# DEVELOPMENT PROCESS IN HOUSING

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Submitted in Partial Fulfillment for the Degree of
Master in City and Regional Planning

at

MASSACHUSETTS INSTITUTE OF TECHNOLOGY
May 15, 1971

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Submitted to the Department of Urban Studies and Planning on May 15, 1971, in partial fulfillment of the requirements for the degree of Master in City Planning

ABSTRACT

The shortage and deterioration of adequate housing is everywhere in evidence. Recent statistical studies of housing needs merely confirm the above and further indicate the decline in interest of housing developers to produce more units. In general, this is due to the uncoordinated efforts of the public and private institutions in the development of housing. Very few builders can deliver housing on their working capital and at their own personal risk. In like manner, very few users can buy housing with cash. Thus, housing problems and solutions in their gravity invade everyone, even those who surround themselves with the illusions of outdated codes and obsolete social policies.

The prime movers of housing (the federal government, banks, and life insurance companies) are argued in the thesis as being ineffective in solving these problems because of their limitations when performing on local levels or during the unending seasons of tight money market.

The thesis therefore presupposes that the answer rests on recognizing the potentials of a powerful and flexible regional or local organization able to maintain very narrow fluctuations in housing mortgage lending and provide at the same time enough incentives to induce, influence, and stimulate the public and private sectors in housing.

Thus, development process in housing is examined as viewed through the Massachusetts Housing Finance Agency, a quasi-public organization funded in 1968. The activities of MHFA are evaluated in the light of its role in economics, aesthetics, management, and the overall general philosophies toward the housing user market. Case studies of the public-private achievements are compared and contrasted with MHFA's achievements; and in the light of that, it is further suggested how to maximize and improve the quality of its housing development process.

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May 15, 1971

Professor Lloyd Rodwin
Chairman
Department of Urban Studies
and Planning
Massachusetts Institute of Technology
Cambridge, Massachusetts

Dear Professor Rodwin:

In partial fulfillment of the requirements for the degree of Master in City Planning, I herewith submit my thesis entitled "Development Process in Housing."

Sincerely,

J. O. Chike Enwonwu
Department of Urban Studies
and Planning
Massachusetts Institute of Technology
Cambridge, Massachusetts

ACKNOWLEDGMENTS

I wish to express my sincere gratitude to the following people whose assistance has been invaluable during the preparation of this thesis.

Professor Langley Keyes for his thoughtful guidance and encouragement during the development of this work.

Professors Justin Gray and Daniel Weisberg whose advice and counseling were very helpful and stimulating.

I also thank the members of the faculty of M.I.T. Department of Urban Studies for their assistance during my study in the Department.

I am very obliged and grateful to the entire staff of the Massachusetts Housing Finance Agency who were very helpful and understanding in making it possible for me to prepare this thesis. I cannot adequately express my thanks to Mr. William J. White, the Executive Director, who allowed me the use of MHFA's materials and facilities during the period of this work.

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# CHAPTER 1 INTRODUCTION: SCOPE OF THESIS

If the housing market has not been encouraging through the prevalent development process, the reason is not that of lack of understanding or lack of criticism by the developers and users alike or lack of government interest. It is because of the confused and duplicated roles performed by these various actors in the production of housing.

The federal government since its initial interest in housing has assumed a role more detailed than it can adequately administer on regional and local levels. The functions of processing mortgage loans, supervising construction work and rent-ups in addition to providing assistance to individual builders and housing users is much too localized an operation to be carried out on a national scale. Time lag and inefficient operations caused by the unavoidable bureaucratic red tape is a price paid by all involved in the housing development field. The end product is simply a nonfulfillment of any one function.

The private housing sector on the other hand is constantly faced with the competition of the commercial and industrial business sectors in the money market.

Because of the magnitude and the long amortization period, the housing development industry is constantly losing out to other business in periods of economic competition.

This thesis, therefore, views the practical problem as finding the right place for the interactions of the various participants in the housing development process. The following chapters examine the housing development process under the demand and supply magnitudes viewed from the posture and philosophies of the Massachusetts Housing Finance Agency.

It is then suggested that development of public housing in the Commonwealth of Massachusetts be principally left in the hands of organizations such as the MHFA, which through its philosophies will coordinate the activities of the public and private sectors of the society. By so doing, incentive yielding devices will be generated which, in turn, will stimulate the housing market, encourage labor-saving techniques, and in general help the overall economy. Furthermore, it is also suggested that public organizations such as the MHFA be endowed such rights and privileges to enable them to compete favorably with the private housing sector and overrule where necessary existing local social policies and obsolete housing laws.

In order to achieve this, it is suggested that the housing industry be made a profitable enterprise; that is, that the various participants in the development of housing be motivated through incentives and rewards such as easier cash flow, easier mortgage terms, and tax relief for developers who in turn can produce better quality units at prices easily accessible to users and at no personal risks. The federal government in abdicating its general role in housing should concentrate more on providing assistance to users and state agencies like MHFA to enable them to compete favorably with the private market.

## CHAPTER 2 MHFA PROGRAM IN HOUSING DEVELOPMENT

### A GENERAL OVERVIEW:

The need to conserve and restore large numbers of deteriorating housing stock coupled with the overall need to provide thousands of new housing units for the low and moderate income aroused concern amongst groups and communities of Massachusetts to provide a panacea which finally became known as the Massachusetts Housing Finance Agency. The background of this Agency is that of a pace-setter oriented in a new direction of housing development to respond to the public and private sectors simultaneously.

During the past decade or so in Massachusetts and principally in the Greater Boston area, many concerned citizens' groups including the real estate organizations were active in the field of civil rights and open occupancy. In the early 1960's many of these interested groups met regularly in an attempt to work out solutions to the low-income housing problems. Included in those groups were Fair Housing, Inc.; Massachusetts Commission Against Discrimination; the Boston Real Estate Board; Boston Redevelopment Authority; and many others.

The then Governor Peabody appointed a Civil Rights Commission from members of these groups. And it was with this Commission that the germ of the idea to originate the finance agency later to be called MHFA was planted.

In the course of subsequent actions, another low-income housing commission was established which made an in-depth study, held public hearings, and submitted a report which later formed the basis for MHFA's guidelines of operation. Because of the broad-based support of the MHFA and the efforts put into its inception by the citizens groups, the legislature with only two negative votes was overly favorable to its legislation.

Although the Agency was formed in 1966, it was not funded until 1968. During that two-year period, there was a great effort made to have the legislature act; and some of the early members of the Agency resigned in protest. However, in 1968, the state loaned the Agency $300,000, which is to be paid back over a ten-year period. Since MHFA's purposes as a public oriented agency was clear beyond doubt, its constitutionality was upheld by the Supreme Judicial Court of Massachusetts in an opinion handed down in 1969.

Following the recommendations of the Low-income Housing Commission, the MHFA program became modelled

after the "Mitchell Lama Program"* although oriented with a different set of goals and operation guidelines, which were geared toward the Massachusetts communities' needs in housing.

The Low-income Housing Commission recommended a program for an agency which represented a major step forward in the development of comprehensive low-rent housing, capable of providing decent units for many thousands of low-income families living in substandard conditions all over Massachusetts. According to the 1960 U. S. Housing Census, the Commission observed that about 20% of the 1.7 million housing units in the Commonwealth which were used by low-income households were in substandard condition. And that these households paid between 20% and 30% of their under $6,000 annual income on rent despite the dilapidated conditions of these units.**

One of the principal ways to combat this deplorable situation, as recommended by the Low-income Housing

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*Mitchell Lama: A New York State Housing Agency which raises its funds through sale of tax-exempt bonds and bond anticipation notes and in turn makes the money available as loans to housing sponsors at below market rate interest. (The Mitchell Lama program was established in 1955.)

**Source of information: U. S. Housing Census 1960. Bureau of Statistics.

Commission, in reducing the cost of housing was to reduce the cost of borrowing money needed to produce this housing. If the cost of borrowing money can be reduced, if the amortization period is lengthened, and if loan-to-value ratios are increased (that is, by reducing the down-payments or the equity capital needed to acquire such loans) then far more housing units can be built at a far lower cost per month to the average family.

The Commission pointed out in reference to MHFA that it was advisable to introduce a program similar to the federal 221(d)(3) at the state level because of the following reasons:

1. The FHA 221(d)(3) program could be used only in 40 cities and towns of the Commonwealth that had Workable Programs* in 1965.
2. The limited amount of funds available for the 221(d)(3) program. As of December 1964, the total allocation of 221(d)(3) funds nationally amounted to almost $1.1 billion or approximately 86,000 units (figuring an average cost of $12,500 per unit). Region 1, which included New York

*A Workable Program for Community Improvement consists of seven parts: comprehensive planning, neighborhood analyses, code enforcement, relocation, citizen participation, administration, and financing, and in addition should be required by HHFA of all communities receiving federal housing or renewal aid. Only communities in the large cities and towns have a Workable Program.

State plus six New England states, received its allocation of national funds based on its proportion of the nation's total population, which was approximately 20%. Within the region, funds were allocated to individual states on a more flexible basis, according to need and demand. Massachusetts in the beginning was receiving a relatively high proportion of the regional funds but by 1965 onwards, her allocation began to decrease.

3. The Commission believed that a good program of this nature (the MHFA program) could be designed in such a way as to provide housing units for low-income as well as moderate-income households.

Specifically, the MHFA program requires that a minimum of 25% of total units developed in each housing project be made available to low-income households at reduced rents which they can afford in their neighborhoods. By doing this, low-income families will have the opportunity to live in decent apartments, without identification (as in the FHA public housing projects) and at the same time in close proximity to family households of differing economic and social levels. Furthermore, low-income families so housed will not be required to move when their incomes increase as is the case with most FHA housing.

In order to achieve a balanced socio-economic mix of households in projects thus developed, the MHFA used the unceasing cooperation of many other public and private institutions. The government agencies, local housing authorities, and the Model Cities agencies responded with enthusiasm in this state-wide effort to develop housing for low-income families in the Commonwealth. The skills of housing sponsors and developers, nonprofit and limited dividend organizations along with their architects, lawyers, management personnel, and realtors have been very crucial in the operation of the MHFA program toward providing a workable solution for the low-income housing problems.

The responsibility of developing decent housing units at costs accessible to the low-income household users became very crucial and meaningful through this Agency's program. Builders became motivated through the easy financing mechanisms which accompanied by a long amortization period made the production of housing faster and less costly. Further government assistance in the form of subsidies and tax reliefs made it possible to deliver housing financed through the MHFA at below the open market rental rates to low and moderate-income households.

MHFA became established as an independent state agency in the Department of Community Affairs but not subject to the supervision or control of either that or any other department in the Commonwealth of Massachusetts. The Agency consists of five members appointed by the Governor for terms of seven years.* The members in turn appoint the executive director, and in this manner its operation resembles that of any business. The staff is hired by the director and all the administration of the Agency is under the director's responsibility, although the ultimate responsibility is to the Agency members.

The biggest administrative problem, typical of most governmental agencies is that of proper staffing. Through a top-flight professional staff of experienced people brought in from private industry, the Agency has been able to avoid many of the pitfalls of government by not building up a lot of bureaucratic red tape. The virtue of this move has been proven by the Agency's effectiveness in closing loans over $100 million in the first year of operation - a major breakthrough for low and moderate-income housing in the Commonwealth.

MHFA raises its funds through the sale of bonds and bond anticipation notes in the tax-exempt market and

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*MHFA Statute

passes on the savings in interest rates to nonprofit and limited dividend borrowers, who in turn develop housing with rents below the conventional market financing. Because of the national interest to private investors of tax-exempt bonds, the accumulated capital on such sales flows into the Commonwealth of Massachusetts from other states.

A characteristic of all MHFA mortgage holdings is that housing loans are made up to 90% of the total cost of a project, and up to 100% in cases where the sponsor or developer is a nonprofit organization. Construction loans are made for the period the development is being built and permanent mortgage loans are authorized for up to 50 years, but are limited to 40 years by policies of the buyers of MHFA bonds, for which the mortgage holdings serve as a security. The lending rates are determined by the amount the Agency pays in the bond market upon the issuance of such securities.*

Further ingredients are still needed to foster the ultimate success of this Agency if it is to maintain a relatively fixed rent structure for the low and moderate income households. Amongst these components would be a standard tax arrangement with cities and towns based

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*MHFA current lending rate is 7% over 40 years for new construction. In exceptional cases loans are written at the same rate for 25 years for rehabilitation projects.

on the gross income of the development at a fixed percentage with a state subsidy going to these cities and towns in order to make up the loss of tax revenue. Secondly, would be some control over local zoning practices and other social policies which ostracise the proposal for development of low and moderate-income housing projects.

Thus, the prime goal and overriding responsibility of the MHFA's program is to maximize the number of dwelling units for low-income families in Massachusetts. The objective of socio-economic interaction through the benefits of such achievement shifts from the traditional concept of housing the poor in isolated projects. Past experiences in public housing have already indicated that concentrated units for low-income families magnify the negative conditions of poverty, call for heavier operating expenses, and in general insure slum conditions rather than combating them.*

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*For example: Columbia Point project, Boston. Built in 1954 by the Boston Housing Authority. The average annual household income in 1960 was below $3,000. (Source: Urban Dwelling Environments: An Elementary Survey of Settlements for Study of Design Determinants, by H. Caminos 1969. Page 89)

The Agency administers two programs on new and rehabilitated construction projects. The Multi-Dwelling Housing Program, under which the minimum development must not be less than three dwelling units, and the Individual Home Ownership Program.* The latter is still in its infant stages as it awaits further legislative action for funds in order to be launched. The thesis concentrates on the Multi-Dwelling Housing Program which has been in operation since 1968.

## PROCESSING PROCEDURE OF THE MHFA MULTI-FAMILY HOUSING PROGRAM

Processing of projects at MHFA follows a general five phase sequence of operation which is flexible and adjustable to suit the undertakings of various developments. The initial phases may be short circuited or completely avoided in cases where MHFA is only providing the construction financing and another lender is taking the permanent loan.

Phase one of the development processing usually referred to as <u>Preliminary Submission</u> involves a series of meetings during which the feasibility of the project is determined. These conferences lead to submissions which include the following:

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*Appendix 1

1. Site Information:* Descriptions of indicators on and around the proposed site. (In rehabilitation existing conditions of the units to be rehabilitated.) A submission of this information enables the MHFA staff to determine whether or not the market in that particular area will support the suggested development. Other indicators that count in favor of the proposal are services and amenities necessary to support comfortable living (schools, shopping centers, bus routes and the like). Problems associated with economic and social integration are also taken into account.

2. Development Team Information:** All participants involved in the development aspect of housing under MHFA financing are evaluated as to their past performances and their ability to fulfill the new role they propose to undertake. Information in the form of personal resumes of the sponsor, developer, architect, lawyer, contractor, manager, and any other consultants and their personal contractual relationships to the entire development

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*Section 3-1

**The development teams are discussed individually in their capacities as evaluated in the MHFA's philosophies: Sections 2-1 through 2-5.

package is evaluated. Agency rules deem certain relationships as not conducive toward an efficient production of the undertakings. For example, if a project architect is part owner of a development, he may not be allowed to act as clerk of works during the construction phase. The Agency works out an amicable relationship whereby the project architect nominates a number of architects, among whom one may be chosen to represent the Agency but be paid by the project architect. This means that the architectural fee for construction supervision is withheld and paid to the selected clerk of works. Another instance is a policy that prohibits persons in public offices from participating in the development of housing through MHFA, since this may constitute a conflict of interest to their public duties.

3. Financial Statement: A financial statement which includes a certified current balance sheet by a public accountant is crucial when evaluating the track record of the sponsor or project developer. Since the housing development industry is full of insurmountable risks, the Agency minimizes its risk ratios through the elimination of fake

sponsors and developers who do not have a straight "track record." Nevertheless, in cases of small developments, the Agency through strict supervision makes mortgage loans to beginners in the housing development industry who do not necessarily have a track record.

The second phase of processing involves the Mortgage Loan Application. Mortgage loans are processed through light of the broad MHFA philosophies viewed from feasibilities in aesthetics, economics, operation and management of the development as discussed in the following sections.

The processing time of phases one and two varies between thirty days and ninety days depending on the ability of the development team to provide the necessary information. When a mortgage commitment is made, the Agency allows a ninety-day period during which the sponsor or developer is supposed to finalize his arrangements with the development team, obtain an acceptable complete set of architectural design and organize his legal and financial documents for the closing.

Closing forms the third phase and necessitates the submission and signing of mortgage loan documents,

architectural drawings and building specifications, management and tenant selection plans, and other legal titles and holdings on business and construction arrangements.

Since the Agency does not receive funds appropriated from tax revenues, its operating expenses are recovered from fees and charges made for its financing services which are drawn during this phase. But because these charges are ultimately built into the rentals or other payments made by the housing occupants, the Agency keeps its charges very low, consistent with the income required to provide its services in a timely and effective manner. The total financing charge obtainable by the Agency amounts to 1% of the amount of the mortgage loan. This includes charges incurred incident to processing of the application, such as for appraisals, title opinions, survey, recording of documents, stamp, taxes, etc.

Phase four is the Construction* period, during which time the Agency's field inspectors visit the jobs to insure that the construction is carried on according to the plans and specifications and according to the general contract agreement.

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*Construction: Section 3-3

The fifth and final phase of operation is the Rent-up and Occupancy. When construction has been successfully completed and checked out, the staff signs the occupancy permit and occupancy proceeds according to the tenant selection plan and the management plan submitted during the earlier phases.*

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*This section is compared to FHA processing procedure in 4-2.

# CHAPTER 3 PHILOSOPHIES OF MHFA HOUSING PROGRAM

## 3-1 FEASIBILITY OF SITES AND MARKET

Processing of mortgage loans through the MHFA program is triggered off by the selection of feasible sites, sound in location and proper in timing for the benefit of the proposed neighborhood housing market. Although the primary aim of the Agency is to develop as many housing units as possible in all parts of the Commonwealth of Massachusetts for its political and geographical existence, nevertheless it places a high premium on the socio-economic feasibilities of its proposed development program.

The acquisition of specific sites (especially if in poor condition) for the purpose of MHFA financing is greatly discouraged until such sites have been checked out and processed by the Agency staff on the basis of the market and its neighborhood. On site selection, prior to seeking financing the sponsor/developer is advised to hold the parcel under option at his personal risk pending evaluations. Inexperienced development teams or nonprofit groups limited in scope by lack of professionalism in site selection receive the benefit of the MHFA staff in search and selection of parcels for development.

The process of acquiring sites may require from the sponsor nominal down payment in the form of option which provides that the site be reserved for him for a certain length of time. Options for sites submitted to MHFA for approval should allow for about six months or more during which time processing of the loan must have been completed and the initial closing granted which will permit the release of the part of the mortgage funds with which to meet his land payments and other carrying charges.

In procurring options of land property, a sponsor/ developer should speculate the future market trend in the proposed project site. If sufficient market consumption of housing is anticipated, it is always desirable to option for or acquire extra land, so that additional sections or projects can be added in the future stages and possibly be planned as part of the initial development.

The allowable land and cost of unimproved land for MHFA housing units varies from one location to another and from one type of site to another. Determination of appropriate prices if shown as different from purchase price depends on the cost of comparable property sales in similar locations of the immediate neighborhood or

similar areas. Other variables for cost determination are availability of services and utilities, such as good access roads and site improvements. Sites serviced by these utilities (public roads, public water and sewer) are evaluated differently from rural sites which use private services and utilities such as leaching fields and private dirt roads.

In general, sites acceptable to the MHFA program must be buildable within a reasonable cost range. This means that the cost of sites forms a great indicator in the allowable mortgage loan. For example, if the cost of a site is $5,000 for every buildable unit and the cost of improving and servicing such is $2,000 per unit, it may mean that the loan amount will present a picture of an average of $30,000 per unit (give or take $5,000 either way for type one fire resistant construction or type six woodframe). A picture of this type presents a rent schedule of about $400 per month for an average two bedroom unit. Since the MHFA program does not care much for this type of rent schedule because of the household income range able to afford that much, the site will be deemed as unfeasible for MHFA financing.

This means that most development of housing for low and moderate income rental range cannot carry site costs which will require too much fill, blasting of rock and ledge, or foundation problems due to the presence of swamps or compressible soils. In addition, a site should not have slopes too steep for the reason that such sites cannot support housing units without excessive improvement costs. Furthermore, in order for sites to meet MHFA's approval, they should not be subject to flood or affected by objectionable odors or traffic nuisances.

Ideally, sites for MHFA financing are viewed as usually possessing the following characteristics:

1. Physical: Convenient transportation and street patterns, schools, churches, and health facilities, stores and service establishments, industrial establishments, parks and recreation facilities, police and fire stations, etc. The pattern of land use, geographic and topograph features should lend themselves to pleasant environmental conditions.
2. Socio-Economics: Availability of social services to residents of project and the overall attitude of the neighborhood residents to the proposed development project.

3. <u>Governmental</u>: Positive attitude of local officials including the taxing and zoning policies, the public housing authority, the redevelopment authority, and the community relationships towards the new proposal.

Sites which meet all of these criteria, no doubt, are very hard to come by in the present real estate market. Thus, the Agency assists the sponsor in acquiring any of the missing aspects in order to develop a feasible project which will respond to good quality aesthetics.

## MARKETABILITY AND NEIGHBORHOOD ANALYSIS

On evaluation of feasibilities of sites, the goals of the Agency are to make sure that the proposed development can support its life in the neighborhood market. By evaluating the existing housing market and the overall neighborhood, it is possible to predict what chances the new proposal has to survive. In addition, it is also possible to decide what type of housing product (including amenities and services) will be most marketable to the housing users.

In a city or town, an analysis of the available housing, their quality and turn-over rates provide an

indication of what is to be anticipated in the proposed development project. A market study entails these factors relative to supply and demand relationships. The characteristics and features of a community and the market will determine how marketable the units can be. For example, construction of swimming pools in a project may be very necessary to market the units if most projects in the neighborhood have swimming pools.

A market analyst must be in a position to visualize the future conditions also. Depending upon the variables of potential housing types and land use types, the sponsor in his search for good market should interest himself in the community-wide trends in the following:

1. Population movement reflected through the age-sex distribution, ethnic disposition, family characteristics, and migration trends of arrivals and departures.
2. Employment and income trends of the labor force, unemployment ratios, distribution of employment by industry, rate of changes in employment, per capita earnings, and the general household income type structures of the area.

3. Housing trends seen as a function of the numerical turn-over, single family compared to multi-family ratios, prevalent housing density which produces varying types of housing conditions, and above all, the rental rates per unit of housing in that market neighborhood.

Thus the sponsor/developer on an adequate analysis of the overall neighborhood with respect to the socio-economics of the community will generally convince himself and the Agency of the feasibility of such a housing development on the proposed site.

## 3-2 MORTGAGE PHILOSOPHIES: ECONOMICS

The MHFA program is not directly supported by the tax revenue, so housing developments financed through its operation must be economically feasible and well structured to pay their way through the life of the mortgage loan. This means that the income from rents must be sufficient to amortize the loan and at the same time pay the expenses for proper management, maintenance, and the operation of the project through the period the loan is contracted.

The Agency statute requires that at least 25% of the units in each project be available within the means of low income households. In cases where not all the units are available to such low-income households, the remaining units carry a different increased rental rate. The additional rent collected on account of this increased ratio is used to make up the difference of the low rates paid by the lower-income family households. (This practice is termed "skewing," and is discussed further under the rent schedules.)

In general, the MHFA program proves only partially successful in lowering housing rents to levels accessible to the low-income households without further government

subsidies. One of the reasons is the extent to which MHFA financing interest rates can be reduced. Although the rates are below conventional lending market rates, they are further controlled by the bond market sales.

In order to insure the maximum potential for creating housing for the low-income household families in various areas of the Commonwealth, the Agency's processing procedure explores the usage of public and private assistance for lowering rents.

RENT SCHEDULES

Principally, the Agency uses three rent scheduling methods to make the units accessible to the low and moderate income households.

1. The use of federal funds under the Section 236* program of the 1949 National Housing Act as amended in 1968, for reduction of interest and rent supplement payments on individual project units.
2. The federal and state leasing* programs and rental assistance administered by local housing authorities.
3. A process of rent skewing whereby rents are adjusted downward and upward within the

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*Appendix 2(a), 2(b), and 2(c)...Supplement Programs

individual project. The upward adjusted rent becomes the maximum rent obtainable but must be below or on the same level as the housing market rent in a particular area. The downward adjusted rent then represents a 10% or more reduction below the MHFA rental. (This may be less but not more than 25% of the occupant's income.)

A further attempt to provide assistance for low and moderate income households is the appropriation of state funds in a form similar to the federal Section 236. This action is undergoing legislative decision in the Commonwealth and the program has yet to be launched. If this becomes a reality, a wide segment of the population of the Commonwealth which does not qualify to receive federal assistance because of the narrow income limitations and at the same time finds it difficult to pay the market rental will receive most of its benefits.*

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*The household income limits qualified under the federal, state, and local assistance programs are restricted to under $8,000 per annum. Households between this income and $12,000 are in many cases stranded and have to use substandard housing. Housing studies indicate that there are as many households in this economic bracket as in the lower-income groups who need some amount of assistance (probably not as much as the lower-income groups) in order to afford decent living.

### 3-2-1 THE COST OF MONEY AT MHFA AND THE "DEVELOPMENT GAME"

Because the net income (including public subsidy funds where applicable) from any housing development must be sufficient to pay off the loan, each application for financing is evaluated and judged as rigorously as it would be by a conventional lending institution (such as commercial banks and life insurance companies). What the housing developer intends to produce as a final project must be shown to be feasible within the limits of the MHFA allowable mortgage loan.

In addition, the Agency's responsibility extends far beyond the stage of completed construction. The projected budget must take into account the requirements of the end product over the life of the contracted loan. The project owner must fully anticipate and account for proper maintenance, management, and owner-tenant relationships. And finally, the housing product apart from being marketable must also be an asset to the community in which it is located.

In order to project an accurate operating budget, a stable tax situation must be created. Housing products financed by MHFA cannot absorb unpredicted increases in tax, for instance, because of the fixed rent schedules and the nature of the charter of the ultimate project ownership which is either a nonprofit or limited-dividend entity.

## THE DEVELOPERS GAME AND EQUITY CAPITAL

The amount of equity funds used in housing mortgages varies widely. Within conventional financing, it is generally required that equity investment in a mortgage loan should amount to up to 30% to 40% of the total development cost.* This has resulted in very limited interest on the part of developers to expand the housing industry since very few builders can afford 30% to 40% of a large capital investment. On the other hand, this practice of requiring that much personal investment in a development takes care of the risk the lender undertakes in the light of such large capital development.

By requiring a large percentage of the developer's personal investment, the amount of risk run by the lender would be distributed proportionately. In

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*Total development cost includes cost of construction items, overhead and profit, fees, carrying charges and land cost.

cases of foreclosure, the lender could at least salvage that part of his remaining loan made on the development. This, it is viewed, would motivate the developer to operate the project in a desirable way since he would be the greater loser otherwise. But very few investors are willing to undertake such a personal risk arrangement when other economic investment outlets may not require such personal involvement. The end result is that either no housing gets built or the developer tries through the "numbers game" and cutting corners to obtain the necessary loan to develop the housing project. This practice is discussed as the "developers game."

## THE DEVELOPERS GAME

Cutting corners or playing the numbers game in conventional mortgage financing is an accepted ethical game belonging to the developer's world. MHFA financing

discourages these tactics since it anticipates that developers doing business with the Agency have a common goal ahead, which is to provide the much needed good quality housing at costs accessible to the low and moderate income households.

The developers cut corners with the conventional lender in order to meet their requirements. On an allowable 70% housing mortgage loan, for example, the developer tries to borrow out possibly 100% of the real total project cost and in many cases more because of other contingencies at the time the loan is contracted. If he is successful in borrowing out his total estimated cost, or "mortgaging out" before construction, through arithmetical juggling of numbers in the mortgage application form, he is most likely found putting all the money into the project. If he gets caught in the numbers manipulation game, is forced into accepting a proportion of his proposed cost, and has not got the remaining proportion to complete the estimated total improvement cost, he tries to deliver the product he can on the allowed sum. And this he does by either producing poorer quality housing than was originally contracted in the mortgage commitment or he tries through depriving suppliers and contractors of their legitimate profits or through other building malpractices to bring in the development at the cost allowed.

This can be a dangerous game if played by shrewd developers, since the end product will bear the scars of the "cut corners." The ultimate buyer or landlord of the project thus inherits a housing product that in many cases is worth 70% (or whatever percentage of loan allowed) of the appraised and delivery value which was set during the bargaining process.

Thus far the writing and lending of 90% of the total project cost to limited dividend entities or 100% to nonprofit groups by MHFA is far more meaningful. Making a 90% commitment loan, if well contracted, leaves the developer only a 10% need to cut corners presumably.

EQUITY INVESTMENT

Not unlike the conventional lending market, the MHFA views the investment of equity capital as a crucial part in protecting the risk of its mortgage loan. Because of the way the funds are raised through bond sales, the Agency cannot afford the reputation of negligency of capital investments. Although, as a last resort, the Commonwealth of Massachusetts in the establishment of the Agency agreed to redeem the MHFA's position during periods of ardent financial losses.

Mortgages are written for 90% of the total project cost and for nonprofit organizations at 100%. While requiring a 10% equity investment from limited-dividend corporations, the Agency recognizes the tendency for borrowers to want "to mortgage out" (as discussed in the development game).

Instead of letting the developer manipulate the dollar numbers, the Agency's mortgage application blank is arranged in a fashion so that the average developer on taking advantage of all allowable maximum percentages in fees and carrying charges can mortgage out over the supposed 90% loan. In order to protect the Agency's position, therefore, the developer

is required to produce a <u>100% performance bond</u> through his contractor for the total sum of all construction items or, at the discretion of the Executive Director of MHFA, a <u>10% irrevocable letter of credit</u> in lieu of the performance bond.

A 100% performance bond generally means a guarantee or bond obtained through a bonding company or an insurance company to cover the amount of money risked on a development. Since this relates to general contractors who through bids or waranty vouch their ability to perform the contract, this bond covers only the construction items which are between 80% and 90% of the total project cost. In order to have a bond company accept such a position on behalf of the contractor, the track record is checked out, and he is made to put up 10% cash in an escrow* account plus the servicing charges of between 0.5% to 1% of the requested bond sum. In this case, the underwriter of such bonds accepts the responsibility for the performance of his contractor client.

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*Escrow Account: A deposit account by a borrower for a larger sum borrowed until contract is expedited. The depositor may incure interest on the amount deposited but cannot withdraw any monies from the account until services are performed. In case of default in contract, the deposited amount passes on to the mortgagee.

Where the Agency accepts a 10% irrevocable letter of credit in lieu of a 100% performance bond, a savings and loan institution underwrites. A 10% irrevocable letter of credit means a deposit of 10% of the requested sum in an escrow account on the behalf of the contractor and the MHFA. The slight difference between the performance bond and the letter of credit is that the latter carries no servicing charges. But at the same time does not establish any form of track record for the mortgagor.

## THE NUMBERS GAME AT MHFA

In its simplicity, the numbers game at MHFA adds up to manipulation of the arithmetical sums in the mortgage application form.* The items which can be manipulated are usually the fees, the carrying charges and the land cost. MHFA has a stiff position about juggling the construction cost items since the quality of the proposed project may be altered thereby.

To the very experienced developers, the numbers game makes very little difference in their mode of

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*MHFA Mortgage Application Form

operation. They manipulate the allowable maximum percentages cutting the cost certifiable items to the minimum, they add a few extras as "fat" to the project for contingencies or as profits for their labor. New-comers in the housing development field usually end up unable to mortgage out and find themselves digging deep into their pockets to produce the 10% "surface equity." Which means that in addition to producing either the 100% performance bond or 10% irrevocable letter of credit, they also put in another 10% equity in the project.

The numbers game as on the MHFA's application follows:

Construction Items
*Demolition & Site Work = $$X^1$ (Real Estimated Dollar Number)
*Residential = $$X^2$ (Real Estimated Dollar Number)
*Accessory Buildings = $$X^3$ (Real Estimated Dollar Number)
Bond Premium 0.5% of $$X^2$ (Cost Certifiable)
Total Construction Items = $A

Construction Fees
**Builders General Overhead 2% of $X^2$ (Game Number)
**Builders Profit 10% of $X^2$ (Game Number)
**Architects Design Fee 4% of $X^2$ (Game Number)
**Architects Inspection Fee 0.5% of $X^2$ (Game Number)
Total Construction Fees = $B

Carrying Charges and Financing
Construction loan for alpha months at 4% of $Y X 1/2 = $M (Real Estimated Dollar Number)
Real Estate Taxes and Insurance = $N (Real Estimated, Cost Certified)
MHFA Site Inspection and Application = $O (Constant, Cost Certified)
MHFA Financing Fee 1% of $Y = $P (Constant, Cost Certified)
Rent-up, marketing, Relocation, etc. = $Q (Real Estimate, Cost Certified)
Total $M through $Q = $C

**Land Cost = $D

If $A & $B & $C & $D = $Z = 100% total project cost.
$Z - 10% Equity = 90% = $Y = Loan Amount.

*Represents items that are negotiable under very serious analysis since they represent the construction items and constitute about 80% of the total project cost. More, it is based on this total that a 100% performance bond is required for which MHFA pays the premium or the 10% irrevocable letter of credit.

**Items which can be adjusted depending on the ability of the developer to convince the staff of their worth. Through manipulation of these items, the developer, if experienced, can end up picking his 10% equity through the columns. By allowing the maximum percentages as prevalent in those trades, the developer through experience is allowed to work out an amicable business relationship with the participants. This can be done by making them joint partners or by bargaining down on the development trade items price. Or furthermore by marking up* the initial costs documented with appraisals in the case of land.

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*Mark-up on land cost: Acceptable appraised value even if original price paid was less at purchasing period.

## 3-3 AESTHETICS AND DESIGN

The need for adequate housing runs parallel with high quality architectural aesthetics. The MHFA does not achieve much by producing a quantity of housing which lacks quality that will support decent living standards over the life of the mortgage. Although the federal government through the FHA* offered minimum housing standards, it still leaves a lot to be desired in good quality housing. If the Agency must meet the society's needs in housing and at the same time compete favorably with the future housing market needs, it must make sure that a variety of high quality housing units are being built. MHFA places equal importance on architectural aesthetics as on economic feasibility of mortgages and their management policies.**

In pursuit of this goal, the Agency staff architects work closely with project architects. The MHFA is not complacent about the quality of architectural standards

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*FHA - Federal Housing Administration, National Housing Act of 1934.

**Introductory speech by W. J. White, Executive Director MHFA: Goals of MHFA. Speech delivered in architectural meeting to establish Design Review Board for MHFA. Boston, Massachusetts March 1971

thus far produced and believes that each succeeding project should be better than the preceeding ones. The staff is open and encouraging to innovation, promptly reviews designs when they are submitted, and insists that project architects produce good quality design work.

Each proposal for housing development submitted to MHFA is different and therefore must contend with different aesthetic and cost problems. MHFA deems undue strict limitations on mortgage loans as one of the major causes toward diminishing the quality of design which along with location, local wage rates, types of construction, and land cost are the crucial variables that affect the total project cost.

The total project cost as viewed by the staff is largely a product of the architecturals in any development. The construction items alone total close to 80% of the expense of production. Fees for architectural services, legal and organization expenses, real estate taxes, land cost, and other non-construction items account for the remaining 20%. Thus, the Agency insists that the project developer produce as accurate a construction budget as possible before the commitment phase. In order to do this, the development team must

have an in-depth notion of the design and structural aesthetic composition of a project development. During mortgage processing, the staff architects place great emphasis on the quality of the construction specifications to be delivered on a particular project. Quantity take-offs and cost take-offs based on the gross square footage of the proposed dwelling units form major indicators for the allowable project cost.

Some project architects argue that it is difficult to produce such detailed architectural drawings on which to base these accuracies when they have not been fully committed or allowed enough expense charges by the sponsor/developer to do so. In support of the argument, the developer claims that there is no way in which he would want to pay that much in fees since he is not sure himself of procurring a commitment even after the funds have been disbursed. He further claims that it is advantageous to him to keep his initial expenses at the lowest so that he does not get hurt financially if the project is evaluated unfeasible by the MHFA.

But the crux of the matter according to MHFA's philosophies is that the developer should be willing to take some initial risks. If the development is sound and meets with the community's needs, the project is

bound to be feasible because of the easy mortgaging terms offered by MHFA. This ideology has yet to penetrate the housing development field. In the past and even currently under conventional financing through banks and life insurance companies, the approach to housing development has been that of laissez-faire where any form of control was short-circuited by the developers in an attempt to obtain maximum mortgage benefits.*

Under conventional financing, the amount of mortgage loan allowed for a project development usually dictates the quality of architectural and structural aesthetics applied. This is so because of the need for the developers to "mortgage out" before constructing the proposed housing units.

With FHA financing, the situation is more complicated. The FHA allowable construction loan is about 20% higher than the conventional financing cost on per unit basis. Despite such high mortgage allowances for the quality of housing product delivered through FHA financing, developers further attempt to make more profits.**

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*Section 3-2-1: "Development Game"
**Section 4-2: Critical Variables in Development of MHFA and FHA Housing Products

MHFA views the more practical approach in its aesthetic philosophies as finding ways and means of manipulating the proposed development package in every individual case. By working closely with the development team from the initial stages of the project's conception, the Agency staff works with the project architect towards the qualities for the social and economic needs of any proposed site. Thus, it becomes very easy to highlight the handicaps of design or structural aesthetics if that would constitute the unfeasible aspect of the project. For example, due to social and economic handicaps, the design of a high-rise construction may be deemed unfeasible aesthetically in a suburban location. In processing such a submission, the project architect learns from the beginning what type of housing structures to implement in his design.

Most important in the order of priority during MHFA design review sessions is the site planning. The Agency staff believes that in order to produce an adequate development environment, the site planning should provide for some green areas, play or recreational areas, and other amenities depending on the project size. In addition, the provisions provided by good site

planning dictate the way the building(s) should be situated on the site. The general MHFA approach to high-rise apartments units layout adds a very unique dimension to the prevalent box-like design approach. MHFA staff architects require that high-rise apartments be treated with appealing features which introduce a feeling of homes. Use of balconies and window proper arrangements which accentuate the design features is often recommended. Apart from the visual qualities thus achieved, balconies for instance provide exterior open spaces for household units located on the upper floors. In general, aesthetically well designed buildings start orienting MHFA projects away from the stigma public housing has on the public partially because of their aesthetic features.

MHFA does not maintain as fixed aesthetic standards as the FHA. Instead, the Agency requires that the project architect should respond to the required needs of a particular development. But as a rule of thumb, it is a general policy of the Agency not to accept bed-rooms not large enough to accommodate two persons. (This rule of thumb is based on the occupancy require-ments imposed on low-income households by both the local and federal housing assistance programs which require

a two person occupancy per every unit receiving subsidization. FHA's minimum standards for bedroom sizes became accepted by sponsors obtaining financing therein as the maximum standard.

Living areas, dining and kitchens in MHFA units are integrated as parts of a common area. Through studies and experiences, the Agency thinks that since most families spend their time together either in the kitchen or over the dining tables, a large integrated common area responds best to such use.

Storage areas, adequate circulation in and around units, and utilities such as laundry facilities are usually present in MHFA's projects. Laundry areas are incorporated in common areas as points for social contact among users of the projects.

In short, MHFA's aesthetic philosophy points to the fact that every development has to be planned differently and be responsive to the particular site constraints and to the community's needs.

## CONSTRUCTION RENT UP AND OCCUPANCY

The MHFA maintains a close liaison with the project sponsor, architect, and contractor from the commencement of construction to the completion of each project funded through its program. The Agency schedules a comprehensive program of surveillance and inspection which is adhered to throughout the construction phase in order to insure that strict contractual compliance with the plans and specifications is met.

For the successful prosecution of this schedule, the project architect furnishes the Agency with the following information:

1. A firm construction commencement date
2. An estimated schedule of programs of payments
3. A realistic detailed construction schedule with anticipated completion date.

During construction, the clerk of works provides detailed breakdowns and "back up" information for all change orders prior to beginning work on any changes, and detailed lists of any inventory for which payment is requested. Usually the MHFA requires that material stored on project sites may not exceed 5% of any trade item and must be under lock for security from theft.

Weekly meetings on the site are arranged between the owner, contractor, major subcontractors, and the MHFA field inspectors.

As the job nears completion, MHFA conducts an inspection with the owner, project architect and contractor, and prepares a punch list. Upon completion of the punch list, the mortgagor submits a letter to the MHFA stating that the project is substantially complete. MHFA then inspects the project and, if it is complete, signs the letter which marks the beginning of the 40-day mechanics lien period.

On obtaining a copy of the Certificate of Occupancy issued by the municipal authority, the mortgagor submits a signed affadavit stating that: Prevailing wages have been paid, and no further amounts are outstanding in payments to the contractors.

With the start of rent-up the Tenant Selection Plan* becomes an important part of the project development. Any deviation from the Tenant Selection Plan is viewed as a default on the mortgage loan agreement. No tenant is allowed to sign a lease without prior notification of the MHFA Tenant Officer.

MHFA staff makes periodic visits to the project site to insure conformance with the Tenant Selection Plan, Management Plan, and Relocation Plan, if applicable.

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*Tenant Selection Plan: Section 3-4-2

## 3-4 MANAGEMENT PHILOSOPHY AND TENANT PARTICIPATION

The innovative features of the Massachusetts Housing Finance Agency program, which responds to creating good quality housing dwelling units for households coming from a variety of social and economic backgrounds, presents an opportunity for an equally new management concept. Ideally, the Agency desires that all development projects consist of low, moderate, and middle income family households. Nevertheless, where there is an established need of more low-income housing units, the Agency's goals in its flexibility will shift to serve the desired needs of the low-income households.

Within any project community, the participants comprising users and manager(s), share an equal involvement and seek the understanding of one another's problems and needs. Together, both tenant and management recognize their role in keeping up the standards of the project. The management must provide good services, and the tenants must cooperate in the process of governing the community if the relationship of the people to the environment is to be safeguarded.

The ideal socio-economic mix of tenant households integrates groups and encourages through interpersonal relationships a learning process of one another's roles, values, and life aspirations. Between the less privileged and the more socio-economically mobile groups, this concept of education chances better understanding and harmonious living, which in turn fosters the relationship between the overall tenant group and the management team. The management responds to tenants' needs and special problems, and the tenants in turn understand the demands to cooperate with the management.

In reviewing the overall management and operation plan, the Agency makes sure that the development will be well maintained and properly administered with all due respect and regard shown to the user households. The plan for this operation drawn during processing becomes part of the contractual obligation of the mortgagor/owner. The Agency in turn exercises its powers through careful surveillance to see that this agreement is complied with throughout the life of the mortgage loan.

MHFA staff works closely with the sponsor to develop a desirable plan for each project. Assistance is given in developing workable mechanisms through

which management and tenants will communicate. Depending on type and location of each project, advice is provided on how to include facilities and utilities which will meet the special needs of the people to be housed. Plans for recreation programs, community activities, programs for the elderly, day care centers, social services, and training programs for resident jobs with the management are evolved and developed in conjunction with the plans for the aesthetic design and economic feasibility of the product offered.

In the event that the proposed project will result in the displacement of any person, family, or business, the owner/developer should include plans of the local public resources which will respond to the displaced person's needs. In cases where there is no public relocation program, the management sets forth a relocation plan which insures that relocation will take place in a manner which will not result in undue hardship to the households involved.

If the proposed development is a remodelling or a rehabilitating of existing dwelling structures,

the plan must provide for adequate relocation of resident tenants for the period reconstruction is going on. This arrangement must provide for satisfactory accommodation arrangements at a rent not very different from what the tenant paid in his previous dwelling, or at least (if in excess) in line with what the tenant is willing to afford. In addition, he is given a first right of refusal* to the project after rehabilitation has been completed.

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*First right of refusal: Provides that previous tenant occupant chooses whether or not to return to the project before tenancy is made open to other prospective occupants.

## 3-4-1 MANAGEMENT PLAN: SUMMARY

The management and operation plan which provides clear and complete information in relation to any project must include the following vital policies in order to pass MHFA approval.

1. Composition of the staff involved in the management and maintenance of the project when it becomes operations. In cases where the staff is already selected, their resumes are requested for evaluation in the light of experience and interpersonal manager-tenant relationships. In other cases where the staff has not been chosen, vital criteria for selecting the resident project manager, janitorial and other members of the management team is discussed in the light of efficient operation. It is desirable from the Agency's goals that the sponsor makes plans for training and employment of interested occupants in the management and the operation of the project.
2. For efficient operation, it is required that the sponsor spells out policies governing the conduct of occupants. Despite such plans, the

Agency advises that issues of delinquencies be treated with personal understanding. For example, the nuisances of an alcoholic should not be treated with summary termination of occupancy lease, but with deeper concern and understanding which may entail recommending him to medical care.

3. Policies relative to use and treatment of the dwelling units, community facilities and utilities, and the immediate environment is also required to be made known to the occupants.
4. Attitude toward and relationship with tenant association fosters smooth operation. In addition to this, the proposed methods of communication with tenants should include arrangements for settling of tenant-management disputes. By including the tenant representative body in the management, this can easily be achieved.
5. Maintenance and repair program of hardware and structural components.
6. Security provisions to safeguard tenants' properties from one another's abuse and, in general, from outside abuse.
7. Program relative to social services.

8. Policy on record-keeping and accounting procedures which includes a course of action on application fees, for instance, and credit reporting.

The sponsor is required to provide a copy of any written materials, policies, rules, etc., relating to any of the above, including an exhibit application blank for occupancy and lease schedules or any other instrument governing terms of occupancy.

## OPERATING EXPENSE SCHEDULE

The annual net income from any MHFA project must be sufficient to amortize its loan and at the same time provide sufficient balance to operate and manage the development. For this reason, the staff cautiously examines the operating expense schedule* and allocates about half of the gross project income to these inventory items depending on type of project, sponsor, location, and management plan.

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*Sample exhibit showing percentage dollar allocation of the total annual income to projects.

Under Management, administration, advertising, and other miscellaneous office expense items whether contracted out to a professional management firm or performed by the sponsoring group require between 4% and 5% of the annual income of the project if it is to be adequately performed to the Agency's and project users' satisfaction.

The Operating utility items are figured as a contractual agreement undertaken by the sponsor because of the type of MHFA program. Under the operating items, fuel, power, domestic water, gas, garbage, and trash removal, janitorial materials and the overall insurance on the project in addition to the operating staff salary are estimated at a low of 13% and a high of 15% of the project income annually.

Allowances for other maintenance items such as decorating every three years at between $100 and $150 per unit, general repairs (patching of floors, fixing glass windows, etc.) at about $40 per unit per year, exterminating, ground materials, and other seasonal maintenance items (like snow removal, upkeep of swimming pools) are estimated at about $20 per unit per year. In an average size project, the total of these amounts to between 3% and 4% of the yearly project income.

A replacement reserve of 0.5% of the total project cost is deducted from the income of the project and kept in an escrow account. This account, if not disturbed, yields further interest which put together with the replacement reserve forms savings to the project. The replacement reserve savings to the project helps toward a smooth and efficient operation of the development throughout the life of the mortgage loan thus:

1. To upgrade the conservative estimated cost of operating, maintaining, and managing of the project in cases of high fluctuations of the overall economy when costs escalate higher than was originally estimated.
2. Forms a handy source to meet payment dues on the mortgage loan if there arose a default due to unforeseen hardships. Hardships could occur due to unforeseen natural disasters. For example, complete destruction of the roof of a building due to a storm which may necessitate out of the way expenses unaccounted for in the maintenance and operating budget. Such major expense items incident to the project would otherwise necessitate a loan increase

which in turn would require a rent increase. But since MHFA aims at keeping the tenants' rents as stable as possible, the replacement reserve is used as a first recourse.

3. Should the replacement reserve fund together with accumulated interest build up without being used, the Agency after about 20 years of the mortgage loan may apply the proceeds to further reduce the tenants' share of the rent roll.

4. Other benefits inherent from this reserve fund apply directly to the Agency's financial position in establishing a stability of self-supporting accumulated reserve on behalf of its overall mortgage loans. In addition to this, the reserve helps offset some of the influences imposed on certain projects by sale of accelerated depreciation* for purposes of tax shelter.

Under MHFA financing, the <u>total annual taxes</u> which is a product of the real estate taxes and the tax on

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*Accelerated depreciation: Appendix 3, Page 99

employee(s) payroll is estimated between 13% and 17% of the project income. The real estate taxes vary from one community to another and the tax assessment imposed on any particular project financed under MHFA regulations depends on the local interpretation of the Section 121(a) and Section 521(a) Acts. In general, the estimated tax assessment varies between 12% and 18% of the project's gross effective income.

This estimated tax depends to a very large extent on the assessment practices of the various cities and towns in Massachusetts.

3-4-2 TENANT SELECTION PLAN

MHFA's approval of a tenant selection plan is a statutory precondition to the mortgage loan commitment given to the sponsor of any project. In broad aspects, the purpose of such selection plan is to establish criteria and procedures by which the prospective tenants will be recruited and selected in order to assure fairness and responsiveness to the needs and interest of the particular project community. In its best, the plan cooperates with the neighborhood needs and aims toward matching the MHFA statutory requirements of socio-economic integration and mix of various family households. MHFA statutory requirements demand the following:

1. The Plan shall include criteria for tenant selection which establishes maximum income limits for eligible tenants. These limits may vary with the size of the family as provided in the Agency's regulations on dependency and medical allowances. Maximum limits on the annual income of an applicant tenant, for the purposes of initial selection, may not exceed six times the annual rental for the unit to be occupied. An effort shall be made to avoid undue economic homogeneity among the tenants.

2. As between applicants equal in need and eligible for occupancy of a unit, preference shall be given to persons displaced by public action or natural disaster.

3. The Housing Authority in the city or town in which the project is located may from time to time designate, and shall have the right to designate, tenants who are otherwise eligible for units designated for rental at the adjusted rental, as such units become available either in the intial renting or as vacancies thereafter occur.

The staff, through careful police action, makes sure that each of these requirements are fulfilled in a manner appropriate to the particular project.

In addition, the Plan should describe, in detail, the specific elements of a comprehensive, community-wide notification system. Means must also be provided for notifying those public and private organizations which would be familiar with the housing needs of low-income families and for ensuring that affirmative action will be taken to make minority group households aware of the availability of the apartments and welcome in them. Notices must include an express pledge that the housing will be available to households

regardless of race, color, creed, and national origin. This pledge shall also be displayed on any on-site signs advertising the housing units. The text of all notifications and publications regarding the availability of the units will be supplied to the Agency sufficiently in advance of final printing so that the staff may comment and make suggestions regarding the content.

Eligibility standards shall be objective and clear. They shall insure that the public interest is served without favoritism, partiality, or arbitrariness in the manner of selecting tenants.

Any priorities which the sponsor intends to recognize (in addition to the statutory priorities described above) should be described in their order of preference. Such priorities may cover such situations as families living in substandard housing, or paying rent in excess of their means, or beset by an emergency. Subject to these stated priorities, the Plan should create a means of assuring that the housing will be chosen in a fair and equitable manner. Chronological processing in accordance with ascertainable standards must be provided for as well as the review and periodic updating of waiting lists. The selection by lot of such tenants as do not enjoy a priority will be acceptable, provided that an objective and reasonable procedure is adopted.

The Plan should state an intention to issue, prior to accepting the first application, a step-by-step description of the application process including a list of forms to be prepared by the applicants, interviews to be conducted, references to be contacted, and credit checks to be made. It shall state that the Agency shall have the opportunity to make comments and suggestions on all such forms and papers.

On tenant advice issues, the Plan should describe the means, if any, which will be used by the mortgagor to determine the opinions and advice of tenants regarding tenant selection policies and procedures.

If the mortgagor expects that the apartments will be converted to cooperatives or condominiums, an explanation of the coordination of this process with the tenant selection procedure should be included, as well as a means for ensuring that the acceptable procedures will be followed after the conversion for tenant selection and/or the sale of shares or dwelling units.

Since MHFA statute allows for ancilliary commercial not in excess of 20% total project area, the Plan shall contain provisions designed to cover these areas if applicable.

# CHAPTER 4

# EVALUATION

Development of housing through organizations like the Massachusetts Housing Finance Agency, which limits the equity investment return to developers, on a careful analysis does not provide sufficient incentives as a financial undertaking, nor does it totally solve the overall housing users' needs without the complementary benefits inherent thereof. Easy financing mechanisms which enable the mortgagor to "mortgage out", as it were, are counteracted by acute surveillance, thereby limiting the sponsor from cutting corners in order to make substantial profits. In addition, the limitations on the rent structure attributable to the tenant limits the developer's return and the allowable mortgage loan. Subsidies through interest reduction payments, rent supplements, leasing, and rent skewing have only partially helped the consumer market.

The competition offered by the conventional mortgage lending institutions through lack of surveillance and the limitless scope of the obtainable rent from the

housing market leaves agencies like the MHFA groping for new mechanisms to achieve its housing goals. Undoubtedly, subsidies in one form or another seem to be the answer if housing units are to be delivered at accessible prices to the users, either low or moderate income.

Subsidized units in the Commonwealth of Massachusetts as of January 1971 constitute about 4% of the total supply of housing, or 72,000 units according to a recent report prepared for the Department of Community Affairs.* A five year plan calls for 10% of the total housing or close to 200,000 units being subsidized through all available forms of subsidies by 1976.

Further research on this line points out that if the housing field is to achieve this goal other forms of subsidy funds apart from interest reduction, rent supplements, and direct public ownership have to be devised. In the light of that, there has been an increasing emphasis upon the use of <u>tax sheltered route</u> as a good way of meeting the unfilled subsidy gaps.

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*Report of subsidized units was prepared by Justin Gray Associates, Cambridge, Massachusetts, in Fall 1970.

The federal government in the 1968 Housing Act set a goal of 26 million additional housing units to the existing stock. In support of the above, federal government policy made it clear that tax shelter as a development incentive is to be one of the preferred mechanisms for the realization of that goal. In deliberations over these issues, the tax reform act of 1969 clearly reassured the indication of the governmental policy to subsidize low and moderate income housing by providing favorable tax treatment of the depreciation deductions generated by the housing units.

The structure of tax shelter and depreciation as an incentive toward providing more housing units in the future is intricate and dependent upon a number of things which stem from the original idealogy. For example, in order for nonprofit sponsors to take advantage of this tax shelter and depreciation, they would have to spin off a limited divident partnership, the rule providing for a pass-through of deductions directly to the partners.

## 4-1 FUTURE OF MHFA IN HOUSING DEVELOPMENT

In order to find additional subsidies for housing development, it is worthwhile, therefore, that MHFA consider the role of the nonprofit sponsors willing to take advantage of the tax shelter and depreciation structure to assist in reducing housing rents and the overall development cost. This will provide tax deductions through limited partnership structure to taxpayers in the 50% and over tax bracket. Thus, the name of the game when put bluntly means that <u>the rich become richer so that the poor can be assisted</u>.

As the nonprofits have become an increasingly important part of the overall subsidized housing market, and as that market itself has increased in overall significance and importance, it has become apparent that one missing element for the future success of the nonprofits is their ability to tap into the incentive provided by Congress in the tax shelter area.

Invariably, it appears that nonprofit sponsors also have found ways in which to make this incentive available to them. They have been able to convert from nonprofit projects to limited dividend projects in order to take full advantage of the limited partnership. For example, the Tenants Association of Boston (TAB), a nonprofit tenants group dedicated to serving the

public needs, converted a small project in Roxbury and Dorchester to a limited dividend form so as to make available to its operation sufficient proceeds from the syndication to enable it to set up a management mechanism for the housing units. A little simple arithmetic shows the advantage of the conversion. Assuming a maximum mortgage amount under the MHFA financing of $2 1/2 million for this project, a conversion from a 100% mortgage available to a nonprofit sponsor to a 90% mortgage, which is the maximum available to a limited dividend sponsor, does not change the total picture of the mortgage. The conversion does make available to the project the cash proceeds from the syndication, about 10% to 12% in net amount, thus making available a pool of funds which enables the sponsor to perform its management functions, thereby further reducing the tenants' share of the rent in a way not otherwise available.

Similar conversions have occurred for CAST in Cambridge, Putnam Square Apartments in Cambridge, Core City Associates in Springfield, Bethany Homes in Haverhill, and many other community nonprofit oriented groups obtaining mortgage financing through the MHFA.

In addition to the obvious interest of the nonprofits in tapping into the tax shelter subsidy, other factors make the merger of nonprofit and limited dividend projects

important. Allocations to nonprofit sponsors in development of housing projects have a very high rating in the MHFA financing program because of their dedication and involvement in producing units as described above. If this trend continues in the future, as is indicative, obviously it will be of the greatest interest to the syndicators and developers to find a way to make their services available and attractive to this major component of the housing market. In addition, the presence of the nonprofit sponsors in the tax shelter device may insulate it from both future Congressional attacks and citizens' criticisms.

The overall benefit is not totally one-sided since the nonprofit can find much to learn from the professional limited dividend developer and syndicator in the form of increased understanding of business techniques as to their unprofessional and at times inexperienced and disorganized production efforts.

## INCENTIVES FOR FUTURE DEVELOPMENT

### TAX SHELTER

It follows from the above that going the tax sheltered route through nonprofit sponsors investment would help solve the need for subsidies in housing. But for the tax savings, in other words, such investments

would not be profitable to the sponsor or to the ultimate benefactors of the development, since one of the best overall tax sheltered areas is multi-family residential real estate involving low and moderate income housing.

The typical form that a tax shelter MHFA real estate investment takes is a limited partnership interest in a partnership which acts as the owner and mortgagor of the property with the developer acting as the general partner and responsible for the management. The property to be developed by the partnership would be a garden or high rise apartment development or a rehabilitation project financed under the Section 236 program for low and moderate income housing.

Because of the low rents and the tremendous demand for units financed under the Section 236 program, this type of development usually offers almost full occupancy, a very speedy rent-up which is almost devoid of all operation risks. In addition, the performance bond required on the construction loan, the replacement reserves needed in operating the budget, and the overall surveillance add more safety to this kind of investment.

Participation of investors in tax sheltered investments is through the acquisition of limited partnership interest in the project. The investment is typically payable in two or three installments. Limited partners who agree only to capital contributions have no say in

the management of the project, although they may be given certain rights of approval such as in the case of a sale or refinancing.

The partnership form rather than the corporate form is used so as to permit the partners to obtain certain tax advantages. Since the project creates substantial tax losses in the early years, the partnership framework permits these losses to pass through to the partners, as if they owned the development directly, and these losses may then be deducted against ordinary income on the federal tax returns. For example, a $50,000 income per annum investor could expect to receive approximately a 4% cash flow of $2,000 which is tax free for some 20 years, and more so, tax losses as follows: $15,000 first year, $25,000 second year, $15,000 third year, and $60,000 over the next five years.

It is obvious that no investor would buy such investments for only a 4% tax free yield, but for the additional tax savings generated by the tax losses which adds to further return. On the assumption that the investment is paid in three annual installments, the yield on an investment at a 50% tax bracket investor is one to two years for the two installments and three years for the third. This payback is the period needed to recover an investment as a result

of tax savings and cash flow. Hence, within a short period after the payment of each installment the investor has saved sufficient taxes and received cash flow to recover his investment. Thereafter, the investor could be said to have a free investment, continuing to receive further tax losses and cash flow.

There are other tax and economic results which an investor considers. Under MHFA financing, projects cannot be sold or refinanced for 20 years without the specific approval of the Agency. Hence a long waiting period is needed for residual value (proceeds of a sale or refinancing). The partnership agreement usually provides that the general partner-developer will share approximately 50% of any residual value after a recovery of the investors monies. Thus, this provides an incentive to the general partners to have the property sold or refinanced. If the project were refinanced, no tax usually results to the investors and the investors receive cash proceeds which may be used for any purpose. If the property is sold, then each limited partner would have a certain amount of tax gain. This gain would be long term capital gain provided the sale occurred after ten years.

In substance, an investor is swapping a present ordinary income tax savings for a potential far off

capital gains tax. Thus, in brief, tax shelter means using tax savings dollars to make a present investment or to use the tax savings for other investments, thereby postponing any tax effect to a later date at capital gains rates which will presumably be such lower than present tax rates.

One risk in this total operation would be the developer's failure to complete or rent up the project. The more astute the developer, the less risk there is.

Another risk is the inability of the project to earn all the projected cash flow distributions, due to poor management, poor location, vacancies, or otherwise. In which case, the project would merely limit or eliminate the projected cash distribution. Although it is nice to have some cash distribution, this risk would not be too serious, since the tax savings in itself would give a substantial return, although the lack of cash profit for the development would effect the ultimate residual value.

In the syndication of this type of investment, the buyer looks for the following criteria:

1. The investor should at least be an effective 50% tax bracket after giving effect to the tax deduction.

2. One has to remain at a high tax bracket for at least six years and, if possible, longer.

3. One must have available funds for such investment and be able to leave them so invested.

4. One should make sure that the economic deal is sound from the standpoint of the development team. The better the economics or business aspect, the better will be the tax sheltered investment undertaken.

Thus, the future of agencies like the MHFA is partially dependent on promoting nonprofit sponsors to joint venture into limited partnership in order to take maximum advantage of the tax shelter investments. Through such merger with experienced developers possessing a good track record, a good management team able to achieve a 6% limited dividend return, and all other aspects policed by the MHFA staff, it will be possible for the nonprofits to achieve the desired goal in producing more housing units and at costs accessible to the users together with the existing subsidies.

## 4-2 CRITICAL DIFFERENCES IN DEVELOPMENT OF MHFA AND FHA HOUSING PRODUCTS

The thesis presupposed an answer to the argument that the development of public housing in Massachusetts be primarily left in the hands of local or state agencies such as the MHFA which through its program and manner of operation will coordinate the activities of the public and private sectors of housing. The federal government, represented in its housing role by the FHA, is argued as incapable of developing adequate housing units at accessible rents to the low and moderate income households without subsidies when performing on local or regional levels due to the extent of localized operation involved in such housing undertakings.

It is in this light, therefore, that this thesis discusses the critical variables in housing development on state and local levels. MHFA and FHA* are contrasted in their roles of providing housing for the low and moderate income groups through light of their ability to produce the needed results in housing development.

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*FHA's public housing development compared to MHFA's is the Section 236 interest reduction payment. Basis of comparison is that MHFA receives limited allocations of 236 subsidy funds for some of its projects.

That is, first to provide adequate housing units at costs accessible to the housing user market of the low and moderate income households; and secondly, to stimulate the housing development field through speedy responses.

MHFA development program is put forward as more desirable in serving the end goals of the general public than the FHA program. The Massachusetts Housing Finance Agency is able to deliver good quality housing at lower development costs, which translates into lower rents for the low and moderate income households even without recourse to government subsidies. (But because these rents are still relatively high for most of the benefactors, it is obvious that governmental assistance is needed to further reduce the tenants' share of payment.) At the same time, the MHFA recognizes the need to provide an inducement to profit-motivated housing developers. Optimum incentives, therefore, are provided by this Agency through easier mortgage terms; and by the public sector, through tax reliefs.

The FHA, on the other hand, although set up to meet similar goals as the MHFA, does not deliver a good quality housing product at as low a development

cost as the MHFA. Consequently, this higher development cost increases the rents for the produced units, and profits more the housing developer. (Although with the presence of the overloaded federal government subsidies, the tenants' share of the rent is considerably reduced under the FHA program.)

Synoptically, the main differences easily noticed between MHFA and FHA developments are the following:

MHFA's goal of socio-economic household integration in high quality housing development projects differs from the FHA's objectives of housing the poor in isolated projects built under the specifications of minimum standards. Through this objective, MHFA's projects are designed and built with adequate facilities and site amenities to serve the socio-economically integrated group of low and middle income alike at rental costs very dependant on household incomes. The FHA policy of maintaining a homogeneous socio-economic group of households limits the scope of such interaction and offers minimum facilities and amenities, thus perpetuating an environment not very different from the previous housing conditions of the lower income households.

MHFA's closer association with the immediate neighborhoods, housing problems, and community needs

in the Commonwealth of Massachusetts produces a reaction of speedy response in processing of housing development proposals. At the MHFA, mortgage loans are processed within an optimum period of three months. Through this fast operation, it is possible to provide quick solutions to housing needs in short periods of time. Furthermore, fast processing time of mortgage loan proposals fosters a reduction of the overall production cost of housing since projected costs can be based on the present economics.

FHA's processing time has an optimum of twenty-four months, principally caused by the fact that decisions to provide mortgage loans are made in FHA's head office in Washington. Time lag and other inefficiencies resultant from this manner of operation throw the initially estimated project cost out of line with the existing production cost. Consequently, even after a mortgage loan has been approved by the FHA, the developer in many cases finds himself needing an increase in cost in order to complete the project. Since such cost increase was not originally anticipated, the initially projected rent schedule would have to be increased in order to meet the current debt services.

MHFA's package, in general, offers a more attractive development product relatively to the tenant user than

to the sponsor/developer. The opposite is the case with FHA's housing product. MHFA places a high premium on developing housing on feasible sites and more so in prime locations of the various communities. FHA housing projects are developed on less desirable sites except in cases where urban renewal parcels are used.

MHFA produces a high quality housing product which can compete favorably in the open housing market. Additional facilities and amenities which place such projects in high demand are offered at no extra cost to the tenants. FHA projects, on the other hand, are built to minimum specification of construction standards and do not offer extra facilities and amenities such as swimming pools, play areas, etc.

Nevertheless, FHA public housing through heavy subsidies from the government in rental assistance (Section 236 interest reduction, rent supplement, and leasing programs) have benefited the low and moderate income household occupants through reduced tenant share of rent payments. MHFA, like many other state agencies suffers from discrimination in allocation of sufficient funds to run its housing program for the low and moderate income households. Thus, in order to obtain as much mileage out of the limited allocation of subsidy funds, MHFA ideally spreads

portions of this subsidy to as many projects as possible depending on the established assistance need of the various communities. Typically, the ideal MHFA project has 50% of the units subsidized through Section 236 interest reduction payments; 25% leased through the housing authorities; and the remaining 25% placed at the open housing market rents. The typical FHA project evaluated is the Section 236 subsidized public housing, where all the units are made available to qualified low and moderate income households and additional assistance is plugged in to further lower the tenants' share.

MHFA projects provide through its gross effective income a highly efficient and desirable management and operation service. It encourages and promotes interaction between tenants and management staff, thus creating a situation of active tenant voice in the project. FHA's projects on the other hand are poorly managed and maintained because the expense ratio is relatively very low. One of the reasons for this is because the Section 236 interest reduction payment subsidies put a ceiling on the tenants' share of the rent. (Even in cases of the 236 exceptional limit rent schedules, the expense ratio is still too low to afford efficient management and operation.)

To isolate the above differences, an MHFA project committed at the same time as an FHA project (not withstanding that the HFA's was proposed 18 months earlier) and that FHA project are analyzed and evaluated for their merits. The basis for comparison is that both projects are similar in construction type, contain the same number of units, and are built in areas of similar socio-economic constraints.

COMPARATIVE ANALYSIS OF MHFA AND FHA DEVELOPMENT

| | MHFA | FHA | DIFFERENCES |
|---|---|---|---|
| Name of Project | Rolling Green<br>Amherst | Bay Village<br>Fall River | |
| Number of Units | 205 | 205 | None |
| Total Project Cost<br>(Replacement Cost) | $3,600,000 | $4,432,400 | $832,400* |
| Equity Investment 10% | 360,000 | 443,240 | 83,240 |
| Loan Amount 90% | 3,240,000 | 3,989,200 | 749,200 |
| Loan Per Unit (÷205) | 15,800 | 19,460 | 3,660* |
| Type of Construction | 2 & 3 Stories<br>Garden Type &<br>Town Houses | 2 & 3 Stories<br>Garden Type | Town Houses* |
| Conposition of Units | 64 (1BR) @ 735 SF<br>137 (2BR) @ 966 SF<br>2 (3BR) @1152 SF<br>2 (4BR) @1550 SF | 60 (1BR) @ 588 SF<br>99 (2BR) @ 810 SF<br>46 (3BR) @1045 SF | Larger Units*<br>in all Cases |
| Average No. of Bedrooms | 1.71 | 1.93 | 0.22** |
| Average Sq. Ft. per Unit | 1071 SF | 911 SF | 160 SF* |
| Total Sq. Ft. in Project | 219,700 SF | 186,800 SF | 33,900 SF* |
| Cost of Construction<br>Per Sq. Ft. | $13.25 | $18.28 | $5.03* |
| Construction Time | 9 months | 21 months | 12 months* |
| Construction Cost at<br>Commitment Jan. 1970 | $2,344,920 | $2,165,384 | $189,536* |
| Construction Cost<br>May 1971 | $2,344,920 | $2,587,469 | |
| | Completed 9/70 | To Be Completed 9/71 | |
| Total Construction Fees | $526,680 | $600,557 | $ 73,877* |
| Total Builders<br>Overhead & Profit | $396,000 | $455,355 | $ 59,355* |
| Total Carrying Charges<br>& Financing Fee | $368,400 | $521,515 | $153,115* |

| | MHFA | FHA | DIFFERENCES |
|---|---|---|---|
| Total Project Income (Rents) | $501,240/year | $578,360/year | $77,120* |
| Total Project Income (Less 5% Vacancies) | $476,178/year | $549,442/year | $73,264* |
| Average Rent per Unit/ Month with Subsidies | $193 | $223 | $30* |
| Subsidies/year | $51,000 (707 Leasing) | $249,853 (S 236)<br>$112,493 (Rent Supp) | |
| Total Subsidies/year | $51,000<br>25% = 51 units | $362,346<br>100% = 205 units | $311,346**<br>154 units** |
| Average Subsidy per qualified unit household | $83 / month | $147/month | $64** |
| Total Annual Project Expense | $233,240 | $188,139 | $45,101* |
| Administration/year | $ 27,000 | $ 17,000 | $10,000* |
| Operating/year | $ 67,000 | $ 50,124 | $17,516* |
| Maintenance/year | $ 26,000 | $ 18,717 | $ 7,283* |
| Replacement Reserve/year | $ 12,500 (0.005%) | $ 15,525 (0.006%) | $ 3,025** |
| Total Taxes/year | $ 78,500 | $ 62,838 | $15,662** |
| Return on Equity Investment 6% | $ 21,600 | $ 23,935 | $ 2,335** |
| Expense Ratio | 49% | 34% | 15%* |

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* = merit for MHFA

** = merit for FHA

The evaluation of Rolling Green, Amherst, and Bay Village, Fall River, projects is a good example of the merits MHFA projects have over the FHA projects.

MHFA projects have a lower replacement cost and mortgage loan amount due to reduced carrying charges and financing fees. The Agency keeps its construction costs constant and relatively higher than FHA's which fluctuates on the high side because of the longer construction period. The longer construction period practiced by developers when obtaining financing through the FHA is intentional since this qualifies them to obtain cost increases on the basis of increased material and labor costs. Ideally, it is assumed that such cost increases are justifiable because of the long processing period involved in obtaining commitment, during which time situations in the building industry must have changed beyond recognition.

FHA's higher replacement cost and mortgage loan amount are due to higher carrying charges, financing fees, and builders overhead and profit. The builders overhead and profit, which is a function of only the construction items, is allowed by FHA as a function of the total replacement cost. Both MHFA and FHA

allow a total builders profit and overhead of 12%. In MHFA financing the 12% applies to total construction cost (usually the construction items form an average of about 75% which on arithmetical assumption allows a total of 9% builders profit and overhead on the total replacement cost). This ratio compared with FHA's 12% adds another extra 3% of the replacement cost as profits to the developer.

MHFA's rents based on the mortgage loan amount are as a policy usually below the market rate. Projected rent schedules for MHFA projects are between $30 and $40 per month/unit lower than FHA's rents without subsidies. Although on a final analysis FHA projects are offered to the tenants at a much lower rent as shown in the comparative evaluation, nevertheless, a straight MHFA Section 236 project will offer a lower rent schedule than a straight FHA Section 236 project.

As an investment benefit in sale of depreciation and tax shelter, MHFA projects compete favorably with the FHA projects despite the setback suffered by MHFA's projects through limiting the developers profits in the developments. Because MHFA's replacement cost per unit is less than FHA's, buyers of such investments have a tendency to consider

the FHA's projects more profiting since the cash flow would be greater. But on a closer evaluation MHFA's low replacement cost is compensated in many ways as a good investment proposal because of its healthy operating and management expense ratio, which principally guarantees a better future life of the project as compared to FHA.

CONCLUSION

The thesis discusses the argument for the appropriate place for producing adequate public housing units at costs accessible to the low and moderate income households as being more effective within a local or state agency such as the Massachusetts Housing Finance Agency. The federal government's role is viewed as inadequate in this response because of its limitations caused by heavy centralization of decision-making authorities, which limits the scope of its operation. For example, the Federal Housing Administration requires that each community have a certified Workable Program in order to receive federal housing and renewal aids. This means that a great many cities and towns in the Commonwealth may not undertake low-rent housing programs unless an alternative state program is available. Since the Commonwealth is in the best position to evaluate the housing needs of its cities and towns, such federal government requirements only reinforce the usefulness of a state agency designed with programs flexible enough to meet local needs.

A similar statement can be made in regards to conventional lending institutions who shy away from

active involvement in housing development when faced with competition from other business and industrial sectors of the economy during periods of tight money market and other socio-economic risk factors.

Therefore, in contrasting the MHFA and the FHA's roles in housing, it is appropriate to put the MHFA in its proper perspective. MHFA in its creation was aimed at bridging the huge gap unfilled by the FHA when operating on the local level and by the conventional lending institutions in the development of adequate housing for the low and moderate income market. In fulfilling this role, MHFA finds itself responding to two difficult functions:

1. To induce the development of more housing units by making the housing development field an attractive enterprise
2. To primarily serve the low and moderate income housing market.

In response to aspects neglected by the federal government, MHFA's program includes a diversification and geographical dispersal of housing for low-income groups. The appropriate income range of families requiring housing in many communities is extended below the private housing rate even without rental assistance. And these conditions are being introduced

in suburbs as well as the central cities. In addition, the Agency's program responds to the fact that the inability for lower-income families to locate outside the central city is one of the crucial causes of the increasing pressure on the low-income housing of central cities, which leads to fiscal disparities and the tendency to further increase the central cities' infrastructure and local services.

MHFA's program and philosophies, therefore, points to the fact that a varied program of "public housing" would have the collateral advantage of helping to overcome the unfavorable image that public housing has acquired in the past through its institutional project-type appearance. In smaller central cities and especially in suburban communities where resistance to conspicuous public housing projects has been strong, the advantage of MHFA's ideals would be particularly benign toward making a subsidy program for low-income housing more acceptable.

Thus, MHFA's program for low and moderate income provides the possibility of undertaking a metropolitan approach to some of our key urban problems. In summary, the thesis points out MHFA's conscious attempt to produce housing that permits the low-income families to live in dignity as well as in a good, healthy, and safe

environment. The forms of assistance and housing package offered by the Agency reflect the belief that families of low-income should not be isolated from the rest of the community by reasons of receiving subsidization. MHFA's programs are designed to encourage the creation of sound, stable, and viable communities, to provide for maximum freedom of choice in the belief that this results in fewer problems for the individual family and for the community as a whole. And at the same time it permits the development of balanced neighborhoods of diverse social, economic, and ethnic groups.

## APPENDIX I

## HOME OWNERSHIP PROGRAM

Chapter 708 of the Acts of 1966, as amended by Section 2, Chapter 855 of the Acts of 1970 provide for the establishment of a special financing program to enable low-income families or persons to own one, two and three family homes subject to the following provisions:

1. That the ownership of houses by low-income families may not exceed one per cent of the total number of families living in a city or town.
2. That the houses whether newly built, existing or rehabilitated must conform to the local building code and the State Sanitary Code.
3. That by making such a loan there will not be an undue concentration of low-income families in any one neighborhood.
4. That the MHFA may purchase these structures in its own name but must be conveyed to a low-income family within a year.
5. That the down payment or investment by the homeowner cannot be less than two per cent of the purchase price.

Chapter 855 also allows for the financing and making of first mortgage loans for the building or rehabilitation of housing designed for condominium or cooperative ownership, convert existing housing however financed to such form of ownership, and finance the ownership of individual shares of cooperative housing, and individual units of condominium housing, and in that connection to make first mortgage loans to finance the organization and construction, to assist and advise tenants and owners during a period of conversion from individual ownership to cooperative or condominium ownership for low-income persons and families and others.

To provide the mortgage loans to finance the Home Ownership Program Section 10 of Chapter 855 establishes the Resident Ownership Fund which will receive monies appropriated and made available by the Commonwealth and as designated by the appropriation for either or all of the following:

1. A subsidy to such families or persons not to exceed the difference between the amount required annually to pay interest and debt service, real property taxes, fire insurance, reasonable management costs and reasonable maintenance costs on a home share, or unit,

and twenty-five per cent of a person's or family annual income.

2. Funds to be used to finance first mortgage loans prior to the issuance of notes or bonds.

3. Funds to provide special advice and assistance to low-income persons or families.

MHFA will create and operate the Home Ownership Program for the three categories above as soon as the monies are appropriated, designated and made available by the Commonwealth.

An example of the scope of the Home Ownership Program and the persons or families that it will be able to assist can be seen from the following tables. When 25% of a person's or families monthly income for the categories in Table I exceeds the monthly housing expense in Table II for the same categories that person or family would be eligible for a subsidy within the terms of the MHFA Home Ownership Program.

TABLE I GROSS INCOME $15,000

#1 Annual Income MHFA

#2 25% of Monthly Income

| No. of Bedrooms<br>No. of Persons | 2 Bedrooms<br>3 Persons | 2 Bedrooms<br>4 Persons | 3 Bedrooms<br>4 Persons | 3 Bedrooms<br>5 Persons | 3 Bedrooms<br>6 Persons | 4 Bedrooms<br>7 Persons |
|---|---|---|---|---|---|---|
| #1 | $14,400 | $13,900 | $13,900 | $13,500 | $13,200 | $12,900 |
| #2 | $302 | $291 | $291 | $283 | $277 | $270 |

TABLE II MONTHLY HOUSING EXPENSE FOR THE FOLLOWING MORTGAGE LOANS. TERMS ARE 25 YEARS @ 7% FOR THE SAME CATEGORIES IN TABLE I

| Mortgage Loans | | | | | | |
|---|---|---|---|---|---|---|
| $17,000 | $217 | $220 | $225 | $228 | $231 | $243 |
| 18,000 | 228 | 231 | 236 | 239 | 242 | 254 |
| 19,000 | 239 | 242 | 247 | 250 | 253 | 265 |
| 20,000 | 250 | 253 | 258 | 261 | 264 | 276 |
| 21,000 | 260 | 263 | 268 | 271 | 274 | 286 |
| 22,000 | 271 | 274 | 279 | 282 | 285 | 297 |
| 23,000 | 282 | 285 | 290 | 293 | 296 | 308 |
| 24,000 | 293 | 296 | 301 | 304 | 307 | 319 |
| 25,000 | 303 | 306 | 311 | 314 | 317 | 329 |
| 26,000 | 314 | 317 | 322 | 325 | 328 | 340 |

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Information from Director of Home Ownership Program
Ed Bryson, MHFA, Boston

APPENDIX 2(a)

## THE FEDERAL INTEREST REDUCTION PAYMENTS FOR RENTALS AND COOPERATIVE HOUSING (SECTION 236)

The Section 236 program of the Housing Act of 1949 as amended in 1968 is the federal government program of interest subsidy for new or rehabilitated construction of multi-family housing for the lower-income families by nonprofit, limited dividend, or cooperative housing sponsors and developers. Under this program, HUD pays to a lending institution such as MHFA on behalf of the mortgagor subsidies consisting of monthly interest reduction payments on loans whose interest rates do not exceed 8 1/2%.

In general, these payments reduce the interest payments of the units receiving subsidies to 1%. The end saving in interest cost to the mortgagee is passed on to the housing occupants in the form of lower rents.

The 236 housing interest subsidies are made available to some MHFA financed projects in accordance with the determination of need and the availability of funds. Neither a Workable Program nor approval of local officials is required for housing units to be assisted by this program. There is no established limit to the proportion of units in a multi-family project which may be assisted by interest reduction payments under the 236 program. The determination is made by the sponsor/developer in conjunction with MHFA staff.

Eligibility for occupancy in housing subsidized under Section 236 is subject to maximum income limits. No eligible family may be required to pay more than 25% of income in rent. Incomes must be certified every two years and the rents should be less than 135% of public housing limits but, in some cases, they may be approved if they are below 90% of the maximum levels established for the 221(d)3 program.*

Families living in projects constructed with Section 236 subsidy funds may be eligible for further assistance under the federal Rent Supplement program.**

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*S 221(d)3: BMIR for families whose income is above the public housing limit but too low for the market level.

**Rent Supplement program. This program is very similar to the straight 236 interest subsidy program. Projects financed and assisted by the 236 program are eligible for rent supplement if they are part of a Workable Program for Community Improvement or have approval from local municipal officials for participation in the program. Not more than 25% of the units assisted by the 236 program are eligible for rent supplement payments.

The basic eligibility of families or individuals is determined by income level, which may not exceed the maximum limits established for public housing. In addition, those eligible shall either have been displaced by government action, be 62 years of age or over, be physically handicapped, be an occupant of substandard housing, or have been an occupant of housing affected by natural disaster. There are also asset limitations amounting to $5,000 for elderly and $2,000 for other families and individuals.

The sponsor or its delegated management is responsible for choice of tenants, for assisting tenants in making application for payments, and in obtaining yearly recertification of incomes for FHA approval. The amount of rent supplement decreases as the tenants income rises. Tenants need not move when their income surpasses the allowable income limits and they are able to afford the FHA approved rental price of the unit.

APPENDIX 2(b)

LEASED PUBLIC HOUSING (SECTION 23 OF THE HOUSING ACT OF 1937 AS AMENDED)

Under this federal program annual contributions are made by the Housing Assistance Administration (HAA) of HUD to local public housing authorities under a contract empowering the authorities to lease housing units of moderate rental from private owners for families eligible for public housing. Such leases may run from one to five years and may be renewed. Participation in the leased housing program must be approved by the local municipal governing body.

Assistance payments to the local housing authority make up the difference between the amount of rent the family would pay for federal public housing and the market rentals for the units under lease. Tenants may be selected by the housing owner subject to being found eligible by the housing authority. Elderly, displaced or handicapped persons or households or those displaced by public action or natural disaster may be eligible for additional contributions up to $120 yearly to assist in meeting rentals.

A presumptive limit of 10% on the proportion of units leased in any multi-family structure may be waived by the local authority in the light of community

need for low-income housing. When tenants' income rises above the public housing eligibility limits, they may remain in the units formally leased by the housing authority by paying market-rate rentals for the units.

Another leasing program applied by MHFA in its housing program is the Long-term Leased Public Housing (Section 10c of the U. S. Housing Act of 1937 as amended. Under this federal program local housing authorities can secure from the Housing Assistance Administration of HUD annual contributions for periods up to 40 years for the cost of leasing units from private owners. The local municipal governing body provides that tax payments on housing under this program will not exceed 10% of its rental.

This leasing program is similar to the Section 23 in other aspects and they are both administered through the same department.

APPENDIX 2(c)

STATE LEASING PROGRAM (RENTAL ASSISTANCE, CHAPTER 707 OF G. L. CHAPTER 121.

This state program is similar to the federal Leased Public Housing (Section 23) program. Units in projects to be financed by MHFA and made available at the below-market rentals and adjusted rentals to be established by MHFA are eligible for leasing under this program. There is a statutory limit of 25% on the proportion of units in a multi-dwelling (9 units or more) structure which can be occupied by rental assistance households, and there is a 20% limit on the proportion of units permitted in one block.

Selection of tenants in this program is made by the local housing authority, and rental payments are made by the authority either directly or to the owner or to the tenant who then pays the owner.

Funds for this leasing program for projects financed by the MHFA are made available by the Department of Community Affairs.

# APPENDIX 3

## ACCELERATED DEPRECIATION AS AN INCENTIVE FOR FUTURE HOUSING GOALS

Under Section 521(a) of the housing reform act of 1969 rehabilitation of property can benefit through the authorization of a depreciation deduction for property, using the straight line method and a useful life of five years, if the property is acquired through qualified rehab expenditure. (Rehab expenditures are the total of all improvement costs minus the cost of acquisition of such units which have a useful life of five or more years.) This has to be in connection with low-cost rental.

Only the first $15,000 (presumably, less a reasonable salvage value) of rehabilitation expenditures per dwelling unit may qualify for such rapid depreciation, and such expenditures must exceed $3,000 per dwelling unit over the course of two consecutive years in order to qualify for such treatment. The determination of whether housing qualifies as low-cost rental housing is made according to regulations in a manner consistent with the policies of the Housing and Urban Development Act of 1968, Section 1250. (Housing units or apartments

qualify under this specification, and excluded are establishments in which more than one-half of the units are used on a transient basis, such as hotels and motels.)

For example, in five consecutive taxable years, a developer spends the following amount (per dwelling unit) to rehabilitate an existing structure which is then offered as low-cost rental housing: $500, $1,000, $3,000, $2,000, and $10,000. The first year's investment will not qualify because $3,000 was not expended over the course of two consecutive years. The expenditures in years 2, 3, and 4 may qualify in total. The expenditures in year five may qualify only up to $9,000, since the total qualified amount may not exceed $15,000 per dwelling unit.

Section 521(c) of the Acts as amended (relating to recapture of accelerated depreciation on real estate) provides that the excess of the depreciation deductions allowable for rehabilitation expenditure over the amount which would have been allowable under the straight line method of depreciation using the property's actual useful life will be treated as additional depreciation. This rule only applies if the property is held in excess of one year. If the

property is held less than one year, all the depreciation is treated as additional depreciation. This is the same rule applied by existing law to other forms of accelerated depreciation relating to real estate.

For example in one year a developer spends $10,000 for rehabilitation consisting of low-income housing, and the expenditures qualify as rehabilitation expenditures. The owner/developer may elect to depreciate the property under the straight line method using a useful life of five years. If he had not elected to do so, the property would have had a useful life of 10 years and no salvage value. The owner/developer depreciates the rehabilitation property for two years and then sells the property. $2,000 of the depreciation taken for the rehab property will be treated as additional depreciation for purposes of Section 1250; that is, the excess of the actual depreciation taken for the property, $4,000 (or two-fifths of $10,000) over the depreciation which would have been allowable under the straight line method using the property's actual useful life, $2,000 (or two-tenths of $10,000).

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