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REPORT AND RECOMMENDATIONS BY THE HOUSING AND URBAN DEVELOPMENT COMMITTEE

PRESERVING MITCHELL-LAMA HOUSING COMPANIES AS AFFORDABLE HOUSING FOR THE FUTURE

I. INTRODUCTION

The preservation of existing Mitchell-Lama (ML) housing companies that provide rental housing have been identified as a priority to numerous private, not-for-profit, and governmental agencies focusing on the affordable housing needs of New York City. The New York City Bar Association's Housing and Urban Development (HUD) Committee, which is comprised of attorneys among the private, not-for-profit, and government sector, have developed the following suggestions to preserve such housing stock.

II. CONSIDER LEGISLATIVE PROPOSALS

New Statutory Definition of AMI

Clearly, affordability is a priority in nearly any housing discussion. Article II of the New York Private Housing Finance Law (PHFL) sets affordability by statute, as well as the amount of profit an owner of a ML housing company can make. See PHFL §§ 31 & 28. Both of these provisions of the statute appear to be driving forces of dissolution. Supervising agencies such as the New York City Department of Housing Preservation and Development (HPD) and the New York State Division of Housing and Community Renewal (DHCR) and interested legislators should explore possible legislative approaches to these issues. Also, because the ML Program was actually created to provide middle-income housing, the statutory formulas have been blamed repeatedly for keeping the area median income (AMI) of new residents exceptionally low, thereby failing to create middle-income housing. It would be advantageous to repeal the current formula and replace it with an AMI. Previous legislative proposals have included setting AMI at 100% to 120% of AMI. We believe that 120% of AMI is currently a very reasonable standard, and it also matches the required AMI of many other HPD programs aiming to provide housing for individuals and families of middle income. However, factors such as demographics should be taken into account when determining an appropriate AMI for a project, and there should be a willingness to consider both higher and lower AMI's to accommodate factors such as neighborhood and current tenants in occupancy.

Mandatory Opportunity to Purchase

Although repeal of the voluntary dissolution provisions of Article II of the PHFL appears unlikely, an alternative approach would be to require the owner of a ML housing company to notify New York State Homes and Community Renewal (HCR) of its intention to exit the ML

Program and to give HCR the opportunity to find a purchaser who would keep the project as regulated affordable housing. By way of example, Section 42 of the Internal Revenue Code (IRC) provides a similar procedure for owners of Low Income Tax Credit projects, who can apply to HCR at year 15, for it to obtain a so-called "Qualified Contract" within one year after notification to HCR. If HCR is not able to find a purchaser under a Qualified Contract within one year, the owner is then no longer bound to keep rents affordable under the tax credit regulatory agreement. Although owners of tax credit projects are thus able to opt out if a purchaser cannot be found, there is a year-long period whereby the projects can be refinanced and the affordability extended. Something similar might be possible for ML housing companies, especially since owners must provide a notice of intent at least a year in advance of dissolving. One option would be for the supervising agencies to have the ability to find a new owner who would agree to continue owning and operating the property as middle-income housing. If such new owners could get favorable financing and tax exemptions, and greater flexibility in terms of income band of new tenants, this could prove to be a highly attractive option for many developers.

Inclusionary Housing

Another possible option for current owners of ML housing companies is to take advantage of the recent amendment to the New York City Rules[1] governing § 23-90 of the New York City Zoning Resolution, which now permits a ML housing company to qualify as affordable housing for purposes of participating in the Inclusionary Housing Program at a higher bonus ratio than previously permitted. Under the Inclusionary Housing Program, in return for agreeing to keep the housing permanently affordable to households earning at or below 80% of the AMI, owners receive a "bonus" in the form of additional developable floor area that the owner can sell or transfer for construction on other sites in the same Community District. The Inclusionary Preservation option might be enticing to other owners of ML housing companies. Furthermore, it may be worthwhile to explore whether the Department of City Planning is interested in permitting a ML housing company to commit only part of the units in a given housing project to Inclusionary Housing, in exchange for a proportionally lower zoning bonus. Such an option might permit an owner of a ML housing company that dissolves and reconstitutes as a Housing Development Fund Company (HDFC) pursuant to Article XI of the PHFL to set aside a certain number of units at 80% of AMI, thereby creating a more diverse mixed-income project if the other units are at a higher AMI.[2]

Although the HUD Committee believes Inclusionary Housing provides a unique opportunity to provide a financial incentive for existing owners of ML housing companies, it should be noted that additional rulemaking and statutory changes would most likely be required to make this option more attractive and truly viable.

[1] Section 41-01 of the New York City Rules was amended to preclude an exemption of real property taxes pursuant to Article II of the PHFL as public funding. The result of this change is that a ML housing company could generate a zoning bonus of 2 times the zoning floor area as opposed to 1.25.

[2] The New York City Zoning Resolution contains numerous limitations on what types of projects can qualify as preservation projects. For example, a mixed-income Inclusionary Housing preservation project is possible only if the project contains more than one building or building segment, which is defined as two or more towers with separate entrances, lobbies and elevators within a single building.

III. ALLOW ALTERNATIVE FORMS OF OWNERSHIP

Article XI

In thinking about the future preservation of ML housing companies, the possibility of dissolving and reconstituting as an HDFC should be taken into consideration. For example, an existing ML may be able to convert to a PHFL Article XI HDFC and receive not only greater subsidies, but broaden the income band of tenants that can be served. HPD's Article II to Article XI Program is an example of such program. HPD has initially created the Article II to Article XI program as an alternative to ML cooperative privatizations, but an Article XI may also be a possible alternative ownership structure for existing owners of ML housing companies that are operated as rentals.[3]

Both DHCR and HPD may wish to consider this option as a mechanism to encourage developers to dissolve and reconstitute ML housing companies as an HDFC in order to maintain their affordable nature while permitting greater investment return than currently permitted by statute for a current owner of a ML housing company. The question remains however as to how to incentivize the owner of the ML housing company to either maintain ownership of the property as an HDFC or sell it to another owner who will agree to operate the property as an HDFC. One possibility may be for DHCR and HPD to work with a series of pre-qualified developers who are financially capable of owning and operating affordable housing developments and who may wish to participate in a voluntary buy-out program.

Although Article XI does in fact provide a greater level of flexibility than Article II, there are current issues and concerns about Article XI that should be considered. A recent letter issued by the HUD Committee to the Taskforce on City-Owned Properties sets out some of the current issues and concerns under discussion by affordable housing advocates.[4]

Interagency Coordination

The HUD Committee were particularly impressed with the recent cooperation between State, City and Federal agencies that resulted in the acquisition of Ocean Village by L & M Development Partners, a private company that has agreed to operate the property as a ML housing company rental. Like many Mitchell Lamas, the Ocean Village project is unique but it might be worthwhile for interested stakeholders to meet with executives from the various agencies such as DHCR, HPD, and the New York City Housing Development Corporation (HDC) to see if there are cross agency opportunities available that may result in more success stories like Ocean Village.

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[3] HPD's Article II to Article XI program currently requires any participating ML cooperative to dissolve and reconstitute as an HDFC in exchange for entering into a regulatory agreement that restricts resale prices, subletting, and AMI, which is set at 135% for subsequent purchasers. In exchange for entering into the regulatory agreement, the HDFC will receive a 30-year Article XI tax exemption. There currently is some concern about the program, mainly expressed by existing ML shareholders who are opposed to any level of equity appreciation and continued tax exemptions for higher income shareholders.

[4] Letter from the Housing & Urban Development Committee, New York City Bar Association, to Andrew Reicher, Executive Director, Urban Homesteading Assistance Board (March 5, 2013), *available at* http://www2.nycbar.org/pdf/report/uploads/20072422-CommentonCitysProposedHDFCRegulations.pdf.

Exiting ML for Bond Financing and Low Income Housing Tax Credits

Although the Mitchell-Lama program was established to provide housing for middle-income families and individuals, the demographics of many existing projects have changed and tend to serve a much lower income band of tenants. In some cases, ML housing companies have become housing for some of the lowest income individuals and families. For such projects, dissolution can be even more problematic. An existing or new owner who operates the project post-dissolution will have the sole purpose of making a greater profit. Serving tenants with incomes at or below 80% of AMI has proven to be contrary to this goal. In such cases, dissolution may still be warranted, especially if a new responsible owner is willing to acquire the project and continue to operate it for the existing income band of tenants. An example of a successful ML dissolution involves Sea Park in Coney Island, Brooklyn. The Arker Companies, purchased the failing ML housing company and rehabilitated and preserved 816 units of housing, by use of tax-exempt bond financing, IRC Section 42 Low Income Tax Credits and other subsidies. This resulted in a new regulatory agreement that requires affordability to be kept at or below 60% AMI, under the Low Income Tax Credit requirements. This financing technique may be attractive to other owners of ML housing companies that have an existing low-income tenant base.

IV. IDENTIFY BROADER SOURCES OF FINANCING FOR EXISTING ML OWNERS

The HUD Committee believes that interested stakeholders should increase efforts to provide information to owners of ML housing companies about existing sources of financing, including grants and tax exemptions, which are available to such owners who agree to maintain projects as affordable housing. A thorough analysis of existing local, state and federal subsidies available to developers may yield a catalogue of mechanisms to fund affordable rents, repairs and for the long-term maintenance of the properties. Greater outreach efforts and transparency regarding such sources of funding, grants, and tax exemptions should be widely distributed and made available to current owners well in advance of any decision to dissolve and reconstitute.

V. CONCLUSION

There is a great opportunity to address New York City's housing crisis through this proposed critical analysis of the dilemma faced by the loss of ML housing companies. Interested stakeholders should consider the experience and wealth of knowledge that various actors involved in the Mitchell-Lama program over the years may have available: Developers, real estate attorneys, and government agencies may yet yield untapped ideas and expertise. We are aware that many of the examples we have proposed are not without hurdles or other concerns, but with careful planning, we feel confident that many of these options might very well work to preserve existing ML housing companies.

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