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Nowhere To Go: Will the Rural Housing Preservation Legislation Withstand Owner Attacks?

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The Rural Housing Service ("RHS"), formerly known as the Farmer's Home Administration or FmHA, serves a unique purpose in providing financing for home ownership and multi-family rental housing for low-income persons in rural areas.

While the rental housing provided by RHS serves a critical need, an increasing number of owners since the 1970s have attempted to prepay their mortgages. Despite a series of legislation aimed at preventing prepayments, the loss of RHS units remains a threat to low-income persons living in rural areas.

This article will outline the statutes and regulations aimed at preventing prepayment of RHS multi-family projects and the requirements with which owners are supposed to comply. Next, it will review the challenges which have been raised in attacks on the laws aimed at preservation, including the case currently pending in the United States Supreme Court. Lastly, the article will address possible opportunities for advocates to be involved in the process of prepayments.

I. Overview of RHS Multi-Family Rental Housing Preservation

Under the Section 515 program, RHS provides financing for the construction of rental or cooperative housing in rural areas for low-income families, senior citizens and persons with disabilities.[1] RHS is a division within the United States Department of Agriculture. Loans under other programs, including Section 514 and 516, are made to finance housing for farm workers.

The Section 515 loans are generally made for a period of up to 30 years.[2] Subsidies available to the projects include an "Interest Credit Plan" that lowers the project's mortgage interest rate and a program known as "Rental Assistance" that assists in ensuring low-income household rents do not exceed 30 percent of their adjusted income.[3]

When it was first enacted, the Section 515 program did not impose use restrictions on the projects as the HUD programs did.[4] Eventually, due to changes in the regulatory scheme as well as increased real estate values, prepayments in the Section 515 program increased and a number of tenants were displaced.[5]

Due to the loss of subsidized units, Congress passed legislation to prevent displacement by placing 15 or 20 year use restrictions on all projects financed by FmHA (now RHS) after December 21, 1979 and prohibiting prepayments by owners of projects with more than ten units.[6] However, the prepayment restrictions were repealed in 1980 after protests from builders and owners of Section 515 projects.[7]

Congress then passed legislation to prevent prepayment of Section 515 loans and further aimed at preventing the loss of subsidized housing units. In 1987, after placing a moratorium on prepayments, Congress passed the Emergency Low Income Housing Preservation Act (ELIHPA). The legislation established a scheme for restricting the prepayment of FmHa loans financed prior to December 21, 1979.

In 1989, Congress prohibited prepayment of FmHA projects financed after December 15, 1989. Then, in 1992, the restrictions on pre-1979 projects were extended to cover projects financed between December 21, 1979 and December 15, 1989.

While owners of Section 514 and 515 multi-family housing projects can no longer prepay without approval of RHS, the restrictions will vary depending on when the project was financed due to the effective dates of the statutes and different financing dates.

For projects financed after December 18, 1989, the legislation precludes prepayment. Therefore, the use restrictions as a condition of the mortgage will remain in place for the length of the mortgage.[8] For other RHS projects, owners can attempt to prepay through a procedure established by statute and regulations.[9] First, owners must file notice with the appropriate RHS office at least six months prior to their prepayment.[10] Within 15 days of receipt of the request, the RHS must take action including notifying all tenants of the prepayment request.[11] The notice is supposed to inform tenants of their rights and the pro-

cess by which the determination regarding prepayment will be made.[12] However, advocates should note that if a prepayment is permitted, tenants are not entitled to the "enhanced vouchers" that are given to tenants in a HUD Section 8 prepayment.

In pre-1979 projects, RHS must make reasonable efforts to enter into an additional agreement with the owner to extend the project's use for low-income tenants, including offering incentives to the owner.[13] If the owner does not agree, the owner is required to attempt to sell the project to a non-profit agency which will continue to operate it for low-income tenants.[14]

However, there are three exceptions to the requirement of sale to a non-profit: (1) if the owner agrees to maintain the property for low-income tenants for 20 years; (2) if the prepayment will not materially affect housing opportunities for minorities and the current tenants will not be displaced, or (3) if RHS determines there is an adequate supply of safe, decent and affordable rental housing in the area.[15]

For projects financed between 1979 and 1989, owners are permitted to prepay their mortgages in three circumstances. First, if the owner agrees to operate the project for low-income tenants for the period the mortgage would cover if not prepaid.[16] Second, RHS can allow prepayment if RHS determines that there is no longer a need for such housing.[17] Lastly, the mortgage can be prepaid if federal or other assistance provided to the tenants is eliminated.[18] These restrictions on prepayments were not well-received by all owners, some initiating litigation as a result.

II. The Road to the Supreme Court

The Supreme Court recently granted certiorari in a pair of cases involving challenges to the statutes preventing prepayment of Section 515 loans.[19] In *Franconia Associates v. United States*, several owners of rental projects financed with Section 515 loans filed suit in the Court of Claims in May 1997.[20] All the owners had loan terms for 50 years and agreed to abide by FmHA (RHS) regulations, including charging reduced rental rates to eligible tenants.[21] Each owner entered into loan agreements with FmHA (RHS) prior to December 21, 1979.[22]

The owners pled two causes of action: first, that the legislation constituted an anticipatory repudiation of the contract between owners and the government, and second, that the repudiation of the owners' contractual right to prepay their loans constituted an impermissible "taking" under the Fifth Amendment.[23]

In a companion case, *Grass Valley Associates v. United States*, owners brought suit stating that the legislation restricted their right to prepay and was an anticipatory repudiation of their contract and an uncompensated taking.[24] The *Grass Valley* case involves loans financed before and after 1979, but only the claims of the pre-1979 owners are still pending.

In both cases, the Court found that the statute of limitations had run on making a contract claim for breach of the pre-1979 loans. The restrictions placed upon the pre-1979 loans were a result of ELIHPA, and the breach of contract occurred when that legislation was passed. Therefore, since more than six years had passed, the owners' claims were barred.[25] Further, the Court ruled that the taking occurred at the time the right to repay the mortgages was prohibited, and so the statute of limitations on the Fifth Amendment takings claim had run.[26]

The Supreme Court is only looking at the question of whether a breach of contract and Fifth Amendment takings claim accrue when Congress enacts a statute which may impair a contractual right.

III. Other RHS Preservation Litigation

What the Supreme Court case will not address is when, if a claim is timely brought, can the RHS be compelled to accept prepayment and if the RHS could be liable for damages for breach of contract or a Fifth Amendment taking.

In the *Grass Valley* case, the post-1979 mortgage owners were not dismissed from the case because of the statute of limitations. RHS filed a motion for summary judgment seeking dismissal of the post-1979 mortgage claims, stating RHS is shielded from liability under the unmistakability doctrine. The judge denied the motion.[27] The court concluded that the unmistakability doctrine does not shield the government from liability unless the act that gave rise to the plaintiff's cause of action was a sovereign act. The court then determined that the legislation aimed at preventing prepayment was not a sovereign act because, although the legislation may have been aimed at advancing the public welfare, the result of the legislation was to impair the contractual rights of the private parties.[28] Therefore, the court permitted the post-1979 owners to pursue their claims.[29]

In a case from the Ninth Circuit Court of Appeals, *Kimberly Assoc. v. United States*, the court likewise decided that the unmistakability doctrine did not bar the action.[30] The case involved a 1981 loan and the contract included a covenant to use the property as low-income property for 20 years, even if Kimberly pre-paid its loan to RHS.[31] The government later accepted a number of partial prepayments without re-

quiring Kimberly to abide by the appropriate procedure.[32] However, RHS refused to accept the final prepayment on the loan and instead told Kimberly they must comply with the regulatory prepayment procedure.[33] Kimberly then brought action to quiet title and the government filed a motion to dismiss.

The court determined that the United States waived its sovereign immunity from quiet title actions.[34] The court also found that the unmistakability doctrine did not bar the suit because the government was not acting in a sovereign capacity when it altered its contract with Kimberly by subsequent legislation. Therefore, the court remanded the case for further proceedings.[35]

The problem with these cases is twofold. First, they reinterpret a line of cases which refuse to allow private parties to enforce contractual provisions that have the effect of blocking the exercise of a sovereign power of the government. Second, they rely on cases which are not analogous to the public welfare aims of preserving low-income housing. These cases, if not reversed on appeal and picked up by other courts, will undermine the current legislation which is aimed at preventing the displacement of low-income tenants.

IV. What Should Advocates Do?

Most advocates and attorneys agree, the most important part of this process is knowledge, that is, advocates need to know if an owner is planning on prepaying their mortgage. Advocates also need to know if any projects will be lost because of foreclosure, natural expiration of mortgages and restrictive covenants, or other servicing action. Some advocates are able to obtain this information by establishing a relationship with their state RHS office; other advocates obtain the information through regular Freedom of Information Act requests.

Advocates should insure that the tenants receive their notices regarding prepayment and understand the potential consequences of prepayment. Often, tenants will come in regarding other issues and the prepayment issue may come up as an aside to an otherwise run of the mill eviction case.

It is important to insure that tenants are involved in the process, as they are allowed to comment to RHS regarding the prepayment. It is vital that tenants and their advocates make their voices heard at RHS because RHS does have some discretion in permitting prepayment under some of the exceptions outlined in the statutes. For example, tenants can tell RHS about their experiences attempting to find other safe and affordable housing in that area that a simple market study or other paperwork may not reveal. Further, in projects where the owner may be required to sell the project to a non-profit organization, tenants can play an integral role in selecting a non-profit and directing the future of the project where they live. Finally, litigation may be especially necessary to ensure that RHS does not permit prepayments that it should not and to ensure that RHS owners abide by their restrictive covenants, which in some cases may outlast the mortgage term and prepayment.

Advocates also need to be involved after the prepayment. Tenants may not understand their rights after prepayment, especially their right to move to other projects and be placed at the top of the waiting list.

While the statutes and regulations restrict owner prepayment of Section 514 and 515 mortgages, the statutes and regulations are subject to challenge and also permit the RHS to approve prepayments in some circumstances. It is essential for advocates to be aware of potential prepayments and assist tenants who are in danger of losing their subsidized housing.

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[1] 42 USC § 1485.
[2] *Id.*
[3] 42 USC § 1490(a).
[4] *See* NATIONAL HOUSING LAW PROJECT, RHCDS HOUSING PROGRAMS, 15/2 (1995).
[5] *Id.* at 15/3.
[6] PUB. L. NO. 96-153, § 503, 93 STAT. 1134 (1979).
[7] PUB. L. NO. 96-399, §514(A), 94 STAT. 1671 (1980).
[8] 42 USC § 1472 (c)(1)(B).
[9] 42 USC § 1472 (c).
[10] 7 C.F.R. § 1965.90.
[11] 7 C.F.R. § 1965.206.
[12] *Id.*
[13] 42 USC § 1472 (c)(4).
[14] *Id.* at (c)(5).
[15] *Id.* at (c)(5)(G).
[16] *Id.* at (c)(1).
[17] *Id.*
[18] *Id.*
[19] Franconia Associates v. United States, 151 L.Ed.2d 688, 70 USLW 3193 (2002).
[20] *See* Franconia Associates v. United States, 240 F.3d 1358, 1361 (Fed. Cir. 2001).
[21] *Id.* at 1361.
[22] *Id.*
[23] *Id.*
[24] *See* Grass Valley Associates v. United States, 46 Fed. Cl. 629, 636 (2000).
[25] *See* Franconia Assoc, 240 F.3d at 1363.
[26] *Id.* at 1365-1366.
[27] *See* Grass Valley Terrace v. United States, 51 Fed. Cl 436 (2002) ("Grass Valley II").
[28] *Id.*
[29] *Id.*
[30] *See* Kimberly Assoc. v. United States, 261 F.3d 864 (9th Cir. 2001).
[31] *Id.* at 866.
[32] *Id.* at 867.
[33] *Id.*
[34] *Id.* at 868.
[35] *Id. at* 870-871.