

URBAN REDEVELOPMENT—THE VIEWPOINT OF COUNSEL FOR A PRIVATE REDEVELOPER

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INTRODUCTION

Prior to the solicitation by the local public agency (LPA)¹ of bids for the land it has acquired, the attorney in private practice is unlikely to have very much professional contact with urban redevelopment. He may be called into negotiations with the LPA when it desires to acquire land owned by a client, and if negotiation fails, he may litigate a property condemnation suit.² He may also be asked for advice when deteriorating property owned by a client, long ignored by the city housing divisions, is given a thorough check in connection with an area rehabilitation program and a long list of violations is served upon the owner.³ Condemnations and code violations are familiar legal work whose principal facet in urban redevelopment is the administrative finding of "slum and blight" by the LPA.⁴

Beginning with land disposition, however, the unfamiliar problems will appear.

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¹ National Housing Act of 1949, § 110(h), 63 Stat. 421, 42 U.S.C. § 1460(h) (1958), defines local public agency as ". . . any state, county, municipality or other governmental entity or public body, or two or more such entities or bodies, authorized to undertake the project for which assistance is sought. . . ."

² A policy of compensating relocatees and condemnees for loss of good will, moving expenses, etc., is evolving not only as a matter of legislative policy, but also as a matter of judicial decision. See Comment, *Eminent Domain Valuation in an Age of Redevelopment: Incidental Losses*, 67 *YALE L.J.* 61 (1957); Note, *Urban Renewal: Problems of Eliminating and Preventing Urban Deterioration*, 72 *HARV. L. REV.* 504, 525-26 (1959).

³ See Guandolo, *Housing Codes in Urban Renewal*, 25 *GEO. WASH. L. REV.* 1 (1956), HOUSING AND HOME FINANCE AGENCY, CODES AND ORDINANCES ADVISORY BULLETIN AB-1-58.

⁴ Because urban redevelopment legislation is comparatively recent, condemnation for redevelopment is still running a gauntlet of constitutionality cases, although the federal constitutionality issue seems to have been resolved, see *Berman v. Parker*, 348 U.S. 26 (1954); and almost all state constitutionality cases (many of which have been brought as taxpayers' suits, presumably by prospective condemnees anxious to avoid the accelerated blight caused by move-outs of established residents and reduction of maintenance when an area is marked for demolition) have found in favor of the legislation. See Annot., 44 *A.L.R.2d* 1414 (1955). One issue more easily raised in urban redevelopment condemnation cases than in many cases where a specific site is essential to a specific public project (such as contiguous land to expand City Hall or land in a particular area for a grammar school) is the propriety of taking property that is itself in good condition. But see *Berman v. Parker*, *supra*, at 35, holding that the effect on the entire area and not the condition of the particular building is the appropriate test: "Property may of course be taken for this redevelopment which, standing by itself, is innocuous and unoffending. . . ." Similarly, it may be urged that the application of the plan to the particular property is an unreasonable balancing of public versus private interests. Thus, Sullivan, *Administrative Procedure and the Advocatory Process in Urban Redevelopment*, 45 *CALIF. L. REV.* 134, 151 (1957), suggests that counsel for private land owners might be more skillful in resisting planners by fighting back on the level of sound planning. Cf. *Bristol Redevelopment and Housing Authority v. J. B. Denton*, 198 Va. 171, 93 S.E.2d 288

Counsel for the prospective private redeveloper will soon find that an urban redevelopment project is "just another real estate deal" in the same limited sense that Alfonso's first evening with Lucrezia Borgia was "just another blind date." In both instances, a wise mentor will urge the suitor that boldness be preceded by research and that desire be tempered with caution. In fact, the problems have seemed so great and the pitfalls so deep that many experienced real estate men have been unwilling to bid for sponsorship of urban redevelopment projects, even in their home cities. No segment of the field of real estate development involves contact with so many public agencies—federal, state, and local. Some realtors believe that time-consuming negotiations with a multitude of government agencies will prevent the smooth flow of construction that is essential for efficiency. Others believe that the pioneering projects will be unprofitable until the new neighborhoods are well established, and that they should enter the field only after bad experiences have produced better procedures.⁵ Some fear that the "608 scandals," which engendered public suspicion and resentment of the home-building industry, may be repeated.⁶ Only a very few American businessmen have, therefore, chosen to specialize in so difficult a field.⁷

Counsel for the redeveloper thus assumes a challenging responsibility in helping (1956), in which the LPA's findings of slum and blight were overruled, in large part, because of impressive statistical evidence introduced by the plaintiff. *But cf.* *Taft Hotel Co. v. HHFA*, 262 F.2d 307 (2d Cir. 1958), *cert. denied*, 359 U.S. 967 (1959), where the Court refused to examine plaintiff hotel company's contention that the plan was unreasonable in providing for a second hotel so near to plaintiff; *Kaskel v. Impellitteri*, 306 N.Y. 73, 115 N.E.2d 659 (1953), *cert. denied*, 347 U.S. 934 (1954), where the court indicated that judicial review of planning decisions should be limited to those made "corruptly or irrationally or baselessly" and paid little heed to the report of a distinguished planner submitted by the taxpayer opposing the project; *Babcock v. Community Redevelopment Agency of the City of Los Angeles*, 148 C.A.2d 38, 49, 306 P.2d 513, 520 (1957), where the court stated: ". . . a court is not empowered to substitute its determination for the determination of the agency or the legislative body in the absence of abuse of discretion, fraud, collusion, or bad faith. . . ."

⁵ For the difficulties of two pioneering projects, see *A Tower Plus Row Houses in Detroit*, Architectural Forum, May 1960, p. 104; *First Steps Toward a New Washington*, Architectural Forum, Dec. 1959, pp. 114. See also *Builders Tell How Bureaucracy Tangles Renewal*, House and Home, May 1960, pp. 70-71; *Redevelopment—Long Delays from Start to Finish Cost More Than Money*, 16 J. HOUSING 116 (1959).

⁶ See *Fieger v. Glen Oaks Village*, 309 N.Y. 527, 132 N.E.2d 492 (1956), where tenants were not permitted to recover from a landlord who mortgaged for \$24,000,000 a property he built for \$20,000,000. For a general description of the section 608 program, see *Mason v. Hirsch*, 140 F. Supp. 453 (E.D.N.Y. 1956). The final stages of the political furor were the attempts to tax the section 608 sponsors. See, e.g., *Gross v. Comm'r*, 23 T.C. 756 (1955), *aff'd*, 236 F.2d 612 (2d Cir. 1956); *cf.* INT. REV. CODE OF 1954, § 312(j), which, under certain circumstances, taxes any excess of mortgage proceeds over the cost of the mortgaged property. These attempts were generally unsuccessful, except in the cases of those sponsors whose realization of profits after 1949, taxable under the collapsibility rules of INT. REV. CODE OF 1954, § 341, might well have gone unnoticed except for the thoroughness with which all aspects of their projects were investigated. See, e.g., *Hartman v. Comm'r*, T.C. No. 111 (Sept. 22, 1960). More useful was a tightening of FHA procedures, pursuant to the cost-certification requirements of the National Housing Act, § 227, as amended in 1954, to require a public accountant's audit and certification of project costs to prevent "mortgaging out." 68 Stat. 607 (1954), 12 U.S.C. § 1715r (1958). See Seligman, *The Enduring Slums*, in EDITORS OF FORTUNE, *THE EXPLODING METROPOLIS* 111, 129-30 (1958).

⁷ See *Housing Developers Vie for Jobs of Clearing Urban Slums*, Business Week, Feb. 22, 1958, p. 80; M. CARTER MCFARLAND, *THE CHALLENGE OF URBAN RENEWAL* 22-23 (Urban Land Inst. Tech. Bull. No. 34, 1958). Only in the United States have urban renewal specialized builders developed. See Schut, *Urban Renewal*, in INTERNATIONAL SEMINAR ON URBAN RENEWAL, REPORT 11, at 13 (1958).

guide the sponsor of a redevelopment project from the selection of the project for which to bid through the profitable operation or sale of a completed real estate enterprise. The path to success winds through a maze of legal problems ranging from the present status of the Rule in *Dumpor's Case*⁸ to whether in 1961 an association of tenants has any more right to picket than did a workmen's combination in 1896.⁹

Counsel for the redeveloper must remember, in rendering his opinion on each problem and in reviewing the decisions to be made by his client, that the success of the particular project is a matter of great public concern not only because large amounts of public money have been invested, but also because the very future of the city may depend to an important extent on the success of the redeveloper in revitalizing the area for which he has been awarded sponsorship. In the antique platitude, urban redevelopment is "affected with a public interest," and counsel for the redeveloper will be wise to use the general approach of the public utility lawyer—being as sensitive to current public opinion and political trends as to the applicable regulations in gauging the limitations within which the redeveloper's legitimate desires must be adjusted to the requirements of the many public agencies involved.¹⁰ The quickest way to sense the broad issues in urban redevelopment and to become acquainted with its jargon is background reading in the nonlegal materials.¹¹ (Legal materials, until recently, have been largely confined to the constitutionality of using eminent domain to acquire private property for urban

⁸ *Dumpor's Case*, 4 Coke 119b, 76 Eng. Rep. 1110 (K.B. 1578); JOHN WILLIAM SMITH, A SELECTION OF LEADING CASES ON VARIOUS BRANCHES OF THE LAW 32 (11th ed. by T. W. Chitty, J. H. Williams and Herbert Chitty 1903). In land disposition agreements, the LPA generally wishes all of the rights of the sponsor to be nonassignable, at least until construction is completed. For the effect of a nonassignment provision subsequent to a consent to the assignment to an affiliated corporation, see generally, Annot., 31 A.L.R. 153 (1924), 32 A.L.R. 1080 (1924). See also CHARLES M. HAAR, LAND-USE PLANNING 597 n. 34, 598 (1959), concerning the validity of restrictions on resale without LPA permission.

⁹ Compare notes 228, 229 *infra*, with *Vegeahn v. Gunter*, 167 Mass. 92, 44 N.E. 1077 (1896).

¹⁰ See Harbeson, *The Public Interest Concept in Law and Economics*, 37 MICH. L. REV. 181 (1938). We are not suggesting here that a completed privately-owned redevelopment project should be treated as a separate property classification for legislative purposes. Rather, we are suggesting that pending successful completion, there is a legitimate public concern with the progress of the project that will influence the attitudes of government administrators, of newspapers and other public information sources, and, indeed, of the courts. Even after completion, by covenants in the disposition documents, some public agencies may try to retain some controls, and the public funds invested will leave a community feeling of legitimate public concern with operations.

¹¹ The *Journal of Housing*, a monthly (except August) publication of the National Association of Housing and Redevelopment Officials, 1313 East 60th St., Chicago, 37, Ill., is the best source of current general news. The Association also offers, by subscription, a Renewal Information Service. Architectural Forum magazine has a continuing interest in the design aspects of redevelopment, with occasional treatment of financial and legal aspects. The best compilations of material for general reading are COLEMAN WOODBURY (ED.), URBAN REDEVELOPMENT: PROBLEMS AND PRACTICES (1953); COLEMAN WOODBURY (ED.), THE FUTURE OF CITIES AND URBAN REDEVELOPMENT (1953); two-part symposium, *Land Planning in a Democracy and Urban Housing and Planning*, 20 LAW & CONTEMP. PROB. 197, 351 (1955). All the legal aspects of modern planning are surveyed in HAAR, *op. cit. supra* note 8, which should be compared with the older real property casebooks by those interested in the extent to which law school courses have started abandoning the study of some of the traditional real property topics. For an excellent recent treatment of renewal problems, see Note, *Urban Renewal: Problems of Eliminating and Preventing Urban Deterioration*, 72 HARV. L. REV. 504 (1959); for an earlier treatment, see Johnstone, *The Federal Urban Renewal Program*, 25 U. CHI. L. REV. 301 (1958);

redevelopment.)¹² The best way to develop practical knowledge is, of course, conversations with the government officials heading the national and local programs. A great many of them became administrators of urban redevelopment after holding legal or planning posts, and they are, in general, able, informed, and articulate.¹³

Increasingly as the stage of land disposition is reached in more and more cities,¹⁴ detailed urban renewal manuals with the viewpoint of the lawyer in private practice will be needed.¹⁵ Meanwhile, the following outline for such a manual, organized in the chronological sequence in which the private lawyer is likely to encounter different problems, may be useful to the neophyte. Because the writers have had experience with urban redevelopment in more than a dozen states, they appreciate the likelihood that general comments may not fit the local law applicable to a particular project, but limitations of knowledge and space obviate any attempt to cover comprehensively the local law aspects of the problems discussed. Particularly because one of the writers has served the government as well as private clients in housing matters, they also are conscious of the restrictions within which officials must work when in charge of subsidy and guarantee programs; but their material will emphasize the redeveloper's needs and thus may necessarily, now and then, seem to ignore the problems faced by public officials. The writers are anxious to leave no such impression. In every instance, the private lawyer must have a good command of the applicable local law (or, if he and his client are both from another area, engage a good local lawyer as associate counsel); and he will also best service his client if he has a full appreciation that the client's problems must be solved not only expeditiously, but in a manner consistent with both the fact and the appearance of proper conduct of public business.

and for a brief treatment, see Kass, *Short Primer on Urban Renewal*, Boston B.J., Sept. 1959, p. 14. The Public Library of the District of Columbia has issued annually since 1956 *Publications Relating to Urban Renewal*, which supplements the *Urban Renewal Bibliography* published in 1955 by the American Council to Improve Our Neighborhoods; another useful list of publications is the HHFA index of articles entitled *Housing References*.

¹² See, e.g., Mandelker, *Public Purpose in Urban Redevelopment*, 28 TULANE L. REV. 96 (1953); Weiss, *Is the Power of Eminent Domain Dangerous Under the Urban Redevelopment Act*, 57 DICK. L. REV. 326 (1953); Note, *Public Use as a Limitation on Eminent Domain in Urban Renewal*, 68 HARV. L. REV. 1422 (1955).

¹³ See Jacobs, *Redevelopment Directors—What Talents Do They Need? What Incentives?*, 16 J. HOUSING 45 (1959).

¹⁴ By the end of 1959, land disposition had been completed in only 51 of the 699 urban renewal projects that had been approved for federal assistance through that date. The projects were located in 417 communities ranging in population from 570 to 7,900,000 and were situated in 42 states, the District of Columbia, and Puerto Rico. 13 HHFA ANN. REP. 271-73 (1959).

¹⁵ An address by B. T. Fitzpatrick entitled "The Private Redeveloper in the Urban Renewal Program" (copies available from the Municipal Law Service Letter, 3400 Chestnut St., Philadelphia 4, Pa.) is practically the only available item from the point of view of counsel for the redeveloper, other than the form kit of the National Association of Home Builders. See *Example Case: Urban Renewal Project Under Section 220*, 15 J. HOUSING 106 (1958). For the view of the redeveloper, see Scheuer, *Developing Proposals*, in INTERNATIONAL SEMINAR ON URBAN RENEWAL, REPORT 59 (1958), and in JAMES M. MILLER (ED.), *NEW LIFE FOR CITIES AROUND THE WORLD* 45 (1959). See also Pollock, *Urban Renewal in New York City and the Investor*, 14 RECORD OF N.Y.C.B.A. 515 (1959), which primarily discusses problems peculiar to New York City's now-abandoned disposition procedures under which the sponsor handled relocation and demolition.

I

DECIDING WHETHER TO BID FOR A PROJECT

The redeveloper's first question is the extent of the experience of the different government agencies concerned with the particular project and how well they are coordinated. The LPA may be "any state, county, municipality, or other governmental entity or public body" authorized to undertake urban renewal projects.¹⁶ Nearly all of the LPAs are cities, housing authorities, or redevelopment agencies whose jurisdictions are city-wide only. The LPA may or may not also be responsible for public housing. In any event, it can be politically potent or at cross purposes with the mayor and city council, and it can gear site clearance with tenant relocation into available public housing ably or poorly. An astute LPA director will have involved the local Federal Housing Administration (FHA) office in his planning very early¹⁷ and will also have sought to interest local banks and commercial and citizen groups in the project. In certain cities, redevelopment progress has been a vote-getting political issue,¹⁸ and LPA staffs have enjoyed strong political and widespread public support. In other cities, misunderstandings and lack of information have lost public and political support for the redevelopment program. A good test for the prospective redeveloper is whether the LPA director, the local FHA director, the mayor, and other local administrative and legislative officials involved in the program are on a first-name basis. If they are not, the occasional administrative and legislative adjustments required as the project planning proceeds may become so difficult and time-consuming that the economic feasibility of the project will be impaired.

A. Local Statutes and Ordinances

In deciding whether to bid for sponsorship of a particular project, the redeveloper will require from his attorney information on any special advantages or disadvantages that the statutes and ordinances applicable to the project include. Occasionally, these will be mentioned in the publicity issued by the LPA in soliciting bids for the project or in the formal bid documents. More often, they are not publicized, but are known to the staff of the LPA and willingly discussed upon inquiry.¹⁹ Such lack of publicity does not indicate deliberate suppression; often the LPA officials do not realize the uniqueness of the local advantage or disadvantage and the significance of it to the redeveloper.

One of the most important special local advantages for which the prospective redeveloper's attorney should check is some form of real estate tax abatement. This abatement usually expires after a stated period of time. Real estate taxes often

¹⁶ 63 Stat. 421 (1949), 42 U.S.C. § 1460(h) (1958).

¹⁷ URBAN RENEWAL MANUAL § 14-4-2, at 3, instructs the LPA to consult with the local FHA and advise HHFA of results.

¹⁸ "This year for the first time renewal will be an issue in a presidential election." Editorial, Architectural Forum, June 1960, p. 83.

¹⁹ The LPA is required to report to the HHFA any provisions for special taxation limitations, exemptions or relief. URBAN RENEWAL MANUAL § 14-2-2, at 4(6).

amount to twenty per cent or more of gross income and thirty per cent or more of total operating costs for residential properties, and even higher percentages for commercial properties.²⁰ The reduction in rents made possible by tax abatement thus can make a substantial difference in the economic feasibility of a project. Indeed, real estate tax abatement is almost always more important in reducing rents than a write-down of land prices below fair re-use value.²¹

Often local officials will predict or even promise lower assessments, and in most instances, an informal abatement will be obtained. Such unenforceable oral commitments, however, are subject to political whims and pressures and to the election or appointment of new officials. Such commitments are also subject to attack by other property owners who are given no such tax relief and who cannot understand why the redeveloper should receive preferential treatment with no legislative standards and controls.²² The very least that should be made available is a public letter from the appropriate official to all bidders. A far sounder basis is a statutory real estate tax concession, such as is offered in Michigan, Minnesota, Missouri, New York, Wisconsin, and other states.²³ Sometimes the real estate tax abatements continue only

²⁰ See Nelson, *FHA Operating Expense Data in 608 Housing*, Appraisal Journal, Jan. 1957, p. 8.

²¹ See McFARLAND, *op. cit. supra* note 7, at 20-21. For example, if land cost is \$50,000 in a project with a total cost of \$1,000,000 and the debt service (interest, FHA annual mortgage insurance premium, if applicable, and amortization of mortgage principal is 7%, getting the land free would save \$3,500 per annum. If, on the other hand, the same project is appraised for real estate tax purposes at \$400,000 (40% of total cost) and taxed at \$35 per \$1,000 of appraised value, a 50% tax abatement would save \$7,000 per annum. Since write-down of land cost below fair reuse value is not politically feasible, but stabilizing real estate taxation of the new redevelopment at what the predecessor slum structure paid does have political acceptability, tax abatements are both a more powerful and a more feasible incentive than write-downs of land cost. (It should be noted that the foregoing illustration is concerned with a write-down of fair reuse value and presumes the initial write-down from acquisition cost to fair reuse value. The initial write-down from acquisition costs to fair reuse value, however, may be greater than the fair reuse value and is not considered in the foregoing comparison.) It has been argued that the city makes a net gain by the reduced cost of municipal services when the slum is replaced, even if real estate taxes remain the same. See ROBERT B. NAVIN, *AN ANALYSIS OF A SLUM AREA (1934)*; see also Blum & Bursler, *Tax Subsidies for Rental Housing*, 15 U. CHI. L. REV. 255 (1948).

²² In Boston, Prudential Life Insurance Co. warned that other property owners would test the constitutionality of an informal tax abatement promise, had to threaten abandonment of a multimillion dollar project to secure legislative affirmance of such informal abatement promise that it reluctantly accepted when a statutory abatement was held unconstitutional in *Opinion of the Justices*, 332 Mass. 769, 126 N.E.2d 795 (1955). Subsequently, the second proposed scheme was held unconstitutional in *Opinion of the Justices*, 167 N.E.2d 745 (Mass. 1960), but with a broad hint as to how a constitutional solution could be found. See also *Business Week*, June 4, 1960, p. 38; *Tax Tricks Designed to Do In Slums*, 16 J. HOUSING 232, 234 (1959). For the story of another broken LPA informal promise—in this instance a promise to cut a major street through Washington Square, New York City, to connect a luxury apartment with Fifth Avenue—see *Inhuman Redevelopment*, *Architectural Forum*, Sept. 1958, p. 89.

²³ See Hershman, *Legal Measures for Removal of Slum Areas*, 14 RECORD OF N.Y.C.B.A. 144 (1959); MICH. ANN. STAT. § 5.3058(12) (1948); MO. ANN. STAT. § 353, 110 (1953); WIS. STAT. ANN. § 66.409 (1957) (assessment freezes); N.Y. UNCONSOL. LAWS §§ 3312, 3426 (McKinney, Supp. 1960); MINN. STAT. ANN. § 462.651 (Supp. 1959) (tax relief). In several other states, there are real estate tax-abatement provisions for cooperatives, but because of the mechanics by which FHA § 213 cooperative apartments are owned and operated, it is presently doubtful whether such projects can qualify under some of these statutes. Attempts are being made, however, to eliminate the mechanical problems here. Exemption of new residential buildings from taxation for the initial five years after construction was held unconstitutional under the state constitution in *Opinion of*

so long as there is public regulation of rents or profits.²⁴

Although the Missouri statute is limited to domestic corporations organized under a special statute, and thus restricts the redeveloper to this particular form of entity,²⁵ it is an unusually good model in other respects. First, it gives the maximum abatement during the initial five years, when the project is most likely to need help. Second, the benefits are automatically received by those who qualify, thereby eliminating political pressures. Third, it ultimately restores the property to full taxation, so that the redeveloper is helped when needed but the municipality's budget is not permanently deprived of these tax revenues.²⁶

It is important, however, to note in this regard that sometimes a municipality finances its share of the cost of land acquisition through the sale of revenue-type bonds to be repaid out of the increase in real estate taxes derived from the redeveloped property in the project as a result of the increase in assessed valuation.²⁷ On this basis, urban redevelopment has been "sold" in a number of communities, with the assurance that there will be no ultimate cash cost. Under such circumstances, tax abatement is most likely not feasible.

Another important statutory advantage may be state assistance to middle-income housing, such as the New York State Mitchell-Lama Act.²⁸ The very substantial advantages in interest rate, direct loan, and length of repayment period may make economically feasible projects that otherwise would be impossible.

The disadvantages of a particular locality are more difficult to ascertain than the advantages because they are buried in codes and ordinances with which lawyers seldom deal except in connection with specialized problems. Most redevelopment projects are in the central city and, therefore, are in the most restrictive fire zone. Building codes intended for fire protection of multistory, high-density residential and commercial structures often produce major cost increases when applied to garden apartments with twenty-five per cent land coverage, and yet fire chiefs frequently oppose any relaxation.²⁹ Zoning must also be checked against the modern planning concepts that the redeveloper's architects may intend to use.³⁰ The attorney's duty

the Justices, 324 Mass. 724, 85 N.E.2d 222 (1949). There may also be equal protection and due process issues under the federal constitution. See Opinion of the Justices, 332 Mass. 769, 126 N.E.2d 795 (1955).

²⁴ See statutes cited in Opinion of the Justices, 334 Mass. 760, 135 N.E.2d 665 (1956); *Dorsey v. Stuyvesant Town Corp.*, 299 N.Y. 512, 87 N.E.2d 541 (1949).

²⁵ See *infra* pp. 139-40, 157-62, re choice of entity to be owner.

²⁶ The FHA in its rent and expense protections may require the redeveloper to accrue during the early years against future real estate taxes, thus blunting, in part, the advantage of the abatement in attracting initial tenants.

²⁷ CAL. HEALTH & SAFETY CODE § 33950; MINN. STAT. § 462.545 subd. 5 (1953). See also Note, *Urban Renewal: Problems of Eliminating and Preventing Urban Deterioration*, 72 HARV. L. REV. 504, 513 (1959); *Buffalo's Beginning*, 15 J. HOUSING 102 (1958).

²⁸ N.Y. CONST. art. 18, §§ 2, 6 authorize financial assistance as well as tax relief. For a summary of the Mitchell-Lama provisions, N.Y. PUB. HOUSING art. XII, see *Government Aids for Private Middle Income Housing in New York City*, 15 J. HOUSING 26 (1958). For recent New York proposals, see TASK FORCE ON MIDDLE INCOME HOUSING REPORT (1959).

²⁹ E.g., in one city, fire walls were required that not only impaired design, but also put the project at a cost disadvantage compared to suburban apartments necessarily reflected in rentals.

³⁰ See Goldston & Scheuer, *Zoning of Planned Residential Developments*, 72 HARV. L. REV. 241 (1959).

here is to suggest that these problems may exist and should be cost-checked, since architects sometimes will assume the code can somehow be ignored or, in the early stages of designing the project, will fail to emphasize to the redeveloper the extent to which construction costs have been increased by items that do not increase rentability.³¹

A second important problem area is whether the legality of the whole redevelopment process has already been established. If the constitutionality of the enabling legislation has been judicially determined, if the land acquisition has been judicially sanctioned, and if land disposition procedures have been carefully tailored to local law, long delays and harassing litigation will be avoided. If any questions do exist with reference to legality, they should be discussed with the counsel of a good local title insurance company. As a practical matter, if title insurance has been issued to the LPA on its acquired project land, similar insurance should be available to the purchaser-redeveloper. At least informal soundings should be made, however, to make sure that the low face value title guarantee given on land at the time of acquisition will be extended to title insurance of vastly greater face value on land and improvements after disposition.³²

A careful check must also be made of state antidiscrimination statutes and municipal ordinances relating to discrimination in construction employment and in occupancy. Sometimes these are of general application, and sometimes they apply by express provision or by court decision only to governmentally-aided projects. In some localities, the lack of public acceptance of such antidiscrimination measures is likely to project the redeveloper into the middle of a major social question, particularly if they do not apply generally to all rental housing in the locality.³³

B. Civic Groups

Nongovernmental assistance of considerable importance to the redeveloper may be available from local civic groups. In many instances, the civic groups have confined their efforts to public relations programs, contributions to study projects, and the support of needed legislation.³⁴ This type of assistance is of tremendous help to a

³¹ See note 29 *supra*.

³² Because FHA requires ATA mortgagee insurance (a type of title insurance standardized by the American Title Association that insures against defects off the record as well as defects disclosed by the record) and the mortgage is a very high percentage of total project value, redevelopers often waive the title guarantee (in the face amount of land cost) usually supplied by the LPA and have an amount equal to the cost of such a title guarantee applied by the title company against the cost of the ATA policy. This leaves the equity uninsured, but as a practical matter, almost any claim that could affect the very thin equity would also affect the very large mortgage and be contested by the title company on behalf of the mortgagee. Of course, as the size of the redeveloper's equity increases, the argument becomes less applicable. Professor Haar raises the question as to why the passage through condemnation does not create good title. HAAR, *op. cit. supra* note 8, at 562 n.16. Where abstracts of title are used, the LPA is authorized to deliver them to the redeveloper at the time of conveyance. See URBAN RENEWAL MANUAL § 13-4-21, at 5.

³³ Some local ordinances apply only to buildings with, for example, five or more suites, and others only apply to government-aided housing. Also see *infra* p. 173.

³⁴ See 17 J. HOUSING no. 1 *passim* (1960).

redeveloper unfamiliar with local conditions. In numerous instances, such groups have persuaded reluctant local bankers to make the necessary construction loans for the project. Such groups with access to public opinion media often create an awareness of urban redevelopment that results in effecting a high degree of coordination between the municipal and local federal officials. Their personal acquaintanceship with members of Congress is often useful in expediting Washington administrative decisions.

A singularly effective civic group has been the Cleveland Development Foundation, which raised a revolving fund of two million dollars to make supplemental unsecured loans that, added to FHA mortgage financing, have meant that redevelopers in Cleveland, Ohio, have been required to invest a minimum of cash in their projects.³⁵

Civic leaders throughout the country are increasingly recognizing the importance of the economic as well as the human aspects of urban redevelopment and are beginning to appreciate the economic stimulus given their own enterprises by the rebuilding of the cores of their cities.³⁶ It can be anticipated that civic groups will plan a more influential role in urban redevelopment than in the past.

C. Visiting with LPA Officials and Inspection of Site

An important step prior to making a final decision to enter a bid for the project is a visit by the proposed redeveloper, his architect, and his counsel to the city to confer with the LPA officials and to examine the site of the proposed project and its surrounding neighborhood.³⁷

Physical inspection of the proposed project site may reveal a good deal of information as to probable fill requirements, sewer problems, foundation difficulties, air pollution, accessibility of public transportation, and so forth. More important, it will provide an opportunity to examine the schools, shopping facilities, and municipal services, such as street lighting, that service and support the proposed project. Unless the LPA and the community have planned for "total redevelopment"³⁸ and have properly timed the different components of it, the redeveloper may conclude that the carrying costs for the period between the time he completes his project and

³⁵ See *Hearings Before the Subcommittee on Housing of the House Committee on Banking and Currency*, 85th Cong., 2d Sess. 34 *et seq.*, 316 (1958).

³⁶ See *The Businessman's Stake in Urban Renewal*, Architectural Forum, Nov. 1959, pp. 146-47. Also see SEARS ROEBUCK & Co., URBAN RENEWAL DIVISION, CITIZENS IN URBAN RENEWAL (1959), which is an interesting example of the extent to which one major corporation feels an obligation to participate in urban renewal and has urged its executives "to assume a leadership role in the field of urban renewal."

³⁷ This visit should be for the purpose of obtaining information and not for obtaining publicity. The latter type of visit is the more common type of one. See Sullivan, *supra* note 4, at 140-41: "The 'big real estate operator' has become a folk-type. With much fanfare he arrives in the survey city on the invitation of business and civic leaders. He travels rapidly about, 'taking everything in,' and is gone again as quickly as he arrived. But he often leaves behind a more or less concrete suggestion—for example, that a project embracing a convention hall, a hotel and a clutch of luxury apartment houses would be ideal for the area between Main Street and the river."

³⁸ See *infra* p. 174.

the time of the availability of the essential supporting services may undermine the project's economic feasibility. Nothing but personal investigation will uncover whether the LPA has a really effective and coordinated plan for total redevelopment.

At the same time, the availability of the various federal aids for the particular project should be preliminarily checked out. Has the Housing and Home Finance Agency (HHFA) Administrator certified to the FHA, the Urban Renewal Administration (URA), and the Federal National Mortgage Association (FNMA) that federal assistance may be made available for the project?³⁹ Has the area in which the project is located been designated, if necessary, an FHA high cost area?⁴⁰ Federal aids change from time to time, and the redeveloper who is relying upon them should be sure the proposed project will be eligible.

Finally, the redevelopment plan and the general program of land disposition should be thoroughly discussed with the staff of the LPA. The prospective redeveloper's counsel and architect should, in particular, check through the redevelopment plan carefully. Although this is a generalized document, the legal effect of which is still open to question,⁴¹ it often contains zoning or other provisions that become troublesome later on.⁴² The programs of land acquisition, relocation, and demolition should be reviewed to ascertain (a) the probable timing of conveyance of land to the redeveloper, and (b) whether any unusual obligations are to be imposed upon the redeveloper. For example, the unique procedure that has been used by New York City put the full task of site management, tenant relocation, and demolition, as well as redevelopment, on the redeveloper. This did not work well. It gave the irresponsible redeveloper an opportunity to turn a quick profit as a slum landlord,⁴³ and discouraged responsible redevelopers from participation because they did not want to undertake site clearance functions with related problems of tenant relocation.⁴⁴

At the conclusion of his visit to the city, the redeveloper, with his architect, counsel, and accountant, should consolidate the factual information that has been

³⁹ National Housing Act of 1949, § 101(c), 63 Stat. 414, as amended, 70 Stat. 1103 (1956), 42 U.S.C. § 1451(c) (1958). The activities of the Administrator consist of review, approval and certification of Workable Programs, determination that the relocation requirements of Title I of the Act have been met, and certification to the FHA Commissioner of the eligibility of the urban renewal project for mortgage insurance under § 220 of the Act. See 12 HHFA ANN. REP. 29 (1958). Letter No. 32 of the Deputy Commissioner of the FHA, entitled "Policy Considerations in Section 220 Processing," Nov. 13, 1956, states that FHA can rely on certifications by the HHFA Administrator as to the eligibility of a project for section 220 mortgage insurance and that "... reasonable doubts as to acceptability of any aspect . . . including marketability, should be resolved in favor of acceptance of the project proposals"

⁴⁰ Higher mortgage limits are available if an area is designated a "high-cost" area. See *infra* note 131.

⁴¹ See Haar, *The Master Plan: An Impermanent Constitution*, 20 LAW & CONTEMP. PROB. 353 (1955).

⁴² See Goldston & Scheuer, *supra* note 30, at 262, 263.

⁴³ See *The Future of Title I*, Architectural Forum, Sept. 1959, p. 107; Cook & Gleason, *The Shame of New York*, 189 THE NATION 287 (1959).

⁴⁴ It has been suggested that "... the relationship of landlord and tenant . . . [is] the second most passionate relationship known to mankind. It could never have been truer than in the case of tenants being uprooted to make way for new improvements." Hershman, *The How and Why of Title I*, 14 RECORD OF N.Y.C.B.A. 506, 511 (1959).

gathered into an analysis of the economic feasibility of the project.⁴⁵ In this connection, the basic economic health of the city and the region should be checked by the available indices of population and business growth, such as bank deposits, car loadings, and utility company load projections. If the necessary level of rents appears attainable for the project that can be built in the project area, then the redeveloper is ready to delve into the more detailed requirements of the LPA's bidding procedures. The redeveloper may wish to check his conclusions with the local FHA office that is directed to review, in a pre-application processing, the redeveloper's analysis of the project's economic feasibility.⁴⁶

II

PREPARING TO BID FOR SPONSORSHIP OF A PROJECT

As soon as the redeveloper decides to bid for the sponsorship of a particular project, his counsel should meet with counsel for the LPA to discuss in detail the LPA's program for disposition of the project.⁴⁷ The LPA may have its own staff attorney; it may use the city law department; or it may engage an attorney in private practice. In any of these events, the LPA counsel in many cities will thus far have had little experience with land disposition. He will have been busy with the arrangements between the LPA and the federal agencies and with his condemnation work; so that, at best, he may have read through the land disposition sections of the *Urban Renewal Manual*⁴⁸ and annotated his copy of the Guide Form of Contract for Disposition of Land for Private Redevelopment⁴⁹ with changes required by local law or the particular circumstances of the local project. Counsel for the redeveloper should also familiarize himself with these materials. The Guide Form of Contract will be discussed in more detail below; the Manual, revised February 1, 1960, is published by the HHFA and prescribes the federal policies, procedures, and requirements applicable to the LPA's carrying out slum clearance and urban renewal projects under Title I of the Housing Act of 1949, as amended.⁵⁰ Of particular interest to the instant topic is part 14, entitled "Land Disposition." Although this *Manual* is subject to interpretation and revision, it, nevertheless, represents the present policy of the federal government with respect to urban renewal, and it lays down the ground rules within which LPAs and redevelopers may negotiate. In many particulars, the LPA may require more from the redeveloper than the requirements of the *Manual*.

⁴⁵ One way of so analyzing the project is by use of an FHA Form 2013. See *infra* p. 154.

⁴⁶ FHA Operations Letter No. 178, Dec. 12, 1955, p. 7.

⁴⁷ For an excellent review of the functions of an LPA attorney, see Dagen, *Staff Attorney's Role*, 15 J. HOUSING 280 (1958).

⁴⁸ The *Manual* is available to the public through the Superintendent of Documents on a subscription basis. The *Urban Renewal Manual* supersedes the previously issued *Local Public Agency Manual*.

⁴⁹ See note 87 *supra*.

⁵⁰ 63 Stat. 413, 42 U.S.C. § 1441 (1958).

A. Selection of a Method for Land Disposition

The first question that counsel for the redeveloper should cover with the LPA attorney is how far land disposition has, thus far, proceeded. Sometimes the LPA will not have decided what method of land disposal it will use. In the case of land to be used for private redevelopment (and it is only with such redevelopment that this article deals), one or more of the following disposal methods (the first five of which are regarded as disposal under open competitive conditions⁵¹) may be selected by the LPA with the approval of the HHFA:

1. Sealed-bid offering.
2. Public auction.
3. Negotiated disposal under open competitive conditions.
4. Public auction with guaranteed minimum bid.
5. Fixed price offering with bidding on other than price basis.
6. Predetermined-price offering.⁵²
7. Negotiated disposal (under other than open competitive conditions).⁵³

Although all of the above disposal methods have been suggested and approved by the HHFA, the LPA may be subject to state and local as well as federal limitations on the disposal of land. In some states—for example, North Carolina—competitive bidding is required in the disposition of urban renewal land.⁵⁴ In some other states—for example, California—public bidding is not required, but a public hearing is.⁵⁵ The LPA attorney should know if any state or local requirements eliminate some of the federally-approved methods.

If the LPA has not yet chosen among the disposition methods available to it, the redeveloper may decide to try to persuade the LPA to adopt a particular method. Urban renewal is a public matter, and anyone is at liberty to recommend to the LPA how it can best dispose of project land. If, for example, a redeveloper believes that his offer will be the highest land price, he may seek to have the land disposed of by sealed bid or public auction. If, on the other hand, he feels that he has an edge on his competitors on an other-than-price basis, he may strive for a negotiated disposition. Of course, the extent to which the disposition procedure can be tailored to the desires of a particular bidder depends on the state requirements as to competitive bidding techniques in land disposition.

⁵¹ See URBAN RENEWAL MANUAL § 14-3-5.

⁵² Disposal by a predetermined-price offering is a special method intended to be limited to the sale of individual lots in a residential, commercial, or industrial subdivision, or to preferential sales to former occupants and owners.

Land may be offered at a fixed price, with the competition among prospective redevelopers on some other criterion, if this method will contribute significantly to the achievement of an important urban renewal objective such as the production of new housing at lowest possible rents or sales prices. See *id.* § 14-3-4.

⁵³ See *id.* § 14-3-6.

⁵⁴ See N.C. GEN. STAT. § 160-464(b) (1952). States are reluctant to invite a fresh round of constitutionality challenges by making changes in their land disposition statutes, even though they seem restrictive, once such statutes have passed initial court tests of constitutionality.

⁵⁵ CAL. HEALTH & SAFETY CODE § 33268. The hearing is not for the purpose of receiving other bids, but merely to review a proposal already accepted subject to public hearing.

In general, LPAs have found that an award on the basis of the highest price bid for the land works best for routine projects intended for moderate-income tenants where the principal goal is to energize cleared land with some sort of sanitary shelter. For centrally located projects intended to revitalize downtown areas, LPAs have found that the best technique is to fix a land price for all bidders and make the award on the basis of architectural aesthetics and design. Several LPAs have tried to mix land price and design criteria, and in almost every case, this has resulted in confused and difficult award determinations.

If the redeveloper can claim any preference, his counsel should, of course, try to see that appropriate recognition of such claim is provided in the disposition method selected. Thus, a redeveloper might be entitled to a preferential position because he is a dispossessee in the redevelopment project area. Federal law, rules and regulations, and also many state and local laws give preferences of one kind or other to owners or tenants within a project area. The HHFA has established procedures for dispositions at predetermined prices, with preferences given to occupants being displaced by projects of the LPA and to owners who desire to relocate structures within the project area.⁵⁶ Such preferences can be very valuable, and the redeveloper, even though he is not an owner, occupant, or tenant in the redevelopment project area, might decide, if it is proper under the circumstances, to place himself in such a position before the cut-off date established by the LPA or by applicable law.⁵⁷

The redeveloper might also decide to try to persuade the LPA to select him as a sponsor, conditioned upon preparation by his architects of plans for a satisfactory development and subject to ultimate mutual agreement upon land price and a form of land disposition contract. Such an arrangement is classified by the HHFA as a negotiated disposal under other than open competitive conditions. The HHFA permits the LPA to enter into such an agreement with a redeveloper very early in the undertaking of a project, and the agreement may leave the price and perhaps the parcelization of the land for future determination.⁵⁸ The agreement must otherwise

⁵⁶ See URBAN RENEWAL MANUAL § 14-3-6. California, for example, in CAL. HEALTH & SAFETY CODE § 33701, provides that every redevelopment plan shall provide for participation in the redevelopment of property in the project area by the owners of all or part of such property, if the owners agree to participate in the redevelopment in conformity with the redevelopment plan adopted by the legislative body for the area. With respect to each redevelopment project, each agency shall, within a reasonable time before its adoption of the redevelopment plan, adopt and make available for public inspection rules to implement the operation of this section in connection with the plan. In *Fellom v. Redevelopment Agency of City and County of San Francisco*, 157 Cal. App.2d 243, 320 P.2d 884 (1958), *appeal dismissed*, 358 U.S. 56 (1958), it was held that redevelopment may be made without necessity of participation of owners, and that permitting owners of improved property to participate in redevelopment without allowing owners of unimproved property to participate was not unreasonable and discriminatory. The court stated that although the legislature in enacting the Community Redevelopment Law hoped the redevelopment would be possible with the participation and cooperation of the owners of the property within the "blighted" area, it was apparent from the entire law that there was provision for a method of redevelopment without participation by the land owners.

⁵⁷ The right to priority is often not clearly defined. See *Some Crucial Questions Raised in Washington, D.C., Renewal*, 16 J. HOUSING 18 (1959), for instance, where both building owner and tenant sought priority to rebuild a restaurant.

⁵⁸ See URBAN RENEWAL MANUAL § 14-3-6.

be complete and must contain provisions whereby the price (usually the fair re-use value as agreed upon by the LPA with the federal agencies involved) is to be determined by the LPA. The agreement must provide that if the redeveloper does not accept the LPA's determination within a reasonable time, all rights of the redeveloper to acquire the land shall terminate. These termination provisions may reserve for the redeveloper a right to meet, within a specified reasonable time, any price negotiated with another redeveloper that is (a) less than the lowest price at which the land was offered to the initial redeveloper, or (b) not more than five per cent above the best offer previously made by the initial redeveloper.⁵⁹

Although such an agreement is, in effect, nothing more than an agreement to try to agree, it is a very desirable arrangement from the viewpoint of a redeveloper. Under such an arrangement, the redeveloper can save the great effort and expense of competitive bid presentations (with often a great deal of the expense devoted to renderings and other "showpieces" useful only for the competition).⁶⁰ At less cost than a bid presentation, the redeveloper can have his architect work closely with the LPA planning staff in a fairly complete designing job for the particular project.⁶¹ Where an LPA desires or is willing to negotiate with a redeveloper prior to the time that a price for the land is ascertainable and the parcelization thereof is determined, the redeveloper usually will be willing to have his architect undertake such a job because the redeveloper will hope he thereby can get his foot in the door, so to speak, and demonstrate to the LPA that he is fully qualified, financially responsible, and in a position to develop good architectural plans available for immediate use for the particular redevelopment. Even though it is possible that the LPA and the redeveloper ultimately may not agree on price, they will have been put into a working relationship; and if a condition of mutual trust and confidence has been established, the chances are good that the agreement on price will ultimately be reached and a land disposition agreement will be executed. Therefore, if a redeveloper has an interest in a particular redevelopment project in its early stages, he may find it worth the effort to try to persuade the LPA to select this type of disposition.

State or local law may prescribe competitive bidding for some LPAs. Other LPAs may adopt it as the simplest alternative. If the only criterion of selection that the LPA intends to use is the price offered for the land, the auction or sealed bid is, of course, the appropriate method. On the other hand, the goals of the urban re-

⁵⁹ *Ibid.*

⁶⁰ One redeveloper has stated "that a competitive bid presentation may cost from \$35,000 to \$50,000 . . ." and further noted that "even the winner's costly plan is not always used in the final project. . . ." *Builders Tell How Bureaucracy Tangles Renewal*, House and Home, May 1960, pp. 70, 71. Another redeveloper has proposed that where redevelopment competitions are based on design, the "huge cost . . . when it is known in advance that the chance in winning is one in five or ten . . ." should be kept low enough to attract numerous proposals by requiring that "the basis of the competition must be kept simple and presentations must be limited to conceptual plans and simple models. . ." See Editorial, *The City as "End Product,"* Architectural Forum, May, 1960, p. 91.

⁶¹ See DISTRICT OF COLUMBIA REDEVELOPMENT LAND AGENCY ANN. REP. 17 (1959) for a discussion of how a redeveloper, through the medium of a memorandum of understanding, worked up a complete designing job for Washington, D.C.—Project C area.

newal program are not best achieved by a price competition for land that, necessarily, results in higher rents or a less desirable structure for the same rent.⁶² The LPAs generally are aware of this, and in a number of instances, the award has not been made to the bidder offering the highest price for the land. Once it is realized that the FHA and FNMA benefits to which land in an urban renewal area is entitled are more important in facilitating redevelopment than the cost of the land as such, it can be appreciated how shortsighted it is to select a redeveloper primarily on the criterion of land price. This criterion merely awards the whole bundle of federal subsidies to the redeveloper willing to pay the most for them and nullifies much of the modern planning and attractive architecture that the subsidies are intended to encourage. To some extent, the final choice of criteria reflects a three-way tug-of-war between the URA, which is interested in minimizing the federal contribution to "net project cost,"⁶³ the local FHA office, which is interested in avoiding a land price so high that the economic feasibility of the project will be impaired, and the LPA, which wants an adequate land price but also an attractive redevelopment likely to arouse community enthusiasm for the LPA's program. It should be remembered that the federal statute requires that the LPA obtain the fair re-use value of the land, and not necessarily the highest price bid.⁶⁴

In any event, where permitted by state and local law, the method of disposition most often selected has been negotiated disposition under open competitive conditions.⁶⁵ Under this method, negotiations are concluded openly after first issuing

⁶² See Lanigan, *The Problem of Selecting Sponsors and Disposing of Land in Title I Urban Redevelopment Projects*, 14 RECORD OF N.Y.C.B.A. 528, 529, 531 (1959).

⁶³ "Net Project Cost" is generally the difference between all costs of a project to the LPA and the proceeds from disposition of land. This Net Project Cost of an urban redevelopment project is shared by the federal government and the LPA. See URBAN RENEWAL MANUAL pt. 17.

⁶⁴ Note, however, the emphasis on price in HHFA ADVISORY BULL. 7-58, ADVERTISING AND MERCHANTISING URBAN RENEWAL PROJECTS, and the criticism of the URA's attitude on land disposition in Editorial, *The City as "End Product,"* Architectural Forum, May, 1960, p. 91. The statutory requirement is merely that urban renewal land be disposed of "at its fair value for uses in accordance with the urban renewal plan." 63 Stat. 413 (1949), 42 U.S.C. § 1450(c)(4) (1958).

⁶⁵ See *Survey of Urban Renewal Land Disposition*, Real Estate Analyst, Dec. 24, 1959, p. 58, which contains the following table:

TYPE OF SALE

Land Use	Fixed Price	Negotiations	Competitive Bid	Combination of Bidding and Negotiation
Residential	2	19	11	4
Commercial	0	33	5	2
Industrial	0	14	35 (30 in Chicago)	1
Public	3	30	0	1
Semi-public	2	14	0	3
	7	110	51	11

If Chicago's record is taken out of the summary, there would be 104 sales by negotiation and 21 by competitive bidding. Since it is not possible to have competitive bidding on land sold for public use, it may be better to subtract this figure, too, leaving 74 parcels sold by negotiation. Most of the fixed price sales were based on FHA appraisals.

a public invitation for proposals. The invitation for proposals normally establishes, among other things, a cut-off date for the submission of written proposals and the date for publicly announcing the name of each bidder and the amount of his offer. Typical standards and criteria that various LPAs have stated will guide their review and acceptance of a proposal are the following:

1. The degree to which the proposal meets the specifications of the redevelopment plan.
2. The financial responsibility, qualifications, experience, and ability of the bidder to finance and complete the redevelopment.
3. The architectural and planning skills and the ingenuity demonstrated in the proposal; the reputation, experience, and demonstrated ability of the bidder's architects.
4. The economic practicality of the project as proposed by the bidder and the benefit to the community in terms of the sociological, aesthetic, and financial aspects of the proposed project.
5. The price offered in the proposal for the purchase of the property by the bidder, which price must equal or exceed the approved minimum price (which usually is the fair re-use value).⁶⁶
6. The time estimates submitted by the bidder for the execution and completion of his proposed redevelopment project.

B. Typical Bid Documents

When the LPA has selected the disposal method for any parcel or group of parcels, it will then prepare the final bidding and disposition documents. Under a negotiated disposal, a typical set of documents includes the following:

1. Invitation for proposals, including instructions to bidders.
2. Disposition parcel map showing boundaries and dimensions of each area to be offered separately and each area designated in the urban renewal plan for a different use. There usually is indicated on the map, in the invitation to bid or separately, the zoning, the size of each area, usually in square footage, the land use classification of each area, and the proposed or established minimum price for each parcel, usually in square footage. It is becoming more customary for the LPA to indicate the minimum acceptable price (fair re-use value) at the time of its issuance of the invitation to bid. This is usually a price which has been approved by the HHFA and meets the financial requirements of the Loan and Grant Contract between the HHFA and the LPA.⁶⁷
3. Bid form or proposal to purchase real property for redevelopment.

⁶⁶ The minimum acceptable price or fixed price established by an offering shall not be less than the estimated fair value of the land for uses in accordance with the urban renewal plan, and any invitation to bid shall provide that the LPA may reject any or all bids. URBAN RENEWAL MANUAL § 14-3-5.

⁶⁷ The Loan and Grant Contract, which provides for federal loan and grants money to the LPA, presupposes a budget containing a resale price for the land by the LPA sufficient, together with other sources of income and noncash grants-in-aid, to fulfill the LPA's obligation to contribute one-third of the Net Project Cost. See URBAN RENEWAL MANUAL § 17-1-1.

4. Contract for disposal of the land. This will be, or will be patterned after, the Guide Form of Contract for Disposition of Land for Private Redevelopment, which is made available to the LPA by the HHFA for the guidance of the LPA and its counsel in preparing land disposition agreements.⁶⁸ The LPA may, with HHFA approval, add, modify, or omit such of the provisions of the Guide Form as it decides for a particular disposition. These changes should be reflected in the form of contract included in its bid documents and eventually in the contract executed between the LPA and the designated redeveloper.
5. Form of deed. This is a rather elaborate form of deed whereunder the grantee (redeveloper) covenants to comply with the redevelopment plan and the land disposition agreement. The deed may also contain rights of forfeiture, re-entry, and reversion of title reserved by the LPA as grantor in the event of breach of said covenants. If the land is to be leased, there will be, in lieu of a deed, a form of lease containing provisions similar in character to those in the form of deed.
6. Redeveloper's statement of qualifications and financial responsibility.
 - a. Redeveloper's Statement for Public Disclosure, the first part of Form H-6004.
 - b. Redeveloper's Statement of Qualifications and Financial Responsibility, the second part of Form H-6004.

The Redeveloper's Statement for Public Disclosure is to be made public by the LPA before it enters into an agreement or contract for, or "understanding" with respect to, each disposition of project land. The Redeveloper's Statement of Qualifications and Financial Responsibility is for the internal and confidential use by the HHFA and the LPA. The purpose of this statement is to enable the LPA to make a determination, concurred in by the HHFA, that the redeveloper possesses sufficient qualifications and financial resources to acquire and develop the land in accordance with the urban renewal plan.
7. Redevelopment plan. This usually consists of a detailed text and maps describing the project area and the use, building and density controls applicable thereto.
8. Declaration of restrictions. This document contains restrictions, covenants, reservations, easements, liens, and charges required by the LPA to provide adequate safeguards that the redevelopment will be carried out pursuant to the redevelopment plan. There may be included or incorporated by reference various documents containing provisions that, in the opinion of the LPA, should be imposed so that the work of redevelopment will be carried out pursuant to the redevelopment plan. The declaration of restrictions is

⁶⁸ See pt. IV of this article. See Brownfield, *The Disposition Problem in Urban Renewal*, in part I of this symposium, 25 LAW & CONTEMP. PROB. 732 (1960).

intended to be recorded or filed in the land records of the locality, with the anticipation that it will be legally enforceable and that the recording thereof will give constructive notice of its provisions.

9. Miscellaneous. In addition to the above-enumerated documents, the LPA may provide special market analyses, engineering studies of soil conditions, and re-use appraisals. These are meant to assist the prospective redeveloper in arriving at the price that he will offer for the property and in reaching a determination with respect to the kind of improvements that can best insure economic feasibility. If such information is not included in the packet of documents provided to prospective developers, it can usually be obtained upon request. LPAs have often been somewhat coy in furnishing information regarding re-use appraisals. An LPA may be disappointed with the price put upon its property by the appraisers it has retained and may harbor the hope that some redeveloper will pay more. In any event, the redeveloper should, to the extent proper, obtain all information that the LPA (or possibly the local FHA office) has in its possession regarding re-use value of the property.

C. Revision of Bid Documents

Some LPAs will make unofficial preliminary drafts of the bid documents available and solicit comments thereon from prospective bidders. Other LPAs will not release preliminary drafts but, in a more formal procedure, will provide for the amendment of officially issued documents in response to corrections and suggestions received. In either event, the redeveloper, with his architect and attorney, should go over the bid documents with great care and decide what changes to suggest to the LPA.⁶⁹

It has frequently happened that the land use controls contained in the redevelopment plan, in the declaration of restrictions, or elsewhere, are impractical.⁷⁰ For example, a declaration of restrictions may provide for an architectural control committee so organized and constituted as to place an intolerable burden upon a redeveloper. Provision may be made for approval by such a committee of construction plans and specifications prior to the erection or placement of any building, without the establishment of any objective standards to guide the committee. The redeveloper under such circumstances may very well find himself the victim of the whim and caprice of a group of architects lacking objective criteria and with one or more of them unenamoured of the urban renewal program and in disagreement with the economic and social objectives of the LPA.

Counsel should make sure that the architect carefully checks all the documents. The architect might assume that to build in conformity with the redevelopment plan, all he need do is to follow the local building code that has been adopted by the

⁶⁹ See *Randolph v. Wilmington Housing Authority*, 139 A.2d 476 (Del. Sup. Ct. 1958), holding that it is not an unconstitutional delegation of the city council's duty for the redevelopment act to provide that the redevelopment plan may be modified by the LPA with consent of redeveloper.

⁷⁰ Rent control provisions may also be inserted. See discussion *infra*, pp. 146-47.

locality; but if he carefully studies all the bid documents, he may, for example, discover that in the redevelopment plan or the declaration of restrictions, there are limitations on distances between buildings, set-backs, minimum floor areas, population densities, and land coverage that are more strict or in some other way different from the zoning ordinance and building code of the locality.⁷¹

Suggestions for changes are best made while the planning of the LPA is still in the formative stage. This, of course, requires taking an interest in a redevelopment project as early as possible—frequently even several years before the property is offered for sale. It requires the investigation of many projects during their planning periods. A redeveloper can learn of the existence of projects in which he may have an interest by watching the local papers or by obtaining from the HHFA its periodic reports on the status of all current projects.⁷²

D. Good Faith Deposits

In addition to the good faith deposit that the HHFA requires at the time of the execution of a land disposition agreement,⁷³ the LPA may request a deposit at the time of submission of a bid. If this is required in an amount from five to ten per cent of the amount bid for the land, to conform with the amount the successful bidder will eventually be asked to put up as a good faith deposit, it will be a substantial burden to the redeveloper. The redeveloper may well decide not to bid when required to immobilize capital equal to five per cent or more of his offer on the land for six months or more.⁷⁴ The redeveloper may have to invest so much in his proposal in the form of expenditures for architectural plans, sketches, and models, market surveys, and promotion, that he will not want to put up any considerable sum in advance of execution of the land disposition agreement. The redeveloper's attorney should, therefore, try to get the LPA to reduce to an absolute minimum or eliminate the bid deposit, with the requirement that at time of execution of the land disposition agreement, a balance will be deposited to bring the deposit up to five

⁷¹ A case in point is the provision that was contained in a Declaration of Restrictions for a project on a steep hill that required that the garage or carport should be so located on a lot that there existed a distance of twenty feet improved as a driveway between the face of the garage or carport and any sidewalk—or if no sidewalk, then street curb. In this particular project area, there were single-family building lots falling off from the planned roadway at grades of forty per cent and greater, and the restriction could be complied with only if wholly uneconomic amounts were spent for grading. Appropriate changes were made by the LPA when this problem was called to its attention.

⁷² These reports are available in the *Urban Renewal Project Directory*, which is issued periodically by the HHFA. This directory describes all local project areas with respect to which there is outstanding, as of the current date, the Agency's approval for the execution of plans for an urban renewal or demonstration project to be undertaken by a local community with federal financial assistance, as authorized under Title I of the Housing Act of 1949, as amended, 63 Stat. 414, as amended, 70 Stat. 1103 (1956), 42 U.S.C. § 1451 (1958).

⁷³ See *infra* p. 144.

⁷⁴ URBAN RENEWAL MANUAL § 14-3-5 states that the closing date for the receipt of bids shall not precede the date on which the LPA will be able to deliver title and possession by so long a time as to discourage wide participation in the bidding. Also, the time between these dates is not to increase significantly the burdens or risks of the redeveloper. Generally, six months to one year would be considered to be a reasonable maximum.

per cent of land cost. Even this may be too soon. Since, in any event, the URA will require a good faith deposit in connection with the land disposition agreement, the progress of the LPA in land acquisition and clearance should be carefully observed to determine how long it may be after execution of a land disposition agreement before the LPA will be in a position to begin conveyance of land. If it appears that a considerable length of time will transpire, the attorney should seek to have included in the invitation to bid a provision that the LPA will not require that the good faith deposit be put up prior to a certain time (say, sixty days) from the estimated date on which the LPA will be able to convey the land to the redeveloper.

Because of the uncertainty as to the length of time between the making of the deposit and the conveyance of land, whether it be at time of bid or at time of execution of a land disposition agreement, the redeveloper will prefer to supply a surety bond instead of cash or government bonds in order to prevent "freezing" of his working capital. Even if the surety company requires collateral in the form of negotiable securities, this probably will be simpler, more economical, and more flexible than putting up cash or bonds with the LPA.

E. Land Preparation

The redeveloper, in deciding what price to bid for the land, must carefully determine the extent of the LPA's participation in land preparation and the type of cooperation agreements the LPA may have with the city and the utilities serving the project area. The redeveloper's attorney should carefully check such cooperation agreements, and if the agreements have not been executed, he may be able to recommend provisions that would be of benefit not only to all prospective redevelopers, but to the LPA and the project itself. Ordinarily the city or utility companies will bring electricity, water and gas, storm drains, and sewer lines up to the project boundaries. The extent to which such services will be carried into the project area at the cost of the city or utility companies varies considerably. It is extremely important for the redeveloper that he distinguishes between on-site and off-site utility work for which he will have to pay in whole or in part. The FHA will not give credit for off-site work in its mortgage calculations, since the property will not be subject to the mortgage, so the redeveloper will be especially concerned about off-site utility costs.⁷⁵

A standard land disposition agreement will provide for the installation and relocation (by the LPA itself or by appropriate public bodies or public utility companies)

⁷⁵ See 24 C.F.R. § 263.7(b) (1959). See also § 220(d)3(B)(ii) of the National Housing Act, which states that the mortgage may include ". . . the land, the proposed physical improvements, utilities within the boundaries of the property or project. . . ." 72 Stat. 73, 12 U.S.C. § 1715k(d)3(B)(ii) (1958). One redeveloper, for instance, constructed a wall around a number of house lots. The FHA attributed the value of the improvement equally to each house, ". . . so, they would only allow it on the outside houses of the development, and we ended up with some \$2,000 per house more valuation than we could use on the outside houses, and nothing on the inside ones." *Builders Tell How Bureaucracy Tangles Renewal*, House and Home, May 1960, pp. 70, 71.

of such sewers, drains, water and gas distribution lines, and electric, telephone, and telegraph installations (exclusive, in each case, of house or building service lines), as are to be installed or relocated pursuant to the redevelopment plan.⁷⁶ In a normal situation, street paving, installation of gutters, curbs, street lighting, sidewalks, and public rights of way will also be provided by the LPA. The redeveloper should be extremely cautious, however, whenever his design and construction plans call for so-called superblocks. The normal rule requiring the redeveloper to bear the cost of utility lines placed in his private property will result in allocating to the redeveloper a higher than normal share of the total cost of such utilities, since the superblock replaces many dedicated highways with private drives and walks. The distorted cost sharing is more than a matter of allocating lineal feet. Very expensive utility trunk lines, always located in public areas under the traditional grid street layouts, may be placed on the redeveloper's private property in a superblock and charged to him.

In the usual situation, preparation of land for redevelopment by the LPA will include the demolition and removal to grade of all existing building structures and other improvements on the property, including the sufficient breaking up of all basement floors to permit proper drainage and the removal of any debris resulting from such demolition. The land preparation will include removal of all curbs, gutters, sidewalks, utility lines, installations, facilities, and related equipment that are to be eliminated or removed pursuant to the redevelopment plan. In addition, it is customary for the LPA to provide such filling and grading and leveling of the land (but not including top soil or landscaping) as shall be necessary to make it ready for the construction of improvements to be made thereon by the redeveloper.⁷⁷

The redeveloper should be careful to ascertain in what condition the LPA will leave the actual building site. Normally, the LPA will not agree to obligate itself to do any building site preparation work. However, most LPAs will agree to remove all excess earth materials that may have been moved onto any building site, so that no site will be rendered inaccessible or unbuildable. In figuring redevelopment costs, it is important to make sure whether the LPA will provide buildable sites and whether, to conform to FHA valuation practices, the cost of unusual foundation work will be compensated for by a reduction in the price for the land if there are excessive grades or unusual soil conditions.

Subsoil conditions occasionally are a major problem. Some slums are located on good land where older dwellings of the well-to-do were abandoned. Frequently,

⁷⁶ There may be a question with respect to telephone and electric service as to whether the lines in the new development will be required (by the LPA or by the redeveloper's architect) to be run underground rather than on poles. Usually the utility company will not pay for underground wires, or, if it pays anything at all, only that part of the cost of underground service that it would have had to pay for overhead lines.

⁷⁷ Even if the LPA fully performs its obligations as to land preparation, the redeveloper will be misled if he figures usual "ditching cost." Working with the rubble and foundations which underlie a cleared area is more expensive than working with earth. See *Builders Tell How Bureaucracy Tangles Renewal, House and Home*, May 1960, pp. 70, 71.

however, unfavorable locations near swamps, over peat bogs, and the like became sites of shanty towns and squatter colonies that were later surrounded by the city and are now being torn down. Modern construction methods make these areas buildable today, but at an extra cost for foundations. Rather than have each bidder try to calculate the cost of subsoil conditions for himself or hope to trap an unwary bidder who assumes that the existence of previous construction (albeit shanties) evidences good subsoil conditions, the LPA should have borings made and engineering conclusions arrived at by a reputable soil specialist and should make all this data available to all bidders.⁷⁸

III

SUBMISSION OF THE BID

A. Bidding Entity

The entity to submit the bid should be selected with care, since there will not only be legal and tax, but also public relations considerations. For example, even using a name with local connotations for the bidding corporation helps reduce undue municipal xenophobia.

All the detailed technical requirements of the LPA for the bid should be meticulously followed; if there is competition, the rival bidders will search out any technical defect about which to complain. If the bidder is a foreign corporation, it may be required to qualify to do business in the state before submitting its bid (either as an LPA requirement or as a matter of state law). A good many legal problems are simplified if the redeveloper organizes a separate domestic corporation to make each bid. In addition, if a "section 1244 plan" is adopted by the bidding corporation so that its stock will be treated as "small business" stock, the investment in making an unsuccessful bid can be treated as an ordinary loss instead of a capital loss.⁷⁹

Whether disposal is by negotiation under open competitive conditions or purely by negotiation, the selection of a redeveloper will be made on the basis of sundry factors other than the price offered for the land. This means that the selection of the redeveloper will be, in large part, a subjective determination, and, as in the case of a personal injury suit tried to a jury, no one can predict what the result will be. Therefore, if the redeveloper is not a local resident, for some of the same reasons

⁷⁸ URBAN RENEWAL MANUAL § 14-2-2 authorizes expenditures for engineering investigation of subsoil conditions. The FHA may not recognize the full amount of special foundation costs in calculating the allowable mortgage, and such costs (like off-site utility costs), therefore, are of special concern to the redeveloper.

⁷⁹ See Groh, *What to do About Stock of the Small Business Corporation*, 37 TAXES 225 (1959). A "Small Business Corporation" under INT. REV. CODE OF 1954, § 1244 is to be distinguished from a "Small Business Corporation" under *id.* § 1371, which can elect to be taxed as a partnership, and also from a "Small Business Investment Company" organized under the Small Business Investment Act of 1958, 72 Stat. 689, 15 U.S.C. §§ 661-96 (1958), to provide equity capital to small business. One small business investment company has already been organized to provide the technical assistance and capital requirements to corporations formed to undertake redevelopment projects. See proposal of Western Urban Redevelopment Investment Corporation for the San Lorenzo Park project in Santa Cruz, California. See also *infra* notes 176-78.

that a party to an action retains local counsel, serious consideration should be given to joint venturing with a local contractor, developer, or investor. Conversely, if the redeveloper is a local resident, he may seek as a partner one of the redevelopers with a national reputation. In short, the redeveloper should employ every legitimate means to improve his public posture and his image in the eyes of those who are to make the selection. In addition, the redeveloper's staff should take into consideration the preferences of the members of the LPA, its staff, and its consultants in formulating the proposal. The redeveloper's architect may consider the request that he adapt his designs to LPA eccentricities as an insult to his personal integrity and original thinking, but, nevertheless, as in any competitive activity, there is no substitute for victory.

B. Approval of Proposal—Public Hearing

Under HHFA rules, the selection of a redeveloper by the LPA must be approved either (a) by the city council, or (b) by the LPA, without city council approval, but after an advertised public hearing has been held on the proposal to enter into a land disposition agreement with the particular redeveloper.⁸⁰ In some cities, both requirements may be imposed. HHFA concurrence will not be required if a minimum disposal price was concurred in by the HHFA prior to the public offering under one of the competitive methods.⁸¹

Many LPAs, however, will be bound by state and local provisions more restrictive than the federal requirements; and a public hearing and/or approval by the city council of any disposition of land may be necessary. The language of the state and local laws is often somewhat vague as to their requirements for a public hearing and/or approval by the city council; and so counsel for the redeveloper must rely on the LPA counsel, who will generally follow agency custom and the path of caution.⁸²

IV.

UNSUCCESSFUL AND SUCCESSFUL BIDDER

A. Unsuccessful Bidder

If the client is not elected as sponsor, a careful review should be made of the basis of the award. Because sponsor selection is governed by both federal and local law, with many formal bid documents and informal procedures, a disgruntled unsuccessful bidder can often find some minor procedural issue. In addition, there are often untested constitutional questions. A shotgun attack made on the legality of

⁸⁰ URBAN RENEWAL MANUAL § 14-4-1, at 5.

⁸¹ URBAN RENEWAL MANUAL § 14-3-5. Under disposition methods providing open competitive conditions, including negotiated disposal, the LPA may accept (a) a bid of the governing body of the LPA, or (b) if the LPA is the municipality, a bid of the municipality if the governing body of the locality adopts a resolution authorizing the acceptance of the bid or proposal. URBAN RENEWAL MANUAL, § 14-3-3.

⁸² See *supra* note 55; Note, *Urban Renewal: Problems of Eliminating and Preventing Urban Deterioration*, 72 HARV. L. REV. 504, 513 *et seq.* (1959). Hearings, even though not required, may be useful in attaining public acceptance. Goldston & Scheuer, *supra* note 30.

everything from the enabling legislation to the letter of award will, if made without real grounds, be poor public relations for the local redeveloper, whose fellow citizens will blame him for all project delay,⁸³ and even worse public relations for the national redeveloper, who will be regarded as a troublemaker in other cities. As a practical matter, courts are not likely to review the propriety of an award where the LPA carefully reserves the right to make the award on any of a number of financial, design, bid price, and other grounds;⁸⁴ but where sponsorship seems to have been awarded on dubious grounds, an attack may be justified and successful. In one instance, the award by an LPA has even been attacked in a suit brought by the Board of Selectmen (city council).⁸⁵

B. Successful Bidder

If his client is selected as sponsor, counsel must promptly work out with the LPA, subject to federal agency approval, a land disposition agreement. An outline or model form of the agreement often will have been included with the bid documents,⁸⁶ and usually it will have been tailored from the Model Contract for Disposition of Land for Private Redevelopment, which was developed by an HHFA task force (chairmanned by Herman I. Orentlicher, Professor of Law, George Washington University) for guidance of both federal agencies and LPAs.⁸⁷ This document is, in general, a reasonably satisfactory model. It need not be followed in detail; the LPA may add, modify, or omit substantive provisions to adapt it to a particular disposal.⁸⁸

One recurrent problem with land disposition agreements is that LPAs and the draftsmen of the Model Contract, in their anxiety to be sure that covenants will run with the land, try to make them enforceable by neighboring land owners, the LPA,

⁸³ The threat of such a suit will concern the agency because it may seriously delay the project by impairing the land title available to the successful sponsor. *Asch v. Housing and Redevelopment Authority of City of St. Paul, Minn.*, 97 N.W.2d 656 (Minn. 1959), was filed to block a commercial redevelopment, but it also delayed a contiguous residential development for more than three years.

⁸⁴ The possible grounds of award are almost unlimited when planning and design factors are considered. See *St. Louis Ready to Approve Project Beside Saarinen's Arch; His Views Unrecorded*, *Architectural Forum*, June 1960, p. 5, for an instance where detraction from the aesthetic effect of a proposed new national monument is an important factor and the National Park Service has been concerned with the award.

⁸⁵ See *Town of Brookline v. Hickey*, Equity No. 69066, Norfolk County (Mass.) Super. Ct. (1959). See also *Brookline's Lost Opportunity*, *Architectural Forum*, June 1959, p. 9; *Tempest Brews Over Renewal Bidding Results in Brookline*, 16 J. HOUSING 207 (1959).

⁸⁶ In any event, the LPA will have submitted a draft of the proposed land disposition agreement to the regional HHFA office prior to soliciting bids. See URBAN RENEWAL MANUAL § 14-2-3, at 1.

⁸⁷ The Model Contract (officially known as "URA, Guide Form of Contract for Disposition of Land for Private Redevelopment, Sept. 1957") is reprinted with a few critical comments in HAAR, *op. cit. supra* note 8, at 559 *et seq.* It is also reproduced in 6 AM. JUR. LEGAL FORMS § 768, at 75 (Cum. Supp. 1959). Both HHFA and FHA have approved the model form as conforming to the requirements of title I. See also Brownfield, *The Disposition Problem in Urban Renewal*, in part I of this symposium, 25 LAW & CONTEMP. PROB. 732 (1960).

⁸⁸ Deviations from the Model Contract must be cleared by the LPA with the HHFA and, if residential redevelopment is involved, with the FHA. URBAN RENEWAL MANUAL § 14-2-3, at 3.

and even "the community."⁸⁹ The intended effect is to make all restrictions—*e.g.*, the redevelopment plan, building codes, and zoning ordinances—into covenants that run with the land. The best approach for the redeveloper's counsel is to try to keep the topics covered by such covenants within reasonable limits⁹⁰ and to make sure that someone has final authority to agree upon changes in the land disposition agreement, perhaps by a provision that the LPA can act for and bind all parties entitled to enforce the covenants.⁹¹ This is particularly important because many LPAs find great satisfaction in immediate recordation of any and all documents that the filing official will accept, and this "overrecordation" of redevelopment plans, city council resolutions, disposition agreements, and lengthy deeds repeating provisions of the earlier documents results in land titles that sometimes defy simple statement.⁹² There really is no reason in most states why anything more should be recorded than a generalized declaration of restrictions and a deed with appropriate covenants.⁹³

If the city's Workable Program⁹⁴ is not sufficient to keep the redeveloped area from deteriorating again, the answer would seem to be improvement of the codes in the Workable Program rather than detailed continuing supervision of the redeveloped area by the LPA. In this connection, the land disposition agreement should expressly require the LPA to take, or have taken, whatever action is needed to conform zoning ordinances, building codes, and other municipal restrictions to the redeveloper's construction plans as approved by the LPA. The relationship of such municipal controls to the redevelopment plan usually is not clear.⁹⁵

Occasionally, an LPA will insist on unreasonable covenants, despite the HHFA policy that "the disposal agreement must be drafted to safeguard the interests of the project without burdening a redeveloper with unnecessary risk or obligations that might impair the marketability or value of the land or the ability of a redeveloper to obtain financing."⁹⁶ Such unreasonable covenants may well be invalid as restraints on alienation or on marketability. Nevertheless, once recorded, they are troublesome until judicially extinguished because of the fine distinction drawn by many courts

⁸⁹ See Ascher, *Private Covenants in Urban Redevelopment*, in COLEMAN WOODBURY (Ed.), *URBAN REDEVELOPMENT: PROBLEMS AND PRACTICES* 221 (1953). The possibly vulnerable position of a redevelopment agency as assignor of a right of re-entry has been noted in HAAR, *op. cit. supra* note 8, at 593 n.2.

⁹⁰ In one city, a planner with an abhorrence of "flashing neon signs" has insisted that a provision against them go in as a perpetual deed covenant.

⁹¹ See HAAR, *op. cit. supra* note 8, at 564 nn. 21-22.

⁹² In one city, the recordation of a series of conflicting master plans and redevelopment plans has resulted in hopelessly confused land restrictions that will probably require entirely new plans recorded as amendments to the original plans. See HAAR, *op. cit. supra* note 8, at 560 n. 10.

⁹³ See URBAN RENEWAL MANUAL § 14-2-3, at 1-2, which requires sufficient recordation to give constructive notice. See HAAR, *op. cit. supra* note 8, at 560 n.10.

⁹⁴ See URBAN RENEWAL MANUAL § 2-1. See also Rhyne, *The Workable Program—A Challenge for Community Improvement* in part I of this symposium, 25 LAW & CONTEMP. PROB. 685 (1960).

⁹⁵ See Goldston & Scheuer, *supra* note 30, at 262 *et seq.*; HAAR, *op. cit. supra* note 8, at 233-34 n.2.

⁹⁶ See URBAN RENEWAL MANUAL § 14-2-3, at 3.

between invalidity and unenforceability,⁹⁷ and because of the murky substantive rules on the validity of restraints and on changed circumstances as a grounds for extinguishment.⁹⁸

Another drafting difficulty is the "antispeculation" provisions contained in most land disposition agreements and suggested by the Model Contract. In the construction of a large project, the land will usually be parcelized and title to each parcel will be taken by an entity affiliated with the redeveloper (a subsidiary, for example), but seldom will it be taken by the redeveloper in his own name. Appropriate provisions should be worked into the land disposition agreement to permit this. (A related difficulty is that the language of some antispeculation provisions may not permit sale at a profit by the redeveloper to a management-type cooperative corporation, independent from the redeveloper, under a contract made prior to completion of construction, as must be done under section 213 of the National Housing Act.)⁹⁹ Land intended for commercial and industrial redevelopment should not be subject to the same antispeculation provisions as land intended for residential projects. Commercial and industrial tenants often insist on direct ownership, sale and leaseback, or other financing arrangements inconsistent with title retention in the redeveloper through completion of construction. Such devices as a lease from the redeveloper with an option for the occupant to buy at completion have been used to meet the needs of commercial and industrial occupants, but the problem would be better handled by adequate flexibility in the land disposition agreement.

Antispeculation provisions also usually restrict the transfer of stock without the prior approval of the LPA. In order to facilitate estate planning by the redeveloper as well as arrangements between him and outside investors who may want equity as well as debt in the project, it is advisable to provide in the land disposition agreement for transfer of stock without LPA approval, so long as the redeveloper retains control of the corporation.

The LPA is required by statute to obligate the redeveloper ". . . to begin within a reasonable time any improvements on such property required by the urban renewal plan,"¹⁰⁰ and HHFA policy is to state times in the land disposition agreement that are short enough to avoid procrastination and holding the land for speculation, but not so short as to be impractical.¹⁰¹ Bringing these generalities down to specifics is

⁹⁷ See *Strong v. Shatto*, 45 Cal. App. 29, 36-37, 187 Pac. 159, 162-63 (1919), *overruled by Hess v. County Club Park*, 213 Cal. 613, 2 P.2d 782 (1931); see also *Marra v. Aetna Construction Company*, 15 Cal.2d 375, 101 P.2d 490 (1940); cf. *Shelley v. Kraemer*, 334 U.S. 1 (1948).

⁹⁸ See *Dumport's Case*, 4 Coke 119b, 76 Eng. Rep. 1110 (K.B. 1578); I JOHN WILLIAM SMITH, A SELECTION OF LEADING CASES ON VARIOUS BRANCHES OF THE LAW 32 (11th ed. by T. W. Chitty, J. H. Williams & Herbert Chitty, 1903); and CHARLES E. CLARK, REAL COVENANTS AND OTHER INTERESTS WHICH "RUN WITH LAND" (2d ed. 1947). Ascher queries whether a constitutionally unenforceable racial restriction in a deed makes title unmarketable. See Ascher, *supra* note 89, at 227-28 n. 8. See also HAAR, *op. cit. supra* note 8, at 635 n. 4.

⁹⁹ National Housing Act, § 213, 71 Stat. 297, 12 U.S.C. § 1715c (1958).

¹⁰⁰ National Housing Act of 1949, § 105(b)(ii), 63 Stat. 413, 42 U.S.C. § 1455 (1958). See HAAR, *op. cit. supra* note 8, at 563 n. 18.

¹⁰¹ URBAN RENEWAL MANUAL § 14-2-3, at 3.

usually one of the more difficult parts of negotiations with the LPA. The LPA, faced by public pressures to see the job done, is likely to think in terms of how rapidly is physical construction possible; while the redeveloper thinks of phasing the physical construction to the likely rate of market absorption of new housing units, to the most economical rate of physical construction, to the most effective turnover of his funds, and so on. A frequently used realistic compromise for residential areas is to require fairly prompt application by the redeveloper for FHA mortgage insurance guarantees, but to permit construction to be timed by the local FHA in its phasing of the issuance of its commitments.

Current URA policy permits the redeveloper's performance to be secured by a corporate surety performance bond in an amount equal to five to ten per cent of the estimated fair value of the land, instead of by a cash deposit.¹⁰² The redeveloper will want to use a bond,¹⁰³ and counsel should check during the drafting stage to make sure that the conditions of release will be satisfactory to the bonding company,¹⁰⁴ since the LPAs sometimes fail to appreciate the necessity of precisely stating the surety's obligations and attempt to insert provisions that corporate sureties will not bond. In many instances, LPAs overreach in specifying the consequences to the redeveloper of default, not realizing that such overreaching may create an unenforceable penalty instead of an enforceable liquidation of damages. It is not generally appreciated that a forfeiture provision may be held to be a penalty even if exacted by a government body,¹⁰⁵ agreed to willingly by the private party,¹⁰⁶ supported by cash deposit or surety bond,¹⁰⁷ and appropriate for many, but not all, events of default.¹⁰⁸ In several instances, agencies have refused to scale down the default forfeiture in proportion to the land purchased, even though a forfeiture directly proportioned to nonperformance is the surest way to establish the validity of the forfeiture as a liquidation of damages.¹⁰⁹

In general, the performance bond provisions should excuse—and current URA policy is to approve the excuse of—the redeveloper if, despite diligent efforts, he is unable to obtain FHA mortgage insurance guaranties (and, sometimes, FNMA mortgage purchase commitments).¹¹⁰ It is almost impossible to proceed with most

¹⁰² *Ibid.*

¹⁰³ See pt. II(D), *supra*.

¹⁰⁴ The corporate surety must be listed in Circular 570 of the Treasury Department.

¹⁰⁵ *Priebe Sons v. United States*, 332 U.S. 407 (1947).

¹⁰⁶ *Ibid.*

¹⁰⁷ RESTATEMENT, CONTRACTS § 340 (1932); *Fidelity & Deposit Co. v. Walker*, 75 F.2d 115 (5th Cir. 1935).

¹⁰⁸ RESTATEMENT, CONTRACTS § 339, comment (i) c (1932). See generally 5 ARTHUR L. CORBIN ON CONTRACTS ch. 58 (1951); 3 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS ch. 28 (1936); RESTATEMENT, CONTRACTS § 339 (1932).

¹⁰⁹ See Dunbar, *Liquidated Damage Clause—When to Use and How to Draft*, 20 OHIO ST. L.J. 221 (1959).

¹¹⁰ See URBAN RENEWAL MANUAL § 14-2-3, at 4, which states: "A disposal agreement may permit the redeveloper to terminate the agreement and recover his good-faith deposit if, after preparing satisfactory plans and making a diligent effort to obtain financing, he is not able to secure financing for the redevelopment on a basis that generally would be regarded as satisfactory by builders and real estate developers. For a residential redevelopment, satisfactory financing may be defined to mean an FHA commitment in the full amount permitted by law under Section 220 of the National Housing Act."

projects in the absence of such federal aid, and the LPA relieves the local FHA and the FNMA of public pressures to cooperate if it makes their noncooperation irrelevant to the redeveloper's duty to proceed. In several cities, redevelopers who agreed to unconditional performance bonds have, nevertheless, been excused when federal aid was not available on the original terms. The principal difficulty with unrealistic performance requirements is that the least experienced bidders are most likely to fail to appreciate the problems and, in a Gresham's law of bidder competition, force all the bidders to offer an unsound provision.¹¹¹

A matter of great importance in the contract is the clear specification of redeveloper versus LPA responsibility for demolition and site preparation.¹¹² If the LPA is an agency independent of the municipality, it often will have entered a cooperation agreement with the city, spelling out responsibility for the cost of driveway curb cuts, land compaction, etc. Cooperation agreements may also exist with both publicly and privately owned utilities.¹¹³ One tricky item is the responsibility for tree lawns. The FHA will regard tree lawn expenditures (including underground sprinklers) as "off-site" and, therefore, nonmortgageable; thus, the redeveloper is greatly interested in getting the city to prepare the tree lawns.¹¹⁴ All these site preparation provisions should be carefully reviewed with the redeveloper's architects, and counsel should make sure that the construction contracts leave no gap between where the city stops site preparation and the contractor starts construction.¹¹⁵ If several redevelopers are working in the same area, the various land disposition agreements should permit the city to coordinate grades, ditches, sidewalks, and the like, so that in neither design nor expenditure will there be lack of coordination and waste.¹¹⁶ Counsel for the redevelopers might well initiate, to the extent feasible between competitors, an exchange of information as to common title problems, legal descriptions of contiguous properties, etc. In some instances, joint action by several redevelopers may be required to obtain appropriate zoning for any one of them.¹¹⁷

An important title problem is to provide for recordable certificates from the LPA

¹¹¹ Cf. Farber, *Development by Shoppers*, Architectural Forum, Feb. 1960, p. 172: ". . . responsible and successful developer-investors . . . avoid redevelopment work because they have had experiences where they did considerable preparatory work, only to find themselves bidding against impetuous amateurs. Amateurs can outbid the professionals."

¹¹² In examining the site-preparation provisions, the redeveloper's architect should check the FHA requirements as to fills and grading in FHA's *Minimum Property Standards Manual*. A particular problem is the depth below the subgrade of paved areas and below finish grade of lawn areas to which the tops of existing foundations must be demolished.

¹¹³ See II(E), *supra*.

¹¹⁴ See note 75 *supra*.

¹¹⁵ Subsoil conditions are an important consideration. LPAs cannot build extra foundations, but some disposition contracts provide for a price adjustment if borings disclose abnormally poor subsoil conditions. See note 78 *supra*.

¹¹⁶ In one city, one redeveloper's grading poured the rain water into the contiguous parking lot of another redeveloper, and paths of the two projects completely failed to meet along the common boundary of the projects. It is difficult for two bidders to adjust from the competition for the award promptly enough to coordinate planning unless the LPA takes an active role.

¹¹⁷ See Goldston & Scheur, *supra* note 30, at 256.

evidencing with finality compliance by the redeveloper with all conditions that might result in reverter or title default.¹¹⁸ Each parcel owned by a separate entity should stand on its own feet for default and completion purposes, since it will be almost impossible to sell or refinance individual parcels interlinked by default provisions with other parcels. In any event, the FHA will almost always insist on this where its mortgage guarantees are involved. The various progress reports to the LPA should be terminated upon issuance of the completion certificates, as should most of the LPA's visitatorial rights. There is a tendency of some LPAs to seek a right of permanent overseeing that violates the theory that, after completion, the project should be treated like any other privately owned real estate. A related problem is that some LPAs try to make the project subject to all future amendments of the redevelopment plan, whether or not agreed to by the owner.¹¹⁹

In a few instances, LPAs may try to shift responsibility for policing the land to the redeveloper prior to conveyance, even though this creates problems for the redeveloper with which the LPA is far better equipped to cope. Also, the redeveloper should not be required to pay for and take title to the land until he is ready to use it. Since the LPA is more interested in construction than in penalties, it should hesitate to convey the land until it is sure the redeveloper is fully ready to proceed. In the event of default, no reverter clause will immediately give as good title (and thereby ability to select promptly a new redeveloper) as the LPA will have if it retains the title.

The contract should give the redeveloper freedom in selecting entities (corporations, partnerships, trusts, or individuals) to redevelop particular parcels so long as the redeveloper remains liable for full performance. The complex financial and tax considerations involved in obtaining equity funds for real estate development¹²⁰ should be recognized by giving the redeveloper full freedom to make equity investment in the project as attractive as possible. Since the URA will permit leasing as a method of disposition, the contract also should contain provisions permitting this.¹²¹ Sometimes leasing, even with an option to purchase, creates financing difficulties, and counsel should be sure the leasing provisions meet FHA requirements for leasehold mortgage guarantees.¹²²

Occasionally, LPAs try to insert rent limitation clauses and other inappropriate, short-lived, provisions in the land disposition agreement. The FHA rules on rent

¹¹⁸ Provision is made for this in the Model Contract. See para. 4.

¹¹⁹ See HAAR, *op. cit. supra* note 8. See also § 5(A), p. 17, of Santa Cruz proposed form of Land Disposition Agreement, San Lorenzo Park Development Project, Santa Cruz, California.

¹²⁰ See Berger, *Real Estate Syndication: Property, Promotion, and the Need for Protection*, 69 *YALE L. J.* 725 (1960).

¹²¹ See Comment, *Long Term Leasing in Urban Renewal: An Alternative Method of Municipal Land Disposition*, 68 *YALE L. J.* 1424 (1959). See also Brownfield and Rosen, *Leasing in the Disposition of Urban Renewal Land*, *supra* p. 37; in some instances, state law may prevent or limit the use of leasing in disposition.

¹²² *Id.* at 1432, 1450, 1452. One recurrent problem has been how the early call premium of LPA bonds (issued to finance the leasehold) is to be paid if the mortgagor-lessee (or mortgagee after default) exercises an option to purchase the land.

will be sufficient control so long as there is an FHA-guaranteed mortgage outstanding. The FHA rent ceilings are flexible, since they are based upon actual construction and operating costs. Fixed dollar rentals, such as are occasionally inserted in redevelopment plans or are proposed for land disposition agreements, are too rigid. Since the agreement will be recorded and difficult to amend, all irrelevant and immaterial items should be resisted.

When the LPA and redeveloper have finally agreed on the form of land disposition contract, it will be submitted by the LPA for review and approval by the URA, which, in turn, will arrange for FHA review and approval.¹²³ The redeveloper should make certain that the form of land disposition agreement has been reviewed by the attorneys of the FHA and the FNMA offices having jurisdiction over the project and that they are satisfied with it. This is important because once recorded it will appear in the title that these attorneys will review, and they may raise more detailed questions on title that were not considered by the HHFA, whose review will have concentrated on whether the document conforms to HHFA land disposal policies and protects the federal financial interest in the project.¹²⁴

V

PREPARING FOR COMMENCEMENT OF CONSTRUCTION

Following the award and prior to commencing construction, the redeveloper must reanalyze his earlier determination of the economic feasibility of the project by obtaining final construction and operating costs figures from an advisory triumvirate consisting of his accountant, his architect, and, if he himself is not a builder, from his general contractor. The accountant, who is normally in the full-time employ of the redeveloper, must schedule (on FHA forms, if FHA financing is to be used) the accumulating cost data that the architect and general contractor produce as plans and specifications are finalized and subtrade bids are firmed up. During this period, the lawyer will supply information on real estate taxes pertaining to the project, will determine the applicable sale and use taxes on the construction, and will work out the final form of the contractual relationships between the redeveloper and the architect and general contractor that may to advantage have already been covered in general terms. Even if the redeveloper is a builder, the lawyer will have to work out, for FHA purposes, the relationship between the redeveloper *qua* redeveloper and the redeveloper *qua* general contractor.

A. The Architect

The redeveloper, prior to the award, normally has employed or used an architect. In fact, in urban renewal projects, unlike many other construction projects, he has

¹²³ See URBAN RENEWAL MANUAL § 14-2-3, at 2. This review will not be limited to form, but may question the reasonableness of any concessions the LPA may have traded out with the redeveloper and will pick up such small points as agreement by the LPA to pay for the federal tax stamps on the deed consistent with municipal policy rather than putting this small (\$1.10 of tax per \$1,000.00 of purchase price) cost on the redeveloper as required by the URBAN RENEWAL MANUAL § 14-2-3, at 4.

¹²⁴ See URBAN RENEWAL MANUAL § 14-2-3, at 3.

probably employed several architects. He will have required a local architect for some of the same reasons he required a local lawyer—not only his knowledge of the locality's building and fire codes, but also his knowledge and acquaintance with local officials. It is in the administration of building and fire codes and other local regulations covering construction that law in action differs from law in theory. In addition, the redeveloper may have hired an architectural firm experienced in city-planning, because in a huge project, considerations of such planning are more important than simple site-planning. Finally, because of the low percentage of ground coverage permitted by most redevelopment plans (frequently twenty-five per cent coverage or less), the significance of a landscape architect becomes much more important. Exedra, gates, lawn furniture, playgrounds, and other forms of so-called "street furniture" must be designed to break up the monotony and make use of the large, open areas.¹²⁵ It is likely that all these architectural services prior to award will have been performed on the basis of oral or informal letter agreements, and not on the same fee basis as will be worked out in the event the redeveloper receives the award. It is unlikely that the redeveloper will want to go to the trouble and expense of working up detailed architectural contracts prior to the project award.

If conventional financing is to be used, the contract with the architect negotiated subsequent to the award will probably be embodied in agreements substantially in the standard A.I.A. form.¹²⁶ If FHA-insured financing is used, the arrangements with the architect will have to comply with FHA requirements. The first FHA question is whether the architect is "dependent" or "independent" according to FHA regulations, since the FHA classification affects the amount of the fee allowable by the FHA for architectural services and the times and percentages of payment. The principal difference is that the architect who is not "independent" may not, under applicable FHA regulations, continue to act in that capacity once construction has begun.¹²⁷

Since the FHA requires that each mortgage parcel be independent of all other mortgage parcels in contractual obligations and also prescribes a form of architectural contract that assumes a single architect, the redeveloper will find that it simplifies his FHA processing if his bidding corporation makes an over-all contract with a single architect in which that architect agrees to make separate agreements with each mortgagor and further agrees to assume payment to other architects and engineers employed by the redeveloper. The contracting architect, of course, will expect the redeveloper to make such arrangements as will assure him that he will "net-out" his agreed fee.¹²⁸ The FHA has a schedule of allowable architectural fees that de-

¹²⁵ See *Redevelopment Progress Reported from Here, There, Everywhere*, 15 J. HOUSING 94 (1958). Redevelopment plans in nine cities include "street furniture" and other touches. See Halprin, *Landscape Between Walls*, *Architectural Forum*, Nov. 1959, p. 148.

¹²⁶ See AIA, *STANDARD CONTRACT FORMS AND THE LAW* (1954).

¹²⁷ See *infra* p. 163.

¹²⁸ FHA forms of mortgagor-architect contracts provide that "all other agreements between the parties" are void (see para. 2 of FHA forms); but this should not affect the over-all contract between the redeveloper and the contracting architect, since the redeveloper is not "a party" to the FHA form of contract.

creases as the total cost of the project increases. One problem here is whether or not the total cost of the mortgage parcels will be lumped together for purposes of determining the allowable fee or whether each parcel will be treated independently. Payment to the architect under his employment contract should, if possible, be made in installments tied to the FHA architectural reimbursement schedule.¹²⁹ Since architects, however, have not taught their families to require food and clothing coincidental with FHA time schedules, it may be necessary for the redeveloper to agree upon a different and earlier schedule of fee payments, reimbursing himself for such advance payments from the mortgage proceeds when the same are eventually received.

Counsel for the redeveloper should impress upon the architect the essentiality of checking and rechecking his plans and specifications against the numerous requirements that must be complied with—the redevelopment plan, declaration of restrictions, and land disposition contract that relate to the particular project, as well as the general municipal restrictions, such as the building, zoning, and fire codes. It is also of utmost importance that the architect be familiar with the FHA's minimum property standards, particularly the room-count criteria for multifamily projects (three or more living units), since there is a per room or per unit mortgage insurance limit, as well as a mortgage insurance limit based on percentage of replacement cost.¹³⁰ The economic feasibility of the project will depend in large measure on the redeveloper's ability to build with respect to each mortgage parcel for no more than the FHA's estimate of replacement cost and to obtain a loan equal to the maximum percentage of replacement cost—*i.e.*, ninety per cent.¹³¹ It may also depend on the redeveloper's ability to build each mortgage parcel within the FNMA per unit limitations if he intends to use the FNMA for permanent financing. Unless the architect is careful, the FHA's room-count limitations may produce a mortgage less than said percentage. In many instances, the room count can be increased by the simple and inexpensive devices of putting a partition between the living room and dining area of a unit, or providing a balcony or patio.¹³² In short, the architect's function

¹²⁹ See *infra* note 194.

¹³⁰ See FHA, MINIMUM PROPERTY REQUIREMENTS FOR PROPERTIES OF THREE OR MORE LIVING UNITS (rev. ed. 1942).

¹³¹ 24 C.F.R. § 263.6 (1959) specifies that § 220 commitments may not insure mortgages in excess of \$2,500 per room (or \$9,000 per unit if the number of rooms in the project does not equal or exceed four per unit). If elevator-type structures are to be built, the per room figure is increased to \$3,000 and the unit figure, in the event the number of rooms in the project does not equal or exceed four per unit, is increased to \$9,400. In areas for which the Commissioner finds construction cost levels so require, the per room allowance, without regard to the number of rooms per family, may be increased by \$1,250. The maximum insurable mortgage amount, over-all, is \$12,500,000. 24 C.F.R. § 263.7 (1959) imposes a second limitation—the mortgage to be insured shall not exceed 90% of the Commissioner's estimated replacement cost of the project. Replacement cost valuation precludes the FHA from taking into consideration, when valuing the proposed project, the character of the surrounding neighborhood and other factors that in a redevelopment area would normally depress the market price between a willing seller and purchaser.

¹³² It has been suggested that the FHA room count regulations are a primary determinant in the architectural planning of apartment houses. See Miller, *The Rise in Apartments*, *Architectural Forum*, Sept. 1958, pp. 105, 106-07. In August 1960, the regulations were changed to reduce the room count for

in an FHA-insured project is to design and redesign the project with frequent consultations with the FHA, to the end that the redeveloper's cost of the project and the FHA's estimate coincide and the statutory maximum mortgage is obtained.

B. General Contractor

If the redeveloper does not act as his own general contractor and has no other relationship with his general contractor except the employment of him to construct the project, the prime construction contract will differ from the customary general contract of the building trade in four principal ways. First, it will be carefully intermeshed with the land disposition contract, so that there will be no gaps between what the LPA must do to prepare the site and what the general contractor must do in his construction.¹³³ (It may very well be that both the LPA and the redeveloper can save considerable money by using the same contractor or contractors, engineers, and architects on land preparation work, or at least make arrangements for their work to be coordinated from the outset.) Second, the payments to the contractor and certifications required from him must be tailored to FHA requirements, if FHA financing procedures are to be used. Third, partly because it is within the control of the general contractor to foresee and avoid certain risks and partly because the redeveloper desires to be assured that the general contractor has double-checked his plans and specifications, the redeveloper will want the general contractor to assume the responsibility for increased costs attributable to subsoil conditions, architectural mistakes, and, if federal financing is anticipated, FHA change orders required by the FHA once construction has begun.¹³⁴ Fourth, as was true of redeveloper's arrangements with the architect, his arrangements with the general contractor should, if FHA insurance is to be used, provide that the general contractor will execute separate construction contracts with each mortgagor.¹³⁵

If the redeveloper does act as his own general contractor or has certain relationships with his general contractor, the FHA may determine that an "identity of interest" exists between them. In many instances, such a determination may be beneficial to the redeveloper. The National Housing Act provides that the FHA replacement cost estimate of the mortgage unit shall include an allowance for a builder's and sponsor's profit, and risk fee of ten per cent of all includable costs balconies from ½ a room to ¼ a room. In many cases, FHA officials felt, balconies had been added to some projects only because they raised the allowable mortgage ceiling by more than their actual cost. See *New FHA Room Count Rules Give Major Boost to Apartment Building Mortgage Limits*, Architectural Forum, Sept. 1960, p. 5.

¹³³ See *supra* p. 145.

¹³⁴ The A.I.A. Standard Form of General Conditions, used by the FHA and incorporated in the FHA form of contract and customarily followed in the building industry, places the risk of subsoil conditions on the redeveloper. See A.I.A., GENERAL CONDITIONS OF THE CONTRACT FOR THE CONSTRUCTION OF BUILDINGS form A2, art. xv (Sept. 1951).

¹³⁵ If the redeveloper is in a position to procure air-conditioners, medicine chests, etc., at a lower price than the local general contractor (perhaps, because, he is a national redeveloper with numerous projects under construction using such items), he may wish to reserve the right in these construction contracts to supply such items against appropriate credits. If the A.I.A. Standard Form of General Conditions is used, this will require a revision of art. IX of said General Conditions.

except land, unless the FHA Commissioner certifies that such an allowance is unreasonable.¹³⁶ However, this is limited by FHA regulations that provide that where there is no "identity of interest" between the mortgagor and general contractor, there shall be included in the replacement cost estimate an allowance for builder's and sponsor's profit risk fee equal to ten per cent of all items entering into the term "actual cost" *except* amounts paid by the mortgagor to the general contractor under the construction contract and for the cost of land.¹³⁷ Lack of "identity of interest" may have the effect of reducing the mortgage and could increase the redeveloper's cash equity requirements.¹³⁸ It is the responsibility of the director of the local FHA insuring office to determine from the information provided if any such "identity of interest" exists. It has been determined that an "identity of interest" does exist if the redeveloper or mortgagor is a member of a joint venture with the general contractor or owns stock of the general contractor.

Once the contract with the general contractor has been executed and subtrade bids obtained, a payment and performance bond¹³⁹ for each mortgage parcel, in form satisfactory to the mortgagee, redeveloper, and the URA, must be obtained by the general contractor. If FHA financing procedures are to be utilized, the bond must follow the form of the FHA "dual obligee" and must name the mortgagor, mortgagee, FHA, and LPA as obligees.¹⁴⁰ The cost of the bond is a mortgageable cost item for FHA purposes.

Occasionally, a supplemental arrangement with the general contractor may be required to cover work done on the project site prior to the recordation of the construction loan mortgage. Either public relations or weather considerations may require this. Sometimes the mayor or the LPA, faced with public predictions of a

¹³⁶ National Housing Act of 1949, § 220(d)(3)(B)(ii), as amended, 68 Stat. 596 (1954), 12 U.S.C. § 1715k(d)(3)(B)(ii) (1958).

¹³⁷ 24 C.F.R. § 263.9c(b) (1959).

¹³⁸ National Housing Act of 1949, § 220(d)(3)(B)(ii), as amended, 68 Stat. 596 (1954), 12 U.S.C. § 1715k(d)(3)(B)(ii) (1958), provides for an allowance for builder's and sponsor's profit and risk of 10% of all items except land. However, the FHA regulations arbitrarily exclude amounts paid to a general contractor where there is no identity of interest. Congress, in writing the 10% builder's and sponsor's profit and risk provision, recognized that urban renewal involved risks greater than those normally encountered by builders and sponsors and, therefore, allowed a greater profit margin than in the case of normal multifamily development. It would seem logical that where a redeveloper assumes all of the risks (including the risk of future profitable operation and excluding only risks related to actual construction) and enters a contract with a general contractor whereunder the latter has no more risk than in the case of any construction project and, therefore, agrees to a fee of less than 10%, the redeveloper is entitled to 10% on all items, exclusive only of land. The override on the construction contract should not be considered as an extra profit on actual construction, but as part of an allowance for profit and risk with respect to the entire project.

¹³⁹ See Cushman, *Surety Bonds on Public and Private Construction Projects*, 46 A.B.A.J. 649 (1960), for a discussion of various types of construction bonds. The FHA requires a payment and performance bond rather than simply a payment bond that does not compel the surety to complete the job. A performance or completion bond may require the surety to become a general contractor and to finish the job.

¹⁴⁰ FHA Form No. 2452; see also requirements of the HHFA as set forth in the URBAN RENEWAL MANUAL § 14-2-3. Upon the furnishing to the LPA of the dual-obligee bond, the redeveloper may have released part of his good faith deposit under the land disposition agreement. URBAN RENEWAL MANUAL § 14-2-3, at 4. See *supra* note 104 for the requirement that the bond be written by a surety listed in Circular 570 of the Treasury Department.

groundbreaking date or with a primary or general election date, may insist that visible work be done on the site. On the other hand, the rainy season may be approaching and unless the earth compacting work is completed immediately, commencement of construction of the project may be delayed several months; if compaction can be done immediately, then the foundations can go in and work can proceed regardless of the vagaries of weather. Commencement of work prior to mortgage recordation, however, creates several legal problems. If FHA-insured financing is involved, it is essential that permission to move ahead in advance of closing be obtained from the FHA; otherwise, the cost of the work done in advance of mortgage recordation may not be included under the mortgage, and the redeveloper will be forced to pay all of the bill in cash. Furthermore, at the closing, the FHA or the conventional mortgagee will insist on assurances that the mortgage is a first and paramount lien on the real property. If mechanics' lien periods have not run, waivers will have to be obtained, and in any event, the title company will have to insure against any and all possible superior liens. Another way to skin this particular cat would be to get the LPA to do the compaction and then consider this earth work as adding to the value of the land and persuade the mortgagee (and the FHA) to value the site to include the cost of the work. This would bring it under the mortgage, and the end result would be the same.

C. Federal Agencies

As soon as the redeveloper has drawings sufficiently advanced and costs sufficiently accurate that it will be possible for the local FHA to consider intelligently the facilities he will provide for the rents he will be charging, the redeveloper should attempt to obtain a "letter of feasibility" from the local FHA office. There is no point in proceeding to develop working drawings if the FHA office will not accept the necessary rents as attainable, and the redeveloper should at the earliest possible point come to grips with this problem. At the same time, it will become clear whether or not it will be necessary to request the FHA to increase the per room or per unit statutory dollar limits of the maximum insurable mortgage. Concurrently, the redeveloper will want to make a final check on whether his project qualifies for the FNMA's "special assistance" fund.¹⁴¹

Before submitting his application for an FHA commitment for mortgage insurance, the redeveloper will want to ascertain the amount of the statutory maximum insurable mortgage and will, if necessary, attempt to persuade the FHA to find that local cost levels require an increase in the per room or per unit mortgage ceilings.¹⁴² The test to determine if the cost level in an area requires an increase in the statutory limit is allegedly relatively simple: "Is the local cost level for material, labor, and

¹⁴¹ National Housing Act of 1949, § 305(b), as amended, 72 Stat. 73, 12 U.S.C. § 1720(b) (1958). See also Note, *Urban Renewal: Problems of Eliminating and Preventing Urban Deterioration*, 72 HARV. L. REV. 504, 535 (1959); *infra* p. 153.

¹⁴² For per room increases in insurable mortgages because of "high cost" determinations, see *supra* note 131.

land such that a segment of the typical rental market is denied benefits of the National Housing Act due to statutory limits?" If so, then an increase is in order up to \$1,250. per room.¹⁴³ This, of course, is easier said than done, and the Washington FHA must approve the local FHA office's recommendations. (Washington is currently studying the possibility of the local insuring office making such a determination within certain prescribed limits.) Because the FHA believes that such findings relax the pressure to keep building costs and hence rentals down, it is not happy about granting increases in mortgage ceilings. Increases in land, buildings, and financing costs, however, are making increases in mortgage ceilings more and more necessary if urban redevelopment is to proceed. This is particularly true in the case of high-rise buildings.

The next step for the redeveloper is to explore the availability of FNMA permanent financing. The construction money mortgagee will most likely have agreed to lend funds only if the redeveloper can procure a FNMA commitment or a conventional "take-out" to buy the mortgage at completion of the period allowed for construction and rent-up. The reason for this is that the market for FHA 5¼ per cent, forty-year project mortgages is not what one would call a seller's market. As of this writing, a private lender is not likely to pay more than ninety-three per cent, which means that a mortgage note in the face amount of \$1,000,000 will only net the mortgagor \$930,000. Such a \$70,000 nonmortgageable discount would take both the profit and the romance out of urban redevelopment. To keep some profit and romance in the program, Congress has authorized the FNMA to buy FHA-insured mortgages out of its so-called "special assistance" funds, without regard to market.¹⁴⁴

At this writing, the FNMA is buying such mortgages at a one per cent discount to net ninety-nine per cent, and also charging both a purchase commitment fee of one per cent and a purchase fee of ½ per cent, which, therefore, nets the mortgagor 97½ per cent of the face amount of the mortgage note. The purchase commitment fee of one per cent of mortgage amount must be paid to the FNMA for the commitment to purchase, which means the redeveloper must pay out that much in cash in advance of the FHA closing. In addition, the mortgagee may require the mortgagor to escrow 1½ per cent of the mortgage amount or furnish collateral, so that the mortgagee will be certain to be reimbursed for the FNMA discount of one per cent and purchase fee of ½ per cent when it tenders the mortgage for sale to the FNMA.¹⁴⁵ In such event, however, the mortgagee may be willing to invest

¹⁴³ See Mason, *Local Cost Levels Guide FHA Mortgage Limits*, J. Home Building, Aug. 1958, p. 61; Miller, *supra* note 132.

¹⁴⁴ See National Housing Act of 1949, § 305, as amended, 72 Stat. 73, 12 U.S.C. § 1720 (1958), which provides that the President may authorize the FNMA to make commitments to purchase, and to purchase, mortgages covering urban redevelopment housing constructed or rehabilitated under §§ 220 and 221. There is a ceiling on the total amount of commitments and purchases that Congress has, from time to time, increased to accommodate the §§ 220 and 221 programs.

¹⁴⁵ The redeveloper's attorney, in drawing up the loan agreement with the mortgagee, should preserve the right in the mortgagor to designate a purchaser other than the FNMA to cover the situation where

such funds and pay the mortgagor the interest thereon.

The redeveloper will next fill out and submit to the local FHA office his application for mortgage insurance.¹⁴⁶ The application¹⁴⁷ requires the redeveloper to set forth his estimated replacement cost of the project, his request for mortgage insurance in a specified amount, his anticipated rental income, and his operating expenses (including real estate taxes) and debt service requirements. An FHA application fee of \$1.50 per \$1,000 of requested mortgage amount is paid by the redeveloper, and the architect's application drawings¹⁴⁸ are submitted. Thereupon, the underwriting section of the local FHA begins its analysis of the application and application drawings to ascertain whether or not it shares the optimism of the redeveloper.

VI

FHA AND FNMA AIDS TO URBAN REDEVELOPMENT

We have commented already on some aspects of the special financing incentives available to redevelopers under the current FHA and FNMA programs. Even with these incentives, it has been difficult to attract qualified redevelopers to many projects; absent such incentives only the few most attractive sites could be redeveloped.¹⁴⁹

The liberal mortgage insurance issued by the FHA under section 220 of the National Housing Act¹⁵⁰ (which is available only for projects in redevelopment areas certified as such by the HHA), unlike other FHA programs, uses a replacement-cost, rather than a fair market, valuation in calculating the maximum insurable mortgage. Replacement-cost valuation precludes the FHA from taking into consideration, when valuing a proposed project, the character of the surrounding neighborhood and other factors that in a redevelopment area would normally depress the during the construction period, interest rates fall. For example, if after the 1% purchase commitment fee has been paid, the mortgage can be sold elsewhere to net better than 98½% (FNMA 1% discount and ½% purchase fee), the mortgagor should have that election with the benefits accruing to him rather than the mortgagee.

¹⁴⁶ Since there is almost always a shortage of funds for construction financing, the redeveloper should ascertain the amount of money available on a rotating basis for construction and then divide his project into mortgage parcels of sizes that will not require mortgages in excess of the construction funds.

¹⁴⁷ FHA Form No. 2013. It has aptly been said that ". . . reading this form and the explanatory notes is an education. . . ." Pollack, *Urban Renewal in New York City and The Investor*, 14 RECORD OF N.Y.C.B.A. 515, 519 (1959).

¹⁴⁸ Application drawings comprise plans and specifications without the detailed drawings of the mechanical subtrades. The required application drawings are described in FHA, MINIMUM PROPERTY REQUIREMENTS FOR PROPERTIES OF THREE OR MORE LIVING UNITS app. D, at D-3 *et seq.* (rev. ed. 1948).

¹⁴⁹ This article will limit its FHA discussion almost exclusively to urban redevelopment projects under § 220, which is confined to urban renewal project areas. There are, however, a number of FHA programs for both new construction and rehabilitation that can be used by a redeveloper. Section 213 covers various types of cooperative housing; § 221 covers relocation housing, inside as well as outside of the urban renewal area; § 231 covers housing for the elderly (§ 202 provides for direct federal loans for construction of elderly housing but has not, as of yet, been implemented); and § 232 covers nursing homes. The procedures under these sections are, in many ways, similar to § 220 procedures, but each has its own particular problems.

¹⁵⁰ 72 Stat. 73, 12 U.S.C. § 1715k (1958).

market price between a willing seller and purchaser. Similarly, the FNMA, under the "special assistance" provisions, is precluded from making a money market valuation of mortgages on redevelopment projects. It is compelled to provide long-term financing when, because of the low interest rates permitted by the FHA on insured mortgages, conventional lenders are unwilling to provide financing.

It is to be expected, as in any private business receiving assistance from, and to a degree, regulated by the federal government, that there will be some conflict of objectives between the Government and the redeveloper, particularly the redeveloper interested in a quick profit rather than in long-term real estate values. The FHA desires to minimize its liability as insurer of the mortgage and to promote well-designed, adequately maintained, and rentable projects. The FNMA does not wish to purchase mortgages where there is a probability of a default or of a moratorium on principal payments. Although Congress has instructed both the FHA and the FNMA to ignore their usual precautions for redevelopment financing, it has proved difficult for the staff of either agency to appraise redevelopment projects differently than the other real estate mortgages that they process.¹⁵¹ To achieve their objectives, the FHA and the FNMA have been granted regulatory powers by the National Housing Act over the activities of section 220 mortgagors¹⁵² and have exercised extensive administrative discretion in interpreting and applying their regulatory powers. Much of such discretion has, in turn, been delegated down to the level of the local FHA and FNMA offices. Consequently, a redeveloper with projects in more than one locality may be astonished to discover what appear to him to be arbitrary differences in procedure between different local offices. Since the distribution of copies of many of the FHA and FNMA policy directives are administratively "restricted" and not available for examination by the redeveloper except when arguing a particular problem with the local office, early and frequent consultation with the officials is essential.

A. Prior to Commencement of Construction

1. *Analysis of FHA commitment to insure*

Although the FHA is willing to insure the mortgage upon completion of the project,¹⁵³ the lender of the construction money will usually require FHA insurance for its advances of mortgage proceeds during the course of construction. Since the FNMA purchase of the mortgage will be conditioned on the mortgage being insured by the FHA, the construction lender will want to be sure the FHA is satisfied with the physical construction work as it progresses. The construction lender will also want to be insured against the risk of having his money tied up in a project that, for any reason, is not completed. Our discussion will, therefore, be addressed only to the

¹⁵¹ Indeed, the FHA Washington office will shortly institute the practice of staffing local FHA offices with one individual trained in § 220 procedures and policies. See House and Home, May 1960, p. 71.

¹⁵² As to FHA's power to control rents, sales prices, capital structure of mortgagor, etc., see 24 C.F.R. §§ 263.9(a)(1) and 263.9(a)(2) (1954), as amended.

¹⁵³ 72 Stat. 73, 12 U.S.C. § 1715k(b) (1958).

"Commitment for Insurance"¹⁵⁴ rather than the "Commitment to Insure Upon Completion." The FHA Commitment for Insurance is a notification to the proposed mortgagee that the FHA is prepared to insure advances up to a specified amount made for construction of the project by the mortgagee, which amount may be the amount requested by the mortgagee or a lesser amount.

A Commitment for Insurance of a mortgage may be issued in a lesser principal amount than requested if the local FHA office uses as its "Estimated Available Market Price of Site" an amount less than the LPA's selling price¹⁵⁵ or if the FHA uses as its "Estimated Replacement Cost" an amount less than the redeveloper's estimate.¹⁵⁶ The local FHA office may also reduce the amount of the mortgage requested by the redeveloper if it deems the proposed rentals for the project to be too high for the market.¹⁵⁷

An FHA reduction in the amount of the redeveloper's requested insurable mortgage will largely represent to the redeveloper an additional and heretofore unexpected equity investment. At this point, the redeveloper may determine that the possible return on the additional equity investment makes the project unfeasible, and, therefore, he may decide not to go forward with the construction of the project. If his contractual arrangement with the LPA contains a so-called "diligent efforts" clause, which releases him from liability if he is unable to obtain an FHA Commitment for Insurance in the maximum legal amount, he will be able to recover his "good faith" deposit¹⁵⁸ but will, of course, have to write off his planning

¹⁵⁴ The FHA is permitted to issue its Commitment for Insurance in advance of the actual lending of money by the construction mortgage mortgagee. Sec. 220(b) as amended, 24 C.F.R. § 232.2(b) (1954). Such Commitments are effective for a period not to exceed 180 days. 24 C.F.R. § 263.4(a) (1957).

¹⁵⁵ This is one reason why the LPA in its land disposition should not seek a price so high that normal FHA § 220 financing becomes impractical.

¹⁵⁶ Some of the FHA's estimating procedures based on cubage, etc. may produce results lower than the subtrade bids the redeveloper has been able to obtain. The redeveloper, his architect, and his attorney should keep in close touch with the FHA office during its processing in order to be alerted to, and try to solve, such problems as early as possible.

¹⁵⁷ The Commitment for Insurance includes a detailed estimate of the replacement cost of the project as figured by the local FHA office and a Project Income Analysis as calculated by the local office. Estimated replacement cost includes, pursuant to 24 C.F.R. § 263.7(b) (1956), in the case of new construction, the cost of land, proposed physical improvements, on-site utilities, architect's fees, taxes, interest during construction, and other miscellaneous charges approved by the Commissioner, including an allowance for builder's and sponsor's profit and risk determined by applying a percentage against the estimated replacement cost excluding land. The Project Income Analysis estimates the reasonable income the redeveloper can anticipate from the project property. It necessarily involves a determination by the FHA of what rents are marketable in the area. From the gross rental derived, there is deducted a 7% vacancy allowance and estimated operating and maintenance charges of the project (these estimates may be higher or lower than estimated by the redeveloper on his application for mortgage insurance). The total debt service (amortization of mortgage principal requested and interest thereon) is then compared to the net income (after deduction of real estate taxes, insurance, FHA replacement reserves, and all other cash operating expenses) to be produced by the project. If the ratio of debt-service to such income is too high (above 90% under present FHA policies), the project income must be increased by increasing rents (it is most unlikely that the FHA will permit this) or the principal amount of the mortgage to be insured will be reduced to an amount less than requested. Furthermore, if the FHA increases the redeveloper's estimate of operating expenses, it may, because of the resultant reduction in project income, issue a Commitment to insure a mortgage in a lesser amount.

¹⁵⁸ See discussion of availability of such provisions in land disposition documents, *supra*, pp. 144-45. The "diligent efforts" clause is authorized by URA in URBAN RENEWAL MANUAL § 14-2-3, at 4.

and organizational expenditures to date, which may be quite substantial. In the absence of a "diligent efforts" provision, it may be necessary for the redeveloper to forfeit his "good faith" deposit in order to avoid an even larger loss by the investment of equity money upon which the available FHA Commitment for Insurance would allow substantially no return.¹⁵⁹

The "Estimated Requirements for Completion of the Project," however, usually exceed the actual out-of-pocket cash needed by the redeveloper in the FHA Commitment for Insurance to complete the project. The FHA rules and regulations provide for a profit-and-risk fee that is included in the estimated replacement cost calculations for purposes of figuring the maximum insurable mortgage.¹⁶⁰ This fee may be waived, in part or in total, to reduce cash requirements at initial closing.¹⁶¹ The architect's fee, if paid other than in cash, may be used, to the extent payment is in such other medium, to further reduce cash requirements at closing.¹⁶²

2. *Determination of the mortgagor entity*

Since "... no housing investor can afford to omit the 'tax angle' from his analysis of the merits of a contemplated investment . . .,"¹⁶³ tax considerations will play an important role in the selection of the legal form of the mortgagor entity. Real estate investment is currently very attractive taxwise because of liberalized depreciation rules. These "... tend to encourage new rental investment by substantially increasing the potential cash take-out during the first few years and by providing a tax offset to the investor with other corporate holdings."¹⁶⁴ Unless investment in section 220 projects can provide at least some of the tax benefits that currently make other real estate investments attractive, it will be extremely difficult to interest investors in redevelopment projects.

Under section 167(b)(2) of the Internal Revenue Code of 1954, an owner of real property improvements held for the production of income may depreciate the improvements on a declining-balance method using a rate twice as great as would normally be permitted if so-called "straight-line" depreciation were utilized.¹⁶⁵

¹⁵⁹ Since the LPA is interested in getting the redevelopment built rather than windfalls from "good faith" deposit forfeitures, it should be careful in its land disposition that it does not select, largely because of a high land price offer, an inexperienced redeveloper likely to get himself into this situation.

¹⁶⁰ 24 C.F.R. §§ 263.9c(a) and (b) (1956), and 241.35(a) and (b) (1959) note that under § 213, if no "identity of interest" exists, there is no sponsor's profit and risk fee provided.

¹⁶¹ See FHA FORM No. 2432, para. 3(h)(2).

¹⁶² Under present FHA procedures, if other than an independent architect is used for preparation of the working drawings, the entire architect's fee is payable to the mortgagor at initial closing or indorsement; and, thus, to the extent said fee is payable other than in cash, the cash available can be used to reduce cash requirements at closing. See FHA FORM. No. 2719-B and FHA FORM No. 2432 para. 3(h)(2).

¹⁶³ LOUIS WINNICK, *RENTAL HOUSING: OPPORTUNITIES FOR PRIVATE INVESTMENT* 143 (1958). Pages 143 through 154 of this book provide a very thoughtful discussion of both tax techniques and taxation policy. For briefer and earlier discussion, see Felix & McIntyre, *How to Save Money on Taxes, House and Home*, Oct. 1959, p. 193. See also Blum & Dunham, *Income Tax Law and Slums: Some Further Reflections*, 60 COLUM. L. REV. 447 (1960); Sporn, *Slums and the Income Tax: A Brief Rejoinder*, *id.* at 454.

¹⁶⁴ WINNICK, *op. cit. supra* note 163, at 151.

¹⁶⁵ Section 167(c), however, limits a taxpayer's right to use the so-called "double declining balance"

Accelerated depreciation on the double-declining balance method would initially amount to five per cent per annum on property with a forty-year life and, in the early years, would greatly exceed mortgage amortization payments on a forty-year mortgage. In all probability, there will also be sufficient depreciation in excess of amortization more than to offset the earnings permitted by the FHA rent ceiling, so that the project will show operating losses for income tax purposes. To the extent the mortgagor does not elect to capitalize interest, real estate taxes, and certain other items during the construction period, the mortgagor will generate a substantial tax loss prior to completion that can be carried forward by a corporate mortgagor. To the extent these items are expensed, the tax basis of the project upon completion will be reduced and the depreciation thereon will be somewhat less. The tax losses of the construction period and early operating period can, of course, be carried forward, subject to certain limitations, to subsequent years.¹⁶⁶ If, however, the owner has other income against which such tax losses can be supplied, he can immediately utilize such losses. Such immediate use to reduce taxes payable on other income, sometimes called "tax shelter," produces an economic benefit to the owner, the amount of which depends on the rate of tax that would otherwise be payable on the "tax-sheltered" income. The redeveloper's problem is to organize his mortgagor so as to utilize such tax benefits in a similar manner to the methods by which the benefits are utilized in conventionally financed real estate projects.

A project mortgagor may not, under current FHA rules and regulations, have any outside income.¹⁶⁷ If the redeveloper uses a corporate mortgagor, it will be necessary, in order to make use of the "tax shelter" generated, to have the corporate mortgagor file a consolidated income tax return with another corporation that is income-producing. A consolidated filing presumes that the redeveloper has another income-producing corporation, has made it the parent of the mortgagor,¹⁶⁸ has no objection to a consolidated financial statement showing the mortgage liability and thereby reducing the consolidated debt to equity ratio,¹⁶⁹ and that such other corporation has sufficient income to create an over-all tax saving that more than offsets the two per cent penalty for filing a consolidated return.¹⁷⁰ If the mort-

method of depreciation to assets constructed or erected after Dec. 31, 1953, or acquired after Dec. 31, 1953, if the original use of the property commences with the taxpayer and after said date. The purchaser of recently constructed and already occupied real estate may choose to acquire the stock of the owning corporation in order to preserve the identity of the taxpayer and continue to utilize the accelerated depreciation allowed by § 167(b)(2).

¹⁶⁶ Unless the mortgagor can use the tax losses during their carry-forward period against income derived other than from the project, it may elect to use straight-line depreciation rates. See WINNICK, *op. cit.* *supra* note 163, at 147.

¹⁶⁷ 24 C.F.R. § 263.92(1) (1954).

¹⁶⁸ It might also be possible for the tax-loss mortgagor to have a sibling relationship with a profitable corporation under a common parent corporation that owns 80% or more of each of the siblings.

¹⁶⁹ Under some circumstances, it might be proper accounting for the parent corporation to present only its net investment in the mortgagor rather than to add the mortgagor's assets and liabilities into the total assets and liabilities of the parent.

¹⁷⁰ INT. REV. CODE OF 1954, § 1503(a). Note that certain public utilities and other consolidated companies are exempt from the 2% penalty.

mortgagor corporation is acquired solely to avoid taxes, however, the depreciation deductions may be disallowed.¹⁷¹

Another tax question that may confront a corporate mortgagor is the applicability of section 341 of the Internal Revenue Code of 1954 relating to "collapsible" corporations.¹⁷² If, as is assumed, depreciation deductions will, for the first several years, exceed project income, it is difficult to see how section 341 would be deemed to apply, since distributions to the shareholders of the corporation would be treated as a return of capital, not as a dividend, the corporation having no current or accumulated earnings. After the recovery by the shareholder of his stock basis, any further distributions, again assuming no current or accumulated earnings, might be treated as ordinary income under section 341; but if such distributions are made more than three years after construction, section 341 would not ordinarily apply.¹⁷³

Most real estate syndications in recent years have been in the form of limited partnerships or trusts, in order to permit investors to take the depreciation "tax shelter" directly against their personal income.¹⁷⁴ It is very difficult to apply most of the currently popular real estate syndication methods to section 220 projects and thereby permit redevelopment investment to compete on an equal basis for available real estate investment funds, because the FHA generally insists that the partners in a mortgagor partnership (or the sole proprietor, if personally owned) assume full personal liability on the mortgage note.¹⁷⁵ Since the FHA will accept a mortgagor corporation of minimum net worth, there is little reason, other than administrative

¹⁷¹ Creation of a subsidiary corporation is an "acquisition" within the meaning of that word as contained in § 269. *Coastal Oil Storage Co. v. Comm'r*, 242 F.2d 396 (4th Cir. 1957). In the case of *Elko Realty Co. v. Comm'r*, 29 T.C. 1012 (1958), the disallowance by the Commissioner of deductions claimed as a result of a consolidated filing was upheld. The taxpayer corporation had acquired control of two § 608 mortgagor corporations that were in poor financial shape and, by a consolidated filing, attempted to offset the losses of its new subsidiaries against its own income. The *Elko* case may be read as a situation where the taxpayer simply failed to carry the burden of proving that its intent was not to evade or avoid taxes. The court observed that despite the taxpayer's insistence that it thought its two acquired subsidiaries would produce net income, the evidence showed that the taxpayer knew one of the subsidiaries to be in default on its FHA mortgage and that both were heavily in debt. It should be noted that the *Elko* case involved loss deductions generated after the date the subsidiaries were acquired, not "carry-forward" losses. The *Elko* case may also be interpreted, however, as applying only when the acquired corporation has an established historical loss pattern at the time it is acquired, and hence the case would be inapplicable to a newly formed mortgagor subsidiary about to begin construction of an urban renewal project.

¹⁷² INT. REV. CODE OF 1954, § 341.

¹⁷³ See Axelrad, *Recent Developments in Collapsible Corporations*, 36 TAXES 893 (1958); Axelrad, *Tax Advantages and Pitfalls in Collapsible Corporations and Partnerships*, 34 TAXES 841 (1956).

¹⁷⁴ For an excellent article covering practical as well as tax aspects, see Berger, *Real Estate Syndication: Property, Promotion, and the Need for Protection*, 69 YALE L.J. 725 (1960). See also *The Growth of Group Finance*, *Architectural Forum*, Sept. 1958, p. 188. INTERNAL REVENUE CODE OF 1954, §§ 856-58 permit real estate investment trusts that would otherwise be taxable as corporations and that have 100 or more beneficiaries to eliminate the corporate tax otherwise payable if they distribute at least 90% of their income. See Roberts, Feder & Alpert, *Congress Approves Real Estate Investment Trust; Exacting Rules Made*, 13 J. TAXATION 194 (1960).

¹⁷⁵ 24 C.F.R. § 263.9a(a)(1) (1954) deals with private corporate mortgagors, and 24 C.F.R. § 263.9a(a)(2) (1954) with private noncorporate mortgagors listing therein ". . . an association, partnership, trustee or legal entity other than a corporation. . . ." 24 C.F.R. § 263.9(a)(d) (1960) makes provision for individual mortgagors. 24 C.F.R. § 241.1(c) (1960) permits trust mortgagors in § 213 cooperative projects.

convenience, why it should not permit the use of so-called "bob-tailed" mortgage notes, which do not permit a deficiency judgment against the maker in the event that sale of the collateral does not realize a sufficient amount to pay the note. It was once thought that the permission for corporations of small size to elect to be treated as partnerships for tax purposes would solve this problem.¹⁷⁶ But subchapter S as finally passed is not applicable to a corporation with two classes of stock, as usually required by the FHA,¹⁷⁷ or with more than twenty per cent of its gross receipts derived from rent.¹⁷⁸

The FHA has occasionally insured "bob-tailed" mortgage notes issued by trustees, and it has published a model form of trust.¹⁷⁹ These trusts have been used mostly in Massachusetts and Illinois, where such form of real estate investment is quite common, and the FHA has been reluctant to permit the use of trusts in other states because of what it believes to be generally unsettled law on many aspects of the validity of trusts established primarily to manage real estate.¹⁸⁰ If properly drafted, a trust that owns real estate may pass the unused depreciation deductions to its beneficiaries¹⁸¹ or, if established as a *Clifford* or "peak through" trust,¹⁸² its property is treated as the property of the settlor-beneficiary and the income or loss therefrom is treated as the income or loss of the settlor-beneficiary.¹⁸³ This is a fairly common method of group ownership of conventionally financed real estate.

¹⁷⁶ WINNICK, *op. cit. supra* note 163, at 252-53.

¹⁷⁷ Cf. Rev. Rul. 120, 1953-2 CUM. BULL. 130, ruling that the \$100.00 of preferred stock issued to the FHA is not a "class of stock," but merely a security device so that a tenant-stockholder of a co-operative apartment corporation would not be deprived of his proportionate share of the corporation's deductible expenses under § 23(z) of the 1939 Code, which requires that "one and only one class of stock [be] outstanding."

¹⁷⁸ An FHA mortgagor corporation that does not capitalize with FHA preferred stock, control being provided by a Regulatory Agreement (but *cf. supra* note 177) and that is not a subsidiary of another of the redeveloper's corporations could qualify as a "small business corporation" under INT. REV. CODE OF 1954, §§ 1371 *et seq.*, as amended in 1958, and elect to be taxed as a partnership, but for the provisions of § 1372(2)(5), which state, in part, that ". . . an election under subsection (c) made by a small business corporation shall terminate if, for any taxable year of the corporation for which the election is in effect, such corporation has gross receipts more than twenty percent of which is derived from . . . rents. . . ." It should be noted that during the construction period, such a corporation could conceivably, prior to the realization of any rental income, pass tax losses on to its shareholders. Under INT. REV. CODE OF 1954, § 1244, as amended in 1958, a small business corporation may so issue its stock that upon sale by its shareholders at a loss or in the event the stock becomes worthless, the loss sustained by the shareholder is an ordinary rather than capital loss. Because of the requirement of § 1244(c)(1)(E) that ". . . such corporation . . ." must derive ". . . more than 50% of its aggregate gross receipts from sources other than . . . rents . . .," it is impossible, once operations commence, for an FHA mortgagor corporation to qualify its stock under § 1244.

¹⁷⁹ FHA Form No. 2529.

¹⁸⁰ Creation of a trust to accept conveyance of an already existing project from the project mortgagor has not, as yet, been allowed by the FHA. A trust must be formed ". . . for the purpose of providing housing. . . ." 24 C.F.R. § 263.9a(a)(2) (1954). (The FHA has construed the word "providing" as if it were "constructing" and has taken the position that a trust entity that proposes to take over an existing project does not, therefore, qualify.)

¹⁸¹ See INT. REV. CODE OF 1954, § 167(g); I.T. 2452, VIII-1 CB84 (1929); *Commissioner v. Putnam*, 143 F.2d 201 (2d Cir. 1944); *McBride Building Trusts*, 10 CCH Tax Ct. Mem. 13 (1951).

¹⁸² Under INT. REV. CODE OF 1954, §§ 671 *et seq.*

¹⁸³ Special care must be taken in drafting the trust instrument, otherwise the trust may be deemed to be an "association" taxable as a corporation, I.R.C. Regs. 301.7701-2 *et seq.*

A trust mortgagor so formed by the redeveloper's income-producing corporation in lieu of a corporate subsidiary escapes the problems posed by section 269 (acquisition of corporation) and section 341 (corporate collapsibility) of the Internal Revenue Code of 1954.¹⁸⁴ In another respect, however, corporate mortgagors have an advantage over trust mortgagors. Because of depreciation deductions and the election to expense items of cost incurred during the construction period the project property will, in a few years, have a negative tax basis—*i.e.*, a tax basis for the collateral lower than the outstanding principal balance of the mortgage thereon. If a trust mortgagor sells a project with a negative basis, the taxable gain will be the difference between the proceeds of such sale and the depreciated basis of the project. If the stock of a corporate mortgagor is sold, the taxable gain will be the proceeds of sale less the outstanding principal balance of the mortgage and less the tax basis for such stock, which, under the assumptions made, would probably be zero.¹⁸⁵ The purchaser, if it is a corporation and if it liquidates the corporate mortgagor within two years after purchase, may obtain the same tax basis for the real estate as if it had purchased property instead of stock.¹⁸⁶ If a corporate mortgagor sells the project, of course, it has the same taxable gain as does the trust, unless it liquidates within the next following twelve months.¹⁸⁷

Aside from tax considerations, the corporation form of mortgagor is preferable as being simpler with which to work when it comes to setting up contracts or leases

¹⁸⁴ Other problems of consolidated returns may also be avoided—*e.g.*, INT. REV. CODE OF 1954 § 1504 excludes certain types of corporations from the affiliated group that may file consolidated returns. See also *J. D. & A. B. Spreckles Co.*, 41 B.T.A. 370 (1940), which suggests that there must be a business purpose for consolidation in addition to tax purposes.

¹⁸⁵ To illustrate: Assume a project with an estimated replacement cost of \$10,000,000, a mortgage liability of \$9,700,000, investment by developer of \$300,000, accumulated depreciation on the date of the sale of the project of \$1,000,000, amortization payments to the date of the sale of the project of \$500,000, and a sale of the project for \$9,500,000.

a. If a trust owns the project, the taxable gain would be \$500,000—*i.e.*, sale price of \$9,500,000 less the adjusted basis for the project of \$9,000,000 (cost of \$10,000,000.00 less depreciation of \$1,000,000.00).

b. If a corporation owns the project and all of the stock of the corporation is sold (not the project itself) the taxable gain would be \$300,000—*i.e.*, \$300,000 selling price of stock (equity over the reduced mortgage debt of \$9,200,000) less the adjusted basis for the stock of zero. The basis of the stock was originally \$300,000 but was reduced as losses were used in filing a consolidated return. The basis of the stock, however, does not fall below zero.

See also *Crane v. United States*, 331 U.S. 1 (1947). In the *Crane* case, the Supreme Court upheld the Commissioner's determination that the taxable gain to the taxpayer upon the sale of encumbered property was the difference between the sales proceeds realized and the taxpayer's adjusted basis for the property, even though taxpayer's adjusted basis was less than the outstanding mortgage balance. The Court decided that the taxpayer received an economic benefit when she disposed of the property subject to the mortgage and rejected taxpayer's argument that her gain was only the sales price in excess of the outstanding mortgage amount. Some commentators interpreted *Crane* to mean "boot" was necessary above and beyond the outstanding mortgage balance before the *Crane* result would occur, but subsequent cases have held otherwise. See *Parker v. Delaney*, 186 F.2d 455 (1st Cir. 1950); *Woodsam Associates, Inc. v. Comm'r*, 16 T.C. 649 (1951), *aff'd*, 198 F.2d 357 (2d Cir. 1952). Abandonment, feasible if the mortgagor is not personally liable on the mortgage note, may involve no "sale or exchange" and hence no tax.

¹⁸⁶ INT. REV. CODE OF 1954, § 334(b)(2).

¹⁸⁷ INT. REV. CODE OF 1954, § 337.

and procuring insurance.¹⁸⁸ In certain states, the real estate tax concessions mentioned earlier are available to corporations and the statutes make no mention of individuals, partnerships, or trusts.¹⁸⁹ Lastly, the familiarity and experience of the FHA local offices with the corporate form of mortgagor makes for fewer problems at initial and final endorsement and in the later day-to-day operations with the FHA.

The choice of the mortgagor entity dictates the form of many of the documents to be supplied to the FHA at initial endorsement, the preparation of which next becomes the immediate concern of the redeveloper and his attorney.

3. *Preparing for initial endorsement*

Because of the increased documentation necessary to comply with FHA and FNMA requirements, initial endorsement is a real estate closing considerably more complex than when conventional financing is used. The local FHA office will supply a check list of the necessary documents and also copies and model forms. At the conclusion of initial endorsement, the local FHA director will endorse the mortgage note for insurance. If the project is divided into several mortgage parcels, an initial endorsement will be required for each parcel; but after the first time through the process, the problems will have been worked out and forms agreed upon with the FHA closing attorney so that the time required will be greatly reduced.

In order to speed up the closing, all documents to be submitted at initial endorsement should be cleared in advance, in rough draft form, with the FHA closing attorney who will be in charge of initial endorsement. If a corporate mortgagor is to be used, the capital structure of the corporation must include \$100 of preferred stock¹⁹⁰ to be sold at initial endorsement to the FHA. The corporation's articles of incorporation, in addition to containing a great many requirements and prohibitions,¹⁹¹ must grant to the preferred shareholder all the powers necessary for the

¹⁸⁸ There is a technical difficulty with mortgagor corporations organized under the law of most states other than New York, in which state the rule of *Randall v. Bailey*, 261 App. Div. 907, 25 N.Y.S.2d 173 (2d Dep't 1941), *aff'd*, 288 N.Y. 280, 43 N.E.2d 43 (1942), permits dividends out of unrealized appreciation. Although the FHA standard corporate charter permits dividend distributions from "surplus cash" whether or not there is a book surplus, most state laws do not permit this. See, Note, *Statutes, Case Law, and Generally Accepted Accounting Principles on the Write-up of Physical Assets*, 28 U. CINC. L. REV. 79 (1959). Thus, the mortgagor might be in default under its charter requirement that it comply with applicable state law. Cf. *Mountain State Steel Foundries v. Comm'r*, 18 CCH Tax Ct. Mem. 306 (1959), *rev'd* 284 F.2d 737 (4th Cir. 1960).

¹⁸⁹ See *supra* p. 124.

¹⁹⁰ In some states, the type of preferred stock required by the FHA may not, under applicable statutes, be permitted. In such instances, the mortgagor corporation is capitalized without the \$100 of preferred stock and must execute with the FHA a Regulatory Agreement (see 24 C.F.R. § 263.9a(a)(1) (1954)) that, by contract, gives to the FHA all the powers it would normally possess as an incident of the ownership of the preferred stock. In qualifying or registering the stock of the mortgagor corporation with the state "blue sky" authorities, consideration should be given to the question of whether or not the existence of the FHA preferred stock presents any complications. In Ohio, for instance, the existence of FHA preferred stock eliminates a rather simple qualification procedure under OHIO REV. CODE § 1707.03(p) (1954), and requires instead a more complicated filing under OHIO REV. CODE § 1707.06 (1954).

¹⁹¹ For example, the articles require the mortgagor to file a dwelling and nondwelling (if commercial units are included in the project) rental schedule and adhere to such schedules, to establish a replacement

FHA to regulate many of the internal practices of the corporation with respect to the operation of the project and must also permit the preferred shareholder to assume control of the corporation in the event of default.¹⁹²

The form of FHA construction contract to be used and the arrangement between the mortgagor and general contractor to be established depend on whether or not the mortgagor and general contractor have established an "identity of interest" for FHA purposes.¹⁹³ If the architect employed by the mortgagor is independent (no "identity of interest"), he can continue to serve as the architect of the project during construction. If he is not independent, he cannot so serve, and the mortgagor must hire an independent architect for the period commencing with construction. In either event, architectural contracts are included in the closing documents.¹⁹⁴

A sample form of title policy insuring the mortgage in its principal amount should be procured and submitted to the FHA closing attorney, as well as building permits and evidence that the project to be constructed will violate no zoning ordinances. Letters of assurance of service from all necessary utility companies should be obtained for the closing, and any utility easements that will be executed prior to initial endorsement should be approved as to form by the FHA closing attorney. Because so many of the FHA reports require independent certification, the redeveloper should during this period employ independent public accountants and acquaint them with the FHA rules and regulations.

reserve and make payments monthly thereto, to make periodic reports, to submit monthly occupancy reports, and to notify the FHA of any transfer of shares in excess of 25% of the outstanding common shares of the corporation. The articles prohibit conditioning occupancy on payment of additional rental for chattel property in the project such as stoves and refrigerators, discrimination in leasing against families with children, renting any unit for less than thirty days, and recordation of any covenant embodying discrimination because of race, color, or creed. The by-laws or code of regulations, except for incorporating by reference all of the restrictions of the articles above mentioned, can follow the pattern of local law.

¹⁹² The legal basis of such control is contained in 24 C.F.R. § 263.9a(a)(1) and (2) (1954). If a trust mortgagor is to be used, a trust indenture, FHA Form 2529, and a regulatory agreement, by the terms of which the FHA will obtain the same control over the project as it would if it owned preferred stock, must be prepared.

¹⁹³ See *supra* pp. 150-51, for discussion of "identity of interest." A lump sum fixed fee contract, FHA Form 2442 (§ 220), is used if no "identity of interest" exists. A cost-plus with guaranteed upset price contract, FHA Form 2442-A (§ 220) is used if an "identity of interest" exists. If the general contractor subcontracts more than 50% of the work to one subcontractor, or more than 75% of the work to three, in an "identity of interest" situation, the builder's and sponsor's profit and risk fee will be reduced. See FHA Form 3306.

¹⁹⁴ See FHA Forms No. 2719-A, 2719-B, and 2719-C. Form No. 2719-A is applicable to an independent architect who continues to act as architect throughout the construction period. This form contains a certification by the architect that he is independent of the mortgagor. If such an architect has been rendering services to the redeveloper, he may have a contractual relationship with the redeveloper covering the entire project and containing terms different from those of Form No. 2719-A. It would not appear, however, that paragraph 2 of said form, which voids all prior agreements between the parties, would affect such an arrangement, see *supra* note 128. Form No. 2719-B provides for the services of a nonindependent architect that terminate at initial endorsement, at which time such architect is paid in full. Form No. 2719-C provides for an independent architect whose services are primarily concerned with supervising construction beginning with initial endorsement and running through the construction guarantee period following completion of construction. Most large FHA offices adequately staffed with project inspectors will not require a project architect or Form No. 2719-C.

Any debt financing that the mortgagor obtains in addition to the FHA mortgage should be evidenced by a deferred note, the form of which should be reviewed by the FHA closing attorney.¹⁹⁵ Secondary financing that creates a lien against the mortgaged project is not permissible.¹⁹⁶ Finally, the redeveloper's attorney must prepare a comprehensive legal opinion covering the validity of the mortgagor entity under local law and the authority of the mortgagor and its officers to execute the various closing documents.

4. *Initial endorsement*

If the closing documents have been cleared in advance with the FHA closing attorney, initial endorsement should be more or less a routine formal delivery of papers. At initial endorsement, the mortgagor also submits to the mortgagee, who, in turn, submits to the FHA, the first request for advance of mortgage proceeds,¹⁹⁷ which includes the cost of the land, expenses of title and recording work, the FHA application and commitment fees, legal and organizational services, and cost of insurance, all of which the mortgagor pays to itself as reimbursement; all (if the architect is dependent) or seventy-five per cent (if he is independent) of the architect's fee which is paid to the architect (or used to reimburse the redeveloper for architectural advances made by him); and the FHA initial insurance premium and mortgagee's service charge,¹⁹⁸ which are payable to the mortgagee.

A payment of two per cent of the principal mortgage amount is made to the mortgagee to establish the "working capital" escrow discussed below, and there will have to be escrowed the cost of off-site improvements not included under the mortgage.

B. Problems During Construction

1. *Disbursement of mortgage proceeds*

Each month, once construction begins, the general contractor will submit to the mortgagor his application for payment setting forth his costs incurred to date, less ten per cent, and the over-all percentage of the construction already completed, including material stored on the site.¹⁹⁹ A percentage of his general overhead and, depending on his fee arrangements, part of his fee is also requested. The architect certifies the request of the general contractor, and the mortgagor incorporates this

¹⁹⁵ Any such note must be in a form approved by the FHA and can be paid only in conformity with FHA rules and regulations—*i.e.*, out of "surplus cash." 24 C.F.R. § 232.19b (1958); 24 C.F.R. § 263.9a (1954).

¹⁹⁶ 24 C.F.R. § 232.18(b) (1954). Public mortgagors may create junior liens under certain circumstances.

¹⁹⁷ FHA Form No. 2403.

¹⁹⁸ Rev. Rul. 56-136, 1956-1 CUM. BULL. 92 indicates the mortgagor during the construction period may deduct such payment as it would interest.

¹⁹⁹ FHA Form No. 2448. This form is matched by the local FHA office with the general contractor's "Trade Payment Breakdown," FHA Form No. 2536, submitted at closing and incorporated as a part of the construction contract. It should be noted that some contractors will attempt to "front-load" cost estimates on the subtrades. By overestimating the cost of the trades that are completed first (*e.g.*, excavation) and underestimating the trades that are completed last (*e.g.*, landscaping), the general contractor may draw down more money earlier in the job than would normally be permitted.

certification into its own monthly request for advance of mortgage proceeds (FHA Form 2403), adds thereto any items to which the mortgagor is entitled, and submits the request to the mortgagee. The mortgagee approves the request and submits it to the FHA, where it is processed and approved, either in the amount requested or a lesser amount if items are disallowed or if the FHA project inspector disagrees with the contractor's estimate of the percentage of the job that is completed.

Prior to disbursement of the monthly amount requested, a cautious mortgagee may require a report from the title company that has insured the mortgage to the effect that no liens have been filed against the project property. If a lien is filed, it must be removed by payment, posting a bond,²⁰⁰ or such other remedy as may be available under state law; otherwise, no disbursement of mortgage proceeds will be made. If the general contractor has materials stored on the site at the date the mortgagor requests a mortgage advance, it may be necessary to have the general contractor assign its interest in the materials to the mortgagee, and both the general contractor and mortgagor execute affidavits as to the safety of storage facilities, insurance, and so on.²⁰¹

2. Change orders

As construction progresses, change orders in the original plans will be required or desired. Using the applicable FHA forms,²⁰² the mortgagor requests the FHA to approve the change order, which may involve an increase, decrease, or no change in cost. An increase in cost, if approved by the FHA, may involve no ultimate out-of-pocket expenses to the mortgagor if the general contractor is making cost savings elsewhere in his work.²⁰³ If the proposed change order is not approved by the FHA or is approved but there are no offsetting savings being made by the general contractor, it may be necessary for the mortgagor to waive an additional portion of his profit-and-risk fee to finance the changes without incurring additional out-of-

²⁰⁰ Some state statutes void the lien of record if the property owner gives the lienor notice to foreclose on his lien and posts with the court a bond double the amount of the lien. The bond theoretically substitutes for the land as the lienor's security. In practice, this has proved to be a cumbersome and almost unworkable procedure. Most surety companies require the property owner to escrow with them the amount of the bond, and some title companies refuse to omit the lien from the title report even though the state statute is complied with. In Ohio, some courts refuse to discharge the property from the foreclosure action even though a bond is posted. Some title companies will omit the lien from a title report if cash in the amount of the lien is deposited with the title company. Most title companies that follow this procedure, however, also demand an authorization from the property owner to pay off the lien if a foreclosure petition is filed by the lienor, without any regard to the merits of the lien claim or the lien and without any judicial determination of same.

²⁰¹ FHA Forms No. 2468-A and 2468-B.

²⁰² FHA Form No. 2437.

²⁰³ Occasionally, the redeveloper may leave stoves and refrigerators out of his original specifications but include them by additive change order if construction cost savings develop. This is the second point at which the redeveloper's attorney must determine whether or not a chattel mortgage is necessary. At initial endorsement, he must, in his opinion letter, advise the mortgagee and the FHA whether or not, under state law, a chattel mortgage is necessary to cover items already included in the working drawings submitted to the FHA. At the time chattel property is placed with the mortgagee as additional collateral, the regular state form of chattel mortgage may be used. The Federal National Mortgage Association (FNMA) may, however, require the real estate mortgage to be amended to include the chattel property.

pocket expenses. If the change order is deductive (reducing the estimated replacement cost of the project as estimated by the FHA), a concurrent additive change order (perhaps mortgaging chattels) may be required in order to prevent the FHA from reducing the amount of its original commitment to insure.

During construction, the redeveloper may request an increase in the mortgage because he believes that certain added costs of construction will produce sufficient increase in rentals to service the increased debt or because he believes that some factor that prevented him from obtaining a maximum mortgage has been overcome.²⁰⁴ In considering whether or not to issue an amended commitment to insure for an increased mortgaged amount (assuming the present mortgagee is willing to lend an additional amount), the local FHA office will re-analyze the entire project. This may prove undesirable if the FHA concludes its earlier estimate of expenses was too low or its estimate of income too high, since a new analysis, even with the chattel property mortgaged, could produce an FHA-amended commitment to insure in a lesser amount than the original commitment.²⁰⁵

3. *Working capital escrow*

The two per cent working capital escrow is established with the mortgagee at initial endorsement to insure that funds will be available for the payment of real estate taxes, hazard insurance, FHA mortgage insurance premiums attributable to the project, and the payment of the initial cost of equipping and renting the project. The disbursement of these funds is arranged solely between the mortgagor and the mortgagee, and the FHA does not supervise the application for or the payment of same. Periodically, commencing with the beginning of the rental program, requests to the mortgagee for disbursements from the working capital escrow by the mortgagor to reimburse the mortgagor for expenses (gas bills, maintenance, advertising, model "show" suite furniture, etc.) incurred to date are made in simple letter form accompanied by a list of items covered by the request. Submission of paid bills and receipts may be required by the mortgagee. If preclosing rentals are sufficient to cover these costs,²⁰⁶ ultimately the deposit in the working capital escrow will be returned to the redeveloper.

²⁰⁴ It may also be necessary to procure a new commitment from the FNMA to purchase the increased mortgage. It cannot be presumed that the original FNMA commitment is "open-ended" and covers any and all increases during construction.

²⁰⁵ Upon collateralizing the increased mortgage amount requested, the FHA will rework its Project Income Analysis and produce a new annual amount to be contributed by the mortgagor to the "Reserve Fund for Replacements," which, in turn, will require an amendment by the mortgagor to its by-laws or code of regulations, if a corporation, or the trust indenture and/or regulatory agreement, if a trust.

²⁰⁶ Although the FHA requires that an advance amortization payment be made from any net income from preclosing rentals, most of the items for which the 2% working capital escrow is established may be expensed against the preclosing rentals in determining the "net income from date of initial occupancy." See FHA Form No. 3307 and FHA Memorandum dated Nov. 5, 1956, § 207, RH-237, and § 220(d)(3)(B), No. 35. In addition, certain fixed charges (e.g., interest, taxes, insurance, land rents) may be allocated from the construction account to preclosing rental expense, thereby creating a construction cost underrun on these items. It is thus to the redeveloper's advantage to seek tenants as rapidly as individual units become available.

4. *Occupancy—FHA requirements*

Prior to the occupancy of any unit of the project, a dwelling rental schedule²⁰⁷ must be submitted to the local FHA office setting forth the rents the mortgagor proposes to charge for each type of unit in the project. The rents to be charged by the mortgagor need not be the exact per unit rents used by the FHA in analyzing the economic feasibility of the project, but they must average out to no greater than the maximum per room rent specified for the project by the FHA in its project income analysis form. The mortgagor, therefore, may, to an extent, "merchandise" his suites by charging more for preferred locations and possibly adjusting the rentals to meet market demands for various-sized suites. Specified charges for leasing of ranges, refrigerators, and other chattel property may be made by the mortgagor if the FHA approves the charge and if such leasing is purely voluntary and not made a condition prerequisite to the leasing of an apartment. Such charges are permissible even if, when added to the basic rental, they exceed the FHA's ceiling on per room rents.

Prior to the occupancy of each unit, the mortgagor must procure from the local building department of the city a letter stating that the apartment building of which the unit is a part has been satisfactorily completed in accordance with the city building code. This letter is then submitted to the FHA together with an FHA form entitled "Permission to Occupy,"²⁰⁸ and approval to occupy, following a visit by the FHA project inspector, is usually forthcoming.

Once occupancy begins, monthly statements as to occupancy, rentals, and expenses must be submitted to the local FHA office.²⁰⁹

5. *Real estate taxes*

On the next tax assessment date following the beginning of construction, in most states, a portion of the construction in place will be listed on the county tax duplicate (unless real estate tax concessions are, by state law, granted to urban renewal projects).²¹⁰ In some jurisdictions, when building permits are issued, the taxing official automatically sends to the owner affidavits of building cost as of the tax assessment date. In figuring the cost of the improvements in place as of such tax assessment date, it is sometimes permissible to exclude the general contractor's profit and architect's fees and list only the dollar cost of bricks, mortar, and construction labor. If such affidavits are not utilized by the jurisdiction in which the project is situated, the mortgagor may have no control over the final tax assessment and will, if he believes the ultimate assessment to be too high, have to resort to the customary protest procedures of filing a complaint with the local county board of revision.

²⁰⁷ FHA Form No. 2458. Requirement of submitting such a form is contained in a corporate mortgagor's articles of incorporation, and, by incorporation by reference, in said mortgagor's by-laws or code of regulations, and in the regulatory agreement covering a trust mortgagor.

²⁰⁸ FHA Form No. 2485.

²⁰⁹ This requirement is imposed by the articles of incorporation or regulatory agreement of the mortgagor.

²¹⁰ See *supra* pp. 123-24.

C. Completion

1. *Cost certification and advance amortization procedures*

Upon completion of construction, the mortgagor (and, if an "identity of interest" arrangement exists, the general contractor) must certify actual costs to the FHA office.²¹¹ The mortgagor's cost certification (which incorporates, as an item therein, the total actual costs of the general contractor) must be prepared and certified by an independent public accountant. Savings by the general contractor in basic construction costs may be balanced, for cost certification purposes, by the additional cost of FHA-approved change orders. Such construction cost savings may also be balanced by expenditures for FNMA permanent financing, which presently total two and one-half per cent of the principal mortgage amount. Any construction costs in excess of the original FHA estimate, however, plus or minus approved change order costs, can be cost certified but may be disallowed. Fees established for legal and organizational expenses, general contractor's general overhead, and architect's fee, if exceeded, may be disallowed to the extent of such excess.²¹² But this is a matter of explanation and negotiation with the local FHA office, which may allow such excess expenses under appropriate circumstances.

If rentals have been collected prior to cost certification, the mortgagor must supply the local FHA office, simultaneously with cost certification, a profit and loss statement from the date occupancy began to the date of cost certification and, perhaps, make an advance amortization payment.²¹³ The administrative rules and regulations of the FHA, to prevent "mortgaging out" as was done under the section 608 program, also require a redeveloper to make a minimum cash investment equal to three per cent of the actual project cost as certified at completion.²¹⁴ The equity investment, which may not be withdrawn for three years, will usually have been made by any redeveloper who is not also a builder. If the full three per cent has not been invested by the redeveloper, he will have to make a cash deposit to bring his total cash investment up to three per cent.

After reviewing the cost certification and calculating the advance amortization payment, if any, the local FHA office issues Form 2580, "Maximum Insurable Mortgage," stating the maximum insurable mortgage that FHA will insure to be the amount cost certified (after disallowances and deductions) or the amount specified in the original commitment to insure, whichever is less.

Upon completion of the above procedures, the FHA project inspector inspects

²¹¹ FHA Forms No. 3378 (mortgagor) and 3378-A (general contractor). Cost certification takes place simultaneously with the so-called "next to the last" draw—the request for payment of the retained percentage due the general contractor. The last draw or request relates to payment of the balance of mortgage proceeds held by the mortgagee and consists of nonconstruction items, primarily the balance, if any, of the profit and risk fee.

²¹² The new forms of architect's contract, FHA Forms No. 2719-A and 2719-C, provide for an adjustment in the architect's percentage fee if approved additive change orders increase the cost of the project.

²¹³ See *supra* note 206.

²¹⁴ 24 C.F.R. § 232.18(g) (1956).

the project, notes the items of delayed completion,²¹⁵ and certifies the project as complete except for such items. An escrow agreement is executed between the mortgagor and mortgagee establishing an escrow in twice the amount of the FHA estimated cost of completing the items of delayed completion,²¹⁶ and thereupon the balance of construction funds held by the mortgagee (the ten per cent retention) is distributed.

2. *Final endorsement*

Thirty days after FHA certification that the project is complete (except for delayed completion items), the mortgage note may be finally endorsed. Final endorsement, as contrasted with initial endorsement, is quite simple and does not require the presence of the FHA closing attorney. Many of the necessary documents will have been submitted during the course of construction. A final site survey, showing the location of the buildings on the project property and compliance with set-back lines, an opinion letter of the attorney for the mortgagor, a request for final endorsement of the credit instrument,²¹⁷ and an updated policy of title insurance²¹⁸ are among the principal papers submitted. Prior to the procurement and submission of the title insurance policy, a completion certificate should be obtained, in recordable form, from the LPA and recorded in order to cancel of record any penalties or reversions that would have resulted from the failure of the redeveloper to complete construction.²¹⁹ The mortgagor should also obtain and record, prior to procuring the title insurance policy, any necessary reciprocal easement agreements with adjacent redevelopers or property owners relating to utility and sidewalk easements and rights-of-way. Such agreements should be cleared in proposed form with the local FHA office and with the FNMA. Lastly, the mortgagor will submit its request for any balance of the mortgage proceeds still held by the mortgagee, which, assuming everything else to be in order, will be paid. Thereupon, the mortgage note is submitted to the FHA for final endorsement.

3. *Sale of mortgage and mortgage note*

If the interest on the project mortgage is at the time of final endorsement higher than current conventional interest rates, the mortgagor may desire that the mortgage note not be sold to the FNMA at the agreed one per cent discount and one-half per cent purchase fee.²²⁰ On the other hand, if the interest rate on the project

²¹⁵ Most typically, this will be landscaping work in the event that final endorsement takes place during a nonplanting season.

²¹⁶ FHA Form No. 2456. The funds so escrowed are disbursed when the FHA project inspector, acting on the request of the mortgagee, inspects the site and certifies the delayed completion items to be completed. The escrowed amount is double the FHA estimated cost of completion, and subsequent to completion, the mortgagor must cost-certify, informally, the actual cost of completing the delayed completion items.

²¹⁷ FHA Form No. 2023.

²¹⁸ Naming both the Federal Housing Commissioner and the FNMA as the insureds.

²¹⁹ This is required by the FNMA, and the title policy should be written with an eye to FNMA requirements.

²²⁰ See *supra* note 145.

mortgage at such time is lower than current conventional interest rates, the construction mortgagee will want to sell the mortgage note to the FNMA as quickly as possible and usually will request the help of the attorney for the redeveloper in assembling the necessary documentation.²²¹

The FNMA requires certification letters from the FHA as to the validity of the mortgage deed, requires FHA certification that it approves the articles of incorporation of the mortgagor, and requires certification by the FHA that such exceptions as are shown on the title insurance policy do not, in the FHA's opinion, affect the FHA appraised value of the project.²²² It will, in all probability, be necessary to supply the FNMA with a new, updated policy of title insurance, since the FNMA requires a policy to be dated within thirty days of the purchase by the FNMA of the mortgage and note, and it will normally take more than thirty days after the FHA final endorsement to consummate the sale to the FNMA. It is also necessary to supply a comprehensive opinion letter, an occupancy report indicating occupancy trends, photographs of the project, and a current profit and loss statement of the mortgagor. Hazard and fire insurance policies, which at the completion of construction were changed from "builder's risk" form to permanent form, must be amended to include the FNMA as an insured. The real estate and chattel mortgages must be assigned and the assignment recorded. The FNMA will not purchase the mortgage and the note if the mortgagor is already in default on same, and as a prerequisite to such purchase, the mortgagor must bring the mortgage note current. Thereafter, the mortgagor may, if it is necessary, make a request for a moratorium on amortization payments and payments to the replacement reserves.²²³

VII

OCCUPANCY AND OPERATION

A. Commercial and Industrial Redevelopment Properties

The occupancy and operation of commercial and industrial properties built under a redevelopment program should not differ at all from usual circumstances. The area may be somewhat better planned and better zoned, because of the absence of nonconforming uses. Except for parking garages, where rates may be regulated,²²⁴ and except for convenience shopping in residential areas, the LPA usually will not seek to retain any control over completed commercial and industrial property, and it will be regulated only by ordinances and codes that apply to the general community.

²²¹ FNMA requirements may be found in the FNMA, *SELLER'S GUIDE*.

²²² These certifications may be in letter form from the FHA to the FNMA.

²²³ The FNMA requirements and procedures relating to modifications of the original mortgage terms are contained in FNMA, *SERVICER'S GUIDE* reg. 115.

²²⁴ There has been a great deal of litigation about the constitutionality of municipally supplied parking facilities. Sometimes they are attacked because rates are not regulated and sometimes because they are. See, e.g., *Foltz v. City of Indianapolis*, 234 Ind. 656, 130 N.E.2d 650 (1955); *Omaha Parking Authority v. City of Omaha*, 163 Neb. 97, 77 N.W.2d 862 (1956). Cf. *Denihan Enterprises, Inc. v. O'Dwyer*, 302 N.Y. 451, 99 N.E.2d 235 (1951).

Many LPAs apply special restrictions on convenience shopping areas not only to achieve harmony with the plan for the related residential property, but also to protect the economic value of any larger shopping centers contemplated by the redevelopment plan to be constructed in the vicinity. Counsel for the redeveloper should resist the desire of some LPAs to make these restrictions very comprehensive and then to insert them into the granting deeds, possibly as covenants to run with the land enforceable by any tenant in the related residential property and waivable only by all the tenants.²²⁵ The larger shopping center may never be built, and expansion of the convenience shopping may become essential to attract tenants to the related residential areas. Changing shopping habits may switch the types of goods and services appropriate for convenience purchasing areas. For example, modern dry cleaning equipment sufficiently safe and simple for operation in neighborhood stores and the newly popular self-operated laundry centers have both had considerable zoning difficulty and in some cities would be excluded from the convenience shopping areas by the language of proposed land disposition restrictions. If the LPA does insist on such restrictions, possibly because they have been frozen into prebid plans and documents, counsel should make sure that the LPA can amend or waive them with as little additional outside participation as possible and that some successor (perhaps the mayor) is designated to the powers of the LPA in the event of its termination without a succeeding entity.

B. Residential Redevelopment Properties

The occupancy and operation of completed residential properties built under a redevelopment program will differ in a number of ways from usual circumstances. If FHA financing has been used, a rental ceiling will be set by the FHA with which the redeveloper must comply.²²⁶ If a property management firm is used, the contract with it should reflect some of the peculiar problems of residential urban redevelopment,²²⁷ and, more important, the property management firm's personnel on the site should be alerted to the special problems they may encounter. These problems derive almost entirely from the fact that in the larger redevelopment projects, the redeveloper is doing much more than just managing a number of

²²⁵ In one city where an important redevelopment official despises flashing neon signs, a covenant that runs with the land in the grant deed perpetually prohibits them, and only a Horatius-at-the-bridge stand by the redeveloper's counsel reduced the prohibition to a covenant from a condition subsequent with reverter. See *supra* note 90.

²²⁶ Aside from FHA enforcement, tenants may directly sue for overcharges, *Parkin v. Damen-Ridge Apts.*, 348 Ill. App. 428, 109 N.E.2d 363 (1952); even if the overcharge is made indirectly by means of a rental agency owned by the landlord that charges commissions. *Brinkmann v. Urban Realty Co.*, 10 N.J. 113, 89 A.2d 394 (1952).

²²⁷ The FHA, if it insures the mortgage on the property, will require that the right be reserved in the management contract for cancellation without cause by the FHA if it takes over the project. Some FHA offices also wish the FHA rental schedules to be stated in the management contract, but this is best handled by a general provision requiring the managing agent to change the FHA rentals as established from time to time. In addition, the managing agent's contract should provide that units cannot be leased for periods of less than 30 days or discriminate against families with children.

apartment houses—he is running a new community, and the residents may occasionally act more like free citizens than tenants.

A good part of such a tenant attitude reflects the fact that government has been deeply involved in the project, and the publicity may have left a community misunderstanding that the redevelopment apartments are some sort of middle- or upper-class public housing. If the governor laid the cornerstone and the mayor welcomed the first tenant, why shouldn't the state house or city hall see that rents are lowered or forgiven when a tenant is out of work or see that better dryers are put in the laundries? This public relations problem may be intensified by a political vacuum created when the area was demolished and that will have been filled by enough new tenant voters to control, perhaps, the election of the local city councilman if the council is elected by wards rather than on a city-wide basis. Some candidate may even be unable to resist promising lower rents and better laundries.

The redeveloper's solution is a well thought-out public relations program for the tenants right from the start, emphasizing that they are tenants of a private owner and that, upon completion, only the FHA rent controls distinguish the project from other private apartments—and, indeed, the FHA rent controls apply to many other apartments outside the redevelopment area. A second public relations problem is to explain to the city officials that in the long run, they are better off seeking a little less publicity and credit as the project is completed and concomitantly receiving a lot less aggravation and blame if a toilet overflows or a roof leaks.

The planning and architecture of large redevelopment projects is often designed to encourage the development of community spirit. For example, instead of many separate entrances, each opening on a public street as in a traditional city apartment block, the buildings may be grouped with path plans, and there may be sitting areas and common rooms. As the paternal industrialists discovered who saw their company unions joining the CIO in the 1930's, redevelopers who build developments so designed and then fail to anticipate, understand, and negotiate intelligently with group action may discover that, like Frankenstein, they cannot control their creation. Tenant-association agitation, rent strikes, and the like are better prevented by astute planning than resisted by court actions. Most of the law on tenant associations has been created in New York City by tenant associations organized to resist landlord attempts to raise rents under the New York rent control act or to oppose the "coping" of rental properties.²²⁸ Peaceful picketing by tenant associations is legal, but

²²⁸ The New York State Rent Control Act makes specific provision for tenant committees and contemplates action by them in enforcing tenants' rights generally in Rent Commission proceedings. See N.Y.S. Rent Comm'n Regs. § 91. In *Barnes-Arno Building Corp. v. Hoffman*, 89 N.Y.L.J. 1324 (1933), the New York court refused to enjoin a group of tenants from peaceful picketing in support of a dispute between them and the landlord concerning the amount of rent to be paid, although they were enjoined from doing any willful damage to the property. The New York courts have, however, enjoined anyone not a tenant from picketing the premises in connection with a property dispute on the ground that there was an insufficient property interest in the controversy. *Birnbaum v. Margosian*, 89 N.Y.L.J. 1323 (March 6, 1933). While the New York courts have sanctioned peaceful picketing generally in public places, it has been held that picketing in nonlabor disputes upon private property does not come within the scope of the rule. See *Sea Gate Ass'n v. Sea Gate Tenants Ass'n*, 168 Misc. 742, 6 N.Y.S.2d

the use of false or misleading placards can probably be enjoined.²²⁹

Another tenant problem is nondiscriminatory or so-called "open" occupancy. The FHA will not permit discrimination to be required by a recorded covenant,²³⁰ and this is about as far as the land disposition agreements of many LPAs go.²³¹ Other LPAs, however, may insert antidiscrimination provisions in the disposition documents, and the local Negro leadership will be aware of them. A recent New Jersey case has upheld a state ban on racial discrimination in housing assisted by FHA financing.²³² To the extent that a high percentage of the cleared areas were occupied by Negro tenants, there will be a feeling in the Negro community and to some degree in the general community that the desire of Negroes to live in the new properties should not be denied. The redeveloper may, therefore, have to accept a small role in solving the minority problem, and individuals unwilling to undertake the operation of integrated housing are best advised to avoid redevelopment.

Finally, the redeveloper during the initial rent-up period may find that the

387 (Sup. Ct. 1938); 70 C.J.S. *Picketing* § 1 (1951). Recently, a city-wide organization of tenants' committees has been organized in New York City, primarily to lobby for continuation of rent control.

²²⁹ See *Bernstein v. Retail Cleaners & Dyers Ass'n*, 31 Ohio N.P. (n.s.) 433 (C.P. 1934), where a retail dry-cleaning establishment was picketed by an association of retail cleaners and tailors, alleging violations of the Code of Fair Competition for the dry-cleaning industry. In denying an injunction, the court made the following observations:

"Picketing, so-called, is a method long established as legal, where not accompanied by intimidating and importunate conduct, as a means of endeavoring to settle economic disputes existing between workers and employers. . . . It has also been frequently used by groups desiring to accomplish political objectives. It is a publicity mechanism, designed to advise the public of the existence of a present controversy between those picketing and the one picketed. . . . But if the objective is the honestly believed correct disposition of a real and existing economic dispute, it is legal. . . . The picketing program has rarely been resorted to by others than labor unions, but in reason, so it seems to me, there is no real distinction between the right of union members so to do and the right of the defendants, under circumstances prevailing in the present emergency, likewise to act." *Id.* at 435-36.

²³⁰ See art. VIII of model form of articles of incorporation and para. A(13) of model form of regulatory agreement.

²³¹ See *Nondiscrimination Clauses in Regard to Public Housing, Private Housing and Urban Redevelopment Undertakings*, 15 J. HOUSING 27 (1958). There has been criticism of the federal housing programs for their cautious action in regard to segregation. See quotation from U.S. COMM'N ON CIVIL RIGHTS (1959), quoted in *House and Home*, Oct. 1959, p. 54. At least one important national redeveloper regards the open occupancy problem as greatly exaggerated and unlikely to affect financial feasibility of long term investment in urban renewal projects. See testimony of James H. Scheuer in *Hearings on Housing Before United States Commission on Civil Rights* 282, at 293-94 (1959).

²³² "Congress did refuse to accept amendments to various versions of the National Housing Act . . . which would have expressly prohibited the discrimination with which plaintiffs are charged. . . . But to construe this against state laws having the same effect is not warranted by the circumstances. Failure of Congress to incorporate in the National Housing Act a positive imposition of a policy of non-discrimination with its necessary national implications, may be grounded in political expediency to secure its enactment, and in any event, such a provision would not account for local conditions and the effect of such a policy, on a local basis, on the national housing program. But state laws incorporating such a policy taking into account and being expressly designed to meet purely local conditions and attitudes, are not subject to the same difficulty." *Levitt and Sons, Inc. v. Division Against Discrimination in State Dep't of Education*, 31 N.J. 514, 535, 158 A.2d 177, 188 (1960). For earlier comments, see *Lehman, Discrimination in FHA Guaranteed Home Financing*, 40 CH. B. REC. 375 (1959); *Comment, Builder of FHA Housing Held Barred from Discriminating Against Purchasers on Basis of Race: Possible Sources of Federal Prohibition and Bases for Cause of Action*, 59 COLUM. L. REV. 782 (1959); *Note, The New Jersey Housing Anti-Bias Law: Application to New State Aided Developments*, 12 RUTGERS L. REV. 557 (1958).

project will not be self-sufficient as early as he had hoped. This usually reflects the fact that total redevelopment is needed before good occupancy rates can be attained. Until the new shopping center, the refurbished school, the improved park, the more frequent bus service, and the better street lighting are finished—or at least obviously well toward completion—tenants will be reluctant to move into the redeveloped neighborhood.²³³ Some of these facilities, however, both commercial and governmental, are difficult to start before the tenants move in. It is the chicken-or-egg-first problem, and both the FHA and the FNMA have been obliged to recognize this with mortgage loan accommodations. The FHA and the FNMA have regulations permitting a moratorium on principal payments and payments to the replacement reserve²³⁴ and have thus partially recognized that the first projects in a large redevelopment area will require additional time for rent-up. The more suitable financing pattern, however, would be one where no debt-service payments commenced until substantial renting-up of the project was completed, and this would require a longer construction loan period with a capitalization of interest rather than a moratorium agreement. In many communities, the local real estate tax authorities have also recognized that the real property assessment must be depressed for an oasis of new construction in a desert of slum and demolition.

VIII

SALE OR REFINANCING OF AN URBAN REDEVELOPMENT PROJECT

If the redeveloper has been careful to obtain and record completion certificates, his title and right to transfer should be clear and the tax considerations of such sale or refinancing will be the same as is the case with most other real estate transactions. First, any sale of the project within three years of completion will create the possibility of ordinary income instead of capital gain treatment under the collapsibility rules of section 341.²³⁵ Second, since the project will have been heavily mortgaged and depreciation will have reduced the tax basis below the principal due on the mortgage note, the project is likely to have a negative basis, so that the capital gain will exceed the consideration received by the seller to the extent of the gap between the tax basis and mortgage balance.²³⁶

For the second of the above reasons, the redeveloper may decide to refinance rather than to sell. Upon refinancing, assuming the collapsibility rules would not apply, no gain is realized, and if the corporate redeveloper has no realized earnings and profits (which it should not have if it has been taking accelerated depreciation), it

²³³ See *Report on Detroit's "Gratiot" Redevelopment Project*, House and Home, Oct. 1959, p. 55.

²³⁴ See 6 FHA, PROJECT MORTGAGE SERVICING bk. A, pl. C, para. 644.10; FNMA, SERVICER GUIDE reg.

115.

²³⁵ See discussion *supra* p. 159 and citations at *supra* note 173.

²³⁶ A sale of the mortgagor's stock rather than a sale of the project by the mortgagor would produce different tax results. See discussion of *Crane v. United States*, *supra* note 185. The *Crane* rule may not apply upon abandonment. See *Crane v. United States*, 331 U.S. 1, 14 n. 37 (1947).

can distribute any proceeds from an increase in the amount of the mortgage as a return of capital or capital gain.²³⁷

From the purchaser's viewpoint, there are only a few problems unique to urban redevelopment. The deed restrictions and other covenants relating to the property must be carefully checked, and if the LPA has been reasonable and the redeveloper's counsel careful, these should not be burdensome. The purchaser must also check carefully what unusual responsibilities he must assume for maintenance of public improvements and utilities by reason of formal cooperation agreements. He should also verify the extent to which real estate tax abatements and any other special advantages enjoyed by the initial redeveloper are transferable.

The purchaser may wish to preserve the FHA mortgage note because of a favorable interest rate, even though the FHA controls will remain in effect. He can do this by buying the stock of the mortgagor corporation, which will require notice to, but not the consent of, the FHA. This purchase of the stock will also preserve the right to take rapid depreciation; but there will be no "step-up" in basis by the amount by which the increased purchase price exceeds the corporation's basis, and the earlier years of heaviest depreciation will have been enjoyed by the seller. A "stepped-up" basis can be obtained if the purchaser organizes as vendee a new FHA-approved mortgage corporation to acquire the property. The transfer from the old FHA-approved mortgagor to the new FHA mortgagor must be requested by the mortgagee, and the mortgagee may not do so if the interest rate it is receiving is below current rates—it would prefer to have the mortgage paid off. In a few instances, the FHA has approved transfer to a general business corporation (with other assets) and permitted such corporations to take the property subject to, without personally assuming, the mortgage. The FHA controls have been imposed by a regulatory agreement. This procedure permits the purchaser to file a single tax return for all of its operations, including the FHA project, without the need for a consolidated tax return.²³⁸

XI

CONCLUSION

The importance to the United States of its urban renewal program cannot be over-emphasized. Almost every American metropolitan center has a rotten doughnut of deteriorating buildings that separates its commercial downtown core from its residential suburbs. This deterioration, if permitted to spread, can undermine our urban way of life by driving to suburbia the types of city dwellers who largely

²³⁷ See Andrews, *Out of Its Earnings and Profits: Some Reflections on the Taxation of Dividends*, 69 HARV. L. REV. 1403 (1956); *Marx v. Bragalini*, 6 N.Y.2d 322, 189 N.Y.S.2d 846 (Ct. App. 1959) (same treatment under New York Personal Income Tax Law). The redeveloper should check the applicability of INT. REV. CODE OF 1954 § 312(j), which taxes the distribution of proceeds of loans insured by the United States. In most instances, § 312(j) will not create a tax problem, since, for its purposes, the adjusted basis is determined without deducting depreciation. Also, see Lurke, *The Messrs. Gross and Morton: Modern '49ers*, 33 TAXES 666 (1955); Alexander, *Some Earnings and Profits Aspects of the Internal Revenue Code of 1954*, 7 HASTINGS L.J. 285 (1956).

²³⁸ See *supra* p. 158 for a discussion of consolidated tax returns.

produce and support our cultural institutions. It has been well said that "when civilizations die, the decaying city sings the requiem."²³⁹

Thus far, the renewal program has been a success in its purely governmental function of demolishing the decay. Almost the only criticisms of the bulldozers have been that they occasionally chew up, along with eyesores and areas, landmarks that it would have been better to have rehabilitated than to have destroyed. But in its construction aspects, where Congress has dictated that the primary job be done by private enterprise aided by various types of governmental assistance,²⁴⁰ the urban renewal program in many instances has been severely criticized. In some cities, cleared areas have lain idle for years as successive sponsors have become discouraged and abandoned projects because of delays, red tape, and lack of coordination between government agencies. Elsewhere, perhaps because some city has been obliged to accept any sponsor who would build anything, new projects have been built that are improvements over the demolished structures only in sanitation.²⁴¹

On the other hand, a number of financially sound, handsome, and delightful projects have been built, in some instances even more rapidly than most non-government-aided developments, and these instances demonstrate that the urban redevelopment experiment of mixing public and private initiative can be made to succeed. Of course, there will be a recurrent need to calibrate the government aids so that they provide adequate but not excessive incentive to private enterprise; and the government program aimed at stimulating private enterprise will remain complex—necessarily, since local, state,²⁴² and federal governments are all involved.

In addition to these interesting problems of federalism, counsel for the private redeveloper in his work will encounter the niceties of ancient real estate law, the higher mathematics of real estate finance, the refinements of federal income taxation, and all the controversial and partially explored issues of contemporary land planning law.²⁴³ Like the land lawyer of the eighteenth century, the railroad lawyer of the nineteenth century, and the government lawyer of the 1930's, counsel for the private redeveloper, when he looks beyond his immediate problems, will see in perspective that his function is to help develop a legal foundation for basic social and economic

²³⁹ Lange, *Where Civilizations are Bought and Sold*, 19 PUB. ADMIN. REV. 198 (1959).

²⁴⁰ National Housing Act of 1949, 63 Stat. 413, 42 U.S.C. § 1450(a)(11) (1958), requires "the urban renewal plan will afford maximum opportunity consistent with the sound needs of the locality as a whole, for the rehabilitation or redevelopment of the urban area by private enterprise."

²⁴¹ See Whyte, *Are Cities Un-American?* in EDITORS OF FORTUNE, *THE EXPLODING METROPOLIS* 23, 25 (1958); Jacobs, *Downtown is for People*, in *id.* at 157, 173; Editorial, *What is a City*, *Architectural Forum*, July 1958, p. 63.

²⁴² There has been relatively little participation in urban redevelopment at the state level. Much of the demand for state participation has been by those who would kill the program by assigning its implementation to the level of government not equipped (largely because of rural domination) to carry it out. See *Hearings before the Subcommittee on Housing of the House Committee on Banking and Currency*, 85th Cong. 2d Sess. 3, 9 (1958).

²⁴³ The lawyer is not the only professional who finds his task in redevelopment a complex one. "Architects and planners realize that under existing conditions reconstructing a city is like trying to perform a major operation without being able to anaesthetise the patient." Minogue, *Rebuilding Britain's Cities*, *Manchester Guardian Weekly*, June 23, 1960, p. 15.

movements that are central and vital to his time. Herein lies the great challenge to him. Can the lawyer's knowledge and the lawyer's skills of analysis, judgment, coordination, and improvisation help blend public goals and private energy into a force capable in the mixed economy of the United States of reshaping the central cities into places where people who could move elsewhere will want to live?

