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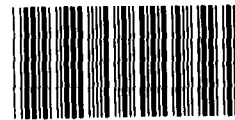
Testimony

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**Potential Reduction in Federally Assisted
Rental Housing From Expiring Section 8 Contracts
and Mortgage Prepayment Restrictions**

Statement of
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Before the
Subcommittee on Housing and Community Development
Committee on Banking, Finance, and Urban Affairs
House of Representatives



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Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to discuss the findings of two recent GAO reports pertaining to possible reductions in the number of federally assisted rental housing units. Our first report, issued June 16, 1986, provides information on the 1985 inventory of privately owned rental housing with project-based federal assistance and the potential impact of expiring section 8 contracts and mortgage prepayment restrictions on this inventory.¹ Our second report, issued October 27, 1986, provides information on the inventory of rental housing with tenant-based section 8 assistance and the potential impact of expiring section 8 contracts on this inventory.² Collectively, these two sources of assisted rental housing represent approximately 2.8 million units, or almost 70 percent of the total assisted rental housing units. My remarks today provide an overview of our findings from both reports as well as recognize key factors that may influence actual inventory reductions.

¹Rental Housing: Potential Reduction in the Privately Owned and Federally Assisted Inventory (GAO/RCED-86-176FS).

²Rental Housing: Potential Reduction in the Section 8 Existing and Voucher Inventory (GAO/RCED-87-20FS).

OVERVIEW OF POTENTIAL REDUCTION
IN THE PRIVATELY OWNED AND FEDERALLY
ASSISTED INVENTORY

In summary, Department of Housing and Urban Development (HUD) and Congressional Research Service (CRS) data show that the fiscal year 1985 inventory of privately owned housing with project-based federal assistance was about 1.9 million units. (See exhibit A.) As indicated in exhibit A, this inventory consists of

- section 8 units, excluding units where tenants receive section 8 certificates or vouchers (1.1 million units);
- HUD-insured and assisted units (347,000 units);
- Farmers Home Administration (FmHA) section 515 units (275,000 units); and
- units with mortgages assigned to HUD (HUD-held) because of loan defaults (161,000 units).

The extent to which owners will continue to maintain this housing as a low-income housing resource as federal subsidy and mortgage prepayment restrictions begin to expire is uncertain. Our review results show a wide range in the potential reduction in the current inventory over the next decade. Expiring section 8

contracts and mortgage prepayments could reduce this inventory from between 240,000 and 890,000 units, resulting in a fiscal year 1995 inventory ranging from 1.0 to 1.7 million units. (See exhibits B and C.) By fiscal year 2005, further reductions could result in an inventory ranging from 174,000 to 842,000 units. Thus, by fiscal year 2005 the existing inventory of low-income housing could be reduced by more than 50 percent. On the other hand, this inventory would be larger as new units are added after fiscal year 1985. However, we had no basis to estimate future additions.

Potential reduction from
expiring section 8 contracts

The largest single component of the fiscal year 1985 inventory was the 1.1 million section 8 units. Expiring contracts could reduce this inventory from between 79,000 and 467,000 units, resulting in a fiscal year 1995 section 8 inventory ranging from 640,000 to 1 million units.

The federal commitment for section 8 units varies between 5 and 40 years, depending on the program component, project type, and the section 8 contract date. In estimating minimum reductions, we assumed that section 8 owners will renew their contracts for the total contract term available. We assumed that owners will not renew their contracts at the next renewal period in estimating maximum reductions.

Potential reduction from expiring
mortgage prepayment restrictions
for HUD-insured programs

The fiscal year 1985 HUD-insured and assisted inventory consisted of 347,000 units, excluding those insured units receiving section 8 assistance. Mortgage prepayments could reduce this inventory from between zero and 233,000 units by the end of fiscal year 1995, leaving an inventory ranging from 114,000 to 347,000 units.

Most owners of section 236 and section 221 (d)(3) below market interest rate (BMIR) projects have the right to prepay their mortgages after 20 years. Our analysis assumes that eligible owners will hold their mortgage loans until maturity in estimating minimum reductions and will prepay their mortgage loans after 20 years in estimating maximum reductions.

Potential reduction from expiring
mortgage prepayment restrictions
for FmHA section 515 program

The FmHA section 515 inventory, excluding those units receiving section 8 assistance, consisted of 275,000 units as of fiscal year 1985. Mortgage prepayments could reduce this inventory

from between zero to 28,000 units by the end of fiscal year 1995, leaving an inventory ranging from 247,000 to 275,000 units.

About 50 percent of the fiscal year 1985 inventory was subject to prepayment when and if alternate private financing became feasible. However, since December 1979, these loans have contained a provision prohibiting prepayment for 20 years. In estimating minimum reductions, we assumed that owners will hold their mortgage loans until maturity. In estimating maximum reductions, we assumed that owners will prepay their mortgage loans after 20 years. To the extent that loans made prior to December 1979 are prepaid before 20 years, our maximum inventory estimate could be further reduced by about 144,000 units. This reduction could occur at any time.

Potential reduction in the
HUD-held inventory

The HUD-held inventory totaled 161,000 units as of fiscal year 1985. We assumed that this inventory will either be acquired by HUD or put back into the private market with some type of tenant-based federal assistance before 1995. To the extent that this inventory is returned to the private market with project-based assistance, our inventory estimates would be increased.

OVERVIEW OF POTENTIAL REDUCTION
IN THE SECTION 8 EXISTING AND
VOUCHER INVENTORY

HUD provides tenant-based section 8 assistance under the existing housing certificate and housing voucher programs. HUD data show that as of July 31, 1986, the inventory of tenant-based section 8 units was about 864,000 units. Current section 8 contracts will provide assistance for this inventory at least until fiscal year 1988. Expiring section 8 contracts would reduce the inventory to zero by the end of fiscal year 1991, assuming minimum contract terms, and by the end of fiscal year 2001, assuming maximum contract terms. (See exhibits D and E.) This inventory would be larger, under either assumption, as new commitments are entered into after fiscal year 1986. However, we had no basis to estimate future commitments.

We estimated the potential reduction in the tenant-based section 8 inventory using assumptions about minimum and maximum section 8 contract terms. The minimum contract terms assume that funding is not provided to renew annual contributions contracts at the next renewal period, which would occur between fiscal years 1988 and 1991. However, information on specific contract renewal periods was not available; hence, we were unable to determine potential reductions from expiring contracts each fiscal year. Therefore, we assumed that the current inventory would be reduced

by an equal number of units each year. On the other hand, the maximum contract terms assume that funding is provided to renew annual contributions contracts for the total contract term allowable--15 years for existing housing and 5 years for housing vouchers.

FACTORS WHICH WILL INFLUENCE
ACTUAL INVENTORY REDUCTIONS

Quite frankly, Mr. Chairman, no one can accurately predict what the owners of privately owned and federally assisted units will do. HUD does not believe that a majority of the privately owned and federally assisted units will be converted to uses other than low- and moderate-income rental housing. According to HUD officials, the fact that section 8 contracts expire or mortgages are prepaid does not necessarily mean that the units will not be available as a housing resource for lower income families. HUD plans to provide housing vouchers to eligible tenants in projects with expiring section 8 contracts.

The extent to which owners will actually continue to maintain these units will be influenced by future uncertainties, such as project marketability including market interest rates and the availability and type of federal assistance. Likewise, the extent that many low-income households will be able to afford rental

housing will depend on the continued availability of section 8 existing housing certificates and housing vouchers.

Project marketability

The current inventory of privately owned and federally assisted housing has been characterized as representing three different market areas. The extent to which owners decide to renew their section 8 contracts or prepay their mortgages will be influenced, in large part, by the economics of these market areas. Unfortunately, specific information needed to analyze the market potential of the projects is not readily available.

Generally, projects located in strong market areas have a high potential to be lost from the inventory. The economics of these housing markets offer owners the possibility of profitable returns through market-rate rentals or conversion to condominiums or some alternative use, such as office space.

At the other end of the housing market are units that have no better economic use or potential than as low-income housing. The markets in which they are located will not support higher rents or alternative uses for the property. The lack of these units' marketability will discourage owners from disposing of them in the private sector.

Other units probably have a borderline position in the market, with the potential to move either way. They may be located in markets which are stable but not showing signs of increased rent or gentrification. The owners can only realize a limited gain by converting to market rentals or other uses.

Availability and type
of federal assistance

Preservation of the current inventory is also likely to be influenced by the availability and type of federal assistance. Cutbacks in housing subsidies and reduced tax benefits may encourage owners of projects in the strong- and middle-market areas to convert to market rentals or some alternative use. This could potentially displace low-income tenants who cannot afford the market rent.

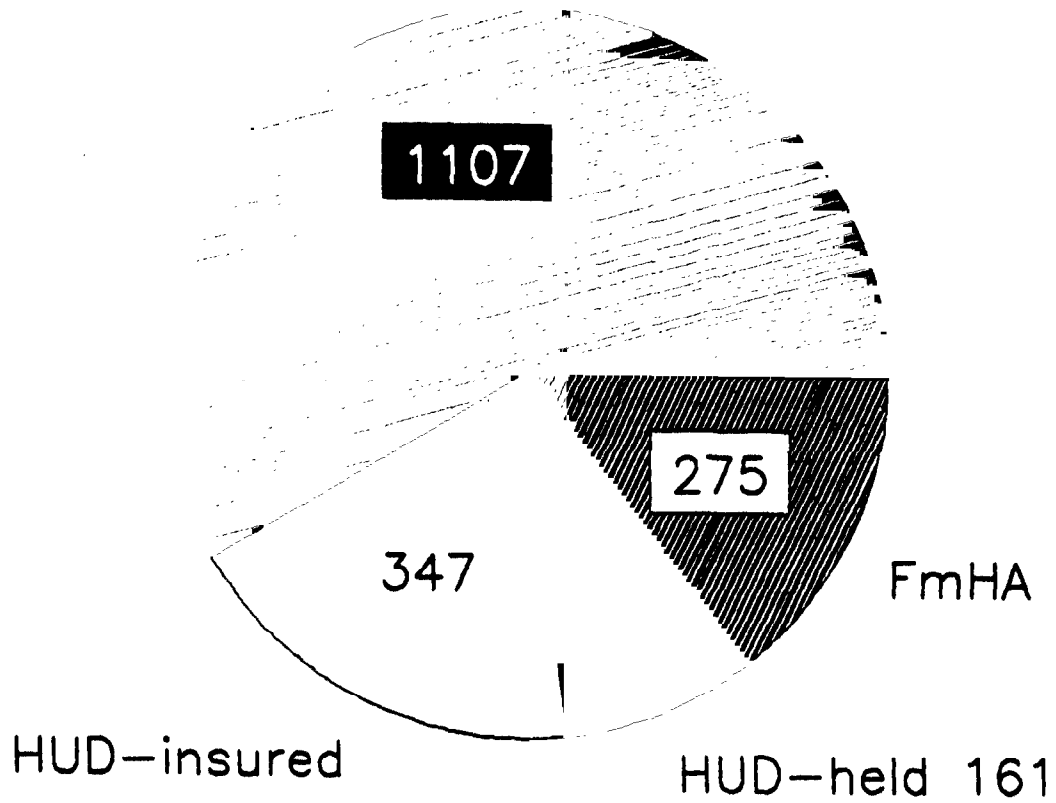
Without additional federal assistance, owners of projects in weak market areas may allow their projects to deteriorate because they are unwilling to spend additional money to rehabilitate or maintain them for continued low-income occupancy. Ultimately, HUD may acquire some of these units through default and foreclosure.

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Mr. Chairman, this concludes my prepared statement. I would be glad to respond to any questions that you or the members of the Subcommittee might have.

Fiscal Year 1985 Inventory of
Privately Owned Rental Units
(in thousands)

Section 8



TOTAL INVENTORY: 1,890,000 UNITS

Source: HUD and CRS data.

Minimum Inventory of Privately Owned Rental
Units With Project-Based Federal Assistance,
Fiscal Year 1995

<u>Program</u>	<u>FY 1985 inventory</u>	<u>Maximum reduction^a</u>	<u>Minimum FY 1995 inventory</u>
----- (units in thousands) -----			
Section 8 inventory:			
New construction	614	163	451
Substantial rehabilitation	114	37	77
Moderate rehabilitation	92	0	92
Loan management	130	130	0
Property disposition	20	0	20
Other	<u>137</u>	<u>137</u>	<u>0</u>
Total	<u>1,107</u>	<u>467</u>	<u>640</u>
HUD-insured and assisted inventory:			
Section 236	224	164	60
Section 221(d)(3) BMIR	90	54	36
Section 221(d)(3) market	26	12	14
Section 221(d)(4) market	1	1	0
Other programs	<u>6</u>	<u>2</u>	<u>4</u>
Total	<u>347</u>	<u>233</u>	<u>114</u>
FmHA section 515 inventory	275	28	247
HUD-held inventory ^b	<u>161</u>	<u>161</u>	<u>0</u>
Total	<u>1,890</u>	<u>889</u>	<u>1,001</u>

^aAssumes minimum section 8 contract terms and assumes that all eligible owners will prepay their mortgages by the end of fiscal year 1995.

^bAssumes that the HUD-held inventory will either be acquired by HUD or put back into the private market with some type of federal assistance. The HUD-held inventory depends on the physical and financial conditions of projects, which we did not evaluate.

Source: GAO analysis of HUD and CRS data.

Maximum Inventory of Privately Owned Rental
Units With Project-Based Federal Assistance,
Fiscal Year 1995

<u>Program</u>	<u>FY 1985 inventory</u>	<u>Minimum reduction^a</u>	<u>Maximum FY 1995 inventory</u>
	----- (units in thousands) -----		
Section 8 inventory:			
New construction	614	0	614
Substantial rehabilitation	114	0	114
Moderate rehabilitation	92	0	92
Loan management	130	40	90
Property disposition	20	0	20
Other	<u>137</u>	<u>39</u>	<u>98</u>
Total	<u>1,107</u>	<u>79</u>	<u>1,028</u>
HUD-insured and assisted inventory:			
Section 236	224	0	224
Section 221(d)(3) BMIR	90	0	90
Section 221(d)(3) market	26	0	26
Section 221(d)(4) market	1	0	1
Other programs	<u>6</u>	<u>0</u>	<u>6</u>
Total	<u>347</u>	<u>0</u>	<u>347</u>
FmHA section 515 inventory	275	0	275
HUD-held inventory ^b	<u>161</u>	<u>161</u>	<u>0</u>
Total	<u>1,890</u>	<u>240</u>	<u>1,650</u>

^aAssumes maximum section 8 contract terms and assumes that all eligible owners will hold their insured loans until maturity.

^bAssumes that the HUD-held inventory will either be acquired by HUD or put back into the private market with some type of federal assistance. The HUD-held inventory depends on the physical and financial conditions of projects, which we did not evaluate.

Source: GAO analysis of HUD and CRS data.

Section 8 Tenant-Based Inventory
During Fiscal Years 1975-91,
Assuming Minimum Contract Terms^a

<u>Year</u>	<u>Units completed</u>	<u>Units reduced</u>	<u>Cumulative section 8 inventory</u>
1975	993	0	993
1976	154,839	0	155,832
1977	141,882	0	297,714
1978	136,027	0	433,741
1979	90,848	0	524,589
1980	68,328	0	592,917
1981	57,859	0	650,776
1982	38,311	0	689,087
1983	28,494	0	717,581
1984	39,642	0	757,223
1985	55,485	0	812,708
1986	51,044	0	863,752
1987	0	0	863,752
1988	0	205,139	658,613
1989	0	205,139	453,474
1990	0	216,203	237,271
1991	0	237,271	0
Total	<u>863,752</u>	<u>863,752</u>	

^aSince contracts are currently in place to continue funding these units until fiscal year 1988, the contracts had to have been renewed. We assumed that contracts are not renewed at the next renewal period, which would occur between fiscal years 1988 and 1991. However, information on specific contract renewal periods was not available to determine contract expirations for each fiscal year. Therefore, we assumed that the current existing housing inventory would be reduced by an equal number of units each year between fiscal years 1988 and 1991. Because of the relatively short period in which contracts are due to expire, we believe that this averaging approach objectively presents potential reductions to the existing housing inventory.

Source: HUD Section 8 Management Information System and GAO analysis of HUD data.

Section 8 Tenant-Based Inventory
During Fiscal Years 1975-2001,
Assuming Maximum Contract Terms^a

<u>Year</u>	<u>Units completed</u>	<u>Units reduced</u>	<u>Cumulative section 8 inventory</u>
1975	993	0	993
1976	154,839	0	155,832
1977	141,882	0	297,714
1978	136,027	0	433,741
1979	90,848	0	524,589
1980	68,328	0	592,917
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1982	38,311	0	689,087
1983	28,494	0	717,581
1984	39,642	0	757,223
1985	55,485	0	812,708
1986	51,044	0	863,752
1987	0	0	863,752
1988	0	0	863,752
1989	0	0	863,752
1990	0	12,056	851,696
1991	0	186,970	664,726
1992	0	141,882	522,844
1993	0	136,027	386,817
1994	0	90,848	295,969
1995	0	68,328	227,641
1996	0	57,859	169,782
1997	0	38,311	131,471
1998	0	28,494	102,977
1999	0	39,642	63,335
2000	0	44,422	18,913
2001	<u>0</u>	<u>18,913</u>	0
Total	<u>863,752</u>	<u>863,752</u>	

^aAssumes that funding is provided to renew contracts for the total contract term allowable. Existing housing program has an initial contract term of 5 years but may be extended at 2- to 5-year renewal periods, depending on available funding, up to a total of 15 years. Housing voucher program has an initial contract term of 5 years and cannot be extended.

Source: HUD Section 8 Management Information System and GAO analysis of HUD data.

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