

RURAL AFFORDABLE HOUSING IN AMERICA'S HEARTLAND: THE WISCONSIN EXPERIENCE

Report of a Workshop[?] Sponsored by
National Affordable Housing Preservation Associates, Inc.
Madison, Wisconsin
March 24, 2003

Rural affordable housing in Wisconsin faces an uncertain future. Although in general properties are reported to be well maintained and to have retained their valuations, the state's rural low-income multi-family housing marketplace is not immune to forces currently buffeting such housing throughout the United States: higher than

[?] On Monday, March, 24, 2003, in Madison, Wisconsin, in cooperation with the Wisconsin state office of the U. S. Department of Agriculture's Rural Housing Service, and the Wisconsin Housing and Economic Development Authority (WHEDA), National Affordable Housing Preservation Associates, Inc., (NAHPA) hosted a one-day workshop to examine the present state of USDA/RHS affordable housing in Wisconsin 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 Madison 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 recent workshop included senior USDA/RHS and WHEDA officials, USDA Section 515 affordable housing property owners, and representatives of several Wisconsin organizations actively involved in rural affordable housing finance and preservation.

Workshop panelists included USDA/RHS officials from the Washington national headquarters and the Stevens Point, Wisconsin-based state office, a senior WHEDA representative, a tax accountant experienced in affordable housing finance, officials with several local Wisconsin organizations involved with affordable housing preservation, and two representatives of sellers of USDA/RHS affordable housing. The workshop was moderated by a NAHPA director.

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.

The work that provided the basis for this publication was supported by funding under an award with the U.S. Department of Housing and Urban Development. The substance and findings of the work are dedicated to the public. The author and publisher are solely responsible for the accuracy of the statements and interpretations contained in this publication. Such interpretations do not necessarily reflect the views of HUD.

expected vacancy rates, a projected long-term stagnant or in some cases declining population base, decisions by would-be elderly tenants to remain in their homes longer than anticipated, declining federal outlays for rural rental assistance and rehabilitation and take-out equity lending, and, most critically, a growing number of property owners heading to the exit gates to escape looming tax and other financial quagmires.

In the face of these serious obstacles to rural affordable housing preservation, public officials at all levels are waging an impressive battle to preserve Wisconsin's rural low-income housing portfolio, husbanding their increasingly sparse resources and thinking creatively to fashion solutions to ever more challenging problems. Although dwindling public financing amid soaring budget deficits continues to imperil many rural properties, for now local, state, and federal government officials throughout Wisconsin are holding their own.

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.

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.

Unforeseen Demographic Trends

Another factor weighing on USDA’s Section 515 program in Wisconsin and elsewhere in rural America is an overall population decline. Although this trend has slowed – or in some states stopped – nationally rural areas have been losing, not gaining, population. In some cases, elderly low-income citizens are drawn to the greater availability of social services offered in more heavily populated areas. In other instances, children are able to help their parents afford rents in more suburban middle-income properties, particularly in regions of the country like Wisconsin where relative rent differences may be modest.

Finally, state housing administrators in Wisconsin and elsewhere are beginning to notice another unexpected demographic trend. Unlike a generation ago when elderly homeowners often sold their residences and moved to smaller, more manageable apartments once their children left home, today’s senior citizens are remaining in their homes longer, in some cases for many more years. According to Wisconsin state officials, this trend has contributed to higher than expected vacancy rates at some Section 515 properties, further clouding some owners’ bottom line financial outlook.

Plummeting Federal Outlays

Substantially declining federal funding for USDA’s Rural Housing Service continues to present a major problem. Overall, the agency considers itself 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 cost 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.

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 late summer 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 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. This has been the experience in Wisconsin, where officials with the Wisconsin Housing and Economic Development Administration (WHEDA) have questioned the widespread applicability of LIHTC financing for rural projects due to the developments’ generally small scale.

Nonetheless, USDA officials and affordable housing legal and financial experts agree that in some instances state-allocated tax credits can play an important role in preserving rural affordable housing, particularly with a transaction large enough to justify the various fees associated with LIHTC financing. One such pending Wisconsin transaction described below will sell tax credits to finance the preservation of a 15 property low-income housing portfolio by a local non-profit organization.

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.

A pending Section 515 affordable housing purchase by the Mercy Housing System of Denver is illustrative of the type of larger portfolio sale preferred by USDA managers and most third-party investors and lenders. In the Mercy Housing transaction, two ownership entities in Washington State have agreed to sell a Mercy affiliate 27 separate Section 515 properties containing more than 1,000 low-income apartments. USDA has agreed to subordinate \$16 million in existing debt and to provide \$2.5 million in new equity financing for much-needed property rehabilitation. The remaining funds for the \$26 million purchase and related due diligence and closing costs will come from a State of Washington bond issue. The Washington State Trust, a non-profit affordable

housing intermediary, has agreed to provide some much needed temporary bridge financing and the properties are slated to receive significant tax abatements from local governments.

The pending Mercy Housing acquisition underscores the benefits of portfolio-sized transactions, especially where high-fee bond funding is the financing method of choice. In such cases, paperwork requirements are often less burdensome and USDA generally allows sellers to combine property reserve funds. Similarly, the new owners usually are permitted to aggregate rental assistance contracts and other federal subsidies among all the acquired properties. According to USDA managers, the key is to consolidate the previously separate mortgages into one loan. Although these transactions are often very complex and benefit from a patient seller, in general agency officials advise that the only major concern is to avoid combining groups of properties across state lines, since respective state laws often pose unacceptable obstacles to property consolidations.

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 are at times excruciatingly complex, in general, no more than ten percent of a previous investment syndicate can 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.

Wisconsin Case Histories

The Rural Housing Service's experience in Wisconsin generally has been very positive. Overall, Wisconsin Section 515 properties are well maintained and have sustained high valuations. Local USDA officials have been flexible in structuring multi-family housing sales, in some cases approving 100 percent equity financing (in one case 102 percent) to keep a property in the USDA Section 515 housing portfolio. Under certain circumstances, agency managers also have exercised discretion by asking Washington officials to withdraw pending compliance actions to facilitate an imminent Section 515 property sale.

As is the case throughout the country, steep cutbacks in federal support for rural rental assistance and direct USDA mortgage lending pose the gravest threat to low-income rural rental housing preservation in Wisconsin. Notwithstanding local managers flexibility and creativity, declining federal budget outlays will inexorably place more and more of the financing burden on non-government lenders. At the present time, local USDA managers have a two-year-plus backlog on new equity lending and are actively looking for new third-party lenders.

One atypical problem facing Wisconsin USDA officials involves the average number of units per Section 515 property: about 19, roughly one-third fewer than the national average of about 27. This tends to make various preservation strategies even more difficult since the underlying value of the real property oftentimes makes relative transaction costs prohibitive. Similarly, many traditional affordable housing lenders spurn the generally much smaller rural affordable housing marketplace because even though the paperwork burdens may be similar to larger urban projects, origination fees are proportionately smaller. As a result, fewer and fewer traditional lenders seem interested in financing rural affordable housing.

Among prospective purchasers of Section 515 properties, USDA managers in Wisconsin and elsewhere generally prefer preservation-oriented non-profit organizations to private investment partnerships. In addition to their more “mission based” approach to affordable housing preservation, non-profit groups often contribute other valuable social services to property ownership. In some cases non-profits also agree to reinvest in the property any transaction fees due the purchaser. While accounting rules require purchasers to collect these fees so they may properly be included in the property’s investment basis, non-profit purchasers are free to use the cash to fund additional tenant services, such as recreational or educational facilities.

Although for-profit partnerships currently account for about half of all Section 515 property sales, recent experience in Wisconsin and elsewhere around the country suggests that non-profit organizations, including such large national faith-based groups as Mercy Housing, Volunteers of America, and National Church Residences, may become increasingly active purchasers of USDA-mortgaged affordable housing. While smaller, locally based non-profits enjoy a unique knowledge of a property’s community – and appear well-suited for smaller acquisitions – larger, national entities have the financial wherewithal and managerial skill essential to successfully conclude the type of Section 515 portfolio sales USDA managers believe will become increasingly commonplace.

I. Wisconsin Partnership for Housing Development

Among several private Wisconsin-based organizations promoting rural low-income housing preservation is the Wisconsin Partnership for Housing Development (WPHD), a non-profit affordable housing intermediary active throughout the state. Based in Madison, WPHD offers for-profit and non-profit developers pre-development loans, technical assistance, and, through WPHD’s affiliation with the National Housing Partnership Network (NHPN), short-term acquisition financing.

WPHD administers a \$30 million revolving loan fund – bolstered by a recent \$4.4 million direct Congressional appropriation – to facilitate affordable housing preservation. Short-term property acquisition loans of up to \$1 million are available to NHPN members at six percent interest for three-year terms. Although most of the properties it has assisted have been in Wisconsin’s major metropolitan areas, WPHD is not precluded from supporting Section 515 property transfers. A HUD HOME program contractor, WPHD also is prepared to use HUD HOME program funds to assist USDA Section 515 affordable housing preservation.

II. Marathon County Housing Association, Inc.

A pending Low-Income Housing Tax Credit application at WHEDA for the purchase and rehabilitation of 15 Section 515 properties in Marathon County, Wisconsin, will utilize HUD HOME funds in a sophisticated financing scheme that also includes a grant from the Chicago Federal Home Loan Bank’s affordable housing program. In a plan designed by a local WHEDA consultant, the properties’ present owner, Marathon County Housing Association, Inc., (MCHA) a three decade old non-profit, will

effectively sell the project to itself as the managing member of a new entity. A tax credit investor will own 99.99 percent of the new ownership group.

Although the 15 properties' existing federal mortgages (13 USDA Section 515 loans and two HUD-insured mortgages) will not be subordinated to the new debt, the separate mortgages will be restructured and consolidated into two new loans, a large USDA mortgage and a smaller HUD-insured loan. Proceeds from the \$12.6 million transaction will be used to rehabilitate the 15 properties' 176 units, which require extensive plumbing and electrical work, new windows and elevators, and significant retrofitting to comply with state and federal accessibility laws. The \$12.6 project budget includes \$1.2 million in soft costs, \$1.4 million in development fees, and a \$700,000 payment to MCHA.

The properties' current tenants are mostly elderly and very low-income. Nearly 60 percent of all occupants have annual incomes below 30 percent of national rural median; almost half are below 20 percent of that critical income benchmark. All of the properties' 176 units are covered by USDA rental assistance agreements or HUD Section 8 contracts. Most tenants have been in their units for at least a dozen years.

One challenge facing MCHA officials is to maintain the rental assistance cash flow during renovation. Under federal rules, developers generally forfeit rental assistance payments if they vacate units during renovation. In this case, MCHA will maintain the all-important rental assistance payments by moving tenants around the building during rehabilitation so that no single apartment is vacant for a full month. Although tenants will be somewhat inconvenienced during rehabilitation, the properties will benefit from the uninterrupted flow of federal rental assistance dollars. As planned, none of the tenants is expected to leave during what MCHA directors acknowledge will be a lengthy construction period.

III. Wisconsin Housing Preservation Corporation

Another local non-profit, the Wisconsin Housing Preservation Corporation, has yet to break into the USDA Section 515 preservation market, although the organization recently expanded its mission and is expected to begin focusing on preserving rural affordable housing in the near future. Created by WHEDA to purchase, rehabilitate, and manage HUD-assisted properties whose owners threaten to pre-pay their federally-insured mortgages and leave the affordable housing program, WHPC has to date acquired 30 properties in Wisconsin's major urban areas.

Outlook for USDA's Section 515 Program

The USDA Section 515 program provides essential housing for many thousands of Wisconsin's most needy citizens. Although to date local agency officials have been able to maintain the bulk of the state's Section 515 portfolio, a looming crisis may lay ahead. Faced with plummeting federal outlays for affordable housing of all types – and mindful of ominous cutbacks by some non-profit organizations and foundations dedicated

to low-income housing preservation – USDA managers fear the loss of significant affordable housing throughout the Badger State.

At the present time, local USDA managers estimate that about 25 USDA Section 515 properties are for sale in Wisconsin. In some cases, properties are located in attractive markets, are well maintained, and enjoy high occupancy and appraisals. In others, the housing is sub-standard and suffers from excessive deferred maintenance. The nature of prospective sellers also varies widely, and includes, among others, conventional limited partnerships whose investors are eager to escape taxes on phantom income, smaller family-held entities seeking to sell a deceased member's interest or reconfigure investments for estate planning purposes, and sole-owned properties whose owners hope to cash out to fund retirement accounts.

To more completely understand the current sales status of its Section 515 portfolio, local USDA officials are in the process of surveying owners regarding their near-term sales plans. The agency has scheduled a training session in Madison during August of 2003 for prospective sellers – and would-be non-profit purchasers – interested in learning more about oftentimes dauntingly complex alternative Section 515 financing arrangements.

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.

Mindful of these severe financial constraints, USDA managers in Wisconsin are prepared to make tough choices about how to properly allocate their very limited preservation resources. In so doing, agency officials recognize the need to assess present and future demand for rural affordable housing and the relative cost-benefit of saving older Section 515 properties in areas of the state with current or anticipated declining low-income rental markets.

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 under-rented 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. Taking the long view, they question budget cutbacks which may result in the loss of a significant portion of the Section 515 affordable housing portfolio in Wisconsin and elsewhere in rural America, short-sighted 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. As evidenced at NAHPA's Wisconsin workshop, similarly creative hybrid financing arrangements employed by both for-profit and non-profit entities also are beginning to emerge.

Although in the end only a significant increase in federal funding for rural affordable housing programs – including rural rental assistance, rehabilitation, and take-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.