

Legal Opinion: CIM-0105

Index: 3.600

Subject: Applic. of Boston Rent Ctrl. Laws on LIHPRHA Appraisal

October 27, 1994

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Dear Mr. Edson:

I am in receipt of your letter concerning Church Park Apartments located in Boston, Massachusetts. Your letter was written on behalf of the owner, The United Company, a Massachusetts limited partnership. Your letter sets forth your position that the Low Income Housing Preservation Homeownership Act of 1990, as amended, 12 U.S.C. Sections 4101 et seq. ("LIHPRHA"), preempts certain rent control provisions of the Rental Housing Equity Ordinance for the City of Boston (the "Boston Ordinance") during the appraisal process.

With respect to the application of the Boston Ordinance on the appraisal process for Church Park, you maintained that Section 232 of LIHPRHA (12 U.S.C. Section 4122) applies during the appraisal stage. You stated that Section 232 was a clear expression by Congress that discriminatory State and local laws are to be preempted for all LIHPRHA purposes. You argued that the Department indicated in the Appraisal Guidelines, 57 Fed. Reg. 19970 (May 6, 1992), that Section 232 applies during the appraisal process. You also argued that Sections 232(a)(2) and (a)(4) are only logical when applied during the appraisal stage. Next, you asserted that Section 232 preempts certain provisions of the Boston Ordinance. You explained that certain provisions of the Boston Ordinance are not saved by the exceptions listed in Section 232(b). Finally, your letter challenged a February 24, 1994 memorandum from David R. Cooper, Assistant General Counsel, Multifamily Mortgage Division (signed by Gains E. Hopkins) to Patricia Allen, Associate Regional Counsel, Boston Office (the "Boston Memorandum"). You asked our office to reconsider the position taken in the Boston Memorandum and conclude that Church Park be appraised with the presumption that it is exempt from the rent control provisions in the Boston Ordinance.

It is our understanding from the Office of Housing that both the owner and HUD have completed their appraisals. The issue is whether the appraisals were conducted in accordance with LIHPRHA, the implementing regulations, and the Appraisal Guidelines. You attempted to frame the issue to be whether LIHPRHA preempts the Boston Ordinance for purposes of the appraisal process. There is no issue of preemption because HUD is not depriving the State or local government of jurisdiction over a subject matter which the

State or local government is trying to regulate. Likewise, neither the State nor local government is attempting to interfere with the Department's administration of the LIHPRHA appraisal process.

An examination of the doctrine of preemption makes clear that the appraisal process is separate and apart from the issue of preemption. Preemption becomes an issue where a State or local law regulates a subject and that regulation interferes with or, is contrary to, the laws of Congress. *Hillsborough County, Fla. v. Automated Medical Lab., Inc.*, 471 U.S. 707, 712 (1985). The preemption occurs when a Federal entity overrides the authority of a State or local government to exercise jurisdiction in a particular area. Preemption is an action taken by a Federal entity directed at a State or local government, not an action directed at appraisers. For purposes of the appraisal process, there is no State or local law that regulates the manner in which the appraiser is directed by LIHPRHA to perform the appraisal. Accordingly, there is no State or local law regulating the LIHPRHA appraisal process to be preempted.

There is no attempt by the Department to deny the State or the local government the authority to regulate the rents. The Department does preempt State and local rent control in other circumstances. For example, HUD preempts State and local rent control in its entirety on all subsidized housing projects that are subject to HUD-insured or HUD-held mortgages. See 24 C.F.R. Part 246, Subpart C. This preemption ceases when HUD is no longer the insurer or holder of the mortgage. The effects of this preemption of State and local rent control are not considered in the LIHPRHA appraisal process because Section 213(c) of LIHPRHA requires that the appraisal guidelines assume, among other matters, the prepayment of the existing federally assisted mortgage. You indicated that HUD should deprive the State and local government of their right to regulate rents. There is no reason for such action by HUD because the State and the local government's regulation of rents does not affect the manner in which LIHPRHA directs the appraiser to conduct the appraisal. The requirements for the appraisal process contained in Section 213(c) of LIHPRHA (12 U.S.C. Section 4104 (c)) are directed at how appraisers are to conduct an appraisal and not at the State or local government.

The only reason why appraisers take into account the effects of State or local rent control is because they are directed to do so by Federal law, not because they are compelled to do so by State or local law. Section 213(c) of LIHPRHA requires that the Appraisal Guidelines, and through them the appraisers, "assume repayment of the existing federally assisted mortgage, termination of the existing low-income affordability restrictions, simultaneous termination of any Federal rental assistance, and costs of compliance with any State or local laws of general applicability." (Emphasis added.) 12 U.S.C.

Section 4104 (c). By directing appraisers to consider the costs of generally applicable State or local laws, Congress included those laws in the governing Federal standard for determining a project's preservation value. Congress, of course, could have

directed the appraisers to disregard these costs. Such a directive would have altered the governing Federal standard for conducting an appraisal; it would not, however, constitute a preemption of those State or local laws. In short, Congress is quite capable of defining what costs should be considered in the appraisal without requiring a preemption of State and local laws.

We believe that the underlying issue is the meaning of "State or local laws of general applicability" in Section 213(c) of LIHPRHA. Unfortunately, the resolution of this issue has been complicated by the contention that, when the costs associated with State and local laws adversely affect preservation value, those laws must be preempted under the preemption of State or local laws provisions of Section 232 of LIHPRHA. Section 232 provides:

"(a) In General.--No State or political subdivision of a State may establish, continue in effect, or enforce any law or regulation that--

(1) restricts or inhibits the prepayment of any mortgage described in section 229(1) (or the voluntary termination of any insurance contract pursuant to section 229 of the National Housing Act) on eligible low income housing;

(2) restricts or inhibits an owner of such housing from receiving the authorized annual return provided under section 214;

(3) is inconsistent with any provision of this subtitle, including any law, regulation, or other restriction that limits or impairs the ability of any owner of eligible low income housing to receive incentives authorized under this subtitle (including authorization to increase rental rates, transfer the housing, obtain secondary financing, or use the proceeds of any of such incentives); or

(4) in its applicability to low-income housing is limited only to eligible low-income housing for which the owner has prepaid the mortgage or terminated the insurance contract.

Any law, regulation, or restriction described under paragraph (1), (2), (3), or (4) shall be ineffective and any eligible low-income housing exempt from the law, regulation,

or restriction, only to the extent that it violates the provisions of this subsection.

(b) Effect.--This section shall not prevent the establishment, continuing in effect, or enforcement of any law or regulation of any State or political subdivision of a State not inconsistent with the provisions of this subtitle such as any law or regulation relating to building standards, zoning limitations, health, safety, or

habitability standards for housing, rent control, or conversion of rental housing to condominium or cooperative ownership, to the extent such law or regulation is of general applicability to both housing receiving Federal assistance and nonassisted housing. This section shall not preempt, annul, or alter any contractual restrictions or obligations existing before the date of the enactment of the Cranston-Gonzalez National Affordable Housing Act that prevent or limit an owner of eligible low-income housing from prepaying the mortgage on the housing (or terminating the insurance contract on the housing)."

12 U.S.C. Section 4122 .

We note initially that Section 232 is directed unequivocally at the action of States or local jurisdictions, not at the conduct of an appraiser. Section 232(a) states: "No State or political subdivision . . . may establish, continue in effect, or enforce any law or regulation" Thus, any preemption effected by HUD should, in turn, be directed at the State or local jurisdiction that is attempting to establish, effect, or enforce a particular law. In the appraisal process, however, there simply is no State or local action to preempt since State or local governments are not attempting to regulate the LIHPRHA appraisal process.

You have attempted to draw preemption into the appraisal process by arguing that Sections 232(a)(2) and (a)(4) are logical only at the appraisal stage. You contend that: Section 232(a)(2) preempts laws which restrict or inhibit an owner from receiving the annual authorized return "Annual authorized return" is equal to 8 percent of preservation equity. (Section 214(a) of LIHPRHA, 12 U.S.C. Section 4104(a)) under LIHPRHA, that the annual authorized return is a function of the appraised preservation value, and that therefore "a local law's limiting effect on an annual authorized return can only take place during the appraisal phase of LIHPRHA." (Your Emphasis.) Your argument ignores the fact that preservation value and annual authorized return under Section 213(c) are dependent on costs of "State or local laws of general applicability." Clearly, Congress intended that such laws of general applicability could result in a lower annual authorized return than would apply if the laws did not exist or were not taken into consideration.

A more logical reading of Section 232(a)(2) is that it is intended to apply, after implementation of a HUD-approved plan of action providing incentives, to laws that would prevent an owner from receiving its 8 percent of equity as approved by HUD in the plan of action. For example, if there were a generally applicable local rent control law that would set allowable rents based upon an assumed 7 percent return on owner investment, that law would be considered in determining appraised value and the amount of the owner's annual authorized return. HUD then would set the rents that an owner could charge at a level that would enable the owner to receive an 8 percent return on its preservation equity. If a State or local jurisdiction then

attempted to reduce the owner's rent because the owner's return exceeded 7 percent permitted by its local rent control, HUD would preempt that law relying on Section 232(a)(2). This was explained in the preamble to the Interim Rule, 24 C.F.R. Part 248. 57 Fed. Reg. 11992, 11995 (April 8, 1992). The preamble provided:

"For example, one commenter suggested that the proposed rule be amended to allow a State or local law which limits owners['] rate of return and applies generally to both federally-assisted and unsubsidized projects. HUD would preempt such a law, finding it to be in violation of subparagraph (a)(2) of this section. While the law is of general applicability, it restricts and inhibits owners from receiving the annual rate of return to which they are entitled under Section 248.121 of this subpart. However, it should be noted that the law would be taken into consideration in appraising the project under Section 248.111." (Emphasis added.)

57 Fed. Reg. at 11995.

You argued that Section 232(a)(4) logically applies only at the appraisal phase because it would be irrelevant at the underwriting phase. We assume this means the phase at which HUD determines the incentives to be provided to the owner or purchaser for being required to maintain the project as affordable. You point out that at this stage the project is going to be preserved, and in reality the mortgage is never prepaid. Your argument ignores the fact that Section 232(a)(4) by its very terms applies at another phase, namely, when the owner has, in fact, prepaid the mortgage or terminated the contract of insurance. Furthermore, the language of Section 232(a)(4) clearly suggests that it is intended to cover owners that have had a plan of action approved under Section 218 of LIHPRHA (12 U.S.C. Section 4108), which authorizes the Secretary to approve a "plan of action that provides for

termination of the low-income affordability restrictions through prepayment of the mortgage or voluntary termination of the mortgage insurance contract." While this has been a rarely, if ever, used alternative to receiving incentives, it nonetheless is a legally authorized form of plan of action, and Section 232(a)(4) protects these owners against State or local governments enforcing laws that apply only to such owners.

We also note that there is no reason to read the Section 232(a)(4) preemption provision into the appraisal process since any law that "in its applicability to low-income housing is limited only to eligible low-income housing for which the owner has prepaid the mortgage or terminated the insurance contract" would clearly not be a State or local law of general applicability within the meaning of Section 213(c) and, therefore, would not be considered in the appraisal process.

In sum, the preemption provisions of Sections 232(a)(2) and (a)(4) are more logically and appropriately directed at circumstances when there is action by the State or local

government to preempt.

To further support your argument that Section 232 applies during the appraisal process, you cited the Appraisal Guidelines and stated that, by HUD's own interpretation, Section 232 applies during the appraisal stage of LIHPRHA. You quoted the Appraisal Guidelines which provide: "any law that is encompassed by Section 232(a) of LIHPRHA, as determined by HUD, shall not be considered when determining the preservation value of the property." 57 Fed. Reg. 19983. Clearly, when there is a law and HUD determines that it is appropriate to preempt State or local jurisdiction over the subject matter of that law, the appraisers should not take the costs of an owner's compliance with such laws into consideration. The above quoted provision was addressing State and local laws in general.

The section in the Appraisal Guidelines that govern the applicability of rent control to the appraisal process provides:

"It is the appraiser's responsibility to explore fully and reflect the effect rent control would have on the unsubsidized value in establishing the assumptions for the appraisals for a specific property. The appraiser is also responsible for justifying the assumptions for the property regarding rent control. Such assumptions must be supported by all necessary data. The appraisers must seek other professional opinions as needed and document their reports accordingly. In summary, the objective of this appraisal is to approximate the value the unregulated property would command in the market place in the absence of any Federal participation, but not excluding legal requirements such as rent control." (Emphasis added.)

57 Fed. Reg. 19983. This objective is met by considering the "costs of compliance with any State or local laws of general applicability" under Section 213(c). This provision carries out the intent of Section 213(c). In fact, the preamble to the Appraisal Guidelines indicates that the Department believed it was unlikely rent control laws would be preempted. The preamble explains that:

"With reference to the specific issue of rent control, section 232(b) of LIHPRHA states that rent control laws are not preempted if they are consistent with LIHPRHA and are of general applicability. Therefore, the issue of preemption should not arise very frequently in the context of laws controlling rents."

57 Fed. Reg. 19977. While the Appraisal Guidelines do discuss Section 232, the Appraisal Guidelines ultimately provide that it is the Department's responsibility to determine whether a State or local law is subject to Section 232. The Department has determined that during the appraisal process, State and local laws would not be preempted due to the mandate in Section 213(c) that appraisers determine the costs of compliance with any State or local laws of general applicability.

In discussing the reasons for preempting the Boston Ordinance, you asserted that you know of no federally assisted housing except LIHPRHA-eligible projects that may prepay its mortgage. This is not the correct standard for determining whether a State or local law is "generally applicable" under Section 213(c). For purposes of the appraisal under Section 213(c), we explained in the Boston Memorandum that the appropriate standard for determining whether a State or local law is of general applicability depends on whether the law in question applies to housing that is not LIHPRHA-eligible, but is similarly situated to the projects being appraised. A comparison must be made between the law that would have been applied to LIHPRHA-eligible projects, had LIHPRHA not been enacted, and the law that is applied to housing that is similarly situated. LIHPRHA-eligible projects, by definition, receive some sort of Federal government assistance. Had LIHPRHA not been enacted, the owners of LIHPRHA-eligible projects could have terminated the assistance on the projects and any accompanying use restrictions. In appraising the LIHPRHA-eligible projects under Section 213, the appraisers must assume that LIHPRHA had not been enacted and that all Federal restrictions on the projects have terminated. Thus, it is the State and local laws that do not specifically target LIHPRHA-eligible projects that apply to housing that has terminated its governmental assistance and restrictions that should be considered by appraisers under Section 213(c) as being generally applicable.

In order to make the determination of whether a law is of general applicability, the following two questions must be answered:

1. What State or local laws would apply to the LIHPRHA-eligible project if LIHPRHA had not been enacted and the Federal assistance and restrictions on the project were terminated?
2. Are the State or local laws in response to question 1 also applicable to housing that is not LIHPRHA-eligible, but is similarly situated by virtue of terminating use restrictions?

If the answer to the second question is in the affirmative, the law would be deemed generally applicable for purposes of the appraisals conducted under Section 213(c).

A law that appears on its face to be generally applicable but that in its effect singles out LIHPRHA-eligible projects for disparate treatment is not "of general applicability" as that term is used in LIHPRHA. In order for a State or local law to be classified as generally applicable for purposes of Section 213(c), it need not apply to all housing within a certain geographic area. The law, however, cannot apply to such a narrow class of housing so as to effectively single out only LIHPRHA-eligible projects. State or local laws that on their face appear to be generally applicable must be reviewed on a case-by-case basis to ensure that they also are generally applicable in their effect.

In the Boston Memorandum, our office concluded that the provisions of the Boston Ordinance that dealt with restrictions on evictions and cooperative and condominium conversions are generally applicable because it applied to similarly situated housing. On further consideration, we have decided that it is not within the Department's purview to decide whether a particular State or local law is generally applicable. The Appraisal Guidelines make clear that it is the appraiser's responsibility to determine whether a law is generally applicable, and, therefore, should be taken into consideration when conducting an appraisal. If the appraiser has a question regarding the general applicability of a State or local law, the appraiser is responsible for obtaining a legal opinion from a qualified professional. 57 Fed. Reg. at 19983. Accordingly, the Boston Memorandum should be read only as an interpretation of the phrase "State or local laws of general applicability" and not as an authoritative statement of whether the Boston Ordinance meets the requirements of Section 213(c).

In conclusion, in determining whether the appraisals were performed in accordance with LIHPRHA, the regulations and the

Appraisal Guidelines, there is no issue of preemption. HUD is not depriving the State or local government of jurisdiction over a subject matter which the State or local government is trying to regulate. Likewise, neither the State nor the local government is attempting to interfere with the Department's administration of the LIHPRHA appraisal process. For the reasons stated above, we cannot agree that your letter provides a basis for the Boston HUD Office to instruct appraisers to ignore what you describe as the "Discriminatory Provisions" of the Boston Ordinance. Under the Appraisal Guidelines, it is the appraiser's responsibility to determine whether a law is generally applicable, and, therefore, should be taken into consideration when conducting an appraisal.

I hope this letter addresses all of your concerns.

Sincerely,

Nelson A. Díaz
General Counsel