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The 235 Experience in Knox County, Tennessee: A Study of the Role of the Private Sector in the Operation of the 235 Home Ownership Program from 1969-1973.

James Dewey Mims
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I am submitting herewith a thesis written by James Dewey Mims entitled "The 235 Experience in Knox County, Tennessee: A Study of the Role of the Private Sector in the Operation of the 235 Home Ownership Program from 1969-1973.." I have examined the final electronic copy of this thesis for form and content and recommend that it be accepted in partial fulfillment of the requirements for the degree of Master of Science, with a major in .

Joseph M. Prochaska, Major Professor

We have read this thesis and recommend its acceptance:

James A. Spencer, Walter L. Shouse

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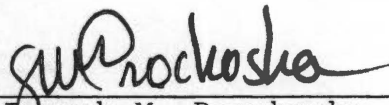
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Vice Provost and Dean of the Graduate School

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To the Graduate Council:

I am submitting herewith a thesis written by James Dewey Mims entitled "The 235 Experience in Knox County, Tennessee: A Study of the Role of the Private Sector in the Operation of the 235 Home Ownership Program from 1969-1973." I recommend that it be accepted in partial fulfillment of the requirements for the degree of Master of Science in Planning.




Joseph M. Prochaska
Major Professor

We have read this thesis and
recommend its acceptance:



Accepted for the Council:



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THE 235 EXPERIENCE IN KNOX COUNTY, TENNESSEE: A STUDY
OF THE ROLE OF THE PRIVATE SECTOR IN THE OPERATION
OF THE 235 HOME OWNERSHIP PROGRAM FROM 1969-1973

A Thesis
Presented for the
Master of Science in Planning
Degree
The University of Tennessee

James Dewey Mims

March 1976

1269758

DEDICATION

The author owes enormous gratitude and appreciation to his wife, Mina, whose encouragement and understanding sustained the author throughout the course of preparing this manuscript. Without her undying faith that the author could achieve the goal of completing the thesis, it is doubtful in this author's mind that he could have ever accomplished what seemed to be an insurmountable task.

Therefore, being very aware of the source of much of his stamina and motivation to complete this thesis, the author would like to dedicate this thesis to his wife, Mina Louise Gingrich Mims.

ACKNOWLEDGMENTS

The author would like to express his appreciation for the cooperation and assistance of the various private sector housing and home finance participants in the Section 235 Program in Knox County, Tennessee. Particular mention should be extended to the builders, developers and brokers of the seven major "235" subdivisions studied in this thesis. Also, the assistance of the various mortgagees who provided many forms and helped this author understand the overall Section 235 process is appreciated. The Economics Section of the FHA insuring office in Knoxville as well as numerous other FHA officials are to be thanked for their cooperation in providing data so essential to the writing of this study.

The author's Major Professor and Advisor, Mr. Joseph M. Prochaska deserves a special thanks for the advice and assistance he provided in the direction of this thesis. In addition, the author is appreciative of the reading of his thesis by his thesis committee which consisted of: Mr. James A. Spencer and Mr. Walter L. Shouse. A special thanks to the author's thesis committee for giving him the opportunity to attend the Graduate School of Planning and to be able to complete the goal of writing this thesis.

Without the untiring efforts of the author's typist Ms. Diana Van Kempen this manuscript could never have been

completed. She provided excellent assistance and that assistance is appreciated by the author.

The moral support and encouragement provided by the author's parents Mr. and Mrs. James E. Mims, sister Ms. Shirley J. Mims, and parents-in-law Mr. and Mrs. Roger H. Gingrich is appreciated and will always be remembered.

ABSTRACT

The purpose of this study was to examine the role of the private housing and home finance industry in the operation of the Section 235 home ownership program in Knox County, Tennessee.

The information and data utilized in this study was derived from a number of sources but primarily from interviews with selected builders, brokers, and mortgagees involved in the development and marketing of seven suburban "235" Subdivisions in Knox County. An assessment was made of the various roles of the private sector participants, their successes and failures in the operation of the Section 235 program, and the overall value of the program to the private sector and the low and moderate income people of Knox County.

The Section 235 program made quite an impact on Knox County in the provision of low and moderate income housing, especially during the period of this study from 1969-1973.

Although the Section 235 program was almost entirely suburban in nature, excluded blacks in the "235" Subdivisions studied, was production rather than quality oriented, and tended to be less consumer oriented than it should be, it was viewed as successful in terms of its operation by the author. Primarily the program was found to be a boon for the builders and brokers of Knox County by the creation of a low and moderate income housing market.

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CHAPTER I

INTRODUCTION

I. BACKGROUND OF THE PROBLEM

Home is the most tangible and desirable of possessions. It pays dividends in services rendered, and not the least of these are the psychological (sentimental, if you prefer) satisfactions which lie deep in the roots of human nature. It is no less important now than in ages gone by for people to have their own "vine and fig tree," their own bit of this earth, where they are at least to some extent masters of their fate.

From a broader social viewpoint homeownership provides an assurance of permanency, which has value in neighborhood, in one's church, in one's job. It means standing among neighbors, good credit, permanent relationships with one's fellows. It means a greater interest in local government and in meeting the problems which affect everyone of the nations citizen's.¹

Although the above quote was made following World War II, there are many who still feel just as strongly about home ownership and the values which it engenders for people. In short, home ownership has long been an American ideal—almost as sacrosanct as motherhood and apple pie. The United States in fact has been described as a nation of home owners. While it is true that most middle and upper-income families own their own homes, it is also true that most poor ones do not.

¹Dorothy Rosenman, A Million Homes a Year (New York: Harcourt, Brace and Company, 1945), p. 247.

By 1968, almost two-thirds of all American families owned their homes (in large part because of the federal government's commitment to the Federal Housing Administration (FHA) mortgage insurance programs). However, over half of all Americans with incomes under \$4,000 were renters. For example, in 1966, only 1 percent of all mortgages awarded under FHA Section 203, went to families with incomes under \$4,000.² With the passage, however, of the 1968 Housing and Urban Development Act, a new program, Section 235, was designed specifically to assist low income people to purchase their own home.

The program involves subsidy payments which reduce the interest to be paid by the home owner. The amount of the subsidy varies with the income of the family, as well as the total amount of the mortgage payment at the private market interest rate. The Section 235 program relies on the private sector for the construction and financing of the housing units. The assistance to families under the program is directed at reducing the interest rate to as low as 1 percent. To qualify under the program a family must meet certain income limits established by the Federal Housing Administration.³

²Byron Fielding, "Homeownership for Low Income Families," Journal of Housing, (June, 1969), 278-279.

³Further details about the requirements and functions of the Section 235 program are found in later chapters of this thesis.

II. STATEMENT OF THE PROBLEM

In order to implement the Section 235 program, the federal government joined with private enterprise for producing housing units for the low income segment of the population. The Section 235 program, created through the Housing Act of 1968, was designed to provide home ownership opportunities for poor Americans. With the federal government using the subsidy technique and the private sector housing industry building, selling, and financing the units, the nation reestablished the goal of "a decent home and a suitable living environment for all Americans." This thesis explores how well the private sector housing industry, in one local market, Knox County, Tennessee, responded to the Section 235 program. Was the program to be a way of providing home ownership for low income families, or instead did the program provide a boon to the builders, developers, and real estate brokers?

III. PURPOSE AND SCOPE OF THESIS

The purpose of this study is to examine the role of the private housing and home finance industry in the operation of the Section 235 home ownership program in Knox County, Tennessee, during the period 1969-1973. An assessment is made of the various roles and responsibilities of the private

sector participants in the program, the successes and failures in the operation of the program, and the overall value of the program to the private sector participants as well as the low and moderate income people of Knox County.

This thesis utilizes the large scale or "package-type" subdivision developers to assess the impact of Section 235 and to explore the process of the Section 235 program. The thesis scope is limited to these large scale subdivision developers and builders of new housing. Excluded therefore is the scattered lot type builders of Section 235 housing. Also excluded from the scope is the rehabilitation aspects of the program.

IV. RESEARCH DESIGN AND METHODOLOGY

The material gathered and utilized in this thesis represents research conducted by the author from 1969 to 1971 while a student at the Graduate School of Planning. The material was later updated so as to allow for a view of the Section 235 program from its inception in Knox County to its demise around 1973.

The information and data in this thesis were derived utilizing the following sources and methods:

1. Personal interviews were conducted with the builders, developers, brokers and mortgagees involved with the seven subdivisions selling homes in Knox County under the Section

235 program. The scattered lot construction and sale of Section 235 housing were not explored in this thesis.

The builders, developers, and brokers chosen for interviews were the key participants in the seven Knox County subdivisions of: Northbrook, Southbrook, Middlebrook, Woodmere West, Hunting Hills West, Canby Hills, and Hidden Hills. The management people were discovered by word of mouth from other builders and developers, as well as through newspaper advertisements in the classified section of the newspapers.

Since there were only seven subdivisions involved in this study, the builders, developers, brokers, and mortgagees were not sourced in order to protect the confidentiality of their statements. This request for confidentiality was made by all the persons interviewed in the course of the author's research.

The personal interviews of these large scale or "package-type" subdivisions constitute the primary source of information for the author concerning the Section 235 operation in Knox County. Other sources utilized include the use of library references such as books, magazines, periodicals, and professional journals. A source of much of the data on the Section 235 program was obtained from the records of the Federal Housing Administration office in Knoxville.

A combination of approaches were used in the development of this study. Primarily used are the descriptive, exploratory, and case study techniques.

CHAPTER II

HISTORICAL PERSPECTIVE OF NATIONAL HOME OWNERSHIP

I. BACKGROUND OF THE FEDERAL ROLE IN HOUSING

The first major piece of federal housing legislation was the National Housing Act of 1934. It was passed during the depression to stimulate construction and employment, as well as to support the mortgage market. The Act also created the Federal Housing Administration to insure long-term, low down-payment mortgages to private individuals, thereby making possible home ownership possible for moderate income families. Further, the Act established the Federal Savings and Loan Insurance Corporation, spurring the growth of savings and loan institutions, which now provide the bulk of private mortgages. Finally, the National Housing Act authorized the charter of secondary mortgage purchase associations. This type of agency eventually came into being, called the Federal National Mortgage Association (FNMA), which provides a secondary national market for mortgage paper, increasing the supply in areas lacking their own institutions. In effect, these measures were designed to increase and more equally distribute the flow of private funds into housing and thus extend the possibility of home ownership to moderate income families.

By contrast, the Housing Act of 1937 initiated the first true "subsidy" program-public housing. It authorized annual federal contributions to amortize the capital costs of publicly owned housing built by local agencies. The federal contribution allowed rents to be reduced so that families otherwise unable to afford adequate shelter could be properly housed.¹

Much of the public housing developed before the war was later converted to military use. After the war, veterans were given preference, and with prosperity, most of the occupants increased their income with many moving on to private housing. The Veteran's Administration also launched its mortgage guarantee program in 1944, providing long term home mortgages with no downpayment. These combined developments seemed to indicate a shift in national housing policy, with increasing emphasis on the needs of middle and upper-income families. But with passage of the Housing Act of 1949, the situation was reversed and housing programs were redirected to lower income families.

The Housing Act of 1949 first declared the national goal of a "decent home and a suitable living environment for every American family." This goal was backed by the authorization of 135,000 units of public housing for each of the next six

¹Robert Taggart III, Low-Income Housing: A Critique of Federal Aid, (Baltimore: The Johns Hopkins Press, 1970), p. 12.

years, or a total of 810,000 units.² Cities were given grants and loans for urban renewal, with emphasis placed upon improving the total environment as well as building new housing.

Urban renewal and unassisted construction became the focus of the federal housing efforts in the 1950's. The Housing Act of 1954 required that communities with public housing projects prepare a workable program for community improvement which would link public housing and renewal more closely. The 1954 legislation also rechartered the FNMA, giving it special assistance funds to purchase mortgages when no private buyers could be found. Urban renewal activity was high, and an enormous volume of relatively low-cost housing was produced under the FHA and VA insurance programs, diverting attention away from the housing subsidy programs. However, in 1959, a direct loan program was created providing funds to nonprofit sponsors of rental housing for the elderly. This marked the first recognition of the separate needs of the elderly. It was also the first use of the below-market-interest rate or BMIR subsidy technique in which loans are made at less than the market rate—in this case, at the lower federal borrowing rate.

²Ibid., p. 13.

The emphasis on subsidy programs continued in the 1960's, and became the primary technique of the federal housing effort.³ The Housing Act of 1961 initiated assistance for families with an income too high for public housing, but too low to afford adequate private shelter under the 221(d)(3) program. Through the FNMA, the federal government funded BMIR loans to sponsors of rental housing intended for families falling in this income gap. The interest was set at the federal borrowing rates as was done under the 1959 loan program for housing for the elderly.

By 1965, the cost of federal borrowing had increased to such an extent that the earlier BMIR programs lending at this rate could not provide an adequate subsidy to serve their intended clientele. Primarily as a result of this problem, the Housing and Urban Development Act of 1965 set the interest under these programs at 3 percent. The subsidy therefore became the difference between interest payments at this rate and those at the higher market rate. The 1965 Housing Act, however, had a more far-reaching impact, by creating two major subsidy programs to be administered by the newly created Department of Housing and Urban Development (HUD). Under the Section 23 lease program, annual contributions were provided to local agencies for the lease of private dwellings

³Ibid., p. 13.

which would be occupied by public housing tenants. Second, payments were authorized to be paid by FHA to nonprofit and limited-dividend sponsors of low-income housing. These two subsidies were designed to make up the difference between a fixed percentage of an occupant's income and the going market rent. The two programs of the 1965 Housing Act increased the involvement of the private sector in housing lower income families, while also creating an alternative to direct BMIR loans which has the effect of tying up large amounts of federal funds. But while all of these new housing programs were to offer an alternative to public housing, none offered a possibility of home ownership.

In 1966, the authors of the Demonstration Cities and Metropolitan Development Act, recognized that housing alone could not solve urban problems. The Act therefore was focused on a spectrum of needs. The Act did, however, introduce a specific program (Section 221(h)) for the rehabilitation of private housing to be sold to low income families, providing direct loans at a 3 percent interest rate. Thus this extended the rehabilitation loan and grant programs initiated in 1964 and 1965. But more importantly, it was the first direct piece of legislation aimed at assistance to low and moderate income families for home ownership.⁴

⁴Byron Fielding, "Homeownership for Low Income Families," Journal of Housing, (June 1969), 279.

II. THE HOUSING ACT OF 1968: BASIS FOR SECTION 235

All of the previously mentioned national legislation led up to the Housing and Urban Development Act of 1968. Like the 1965 Act, it placed increasing reliance and importance on the private sector for provision of housing. It also sought to avoid direct federal loans. In the 1968 Act a new assistance technique was introduced, the interest subsidy payment to the private financial sector. This reduced the effective interest rate paid by the nonprofit or limited-dividend sponsors of low-cost housing. Two programs were initiated which utilized this technique, one subsidizing loans to sponsors of rental housing for low-income families (Section 236) and the other assisting low and moderate income home buyers (Section 235). Also created under the 1968 Act was the Government National Mortgage Association (GNMA) to replace the FNMA. The FNMA was made a private corporation, while the GNMA took over the special assistance functions. The effect of all this was to provide a separate source of mortgage financing for the subsidy programs and to give them a greater degree of independence from conditions in the private housing markets. Finally, the HUD Act of 1968 established a ten-year production goal of 26 million housing units, including 6 million to be supplied under the newly created subsidy programs. The Act directed HUD to prepare

an annual housing report for the president detailing programs toward reaching this goal and to serve as a basis for further legislative action.⁵

III. THE SECTION 235 HOME OWNERSHIP PROGRAM: GENERAL PURPOSES AND PROVISIONS

Purposes

As pointed out already, the Housing Act of 1968, when finally passed, "moved federal housing into the private marketplace."⁶ This is the major thrust of the '68 legislation.

During the past 30 years, for every dwelling unit built in the subsidized area by the private sector, there have been 12 units built through the Federal Housing Administration. Some persons have said that if the nation is going to produce six million new low income housing units by 1978, the pace of housing development must be stepped up. The idea behind the Section 235 program (created by the '68 Housing Act) is to use federal funding as a "catalyst" to create greater private funding.⁷

⁵National Commission on Urban Problems, Building The American City (Washington, D.C.: Government Printing Office, December 1968), pp. 173-179.

⁶John McMahan, "An Opportunity for Private Capital in the Housing Market," Private Capital and Low-Income Housing (Washington, D.C.: Nonprofit Housing Center, 1970), p. 10.

⁷Ibid., pp. 10-11.

A second reason for passage of the Section 235 home ownership program was a concern that the 221(d)(3) program was not reaching poor families.⁸ For example, in 1968 approximately 14 percent of the families in the United States earned less than \$3,000 a year, approximately 14 percent earned \$3,000 to \$5,000 a year, and approximately 18 percent earned \$5,000 to \$7,000 a year. Assuming that those families below \$3,000 are the responsibility of the Public Housing Programs, and that \$7,000 represents the minimum income for private housing, this places about 32 percent of the families in the United States in the "twilight" range between public and private housing. Through December of 1968, Section 221(d)(3) housing had appealed to a median income range of approximately \$6,000.⁹ Therefore, one of the major objectives of the 1968 legislation was to develop a program which could capture those persons in the \$4,000 to \$6,000 income range because the low to moderate income families were not being reached by the existing federal housing programs.

In addition, another major purpose of the 1968 legislation was to extend home ownership on a much broader scale in the \$4,000 to \$6,000 income range. The brief success, for example, of the Section 221(d)(3) program had led many people to believe that the program could be expanded.

⁸Ibid., p. 11.

⁹Ibid., p. 11.

The overall goal of the Section 235 program was to increase the supply of low cost housing stock rather than merely transfer ownership of existing units to low income families. In fact, specific limits were originally set on the portions of contract authority which would be used for existing housing—not more than 25 percent through fiscal 1969; 15 percent in fiscal 1970; and 10 percent in fiscal 1971. After that, all assisted units were to be new, except in those cases where they could not be provided economically.¹⁰

Provisions

The Section 235 program provides no funds for the construction or rehabilitation of a home. What is appropriated are monies which go towards reducing the interest an eligible family would normally pay on a FHA-insured mortgage loan from a private lending institution. The amount of the interest rate subsidy depends in each case on family income, the size of the mortgage, and the interest rate on FHA-insured loans at the time the mortgage is executed. With the subsidy, which is paid by FHA to the lending institution, a family may pay as little as 1 percent interest on the

¹⁰"Federal Housing Administration's Section 235," Journal of Housing (June, 1969) 281.

mortgage loan. As the family income rises, the subsidy is reduced. The subsidy ceases altogether when the family is able to pay the full mortgage interest rate, insurance, and property taxes without exceeding 20 percent of their total income. However, maintenance costs, heat, water, and other utilities are not included in determining the size of the interest-rate subsidy. Thus, a family could probably purchase a home under Section 235 for about the same monthly costs as if they were to rent a home under the Section 236 program rental subsidy program.

The 20 percent income limitation is not firm, however. The FHA may approve mortgages for some families that might have to pay more than 20 percent of incomes even with the maximum interest-rate subsidy. As an example, if a family had regularly been paying 35 percent of their income for rental housing, the FHA might approve a "235" mortgage, especially if the monthly mortgage payments would be less than the family had been paying in rent. The FHA policy is also to stretch the 20 percent limit if it would enable a family to move out of substandard housing and into new housing.

In order for a family to be eligible for subsidy assistance, the family income must not exceed 135 percent of the maximum income limits for their community. However, in the case of persons displaced by urban renewal or other

public programs, the limit is 90 percent of the maximum for rental housing financed under the Section 221(d)(3) below market interest rate program for moderate income families. To determine income for qualification purposes, a family may deduct \$300 for each dependent child under 18 years of age.

A family qualifying for the Section 235 program must have their income recertified every two years by the financial lender, who gave them their mortgage. However, a family may apply for recertification at any time in the event of a decline in income, additional dependents, or if an increase in property taxes occurs.

Mortgages written for the Section 235 program are for 100 percent of the purchase cost and are generally amortized for 30 years, although some may be extended to 40 years, in certain circumstances. Families qualifying under Section 235 are required to make a small payment at the time of closing to cover title insurance and other closing costs. An additional charge is also levied for the administrative handling of the loan. This amounts to about \$35.00 per month on a typical mortgage loan.

The maximum mortgage that FHA will insure under the Section 235 program is \$18,000 (\$15,000 under the original legislation). In high cost areas, the mortgage can be extended to \$21,000 (\$17,500 originally). An additional

\$3,000 can be provided for 4 bedroom homes purchased by families of five or more persons.¹¹

A more detailed description of the design of the Section 235 program, how it works, and examples of the subsidy provision will be discussed in Chapter IV.

¹¹U.S. Department of Housing and Urban Development, Federal Housing Administration, Homeownership for Lower Income Families (Section 235), HUD Handbook FHA-4441.1, (April 1970), pp. 1-11.

CHAPTER III

PRIVATE SECTOR ROLES IN THE OPERATION OF THE SECTION 235 PROGRAM

I. CONCEPTUAL OVERVIEW OF HOUSING INDUSTRY ROLES

The Housing Act of 1949 stated as one of its major policies: "private enterprise shall be encouraged to serve as large a part of the total needs as it can."¹

This was only the beginning of policy statements aimed at enlisting help and assistance from the private sector in providing housing needs for the public. Not until the Housing Act of 1968 did the federal government design a housing program that was tantamount to creating a housing market for the private sector—specifically the Section 235 program. The following is an overview of the abstract roles of the housing industry (viewed in general terms).

The housing industry, . . . is not a clear-cut entity like steel-making or textile manufacturing, in which the operations of any single firm are under continuous management control. It is, in fact, a heterogeneous aggregation of more or less related industries, government bodies, financial institutions, and labor unions. . . .²

¹James H. Boykin, "Changing Roles of Governmental and Private Enterprise in Low-Income Housing," The Appraisal Journal (January, 1970), 18.

²Martin Meyerson et al., Housing People and Cities (New York: McGraw-Hill), pp. 104-105.

The Role of the Builder

The Federal Housing Administration administers the . . . 235 Homeownership program and the major rental programs involving private ownership. A . . . builder earns profits under Section 235 in essentially the same way he earns them when he builds and sells conventional houses. The builder prepares plans and has them approved by FHA prior to the beginning of construction. On completion, the units are sold to qualifying purchasers. . . . If the builder is efficient, this price should include a fair profit.³

After all, "Builders are businessmen whose prime objective is to build and sell houses at a profit."⁴

The Role of the Real Estate Broker

Most . . . (brokers) serve as intermediaries at the beginning of the housebuilding process by assembling a site and negotiating its sale to an individual or a . . . builder, and at the end of the process, by servicing the market for the sale of houses to consumers. The (buyer) depends upon the broker for information about the characteristics of a dwelling, its relative value, the soundness of its construction, its conformity to codes and ordinances, the characteristics of the neighborhood in which it is located, and even the sources of funds by which it can be financed. . . . The typical brokerage is a one- or two-man operation. Rarely is it as large as five. Large scale (builders and) developers typically bypass brokers and sell their houses through salesmen employed on a salary basis. Other . . . builders retain brokers on a fee basis. . . .⁵

³The Report of the President's Committee on Urban Housing, A Decent Home (Washington, D.C.: U.S. Government Printing Office), p. 79.

⁴Twin Cities Metropolitan Planning Commission, Selected Determinants of Residential Development (Minneapolis: Twin Cities Metropolitan Planning Commission) p. 15.

⁵Meyerson, op. cit., pp. 110-111.

In short, what does a real estate broker have to offer the buyer of a home?

First, the broker knows the intricacies involved in dealing in what is one of the most complex of commodities. He understands title transfer, finance, and dozens of local peculiarities such as taxes, utility rates, zoning laws, building codes, etc.

The second kind of expert knowledge which the broker has and makes available to his clients is knowledge of the market. . . . He knows values because he keeps constant track of what property is selling for. . . .

Finally, the broker and his salesmen are experts in the marketing of the property they undertake to sell for their clients . . .⁶

The Role of the Lender

The lender is in business to make a profit with a minimum of risk. Fundamentally, he provides a service and the necessary financing for the whole housing industry and the (buyer). The lending risk does not usually depend upon the builder selling his house to the (buyer) but upon the (buyer) continuing to meet his obligations. In addition, the lender is concerned that the property maintain its value over a long period of time in the event that foreclosure might become necessary. This is somewhat the converse of the builder who generally is not directly involved with the house after its sale. (Also,) when the lender invests money in construction loans and land development loans, he is concerned with the ability of the builder to market the products.⁷

"In contrast to the building industry, the lending field is very articulate and highly organized with segments of it extremely influential on national housing policies."⁸

⁶Clayton C. Curtis, Real Estate for the New Practitioner (Gainesville: B-J Publishing Company, Inc.), pp. 4-5.

⁷Twin Cities Metropolitan Planning Commission, op. cit., p. 17.

⁸Ibid.

There are four principal financial institutions which are involved in providing mortgage money on homes. These are (1) savings and loan associations, (2) life insurance companies, (3) Commercial banks, and (4) (mortgage bankers).⁹

Savings and loan associations . . . are the most important lenders on single family homes. . . . Over 80 percent of their total assets are committed to mortgages on such property.¹⁰

Life insurance companies are, of course, primarily engaged in selling life insurance to people to provide protection for families and dependents. In the course of this work, however, the companies collect premiums which greatly exceed what they are paying out in any one year. This money which belongs to their policy holders must be invested in as safe a fashion as possible and with a view to earning as much as the investment can within the safety limitations. In general, they are also interested in relatively long term investments which will not require continuous re-investing. Mortgages fit these requirements nicely and life insurance firms have, since their inception in this country, been heavy investors in mortgages. Approximately 34 to 35 percent of their enormous assets are so invested. . . . (In particular), in the residential sector the insurance companies have been heavy participants in the FHA and VA program, particularly in the case of loans acquired through mortgage bankers.¹¹

Commercial banks are the financial institution that the average person thinks of when he thinks of a bank. . . . The commercial bank can be distinguished from all other financial institutions in that it is the only one which is allowed to have demand deposits . . . commonly called, checking accounts.

As commercial banks moved into the twentieth century many of them began to acquire, in addition to their checking accounts, time deposits . . . commonly called savings accounts. In effect, what happened was that these institutions began to build savings banks within the commercial bank. These kinds of accounts are much more stable than checking accounts since people tend to put money in these accounts and

⁹Curtis, op. cit., p. 74.

¹⁰Ibid., p. 76.

¹¹Ibid., p. 78.

leave it over substantial periods of time. Because they were more stable, banks could afford to make more long term kinds of loans where they held large savings accounts. This of course, included mortgages.¹²

Finally, the mortgage bankers buy mortgages for other institutions which have funds to invest, such as for life insurance companies. The mortgage banker plays an important middleman role in providing funds for the building and purchasing of homes, as will be pointed out in a later chapter.

The Role of the FHA

Although not a part of the private sector operation, the FHA does play a very important role in the administration of the Section 235 program because it insures mortgages. Thus, a mention of their overall responsibility is made here.

The FHA is most often associated with the lending or financial field since FHA encourages lending institutions to invest in FHA mortgage programs. The FHA thus influences the lending institutions through the housing policies of the federal government. Also, the FHA is responsible for property appraisals and mortgage risk rules and is therefore in close contact with builders, real estate brokers, and lending institutions in the course of administering the various FHA programs.

¹²Ibid.

All FHA financial housing—subsidized as well as non-subsidized—is marketed through private channels. Even where there is a default under an FHA mortgage and the FHA acquires the property, it is managed and sold by private real estate brokers. In short, the 235 program like other FHA-insured housing programs was designed not as a direct Federal lending or construction program but as a mechanism for encouraging the private housing and home finance (industry) to produce, finance, and make available housing for low and moderate-income families. The success of the program depends on the willingness of private enterprise to participate.¹³

Therefore, giving the private housing and home finance industry primary responsibility for operating the 235 program, including publicizing the availability of 235 financing and soliciting potential 235 buyers, was very much in keeping with FHA tradition. That is, under Section 235, FHA confined itself essentially to the same role it plays in all its single family insurance programs—approval or rejection of mortgage insurance applications submitted to FHA by approved lending institutions.¹⁴

This brief overview of the conceptual roles of builders, real estate brokers, and lenders is intended to serve as an introduction to the Housing Industry in general. The remainder of this chapter delves into the actual operation of the private sector Housing Industry in Knox County, Tennessee, in terms of its participation in the 235 home ownership program from 1969 to 1973.

¹³United States Commission on Civil Rights, Home Ownership for Lower Income Families (Washington, D.C.: U.S. Government Printing Office, 1971), p. 78.

¹⁴Ibid.

II. PRIVATE SECTOR PARTICIPANTS IN SECTION 235 IN KNOX COUNTY

Major 235 Subdivision Developers/Builders

The new large Knoxville subdivisions in which many homes were built to be sold under the Section 235 program are: Woodmere West, Hunting Hills West, Southbrook, Northbrook, Middlebrook, Canby Hills, and Hidden Hills. Although not all of the housing in the subdivisions were sold under Section 235, the majority in most cases were originally purchased as such. The main reason most large subdivisions were chosen for study was to explore the "package" type processor of "235" housing. This refers to the combined builder/real estate broker operations. They have the expertise to build the homes, as well as to advertise, and sell their own housing. Each of the subdivisions surveyed and their principals fit this general classification.

Characteristics of Developer/Builder Operations

The management operations in all seven subdivisions were interviewed. They all were basically "package type" builder-developer/broker operations. In fact, three operations were family-run and family managed, with one of the family members a builder and the other a realtor, in all three instances. In the other operations, they built the homes, and had a broker or salesman on their staff who

advertised and sold the homes, or contracted with a real estate firm to handle their sales. The builder/broker operations ranged in size, from the largest, with 74 full-time employees, to the smallest with four full-time employees. The average size operation was about 25 full-time employees. However, in those cases where there were small management operations—they had the basic builder/broker nucleus, and subcontracted the actual building of their homes. There were two such operations.

The management was asked "what percentage of their subdivision housing was built to be sold as low and moderate income housing (basically under the Section 235 program)?" All seven operations indicated that 90-100 percent of the housing they produced was geared primarily toward the 235 housing market. Of the units they had sold in their subdivisions at the time of the interview their expectations for selling their housing was paying off, with about 90-95 percent of all their produced housing being sold under the Section 235 program.

The number of lots available for building housing in the seven subdivisions ranged from 94 to 330. Overall, the average number of lots in the seven subdivisions was 125.

Geographic Location of "235" Subdivisions

Four of the seven subdivisions are located in the western part of Knox County. In fact, the rapid growth of

this area led to some concern in the early part of 1971 about this growth: "Some of Knoxville's finer residential sections are being crowded in with 235 homes and affecting the evaluation . . . There's been a big squawk in West Knoxville . . ."¹⁵

As it turned out, the article did not seem to have any detrimental effect on the growth of Section 235 housing in the western portion of the County. Two of the seven subdivisions were located in the northern part of the County, while the seventh subdivision was located in the southern part of the County. All of the subdivisions, except one were located in the suburbs (outside the Knoxville City limits). The remaining subdivision was originally located in the suburbs and was later annexed into the city, so as to take advantage of city sewer hook-up.

Thus, the phenomenal growth of the "235" Subdivisions, especially in the suburbs was probably a surprise to some. It certainly wasn't because of an FHA policy. In fact, an FHA circular stated that: "Eligible locations:—Any location otherwise eligible in any FHA mortgage program. We prefer the various inter-city areas. Your attention is particularly invited to urban renewal areas. . . ."¹⁶ Thus, although the

¹⁵"Control of '235' Homes Sought," Knoxville Sentinel, March 8, 1971, p. 21.

¹⁶FHA Circular Letter No. 70-2, January 23, 1970.

intent was there in the FHA circular to provide Section 235 housing in the inner-city areas, heavy "235" Subdivision activity was clearly in evidence in the suburban areas of Knox County. However, this situation was no different in Knoxville than it was nationally: The majority of new Section 235 houses nationally are located in suburban areas. "This is because vacant land is scarce in central cities and prices tend to be higher (and land is not as available) in cities as in the suburbs."¹⁷ Furthermore, the concentration of new Section 235 homes in suburbia was somewhat anticipated. Even as early as 1969, President Lyndon Johnson said in his annual message on the status of the nation's housing efforts:

As opposed to the other subsidized programs, the great bulk of the 7,200 units of new construction under Section 235 is expected to take place in out-lying suburban areas where land problems should not be too severe.¹⁸

The rush to the suburbs for lower cost land for the Section 235 housing possibly upset the projected location for new housing, however, as evidenced by a 1971 response in the Knoxville Sentinel: ". . . the 235 Program is putting more students into certain schools than had been expected."¹⁹

¹⁷The Report of the President's Committee on Urban Housing, op. cit., p. 147.

¹⁸Message from the President of the United States, First Annual Report on National Housing Goals (H.R. Doc. No. 91-63, 91st Congress, first session 1969), p. 44.

¹⁹"Control of '235' Homes Sought," loc. cit.

Although, this statement might not have been articulated very well, it does raise the issue of whether the rapid growth of the Section 235 program all across the country had an adverse impact on a community's financial resources to keep up with the needed community facilities and services required for the residents of the Section 235 housing developments. However, the location of Section 235 subdivisions in the western part of Knox County in 1969-1973, was merely the continuation of a trend toward development in that part of the County which had started in 1965 and continued through 1968 as seen in Table III-1.

TABLE III-1
SUBDIVISION LOTS PLATTED IN SELECTED
KNOX COUNTY AREAS, 1965-1968

Geographic Area	1965	1966	1967	1968	Total
North	113	104	46	91	478
Northwest	127	311	93	93	743
West	315	232	336	570	1,687
South	35	8	--	13	447
Total Lots Platted	590	655	476	768	3,355
Total Permits Issued	1,340	990	1,274	1,264	6,042

A study by Real Estate Research Corporation summed up the situation in a 1970 report:

(the) Table confirms that a majority of Knox County residential development is located in the four areas

studied with by far the greatest share of this growth coming from the western . . . districts . . .²⁰

The plat growth is also substantiated by the growth in the number of households in the Western part of the County: there were 4,500 households in this part of Knox County in 1960, growing to 7,649 households in 1968; thus, a phenomenal increase in households of 3,041 percent over the 8-year period for this very active area of Knox County.²¹

The previous section described where much of the Section 235 housing was being built; the next section analyzes how many units were produced from 1969-1973.

Section 235 Production in Knox County

As of December 31, 1970, the Knoxville-Knox County area ranked No. 12 in the nation in the total number of Section 235 insured homes. This is a commendable total; however, even more significant, the Knoxville area ranked 8th in the nation in terms of new Section 235 houses insured.²² In 1971, the Knoxville office was to achieve a ranking of 4th in the nation in the number of new Section 235 construction. The new construction units in 1971 constituted almost 90 percent

²⁰Real Estate Research Corporation, Commercial Development Analysis (Knoxville, 1970), p. 14.

²¹Ibid., p. 8.

²²United States Commission on Civil Rights, op. cit., p. 95.

of the total Section 235 insured homes with existing units sold under Section 235 accounting for the remaining 10 percent.

In the 37 counties in Middle and East Tennessee which the FHA office serves, there have been over 5,000 approvals for insurance for Section 235 since early 1969. Of this total approximately 1,700 Section 235 units have been insured in the Knoxville-Knox County area through 1973.²³ On the national level, at the end of 1971, a total of 143,500 mortgages have been insured under Section 235 with 43,500 existing units and 100,000 new units. Prior to this, in 1970 there were approximately 45,000 Section 235 units insured, and in 1969 only about 2,500. It was clear the program was picking up steam nationally. What about in Knoxville-Knox County?

There were only 15 Section 235 units approved by FHA in 1969. However, this total increased to 370 in 1970, 681 in 1971, 453 in 1972 and 178 in 1973, for a total of almost 1,700 approved Section 235 units for Knoxville-Knox County.²⁴ What kind of impact this has had on Knoxville-Knox County Housing market can be seen by looking at Section 235 as a

²³Federal Housing Administration data on Knoxville-Knox County, 1975, Table 5.

²⁴FHA, Analysis of the Knoxville, Tennessee Housing Market (Knoxville: Federal Housing Administration, 1973), Table 4.

portion of the total housing in Knox County from 1969 to 1973.²⁵ (See Table III-2.)

Impact of Section 235 Housing

At first glance one might say Section 235's impact on providing moderate cost housing was minimal. A closer look reveals that Section 235 housing constituted almost 1/3 of all single-family housing in 1970, increasing to almost 2/3 of all single-family housing in 1971 (60.5 percent).

Of course, as the program began to die out nationally, the effect was felt in 1972 and 1973, as Section 235's dropped to 43.1 percent in 1972, and plummeted to 14.6 percent in 1973. Section 235 housing was extremely significant in its impact as a type of subsidized housing in 1970, accounting for almost 80 percent of all subsidized housing for Knox County. With the growing influence of Section 235 housing on the market in 1971 (22 percent), Section 235 housing still comprised almost half of the total subsidized housing units produced for the County. The Section 235 housing program accounted for almost half of all subsidized units until 1973, dropping to 30 percent. That year 236 housing increased its share to 61.4 percent.

Another point of significance is that while the influence of Section 235 housing gained in impact in 1970 and 1971, the

²⁵Ibid., Table 2.

TABLE III-2

HOUSING UNITS-SUBSIDIZED AND NONSUBSIDIZED, 1969-1973

Years	Nonsubsidized Housing Units			Subsidized Housing Units*			Total	Total All Units
	Single-family	Multi-family	Total	LRPH and RS Housing	BMIR and Sect. 236	Section 235		
1969	998	429	1427	548	0	15	563	1990
1970	1183	904	2087	96	0	370	466	2553
1971	1126	1456	2582	390	300	681	1371	3953
1972	1050	3887	4937	200	304	453	957	5894
1973	1221	3776	4997	51	365	178	584	5591

Source: FHA Office, Knoxville, Tennessee, 1973.

* LRPB-Low Rent Public Housing; RS-Rent Supplement program; BMIR-Below Market Interest Rate program; Sect. 236-rental interest reduction program.

nonsubsidized single-family housing decreased. Only after Section 235 waned in 1973 did the amount of nonsubsidized housing begin to increase again.

The impact of Section 235 was about the same nationally during the heyday years of the program:

In the past two years ('69 and '70) there were approximately 694,000 low and moderate income housing starts; in 1959-1968 there were about 683,000 starts. Thus, there had been more low and moderate income housing produced in two years than for the previous 10 years.²⁶

Finally, it should be pointed out that according to the FHA office in Knox County, the annual demand for single family housing in the \$20,000-\$22,500 price range was approximately 100 units or about 10 percent of the total single family housing needs for Knox County. Since that price range was about the same as the price range limits for Section 235 housing, this price range of housing could have been provided by the Section 235 program. For example, even in 1973, when Section 235 was on the way out, there were 178 units produced in Knox County. All this is even more important when the percentage of families are considered who were primarily benefiting from the Section 235 program. The program's emphasis as pointed out earlier, was on the \$5,000-\$8,000 income range family. A report by the FHA office indicates that about 23 percent of all Knox County families

²⁶"HUD's 1970 Goal: 425,000 Homes for Lower Income Families," HUD Challenge (Washington, D.C.: U.S. Government Printing Office, March/April, 1970).

fell in this income range in 1969.²⁷ A study by the Sales Management magazine for the same year had the \$5,000-\$8,000 income range as 1/4 of all households in the County.²⁸ At any rate, the implications of a significantly large number of low to moderate families having the opportunity to purchase their own home as a result of the Section 235 program was extremely encouraging during these years in Knox County and of course across the nation.

This need for more housing, especially low and moderate income housing in Knox County was precipitated by the 1960-1970 growth of the Knoxville area:

The Knoxville Area had a 1970 population of 276,293, an increase of 25,770 persons (10.3 percent) between 1960 and 1970. Also, the population of the City of Knoxville increased by 62,760 persons (56.1 percent) between 1960 and 1970, largely as a result of an annexation which doubled the city's land area. By January 1973, the estimated population of Knox County was 284,800 persons.²⁹

The private sector's response to the Section 235 program nationally was met with just as much fervor as by the Builders of Knox County, as evidenced by the following:

The private sector responded to the new (Section 235) homeownership program with immediate success. In January 1969, 3 months after the first appropriations had been made for the program, President

²⁷ FHA, Analysis of the Knoxville, Tennessee Housing Market, op. cit., Table 4.

²⁸ Sales Management (June 10, 1970), p. 146.

²⁹ FHA, Analysis of the Knoxville, Tennessee Housing Market, op. cit., p. 2.

Lyndon Johnson said: "there are signs that the 235 program may well be the most rapidly accepted program for low- and moderate-income families. There is tremendous interest in it on the part of the (housing) industry. . . ." In fact, the initial \$25 million in contract authority which Congress appropriated in October 1968 was rapidly exhausted—in some HUD regional offices, funds were fully committed as early as January 1969. Moreover, an impressive amount of housing was provided under the program within a short time after its enactment. By May 1969, (only) 9 months after the program was established and less than 7 months after funds initially were made available, 3,000 units had already been purchased and occupied by lower-income families. An additional 7,500 units had received FHA Commitments and 57,000 units were in process. HUD reported that FHA was receiving applications under the (235) program at the rate of 2,000-3,000 units a week.

By the end of 1969, more than 25,000 units had been purchased (nationally) under the 235 program. By the end of 1970, this figure had risen to more than 130,000. Thus the 235 program, barely 2 years old, already had accounted for well over one-tenth the number of low-income units that the low-rent public housing program had produced in more than 30 years of existence.

The birth of the 235 program occurred during a period of inflation and low productivity for the housing industry in general. In fact, housing production had declined sharply and over the last four years the volume of housing produced had been more than 1 million units short of the number necessary to keep pace with the Nation's growing population. The 235 program has been responsible for a substantial proportion of all new lower-cost housing produced. In 1969, for example, there were only 112,000 new houses that sold for less than \$20,000. Some 10 percent of these were purchased under the 235 program. Section 235 accounted for an even larger proportion of lower priced housing in 1970. During that year, 256,000 new dwellings sold for less than \$25,000 of which more than 77,000 (30 percent) were purchased under the 235 program.

In fact, the 235 program had been a major support for the private housing and home finance industry during a trying period. One builder reported to a

congressional committee: "You take away 235 and 236 and we are not even existing." (Further), . . . as the mortgage Bankers Association put it: "The Federal Government's assistance to housing through the subsidized programs of Section 235 and 236 has been a major sustaining force of the housing industry."³⁰

III. BUILDER/DEVELOPER REACTIONS

This author asked all the builders of the seven major 235 Subdivisions in Knox County, about the phenomenal success of the program, and to react to the previous quote. The following are the responses:

The overwhelming response was that 1969 and 1970 was "tough times." There was a tight conventional money market coupled with high interest rates. Thus, they agreed with the quote and its emphasis on sustaining the building industry through the creation of the Section 235 program. One builder even went further by saying: "If it wasn't for Section 235, half of the builders would have been bankrupt by now."³¹ The builders, of course, recognized an opportunity and seized upon it.

But more than that, the builders pointed out in the interviews that although the Section 235 program helped them

³⁰United States Commission on Civil Rights, op. cit., pp. 8-9.

³¹Personal interview with a builder, Knox County, Tennessee, November, 1970.

through a tough economic situation, that it would not have been successful without the latent demand for low- and moderate-income housing in Knox County. The seven builders also were in general concensus about the other factors they felt that accounted for the success of the Section 235 program. They are:

1. Low labor costs in Knox County. Also, the large "235" subdivision builders/developers were never short of good construction labor—even though some of the smaller builders in Knox County might have suffered at times.

2. Low cost for land—especially in the suburbs. The Knox County builders/developers know they were fortunate to have few problems with finding land in the suburbs that was not too costly. But this author wonders if they really knew, as evidenced by a developer's reaction in Philadelphia: ". . . it is impossible to get land (for low-cost housing) in the suburbs. . . ." ³²

3. Another key to the success of Section 235 from the builder's point of view was that construction costs could be kept fairly low. Again, what was possibly a big reason for the Knox County "235" success was the downfall of Philadelphia. Another Philadelphia builder . . ."complained of rising construction costs and said that units which could

³²United States Commission on Civil Rights, op. cit., p. 51.

be built for \$17,000 2 years ago now cost \$19,400 to build."³³

4. Most builders also gave some credit to the FHA office in Knoxville for the success of the program. They felt that the people in charge of the program did a good job of informing the builders/developers, real estate brokers, and mortgagees of the program requirements, any changes that occurred and in general went out of their way to keep everyone up-to-date about Section 235.

5. The builders unanimously said that when FHA raised the allowable maximum sales price of Section 235 from \$15,000 to \$18,000 in 1971, that this again saved the builders/developers from being constrained by the escalating cost of construction.

6. Finally, the builders/developers this author interviewed were very cognizant of the impact of a major federal program like Section 235 on the private housing market. They also realized that without this program opening up a new housing market for the production and sale of new housing to low- and moderate-income individuals, the housing industry in Knox County during 1969-1973 could have been pretty dismal economically—at least for them.

Even with the overall success of the Section 235 program in Knox County, there were some obstacles for the program.

³³Ibid., p. 52.

There were varying responses from the builders/developers in Knox County:

1. Some builders felt that many people were against Section 235 housing because they were afraid it would depreciate their property values; most of all they felt people were against the housing because it would attract Blacks— "after all, this is redneck country, isn't it," one builder said. When this author would approach the subject of the builder's personal reactions to Blacks and their Subdivision, the conversation abruptly ended. In the seven major "235" subdivisions there were not any black families. In a thesis on Section 235 in Knoxville by Dorothea Hohmann Nelson she surveyed the race of those persons who were inhabiting 235 homes; in her sample of fifty, only 3 families or 6 percent of the sample were black. However, as Ms. Nelson points out: "None of the three black households of the sample were found in a new subdivision."³⁴

2. Most of the builders also indicated that they had received criticism from the Metropolitan Planning Commission: that the builders by putting their "235" subdivisions in the suburbs were propagating urban sprawl. The builders responded to this usually by saying that they weren't the

³⁴ Dorothea Hohmann Nelson, "Comparison of New Homes With Previous Residences by Families Purchasing Houses under Section 235 Of The National Housing Act" (master's thesis, The University of Tennessee, 1972), p. 47.

first to start building in the suburbs, "so why should we suffer." Further, they felt that the cost constraints and scarcity of inner-city sites justified moving their developments to the suburbs. And finally, most were quick to reply that this is the life-style most favored by the American public. "Isn't this the trend, isn't everyone moving out of cities and going to suburban living?" Ms. Nelson in her study of Section 235 in Knoxville was also concerned about the heavy building of Section 235 in the suburbs: "Are they to continue the same pattern of urban sprawl?"³⁵

3. Most of the builders/developers were also quite aware of public statements by some that the Section 235 subdivisions would place an additional burden on the already overburdened school system (see author's discussion of this on page 28). And of course certain people had reason to feel this way since many of the families buying under Section 235 in the subdivisions were young and usually with at least one child. This situation, however, was by no means unique to Knox County as pointed out in the following statement by a former Director of the California Department of Housing and Community Development:

Currently, we see in our State what might be termed a "backlash" to the Section 235 and Section 236 subsidy housing programs for low- and moderate-income

³⁵Ibid., p. 105.

families. Some communities have utilized their police powers inherent in zoning practices to successfully kill proposed projects under these programs.³⁶

IV. REAL ESTATE BROKER ROLES AND REACTIONS

This author found that the major responsibility for informing the public and potential buyers of Section 235 housing of the existence of the program fell upon the real estate brokers and salesmen. This situation was compounded by the fact that the FHA office did not advertise the Section 235 program publicly, nor did they seek out potential buyers. This was, of course, no different of a role for FHA than for any of the other programs FHA administers. Thus, the FHA office informed the builders/developers, real estate brokers and salesmen, and mortgage lenders of the program and then passively waited for these private sector participants to bring them applicants. The builders, through their real estate agents, sought out potential "235" buyers themselves and attempted to qualify them for the program.

Therefore, the heavy authority and flexibility the real estate agents had in informing the public of Section 235 housing, also was part of the problem. Since the Section 235 applicant usually came into contact first with the broker or salesman (representing the builders/developers of the seven

³⁶ United States Commission on Civil Rights, op. cit., p. 52.

major 235 subdivisions), they could select who they wanted for the program.

Methods of Informing the Public

This author interviewed the real estate brokers and/or salesmen for the seven "235" subdivisions in Knox County. They all responded overwhelmingly that their primary method of informing the potential buyer about their housing, which could be purchased under the Section 235 program, was through newspaper advertising. However, they were also quick to say that this probably wasn't the best method since "the people we are trying to reach probably don't read the newspapers." At least that sums up what the majority of real estate agents this author interviewed felt about their potential clientele. The real estate agents said that their most effective advertisement was probably through "word of mouth."

The real estate agents did however, perform a very important series of roles in the operation of the Section 235 program.

Broker Roles

The most uniform roles of the real estate agents this author interviewed were:

1. To assist the builder in locating land on which he could build the housing.
2. To attempt to find potential buyers through advertising in the newspapers (only one real estate agent

ran advertisements on TV in Knox County and this was intermittent).

3. The real estate agents worked closely with the FHA office to stay abreast of the Section 235 program and any changes which might occur in the provisions and guidelines of the program.

4. Probably the most important role that the real estate agent played was in screening applicants for the Section 235 program. The agent knew the provisions of the program while the buyer of course did not. It is possible that the broker or salesman could sway a potential buyer one way or another depending on his particular philosophy. For example, several real estate agents implied to this author that the program was so complex "that the average buyer of course would be helpless without our knowledge of the application process and requirements of the program."

An example of this influence on the buyer by the real estate sector is illustrated by the findings of Ms. Nelson in her interviews with Section 235 owners:

Many people (interviewed) had heard of their eligibility for the "235" subsidy through a real estate agent. Most agents told them that the type of housing being built mostly in subdivisions, was the only available housing eligible for the "235" subsidy. The agents did not tell (the buyer) of possible alternatives, which in the case of Knoxville-Knox County would be detached units built in the city, and would mean referring the

client to one of the few agencies that supply this type of "235" housing.³⁷

5. Most real estate agents also maintained close contact with the various FHA approved mortgage lenders in Knox County. Once the agent qualified a buyer for the house, he must check at various points with the mortgage lender as to credit approval of the applicant, etc.

6. The real estate agent is in business to sell houses, and sell the agents did. Most brokers commented to this author about "how easy it was to sell a house to a '235' buyer." The program was complex as far as they were concerned and of course as pointed out, they knew the buyer was somewhat at their mercy. However, the buyer of a house (especially the 235 buyer) was eager and ready to purchase a house.

This is in fact why the real estate agents felt the program was successful from their viewpoint. As one salesman put it: "I have almost total flexibility in the way I handle this program and the buyer."³⁸

This author, encountered extreme difficulty, when attempting to find out what real estate agents felt about Blacks in the new 235 subdivisions. While only two real estate agents would even discuss the subject at length, it

³⁷ Nelson, loc. cit.

³⁸ Personal interview with real estate salesman, November, 1970.

was the author's feeling that most agents felt like the one agent who offered the following statement:

My partner and I have lived here all our lives—we know this redneck country. Most people here don't want to live next door to Blacks. Besides most people would be afraid that it would hurt the neighborhood property values.³⁹

³⁹ Personal interview with real estate broker, December, 1970.

CHAPTER IV

SECTION 235 AND THE MORTGAGEE: THE LENDER'S ROLE

I. ROLE OF THE MORTGAGEE

The mortgagee¹ plays the role of the middleman in all FHA programs. If a seller or builder wishes to have his house appraised by an FHA appraiser, he or his broker must apply for the appraisal through an FHA approved mortgagee. Further real estate brokers or builders who wish to sell houses to FHA buyers must submit the buyer's application through an FHA approved mortgagee. It is the mortgagee who receives periodic information from FHA regarding the procedures to be followed in obtaining a Section 235 mortgage, and it is the mortgagee who usually informs brokers and builders about the operation of the program. In short, of the three (key participants) of the private housing and home finance industry involved in the 235 program, the mortgagee is in the best position to observe the way the program is working and, through his mortgage lending policies, to exert influence over it.²

The above quote describes very closely the role of the mortgagee in Knox County in the operation of the Section 235 program.

¹The mortgagee is a financial lender who makes the mortgage loan. Mortgagees if they are to make FHA insured loans, must be approved by FHA.

²United States Commission on Civil Rights, Home Ownership for Lower Income Families (Washington, D.C.: U.S. Government Printing Office, 1971), p. 57.

II. TYPES OF LENDERS IN SECTION 235 IN KNOX COUNTY

According to the U.S. Savings and Loan League, the trade association for savings and loan associations, savings and loan associations represent the major finance institution. However, this author found that few savings and loan associations were actually primary sources of mortgage loans for the Section 235 program in Knox County. Of the seven major "235" subdivisions, five utilized mortgage companies (or mortgage bankers as they are sometimes called). In fact, of the five builders/brokers utilizing the mortgage companies³ in Knox County, these five indicated that they gave most of their business to only three or four mortgage companies. There were in fact nineteen mortgagees on the FHA approved list which included savings and loans and commercial banks (see Figure IV-1).

While the author was not able to discern the reason for the disproportionate amount of mortgage companies handling the "235" loans in Knox County, the following quote from a national study might offer at least a partial answer:

³Mortgage companies generally resell their mortgage loans to investors such as insurance companies, pension funds, employment funds and the Federal National Mortgage Association. In most cases, the mortgage companies continue to serve (collect payments) the loans. According to the director of research of the Mortgage Bankers Association of America, as of April, 1970, Section 235 loans were making up to three-fourths of most mortgage bankers' business.

FEDERAL HOUSING ADMINISTRATION
725 Gay Street, S. W.
Knoxville, Tennessee 37902

KNOXVILLE AREA

Athens Federal Savings and Loan Association	Athens
Bank of Maryville	Maryville
Bank of Oak Ridge	Oak Ridge
The Bount National Bank of Maryville	Maryville
Fidelity Federal Savings & Loan Association	Knoxville
Brown, Brown & West	Knoxville
Chamberlain Company, Realtors	Oak Ridge
Citizens Bank & Trust Company	Wartburg
The Citizens National Bank of Athens	Athens
Claiborne County Bank	Tazewell
Claiborn, Lothrop & Sample, Inc.	Knoxville
Collateral Investment Company	Knoxville
M. B. Crum	Maryville
Cumberland County Bank	Crossville
Curtis Mortgage Company, Inc.	Knoxville
Dobson & Johnson, Inc.	Knoxville
First Federal Savings & Loan Association	Maryville
First Federal Savings & Loan Association	Oak Ridge
First Federal Savings & Loan Association	LaFollette
First Investment Company	Knoxville
First National Bank of McMinn County	Athens
First National Bank	Crossville
First National Bank of Gatlinburg	Gatlinburg
First National Bank of Harriman	Harriman
First National Bank	Jefferson City
First National Bank	LaFollette
First National Bank	Lenoir City
First National Bank of Loudon	Loudon
First National Bank of Oneida	Oneida
First National Bank	Pikeville
First National Bank & Trust Co.	Rockwood
First Trust & Savings Bank	Oneida
Guaranty Mortgage Company of Nashville	Knoxville

Source: FHA Office, Knoxville, Tennessee, 1971.

Figure IV-1. Approved Mortgagees, Correspondents, and Agents Initiating Insured Loans Within the Jurisdiction of the Knoxville Insuring Office.

KNOXVILLE AREA

Hamilton National Bank of Knoxville	Knoxville
Branches:	
Commercial	
Kirkwood Avenue	
North Knoxville Branch	
West Cumberland Avenue	
Hamilton National Bank of Morristown	Morristown
Home Federal Savings & Loan Association	Knoxville
Inland Mortgage Corporation	Piqua, Ohio
International Acceptance Corp.	Mobile, Alabama
Jefferson Federal Savings & Loan Association	Morristown
Kingston Bank & Trust Company	Kingston
Knox Federal Savings & Loan Association	Knoxville
Liberty National Life Insurance Company	Birmingham, Ala.
National Bank of Newport	Newport
National Executive Life Insurance Co.	Knoxville
National Homes Acceptance Corp.	Atlanta, Ga.
Newport Federal Savings & Loan Association	Newport
Park National Bank	Knoxville
Branches:	
Bearden	
Dale Avenue	
Heiskell Avenue	
Magnolia Avenue	
South Knoxville	
Peoples National Bank	LaFollette
Schumacher Mortgage Company, Inc.	Knoxville
Sevier County Bank	Sevierville
Tennessee Mortgage Company	Knoxville
Tennessee Valley Life Insurance Co.	Knoxville
Union Peoples Bank	Clinton
United Mortgagee Servicing Corp.	Knoxville
Valley-Fidelity Bank and Trust Company	Knoxville
Prudential Insurance Company	Knoxville

FHA Form Number 21770

FIGURE IV-1 (continued)

In 1969, the U.S. Savings and Loan League expressed cautious support of the 235 program but indicated that the lender needed more financial incentive to make 235 loans—"with respect to specific provisions of the 1968 Housing Act, we feel that the interest and rent subsidy programs will prove to be an effective means to help meet the housing problems of low income families when they are more fully funded and in workable form. Section 235 and 236 loans will probably always be somewhat more difficult to make than regular FHA and conventional loans and may involve the lender in potential social conflicts in his community. Thus, some type of incentive in addition to the market rate of interest may be required to encourage the (savings and loan) lender to finance any real volume of these loans and other loans . . ." ⁴

III. VIEWPOINTS OF LENDERS CONCERNING SECTION 235

One savings and loan official in Knox County, when questioned about the reasons for few savings and loans being involved in Section 235, offered no real explanation of this situation. He did verify that the above quote was a possible reason for the situation. He pointed out "that he felt the real beneficiaries of the 235 program was not the purchasers of the home, but rather the builders and brokers in Knox County." ⁵ Since the savings and loan officer might have been somewhat biased because his association was not participating in the program, a mortgage banker (who was in the business of

⁴United States Commission on Civil Rights, loc. cit.

⁵Personal interview, lender, Knox County, January, 1971.

making "235" loans) was interviewed. His response was about the same in

that he felt the builders and brokers were profiting from the Section 235 program. He also felt that if the program had not come along when it did that a number of builders in Knox County would have suffered drastic economic setbacks.⁶

Several mortgagees interviewed felt that the "235" buyers were not good clientele. Most responses were that "this income level of people will not make homeowners, they don't know what it takes to be good homeowners." There was also some general dissatisfaction among some mortgagees over the number of young couples getting into the program. They felt that these young couples weren't up to the responsibility of managing and maintaining a home. However, these same loan officers also admitted that they personally wrote a large number of loans for these very young people.

On the whole, however, most mortgagees interviewed were in favor of the Section 235 program and saw it as a boon for many buyers who would not be able to afford home ownership otherwise.

Although the middleman role of the mortgagee is a passive one, the viewpoints of the mortgagee on the number of Blacks in the Section 235 program were solicited (just as was done with the builders and brokers).

⁶Personal interview, lender, Knox County, January 1971.

One mortgagee hinted that the reason no Blacks were in the "235" suburban subdivisions is because of discrimination on the part of builders and brokers. Of course, he was quick to point out "that this was what most white owners wanted." Also, he pointed out that

most builders and brokers know that if they allowed even one Black family in the "235" suburban subdivisions that there would be an outcry from those families already living there. Moreover, those builders and brokers would then have a very difficult time selling their homes in the area where the Black family was located.⁷

As pointed out, even though most mortgagees felt the Section 235 program was of benefit to purchasers, some of the lenders also felt that the type of person who is buying a "235" home "is getting something for nothing."

Although this author found isolated comments like the one above, it was his general impression that most mortgagees acted professionally, even though they were aware of certain problems with the program, as well as harboring certain distastes for their "235" clientele.

The same lenders who expressed the viewpoint that the "235" buyer was not reliable, also felt that many of these buyers were either in default or would end up having their home repossessed. This author pursued this point with the FHA and utilizing FHA statistics found that of almost 1700 insurance cases written on Section 235 through 1973, that

⁷Personal interview, lender, February, 1971.

only 40 cases or about just a little over 2 percent (2.3) of the "235" buyers ended up in total default.⁸

IV. FNMA-SECONDARY MORTGAGE MARKET

Because of the importance of the Federal National Mortgage Association (FNMA) and its vital relationship to the mortgage market, a brief explanation of its function and purpose is provided.

The Federal National Mortgage Association is a government sponsored, private corporation which provides support for residential mortgages originated by mortgage lenders. Using private capital borrowed on the open market or mortgage-back securities, FNMA commits for, purchases, and sells government-insured or guaranteed residential mortgages (and starting in 1971), conventional mortgages. It does not, however, originate loans directly. FNMA also makes short term loans on the security of these mortgages and engages in construction financing on certain types of loans.

Mortgages can be purchased from lenders, including banks, savings and loan associations, mortgage companies, and other organizations that have qualified as eligible sellers and have entered into a selling agreement with the corporation.

⁸FHA Office in Knoxville, 1975. Total default is defined by FHA as foreclosure on the 235 home has been completed, and the home has been acquired for resale.

How to Sell Mortgages to FNMA.

Through its Free Market Auction System, FNMA makes available bi-weekly funds for advance commitments on home mortgages. Sellers may bid for a three or six-month commitment covering new or existing housing; twelve, fifteen, and eighteen month commitments are also available for mortgages covering new construction only. At the designated closing time, FNMA officials determine the acceptability of offers, on a competitive basis as well as executing all eligible noncompetitive bids. Offers not accepted by FNMA are formally declined.

Upon notification that its offer has been accepted, a seller must immediately send to the appropriate FNMA office, a check for the appropriate commitment fee ranging between 1/2 percent and 1-1/2 percent depending on the length of the commitment and 1/4 percent common stock subscription. The commitment fee is not refundable by FNMA.

Also in 1970, \$500 million was allocated from FNMA (Government National Mortgage Association) for the purchase of Section 235 mortgages on the secondary market through the "Tandem Plan." An estimated 32,250 persons were expected to benefit from the first use of this revolving fund.

The fund works like this: When a builder obtains a firm FHA commitment under Section 235, he will be able to obtain the GNMA firm commitment for purchase of the "235"

mortgage at a discount price of \$97 regardless of the price of the FNMA auction markets. GNMA will not require a 1 percent commitment fee for its firm commitments to purchase the Section 235 mortgages.

What follows is a description of the eligibility, income, financial and mortgage provisions for processing an applicant under the Section 235 program.

V. FINANCIAL AND MORTGAGE PROVISIONS OF SECTION 235

The Section 235 program involves direct subsidy payments based upon the financial picture of the applicant. The amount of the subsidy varies with the income of the family and the total amount of the mortgage payment at a certain rate of interest on the money market. Mortgage money is provided by private lending agencies (mortgagees), with insurance protection underwritten by the FHA. This mortgage insurance is provided to protect the mortgagee against the foreclosure of mortgagees.

Income Eligibility

Assistance is provided to families by reducing the interest rate on the mortgage, to as low as 1 percent. To qualify, the applicant must have an income within the limits established by FHA for each geographic area. These limitations are based on 135 percent of the income for public housing in the area. To be eligible for the subsidy,

the annual adjusted gross income of the Section 235 applicant cannot exceed the amount listed on Table IV-1 for Knox County.

TABLE IV-1

ADJUSTED FAMILY INCOME LIMITS FOR SECTION 235
HOUSING IN KNOX COUNTY, TENNESSEE

No. of persons in family	Income limit
1	\$4,860
2	5,940
3	6,210
4	6,480
5	6,750
6	7,020
7	7,155
8	7,290
9	7,425
10	7,560

Source: FHA Circular Letter No. 71-11, May 5, 1971.

In order to determine the applicant's adjusted income, the following method is utilized by the broker or mortgagee:

- a. Total Annual Family Income \$ _____
 Less Earnings of Minors \$ _____
 Total Adjusted Family Income \$ _____
- b. Less Unusual Income \$ _____
 5 percent of Total Income \$ _____
 Other \$ _____
- c. Adjusted Income of Adults \$ _____

d. Less No. of Minors ____ X \$300 \$ _____

e. Certified Adjusted Annual Family Income \$ _____

The Income Limits are reviewed by FHA and changed periodically. During the period of this study, the income limits were changed several times by FHA.

Exception Income Limits

Families whose income exceeds the 135 percent formula, but are within the FHA Exception Income Limits (90 percent of Section 221(d)(3) limits) could still be eligible for qualifying under the Section 235 program. However, these persons are required to pay a minimum cash investment (down payment) of 3 percent.⁹

Definition of a Family

According to FHA guidelines a family is defined as:

(1) Two or more persons related by blood, marriage or the operation of law, who occupy the same unit, or (2) a physically handicapped single person who has a physical impairment which is expected to be of continued duration and which substantially impairs his ability to live independently and which would be improved by more suitable housing or

(3) a single person, 62 years of age or older.

⁹FHA Circular Letter 70-2, January 23, 1970.

Assets Limitations of Section 235

If the head of the family of a household is under 62 years of age, he cannot have assets of more than \$2,000 plus \$500 for each dependent plus an amount equal to the applicant's share of the mortgage payment for one year. On the other hand, if the head of the family is 62 years of age or older, the asset¹⁰ limitation is \$5,000 plus the other items detailed.

Mortgage Amounts Allowed Under Section 235

The following loan amounts are established by FHA for the type of residences listed. These limits were set originally in the HUD Act of 1968, and have been changed by subsequent legislation to reflect the escalating costs of construction in the housing market. The original single family maximum amount was \$15,000 for low cost areas.

Maximum Loan Amount:

<u>Type Residence</u>	<u>Low Cost Areas</u>	<u>High Cost Areas</u>
Single family	\$18,000	\$21,000
Single family residence— (5 or more persons, purchasing a 4 bedroom house).	21,000	24,000

¹⁰ Assets are defined by FHA as bank accounts, stocks, bonds, real estate and cash. For purposes of determining assets, automobiles, household furniture, and other personal property are excluded.

Minimum Investment (Down Payment)

The "235" buyer must invest a minimum of \$200.00, all or a part which must be used for prepayable expenses. The buyer may put down more than the \$200.00, but only to (1) reduce the maximum allowable mortgage, or (2) pay for required prepayable expenses in excess of \$200.00.

If the purchaser does not have \$200.00 for cash investment, he is allowed to perform part of the labor in connection with the house construction. This is referred to as "sweat equity." Mortgagees indicated that few builders allowed this and fewer brokers mentioned it to buyers since "it caused a lot of excess work."

However, if the builders or broker should go along with the "sweat equity" provision, then the sales contract should specify the exact nature of the work to be performed by the buyer. This will enable the FHA to determine if the work has a value equivalent to the amount of dollars being allowed by the builder or broker.

Maximum Sales Price

FHA specifies that the property may not be sold to the purchaser at a price, including closing costs, greater than the FHA appraised value, or for an amount which will require a cash investment in excess of the minimum required by statute. For example, if the FHA appraised a house at

\$18,500, the property can not be sold for \$18,500 with the borrower paying \$500 cash down payment. However, the sales price could be \$18,050 with the buyer paying \$150 for prepay items and thus the loan would be \$18,000.

Maximum Subsidy

The amount of the subsidy is established by taking the lesser amount of: (a) the monthly payment to principal and interest on an 8-1/2 percent loan (for example) plus the FHA Mortgage Insurance Premium (MIP) plus taxes and insurance minus 20 percent of the buyer's adjusted gross income, or (b) the monthly payment to principal and interest (P&I) at 8-1/2 percent interest (for example) plus the FHA MIP minus monthly payments to principal and interest on 1 percent.

EXAMPLE: A family with an adjusted income of \$400 per month requests a subsidy on a loan of \$13,000.00. Assuming regular monthly payments of \$126.00 (including principal, interest, MIP, taxes, and insurance).

CRITERION #1		CRITERION #2	
Regular Monthly Payment	\$126.00	Principal and Int.	
(20 percent of \$400.00)	<u>-80.00</u>	(8-1/2 percent)	\$99.97
	46.00	MIP	<u>5.40</u>
			105.37
		Less P&I (a)	
		1 percent	<u>-41.86</u>
			\$ <u>63.51</u>

Since \$46.00 is less than \$63.51, the subsidy in this example would be \$46.00 and the buyer would pay the

difference of \$80.00. However, if Criterion #1 established the subsidy payment, the FHA will absorb any future increase in hazard insurance on taxes up the maximum subsidy allowed. If Criterion #2 establishes the subsidy payment, the buyer must absorb any increase in hazard insurance or taxes.

Terms of Loans

The maximum term for "235" loans is 30 years. However, in certain circumstances the buyer may be accepted for a 35- or 40-year mortgage.

Costs of Seller

Since the Section 235 program is geared to those families with limited assets, most families in that case will want to purchase their home with the minimum down payment of \$200.00. Therefore, the seller in that case must absorb the buyer's closing costs and possibly a portion of the prepaid items.

Mortgagee Must Recertify Income

Every two years, the mortgagee (lender) is required to obtain from the "235" home owner a recertification of the owner's gross annual income. Of course, as the owner's income goes up the amount of subsidy he receives will diminish.

Credit Counseling (Section 237)

Under Section 237 of the HUD Act of 1968, provisions were made for low or moderate income buyers of 235 housing

who could not meet normal credit standards because of a poor credit standing, debt obligations, or total annual income. To qualify for Section 237, it must be shown that the buyer will be a "reasonably satisfactory" credit risk if he receives counseling concerning budgeting, debt management, and other financial related counseling.

Although this part of the program was included in the HUD Act of '68-'70, it was not funded. Some of this counseling was provided by non-profit groups, and very limited counseling was provided by the FHA. The mortgagees made their position clear with regard to Section 237: most interviewed felt it was a "mockery of the established credit system, and was unnecessary."

VI. THE PROCESS OF SECTION 235: A HYPOTHETICAL CASE STUDY

The process of securing the approval of the FHA to build a subdivision (to sell homes under the Section 235 program), and the processing of all the financial applications of the buyer involve the mortgagee. Thus, the process of a hypothetical "235" subdivision securing approval from FHA and the selling of a home under the Section 235 program is included in this chapter on the mortgagee. The following hypothetical case study of the "235" subdivision approval and financial processing of an applicant serves to illustrate

the typical situation encountered for the seven subdivisions studied in Chapter III. It also explores the financial commitment process and the various financial procedures and forms necessary to qualify and sell a home to a buyer under the Section 235 program. Although the process of securing zoning approval for the developer/builder's property is vital to the process, the case only explores the process of the private sector participants dealing with the FHA office.

Included in this hypothetical case is many of the actual forms utilized by the FHA, the builder/broker, and the mortgagee (lender) that are necessary for making an application to FHA for the Section 235 mortgage insurance and assistance payments.

As pointed out earlier, when built by a builder/developer, the house is sold to a buyer who meets the Section 235 requirements and is eligible to purchase under the Section 235 program. The home is sold by the builder and/or broker who coordinates with a private lending institution (e.g., the mortgagee). The mortgagee files the buyer's application to the FHA for an insured loan. If approved, the mortgagee gets an insured loan and the buyer receives a subsidy from the federal government to defray a part of his mortgage payments. Assuming the buyer received the maximum government subsidy (based on his income), the new home owner's interest rate could be reduced to as low as 1 percent.

Although the following case is hypothetical in looking at the key participants in the operation of the Section 235 program, the forms are some of the actual forms and procedures that the developer/builders/brokers in the seven "235" subdivisions studied in Chapter III utilized, and the mortgagee, discussed in Chapter IV followed in the Section 235 program process in Knox County, Tennessee.

Background of the Case

The sponsor of the subdivision is a profit motivated builder seeking a reasonable return for profit and overhead from his sales. The entire application once completed would be submitted to the local FHA insuring office by an FHA-approved mortgagee.

The application is divided into two separate submissions. Submitted as one package of forms is the appraisal and commitment, the plot plan, the complete working drawings, the description of materials, and the request for preliminary reservation of funds. This is only the initiation of the process by the developer/builder to have his subdivision approved by the FHA for the sale of houses under the Section 235 program. At this point in the process, the prospective "235" purchaser has not been found, nor for that matter is the builder under any obligation to sell his homes under the Section 235 program.

The second package of forms and procedures takes place after the developer/builder's subdivision has been approved by FHA, the first home(s) have been constructed, the real estate broker or salesman has begun his advertising program, and a potential purchaser who can qualify for the Section 235 program has been found. The forms included in this set consists of the application for the buyer's credit approval, other credit verifications, the sales contract, the summary of estimated costs, and the application for Section 235 assistance payments.

The Hypothetical Case-Processing Schedule

1. March 1—Two sets of "Application for Subdivision Feasibility Analysis" are filed by the developer for a subdivision containing 116 lots. (See Figure IV-2, p. 67.)
2. March 4—The local FHA office replies that the application has been received and that processing of the developer/builder application is underway.
3. March 9—The FHA office issues a letter stating that the subdivision is feasible and requests submission of complete preconstruction exhibits.
4. March 25—The developer/builder submits 2 sets of exhibits for preconstruction analysis. The exhibits include plans for each basic type of house.
5. March 27—The FHA office replies that the exhibits

FHA FORM # 2250 (Abbreviated)	U.S. DEPARTMENT OF HUD FEDERAL HOUSING ADMINISTRATION	Budget Bureau No. 63-R1203
Sponsor's Name: SHERLOCK HOMES, INC.	FHA File # 15	
Street Address: 3417 ROSEWOOD LANE BAYVIEW IOWA 55006	Subdivision Name: SUN RIVER ACRES Tract Number: SECTION 4	
City or County State Zip Code Phone: 515 733-1970	Location: PALATINE & SCHOENBECK ROADS	
Area Code	TODD COUNTY, BAYVIEW, IOWA 55006	
<u>APPLICATION FOR SUBDIVISION FEASIBILITY ANALYSIS</u>		
A feasibility analysis of this proposal is requested and the following exhibits are enclosed:		
<input checked="" type="checkbox"/> Location Map <input checked="" type="checkbox"/> Preliminary Subdivision Plan <input checked="" type="checkbox"/> Signed FHA Form 2010		
GENERAL INFORMATION:		
1. Sponsor is <input checked="" type="checkbox"/> Land Owner <input type="checkbox"/> Option Holder	10. Covenants recorded? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	
2. Size of this Parcel <u>44 ACRES</u>	<input type="checkbox"/> Will be identical to previous unit.	
3. Number of Lots: <u>116</u>	<input checked="" type="checkbox"/> Will conform with FHA Data Sheet 40.	
4. Typical Lot Size: <u>80 x 130</u>	11. a. Water System: <input checked="" type="checkbox"/> Central (Public or Community) <input type="checkbox"/> Individual	
5. Adjacent Land Under Sponsor's Control: <u>NONE</u> Acres	b. Sewerage System: <input checked="" type="checkbox"/> Central (Public or Community) <input type="checkbox"/> Individual	
6. Other Land Uses: <u>3.43 ACRES: KINDERGARTEN & PLAYFIELD</u>	12. Proposed Street Improvements: Pavement Base <u>ROLLED STONE 8"</u> Wearing Surface <u>ASPHALTIC</u> <u>CONCRETE</u> <input checked="" type="checkbox"/> Sidewalks <input checked="" type="checkbox"/> Curb and Gutter	
7. Sponsor will: <input checked="" type="checkbox"/> develop land and build homes; initial plan is to start <u>47</u> homes in \$ <u>18,500</u> to \$ <u>21,500</u> price range.	13. Underground electric and telephone? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	
8. Is Tentative Map approved by Local Authorities? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		
9. Is Plat recorded? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		
REMARKS: KINDERGARTEN & PLAYFIELD--3.34 ACRES (TO BE DEDICATED TO THE MUNICIPAL AUTHORITY) PREVIOUS FHA EXPERIENCE: PUMB RUN, FHA #8 LITTLE RIVER ACRES, FHA #13		
Signed: _____ (Sponsor)	PRESIDENT (Title)	SHERLOCK HOMES, INC. (Name of Development Company)
Date: <u>MARCH 1, 1971</u>	ASP-1	

Figure IV-2. Application for Subdivision Feasibility Analysis.

submitted by the developer/builder have been received and that processing will now commence.

6. April 10—The FHA issues a letter stating that the subdivision review analysis has been completed, and that the developer/builder may begin subdivision improvement for 47 lots, and applications for commitments on individual properties may be submitted. One set of preconstruction exhibits are returned to the developer indicating revisions, if any to be made.

7. April 11—The developer/builder using FHA Form 3122-A makes a request for 25 units (under "priority registration") anticipating that the balance will be sold under the standard FHA 203(b) program.¹¹ This system provides that the housing units sold to the "235" buyers will be processed as funds are available; some firm "Reservations of Contract Authority" may be granted if the funding of the program improves.

8. April 12—The developer/builder begins to make improvements on his subdivision.

9. April 20—The builder/broker and the mortgagee

¹¹Under the FHA 203(b) program anyone is eligible. The Cash Investment (down payment) is 3 percent of the first \$15,000 of value plus 10 percent of the next \$10,000 of value plus 20 percent on all over \$25,000. The maximum mortgage allowed is \$33,000 for 1 family, \$35,750 on 2 and 3 family homes, and \$41,250 on 4 family homes.

(lender) submit three sets of applications for FHA appraisal and commitments on each individual property.

10. April 26—FHA indicates that analysis of individual property applications has been completed and issues the commitments requested by the builder and the mortgagee.

11. April 30—The developer/builder calls for a site inspection by FHA prior to beginning the construction process.

12. June 15—The developer/builder completes the first units for potential sale under the Section 235 program.

13. June 16—The real estate broker on behalf of a builder advertises that houses just completed are available for sale to persons who qualify under the Section 235 program.

14. July 1—The first buyer's application for home ownership assistance is taken by the broker or mortgagee but is submitted by the mortgagee to the FHA office. (See Figure IV-3, page 70). Along with the Application for Home Ownership Assistance (FHA 3100), an application for credit approval (FHA 2900) is submitted for verification by the mortgagee to a recognized credit agency.

In addition to the request of a credit report on the potential "235" buyer, the mortgagee also requests a "verification of deposit" from the applicant's bank, as well as a "verification of employment" from the applicant's present employer. The time frame for this process varies considerably depending on an individual applicant's case.

FHA FORM NO. 3100

APPLICATION FOR HOME OWNERSHIP ASSISTANCE UNDER SEC. 235 OF THE NATIONAL HOUSING ACT		A.FHA Case No. (HYPOTHETICAL)					
B. Mortgagee-Name and Address: MIDWEST MORTGAGE COMPANY 3100 MAIN STREET BAYVIEW, IOWA 55006		C. Mortgagor(s) Name(s): Husband or Head: <u>JOHN W. PARIS</u> Spouse: <u>MURIEL PARIS</u> Co-Mortgagor(s): <u>2930 ORVILLE HEIGHTS RD.</u> <u>BAYVIEW, IOWA</u>					
D. EMPLOYMENT:		Years					
(1)Occupation (2)Soc.Sec. (3)Empl'd (4)Employer							
Husband or Head:	<u>TEACHER</u>	<u>509-38-2125</u>	<u>6</u> <u>MAYVIEW HIGH S.</u>				
Spouse:	<u>SEAMSTRESS</u>	<u>509-38-2126</u>	<u>2</u> <u>NICE INTERIORS,</u> <u>INC.</u>				
E. HOUSEHOLD COMPOSITION AND ANNUAL INCOME:							
Name	Age	Sex	Relation- ship	Wage or Salary	Disa- bility	Unemploy- ment	
1. JOHN W. PARIS	37	M	HUSBAND	6,545	100		
2. MURIEL PARIS	34	F	WIFE	1,200		780	
3. ANDREW R.	16	M	SON	500			
4. WALTER	13	M	SON	NONE			
5. MURIEL B.	11	F	DAUGHTER	NONE			
TOTAL (6)				8,245	100	780	
7. Number in Household:	<u>3</u>	9. No. of Dependents (exc.Spouse):		<u>3</u>			
8. Number of Eligible Minors:	<u>3</u>	10. Number of Handicapped:		<u>0</u>			
11. Total Annual Income(F-8(b) or (c))				<u>\$8,625</u>	HOME INSURANCE TRANS-		
(a)Less 5% of Total Annual Income---					ACTION:		
(b)Less Unusual Income-----				<u>1,311</u>	1. Sale Price: \$19,100		
(c)Less Eligible Minors(F-10 3x300)--				<u>900</u>	2. Mortgage Amt.: \$19,100		
12. Adjusted Annual Income-----				<u>\$6,414</u>	3. Down Payment: \$ 100		
13. Adjusted Monthly Income (15+12)-----				<u>\$ 534</u>	4. Term in Months: \$ 360		
					5. Interest Rate: 7 1/2%		
					6. Est.Mtg.Paym.: \$165.73		
ASSISTANCE CALCULATIONS:							
1. Area Income Limit for this Family: \$6,885.00							
2. Monthly Mortgage Payment \$165.73				ASSETS ALLOWANCE:			
3. 20% of Adj. Monthly Income \$106.80				1. Dependents (F-12)			
4. Formula(1)for Mo. Subsidy				3 x\$500) ----- \$1,500.00			
(G-3 minus G-4) \$ 58.93				2. Annual Share of Mort.			
5. Monthly Payment				Paym't(G-10x12)----- \$1,281.00			
(Princ.+Int.+MIP) \$147.30				3. If Mortgagor is 62 or			
6. Monthly Payment \$				Older, enter \$5000 or			
(Princ.+Int.+@1%) \$ 61.18				if less than 62, enter			
7. Formula(2)for Mo. Subsidy \$ 86.12				\$2000----- \$2,000.00			
8. Assist. Paymt. Auth. \$ 58.93				4. Total Assets Allowance \$4,781.00			
9. Mortgagor's Monthly Paymt. \$106.80							

Figure IV-3. Application for Home Ownership Assistance Under Section 235.

15. July 10—The developer/builder requests to the FHA insuring office that he receive FHA approval for a prescribed number of additional lots.

16. July 15—The FHA office issues a "letter of approval" for the developer/builder to continue construction in his development.

17. September 1, 1971—The developer/builder submits a letter to FHA certifying that he has completed "Subdivision Improvements in Substantial Conformity with Approved Plans and Specifications."

18. Continued Processing—The buyer's application forms are now in process by the mortgagee and the credit agency. If he meets all the requirements, he will be the owner of a home under the Section 235 program.

CHAPTER V

ASSESSMENT OF THE PRIVATE SECTOR

PERFORMANCE IN SECTION 235

I. FINDINGS AND CONCLUSIONS

1. It was found that the key participants who make up the private housing and home finance industry—developers/builders, brokers, and mortgage lenders have the primary responsibility for the operation of the Section 235 program. The private sector participants in fact were the keys to the success of the program in Knox County. They built the houses, publicized the availability of the program, advertised for potential buyers, and in many cases actually determined who participated in the program.

2. The real estate sector in particular were very exploitative of the "235" buyer. They knew the buyer was not knowledgeable of the Section 235 program, and was inexperienced as a home owner, and was desirous of owning his own home and therefore vulnerable to the "sales pitch."

3. The "235" subdivisions studied contained no Blacks. This may or may not have been overt discrimination on the part of builders and brokers.

4. Mortgage lenders, although they play a "passive role" in the operation of the Section 235 program (they do not

advertise or solicit buyers as do the builders and brokers), play a key role in the process. The lender is the informational link between FHA and the builder and the broker concerning the procedures to be followed in carrying out the program. It was also found that the lenders were aware of discriminatory practices by builders and brokers.

5. The major characteristic of the "235" subdivisions studied in Knox County was the "package type" operation. That is they provided the full range of management services. They built the houses and had a broker or salesman to advertise and solicit buyers. Three of the "package" operations were family owned and operated. All seven of the operations indicated they had specifically geared their subdivisions toward the Section 235 housing market.

6. All seven of the "235" subdivisions studied are located in the suburbs of Knox County. Four of the seven are located in the western part of Knox County. With the rapid development of these "235" subdivisions (especially during the 1969-1971 period), there was some general concern voiced about the "235" subdivisions crowding other subdivisions and causing property devaluations. This was only a short-lived concern, however. The growth of the "235" subdivisions was actually just a part of the general growth trend toward development in the western portion of the County.

7. At one point in 1971, the Knoxville FHA ranked 4th

in the nation in new Section 235 construction insured. From only 15,235 units approved by FHA in 1969, the total increased to 370 in 1970, 681 in 1971, 453 in 1972 and 178 in 1973, for a total of almost 1,700 insured Section 235 units for Knoxville-Knox County during the 4-year period. The new Section 235 housing built was significant in providing housing for low and moderate income families. In 1971, Section 235 housing accounted for almost 2/3 of all single family housing (60.5 percent).

8. The Section 235 program was geared to the \$5,000-\$8,000 family income range. In 1969, about 25 percent of all Knox County families fell in this income range. Thus, there was a significantly larger number of low to moderate income families with the opportunity to purchase their home as a result of the Section 235 program.

9. The birth of the Section 235 program nationally and of course in Knox County occurred during a period of rapid inflation and low productivity in the housing industry. During this period of time, the Section 235 program became a major support for the private housing and home finance industry in Knox County as well as the nation. All the builders interviewed indicated that the Section 235 program sustained them through the tough economic times between 1969-1971, when they experienced a tight money market and high interest rates. The builders also felt that the creation of this low and moderate income housing market provided a strong

stimulus for the entire housing industry, thereby preventing a large number of builders and developers from actually suffering economic setbacks.

10. The seven "235" subdivision developers and builders agreed that the following factors accounted for much of the success of the Section 235 program in Knox County: (1) Low labor costs during the period of the later 60's and early 70's. (2) Low land costs—especially in the suburbs. (3) Overall construction costs were kept fairly low. (4) The FHA office in Knoxville kept the mortgagees well informed, as well as the builders, developers, and real estate brokers, and salesmen. (5) The Section 235 program opened up a new housing market for the production and sale of new housing to low and moderate income individuals. They felt, however, that the latent demand for the low and moderate income housing and the arrival of the 235 program when it did, are good reasons for the success of the program.

11. Even with success there are usually some drawbacks and the Section 235 program operation in Knox County was no exception. There was some strong sentiment against the Section 235 program—in particular, with regard to the "235" subdivisions: (1) Some people felt "235" housing would depreciate their property values which was closely related to the fear that Blacks would buy in the "235" subdivisions (2) The builders of the "235" subdivisions received criticism

from some that the builders and developers were propagating urban sprawl with their suburban subdivisions. (3) Public reaction to the "235" subdivisions included a concern by some that the "235" suburban subdivisions would place an additional burden on the already overburdened school system.

12. The author found that the major responsibility for informing the public and potential buyers of "235" housing of the existence of the program fell upon the real estate brokers and salesmen. Thus the major role for the brokers also created a problem. Since the brokers and salesmen were usually the only contacts initially with the potential "235" buyer, they could influence who they wanted to purchase the housing and where he would buy. The real estate sector reached the public through newspaper advertising, although most brokers interviewed felt that newspaper advertising was not the best method of reaching the "235" clientele. They felt their best method in the long run was by "word of mouth."

13. It was found that most real estate brokers and salesmen manipulated the potential "235" buyer because of the broker's knowledge of the Section 235 program, and concomitantly the buyer's lack of knowledge. The brokers interviewed also exhibited strong sentiments against Blacks locating in the "235" suburban subdivisions because they felt whites didn't want it.

14. The author found that the mortgagee (lender) plays the role of the middleman in the Section 235 program. For example, if a seller or builder wishes to have his house appraised by an FHA appraiser, he or his broker must apply for the appraisal through an FHA approved mortgagee. Also, real estate brokers or builders who wish to sell houses to FHA must submit the buyers application through an FHA approved mortgagee. And finally, it is the mortgagee who receives periodic information from the FHA regarding the procedures to be followed in obtaining a Section 235 mortgage, and it is the mortgagee who usually informs brokers and builders about the operation of the program.

15. Most mortgagees interviewed felt that the real beneficiaries of the Section 235 program were not the purchasers of the "235" home, but rather the builders and brokers in Knox County.

Other opinions and viewpoints by mortgagees concerning the "235" program centered around the fact that most "235" clientele were not good home owner material, especially the young couples. They also felt that in general, most "'235' buyers were getting something for nothing." Although the author found that most mortgagees acted professionally they still on the whole made comments like the ones quoted. And as might be expected the mortgagees expressed a bias against "235" buyers in that they felt they were not reliable. They

felt that many of the "235" type buyers would end up in default, including having their homes repossessed. The author checked with the FHA and found this situation to be totally erroneous, as few "235" buyers actually ended up in total default.

16. The FHA played a vital but passive role in the operation of the Section 235 program in Knox County. They left the primary responsibility for operating the program, including publicizing the availability of financing and soliciting potential buyers in the hands of the private sector. Thus, under the Section 235 program FHA confined itself essentially to the same role it plays in all its single family insurance programs—approval or rejection of mortgage insurance applications submitted to FHA by approved lending institutions. The FHA was also passive in that the actual dissemination of information about the Section 235 program was left to the private sector.

17. Approximately 85-90 percent of all new Section 235 housing constructed in Knox County was located in the seven suburban "235" subdivisions studied by the author. These "235" subdivisions were all white, as is the experience of Knox County. Thus, the Section 235 program only continued what was already a trend in Knox County—the separation of Blacks and whites along housing lines and location with the Blacks in the inner-city, the whites in the suburbs. Each of

the private sector participants interviewed, as well as the FHA contributed to the fostering of this situation through their biases.

18. The FHA office was extremely successful in encouraging builders and developers to participate in the program through their information program directly to builders and brokers and indirectly through the mortgagees. This active encouragement did partially account for a very commendable production record for Section 235 in Knox County. At one point this emphasis on production at the expense of some quality led to the FHA office in Knox County ranking 4th in the nation in the number of insured new Section 235 homes. FHA had its failures also such as taking a passive role with regard to discrimination and to the lack of Blacks in the "235" subdivisions. For as indicated by this author's findings no Blacks were found in the "235" suburban subdivisions in Knox County at the time of this study.

II. FHA VIEWPOINT OF THE SECTION 235 PROGRAM

Since the focus of this thesis was on the roles and operation of the private sector in Section 235, the FHA role was only given limited treatment. Further, the viewpoints of FHA were not included in the main body of the thesis. Therefore, in fairness to the FHA, this author interviewed a key person in the FHA office in Knox County who was

intimately involved in the operation of the Section 235 program during the period 1969-1973. What follows is excerpts from the interview which express the viewpoints of this FHA official about the operation of the Section 235 program in Knox County:

1. There are people who purchase homes under the 235 program that should not have purchased a home under any type of program, because they were not capable of being home owners. It is hard, however, for FHA officials to see this in the papers contained in the application.

2. The final authority for applicant eligibility did rest with FHA. Form 3100 was the application for homeownership assistance. The 3100 was only one exhibit among many that the mortgagee submitted to HUD. The mortgagee was expected to put the entire package together and submit it to FHA. Some mortgagees had other people do their "leg work" to put together applications, such as the builders and brokers, but the FHA held the mortgagees responsible for the application package, not the builders and brokers.

3. All the application papers were necessary to FHA because they never got to see the applicant. The FHA's customer by law was the mortgagee, who was seeking mortgage insurance approval from FHA, not the buyer. FHA usually only got to see a 235 applicant when he was rejected, and he made a personal visit to the FHA office for an explanation. Following some of these personal interviews there was a change in the case study findings. But it was generally felt that personal interviewing by FHA would not have improved the program. In some cases it would have been good to see the applicant, but not in all cases.

4. One of the problems is when the program came out they (private sector) tried to hit it too hard and too heavy. It was geared on production quantity and not enough attention was given to quality.

5. There were a lot of applications that were in the "gray area." The FHA tried to look at the program so optimistically that they would often stretch points to accept an applicant. Some buyers succeeded, other didn't. There were some cases where people lived in their house six months and would be behind several

months in their payments.¹ They would go to the real estate broker who sold them the house, give them the key and tell them they were moving out. These people obviously did not understand the difference between rental and home ownership.

6. The majority of complaints that came in from these home owners were no greater than in any other FHA program. This program had so many complaints because of the emphasis on the volume of construction. In a lot of cases the home owners making complaints were not responsible people. There will always be "call-backs," no matter who the builder is. The builder usually allows for this. Some builders stay right on top of the problems, some do not. There have been some letters from 235 home owners with fifty or sixty items of complaint. FHA cannot force the builder to make the repair, but if FHA feels it is a justifiable complaint, they tell the builder this and ask him to repair it in a certain period of time and report it to FHA. If he doesn't repair it, then the FHA takes action and puts the builder on a restricted list. This means he can no longer do business with FHA until the complaint is resolved. This had to be done in a few cases.

7. At the time this program started most builders were not producing a \$15,000 or \$18,000 house. There were a lot of people who later could qualify for home ownership under Section 235 and were able to purchase an \$18,000 house. The program enabled the builder to market a low cost house, and the buyer to be able to afford it. The 235 program thus filled a void in the real estate market for low and moderate income housing.

8. There were a number of people between \$5,000 and \$8,000 per year who could not buy the home they wanted. The 235 program gave them this opportunity. The 235 program opened up a whole new market. For one of the things the law makers were looking at when they wrote this program was not only providing housing for lower income people, but also providing business for builders.

9. I believe that the good of home ownership for many in Knox County was met through the 235 program, maybe not to the degree Congress intended,

¹Although the default of 2 percent might seem low, FHA officials indicated that foreclosures with Section 235 housing were not a large problem.

but there were a lot of people who bought homes who didn't have a chance to buy otherwise. Builders made money, salesmen made high commissions, and some mortgagees did real well—a lot of people were helped by the program.

10. The 235 program was so successful in the Knox County area that the FHA office constantly ranked in the top 10 cities nationally. Much of the success of the program depends on the builder's receptivity. The builders in the Knoxville area got with the program. The builders and brokers deserve the credit for the success of the program. They learned the program well. There were always good communications between the private sector and the FHA.

III. AUTHOR'S COMMENTS AND CONCLUSIONS

The author found that overall the Section 235 program was popular and successful in Knox County, primarily during the period of time studied. It was successful in that it reached a large number of families in a short period of time, giving these families a chance to experience home ownership.

While all the private sector participants studied had weaknesses in their approach to the operation of the program, this author would have to assess the overall performance of the private sector in the operation as good. The "235" program was after all a new program that came on the scene very quickly. The goal was production, and so the builders produced. The brokers learned the program well as evidenced by this author in the interviews with the real estate sector. Some brokers in fact learned how to manipulate the program to the disadvantage of the unsuspecting buyer at times.

The mortgagee played too passive a role in the operation of the program this author felt. He held the purse strings. If he had also held a social conscience about the quality, location, and whom the program was (or was not) reaching, he could have been extremely influential. The same can also be echoed about the FHA; the FHA could have been much more active about the same concerns. In addition, the FHA should have been more concerned with the counseling of buyers of Section 235 (the consumer) than they were. Any future revitalization of home ownership for the low and moderate income families (and this author feels this should occur by the federal government) should carry with it a mandate that the FHA have a closer interviewing and counseling relationship with the potential buyer.

Viewed in its broadest perspective this author feels the Section 235 program was a good thing for the nation, particularly the Knox County experience. However, the question would have to be asked: "Was the program a panacea for the poor, or a boon for the builders and brokers?"

Dorothea Hohmann Nelson in her thesis on "Comparison of New Homes With Previous Residences By Families Purchasing Houses Under Section 235 of the National Housing Act" summed up her thesis with:

When viewed through the eyes of the respondents (235 home owners) in the sample, the author (Nelson) would have to give a favorable response to the 235 program in Knox County.

Her thesis was the viewpoint of the buyer, and maybe this is where the real test of whether the program was successful or not, and whether it reached its goal of home ownership.

The findings of this study indicate that the pendulum would have to be swung in the direction of the private housing, real estate, and home finance industry. As one interviewee said: "The real beneficiaries of the 235 program were the builders and brokers and not the buyers." While this author is of course glad that many buyers benefited from the experience of knowing home ownership (who would not otherwise have been able to without the Section 235 program), his conclusion would have to be that the Section 235 program was more tailor-made for the benefit of the successful operation of the private sector than for the "235" buyer.

Finally, the author would like to see the federal government reinstitute a housing policy which has a high priority again for home ownership for low and moderate income persons. And while the operation of the Section 235 program (at least in Knox County) was successful, this author would like to see a home ownership program less beneficial to the private sector and more buyer or consumer-oriented. A strong possibility for redirecting this effort might be to experiment with a general housing allowance for prospective buyers. In short, direct cash grants could be made to potential buyers. Whereas, the subsidy technique was adequate, it did have a

major drawback—no equity buildup was possible for the purchaser. A direct cash grant to low and moderate income persons could make home ownership a reality again plus it would give them what so many other Americans already enjoy—the opportunity to experience the accrual of equity buildup.

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Following graduation from the University of South Florida, he served two years as an officer in the U.S. Army. He was employed following the service as a planner with the Hillsborough County Planning Commission in Tampa and worked with the Commission until entrance in the Graduate School of Planning, The University of Tennessee in September, 1969. He left graduate school after completing all course requirements in 1971 to take a job in planning. He continued to work on his thesis part-time and received the Master of Science in Planning degree in March, 1976.

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