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Preserving Small Rental Buildings during the COVID-19 Crisis

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The economic impact of the COVID-19 pandemic has disproportionately affected renters, especially renters who live in small, unsubsidized multifamily buildings, many of whom work in industries most vulnerable to COVID-19 job losses (HFPC 2020). Small rental housing stock (properties with between 2 and 49 units) composes 50 percent of all rental stock and is an important source of moderately priced affordable housing (2019 American Housing Survey). Properties with 2 to 49 units have more affordable rents than either single-family rental housing or buildings with 50 or more units.

Even before the COVID-19 crisis, many regions had incredibly tight housing markets with many renters paying much more in rent than the federal standard of 30 percent of their income.[1] Complicated land-use restrictions and increased building costs have limited rental supply (Neal, Goodman, and Young 2020), especially units with low and moderate rents. Since 2000, the level of rent burden has increased not only for the lowest-income households but for all rental households with annual household incomes below $75,000 (JCHS 2020).

The pandemic's impact on small, unsubsidized multifamily buildings could mean loss of low- and moderate-cost units, both in neighborhoods that are strong or are primed for reinvestment as well as in weaker markets that cannot replace units lost to disinvestment. In addition to the loss of relatively affordable units, this could mean loss of livelihood for owners. Both impacts could have deleterious effects for people of color who are more likely to be renters and, in some cases, owners of small rental housing stock (An et al. 2017; HFPC 2020).[2]

About the Renters and Rental Market Crisis Working Group

The Urban Institute convenes the Renters and Rental Market Crisis Working Group to inform the development of federal policies to address the immediate and impending effects of the COVID-19 crisis on renters and the rental market. The working group comprises leaders from the housing field including housing providers, advocates, foundations, and capital providers. The group tracks trends in data and analysis about the crisis and uses data and research to sharpen policy development proposals.

Through the Rental Crisis Working Group, the Urban Institute convened a subgroup of representatives from rental housing organizations and affiliated researchers to inform Urban's research questions. This brief results from the discussions with experts in this subgroup.

Preserving small rental buildings requires capital during a time when there are many competing housing needs and resources are stretched thin. Well-targeted and efficiently administered rental assistance is the most effective way to support renters and their building owners. The December federal recovery bill provided $25 billion in emergency rental assistance, and an additional $25 billion in emergency rental assistance is part of a $1.9 trillion relief package that passed on March 11. Rental assistance can provide short-term relief for struggling renters and owners, but the funds are not sufficient to provide a long-term solution to the affordability crisis that prevailed long before the pandemic. Additionally, rental assistance may prove elusive for small building owners and their tenants. Applications could be too onerous or this group of landlords, and tenants (who are unaccustomed to identifying and applying for public subsidies) could be unaware of this assistance.[3] Although building more housing is critical, preserving existing rental units is the first step to stabilize the rental market.

In this brief, we explore policies and programs that can complement rental assistance to preserve small, unsubsidized rental housing and provide long-term solutions to keep affordable units in the market. Without deep subsidies, rents typically cannot be affordable to the lowest-income households, but there is value in maintaining the portions of the unsubsidized housing stock that charge moderate rent levels to avoid compromising the limited supply of affordable housing and minimize future rent increases. Further, it is critical that policies that preserve small, unsubsidized rental housing also stabilize existing tenants.

For each program or proposal we analyzed, we asked whether the policy included or could include protections for existing tenants, such as by providing affordable rents to existing tenants in exchange for support, by agreeing not to evict current tenants, or by providing affordable rents to future tenants. In addition to stabilizing tenants, there is a need to ensure that existing owners who have provided safe, stable housing and wish to remain owners of their rental properties have the chance to do so. Many of the programs we studied structured their programs to preserve the unit but not always the owner. This is an important consideration for future policies. We examined federal, state, and local programs, but we believe the federal government will need to play a large role in funding preservation policies because states and localities have been financially squeezed by the pandemic's economic effects. Below, we describe promising federal, state, and local policies.

Small Rental Building Preservation Policies

In this section, we describe several existing or nascent programs that could, with minor modifications, provide flexible financing targeted to the small, rental building owners most in need of assistance. We reviewed both federal and state and local programs. We highlight three federal programs that could be expanded and better targeted toward preservation. There are too many state and local programs to cover, but we highlight a few types of local programs that could be expanded with greater federal funding or that could be a promising practice for other, similarly situated localities.

Federal Preservation Programs

TABLE 1

New and Modified Federal Programs to Preserve Small Rental Buildings

Program	New or modified	Eligible building type	Delivery mechanism	Protects existing tenants?	Supports existing owners?
Small Building Risk Sharing program	Modified program	5-or-more-unit properties	Low-cost loans offered through community development financial institutions and other Federal Housing Administration–approved lenders under the US Department of Housing and Urban Development Risk Sharing program	Yes, would require some level of tenant income certification or rent restrictions for the life of the loan	Yes, through the financing of existing properties without substantial rehabilitation
First Look program	Modified program to expand eligibility from 2-to-4-unit to 5-to-49-unit properties and add tenant protections	2-to-49-unit properties	Banks, government-sponsored enterprises, and the Federal Housing Administration offer discounted multifamily real-estate-owned sales to mission-driven investors	Yes, if property is purchased at a discount, new owners must agree to nondisplacement of existing tenants and affordability protections for future tenants	No
Stabilization Acquisition Emergency Fund	New program	2-to-49-unit properties	No- or low-cost loans offered through the US Treasury's Capital Magnet Fund to mission-driven lenders and housing providers	Yes, 10-year affordability requirement	No

SMALL BUILDING RISK SHARING PROGRAM

In 2015, the US Department of Housing and Urban Development's (HUD's) Federal Housing Administration developed program rules for a Small Building Risk Sharing program to support the preservation of small rental housing by encouraging community development financial institutions (CDFIs), and other Federal Housing Administration (FHA)–approved lenders to provide long-term, fixed-rate loans to small building owners (HUD, n.d.). The Small Building program was to be a variation of its Risk Sharing program for state and local housing finance agencies (HFAs), which is not limited to small buildings.

Under the small business initiative, the loans would support the acquisition, substantial rehabilitation, or financing of existing properties without substantial rehabilitation. Under this program, HUD would use existing statutory authority to offer loans up to $3 million, or $5 million in high-cost areas, for eligible rental buildings with five or more units. As under the FHA platform, the financing was structured such that HUD provided full mortgage insurance on the loans issued by the lenders, which would absorb 50 percent of any loss. No dedicated reserves were required for losses, but lenders had to demonstrate financial capability to back any losses. The program was widely interpreted to require a regulatory agreement that restricted tenant incomes and rents that could be charged to tax credit levels, but with no offsetting subsidy—a significant barrier to participation by small property owners. The Federal Financing Bank, a government corporation supervised by the US Treasury Department, was to provide long-term fixed-rate funding for the loans, as it did for HFA Risk Sharing loans committed before 2019.

HUD published program details and obtained public comment but has not implemented the program. HUD should consider standing up this program, as it could provide liquidity for small rental housing, particularly to decrease borrowing costs for existing owners who do not need to substantially improve their properties or treat substandard housing conditions. Currently, there is little long-term fixed-rate financing available to mission-driven lenders.

We offer several considerations for creating an effective program. First, to limit duplication, it is critical that financing is targeted to the parts of the housing market that Fannie Mae and Freddie Mac are not already serving, specifically properties with low to moderate rents that are not served by other federal subsidies, such as the Low Income Housing Tax Credit program. Second, financing should accommodate small properties offering affordable rents and that, as a condition of the financing, rents should remain affordable for the life of the loan. Although HUD's other risk sharing programs require income documentation on tenants, this is onerous for small rental owners. A more streamlined approach, proposed by Representative Nydia Velazquez in 2020 as the Federal Financing Bank Risk-Sharing Act of 2020 and supported by a wide range of national housing organizations, would be to ensure that rents do not exceed a local threshold but not require documentation of tenant incomes. For example, the Risk Sharing statute requires at least 20 percent of units at 50 percent of the area median income or 40 percent of units at 60 percent of the area median income. Finally, CDFIs and other mission-driven lenders do not serve all markets. To reach these underserved markets, HUD would need to identify them and provide additional flexibilities for the types of lending institutions that it partners within underserved markets.

FIRST LOOK PROGRAM

The First Look program currently operates in the one-to-four-unit market and provides mission-driven organizations an initial opportunity to place offers to purchase real-estate-owned (REO) properties from banks, the government-sponsored enterprises (GSEs), and the FHA. Under the Fannie Mae (HomePath) and Freddie Mac (HomeSteps) First Look programs for one-to-four-unit REO properties, owner occupants and selected nonprofit organizations engaged in neighborhood stabilization activities obtain the exclusive right to bid on the REO properties through the first 20 days (30 days in Nevada) without competition from investors. When the initial period expires, investor offers are considered along with those from owner occupants and nonprofits. The existing First Look program does not contain any tenant affordability protections.

To expand this program, in which mission-driven organizations get a first look at larger REO properties (with 5 to 49 units), it would be reasonable to expect the new landlord to restrict future rents to an affordable level for a period (10 years) and enter into repayment arrangements with existing tenants. As part of their mission obligations, the GSEs and the FHA should be prepared to provide a discount on the REO sale as an offset to the new owner's agreement to restrict rents at affordable levels: this restriction would remain in place for the full 10 years, even if the property is sold during that period. Banks should also be required to provide a First Look program for their REOs on substantially the same terms as the GSEs and the FHA as part of their Community Reinvestment Act activities.

A program for 5 to 49 units would likely be small, as the number of multifamily loans that are seriously delinquent is far lower than in the single-family world. Fannie Mae has an overall multifamily delinquency rate of 0.98 percent, and Freddie Mac has an overall rate of 0.16 percent, versus a single-family delinquency rate of 3 percent for both GSEs (Fannie Mae 2020; Freddie Mac 2020). Loans in forbearance, where the borrower is not paying, count as delinquencies for this purpose. But there is a much lower take-up rate on forbearance and hence more muted delinquencies for rental buildings with 5 or more units, in part because the payback provisions for forborne properties with 5 or more units are far less generous than for 1-to-4-unit properties. This reflects the fact that 2-to-4-unit properties are financed under the GSE single-family programs, which have more generous and flexible forbearance terms than do the 5-or-more unit rentals; the latter are subject to the stricter forbearance requirements of the multifamily programs.

STABILIZATION ACQUISITION EMERGENCY FUND

David Abromowitz and Andrew Jakobovics propose using the US Treasury's Capital Magnet Fund to extend low- or no-cost capital to mission-based organizations, such as CDFIs and community-based nonprofit housing organizations, to quickly purchase small, market-rate rental buildings at risk of loss to the affordable housing stock because of the economic impacts of COVID-19.[4] The fund would be targeted to mission-based owners with the capacity to acquire and manage rental housing. They propose providing direct acquisition capital for a loan term of 10 years or longer, allowing mission-based organizations to compete with for-profit organizations in buying at-risk properties quickly. The program would target owners who are willing to sell their properties as an alternative to default and foreclosure. The fund would also provide some dollars for light rehabilitation and to make repairs for habitability. The authors contemplate that the Capital Magnet Fund would retain its 10-year affordability commitment for loan recipients, with a requirement for certification of rent affordability rather than for imposing income limits on tenants.

State and Local Preservation Programs

Thus far, we have discussed federal programs. States have been executing various policies to support renters and owners during the pandemic (Reina et al. 2021). In addition, states and localities are charged with distributing emergency federal rental assistance approved in December and in the most recent stimulus bill to struggling landlords and tenants. Many states and localities also have preexisting preservation programs. In this section, we highlight a few approaches that have been successful in at least one geographic area and that could be expanded. State and local programs can be implemented quickly and tailored to the needs of a particular housing market. These programs can complement federal policies.

The financial capacity and human resources to implement these programs vary across states and localities, as does the need for these programs (Reina et al. 2021).[5] Moreover, the demands of the COVID-19 crisis have meant state and local governments are facing many budget and housing market challenges that make it difficult to allocate resources to address the needs of small landlords. Therefore, federal funding and additional administrative capacity would likely be needed to expand any of these programs.

TABLE 2

Examples of Scalable State and Local Approaches to Preserve Small Rental Buildings

Approach	Eligible building type	Delivery mechanism	Protects existing tenants?	Supports existing owners?
Private-public partnerships to buy unsubsidized affordable housing	2-to-49-unit properties	Private and public partners purchase existing rental units with agreement to keep rents at or close to their current levels	Yes, rental price limits are imposed	No
Forgivable or low-interest rehabilitation loans	2-to-49-unit properties	State provides owners loans for rehabilitation in exchange for securing a certain portion of affordable units	Yes, keep agreement to keep rents affordable	Yes
Right of first refusal	2-or-more-unit properties	Tenants are given the first opportunity to purchase their rental units	Yes, protects tenants from displacement	No

PRIVATE-PUBLIC PARTNERSHIPS TO BUY UNSUBSIDIZED AFFORDABLE HOUSING AND KEEP IT AFFORDABLE

Several private-public partnerships and funds have been established to buy "naturally occurring" affordable housing and keep it affordable. A recent example is Charlotte, North Carolina's Housing Impact Fund,[6] but there are several other examples throughout the US.[7] Typically, there is both a public contribution and social impact private investors who are willing to accept a lower but still reasonable (7 to 8 percent) return on their investments to enhance a social purpose.

The City of Charlotte provides some funding, by directing some of the proceeds of its bond issue, to the Housing Impact Fund. This is augmented by social impact investors. The fund manager uses the money to buy unsubsidized but naturally occurring affordable rental housing and commits to keeping 80 percent of the units affordable to those making up to 80 percent of the area median income for 20 years.

But the speed at which these private-public partnerships can expand is unknown, as most are in their early stages, and some will face headwinds. Potential preservation buyers must move quickly to bid on properties in hot housing markets before "value add" buyers, who plan to make the properties more upscale and raise rents, step in with all equity bids. Obtaining financing commitments from fund managers can be a slower process, which makes it difficult for preservation buyers to compete with other bidders. Also, preservation buyers who plan to limit rents at currently affordable levels often are not the highest bidders when competing against buyers who will pay a higher price based on the potential to increase property cash flow by raising rents.

FORGIVABLE OR LOW-INTEREST REHABILITATION LOANS

Many state and local programs offer forgivable or low-interest loans for rehabilitation, but these loans often support substantial rehabilitation, which necessitates some increase in rents, even with a subsidized loan. An interesting approach is to offer small, forgivable loans or grants to owner occupants and small rental building owners without access to other financing sources for minimal repairs. For example, the Washington, DC, Small Buildings Grant Program provides up to $25,000 per dwelling unit or $200,000 per project in grants if affordability is maintained. But this program is restrictive in scope. It is limited to buildings with substandard housing conditions, including safety and environmental hazards. The building must have 5 to 20 units, it must be at least 75 percent occupied, and at least 25 percent of the units must be affordable to families earning below 50 percent of the median family income, or 100 percent of the units must be affordable to families earning below 80 percent of median family income. Under DC's program, the rents are subject to a five-year minimum affordability covenant that restricts the maximum allowable rent. The grants must be repaid for property owners that do not maintain required affordability restrictions or incur additional code violations during the affordability period.

A less restrictive version of this program would allow for rehabilitation funding while preserving affordability. To make the dollars go further, it would be conceivable to offer half the amount as a grant (which does not have to be paid back, subject to maintaining affordability for a period) and the other half as a loan (which carries a low interest rate and does have to be repaid). Alternatively, the program could be structured to provide low-interest-rate loans in exchange for some, but less onerous, affordability features. For program funding that is provided as a loan, if the affordability is not maintained, the loan interest rate would adjust upward as a penalty.

RIGHT OF FIRST REFUSAL

Right of first refusal offers tenants the first opportunity to buy their building to protect them from displacement from the sale of the building. The program could be modeled on the Washington, DC, TOPA (Tenant Opportunity to Purchase Act) program, enacted in 1980. Single-family units are largely exempt (as are single-unit rentals in condominiums and cooperatives); the program applies to most structures containing 2 or more units. More than 3,000 units have been preserved in Washington, DC, under this program since 2002—a figure that does not include units purchased through private means. For properties with 5 or more units, TOPA is exercised through a tenants' association, which can be stood up expressly for this purpose. For structures with 2 to 4 units, the tenants can together submit a statement of interest, but if there is insufficient interest, one tenant can do so alone. This program could be expanded more broadly.

The DC Department of Housing and Community Development provides technical assistance to tenant groups in properties with five or more units to convert the building to a condominium or cooperative if more than 50 percent of the tenants are interested in purchasing a unit and 50 percent or more members of the tenants' association qualifies as low-to-moderate-income households. This assistance includes assistance in structuring and organizing the tenants' association, preparing legal documents, and helping with loan applications. If renters do not have the funds to purchase the building, which is generally the case, they can assign their right of first refusal to a for-profit developer in exchange for joint ownership and certain provisions, such as affordable rent for a period. The developer usually applies for tax credits or other public subsidies and handles the property's rehabilitation and redevelopment. This type of program could be implemented in other geographic areas.

This program is not without drawbacks. First, if renters assign their right of first refusal to a for-profit developer in exchange for affordable rent for a period, these provisions benefit current tenants but not necessarily future tenants, depending on how the affordability restrictions are structured. Moreover, buildings with five or more units usually require a developer to provide the financing, and the economics often do not attract a third-party developer for the smallest properties.[8] Despite these drawbacks, the program could stabilize tenants and prevent displacement when the sale of a rental building is inevitable.

Conclusion

Preserving affordable units was a problem before COVID-19, and the pandemic's economic impacts have only compounded the issue. The recent authorization of emergency rental assistance could help stabilize renters and owners, but it is likely not enough to preserve affordable units that were already scarce.[9] In this brief, we have looked at options to help preserve small, multifamily units.

According to the 2018 Rental Housing Finance Survey, 45 percent of owners of 2-to-49-unit properties were individuals, compared with 7 percent of owners of properties with 50 or more units. Individual owners, who on average have less capital than institutional investors, are likely to face greater challenges sustaining their property both during and after the pandemic. Our proposed programs could help preserve small rental properties by allocating resources to owners and tenants and offering incentives and assistance to keep rental prices affordable for the long term.

These programs would all require some level of new funding, either through new federal appropriations or state and local sources. It is unlikely that state and local programs will have the funding to stand-up programs to preserve small rental housing at the scale needed. It is essential that the federal government provide funding to ensure that small rental buildings are preserved. In addition to federal appropriations, some innovative funding sources could be tapped to support such activities. For example, the 10 basis-point tax on GSE guarantee fees, passed in 2011 to fund a temporary cut in the payroll tax, is set to expire in 2021. This tax could be continued and repurposed for affordable housing. In a similar vein, the EB-5 Immigrant Investor Program, which was created to encourage capital investments by international investors, could be amended to allow the preservation of a minimum number of affordable units to be a permitted investment. These affordable housing funds could support federal programs or be allocated to localities to administer through local preservation programs.

Small multifamily properties with 2 to 49 units provide a disproportionate amount of affordable and moderately affordable housing. These units need to be preserved where possible to avoid aggravating the already tight supply of affordable rental housing. Much of the groundwork has been laid: programs can be implemented or modified at the federal level. States and localities have also tested approaches that could be implemented more broadly. The largest obstacles to implementation are focus and funding.

Notes

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5. The share of 5-to-49-unit buildings varies greatly across metropolitan areas. According to our analysis using 2013–18 American Community Survey data, 44.3 percent of rental housing in Dallas-Fort Worth-Arlington, Texas, was in 5-to-49-unit properties, the highest share among the 20 most-populous metropolitan statistical areas. In Riverside-San Bernardino-Ontario, California, this share was 25.1 percent. See HFPC (2020).
6. See Nate Berg, "Charlotte May Have Cracked the Code on Affordable Housing. Here's How," Fast Company, January 25, 2021, https://www.fastcompany.com/90597128/charlotte-may-have-cracked-the-code-on-affordable-housing-heres-how.

[7] See Turner and O'Brien (2020) for other examples.

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