STATE RENTAL PRODUCTION PROGRAMS IN VARYING MARKET CONDITIONS

by

John Quinn

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Signature of the author ____________________
John Quinn
Department of Urban Studies and Planning
July 27, 1990

Certified by ____________________
Michael Wheeler
Visiting Professor of Urban Studies & Planning
Thesis Supervisor

Accepted by ____________________
Gloria Schuck
Chairperson
Interdepartmental Degree Program in Real Estate Development

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Submitted to the Department of Urban Studies & Planning
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ABSTRACT

Today's housing problems are no longer isolated to the ill housed as increasingly the realities of housing needs permeate our society.

Affordable housing is a pervasive issue in the United States and must be addressed. High housing costs have limited homeownership opportunities for young households and increasing numbers of low income households compete for the dwindling supply of low cost housing both on the homeownership and rental side. Housing price increases during the 1970s and the reduction of federal subsidies combined to create growing problems of affordability and quality. Although affordability presents problems for many households, low income households have been impacted the hardest. Nearly two-thirds of all poor families live in housing that costs more than they can afford. Three trends underscore this contention: (1) the poor lost income at a historically rapid pace during the inflation of the 1970s and the recession of the early 1980s; (2) housing costs increased faster for the poor than for any other group; and (3) reductions in federal housing subsidies were realized fully in the late 1980s.

Given the federal government's retrenchment in housing, the burden has been placed on the states to provide affordable housing. States have responded by creating housing finance agencies which exhibit varying levels of sophistication and activism in regard to state housing programs, housing finance, and regulatory powers. A comparative study was performed to examine the ability of states to manage successfully housing programs. Three states — Massachusetts, Rhode Island, and Maryland — were selected, based on their commitment to affordable housing, activist leadership, innovative reputation and accessibility. In each state a rental production program was chosen. The program's strengths and weaknesses were illustrated, compared, and then evaluated as to success.

The results demonstrate that these states have shown a commitment and increasing capacity to undertake major housing initiatives. Yet, new challenges, such as varying housing market and state fiscal conditions, face the agencies in the 1990s demanding that they continue to foster entrepreneurial efforts.

Thesis Supervisor: Michael Wheeler

Title: Visiting Professor of Urban Studies & Planning

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INTRODUCTION

> *America is increasingly becoming a nation of housing have and have-nots.*
>
> *William Apgar*

The United States faces many serious housing issues, i.e. homelessness, housing unaffordability, declining rates of homeownership, the loss of low income housing due to the retreating role of the federal government and available subsidies, an inadequate amount of housing stock and concerns over expiring use. Affordable housing lies at the root of many of these issues and must be addressed, particularly for low income households. While it is true that homeownership presents problems for many households, the number of households suffering from first time buying affordability problems is significantly smaller than the number suffering from low income affordability problems. Anthony Downs illustrates this point by noting that an estimate of total housing sales both new and existing would approximate 5 percent of the total number of households. He estimates that the fraction of total sales likely to involve first time home buyers would be 40 percent, which means that approximately 2 percent of all households might be potential first time homebuyers in any given year. Moreover, in 1979 the

median income of first time homebuyers was $25,230 or 53 percent higher than the median income of all households in that year ($16,461). The median income of renter households in 1979 was only $10,000. Therefore in 1979 the median income of first time homebuyers was 2.5 times that of renters, which clearly illustrates that this group does not require financial assistance nearly as much as renters as a group, particularly low income renters.[1] Low income households are defined at those with annual incomes below 50 percent of the median household incomes in their areas.

Housing price increases during the 1970s and reduced federal subsidies during the 1980s have exacerbated the affordability problem for all Americans but have most seriously impacted the poor. The majority of poor people are renters as indicated by the National Housing Task Force, which reported that in 1987 63 percent of all poverty level households were living in rental housing. A growing dysfunction in the housing market for low income households has been seen in recent years. This disparity between rent and income has increased. From 1980 to 1986 real rents increased by 15 percent nationwide and are at their highest levels in twenty years. Areas characterized by strong economic growth have

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[1] Downs, Anthony. *A Strategy for Designing a Fully Comprehensive National Housing Policy for the Federal Government of the United States,* (March, 1988), p. 20.

experienced even more dramatic rent increases, 20 percent in the Northeast and 25 percent in the West.[2] This group lost income at a historically rapid pace during the inflationary period of the 1970s and recession of the early 1980s. At the beginning of the 1970s poor families spent 30% of their income for housing but by 1985 they were spending 58% for housing.[3] In addition, the nation lost more than 4.5 million housing units between 1973 and 1983 due to displacement, abandonment, and upgrading, almost half of which were occupied by low income households. During this time real median incomes of all renters fell by 12 percent.[4] The effects on low income renter households have been devastating. From 1974 to 1983 the number of households below 50 percent of median income increased by over 5 million while the number of units affordable at 35 percent of income actually decreased by over 300,000.[5] The affordability gap has widened particularly for the low income household.

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[2]Council of State Community Affairs Agencies, *The States and Housing: Responding to the Challenge, Housing Production,* (May 13-14, 1988), p. 7.

[3]Ford Foundation, *Affordable Housing: The Years Ahead* (August, 1989), p. 13.

[4]The Report of the National Housing Task Force, *A Decent Place to Live,* (March, 1988), p. 6.

[5]Council of State Community Affairs Agencies, The States and Housing: Responding to the Challenge, Housing Production, (May 13-14, 1988), p. 7.

It must be noted that the affordability problem is not only a social concern but also an economic one. High housing prices in Massachusetts make it extremely difficult for the area to grow as firms find it hard to recruit new employees which drives up wages and results in a less competitive position for Massachusetts' firms. Walter Palmer, an officer of Raytheon Company, believes that "People don't even apply for jobs in the Boston area because they know about the high cost of housing."[6] Heinz Muehlmann, an economist at the Associated Industries of Massachusetts, states that "The difference between housing prices in the Midwest and here is so enormous that they are almost impossible to compensate by higher wages."[7] Thus, as one can imagine the issue of affordable housing has far reaching implications.

Housing subsidies traditionally provided by the federal government have been the mainstay of the affordable housing program. Government intervention was first witnessed in the 1890s but did not really become a movement until the 1930s when government supported began to expand rapidly. Yet by the end of the 1970s the federal government's momentum had slowed considerably and would soon be reversing. Production subsidies

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[6]*The Boston Herald,* October 21, 1987.

[7]*Ibid.*

which one targeted the supply side to create new housing changed course and focused on demand side subsidies which aided in reducing the cost of housing for low and moderate income households by improving their purchasing power in the existing housing market. Such subsidies encourage rehabilitation rather than new construction. Support for subsidized housing plummeted from $30 billion in 1981 to less than $8 billion in 1989.[8] The withdrawal of federal assistance coupled with the adverse affects of the 1986 tax law, primarily the reduced usability of tax exempt bonds for housing and substantially lessened incentives for constructing privately financed rental housing, has placed increasing demands on the states' ability to target, provide, and regulate housing.

In order to replace HUD's activism, many states have embarked on several programs including the establishment of housing finance agencies. Although the approach and degree of success of state housing initiatives vary, the diversity of responses illustrates the desire and ability of states to undertake housing programs. States are ideally situated to manage this responsibility as they possess resources and information of both local and federal levels and have powers not available to either. They have the requisite skill and

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[8]Ford Foundation, *Affordable Housing: The Years Ahead* (August, 1989), p. 13.

expertise in the management of programs and also have an understanding of the sensitivity to local housing issues.

This thesis will examine the role and strategies of states regarding their ability to manage housing programs. Specifically I will investigate three states, namely Massachusetts, Rhode Island, and Maryland which were selected as a result of their high level of commitment to affordable housing, activist leadership, and innovative reputation, the changing environment (for instance, the bursting of the Massachusetts miracle), and accessibility. In each state I will evaluate a rental production program, i.e. in Massachusetts the State Housing Assistance for Rental Production Program, in Rhode Island the Rental Production Program and in Maryland the Rental Housing Production Program. The strengths and weaknesses of each program will be illustrated through comparative analysis in order to share some lessons from these experiences. An evaluation of the success of the programs will be based on five criteria: the number of units produced, the realized intent of the program, cost effectiveness, adaptability to varying housing market and economic circumstances, and state support. My concentration on rental programs stems from the fact that as illustrated earlier homeownership represents only a small fraction of the housing problem, whereas affordability for renters, particularly low income

renters, is the major dilemma and this group is in much greater need of assistance.

Chapter I will present an overview of the federal government's involvement in housing and its pursuant withdrawal as well as the states' response to this shift in responsibilities. Chapter II will discuss generic subsidy strategies and introduce the Massachusetts environment and SHARP program. Chapter III will present Rhode Island's experience with the Rental Production Program and Chapter IV will examine Maryland's initiative. Chapter V will serve as a forum for comparison and present some lessons and recommendations.

CHAPTER I

A Change in Housing Policy

Housing policy and the federal government's involvement in this area can be divided into five periods, namely: the 1890s through the 1930s characterized by deep concern over living conditions and public health and safety; the 1930s through the 1950s with the initiation of production oriented programs and the dominance of public housing projects; the 1960s when deep targeted subsidies for the poor emerged and low income housing production shifted to private developers; the 1970s with a moratorium on production and a change to income based programs; and the 1980s marked by a retrenchment of federal involvement and support as evidenced by the removal of federal subsidies and tax reform.

The federal government first intervened in housing when in 1892 Congress authorized a commission to explore the horrendous living conditions of the nation's largest cities. The dilapidated slum like dwellings posed a considerable threat to public health and safety. Although the Congressional initiative was not pursued immediately by further federal efforts, this action spurred a series of private, state and local government initiatives commonly known as

the Tenement House Reform movement.[9] The noteworthy result of the movement was the enactment of various new or improved building and house codes founded on concerns over public health.

Government intervention was evidenced during the Great Depression most notably through public housing slum clearance and Federal Housing Administration mortgage insurance for the middle class. Soon after World War II, further government involvement in housing was witnessed, partly inspired by the need to rehouse returning veterans. In 1949 the passage of the Urban Redevelopment Act declared the government's commitment to a "decent home in a suitable environment for every American family."[10]

The 1960s' efforts were initiated during President Kennedy's New Frontier and expanded during President Johnson's Great Society. This period was characterized by an enormous increase in subsidies for housing production, the focusing of benefits to low and moderate income families, and attempts to make private enterprise the main means of providing subsidized shelter. Such efforts were not only a response to the recent public awareness of pervasive poverty but

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[9]Ford Foundation, *Affordable Housing: The Years Ahead* (August, 1989), p. 2.

[10]The Report of the National Housing Task Force, *A Decent Place to Live,* (March, 1988), p. 2.

also a recognition of the growing problems of the near poor, those above public housing but below FHA-VA levels. A multitude of subsidized rental housing programs targeted the in-betweens, primarily in the form of below market rate mortgages. Although still a predominantly private housing market, the federal government during this time became a main actor as it controlled a comprehensive system of mortgage insurance and subsidies.

From 1961 to 1973 subsidized housing grew from 460,000 units to more than 1.5 million units and for the first time subsidies were based on income.[11] Also the new housing programs were designed particularly to spur private ownership of units. Yet, not until 1969 and the enactment of the Brooke Amendment did public housing become available to the nation's poorest families.[12] This Amendment limited the rent public housing residents paid to twenty five percent of their household income. In addition, a creative first time tax policy initiative was developed to encourage support for the production of low and moderate income housing which enhanced returns to investors. Tax exempt bonds were authorized to finance privately developed units leased by local public housing authorities,

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[11]Ford Foundation, *Affordable Housing: The Years Ahead* (August, 1989), p. 28.

[12]*Ibid.*

and introduced into the tax code were accelerated depreciation schedules for low income housing.

The growth of federal housing programs although impressive encountered tough criticism. Housing proponents claimed that developers were reaping excessive profits and developers complained that HUD was extremely inefficient as administrative delays were costly. Also double digit inflation coupled with rising utility and maintenance costs outpaced incomes which further increased the affordability gap. Defaults in several subsidized programs combined with the 1972 demolition of the Pruitt-Igoe public housing project in St. Louis led to an increasing national awareness of public housing difficulties in management and design.[13]

Given these problems President Nixon in 1973 declared a moratorium on all federal housing programs and developed a National Housing Policy Review, which emphasized two main findings, i.e. that housing programs should concentrate on the family rather than the unit and housing assistance should be focused on the income of this household rather than the cost of the unit. With this aim in mind, the 1974 Housing and Community Development Act shifted priorities from the old "supply side" (production orientation) programs to various Section 8 "demand side" programs; this program

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[13]Ford Foundation, *Affordable Housing: The Years Ahead* (August, 1989), p. 30.

shift altered the course of federal housing policy. The Section 8 subsidy provides an income supplement for qualifying households (initially those with incomes up to 80 percent of area median; currently those with incomes up to 50 percent of area median). Section 8 recipients originally paid 25 percent of their income in rent (now 30 percent) with the subsidy covering the remainder up to a predetermined fair market rent.

By the end of the 1970s most of the programs introduced in the 1960s were phased out and replaced by programs with similar intent but a different orientation. Private investment in housing was encouraged through increased tax incentives and tax exempt bond financing became available for Section 8 and other projects that reserved a specified amount of their units for qualifying households.

At the close of the decade it was evident that the housing programs were no longer growing. In 1981 President Reagan's Commission on Housing concluded that future housing policy should focus on housing affordability with less emphasis placed on housing production and rehabilitation. Housing vouchers, an income aid similar to the Experimental Housing Allowance Program, were introduced and the commission proposed the termination of all four Section 8 programs. Two other programs were also added, namely the Housing Development Action Grant (HODAG) and the Rental

Rehabilitation Grant program. The former program is a one time grant used to subsidize construction or rehabilitation costs for projects in which 20 percent of the units are targeted for low income households, while the latter program involves city competition for block grants that are used to subsidize moderate rehabilitation. Each grant is matched by a Section 8 subsidy. Both programs continue to operate but at very modest funding levels.

Reductions in funding for housing programs were a common occurrence during the 1980s as the federal government all but removed itself from housing as evidenced by a more than 70 percent decline during the decade in annual allocations for federally subsidized units. Such federal retrenchment forced the states to take responsibility for housing programs. Previously they were mere spectators, yet recently they were compelled to take a much more pro-active role in housing. States' resourcefulness became evident as many soon developed housing policy, managed housing programs, provided housing finance mechanisms, and assumed the role of regulator, planner, and partner in residential land use decisions.

Given the withdrawal of federal support for low income housing in the 1980s, many states and local governments, community groups, nonprofits, and low income housing developers have responded with creative measures to address a diverse range of

housing needs. The federal government's retreat from the housing business left a void which demanded state activism in particular. States have only recently become involved in housing in relation to local agencies. The vast majority of state housing programs are less than a decade old and many states have funded housing programs from their own revenues only within the past seven or eight years.

Many states have introduced housing programs and have contributed significant resources to them like Massachusetts, while others have yet to make serious inroads. The state level of commitment to housing varies considerably amongst states and their approach to participation tends to be incremental often spurred by a major housing dilemma.

The 1970s witnessed state and local government creation of Housing Finance Agencies (HFAs) which complemented federal housing programs. Under federal law HFAs issue tax exempt housing bonds which underwrite new construction of rental housing. Tax exempt status enables lower mortgage interest rates to be offered. Qualifications for tax exempt financing demand that developers reserve a particular percentage of the housing they build for low income households. Such tax exempt bonds have been extremely valuable over the years from a rental production standpoint. In fact

for the first half of 1985 tax exempt financing exceeded the total for all of 1984.

States have primarily employed industrial development bonds (IDBs) to provide financing for the development of rental housing. IDB use has centered around increasing the stock of rental housing with over 95 percent of multi-family IDBs used to fund new construction and substantial rehabilitation of apartments.[14] The countercyclical element of tax exempt bonds is an extremely important feature. Yet, due to the loss of federal revenues from such bonds the 1986 Tax Reform Act limited the amount of bonds each state could issue and set tougher affordability standards resulting in a decreased contribution to housing finance programs.

In addition, some states are reclaiming some of the land use and other regulatory powers which were formerly delegated to cities and towns as inefficient practices, and disputes at the local level over land use and growth rarely provided affordable housing in the best interests of low income households, as the "not in my back yard" opinion dominated many communities. This dilemma raises the question of the appropriate level of government. Housing is a very local issue with specific market conditions, actors, and land use policy

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[14]Terner, Ian and Cook, Thomas. *New Directions for Federal Housing Policy: The Role of the States* (March, 1988), p. 17.

demanding adaptability to local circumstances. These factors require that subsidy programs be managed by a governmental agency which understands the intricacies of the local market. As illustrated the parochial tendencies of many local governments suggest that local control would be ill-advised. A lack of expertise or interest in providing affordable housing on the part of cities and towns can pose considerable problems and obstacles. In order to achieve larger housing objectives it is necessary for the government agency to take a broader perspective regarding housing issues. Also, although housing is a local concern housing markets tend to operate on a metropolitan or regional level rather than a city level.

Anthony Downs contends that the metropolitan level is the most appropriate level of government for the administration of housing programs as the decision makers are near enough to comprehend local concerns but removed enough to take a regional outlook. Yet, Downs notes that very few functioning metropolitan governments exist and the development of new regional bodies would prove most difficult due to political and bureaucratic considerations. Given this situation Downs believes that the state is best positioned to administer federal housing resources.[15] States' political and managerial machinery which can be used to explore,

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[15]*Ibid.*, p. 5.

comprehend, and target housing policies coupled with their expertise in public finance, the management of programs and allocation of funds between competing claims, uniquely situates states to fulfill this demanding role. States can understand local realities and possess regulatory powers over local land use decisions which are constitutionally prohibited from the federal government. Other resources which state governments afford to low-income housing development include appropriated funds, dedicated state revenues, tax incentives, credit enhancement, etc.

States' competence to undertake this role depends on a variety of state attributes and characteristics, i.e. leadership, commitment to housing, size, wealth and resources, particular economic conditions, traditions, development of efficient and proper agencies, and their ability to coordinate diverse resources and various players in the operation of housing programs, as well as target programs to meet specific needs, etc. As such conditions vary among states so too will their ability to manage their housing responsibilities. In order to gain further insight into states' commitment and ability to operate housing programs, it is necessary to explore the situation in greater detail and it is this charge that I now undertake.

CHAPTER II
Subsidies and the Massachusetts Experience

Before describing the rental production programs of Massachusetts, Rhode Island, and Maryland, I will present a brief overview of subsidy strategies, as outlined by Downs —namely, the demand side subsidy and the supply side subsidy.[16] I will concentrate more on the latter as it directly increases new rental housing supply.

The demand side subsidy strategy emphasizes either housing vouchers paid directly to low income households or rent supplements paid to their landlords. Many housing observers believe that this is the best approach in areas that experience soft rental housing markets, but in tight rental markets it may be necessary to subsidize construction of new rental units. Other forms of housing assistance target existing housing units rather than add to supply and attempt to maintain or improve the units' condition. These include rehabilitating existing units and precluding them from becoming market rate. Historically, rehabilitation programs have been divided into three categories according to the level of work performed on the units: substantial rehabilitation can be as expensive per unit as new

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[16]Downs, Anthony. *A Strategy for Designing a Fully Comprehensive National Housing Policy for the Federal Government of the United States*, (March, 1988), pp. 53–56.

construction; and moderate, and minor rehabilitation costing less per unit than new construction but more than housing vouchers. Though the former increase the supply of quality units, generally the vouchers do not.

There are four basic supply side subsidy strategies. The first is the hidden subsidy of tax benefits to homeowners. Here it is hoped that even without a direct subsidy, improvements in low income housing will ultimately occur from the "trickle-down" process (where upper and middle income households vacate their once new housing units as time passes and move into newer units, and other households farther down in the income distribution move in). There are several problems regarding the "trickle-down" process, however. By the time the old units reach the affordability level of the low income households many units are deteriorated and in disrepair. Also, discrimination can pose a formidable obstacle to the process. Moreover, as the early 1980s indicated, this mechanism encounters great difficulty whenever new housing starts fall low relative to the total of net new household formations and removals of housing from the stock. Such a process often forces many poor households to live together in the most dilapidated conditions and neighborhoods.

A second approach — the deep subsidy strategy — provides directly subsidized new units for low income households. Large

subsidies are needed due to the high cost of new units relative to the rent paying abilities of this income group. Attention and resources are focused on the households with the greatest needs, but the large amount of subsidy needed per household necessarily means that such programs can only influence and assist a small number of people. The percentage of income eligible households who will receive such subsidies is very low. The addition to the total housing supply is no way near as great as would be provided by spreading the same subsidy broadly, but shallowly.

There also can be a resulting small spillover gain to all low income households, even to those who do not receive the direct subsidy benefit, when total supply of units increases. This gain arises from the situation where total supply increases faster than total demand, thereby exerting downward pressure on the rents of units in the proximity sharing the same income characteristics. Again, a shallow subsidy program that produces more units should produce more of this spillover. Measurable positive spillover effects occur only when the number of new subsidized units is extremely large as the early 1970s illustrated; with small increases in new units, spillover effects are unremarkable.

The deep-shallow choice also causes significant concerns of fairness as deep subsidies provide low income households with new

units which are often of higher quality than the housing of the taxpayers who are paying for the subsidies. Locational issues are also controversial as most neighborhoods do not want low income projects built in their area.

A third approach — a shallow subsidy — has already been mentioned. It also enables directly subsidized new units to be built for low income households. As noted, a shallow subsidy provides more new units for low income households per million dollars of public funds spent as the average subsidy per household is smaller. The resultant larger overall increases in the total housing supply can produce larger spillover effects for unsubsidized low income households in the area if as previously noted the increase in subsidized units is sufficiently large. Also these household units are often developed in conjunction with market rent units in a mixed income approach, which tends to be more acceptable by nearby residents than projects comprised totally of low income households.

Finally, a two-sided subsidy strategy employs very shallow subsidies which due to their shallowness can only assist moderate income households not low income ones. Once again the savings through smaller subsidies translates into many new subsidized units being built. If the amount of units built is large enough, the overall rental supply downward pressure on rents will be evidenced

throughout the market. Housing vouchers are then deployed to low income households which enables them to occupy good quality older units and due to the spillover effect unit rents will be lower. This two pronged approach appears quite beneficial to low income households in that it assists housing voucher recipients as well as those who occupy existing units which have experienced rent reductions. Yet, once again the main condition of positive spillover must be present if this strategy is to be effective — i.e. a large number of new subsidized units must be built each year. This prerequisite has rarely been met.

As should be apparent, these four approaches are not mutually exclusive; subsidies can and often are combined in various mixtures. Such matching can prove fruitful, but one must carefully consider and weigh the advantages and disadvantages of each strategy in formulating a balanced mix. These approaches, moreover, are generic and could be used in any state, or for that matter by any level of government.

With this as a background, we turn now to the specific programs of Massachusetts, Rhode Island, and Maryland. To fully appreciate their design and implementation, one must understand some of the underlying economic factors and market forces which shape the housing environment in each state.

Affordable housing has become a major policy issue in Massachusetts due in part to the pervasiveness of the housing market imbalances. Low income households are no longer alone in their plight. Moderate income households — in fact, households on all rungs of the economic ladder — are affected by escalating prices. The so-called Massachusetts Miracle and the associated economic success was indirectly responsible for the problem, as not only did newly prosperous households encounter cheaper credit and terms and decide to home shop, but also a dramatic increase in households trying to locate separate living space led to a sharp increase in demand for housing relative to available supply. These factors drove housing prices up for all income groups. During the late 1980s, media attention highlighted this phenomenon. Across the Commonwealth (and particularly in the Boston area) people could not afford to rent or buy housing in their hometowns; and industries were frustrated in attempts to recruit workers from other areas. The prosperity of households and the competitiveness of the state's industries are still being undermined by the high cost of renting and owning housing.

In the 1970s strong demand for housing from new households exerted upward pressure on home prices in Massachusetts to such an extent that they rose more rapidly than the cost of living,

establishing the idea of the home as an inflation hedge and desirable investment. Unprecedented inflation rates between 1979 and 1982 forced mortgage rates to a level which prevented many potential buyers from entering the marketplace and hampered sales and price increases throughout this period. The economic recovery coupled with a turnaround in interest rates served as a catalyst for the pent-up demand of the previous years and resulted in an explosion onto the housing market which underscored the notion of a house as not only a home but also a nearly certain high yield investment. From 1983 to approximately mid-1985, the median priced home in the Boston Metropolitan Area became the most expensive median priced home in the country.[17]

If prices had remained stable, of course, rising median incomes and the steady decline in interest rates from a high of over 17 percent in late 1981 would have made housing more affordable, but continued home price increases more than offset those factors. The rate of increase had slowed in the fourth quarter of 1986 and was the smallest percentage increase since 1984, when home prices in the Boston area began to increase dramatically. The median home

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[17]Massachusetts Housing Financy Agency Report, *The Housing Environment in Massachusetts* (July, 1987), p. 3.

price had increased 15.9 percent within the previous year to $167,800 and by mid-1987 had risen to $175,000.[18]

Viewing income, interest rates, and home prices together provides insight into the affordability gap. Specifically, in Massachusetts the gap between the income required to finance an average priced home and the median income in the state grew from approximately $12,000 in the second quarter of 1983 to almost $30,000 in the second quarter of 1986. In the latter year, a household would need an income of over $60,000 to afford a home priced at the average of $141,000.[19] Population structure, demographics, and changes in lifestyle also have contributed greatly to market conditions.

Compounding the demand problem were a number of supply constraints that further restricted its affordability to all income groups. Labor, materials, and financing costs have kept pace with inflation (or increased faster than inflation), making new homes as expensive as existing ones and just as unaffordable for many budgets. Given lower inflation, building has increased but generally only in the markets for move up and luxury homes. Perhaps even

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[18]Massachusetts Housing Finance Agency Report, *The Housing Environment in Massachusetts* (July, 1987), p. 11.

[19]*Ibid.*, p. 14.

more important, zoning, building codes, and other environmental controls have limited the supply of developable land, reduced density, and added significant costs of delay. Developers point to land transfer taxes where applicable, linkage and other exactions as exacerbating the problem.

On the other hand, there are several regulatory tools available to developers to encourage localities to provide their fair share of land available for low income housing. The most prominent such "sticks" are Chapter 774, the Anti-Snob Zoning Law and Executive Order 215. The former statute permits a builder to appeal a local land development ruling that prohibits low and moderate income housing to a state board. While the latter mechanism allows the Executive Office of Communities and Development to block certain state discretionary funds to a locality if the locality has failed to provide a broad range of housing choices. Still, on balance Massachusetts' approach to land development requires developers to pass various regulatory tests, and an environmentally conscious public which demands a balanced development program, has resulted in a reduction in the supply of buildable land and increased prices for available land.[20]

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[20] Council of State Community Affairs Agencies, *The States and Housing: Responding to the Challenge, Building State Housing Capacity,* (May 13–14, 1987), p. 36.

Although rental and owner-occupied housing are often regarded as separate commodities, their markets are in fact closely intertwined as rising home ownership costs create a ripple effect through the rental market. Frustrated home buyers crowd the rental market and bid up rents causing hardship for low income groups. (The 1980 census reports that renters have on average half the income of homeowners in Massachusetts.) Unfortunately, the increases in attainable rents often are burdensome for tenants but insufficient to spur new construction or rehabilitation of older units. Landlords thus may be prompted to convert their properties into condominiums. This accelerates the reduction in supply. Low income households have been hard hit in the 1980s by economic recession than by the housing recovery which aided in driving rents beyond their means.

Demand for rental units increased dramatically during the early and mid 1980s as a result of the affordability problem in homeownership and new household formation. Rental vacancy rates, a proxy for market conditions, rapidly declined during the mid 1980s to levels below five percent — once considered a minimum threshold by the federal government. The Rental Housing Association and Greater Boston Real Estate Board report that vacancies for the state further declined from 4.1 percent in 1982 to 2.4% in 1986; in turn,

the Boston Redevelopment Authority reported Boston vacancy declining from 7.5 percent in 1980 to 2.7 percent in 1986.[21] Local housing authority backlogs of applicants and waiting periods of several years also illustrated the unmet demand at the time.

The context of the supply of rental units was shaped by a number of factors not least of which was inflation which gathered momentum in the early 1970s and received bursts from the oil shocks of 1974 and 1979. Also many areas of the country witnessed increasing land costs due to fewer buildable parcels, escalating operating costs (which often outpaced rental income), and rising financing rates, all of which burdened development. Such economic stress prompted many developers to reduce maintenance which sometimes led to abandonment, sale or conversion to condominiums. A Boston Redevelopment Authority study of households in the City of Boston reports that the rental component of the housing stock declined from 33 percent in 1980 to 28 percent in 1985 while the number of condominiums rose from 4,610 to 18,439 in the same period.[22] The private sector's shift away from rental housing contributed to the problems of displacement and homelessness and

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[21]Massachusetts Housing Finance Agency Report, *The Housing Environment in Massachusetts* (July 1987), p. 22.

[22]*Ibid.*, p. 25.

were coupled with the federal government's withdrawal of rental housing production programs has added to the gap between supply and demand.

Market inefficiencies also caused rental prices to be bid up dramatically. The Rental Housing Association Industry Surveys indicate a 38.8 percent nominal increase in median rents statewide between June 1982 and October 1986; in real terms this amounted to a 22 percent appreciation rate with Boston in particular experiencing a 19 percent rise above inflation.[23] The Bureau of Labor Statistics data regarding the Consumer Price Index was dissected to illustrate the degree of rent escalations compared to other consumption items over a fifteen year period. Comparative analysis shows that from 1978 the 1981 Boston metropolitan rents, which in many cases were regulated by rent control, did not increase as fast as other costs of living, which translates into a fall in real rents. Yet, in 1981 renters in the Boston SMSA were no longer enjoying a rent advantage: even though rent increases slowed from 1981 to 1984 they still far outpaced inflation. Even more alarming was the fact that from 1984 to 1986 yearly average rent increases rose while inflation decreased; this continued a three year trend producing the largest real increase

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[23]*Ibid.*, p. 26.

in rents in nine years.[24] Such factors underscore the mismatch in the rental marketplace.

Given this rental housing condition in the state a number of programs were created to address the critical and growing need for affordable rental housing in the Commonwealth. Among them was the State Housing Assistance for Rental Production (SHARP) program which was enacted in December, 1983, by the Legislature. Various relevant elements from the SHARP guidelines were extracted in order to provide an outline of the program. SHARP's primary purpose was to expand the supply of rental housing in the Commonwealth; it was not geared toward the repair of basically sound existing housing. Projects which received SHARP subsidy generally involved new construction or substantial rehabilitation of vacant buildings. SHARP was designed to stimulate the production of privately owned and managed high quality, mixed income rental housing. Under the mix, at least 25 percent of the units are reserved for low income households, while the remainder are market rate units. This expands the supply of low income housing by leveraging the resource of the Section 8 Existing Housing Certificate and maximizes the production of affordable housing with the infusion of a shallow state funded subsidy program.

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[24] *Ibid.*, p. 27.

The Massachusetts Housing Finance Agency (MHFA) provides construction and permanent financing through the sale of bonds, and the Executive Office of Communities and Development provides SHARP funds to write down the cost of interest payments to a level generally no lower than five percent for a term of no more than 15 years; after that time projects are expected to be self-sustaining. The state subsidy is a loan, not a grant, and must be repaid to MHFA which may then be recycled by MHFA to promote further housing production or otherwise benefit low and moderate income households. By statute the subsidy must be the minimum amount necessary to ensure project feasibility.

SHARP was designed as an interest reduction subsidy to bridge the gap between cost based rent and attainable rent. The former is defined as the rent needed to support the mortgage loan and operating cost of a project while the latter is the maximum rent at which units can be rented on the open market (in the case of units reserved for low income households, the attainable rent will be no higher than the published Section 8 Existing Fair Market Rents, with allowance for a maximum amount trending rate of five percent). Inherent in the SHARP program is the expectation that attainable rents will grow more quickly over the term of the permanent mortgage than cost-based rents as the later are closely tied to fixed

debt service payments. This hoped-for trend would allow both that a project would become self-sustaining by its fifteenth year but also that the minimum amount of necessary subsidy to ensure project feasibility would decline during the term of the subsidy. In order to maximize the SHARP subsidy and possibly increase the number of low income units, developers are encouraged to combine SHARP with other public/private resources.

The legislature appropriates SHARP disbursements for the upcoming fiscal year and the state budget includes an authorization for the SHARP program. The authorization establishes the maximum annual contract authority which EOCD may commit to particular SHARP projects. As SHARP funds are awarded before the construction of a project and those subsidies are not expended until construction is complete, the authorization provides a method whereby the legislature can regulate the growth of the program in future years.

SHARP funds are awarded at various competitive funding rounds where developer proposals are reviewed against a set of minimum standards and ranked accordingly. Since 1984 MHFA has conducted four annual competitions for funding. The legislature has authorized MHFA to enter into SHARP contracts for $38 million.

The SHARP subsidy has amounted to approximately $28.6 million and has yielded 83 developments totalling 9,456 units of which 3,179 are low income units. MHFA's financing commitment to these projects exceeds $785 million. Projected jobs and revenue generated during construction and thirty years of operation include 8,317 construction jobs, private sector revenue of $1.23 billion and public sector revenue of $228 million.[25] The Tax Reform Act of 1986 has made it more difficult to develop and syndicate rental housing, yet the SHARP program remains competitive and continues to address the need for additional rental units in Massachusetts.

The SHARP program was developed at a time when affordable rental housing in general in Massachusetts was badly needed and all forms of rental production needed to be encouraged. A tight rental environment coupled with a healthy Massachusetts economy and strong public and political support for SHARP provided a comfortable foundation on which to launch and build the program.

However, times have changed since the inception of SHARP in 1983. As the Massachusetts Miracle has disappeared, the state has experienced increased unemployment, contractions and layoffs in core industries, and incurred a large deficit. All these broader

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[25]Annual Report, Massachusetts Housing Finance Agency, *Beyond Bricks and Mortar,* (June 30, 1989), p. 14.

economic changes might reasonably be expected to soften the housing market. Sales are down significantly, some condo developers are in default, but median prices have yet to decline. These are just a few of the problems the State faces, and as a result the housing market is different today. The cost of homeownership is down from its high of over $180,000 a few years ago; it has stabilized but not dropped below $170,000 and although the affordability gap has stabilized it has not closed. According to all the developers and agency officials I interviewed, the market rate rental side is much softer and has witnessed added competition from the sagging condominium market as developers are now renting the condominiums for the short term to help offset carrying costs.

These changing market and state conditions obviously have impacted the SHARP program. Their effect helps to illustrate the strengths and weaknesses of SHARP, a matter to which I now turn. Prior to discussing these traits it is important to mention and understand the context in which SHARP has operated. Massachusetts is very much an activist state regarding affordable and low income housing and is considered by many observers and insiders as the innovator in this regard. The concept of social responsibility runs strongly in Massachusetts. Support for affordable housing appears to be as strong today as it was in the "Miracle" days as indicated by a

recent Boston Globe survey of Massachusetts residents which revealed that a significant majority of residents would pay more taxes to assume that decent affordable housing be provided in Massachusetts.[26] Moreover, such support has become more vocal and received more attention recently when the issue of affordable housing gained bipartisan support at the gubernatorial forum at CHPA. As was seen, the political leadership certainly favors affordability programs even in today's environment. Thus, as illustrated support for programs such as SHARP is still intense.

The downturn in the real estate market is imposing costs on all development — for instance, greater expenses and increased turnover. SHARP developments might seem even more vulnerable, given their initial tight financing and optimistic projects for attainable rents. Yet, the SHARP program has fared extremely well over the years and notwithstanding the soft market, it boasts a stellar record. No foreclosures have occurred and most of the 83 SHARP developments have become self sustaining — that is they no longer require continuing subsidies. Marvin Siflinger, Executive Director of MHFA, noted that:

> ...the key advantage is that given certain constraints, even in the best of times we have

[26]*The Boston Globe,* Poll: "Mass voters back spending cuts, no new taxes," March 12, 1989.

> limited resources as does the State. We've been able to develop a program that provides excellent housing for low and moderate income people, particularly the low income people. One of our strengths at MHFA is to be supportive of mixed income housing and the SHARP program fits very well with that philosophy.

Many cultural constraints exist in our society and such a mixed income approach involves both economic and racial integration.

However, a major advantage which Massachusetts enjoys is its demonstrated experience with such developments. The success of the Section 236 program, a rental assistance program supported by the Federal Government in the 1970s, served as a base on which to build the SHARP program. Mr. Siflinger commented:

> The advantage we have in Massachusetts is that we can alleviate a lot of fears by showing the public how great looking these developments are and how happy the current residents are living in these developments. You may be living next door to a 236 or a SHARP development and you wouldn't know it. It doesn't have any kind of a stigma. It looks like decent conventional housing with proper amenities.

Low and moderate income and market rate residents can live together and enjoy a community experience if the development is well managed. This has been a key to SHARP's success as experience has been employed to manage diligently the portfolio. Josh Posner,

Vice President of Development with The Community Builders, was one of the many individuals who praised MHFA's management ability. Providing low income housing has been a major concern in Massachusetts and SHARP has responded very well to this challenge. As previously mentioned SHARP has proved to be very successful but its success is highlighted further by the people it has assisted. MHFA recently completed an occupancy survey and average household income of the SHARP occupied units was on average at or below the median income in Massachusetts which was surprising because many observers felt that SHARP would have hit a higher than median income market. Such results further underscore SHARP's track record.

Interviews with several housing experts at MHFA and EOCD, as well as with many developers including Gene Kelly, Chairman of the Developers Council (an organization comprised of seventy five members), revealed that the greatest strength of SHARP had been its flexibility. SHARP's ability to respond to the market place and adapt to adverse market conditions appears to be a unique characteristic that separates it from other programs. National rental production programs such as the Section 236, Section 221D3, and Section 8 were created in Washington without taking into consideration the diverse economies in the various states. Such programs will either work or

prove unproductive depending on the creativity of state government administrators and do not possess the flexibility that SHARP exhibits. SHARP was the result of the collective experience in Massachusetts, the mistakes of the aforementioned national programs, and an understanding of the Massachusetts environment and was created to be responsive to its particular needs. Robert Pyne, Director of Development at MHFA, underscores the state specific aspect of housing programs and recognizes that housing is a "trial and error process." He stated the general sentiment of MHFA and the development community:

> SHARP has responded well and I am delighted at the fact that given the market downturn we can change the program to respond to the market . . . that's the whole point.

The flexibility of the program is evidenced by the number of changes to the program over time. As previously discussed SHARP funds are awarded on a competitive basis at funding rounds according to MHFA and EOCD issued guidelines. Over the years these guidelines have changed to reflect changes in policy, demand for low income housing, and market conditions. For example, if the attainable rent decreases or stabilizes in a softer market (instead of increasing as originally anticipated), the program has been adapted to continue to fill the gap and bring in more subsidy. A process was

devised which will authorize the state to provide additional subsidies but, at the same time, will require developers to put more of their profits back into the developments. Most recently, due to the oversupply and availability of many market rate units, the program guidelines have been altered to make SHARP a moderate and low income program with a market rate component only where the markets are still strong like in Cambridge and Newton. Yet, in other softer Massachusetts' markets, the program was changed to increase the per unit subsidy and focus on the need for moderate income units. Some changes, as well, were made due to changes in tax law particularly the tax reform act of 1986, while others were made in response to the perceived need to increase the percentage of units available to larger families, still other chances were more administrative regarding the workings of the program. A major change in round 4 was to require that the low income units be set aside for low income households in perpetuity.

Real estate changes and state fiscal conditions in Massachusetts have dampened development. As a result, there has not been a SHARP funding round since 1987. Moreover, market factors and the fiscal crisis have combined to create some SHARP portfolio concerns. Although there have been no foreclosures to date, approximately seven developments are experiencing financial difficulties in meeting

their debt service payments. The state had always viewed the SHARP program as a declining fund commitment because as debt service would be fixed, rents were expected to increase more than enough to offset operating expenses, and the resultant increasing cash flow would offset the declining SHARP subsidy. Some of these developments now face problems, however, because cash flow has not increased; rents have not risen as projected and operating expenses were underbudgeted. Mr. Posner commented:

> Historically rents have gone up, so it's not unreasonable if you are trying to get as much done as you can for the minimum amount of dollars to think aggressively, act aggressively, and count on rent increases. I think it was probably pushed too far. If you look historically over the last 30–40 years, rents have gone up 5% a year. But that doesn't mean there are not four to five years that they do not go up at all. I think we are in that kind of a time period now.

As can be seen, misjudging various key assumptions — market decline coupled with a simultaneous weak state economy and budget difficulties — can lead to troubling circumstances. Such a situation is likely to arouse finger-pointing and calls by developers for the state to intervene and provide the necessary funding to cover the shortfalls. Mr. Kelly stated that:

> Right from the beginning there was always an understanding that flexibility in the

> program would allow for changes in the marketplace, changes in circumstances that were beyond the developers control, and that there would be additional funds there to maneuver through whatever times that confronted us. However, that was not the way events occurred because the money that was allocated in the state budget for SHARP was based on the 15-year projections that were being submitted. When MHFA and EOCD were asked by the legislature 'how much do you need, what is the absolute minimum you need to make this thing work,' they would go back to their fifteen year schedules and see what they needed. They never took into account unforeseen circumstances of not being able to get 5% rent increases every year, not being able to achieve rent up of units as quickly, etc.

As illustrated a proper cushion was not implemented as part of the process. Kelly added:

> The real problem is the states inflexibility and being able to add additional subsidy when circumstances warranted. I don't think anyone would have gone into the SHARP program initially if they had ever thought that the 15 year schedule they were putting in was going to be set in stone. That's the main problem.

Kelly stated that these comments reflected his viewpoint but also the sentiments of many of the Council's members.

Another problem with SHARP developed as a result of its inherent market rate characteristic. SHARP and other similar schemes formulated during the tight rental markets of the 1980s

tried to subsidize affordable housing not with government funds but with the market rate component of the development. Such a program operates well in a tight environment but when the market peaks and softens problems begin to emerge as one may not rent up as projections are not met and revenues fall short of projections. There needs to be some financial flexibility in the program. Yet, as Kelly aptly noted, "the state doesn't have the money to be flexible."

The Legislature has authorized MHFA in 1990 to enter into contracts of $38 million. The agency has contracted approximately $28 million, and MHFA is requesting an additional $10 million to cover existing troubled developments. Given popular support for affordable housing and the lobbying efforts of housing proponents, the chances of receiving funding are not as bleak as one might first think. Yet, the possibility that funds will not be appropriated is a serious concern that housing advocates must face. In the interim, developers have been required to take responsibility for their particular situation — funding operating deficits with their own resources, including letters of credit. Developers must fulfill letters of credit requirements which are guaranteed for operations in order to close projects. Originally the amount required was four percent of the mortgage but it has increased to six percent. Kelly explained the scenario:

> The developer has to make the decision as to whether they are going into default and have the letter of credit called or whether they are going to print some of their own cash and thinking it's going to make it work out. But once the letter of credit is gone then there is no other source of funds for the project other than going back to the limited partners or going back to the general partner and saying 'we are going to foreclose here and you are going to face recapture of all of your tax deductions and it's going to be very expensive for you. You would be better off putting some more cash into the deal and make it work.

Developer complaints stem primarily from this issue of responsibility as it has created considerable debate.

These developer responsibilities and liabilities, the banking contraction in the area, and uncertain demand for product pose a risky environment for development. Presently, asset management is the prime concern of most developers. Kelly believed that the only people who would consider engaging in a project would be those

> ...who already own land or are involved in the second stage of a project or part of a development that's already finished so they already have a substantial investment in place... but other than that there is no reason.

The impact of the housing market and state fiscal condition on the SHARP program has been damaging. Kelly explained:

> The whole concept isn't working anymore because part of it is that the program was

> driven in large part by demand, subsidy, and the syndication market. Supply has out-stripped demand, subsidy resources are in jeopardy given the state's fiscal mess, and the Tax Reform Act of 1986, when it went into effect basically in 1987, substantially changed the value of syndication due to the passive loss rules, etc., and so it became less worthwhile to do these deals. All these factors combined have hurt and basically we had a program that worked fine while inflation was going on and rents were increasing, but it isn't working now due to the factors that I already mentioned.

He added:

> Housing programs have a life and they sort of fade as times change and new ones are developed with new concepts, ideas, sources.

This point is further underscored by the political realty of an election year. There will be a new governor at the beginning of the year and more than likely he/she will want to establish housing policy and programs with his/her imprint. Uncertainty is a crucial factor as Kelly notes that "...you are going to have different people involved and the whole face of the business changes because you don't know who is going to be around in a couple of years."

Kelly and other developers believe that the SHARP program has run its course and that more moderate income units must be targeted as market rate units saturate the market. This criticism has been addressed and SHARP has responded by providing for such a

new orientation in its next round as a programmatic change has been made from a production focus to an affordability focus. Yet, as Kelly noted, today's changed environment and the uncertainty associated with it do not spur enthusiasm for new development especially when a new untested program is concerned.

Not surprisingly, profit issues are concerns of all the parties involved. MHFA has defined reasonable profit as 10 percent of project costs, but developers feel that 15 percent is more appropriate. Siflinger commented:

> It's our job to give them a profit that will entice them into the program but to make sure that the profits are not abusive as they were in some federal programs. If profits are abusive then we'll find that the Massachusetts taxpayer will turn off and will not be supportive of the program and their support we cannot afford to lose.

Siflinger's view is characteristic of agency officials not only in Massachusetts but in Rhode Island and Maryland as well. Debate over profits will continue as it is a contentious issue.

As indicated the main criticism of SHARP surrounds the issue of flexibility. Developers complain that the $10 million has not been made available to them fast, yet it is MHFA's strategy to ensure that projects actually needed assistance. As Pyne explained:

> We are not in the business of bailing out developers who have mismanaged their

> developments, and through our management function we can objectively determine the management job that developers are doing. If they do a poor job, then they must bear the cost of mismanagement. If developments are found to be in need it is also part of our strategy that developers share the pain. It should not only be a burden to the Commonwealth of Massachusetts to pay for project shortfalls, but if developers were making reasonable profits then they ought to put them back in. So we spent a long time in developing program guidelines and negotiating those guidelines with the developers.

Diligent reviewing standards and policies cannot be faulted but state budgetary woes have obviously encumbered the program and negatively impacted its flexibility. When asked if there were any measures which could be implemented to safeguard SHARP from such dilemmas,Siflinger responded:

> I don't think so. I think it is proper that programs go through an appropriation process or a decision making process that compares the value of these programs with other Massachusetts programs — education, health, other services, so that our political leaders can make a judgment about what our priorities are. It's a healthy process and I think that when we think of expanding our housing programs, they must run the gauntlet of restrictive resources and a very healthy political decision making process.

CHAPTER III
Rhode Island's Rental Production Program

Similar affordability problems have been witnessed across the country including Rhode Island. Changing demographics and a real estate boom coupled with reduction in federal funds for producing affordable housing have place great pressure on the low end of the rental housing market. Many low end units disappeared through upgrading and condominium conversion while the number of potential renters was rapidly increasing due to similar forces of the Massachusetts experience, i.e. increasing homeownership costs, larger affordability gaps, new household formation.

Although the population of Rhode Island has remained relatively stable, there has been a dramatic net increase in the number of households mainly due to changes in the composition of families and increases in individuals living alone, which has created a major housing crunch. From 1980 to 1985, the number of households increased by 30,015 with three groups exhibiting relatively low historical rates of homeownership growing rapidly, namely families headed by single parents, households composed of unrelated individuals and persons living alone. The largest increase in households amounting to 25,042 occurred in the single parent and nonfamily household groups where 70 percent of the households

rent.[27] Another characteristic of the times was the "baby boom" generation reached home buying age. In fact, the population of residents between the age of 25 and 39 (prime home buying years) rose 42 percent since 1975.[28] The size of this age group is expected to continue to be high well into the 1990s and then steadily decline until about 2010.

The housing industry grew strongly during this period but its response has been insufficient as evidenced by the fact that only approximately 18,000 housing units have been added since 1980 to serve the additional 30,015 households formed during this same period.[29] Increased demand for homeownership by baby boomers, falling interest rates, rising inflation, and the changing notion that the house was no longer just a home but an investment increased the number of sales statewide and sent home purchase prices upward. The average purchase price statewide in 1981 was $56,315 and in 1984 was $63,875 but 1989 it rose to $140,878.[30] Also the affordability gap has increased over the years adding to housing

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[27]Rhode Island Housing and Mortgage Finance Corporation, *Summary: Housing Needs and Market in Rhode Island,* (March, 1988), p. 1.

[28]*Ibid.*, p. 2.

[29]*Ibid.*, p. 2.

[30]Rhode Island Housing Department of Policy and Program Development, *Housing in Rhode Island, 1989 Summary Statistics,* 1989, p. 17.

concerns. In the 1950s a typical thirty year old person spent approximately 14 percent of their paycheck on house payments. By the 1970s the required share of income rose to 21 percent and by 1985 it increased to 44 percent. By 1989 the income required to purchase an average priced home was $53,965 as compared to the median income of $36,700.[31]

The high demand for single family homes pushed up land prices, profit and overhead in comparison to other costs. Even though production of single family housing in the state has somewhat matched demand in regard to numbers, such escalating prices have resulted in declining rates of homeownership. As a further illustration, from 1980 to 1982 income gains matched gains in home prices. Since 1984 income in Rhode Island increased 10.5 percent, yet housing prices rose 59.2% in the same period.[32]

Furthermore, the rental shortage caused rents to increase substantially and enhanced the attractiveness of real estate as an investment resulting in rapid turnover of properties and a reduction in owner occupancy. Statewide sales of multi-unit properties more than doubled between 1980 and 1985. By 1986 less than one third

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[31] Rhode Island Housing and Mortgage Finance Corporation, *Summary: Housing Needs and Market in Rhode Island,* (March, 1988), p. 2.

[32] *Ibid,* (March, 1988), p. 3.

of multi-family homes in the state had an owner occupant. Such trends continued and rents rose as new investors demanded market returns. In 1980 the average rent was $161 per month; by 1986 it had increased to $454, a $181 percent increase; and by 1988 to $591 per month.[33]

These rental increases have most seriously impacted low and moderate income households and single person households. In many communities over 50 percent of renter households cannot afford the average apartment. Also, it has been estimated that 20% of Rhode Island households spend more than 35 percent of their income on rent. Waiting lists for public assisted housing increased and the state is faced with losing approximately 4,200 units as a result of the expiring use situation.

The result of these conditions has been a serious shortage of affordable family rental housing. Simultaneously, the cost of producing new units is prohibitive to low income households. Due to the critical need for affordable family rental housing, the program emphasizes production of these units. All the units built in this funding cycle have been built for family households with incomes below 60 percent of median, and many serve households with incomes as low as 30 percent of median. The Rhode Island Housing

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[33]*Ibid.*, p. 3.

and Mortgage Finance Corporation realized the need to concentrate its efforts on low income family housing just as the federal government began its cutbacks in production funding. This high cost, limited resource environment spurred the development of the Rental Production Program (RPP).

Various elements from the RPP guidelines were selected to provide an outline of the program. The Program instituted in 1987 is a multi-faceted approach to rental housing development which purports the following strategy: to reduce hard and soft costs wherever possible, find as much equity as possible, discover operating subsidies when available, and then employ limited Corporation resources to fill the gap. To address the gap through financing, the Corporation established the Targeted Loan Fund (TLF) which offered deferred second mortgages of up to $30,000/unit at zero percent interest. Thus, agency reserves are used to write down the development cost of low income housing developments. Housing sponsors may submit a proposal to use these funds as either an up-front capital contribution, or as an annual income subsidy similar to the SHARP program in Massachusetts. First mortgage financing from Rhode Island Housing is provided through the sale of tax exempt or taxable bonds. Yet, the size of the gap and the limited resources available for the TLF prompted the Corporation to seek further

financing options. In order to maximize the advantage provided by the federal low income housing tax credits, a requirement has been stipulated that syndication proceeds must be retained as equity and not withdrawn and treated as a developer's fee. Also the state approved a Rental Subsidy Program in June of 1988 whereby funds would be available for up to 20 years to provide rental assistance to housing developments statewide. Thus, the combination of first mortgage, second mortgage, development based rental subsidies and equity raised through the sale of low income tax credits can be employed for development efforts.

The Corporation in order to reduce transaction costs has also instituted three major initiatives, namely the Equity Pool, the State Pension Fund, and the Lawyers Clearinghouse. The Equity Fund is an important public/private venture which has provided a method for reducing the transaction costs of converting tax credits into equity. The Rhode Island Housing and Mortgage Finance Corporation established a subsidiary, the Rhode Island Equity Corporation to become General Partner in a limited partnership with the Rhode Island Housing Equity Pool. The limited partners are Rhode Island corporations which not only participate in producing affordable housing but also enjoy substantial tax and investment benefits. Also the State recognizing the need for operating subsidies to make rental

housing more affordable established a one time rental subsidy program in 1988 through the General Assembly which allocates $5 million per year for twenty years. The Rental Subsidy Program in order to ensure the viability of new rental units gives priority to new units produced through the Rental Production Program.

Another way to reduce costs was through the provision of a secure source of purchasers for the bonds backing developments. The Corporation reached an agreement with the State Investment Commission to purchase up to $15 million in taxable bonds on very favorable terms. The purchase agreement provides a substantial savings in interest rates, marketing costs, and reduces uncertainty for housing sponsors. Due to the presence and involvement of so many non-profit developers, an effort was initiated to aid in reducing soft costs. The Rhode Island Lawyers Clearinghouse for Affordable Housing was created to provide free legal advice to serve both the development and corporate needs of non profits.

The Rhode Island Rental Production Program has enjoyed success from its inception in 1987 when request for proposals were issued and only eight responses were initially received. The environment then, however, was different as James Beachler, Executive Director of Rhode Island Housing Finance Corporation explained:

> Tax credit programs in 1987 were ones where very few developers knew anything about it. It was a time of restructuring programs to accommodate the different resources that were available. The development community did not understand the workings of the program and its been a learning process. Also many developers were building condos and commercial strips that were sprouting up throughout the region at that point in time. So there were very few developers interested in housing.

Yet, in 1988 the Corporation received 30 proposals and the most recent request for proposal ended with 35 responses. The Program has provided 742 units primarily low income and has invested $30 million. To date there have been no foreclosures or financial difficulties with the properties. As mentioned there are many aspects to the overall program and many aspects work in tandem to produce the desired product. Unlike in Massachusetts where a clear distinction is made between, for example, the SHARP program and the TELLER (tax exempt bond) program, Rhode Island Housing does not delineate carefully the contributions of each phase of the overall program.

Furthermore, the unique history of the Rhode Island Housing Finance Corporation has greatly contributed to the formulation and direction of the program. The Section 8 program was still operating in the late 1970s and for the most part continued until

approximately 1980 when it was effectively cancelled by the Reagan Administration. Developments were still being produced under the auspices of the program for about the next two or three years and then from a pipeline standpoint ceased. No rental subsidies were available for developments except for those that were built through the Section 8 Moderate Rehabilitation Program.

As a result of the Tax Reform Act of 1986, a tax credit program was created as a three year program from 1987 to 1989 and has received a one year extension for 1990. In 1984 the Corporation underwent a scandal as the first and only executive director for twelve years misappropriated funds and was removed in 1985. This event proved to be a major embarrassment, obstacle and setback for the Corporation. In light of these developments, in 1986 the charge of the Corporation was to develop new programs that met the new era and in 1987 the Rental Production Program was instituted.

Emphasis on low and moderate income developments continued to be the direction of Rhode Island housing policy with only a few mixed income developments initiated to date. Only low and moderate income units receive targeted loan funds. Non-profits have tended to be the major participants in the program for several reasons, namely: the apprehension on the part of the Corporation to engage in activities with for profit developers and the negative

connotations of this group directly after the scandal; the complexity of the program from a developer's perspective regarding rules and guidelines and the associated learning curve experience; the fact that many for profit developers were involved in the development of market rate units, condominiums, commercial ventures, etc., and concentrated their efforts in these pursuits and markets with which they were familiar; and profit margins tend to be low, approximately 10%, with limited upside potential.

A major characteristic and strength of the Rental Production Program is rooted in the history of the Corporation's endeavors in that it has accumulated significant reserves from being quite active in the Section 8 program. Targeted loan funds are provided by the Corporation's reserves as opposed to the legislature appropriating funds as is the case in many states. In the previous era, a group within Rhode Island Housing dealt almost exclusively with developing primarily elderly developments in non-urban areas and charged healthy fees for services rendered. The projects which were undertaken were not risky developments and as a result over the years excessive profits were accumulated.

Having profited from the bond issues the Corporation's Board was one of the first boards in the country to make a decision to extend some of the accumulated reserves for housing. From both the

state's, Corporation's, and developer's perspectives this unique set of circumstances is most advantageous. The State is presently encountering a deficit of approximately $100 million and if were not for the Corporation's excess reserves, rental production for low and moderate income households would be at a standstill. In fact, the newly created rental subsidy program whereby the state provides funds for rental assistance for up to 20 years, has in fact been funded from the Corporation's reserves for the past two years. These funds will not be repaid.

Given the budget deficit, the legislature is quite happy to see the program develop in this way and is afforded the luxury of a reserve funding source for its rental subsidy program. Ross Dagata, Executive Director of the Rhode Island Builders Association, spoke for his membership and noted:

> The legislature seems to treat Rhode Island Housing fairly quickly in the process as if it were an extension of the state budget so the upshot of all this is that the Rhode Island housing's semi-independent funds are used in the same way basically by the legislature. So the legislature gets away with not funding affordable housing, yet the likely result of insisting that the funds come from Rhode Island Housing is that not very many funds will come. They can maybe afford to do a certain amount of up front one time subsidies but they can't afford to take on within their budget 15 year contracts for rent subsidy. They certainly can't do both. They have

> accumulated a lot of excess profits over the years but it's not an unlimited amount, so it has constrained rental production to some extent due to the limits of the funding source.

These comments were in accordance with and generally accepted by the developers I interviewed. These developers felt their views were representative of the development community regarding this subject.

Nevertheless, the ability of the Corporation to fill the gap when the state experienced fiscal problems is a major benefit. The Corporation enjoys this power in that it is not dependent on the legislature to appropriate funds to the program and is not as subject to state budgetary concerns. The developer gains security with such an arrangement for he knows that funds are available even in a poor state fiscal environment.

The comprehensive approach and focus of the Program serves as another strength. Mr. Beachler echoed this view:

> We as an agency incorporate all facets of the development process under one roof. We have a pretty thorough program with the first and second mortgage financing, tax credits and over the past year we have subsidy funding for the low income units.

Also, by having focused on the development of low income units which have enjoyed rental assistance market sensitivity is not a factor and rental income is more solid than in developments with a

market rate component which can be volatile and affect the performance of the entire development.

Also, the program has adopted to meet changing circumstances and developer needs as Posner described:

> More recently as we have tried to do more difficult developments and Rhode Island Housing has reduced the size of the targeted loan fund, we have taken the upfront money and created an annuity and turned it into a declining amount of funds that comes into the development overtime based on 5 percent rent increases. We do this is conjunction with Rhode Island Housing. We put the annuity with them and they provide the funds monthly but supposedly it's been funded up front.

This practice is common for many developers. The targeted loan fund provides second mortgages two different ways: a lump sum which offers the benefits of a lower mortgage, principal and interest payments; and an operating subsidy format where funds are expended over time. A cushion is provided as rents are projected to increase at such a rate, 5 percent, to more than offset operating expense increases and constant debt service payments resulting in a net gain. From that net gain the targeted loan funds are expected to be repaid, but such repayment can be deferred or forgiven if justified.

It is important to note that given the size of the program and the number of units produced, support for affordable housing is strong. Although the legislature acts like it is sticking the Corporation with the bill it is behind this effort and is temporarily handcuffed by the state's fiscal situation. The governor and mayors are advocates of this cause and all lend it support.

In addition to some of the apparent advantages of the program, the developers that I interviewed voiced specific concerns about the program. The issues of profit margins and lowered loan amounts over the years was a common complaint. Ross Dagata stated:

> They've been juggling around how big that program is mostly to make sure it is the smallest amount it can be and still get the job done. So the value has declined dramatically over the last couple of years. When it first started it was much more and provided $30,000 per low income unit, and now it's about $18,000.

Production of rental units was another concern of many developers. Mr. Dagata believed that the program overemphasized the involvement of non-profits yet feels more attention should be given to working cooperatively in conjunction with them to produce more work for developers and a better quality product.

As far as the management of the Program is concerned, it has made an admirable comeback though as it was only recently

instituted, it still appears to be in its formative years. Posner commented:

> There is an unrealistic view on the part of the agency on how much it costs to build good quality affordable housing. So, as they come to believe that they can do more with less, they cut their own rules and budgets.

He continued:

> Rhode Island's unique history and limited experience in affordable housing production has resulted in less flexibility and a somewhat adversarial approach to funding. The state/ developer relationship is not as helpful as it could be, but I think that will come with experience and more construction units under the belts of the development community.

These views concurred with the attitude of many of the developers surveyed.

Having one agency, the Corporation, providing practically the full range of services provokes some concern amongst developers as Posner explained:

> I have a real problem with some of the different hats that Rhode Island Housing is wearing, as they are wearing a lot of them, that is, the subsidy provider, mortgage lender, equity source, as the lawyer in some cases through the clearinghouse they have a development company where they will be the developer. It gets a little incestuous and I feel that such centralization can lead to an

> unbalanced industry. I think there are different roles, different pieces that the real estate industry has and they are valuable. Centralizing it can make it difficult for non-profit community groups to deal with because basically they are subservient to one agency instead of being the key actor that balances out competing interests from investors and lenders to subsidy sources. There is much more potential for them to be treated as non-essential players and I think that is extremely unhealthy.

The centralized position of the Corporation was a general concern of many developers, particularly the non-profits.

CHAPTER IV
Maryland's Rental Housing Production Program

Maryland has also encountered housing affordability problems. In 1989 the Maryland Housing Commission reported that approximately 285,000 renter households were paying more than 35 percent of their income for rent. Currently, Maryland's strong economy has meant continued upward pressure on home prices in the short term, further decreasing the opportunity for many families to move up to homeownership. Home prices have increased steadily over the years as average home prices statewide rose from $97,039 in 1987 to $112,475 in 1988 and by 1989 were bordering $130,000.[34] Specific data regarding the income required to purchase an average priced home and median income was difficult to obtain, but interviews with agency officials indicated that the gap was widening. Rental information also was scarce and impressionistic, but the rental market was described as being tight, particularly at the low end of the market with the market rate units exhibiting some softness. The excess demand at the low end of the market may be further exacerbated, as reports indicate that by 1992 as many as 32,000 federally subsidized units in the state could be in danger of

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[34] Regional Planning Council.

converting to market-rate housing or to condominium units if the owners pre-pay their mortgages or end their federal assistance agreements. Even though the federal government imposed a moratorium on such concerns in 1987, that action is only temporary and does not provide a final solution.

Assessing the Maryland housing market, Christopher Tawa, Administrator of Housing Finance at the Community Development Administration (CDA), the state's housing finance agency, stated:

> Here you have a strong market driven partly by the fact that we're so close to D.C. Also the federal government is said to be recession proof and because of its strong employment base and the fact that it doesn't really contract, there is not as much soft market activity. There is a bit of overbuilding in the rental market rate but it is not the same given the concentration of our program on low income households. On the homeownership side the Maryland market is strong and has had a pretty strong appreciation but that is more of an appreciation based on about 5 to 8 percent per year, maybe 10 percent. Also a big factor was we had very steady growth that closely equated with the population growth. So you had projects that were being created at, in parallel with, the increase in the population increase.

These factors, together with the strong state economy, have made for a favorable environment regarding low income production.

CDA has attempted to alleviate the affordability problem by creating a variety of homeownership and rental programs. Throughout the 1970s and early 1980s CDA coupled multi-family tax exempt financing with federal subsidy programs such as Section 236, an interest subsidy program, and Section 8, a rent subsidy program. Since 1982 CDA has financed market rate multi-family developments with tax exempt bonds, and in 1986 it expanded its rental programs to include state general fund financing programs to serve very low income renter households.

The Rental Housing Production Program (RHPP) was part of that package and was designed to increase the supply of rental housing for low income families. The program provides below market rate and deferred payment loans to developers. Loan terms are structured to help make the development viable and affordable and may range from 15 to 30 years with flexible interest rates and deferred payments of principal or interest or both. The amount of any one loan is capped at $1 million. Funds may be used for acquisition, construction, rehabilitation and development costs, i.e. market studies, appraisals, legal and architectural and engineering fees, and other costs directly related to the development of housing as well as to subsidize the operating costs of newly constructed or rehabilitated housing. Eligible resident households must have annual

income of 60 percent of the area median income or less, adjusted for family size. Priority is given to developments which serve the greatest number of families with income below 30 percent of area median income. Local government involvement is also witnessed as the local jurisdiction, in which a rental housing development financed through the program is located, must approve the development and make a contribution which significantly reduces the project's development or operating costs, or otherwise materially support the development. Cries of "not in my backyard" can pose roadblocks to developments. To date these objections have not presented a problem but Tawa observed that in the future they could pose obstacles. Under RHPP $22.6 million in funding has been used to produce 1,246 units. The program has received the largest budget allocation of any of the state funded programs and has experienced increases in funding from $9 million in 1987 to $12.5 million in 1990.[35]

Although RHPP has only a brief history many of the agency officials and developers I surveyed were quite pleased with the program, and viewed CDA as a very experienced agency with a

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[35]Maryland Department of Housing and Community Development, Overview of the Programs of the Community Development Administration (December 1989), p. 4.

skilled and knowledgeable staff. For example, Marilyn Ducker, Vice President of Shelter Corporation in Baltimore, commented:

> CDA will permit its funds to be the first money into the deal. But they will go in ahead of, for example, the first mortgage construction lender. That's another strength of the program in that they'll put their money up early and since you are not paying any interest at all during the construction period normally, interest doesn't usually start accruing until you're in an operating phase. That's a tremendous advantage to your project because you're not loading it up front with the big interest costs from a private debt source that's at a prime based interest rate.

Other developers also concurred that the capital cost subsidy approach of the program was effective, defraying up-front costs. Also, the funds are nonrecourse debt; so if the project performed terribly, experienced poor appreciation and then one went to sell it after 20 years, having paid off the first mortgage and one's investors, one is not obligated to repay the loan if funds are not available. From CDA's point of view, certain monitoring protections were built into the document so if the developer was not performing CDA can insist on new management or other necessary changes.

When markets are soft, vacancies are high, the amount of revenue is less than expected, a project encounters distress and unless an operating subsidy is an available alternative a workout

situation arises. According to Valerie Montague, Assistant to the Director of the Office of Research and Information Systems at CDA, if developers were still obligated to make payments to CDA, the agency "can defer payments, we can suspend those payments on the debt service side, we can refinance the project and deliver a lower rate of interest to the project." Yet such market conditions do not appear to affect directly the focus of RHPP. As Tawa explained:

> Obviously it's our view that the demand for housing that is affordable far exceeds the supply and probably always will. So that when you create units for person at 60 percent of median income or less and charge them rents based on 30 percent of their income, that means that you've driven your rent down to a level that's pretty low in comparison to the market. It's our feeling that if the project is of good quality, a decent product, then there ought to always be a very strong demand for that housing because even in a soft market you can still be producing units that are less expensive to low income persons. So I think the market for these units tends to be quite strong even in a soft market.

An additional strength of RHPP was identified explicitly by all the individuals I interviewed: the program is flexible in regard to terms, rates, and ability to adapt to changing developer needs. James Ginsburg, President of the Waterford Group, a development company in Montgomery County, commented:

> Flexibility is a big attraction of the program. The fact that the money is extremely flexible — it's the hardest working money when you can get the cash flow mortgage and can use the different ways of extremely flexible source of funds. For example, you can take a third mortgage, you can take a 30 year term, you can have no payments on a loan for the first 5 years. [The program] can do flexible terms as well as interest rates.

The concept behind this flexibility is to work with the developer to make the project work. Discussion and negotiation characterize the process.

Allowable profit margins of up to 15 percent were encouraging to many developers, and strong state support for affordable housing programs underscored developers confidence in the program. In fact, this past year the legislature passed the largest state funded overall housing budget to date, $50 million.

There was much enthusiasm from the development community regarding CDA efforts and RHPP specifically, yet developers and CDA officials did have some concerns. The main complaint from both groups was that more money was needed to supply more units. The form and timing of the funds was also a concern. Tawa explained:

> Maryland does not have any state funded operating subsidy program. We have no rental assistance program that we fund directly. That means all the business we do in Maryland in terms of affordable housing is done by providing discounted capital. Now

> that means because we write down the cost of capital instead of providing an operating subsidy, ours is not as flexible a subsidy.

If, for instance, revenues did not provide the expected buffer with respect to expenses and debt service, then there was no cushion available.

Also, the maximum loan cap of $1 million was seen to present a problem for larger projects, as the per unit subsidy decreases and with it the defraying of capital costs. Although CDA may waive the limit and some developers have received waivers, the process involved is very involved and time consuming. In fact, CDA does not like and even discourages one from pursuing this option. Limited funds and political realities impact this process in any event. Daniel Henson of Struever Brothers, Eccles & Ross, a development firm in the Baltimore area, elaborated on this well accepted point:

> Politics plays a role, because if you have a limited amount of funds that's sort of the easiest way to make sure that lots of different people benefit from it rather than a couple of large projects in select areas. This way I think they feel they can help more jurisdictions and get more political bang for the buck.

Not only was the programmatic design an effort to spread the wealth and benefits across the state, but also it considered the political environment. Tawa explained:

> ... to purchase an offering and subsidy program means that every year the state legislature has to appropriate funds and come up to the bar to put more money into the program. Here in Maryland it's a one shot deal where you make the capital loan and you don't have to put any more money into the project you've done it. It's not repeatable each year providing funding for a project.

The basic funding approach of the program and statements of the interviewees leave the impression that state support is strong yet conservative. The future for such programs and accompanied funding is not entirely certain. Local government approval and funding support have not presented major obstacles to date, but there exists the concern among CDA officials that lack of appropriate measures to ensure proportionate responsibility for affordable housing could isolate low income communities or thwart further efforts. As Tawa stated:

> State and local governments need to develop and promote model zoning provisions assuring affordable housing. After an initial implementation period, the state needs to target resources to political subdivisions that either zone for affordable housing or take other actions to create or retain affordable housing.

The Community Assistance Administration, Maryland's comprehensive community development agency has begun work on such a zoning package.

The only other complaint voiced was the apparent insufficiency of CDA staff. In fact, according to Marilyn Ducker, the only negative press the program has received was that they did not spend all of their budgeted allotment last year. The reason for this appears to be a lengthy bureaucratic process which has frustrated many developers. Yet all factors considered, the program enjoys success and support.

CHAPTER V
Comparative Analysis

Having outlined the three states' housing markets, economic situations, and rental initiatives, I will now analyze the significant similarities and differences among the programs, with a particular eye toward judging the success of the programs and identifying lessons and recommendations for other states less experienced in promoting affordable housing. General impressions may provide some insight when judging the success of state housing programs, but for a more appropriate and meaningful gauge I needed to scrutinize the programs with the aid of certain criteria: number of units produced, a definitional orientation emphasizing realization of intent, cost effectiveness, robustness — the ability to adapt to changing market and political factors — and state support.

As stated earlier, each state possesses its own unique set of circumstances, political realities, market conditions and forces, fiscal and budgetary issues, history and tradition, all of which shape the way it approaches certain issues. Housing is no exception. The SHARP program in Massachusetts, instituted in 1983, served as a shallow operating subsidy and enjoys a longer history than the Rental Production Program (RPP) in Rhode Island and the Rental Housing Production Program (RHPP) in Maryland (both of which

were both designed in 1986). That longer experience has proven extremely valuable for as Siflinger mentioned, "We tend to do things on a trial and error basis. We learn from our mistakes and the mistakes of others."

Nonetheless, all of these states have the reputation of currently being activist in regard to affordable housing. Maryland received praise from its development community and other housing finance agencies; Rhode Island recently received an award in 1989 for the best overall Rental Production Program; and Massachusetts has been heralded for years as the innovator concerning state housing programs.

Units Produced

Popular accolades aside, it is now necessary to enlist the success criteria. Guidance was needed and Massachusetts and a few other states provided the housing finance agencies and creativity which led the way through the uncertain environment created by the Reagan Administration cutbacks and the 1980s. Production is one obvious test of success. The SHARP Program track record speaks for itself. SHARP was responsible for the development of 9,456 units including market rate, from 1983 to present. Today, however, SHARP's future is less certain, due to state budgetary problems. Rhode Island's overall Rental Production Program in the last few

years has produced 742 units. It is important to remember that the Corporation employs an integrated approach to housing production regarding the various tools and devices at its disposal, first mortgage finance, the targeted loan fund (second mortgage), tax credits, etc. Thus, it was difficult to ascertain which specific aspects of the overall program were responsible for what developments as oftentimes many resources were used in conjunction. The targeted loan fund (the zero interest loan which can be taken as a lump sum or arranged as a declining operating subsidy like SHARP) was the piece of the overall program on which I concentrated. According to Beachler, it was responsible for approximately 30 percent of the developments or 222 units. In turn, the first mortgage and tax credit program each comprised approximately 35 percent. Although Rhode Island also encountered deficit problems, it will continue to increase its production of affordable housing due to its unique funding source, the Corporation's reserves.

Maryland's RHPP as capital cost subsidy has been effective in assisting the production of affordable housing and has aided 1,246 units. The budget for next year allows for the same amount of funds to be allocated to RHPP as this year, namely $12.5 million. As seen each program has made a strong effort regarding rental production for not only affordable housing but also low income housing.

Realizing Intent

These three state programs made a measurable impact during the time they have been in service, yet it is important to note that each faced different origins, environments, and challenges. Times and circumstances changed considerably since these programs' inceptions and have affected some more than others. Pursuing and achieving the stipulated intent and desired result of a program constitutes a more formal definition of success. The SHARP program was developed and implemented at a time when the state economy was entering a period of tremendous growth in Massachusetts and the great need was for rental production of all kinds. In response, a mixed income approach was adopted which would produce 75 percent market rate units and a 25 percent low income component. This design decision was based on the need to spur overall rental production in an aggressive manner. SHARP fared well and succeeded in increasing the supply of well designed affordable, marketable units through most of the 1980s.

When the economy and housing market began to soften in the late 1980s, however, SHARP encountered difficulties as rental revenues were not meeting projections and expenses increased at higher than expected rates resulting in operating deficits for several projects. SHARP relied on a market rate component to subsidize the

project unlike Rhode Island's program and Maryland's RHPP. Such a program can be a double edged sword if market conditions are not properly monitored and factored into policy decisions. All was well until the market became overbuilt and softened, leaving SHARP in the unenviable position of being faced with a dual threat, i.e., a soft market and a state budget deficit. Yet, Sharp succeeded in fulfilling the intent of its design by greatly facilitating the production of rental housing.

Rhode Island and Maryland both adopted programs which would serve low income households and which would benefit those with the greatest need. These two states' housing market circumstances were different than the Massachusetts experience with the development of SHARP in that although there was a tremendous need for low income housing, there was not as great a demand for market rate rental production. This aspect of the housing environment permitted a more selected focus. The history and tradition of the housing finance agencies, particularly the Rhode Island scandal, and subsequent aversion to the developer's profit orientation, as well as the philosophies of certain key agency officials also were factors leading to a low income and nonprofit concentration. The program design decision to target funds to low

income families stemmed from a resource allocation issue based on cost benefit analysis.

Both housing finance agencies wanted to maximize resources and felt that subsidizing market rate units as done in the SHARP mixed income approach was not appropriate and efficient given their objectives and housing market conditions. Both agencies stated that their resources would only be used to assist low income units. With this targeted approach one does not have the advantage of the upside of the market rate side of a mixed income development, yet, the downside is limited and some policy makers believe if a project is well designed and managed then there is no market downside.

Rental information in all three states was very difficult to obtain as was a gauge on the demand for low income housing. Specific figures could not be obtained and the data I received was anecdotal and impressionistic. The general sentiment was voiced by one agency official:

> We know there is a great demand for low income housing such that the demand will almost always exceed the supply. We know the demand is there so we feel no compelling reason at this point to specifically quantify a demand which we know is overwhelming.

Thus, the argument continues that there is always a strong demand for low income housing and so a program with this orientation is

much less susceptible to a soft market as the rental income is basically more solid. RPP and RHPP also have been true to their intent by aggressively producing low income housing.

Cost Effectiveness

Given the scarcity of state resources, cost effectiveness is a major concern and serves as another test of success. The SHARP program subsidizes not only the low income units but also the market rate units which leads one to question whether funds are being wasted. Would not funds be better spent on all low income units thereby assisting many more low income people? This issue was carefully deliberated in the design stage and the mixed income approach was adopted for a host of reasons, including housing needs at the time, marketability and developer pressures. Even though the market rate units are subsidized they serve to cross-subsidize the development, thereby potentially offsetting the subsidy. It should be noted that SHARP has assisted in producing over 2,800 units of low income housing. Also mixed income developments can enjoy a political advantage in that they tend to be more accepted by the locality in which they are located than one hundred percent low income developments.

Moreover, cost effectiveness is intertwined with the intent of the program. At the time of SHARP's inception, affordable housing was in great demand which meant that all income levels were suffering from affordability problems. Subsidies were desparately

required to assist these various income groups and SHARP benefits were not wasted. At that time the mixed income format proved to be the only approach which produced affordable housing.

Rhode Island's low income focused program is still in its formative years and its concentration on non-profits has resulted in expensive cost overruns. Dagata commented: "Rhode Island Housing's over-reliance on nonprofits many times costs them more in the long run than working with a for profit because of nonprofits inexperience and lack of expertise." Although this sentiment was generally accepted by private developers, it should be noted that they are biased. The RHPP in Maryland was viewed by both agency officials and developers to be an efficient use of funds and cost effective. All of these programs have used successfully their resources to maximize production of rental housing.

Adaptability

Rhode Island was experiencing some softness on the market rate side as was Maryland, although to a much lesser extent. Yet these conditions have not significantly affected their programs, thereby calling for no immediate response. The SHARP program in Massachusetts, on the other hand, has been gravely impacted by market softness and in theory has responded well to the challenge. The flexibility of the SHARP statute has enabled MHFA and EOCD to

change the rules and guidelines for SHARP competitions. One of the most notable alterations has been a redirection away from a strong market rate focus to a moderate income and low income focus. SHARP in its traditional form can and will be used for developments in strong local market areas, but in the majority of areas the new changes were appropriate as the markets were weak. In practice, however, many developers have been less than optimistic about the new changes, believing the program has been entirely transformed. A new program instituted in very uncertain and unfavorable times, coupled with serious concerns as to the program marketability, did not inspire aggressive or even curious interest on the part of the developers that I interviewed.

Another theoretical adaptability of SHARP is its ability to receive further funding if projects encounter difficulties. If, for example, rents do not meet projections or it takes longer to meet occupancy targets and operating deficits arise, MHFA is authorized to request further funds from the legislature to increase the SHARP subsidy. The provision of this safety cushion feature is predicated obviously on the fact that the state is economically healthy and funds are in abundance to allocate. Presently, SHARP needs $10 million to cover existing project shortfalls, and with the state in a fiscal crisis the program is threatened. Kelly commented on the budget situation:

> I don't think anybody really anticipated or could have anticipated that the state would be going through the same kind of major downturn that the properties would be going through and that there wouldn't be a source of revenue there. That part of it I don't think crossed anybody's mind.

The programmatic decision by MHFA was to be aggressive, to produce affordable units, and to provide the minimum amount of funds necessary to make the project feasible in order to maximize resources. However, having relied heavily on trending projections with a small amount of operating cushion, adverse economic conditions have underscored SHARP's limitation, namely a solid funding source.

Rhode Island's RPP is much less prone to market fluctuations due to its low income bias and although the state experienced a deficit and cannot meet its obligation to the rental subsidy program, the RPP did not suffer from lack of state resources due to one critical characteristic, i.e., the targeted loan funds are not tied to legislature appropriations as in Massachusetts or Maryland, but instead are funded by the Corporation's reserves. MHFA did not have such reserves as it has tried to develop aggressively and leverage its reserves as much as possible.

The Corporation's independence and vast reserves enable it to proceed with its low income housing program without the fear that it

will be undermined by state budgetary problems. In fact, the Corporation for the last two years has assumed responsibility for the states' commitment to the rental subsidy program. The advantage of such a funding arrangement cannot be overemphasized. However, the targeted loan fund if employed in a declining operating subsidy fashion like SHARP encounters similar problems if projections are not met. Yet, the RPP has more stringent guidelines than SHARP in regards to providing an added cushion. Both programs require that careful distinction be made as to what constitutes the minimum subsidy required to make the project feasible and ensure success, and what would merely subsidize a greedy developer. Rhode Island's bad experience with profit developers in the mid-1980s may have left imprints on processes and procedures.

Maryland enjoys a growing economy, healthy state fiscal situation and a strong demand for low income housing. Steady growth and development has not led to the overbuilding exhibited in other part of the country. Like Rhode Island's RPP, the somewhat soft market rate side does not affect RHPP for reasons already discussed and the state has been generous in housing budget allocations. RHPP was viewed favorably by many developers, but the main complaint was lack of funds. Funding is tied to the legislature, as in Massachusetts, and although Maryland is not

presently encountering fiscal problems, it may some day and that reliance on state funds may interrupt the program.

It is noteworthy that not only is the source of funds an important issue but so too is the form of the subsidy. All the programs are in the practice of making loans yet the specific amount and form of the loans differ. SHARP stipulates that the loan must be the minimum amount necessary to ensure project feasibility and serves as an interest payment write down subsidy, in other words an operating subsidy. In turn the RHP in Rhode Island offers second mortgages of up to $30,000 per unit at zero percent interest; if taken as a lump sum up front, this serves as a construction loan which can roll into a permanent loan, in effect, a development write down cost or capital subsidy. Also the funds can be expended over time and function like SHARP as an operating subsidy. Finally, Maryland offers a loan with very flexible terms and rates and a $1 million cap per project, which operates as a capital subsidy. This latter form of subsidy is advantageous in that it assists in defraying costs associated with what many consider to be one of the more riskier phases of the development effort. One receives the funds up front; terms and rates are negotiable and the money can be used to help offset a variety of development costs. The main drawback to this approach is that you are not able to service the project and its

affordability as you are with the operating subsidy. An operating subsidy affords greater flexibility with the type of projects that one can pursue. As implied, the key factor is the amount of resources that a state has at its disposal. Ideally, one would have capital funds that can be discounted up front and an operating subsidy that can be injected into the project so that at any given instance one can employ the better of the two resources and use the optimal combination for the project.

State Support

The ability to acquire appropriations for affordable housing programs and the form of funding (whether up front or a declining operating subsidy) depends not only on the state's fiscal position but also on the state's commitment to affordable housing and the omnipresent political realities existing in the state. State support is an indirect test of success. Massachusetts has enjoyed tremendous support for its affordable housing programs, particularly SHARP. When politicians can boast that approximately 9,500 units are produced and the track record has been exemplary as SHARPs has been, the band wagon will roll easily. The political state of affairs concerning affordable housing in Massachusetts has produced an extremely supportive legislature which provides annual appropriations for housing contracts as stated by SHARP. Moreover,

Chapter 774 and Executive Order 215 provide statutory support for the affordable housing effort, whereas Rhode Island and Maryland lack these "sticks."

Maryland also enjoys support for its housing programs. In fact this year the legislature approved a $50 million state funded housing budget, the largest in Maryland's history. Yet, the RHPP is a one shot deal where the capital loan is made and no further money is put into the project. Also, the political environment in this state is more conservative in this regard. The capacity of the program to adopt to changing political factors seems much less secure than in Massachusetts. The Rhode Island legislature enthusiastically supports RPP (as well it should, for the Corporation funds the program from its reserves) and has accepted the state's commitment regarding the rental subsidy program for the last two years. State support is evidenced but cannot match that of Massachusetts. It remains to be seen what action the state will pursue when Massachusetts' budgetary problems lessen. Undeniably political considerations impact the funding decision as to amount and type.

Comparative analysis has illustrated several important points. First, states pursue different programmatic options depending on a variety of influencing variables. Second, there is no one universal program that can be applied to all circumstances. In concurrence

with contingency theory, I feel one must discover a best fit with one's environment. As times and circumstances change, so too must programs adapt to meet new needs and demands. A state wishing to re-evaluate its existing posture regarding housing or one desiring to develop a program must deal with many issues.

Third, an overriding factor in policy issues, of course, is the basic overall housing market. Research and analysis must be conducted to ascertain the various market areas, i.e. market rate, moderate and low income, and any subcategories, as well as the forces impinging on these markets. One needs a firm understanding and appreciation for the dynamics involved. The federal government's policy concerning housing as well as the tax code and any imminent changes must be factored into policy decisions. Other important factors include concerns such as the state's fiscal situation and overall economy, the political environment, and past history with housing.

Fourth, it is essential to know one's resources and understand that programs should not be designed in isolation or viewed as a panacea. Fifth, state and local resources are too scarce to provide a sufficient response to the growing demand let alone permit one to believe that one program is the answer. A specific program like SHARP needs to work in conjunction with other federal, state, and

local resources, such as the tax credit program, for example, in order to be effective and produce a significant amount of affordable housing.

Sixth, only after diligent analysis and consideration of the above mentioned factors can one determine what should be the housing finance agency's realistic objective. In formulating policy, flexibility in some form needs to be incorporated in the program whether it is through the statute, programmatic guidelines, terms and rates, etc. Once again such decisions cannot be made independently as one must consider such issues as the funding source, other agency involvement, administrative and bureaucratic experience, skill and staffing.

Seventh, an awareness of change to the environment is mandatory if a program is to be adaptable and successful. Change will eliminate some opportunities while simultaneously creating new avenues and attention to this reality is a must. Expected and unexpected change will affect the program in varying degrees. Massachusetts experienced a soft market and a deficit and SHARP adapted to the new situation but in doing so has transformed itself programmatically from a market rate focus to a low to moderate income orientation. In effect the original intent of SHARP ended as it embarked on a new format given existing circumstances. This

example underscores a point made earlier that housing programs have a limited life span.

As we enter the 1990s the federal government is discussing various housing packages but many observers are skeptical of relief in the near future. States cannot afford to bide their time in the hope that the federal government will rescue them and provide the much needed funding for affordable housing. States need to continue to engage in activist pursuits, develop innovative programs, create financing schemes, and most of all to learn from their own and others' experiences.

Comparative analysis illustrated several points but I feel the one which was highlighted was the fact that states cannot attempt to solve the housing affordability crisis alone. They can provide some valuable assistance but they need the support of the federal government. Otherwise programs will be insufficient, discontinuous, and opportunities will be lost, such as construction slowdowns when it is cheaper to build due to competitive bidding but state funds are unavailable as a result of fiscal problems. Federal government support is crucial to the housing effort.

Ian Donald Terner and Thomas B. Cook succinctly stated the issue in *New Directions for Federal Housing Policy: The Role of the States:*:

> Thus, while the 50 states in general, and even the most aggressive housing "activist" states may never attain a primacy in the funding or finance area relative to the potential of the federal government, their period of activism during the federal retreat may establish many of the states as powerful and constructive partners in any reconstituted federal housing effort. This may likely not be true for all of the states, some of which are still on the sidelines waiting for the federal government to resume the game. And still others of the states may fall short of the role of active or constructive partner, because of deficiences of leadership, or competence, or both. States may, at worst, offer the disservice of a clogged or superfluous layer of bureaucracy, threatening the flow of funds and aid from federal funding sources to local government and private sector implementors. Nonetheless ... states have shown commitment and growing capacity to undertake major housing initiatives.

In addition to the obstacles encountered by state programs, the last two to three years since these authors' assessment have produced new demands on state programs for the 1990s. Among these challenges are changing housing markets and state fiscal conditions.

The creative capacity of states has been illustrated as they have devised a variety of approaches and funding sources to cope with their responsibilities. It was fortunate that the programs I examined enjoyed relatively favorable environments in which to develop. Undergoing the learning curve experience is difficult enough without having to deal with other threatening factors.

Massachusetts experienced a tight housing market and the Massachusetts Miracle was beginning to take shape. Maryland's and Rhode Island's markets were strong, and while the former's economy was stronger, the latter's rental program was not as dependent on the fiscal condition of the state. Yet, times and conditions have changed and these and other state programs conceived under similar conditions will face new challenges for the 1990s. States must continue to be entrepreneurial as changes in market conditions can be problemmatic. For example, with mixed income oriented programs when markets become soft it will be necessary for the state to have the flexibility to adjust the program accordingly and have the systems in place to assist the transition. States need to undertake more seriously contingency planning so when the unexpected happens, as it did in Massachusetts, a soft market opportunity program can be instituted readily.

Moreover, budgetory problems can impose serious interruptions and effectively terminate programs. Given this factor, agencies will need to re-evaluate the aggressiveness in which they use and leverage their reserves. Having sufficient reserves available for program funding proved to be a major advantage for Rhode Island Housing. Obviously, their reserves are excessive and most agencies cannot hope or even desire to achieve such a level, but the

idea of storing reserves has merit: continuity is provided and agencies can capitalize on market oppotunities such as decreased condominium prices and construction costs. Thus, as can be seen, states must be entrepreneurial to adapt to new challenges.

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Massachusetts

Antonelli, JosephKelly, Gene – Keith Development, Chairman – Developers' Council

Matulef, Mark – Director of Program Development, Policy and Private Housing – Exectuive Office of Communities and Development

Phillips, Rufus – Research and Program Development Officer

Posner, Josh – The Community Builders

Pyne, Robert – Director of Development MHFA.

Siflinger, Marvin – Executive Director of Massachusetts Housing Finance Agency (MHFA).

Stevens, Rebecca – Research Associate, Boston Redevelopment Authority

Zapata, Cesar – Senior Development Officer, Massachusetts Housing Partnership

Rhode Island

Beachler, James – Director of Housing Development, Rhode Island Housing

Dagata, Ross – Executive Director, Rhode Island Builders Association

Engel, Jeanne – Director of Policy and Program Development

Jacoboski, Ted – President, Easland Property

Robertson, Jean – Coordinator of Research, Rhode Island Housing

Vermeer, Kimberly – Program Development Officer, Rhode Island Housing

Maryland

Bonderud, Kendra – Research Associate Community Development Association (CDA)

Brown, Barry – Baltimore Department of Housing and Community Development

Ducker, Marilyn – Vice President, Shelter Corporation

Duffy, Patrick – Shelter Corporation

Ginsburg, James – President, The Waterford Group

Goodman, Robert – Director of the Office of Research and Information Systems

Greenlaw, Sheila - Director of Program and Policy Development, National Council of State Housing Agencies

Henson, Dan – Struever Brothers, Eccles and Ross

Logan, Mary – Baltimore City Regional Planning Council

Massey, Patricia – Baltimore Housing Partnership

Montague, Valerie – Assistant to Director of the Office of Research and Information Systems

Nenno, Mary – National Association of Housing Redevelopment Officials

Phelps, Tana – Baltimore Housing Partnership

Tawa, Christopher – Administrator of Housing Finance (CDA)