller, locally-based non-profits enjoy a unique knowledge of a property's community – and appear well-suited for smaller acquisitions – they believe that larger, national entities are more likely to have the financial wherewithal and managerial skill essential to successfully conclude the type of portfolio-sized Section 515 transactions USDA managers forecast will become increasingly commonplace.

## **Creative Financing Alternatives**

### **I. Secondary Mortgage Market**

To overcome this paucity of financing, National Affordable Housing Preservation Associates (NAHPA) cooperated with USDA managers and secondary mortgage market officials to pursue development of an alternative financing method for Section 515 owners eager to sell or refinance and rehabilitate their properties. Faced with steadily declining direct federal budgetary support for rural rental housing, USDA managers view the development of a market-driven financing model acceptable to private lenders and the mortgage investment community as a way to both streamline the current transfer process and, most importantly, bring secondary mortgage market capital to many thousands of at-risk Section 515 properties.

Under the financing model promoted by NAHPA, USDA has agreed to subordinate existing federal mortgage debt, allowing new first mortgagees to bundle acquisition and rehabilitation loans for sale on the secondary mortgage market. USDA also has agreed to maintain interest rates on the assumed Section 515 debt at one percent, to extend the loan term, and, in some cases, to forgive a portion of the outstanding principal. By accepting a second mortgage position and offering property owners substantial interest rate and principal concessions, USDA hopes to leverage its limited operating budget into many times that amount in permanent private-sector financing to preserve rural and small town affordable housing.

New first mortgages will originate with Fannie Mae-approved Delegated Underwriting and Servicing (DUS) lenders, who will service the loans and refinance the long-term debt on the secondary mortgage market. Local USDA managers will oversee property rehabilitation, where necessary, and allow borrowers to set aside escrows for property taxes and insurance. The first transaction financed under the Fannie Mae-DUS model – the sale of a USDA Section 515 property in upstate New York to Volunteers of America – is in the mid-processing stage and should be finalized by the end of 2003.

As with most sales of smaller, lower-valued properties, transaction expenses for various pre-closing services, including legal and accounting fees, often dictate that Section 515 properties be combined for purposes of sales and/or rehabilitation financing. Often, these transaction costs make otherwise attractive preservation options prohibitively expensive. Nationwide, average Section 515 property indebtedness is

roughly \$675,000 per multi-family project, while average new equity financing is about \$450,000 per property (roughly \$17,000 per unit). With average soft costs for various due diligence, legal, and accounting services in the \$50,000-plus per transaction range, sales of larger rural affordable housing portfolios clearly is the preferred alternative.

## **II. Low-Income Housing Tax Credits**

High transaction costs may be particularly problematic in purchases partially financed by the sale of Low Income Housing Tax Credits (LIHTC) allocated to the states by the U.S. Department of the Treasury. Although some USDA managers and state housing finance agency officials believe they could spend “full time closing tax credits deals,” tax experts caution that LIHTC financing may have limited applicability for non-portfolio sized Section 515 purchases in part because of the high transaction fees involved compared to the relatively low property valuations of individual rural affordable housing properties.

The scarcity of tax credits and pressure within state housing finance agencies to use them to fund significantly more expensive urban housing also may serve to limit their availability for Section 515 property preservation. Nonetheless, North Carolina Housing Finance Agency (NCHFA) officials are actively exploring the possibility of using tax credit financing for the construction of new Section 515 properties. While some affordable housing experts have questioned the use of tax credit financing due to the generally small scale of most Section 515 developments, North Carolina officials believe that LIHTC financing may play an important role in funding larger, portfolio-sized rural housing developments.

## **III. Bond Financing**

Such constraints apply to an even greater degree to the sale of state-backed bonds to finance Section 515 affordable housing preservation. Substantial legal and accounting fees dictate that bond financing be used exclusively for larger portfolio purchases. However, as with LIHTC financing, bond sales may be an attractive Section 515 preservation alternative, particularly in cases where a non-profit organization is consolidating a group of USDA properties into a larger portfolio sale.

North Carolina Housing Finance Agency (NCHFA) officials are particularly keen on the prospects for using the state’s untapped economic development bonding authority to finance the acquisition by non-profit organizations of large portfolios of Section 515 multi-family housing properties. Due to the current economic downturn, North Carolina has between \$50 and \$100 million in untapped bonding authority. Although historically reluctant to issue statewide housing bonds, NCHFA directors recently asked a private property management company to assist the agency in compiling likely pools of USDA Section 515 properties for possible purchase by non-profit organizations using state-issued affordable housing bonds.

North Carolina's possible issuance of statewide housing bonds is driven in part by the over-subscription of the LIHTC program and in part by historically low interest rates. Although NCHFA officials recognize that low interest rates generally reduce the spread between taxable and non-taxable instruments and may therefore make tax-free issuances somewhat less attractive to investors, they also see the current cheap money environment as a rare opportunity to finance low-income housing preservation at bargain basement rates. If the state pursues this financing option, NCHFA officials believe the various fees associated with bond financing would require the minimum size of any single Section 515 transaction to be in the \$8-plus million range.

As with other North Carolina Section 515 preservation strategies, bond financing also is constrained by a scarcity of USDA rural rental assistance. As such, NCHFA officials are expected to combine Section 515 properties into portfolios which maximize cash flow, either through increased rents, adequate (or in some cases increased) rental assistance, or both. One advantage of issuing statewide housing bonds – something North Carolina has avoided since 1986, when a federal tax overhaul led to so many unanticipated bond defaults – is that the state would be able to group together Section 515 properties from different counties, a practice prohibited under conventional local housing authority bonding rules.

#### **IV. Conversion to HUD-Insured Financing**

One local North Carolina developer has successfully refinanced more than a dozen USDA Section 515 properties with mortgages insured under the U.S. Department of Housing and Urban Development's Section 223(f) multi-family housing program. In each case, Community Management Corporation (CMC), a for-profit developer based in Winston-Salem, prepaid the USDA Section 515 mortgage and placed new HUD-insured debt on the property. According to a CMC official, HUD rules permit property owners to earn a rate of return greater than what USDA allows, something of particular appeal to limited partners currently participating in Section 515 investment syndicates.

Although this financing switch may provide an attractive alternative for some Section 515 owners – particularly limited partners in syndicated developments – the properties converted by CMC have unique characteristics which may limit the usefulness of this particular preservation strategy. In each case, the converted Section 515 properties were exempt from USDA prepayment restrictions and, significantly, were covered by long-term "project-based" HUD Section 8 rental assistance contracts.

#### **Future Challenges**

The central challenge facing local USDA managers is to preserve as affordable housing as many Section 515 properties as possible, either through direct federal intervention or by facilitating the sale of properties to groups committed to managing them under the USDA program umbrella. That task, problematic in any event, will be made all the more difficult by historic declines in federal and state support for affordable

housing programs and, equally worrisome, by one of the weakest overall private-sector financial and investment markets in recent memory.

For USDA managers, the objective is to better read the housing tea leaves. In some cases agency officials may encourage property consolidation to offset current or forecast excess rental capacity or, if buildings are either too badly deteriorated or no longer serving a low-income rental market, allow properties to leave the Section 515 program. In many other instances it is likely that USDA managers will conclude that currently at-risk properties will become economically viable if they are refinanced and rehabilitated.

While unrelenting budget pressures doubtless will limit these policy choices, USDA officials believe it would be foolish to abandon admittedly marginal properties now if long-range forecasts show a need for more affordable housing units in the future. This is particularly true in North Carolina, where demographic trends reveal a growing need for low-income rural housing. Taking the long view, federal and state housing officials question budget cutbacks which may result in the loss of a significant portion of the Section 515 affordable housing portfolio, shortsighted policies they predict will cost governments at all levels considerably more down the road.

The paucity of public funding for rural affordable housing is having one unintended positive result: it is forcing USDA managers to think evermore creatively about alternative preservation arrangements. The Fannie Mae-DUS model developed with NAHPA's assistance is an example of an alternative financing scheme USDA managers hope will lead to a significant infusion of private-sector capital into the rural low-income housing marketplace.

Although in the end only a significant increase in federal funding for rural affordable housing programs – including rural rental assistance, rehabilitation, and take-out equity financing – is likely to result in the preservation of many border-line USDA Section 515 properties, creative intervention by non-profit groups dedicated to rural low-income housing preservation is likely to play an increasingly important role in successfully responding to this impending rural affordable housing crisis.