

Eligibility to Receive Incentives Under LIHPRHA

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Subject: Eligibility to Receive Incentives Under LIHPRHA

April 3, 1992

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Dear Mr. Taylor:

This responds to your letter dated March 3, 1992 concerning the eligibility of the captioned project to receive incentives pursuant to the Low Income Housing Preservation and Resident Homeownership Act of 1990 ("LIHPRHA").

Skyline Park Apartments (the "Project") was originally insured under Section 236 of the National Housing Act. In 1981, the Department provided the Project with a flexible subsidy loan, pursuant to Section 201 of the Housing and Community Development Amendments of 1978 ("HCDA of 1978"). It is our understanding that at the time the loan was provided the owner executed a Financial Assistance Contract, but never entered into a use agreement or amended the original Deed of Trust Note to reflect the provision of such assistance. The flexible subsidy loan was paid in full in 1984. The owner is now interested in receiving incentives under LIHPRHA and questions whether it is eligible to do so.

Section 201(d)(1) of the HCDA of 1978 was amended by Section 211(c) of the Housing and Community Development Amendments of 1979 ("HCDA of 1979") authorizing HUD to provide flexible subsidy assistance to a project only if "the owner has agreed to maintain the low- and moderate-income character of such project for a period at least equal to the remaining term of the project mortgage." The Department has implemented this statutory requirement in Section 219.110(b) of Title 24 of the Code of Federal Regulations.

Housing which is eligible to receive incentives under LIHPRHA is defined in Section 229 of the statute as "eligible low income housing" and includes, in part, those projects which are:

"insured, assisted or held by the Secretary or a State or State agency under section 236 of the National Housing Act... and... will within 24 months become eligible for prepayment without prior approval of the Secretary."

This statutory definition is restated in 248.101 of the proposed

rule amending part 248 of title 24 of the CFR (the "proposed rule"). The Department construes the term "eligible low income

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housing" as excluding projects that are subject to use restrictions which are independent of the original mortgage, and hence, would survive any prepayment of the original mortgage. This construction has the effect of excluding from the definition of "eligible low income housing" those projects which received flexible subsidy assistance after December 21, 1979.

Projects receiving flexible subsidy assistance are also excluded from receiving incentives pursuant to the Emergency Low Income Housing Preservation Act of 1987 ("ELIHPA"), the predecessor to LIHPRHA. The Department's rationale for excluding flexible subsidy projects from ELIHPA is principally because owners of projects subject to use restrictions cannot demonstrate that the project has a "higher and better use," as required by 248.233 of the regulations. In order to justify a request for incentives in exchange for retaining the use restrictions on the property, an owner must demonstrate that the project has higher and better use other than as low income housing. Since projects subject to flexible subsidy use restrictions can only be used as low- and moderate-income housing, those projects have no "higher and better use," and hence are not eligible for incentives. The same rationale supports excluding flexible subsidy projects which are subject to use restrictions from LIHPRHA.

In addition, Congressional intent would not be fulfilled by including projects that are subject to use restrictions in the definition of "eligible low income housing." LIHPRHA was enacted in order to preserve privately-owned low income multifamily housing which could be lost if an owner exercises its right to prepay the mortgage or terminate the mortgage insurance contract resulting in the termination of the use restrictions imposed in connection with the original mortgage. LIHPRHA restricts an owner's right to prepay its mortgage and creates an incentives program which provides owners with a market rate of return on their investment, while maintaining the property as low- and moderate-income rental housing. Those projects receiving flexible subsidy assistance are subject to use restrictions which are independent of the original mortgage. Therefore, prepaying the mortgage or terminating the mortgage insurance contract would have no impact on the requirement that the property be used for low- and moderate-income housing. Hence, providing incentives to these projects to restrict them from prepaying would not fulfill the purpose of LIHPRHA. Since the owners have already agreed to maintain the use restrictions for the remaining term of the mortgage, there is no need to "preserve" the projects. For this reason, projects receiving flexible subsidy assistance after December 21, 1979 are exempt from the prepayment prohibition established under LIHPRHA.

The failure to execute a use agreement in connection with the provision of flexible subsidy assistance will not qualify a flexible subsidy project as eligible low income housing, nor will

it permit an owner to evade the use restrictions it agreed to maintain as a condition of receiving such assistance. The requirement that an owner may receive flexible subsidy assistance only upon its agreement to maintain the affordability restrictions on the project for the mortgage's remaining term is statutory. The Department cannot waive this requirement, and if this statutory requirement has not been implemented due to an administrative error, an owner nevertheless accepted the flexible subsidy assistance with constructive knowledge of the condition that the use restrictions be maintained on the project. Therefore, an owner is bound by the restrictions, despite the fact that a use agreement was never executed.

The repayment of flexible subsidy assistance does not affect the validity of the use restrictions imposed on the property. While the use restrictions are imposed as a condition to receiving flexible subsidy assistance, the termination of those restrictions are not dependent upon the repayment of the assistance. As previously noted, the statute, at Section 201(d)(1) requires that the use restrictions remain on the property "for a period at least equal to the remaining term of the project mortgage." Section 219.220(b) of the regulations requires that any flexible subsidy assistance be repaid "at the earlier of the expiration of the term of the mortgage, termination of mortgage insurance, or prepayment of the mortgage." These provisions indicate that the original mortgage on the project could be prepaid and the flexible subsidy assistance repaid, while the use restrictions continue on the project until the maturity date of the mortgage. Hence, the flexible subsidy use restrictions very well could survive repayment of the flexible subsidy assistance.

In this case, the owner received flexible subsidy assistance in 1981, after the enactment of Section 211(c) of the HCDA of 1979, and therefore is subject to the statutory requirement that the project be maintained as low- and moderate-income housing for the remaining term of the original mortgage. Despite the fact that a use agreement was never executed and the Deed of Trust Note was never amended, the owner had knowledge of the restrictions and agreed to them as a condition of receiving flexible subsidy assistance. According to information provided by the Denver Regional Office, at the time of receipt of the flexible subsidy loan the owner executed a Financial Assistance Contract (Form HUD 9819, dated March, 1980) which states, in paragraph 17:

In compliance with the provisions of Section 201 of the Housing and Community Development Amendments of 1978 as amended by Section 211(c) of the Housing and Community Development Amendments of 1979, the Housing Owner, for itself and its successors and assigns, covenants and agrees that it will maintain the low- and moderate-

income character of the project and will continue to operate the project in accordance with the provisions of Section 236 of the National Housing Act and the regulations thereunder until the maturity date of the mortgage note .

Because the Project is subject to use restrictions which are independent of the Section 236-insured mortgage and which would survive the prepayment of the mortgage and the repayment of the flexible subsidy assistance, the Project has no "higher and better use," making it ineligible for incentives under LIHPRHA.

If you have any further questions regarding this matter, please contact Susan M. Sturman at 202-708-3667.

Very sincerely yours,

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