



CHANGING PATTERNS OF RESIDENTIAL RENTAL PROPERTY  
INVESTMENT IN HOLYOKE, MASSACHUSETTS

by

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ABSTRACT

The resources of those who inhabit low-cost, low-quality rental housing has declined over the last twenty-five years. This, in combination with increased operating costs has created a cash-flow crisis that has led many investors to abandon their buildings or adapt them to other uses. This crisis was partially and temporarily relieved by the use of marginal sources of income and tax benefits outside the traditional cash rent income stream. These new sources encouraged a shift in the ownership patterns that, while providing some short-term profitability, ultimately accelerated the destruction of these rental units. This case study of a building, its neighborhood and the surrounding City of Holyoke, Massachusetts attempts to illustrate this evolutionary process and its implications for current residents.

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## CHAPTER I: Introduction

Homelessness, overcrowding, and unaffordable rents are an expected part of our nations's urban landscape today. The roots of this disaster in the economic and political changes of the last quarter century are well-documented. What is missing is an investigation into the social consequences of these changes. The social effects on small property owners are particularly important because they provide most of the housing used by low-income households in this country. Why investors choose to invest; where they invest; for how long; who they choose to rent to; how they decide to make improvements, raise rents, refinance, or sell a property are not simple economic equations determined on a spread sheet. What we will find in the case study that follows is a complex set of relationships that is strongly affected, but in no way determined, by the economic and political changes that have given rise to a new set of social relations in the operation and tenancy of low-income, low-quality rental housing.

On January 21, 1991 the Springfield, Massachusetts Morning Union newspaper published a list of landlords owing taxes and sewer fees to the City of Holyoke, Massachusetts. Fifty-one delinquent properties out of a tax list of some 10,000 parcels may not seem like a great many, but the amount owed by landlords of apartment buildings was up more

than 300% from the previous year, from \$19,000 to \$72,000. The Tax Collector, Terrence C. Ginley, believed the increase was caused by "real estate speculators who came into the market when it hit a peak (and now) are faced with a declining cash flow and are having difficulty making payments." Mr. Ginley wasn't too sympathetic, however. It is "unconscionable that apartment owners would raise the rents, take the profits during the rising market and not pay when the income from the housing drops." Included in this list of properties were 554-556 and 558 South Summer Streets, owned by South East Summer Trust. This trust has only one trustee, an investor who lists his address in an upscale Boston suburb.

South Summer Street is located in a 200 acre section of Holyoke known as South Holyoke, or Ward II. This is one of the two areas often referred to as the "Lower Wards" (along with Ward I, or "The Flats"). It contains much of the city's original commercial district lining Main Street. It also includes some factories and warehouses, a few parks, several acres of vacant land, and a great many brick apartment blocks built before the Depression. In 1980 92% of the 1,073 rental units were found to be in buildings with 5 or more units. These apartment blocks, and the vacant lots of those demolished, form the core of a residential neighborhood covering 35 acres.

Turning the corner on Sargeant St. and driving north on South Summer Street one is immediately struck by a series of curious visual contrasts. Sections of the street and sidewalk are virtually covered with litter piled into alleyways, gutters and doorways while other parts have been fastidiously swept clean. On the left side there is a bright, new, two story, clapboard duplex with a fenced-in yard standing a few feet away from a four story apartment building of blackened brick. The right hand side of the street forms a continuous line of four story buildings from Sargeant Street down to the next corner. The first in line has obviously undergone some recent rehabilitation, including clean brick, new windows, and a modern glass entry way. The entrance is flanked by two planters with spreading yews. The building next door has also been fixed up. This building holds the offices of Nueva Esperanza, Inc., a community development corporation. The next two buildings are 558 and 554-556 South Summer St.. The stone stairway leading up to the second building has been reduced to a pile of rubble. A plywood covered door stands ajar and a glimpse inside reveals a grimy, unlit interior. The street itself has recently been paved. Healthy, new trees rise out of cuts into the new sidewalk at regular intervals.

Across the street from 558 South Summer street is 563 South Summer Street. Plywood covers the first floor windows and several upstairs windows are broken. This building now

belongs to a subsidiary of the Bank of New England. They bought it from the bank after a foreclosure auction failed to bring an outside bidder. Prior to this, it was sold three times between 1984 and 1987. Irene F. Lemire was a tenant in the building for almost five decades prior to 1984. She "can't believe it, what can happen to a building in just a year and a half." Her last landlord collected rent for 24 years. When he sold the building in 1984 for \$4,000 per apartment he had no idea that the building would sell for \$12,500 per apartment the following year. Then two years later the building sold again for \$26,000 per unit. At the time observers remarked that there was not enough income such that repairs could be made and the debt service paid off. "Someone will be stuck paying the bill", said real estate developer Richard Courchesne. "We'll see some foreclosures. The ultimate threat is demolition."<sup>1</sup>

In an age of expanding homelessness, demolition is a serious threat. In a city whose downtown neighborhoods have traditionally provided the poor working class with thousands of inexpensive housing units, over half are now gone and more disappear each year. This current threat is only the most recent in a long history of deterioration. As a nineteenth century industrial city built to exploit the water power of the Connecticut River in Western

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<sup>1</sup>Transcript-Telegram, "Flip side of the buying boom", 11/30/87.

Massachusetts, Holyoke's population peaked at 60,000 in the 1920's and has now declined to about 40,000.

Loss of economic advantage is, of course, a major part of this story. Aging New England mill towns all suffer this problem in one way or another. And, of course, many cities like Holyoke have been weakened by their failure to adapt successfully to the changing demands of modern transportation, communications, distribution of services, and uses of land. This changing political and economic landscape has altered the shape of its low-grade rental housing, as well. I use the term "low-grade" instead of low-rent or low-income or low quality because it suggests low quality for low rent without confirming that it is either affordable or necessarily substandard, which might be implied by these other adjectives. It denotes a class of rental properties that lies at the bottom of the grading scale and would typically be considered among the least preferable apartment choices available. Focussing primarily on the investment strategies of small owners of this low-grade rental property (those with under 300 units), this case study examines the evolution over time of an apartment building, its neighborhood of South Holyoke and the larger city surrounding it. Two major themes arise out of this investigation:

#### **Home Versus Investment**

What becomes apparent throughout this history is the tension between the uses of residential property as investment or as shelter. Rental property is both a home and a way to make money. These uses can complement or contradict each other. A property may earn money without providing decent shelter and vice versa; or it may do both or neither. Without attempting to define an ideal balance, one would certainly prefer a situation where earning money is, at least in part, dependent upon the provision of decent shelter. And yet we will find that the income-producing elements of low-grade rental property investment have often been divorced from the practice of providing shelter.

This should in no way reflect negatively on those who have provided decent shelter and also made money. Those investors skilled in the practice of providing shelter are an important resource and deserve much (though perhaps not always all) of their financial rewards. What is worthy of a critical review is a system of financial rewards that enables those with the least interest in providing shelter (and sometimes the least capacity to do so) to reap the greatest financial benefits.

#### **Marginalization of Low-income Renter**

Another important theme derives from the segregation by income that has occurred in the post-war period. The numbers of households at the bottom of the income scale has



increased during a time when zoning regulations and escalating housing prices have raised the "price of admission" to many suburban communities far beyond their reach. Older, inner-city rental properties increasingly offer the only remotely affordable shelter available to the low-income household. As more affluent tenants move to other markets, the average income of those who remain declines. Buildings that must depend on the shrinking resources of inner-city residents are likely to deteriorate, further encouraging the flight of those able to do so, in an escalating cycle.

As household incomes of inner-city residents become proportionally smaller than those who live in the surrounding communities, sharp economic divisions between the haves and the have-nots create disturbing social and political tensions. It becomes harder to imagine an economically integrated community.

The efforts of city boosters to improve their city's tax base and encourage private investment often lead them to conclude that low-income households have little to offer. They cite marketing studies that show potential middle-income residents (The group they most want to attract.) unwilling to move to what they consider to be low-income neighborhoods. Further, they find that middle-income households want to maximize their personal returns from investments in property taxes. Communities that spend a

high proportion of their taxes on services for the poor are considered poor investments. Finally, the demand for low-skilled labor has shifted to the retail and services sectors located away from the traditional, inner-city, low-income neighborhoods. Hospitals and regional malls are not dependent on a concentrated supply of low-skilled workers, but rather recruit from a wide area, including part-time homemakers and young workers still living at home with parents.

When, on top of all of this, the residents of these low-grade rental properties do not participate in the political process, they may find that city leaders not only can afford to ignore them, they are encouraged to find ways to displace them, as well. Of course displacement is not extinction. People don't disappear, they are simply pushed a little further out of the way. Being pushed to the edges of mainstream society, is what I mean by marginalization of the low-income renter. It is an important housing issue because it underlies the political discussion over land-use and housing assistance programs. However, it is clear that this issue cannot be approached without attention to the larger questions of race, class, and social justice.

These two themes--"Home vs. Investment" and "The Marginalization of the Low-Income Renter"-- will hopefully bring into focus some of the important changes that rental housing has undergone in Holyoke since the construction mill

worker housing almost a century ago--especially the most dramatic changes which have occurred in the last twenty-five years. For Holyoke these changes have been strongly shaped by economic and political forces outside its boundaries. But they are also the product of a unique local history and of the actions of those who owned, managed and tenanted its rental housing. These changes have confounded Holyoke's residents and planners for decades. They have led to bitter disputes, even to riots. They have challenged fundamental notions of what housing should be, whom it should serve, and who should be responsible for its fate. And most fundamentally, they have combined to put scarce housing resources for our most disadvantaged households at extreme risk.

Following a further discussion of this theoretical framework in Chapter 2, the thesis continues with the history of Holyoke's nineteenth century mill worker neighborhoods. Chapter 3 traces the shifting patterns of investment, ownership and tenancy in Holyoke that combined to allow (or prevent) the provision of shelter from the 1840's up to the 1960's. Chapter 4 then moves into a closer examination of the last twenty-five years with particular attention to the effects of changing conditions on the decisions of those who own that housing. Those changing conditions include: the local market; state and local

regulation; national housing and financial policies; demographic shifts; and the national economy.

In Chapter 5 the paper traces those shifting conditions through the history of 558 South Summer and how its various owners used that property, ie: as an investment, a home, a service to the community, etc. Indicators such as owner-occupancy, capital improvements, equity investment, refinancing, and resale in addition to management practices such as tenant screening, turnovers, and rent increases will hopefully reveal the landlord's overall use of the property. The effect will be to show the individual investor facing an array of choices and pressures and the decisions that resulted.

In Chapter 6, we will look at the views of current investors and the various ways that they are responding to the current conditions. The variety of the responses should provide us with some sense of the range of opportunities available to policy makers. Using the historical analysis as a reference point, Chapter 7 will suggest how policy-makers might exploit these opportunities in the coming years.

## CHAPTER 2: The Discussion in the Literature

Much has been written about housing affordability and the lack thereof-- especially for our lowest income households. This literature supports the argument that rental property investors at the lower end of the market have been facing a cash-flow squeeze that has forced many of them out of the market entirely. Often this has meant the loss of the housing units themselves. But the people remain and their search for relatively inexpensive housing is unabated. Recently, a new wave of investor has been able to respond to this demand. They have bought, financed, and managed rental properties to house these households. However, they have done so in ways that has often threatened the long term viability of that housing.

To help clarify these events it is useful to consider them through two theoretical lenses. One, "The Marginalization of the Low-Income Renter", reveals a long-term trend in which property owners have not only lost profits, but they have also lost touch with their tenants and their shelter needs.

The second lense, the "Home vs. Shelter" conflict, reveals another dissociative trend. As the new investors sought to improve the profitability of their properties, they looked to income-producing means that were only marginally dependent on the provision of shelter. The

social contract between landlords and tenants that was implied in the first two-thirds of the twentieth century deteriorated markedly under these new investors. Instead of depending on the satisfaction and long term tenancy of their tenants, these new investors discovered that liberal debt financing, generous subsidy programs, and lucrative tax benefits were more important sources of income than their impoverished tenants.

The following discussion is divided into these two themes:

#### The Marginalization of the Low-Income Renter

The most significant economic factor in this process has been the spreading gap between what it costs to operate rental housing and what the tenant has available to spend on it-- The Affordability Gap.

#### **The Affordability Gap**

Perhaps one of the most often quoted documents of the housing crisis in recent years has been A Decent Place to Live: The Report of the National Housing Task Force of March 1988.<sup>2</sup> This report, alternatively called the Rouse Commission Report has been credited for much of the impetus

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<sup>2</sup>National Housing Task Force, A Decent Place to Live, (Washington: The Report of the National Housing Task Force, 1988).

for the new federal Cranston-Gonzalez Affordable Housing Act of 1990. This report points to a number of indicators of housing problems faced by families in this country today. Its principle finding was that increases in the costs of housing were fast outstripping the growth in household earnings used to pay those costs. While in 1982 the median income of renters was \$18,000 (1986 dollars), by 1986 it had declined to \$15,300, while those households with incomes under \$5,000 (1986 dollars) had nearly doubled. At the same time rents grew substantially. The Task Force found that approximately half of all renters were paying half of their income for their rent, an increase of 2 million households between 1974 and 1987. Single parent households found their rent burden had increased from 35% in 1974 to 58% in 1987.<sup>3</sup>

Another way to state this affordability gap is offered by William Apgar. "Even adjusting for inflation, the number of units renting for less than \$300 per month dropped by nearly one million between 1974 and 1983."<sup>4</sup> "From 1983 to 1987, the number of poverty-level renter households increased by 300,000 to 7.5 million."<sup>5</sup>

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<sup>3</sup>Ibid., pp.11-13.

<sup>4</sup>Apgar, William C., The Nation's Housing: A Review of Past Trends and Future Prospects, (MIT Center for Real Estate Development), p.37.

<sup>5</sup>Ibid., p.29.

The reasons for the impoverishment of renters are not central to this thesis. What is important to recognize is that this condition is not simply the result of a recession or a "downturn in the economy". This is a long-term structural change that grows out of the way we organize our economy and distribute the wealth that is created. Our economy currently guarantees a large population of low-income households who must use extraordinary means to afford the least expensive housing. This has an important effect on the investment choices of rental property owners who have found that the rents they can charge are increasingly limited by the shrinking income of their tenant households.

In traditional economic theory, if demand is greater than supply, then prices should rise. Rising prices should attract capital investment and expand supply to the point where supply is in equilibrium with demand. Particularly when discussing housing, demand has to be distinguished from need. Just because people need and want housing, doesn't mean that they can afford it. Demand is only the demand which the buyer can afford to effect via cash. In the current market, rising prices have not led to more production as much as they have led to under-consumption (ie: homelessness, overcrowding, and substandard conditions).



Real Estate Research Corporation's Emerging Trends in Real Estate 1990 reports their annual assessments of the real estate industry's investment opportunities. In analysing the residential market, the report finds a significant cause for slowed growth in apartment demand: "Most important, a high proportion of traditional renter demand comes from households that can't afford to compete for today's new, market-rate housing." They argue that those apartments which are attracting investors are those which serve the needs of "higher-profile renter households" such as "affluent younger renter(s)", "empty nesters" and a "growing class of moderate income" renter households. <sup>6</sup>

This failure to generate an effective demand may account for the loss in the absolute number of housing units previously available to renters at the lower end of the market.<sup>7</sup> As tenants' ability to pay declines to the point where they are unable to afford the minimum operating costs of their housing, the owner of rental apartments at the lowest end of the market is faced with the choice of pulling out or trying to redirect his marketing to a different set

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<sup>6</sup>Real Estate Research Corporation (RERC), Emerging Trends in Real Estate: 1990, October, 1989.

<sup>7</sup>One could argue that these are linked. It would seem reasonable to assume that a decline in the absolute number of low-rent rental units is linked with the increasing difficulty of low-income renters to pay for their housing costs. After all, why wouldn't landlords logically withdraw from such a problematic market?

of potential tenants. The producers' response is to stop producing units for those households. Observers noted that between 1973 and 1983, 4.5 million units were removed from the rental market through conversions or demolitions, half of those estimated to be occupied by low-income households.<sup>6</sup> Privately-owned, non-subsidized housing available and affordable to low-income households is becoming a "vanishing resource...(that) continues to be either lost to abandonment or upgraded to serve higher income households."<sup>7</sup> Though the homeless may lack housing for various reasons, independent of their ability to pay the rent, the evidence that much of the current homeless population is made up of families with children and employed workers underlines the economic sources of the homelessness problem.

#### **Widening Social and Cultural Gaps**

The marginalization of the low-income renter need not refer only to the lack of the economic power needed to demand a place in the mainstream of the community. Health,

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<sup>6</sup>National Housing Task Force, p.12.

<sup>7</sup>Apgar, William, "The Declining Supply of Low Cost Rental Housing", Testimony presented to the U.S. Senate Subcommittee of Housing and Urban Affairs," June 5, 1987. Cited in Keyes, Housing and the Homeless, 1988, p.7.

developmental, and social problems<sup>10</sup> experienced by the homeless and those living in overcrowded, lead-painted, poorly-heated, vermin-infested or otherwise substandard housing are also perceived by the larger community as indicators of some personal or social defect. Indeed, when the inhabitants of such housing are of a different racial or ethnic group, the defect is often attributed to that group. The marginalization that is implied in the terms "inter-generational poverty", "ghettoized" or "culture of poverty" suggest social isolation and devaluation that may go well beyond simple economic status.

### Home vs. Investment

#### **Marginal Profit-making**

Although it is shrinking, there remains a housing market for low-income households. Despite their increasing difficulty finding adequate housing, many low-income renters continue to do so. Much of those units are operated by small rental property owners who have continued to find financial opportunities in rental housing. In some cases, it is housing that receives government subsidies. In many more, it is housing where overcrowding (in order that tenants can afford the rents) and low maintenance (in order

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<sup>10</sup>Gove, Walter, Michael Hughes, and Omar Galle. 1979. "Overcrowding in the Home: An Empirical Investigation of Possible Pathological Consequences." American Sociological Review 44:59-80.

that landlords can maintain the cash flow) may make the units temporarily affordable, but such abuses also guarantee accelerated deterioration of the units.

Another means that has been especially significant in recent years includes the use of outside income and other benefits to substitute for the disappearing income stream. This includes tax benefits (or most recently) cash from lucrative loans provided by aggressive banks and thrifts. The point here is that the simple business of offering decent accommodations to low-income households in exchange for a reasonable rent check is no longer profitable. Faced with this challenge investors are discovering profit-making opportunities on the "margins" of their rental property investment. This change in the way of doing "business" has had various (and often disastrous) implications for the provision of decent, affordable rental housing. These marginal profit-making opportunities include: speculative inflation, debt-leveraging, and tax benefits.

### **Speculative Inflation**

An investor analyzing the earnings potential of a property partly bases his measure of return on expected inflation: inflation of expenses, income, appreciation and interest rates. The price he is willing to pay anticipates the growth or decline in his net return over the holding period. Buyers in the 1970's and 1980's were generally very

optimistic in their assessment of overall returns. These anticipated returns caused buyers to bid up the properties they were buying. These purchases were then financed by banks that also anticipated appreciation in values and thus felt assured that the amount of the loan would be covered by the resale value of the property. These mortgages demanded repayment schedules that significantly increased the operating costs of the properties. Every resale of these properties, especially during an inflationary period like the 1970's, ratchets up the cost of housing another notch.

When a significant proportion of the return is derived from the gain on the appreciation of the property, investors must sell in order to realize that gain. As the speculation intensifies the trading becomes almost like a game of musical chairs with each new buyer eager to reap his benefits before the music stops and values fall markedly.

Speculative turnovers were further encouraged by the short depreciation schedules available before 1986. Investors seeking to maximize their returns would rarely hold their property beyond the depreciation period if there was any possibility for sale. At a time when increases in housing prices were reaching historic proportions, the increased rate of turnovers due to short holding periods only served to exacerbate the inflationary spiral.

The inflation of the '60's and '70's also led to banking reforms that further contributed to this speculative cycle.

## **Debt Leveraging:**

### **Banking Deregulation and the Credit Boom**

Prior to the banking reforms of the Roosevelt administration, most mortgage financing was provided by small investors lending for short periods. In many cases the seller provided a significant share of the financing. The innovative housing finance programs of the New Deal not only facilitated homeownership, but also increased the availability and profitability of debt leveraging in the rental market as well. One of those innovations was the fixed-rate, long-term, level-payment, self-amortizing mortgage. As inflation increased in the late 1960's, these mortgages, over time, returned to the lenders an interest rate less than the deposit rate after inflation<sup>11</sup>. At the same time the primary vehicle for these home mortgages, the nation's savings banks, were constrained by regulators from offering competitive interest rates to their depositors. Neither were they able to invest in other potentially lucrative deals, currently being used by those competing for depositors' cash. When the crisis led to record losses in 1981, the Congress moved to provide legislative relief.

The Depository Institutions Act of 1982 both provided new

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<sup>11</sup>This contributed still another source of income to the investor. When interest on a mortgage was less than inflation, the real, after-tax interest rate was often negative.

government aid and new flexibility in investment. It also overruled state laws restricting "due-upon-sale" clauses, allowing thrifts to "catch-up" with prevailing interest rates each time a house was sold. The new flexibility allowed a federal thrift to increase its assets in commercial-type investments in several areas up to a total of 90% of its total assets. This new competition moved the savings bank industry out of its post-war era of turning local depositors' savings deposits into home mortgages and into a new high-stakes player in global capital markets.<sup>12</sup>

In this competition for capital, another provision of the new legislation made it easier for mutual savings banks to convert to stock ownership. As the savings banks began to amass huge new sources of capital by issuing stock, they also began to feel increasing pressure to earn income on that capital. Stockholders now became intensely interested in the thrifts' ability to earn a high return on assets. As the regulatory doors were opened to all sorts of non-traditional investment opportunities, they were simultaneously under pressure to exploit those opportunities quickly. From junk bonds to skyscrapers, the savings banks were eager to put their newfound capital quickly to work in high earning investments.

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<sup>12</sup>Meyerson, Ann, "Deregulation, Restructuring of Housing Finance System", in Critical Perspectives on Housing, (Philadelphia: Temple University Press) 1986.

According to one banking source, this aggressive lending attitude had a significant impact on the real estate market in the mid 1980's. Lenders did not change their official underwriting standards. Nor did they knowingly put their depositors' money at increased risk. And yet, he admits, loans were often made without anyone from the bank ever visiting the property. "With the volume we were experiencing, loan officers didn't have the time." Outside appraisals were taken at face value. "Developers were trusted", he says. "You have to remember that there had been over 10 years of continuously appreciating real estate. Many of these loan officers had never experienced a downturn in the real estate market."<sup>13</sup>

Developers readily took advantage of this situation. With sellers being offered unheard-of prices, they could afford to take back a second mortgage for a fraction of the sale price. The total of that mortgage plus what the bank had loaned often exceeded the sale price. One Holyoke property manager who assisted in dozens of real estate transactions in the 1980's told me that a buyer rarely left the closing table without some cash, in effect a negative down-payment. A former banking commissioner writing about some of the more egregious and, perhaps, criminal examples of this kind of lending found that developers were able to obtain mortgages

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<sup>13</sup> Interview with Roy Scott, 5/15/91.



on properties for tens of thousands of dollars more than their market value.<sup>14</sup>

The implications for property investment were quite simple and quite disastrous. With this liberal lending climate, it was possible for investors to purchase properties (a) without any demonstrated capacity to manage them, (b) with no financial risk to themselves if the properties failed, and, (c) enough easy capital resources to make these doomed investments on a grand scale, buying hundreds of units at a time.

#### **Tax Benefits**

Tax benefits constitute the third major contribution to rental profitability during a period of lagging rents. These benefits, prior to 1986, took three forms: capital gains exclusions, accelerated depreciation schedules, and income sheltering.

(1) Up to 1986 60% of the gain on sale was excluded from taxation. By 1988, however, capital gains were treated no differently than other income. Capital gains exclusions, by enhancing the value of the income from the eventual sale of the property, enabled investors, in an appreciating market, to forego operating income and still maintain a reasonable return on income.

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<sup>14</sup>Focer, Ada, "The Great Bank Robbery", in New England Business, March 1991.

(2) The depreciation of a capital asset can be accounted for as a business expense to offset taxable income. The federal government has attempted in the past to spur investment in housing by offering accelerated depreciation rates for residential properties. In 1980, that acceleration was further enhanced, cutting the straight-line depreciation period to one half its previous rate. Although this rate was lengthened in successive years, it was still considered a significant benefit until the 1986 reforms when residential properties were increased to 27.5 years with no acceleration options available.<sup>15</sup>

(3) Prior to 1986 it was possible to offset one's income from one source by applying losses taken from any other source, often real estate. Doctors, lawyers and other high-income professionals could effectively "shelter" their income by investing in properties that lost money (on paper). The new tax law significantly restricts such activity. However, in the past, the paper losses engendered by accelerated depreciation schedules and large mortgage interest payments made real estate a particularly attractive investment. Those seeking tax shelters were rarely interested in the actual operation of their properties.

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<sup>15</sup>It should also be noted that accelerated depreciation schedules increase the likelihood of short ownership periods. As owners "use up" this tax benefit more quickly, their financial incentive to hold on to their property is proportionally reduced.

They often had little knowledge of the building, its tenancy, or even its location.

These marginal sources of income: speculative inflation, debt leveraging, and tax benefits allowed rental properties to generate income where that might otherwise have been impossible. Although this contributed to many successful developments, the overall effect in many areas was to shift the attention of the investor away from the business of providing physical shelter for his tenants and instead to the business of providing income shelters to his partners. Intimate knowledge of one's property and tenants, a tough hand with the budget, and a commitment to the long-term viability of the property and the surrounding neighborhood were no longer the key elements in this new investor strategy. The new strategy depended, instead, on a knowledge of loan underwriting requirements, tax laws, market trends and access to wealthy investors seeking to shelter their income. The old strategy was not profitable and those who used it soon gave way to the new investors who were able to offer high prices based on their enhanced use of these marginal income sources.

The reforms of 1986 and the crash in the real estate market soon after has removed most of these marginal incentives. As these new investors are forced to return to traditional investment strategies they are finding that the legacy of deferred maintenance and high debt service

payments is more than these properties can bear. The traditional investment strategy may not have been working well, but the new solution has proved even worse. Not only are these properties financially untenable, but a generation of investors who might have held on for a little longer have all disappeared and their replacements seem ill-prepared for the return to the difficult and unrewarding job of managing low-grade rental property.

#### **Marginal Versus Rent-Driven Profit-Making**

I believe the term "marginal profit-making" to be useful because it makes an important distinction in the way an investor earns income from the use of his property.

This method is contrasted with the more traditional method which I call "rent-driven". The rent-driven landlord is dependent for his income from the rent, either as collected every month or as capitalized by a buyer at the time of sale. In this example, the landlord can only earn income so long as people are willing to pay a rent that is greater than the costs of operating the building. This basic strategy is "rent-driven", because it relies on the cash income from rents. Ideally, when this works, it is a self-sustaining strategy that ensures a long life for the building and a prosperous return to the investor.

What the findings below will show is that, as the net operating income from rents declined over the last twenty

years, there was a period when the traditional rent-driven landlord was supplanted by those using these "marginal" sources. Increasingly complex rules of finance, expanding tenant rights and increasingly vigorous health and safety regulations put the traditional small property owner at a decided disadvantage. As these owners failed or sold out to financially sophisticated buyers, the composition of the rental property-owning community shifted from local owners with a relatively intimate knowledge of their properties toward outside investors, some of whom never saw their buildings and even refused to visit them.

#### **Declining Commitment to Public Housing**

As the private market was discovering that the most profitable uses of low-grade rental property had little to do with fulfilling the needs of low-income tenants; as small investors were deciding either to abandon the property, upgrade it, or use it for the marginal benefits described above; as the private sector was making choices that would ultimately reduce the supply of low-income housing for years to come, public action was sorely needed. Nationally, however, the trend has not been to increase the public commitment to subsidized housing, but rather the opposite.

For many low-income households, the availability of federally-subsidized housing assistance over the last fifty years has been an equalizer. Despite significant failures,

public housing assistance has given millions of disadvantaged households a badly needed opportunity to live in decent, safe, affordable housing. Perhaps predictably, the initial generosity of federal housing programs peaked in the early 1970's and has now waned for almost twenty years. Following a brief resurgence during the Carter years, the Reagan administration sharply applied the brakes beginning in the first term.

"Since 1980, (federal) housing assistance has been slashed by 73 percent ... from \$33 billion to \$9 billion, the largest cut of any domestic program ...."<sup>14</sup>

Chester Hartmann's 1986 piece in Critical Perspectives in Housing cites three elements of the Reagan administration's attack:

1. Termination of existing new construction programs for lower-income households.
2. Sloughing off existing lower-income housing developments through deterioration, demolition, or sale.
3. Extracting ever larger portions of lower-income households' budgets as a price for getting federally-subsidized housing (increased from 25% to 30%).

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<sup>14</sup>Dreier, Peter and John Atlas, "Mansion Subsidy Revisited", Shelterforce, May/June 1991.

He goes on to cite the steady decline in HUD's lower income housing starts with 183,000 units in 1980 to only 28,000 in 1985. He lists cuts in the Community Development Block Grant (CDBG) program, cuts to existing public housing operating subsidies and modernization expenditures and cuts to other housing-related programs.

This dramatic decline goes beyond the demands of any new austerity that might be demanded in a period of low economic growth. Even ignoring increased spending in other areas (ie: military programs) or wasteful spending (ie: the Pierce scandals), it is clear that the Reagan administration made deliberate political decisions to get government out of the business of increasing housing opportunities for low-income households. The new Bush administration has done little to reverse that trend.

I would argue that these policies have further contributed to the marginalization of the low-income household and the small property owner who has traditionally provided their housing. The loss of housing units that might have been built during a period of growing demand surely contributed to the tight market that pushed people out onto the streets. The cumulative effects of years of living in substandard units where most of the household budget went to pay exorbitant rents must have reduced the life chances of many of our nation's children. The deterioration of public housing from underfunding has

certainly contributed to the public perception that public housing is fundamentally impractical and that those who live in it are unworthy of public support.

The declining resources of those who inhabit low-grade rental housing in the post-war era has created a cash-flow crisis for investors that has led many owners to abandon their buildings or adapt them to other uses. This crisis was partially and temporarily relieved by the use of marginal sources of income and tax benefits. However, these new sources encouraged a shift in the ownership patterns that, while providing some short term profitability, ultimately accelerated the destruction of these rental units.

Although the existing literature emphasizes the economic effects on rental housing and its tenants, the social effects have also been powerful. The traditional small rental property owner, able to make a decent living through the provision of a socially acceptable service (ie: housing low-income households), is threatened with extinction. Neighborhood residents experience that loss as isolation, powerlessness, and the loss of neighborhood identity and mutual accountability. This should sound familiar to those familiar with community-based groups, whose attention to these abstract social problems is often as strong as their support for improved housing and city services. Planners might do well to consider the importance of these social



effects as they attempt to "rehabilitate" neighborhoods with shiny, new buildings and larger, more distant investors.

Before we examine the post-war period more closely I believe it is important to establish the historical roots of the neighborhood of South Holyoke and the forces which shaped it. That history provides the present with both physical and abstract legacies that cannot be ignored: (1) a built environment that must be accomodated-- even its demolition must be accounted for; (2) a way of doing things that presupposes what can and cannot, should and should not, be done-- traditions that have summarized a complex evolution of interpersonal exchanges into a simpler set of social norms and cannot be easily reinvented. The origins of the buildings of South Holyoke and the traditional ways that they have been used is covered in the next chapter.

#### **Methods and Data**

The sources for the information in this case study come from three sources. The first is the author's personal experience as a property manager in South Holyoke for four years; as a member of the Greater Holyoke Rental Housing Association; and as an owner of rental housing.

The second source is a series of interviews with small rental property investors, property managers, lawyers, housing advocates and bankers both during the Summer of 1990 and the Spring of 1991. For most of these interviews,

confidentiality was a pre-condition and therefore few quotations are attributed. Interviews with six investors-- each holding investments in rental properties totalling less than 300 units -- were conducted. Investors were asked to discuss how they decided to invest in rental properties, what changes they had seen in the regulation, financing and profitability of their properties over the years, and what they saw for the future.

The remaining information was culled from published and unpublished reports, Census data, newspaper clippings and the files of the Holyoke Planning Department.

I had hoped to be able to have available the exact financial records of investors for the purposes of explicit analysis. The reluctance of investors and the confused nature of their bookkeeping combined to make this impossible for this report. However, after having concluded this research, I am more convinced of the usefulness of more detailed financial analysis and would encourage further attempts to do such an analysis.

## CHAPTER 3: The Early History of Holyoke's Low-Grade Rental Housing, 1846 - 1965

### Introduction

Most of the apartment buildings of South Holyoke were built around the turn of the century. Their size, configuration, placement and density were primarily designed to house the millworkers and their families. The original plan was to provide a large supply of inexpensive units within an easy walk of the surrounding manufacturing mills. The subsequent loss of local manufacturing jobs<sup>17</sup> and the increased use of the automobile for commuting has seriously challenged the underlying premise for this plan. Local observers report that few of South Holyoke's residents continue to walk to work, today. Nevertheless, the buildings remain. And, regardless of the changing economy, people have continued to buy them and make use of them-- for both shelter and profit.

Comparing these investors and their investment strategies, we will note how, at times, their efforts seem to promote the long term capacity of these buildings to provide shelter. Furthermore, we will see how the owners of these buildings may have even nurtured a self-sustaining

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<sup>17</sup> Between 1970 and 1988 the Census Bureau and the Massachusetts Department of Employment Security reported a total of nearly 4,000 manufacturing jobs lost in Holyoke.

community. At other times those interests have been destructive of these buildings and the neighborhoods that they comprise. Understanding how a building in one period can "work" to provide a sustaining and sustainable shelter and in another period can become useless or even dangerous can provide important clues to setting public policies designed to promote the former condition and avoid the latter.

In this chapter we examine the evolution of Holyoke's mill worker housing from its original conception and construction through World War II up to 1965.

#### **Sheltering the Mill Worker: Landlord As Mill Owner**

From its very beginnings, this industrial city on the shores of the Connecticut River has been plagued with a "housing problem". When a group of Boston industrialists formed The Hadley Falls Company in 1846 and bought 1200 acres of land to build an entire city at the site of the 57 foot Hadley Falls, the attraction of cheap and plentiful hydraulic power<sup>10</sup> was expected to draw manufacturers from all over New England. With a massive dam to capture the water and direct into canals, mills were to be located so that water from the upper canals would flow through the

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<sup>10</sup>Water power charged to mills at the rate of \$4.62/horsepower in 1887 while steamcost at least \$19.89/horsepower. From Holyoke City Directory, 1887.

mills to the canal below and so on to the river. Original drawings showed 25 cotton mills located along the canals.<sup>19</sup>

Attracting labor was not expected to be a problem. Most of the construction and mill work was low-skilled and Irish immigrants had begun flocking to the States as conditions worsened in Ireland in the 1840's. To plan for an adequate supply of housing for the workers in the anticipated mills, the owners set aside parcels of land immediately adjoining the mill sites to be used for housing the workers for that particular mill.

In this early period the use of housing as a means for earning income was directly tied to the supply of labor for the local factories. The purpose of housing was to shelter workers in order that their work might provide income to the mill owner. Housing was not seen, as yet, as a profitable commodity in and of itself. During this period mill wages for most workers were "little more than enough to live on". The average wage at the Lyman Mills in 1871 was \$3.24 per week with board costing an average of \$3.00 per week in the company boarding houses<sup>20</sup>. With so little disposable income, the investor with capital at this point would have

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<sup>19</sup>Green, Constance McLaughlin, Holyoke, Massachusetts: A Case History of the Industrial Revolution in America, Archon Books, 1968.

<sup>20</sup>Green, p.105

found comparatively little reward for his investment in the production and rental of housing for these workers.

### "Cornering" the Land Market

The lack of transportation and the location of the city in the crook of a major river with no bridges, made alternative housing sites scarce. The owners refused to allow other available land in this "corner" of the western shore to be used for housing. They felt that the highest and best use for the land was manufacturing mills, which they felt sure would flock to the City.

In 1855 there were only 514 dwellings to accomodate 778 families.<sup>21</sup> In the neighboring city of Chicopee, townspeople pointed out that small, comfortable houses were common while Holyoke offered only brick blocks three and four stories high and the rent for apartments in such places was higher than any surrounding town. One observer reported in the local paper that the owners, instead of hoping to capitalize on the anticipated boom, should instead seek to "create an attractive manufacturing village"<sup>22</sup>. For those who were unable to find housing in the available tenements, the other option was to build a shanty along the shores of the river.

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<sup>21</sup>Green, p.41.

<sup>22</sup>Green, p. 41.

Squatting on the land, the newly arrived poor Irish dug out a hole, put up a few boards and built a one-room, windowless shelter. When it was possible to move on to better accommodations, another newcomer often moved in. These neighbors, living in what was called the "Patch", often worked together building shelters, collecting firewood, sharing the few water pumps and baking ovens available. This historical sidelight provides an interesting example of ethnic and community-based self-help in the face of mainstream neglect that may have implications for Holyoke's most recent newcomers.

Many of the townspeople blamed the housing shortage on the Company's directors who still owned all the developable land. These landowners had opposed the construction of a bridge to the neighboring South Hadley and restricted the use of their land for housing development, preferring overcrowding to lowering real estate values.

#### **Crisis and Accomodation:**

#### **The Rise of the Independent Investor and the Owner-Occupant**

When cotton mills failed to flourish, paper mills were introduced with great success. A new railroad and new commercial banks aided the overall economic expansion. Growing employment contributed to an increasing demand for housing. Though the mills often provided housing for their

mill hands, there was not enough housing for these workers' households, much less for those of the laborers, clerks, merchants and others. In 1866 public health officials found a block with 105 people living in 17 rooms, some with 10 people in one room alone<sup>23</sup>. Health officials continued to find appalling conditions in Holyoke, even for those times, and found infant mortality rates, death rates, and residents/room occupancy ratios that rivalled the worst in the nation.

But the political complexion of the town was changing. The new paper mill owners were often local businessmen involved in the life of the community as opposed to the absentee owners of the cotton mills, derisively called "the cotton lords". The wage scale in the paper mills was higher than that for cotton. Industrial growth fed the building industry, including contractors, lumberyards, sawmills and brickyards. They, in turn, sought orders for new residential construction. Combined with the rising earnings of Holyoke millworkers (among the highest in the state), the demand for new housing opportunities for Holyoke's workers could no longer be ignored by the Company's successor, the Holyoke Water Power Company.

In the 1870's their policies were relaxed somewhat. In 1872, a bridge was built to South Hadley. In 1873, the

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<sup>23</sup>Green, p.116.



company stopped requiring that housing sites be developed only in conjunction with specific mills. Land was more easily bought by small investors, who constructed apartment buildings in which they often occupied one of the units.<sup>24</sup>

### **The Die Is Cast**

By 1923, the downtown development of Holyoke had peaked. Built around a manufacturing center that required thousands of inexpensive housing units within easy walking distance while occupying the least amount of space necessary, its neighborhoods were filled with densely constructed tenements with few amenities. For many years Holyoke's occupancy ratio was higher than any city in Massachusetts, except Boston. In 1880 it was 10.52 per dwelling, in 1900 it was 10.9 per unit, in 1910 it was 11.9. In South Holyoke, the ratio was 22.3 per dwelling unit in 1915.

"Tigertown", as South Holyoke was called originally, was known for its rough character. It was a neighborhood whose rental units were available to those with the least resources for the lowest rents. That status, of being on the lowest rung of the ladder, has remained virtually unchanged to this day. What has changed so dramatically, particularly in recent years, is the gap between the rungs on that ladder. The earlier residents of South Holyoke may

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<sup>24</sup>Green, 172.

have been poor, but they were only slightly less so than most of the other immigrant<sup>25</sup> families who made up over 75% of the City's population in 1920.

The ethnic construction of Holyoke's society was established as well by the 1920's. With the new immigration restrictions of that decade there were no new waves of ethnic groups to disrupt the social fabric of linguistic and cultural enclaves.

### **Industrial Stagnation**

Holyoke's main advantage as an industrial center, hydro-power, was diminished with the advent of electrical generation. Local power stations on the river were eager to sell their power to any manufacturer anywhere. Though delayed by the temporary increase in demand for goods in the first World War, by 1922 it was clear that Holyoke had peaked as a manufacturing center. As manufacturing firms closed their doors and thousands of workers were laid off, the population began to decline. World War II provided some relief but the trend reappeared in the 50's and continued, slow but steady, through the 60's. From its estimated height in 1923 of 63,094 the population fell to 53,065 in

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<sup>25</sup>Non-native born plus native born of foreign parents.

1960. The number of wage earners in Holyoke's factories in 1957 was 65% of its 1923 peak.<sup>26</sup>

### **The Consolidation of a Neighborhood**

Those familiar with South Holyoke during the period following the Depression often describe it as a strong, diverse and stable neighborhood. They remember the variety of shops along every street, the churches and meeting halls which residents widely attended, and especially the extended tenures of residents. The sense was that people rarely wanted to move away. Households living in the same building for twenty years were not considered uncommon. With church, school, family, friends, work and stores all located within easy walking distance, there was a strong incentive for families to stay as long as possible where they lived. Landlords rarely advertised in the paper.

It was a common practice for an apartment to be "spoken for" some time in advance of a vacancy as existing tenants made arrangements for family and friends to move into the next vacant apartment. This practice was supported by the strong demand for rental units following the Depression, especially during WWII, when soldiers stationed at Westover Air Force Base often lived in apartments in the neighborhood.

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<sup>26</sup>Saunders, M.O., Master Plan Report, (Holyoke: Holyoke Planning Board), 1961.

The ethnic and religious groups that had established their own neighborhood enclaves found little to disturb their status quo. By the 1950's the Irish/French-Canadian rivalry had long subsided. South Holyoke's Irish residents no longer dominated it by the 1950's. The French Canadians, however, remained within easy walking distance of the local French-language parish church. They outnumbered the next largest ethnic group by 7 to 1. Aside from a handful of southern African-Americans (3.5% of total), there were few challenges to this ethnic balance in Holyoke's traditional "gateway" neighborhood. Throughout the City as a whole, the number of census respondents who reported themselves to be foreign born in 1950 was less than half what it had been in 1910 when it was nearly half the population.

The result was a close knit social structure within the individual buildings and throughout the neighborhood. Tenants were obligated to pay the rent and landlords were obligated to fix what broke, but that was only a small part of the relationship. Children were cared for by neighbors, whether landlord or tenant. The sick and elderly could depend on healthy neighbors to run errands, purchase groceries and provide transportation.

#### **The Owner As Occupant**

The predominance of the owner-occupant in apartment buildings is hard to document. However, the most recent

publishers of the Holyoke City Directory began in the 1930's to indicate when a resident reported that they or someone in the household was also an owner. This rough accounting should afford us with some sense of the trend, at least. Simply counting those addresses with more than one unit on just one street in South Holyoke (South East Street), I found that 11 out of the 28 apartment buildings listed had an owner-occupant in 1935. This increased to 14 in 1940 and returned to 11 in 1950. However, by 1960, that number had dropped to only 5. In 1980 there were only 3 in the 18 apartment buildings still listed.<sup>27</sup>

We will see in the example of 558 South Summer Street that the range of relationships was not simply limited to either owner-occupant or absentee landlord. Like 558 South Summer St. buildings often held relatives of the owner as tenants. This, however, becomes less likely as the economic status and ethnicity of the owner and tenant population diverge. Although there appears to be no easy way to document this "owner-occupancy, once-removed", or its evolution over time, I can relate some examples from personal experience.

I personally was involved in the purchase of eleven occupied buildings in South Holyoke in the mid 1980's. Only two included relatives as tenants. In one building the

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<sup>27</sup> The Price and Lee Company, Holyoke South Hadley Directory, New Haven, CT.

owner's father-in-law had lived for many years, though recently his children had been trying to get him to move out. In another case, it was the young children and their families who occupied the building. In both these cases the owner had bought the buildings many years ago. Only one of the investors I interviewed still maintains this practice and she has been doing this for almost 30 years.

Maintaining "a good building", for the owner-occupant, does not always correspond with a good return on investment. Landlords were constrained from raising rents often by their own friendships with tenants. Their "investment" was not only in the financial dollars that paid for the construction, operation and their profit, it was also an investment in the structure of social relationships which became as life-sustaining as the flow of rental dollars.

#### **The Suburbs: The Shift to Homeownership**

After World War II, the decline in Holyoke's population exceeded the loss of jobs. The authors of a 1961 study of Holyoke blamed the decline in population on the movement to the suburbs. Their report speculates that the population of Holyoke was likely to be "unusually mobile" due to the large numbers of single person households and multifamily housing with "a large amount of tenancy" as opposed to homeownership. The report suggests that if more Holyokers

owned their own homes, they would be less likely to seek those opportunities elsewhere.<sup>28</sup>

The implications of this recommendation for a densely urban neighborhood are not encouraging. Prior to the advent of the automobile suburb, Holyoke's downtown neighborhoods were considered by many to have been strong, vital places in which to live. With the car, its highways, and the expanded homeownership opportunities of the suburbs, inner city rental tenure was losing its appeal to those with the resources to move out. Providing homeownership opportunities in aging 8-unit brick tenements was not what these advisors recommended. Consonant with much of the popular wisdom of the Urban Renewal era, these advisors found South Holyoke's housing to be outmoded and they recommended turning South Holyoke into an industrial park.

Others refuted this line of thinking, preferring to emphasize the traditional values of the urban neighborhood and the importance of inexpensive rental housing to both the residents and local industry. Nevertheless, the trend was unmistakable.

In an age of automobiles, the value of proximity had declined. In an escalating spiral, bus ridership losses led to cuts in bus service. Cars choked the streets. Building permit records indicate that landlords had begun (beginning

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<sup>28</sup> Holyoke, City of, Master Plan Report, 1961.

as early as the 1920's) to fill their tiny backyards with garages and parking areas. Convenience was turning to annoyance and the suburbs were the escape.

But even as the most affluent of Holyoke's inner-city residents began to buy new homes in the surrounding farmlands, the immediate post-war demand for rental apartments remained high. As returning soldiers created new households, rental apartments offered them an opportunity to live inexpensively and it often took many years to save enough for a down payment. However, by 1955, the rate of decline in the mill-worker neighborhoods was higher than ever.

#### **Aging in Place**

By 1955, these neighborhoods had lost over 20% of their peak populations. Census reports in 1960 indicated that those wards were continuing to lose population in greater numbers than other neighborhoods. However it is not simply the case that people moved away. Some did. These same census reports indicate that the household size decreased while the median age increased. This aging neighborhood was attracting fewer new families with children and, increasingly, consisted in older and smaller households.

The post war years in South Holyoke are often remembered with fondness by the previous residents. It is ironic that, even as it was undergoing profound, if at times slow,



change, the neighborhood's post-war image of stability and order remains a strong memory to this day. The squalor of the industrial boom era had been reduced by health and sanitation improvements. The crushing overcrowding had been eased by the exodus of jobs and workers and the decreasing proportions of families with large numbers of children. Storekeepers still lived in an apartment behind their shop. Lawyers, doctors, and professionals still could be found living with their families next door to mill-hands and day-laborers. Economic stagnation had reduced the demand for foreign labor and ethnic conflicts, though by no means eliminated, were less prominent. But even as this image was being formed, the foundations on which it was built were being destroyed.

## CHAPTER 4: THE LAST 25 YEARS

### Introduction

The environment for small rental property owners in Holyoke over the last twenty-five years has been shaped by several factors. The loss of manufacturing jobs, the decline in median household income, the recent wave of Puerto Rican immigration, banking reforms, declining federal commitment to housing and social programs, expansion of non-project-based, deep rental subsidies, local efforts at urban renewal, expanding tenants' rights and increasing owner liability for tenant damages from discrimination to lead poisoning, all led to significant changes in the nature of rental housing in South Holyoke between 1965 and 1990.

### Accelerating Decline--Fewer and Poorer Residents

Vacancies increased tenfold during the 1950's and continued to swell through the 60's. As the skilled workers left for better jobs and/or suburban communities, there were fewer and fewer new households willing to set up a home in the neighborhood. The traditional closed system of filling vacancies--word of mouth and personal referrals-- failed to work adequately to fill the units.

Those who remained represented those with fewer choices, the less wealthy. In keeping with the "filtering" model of neighborhood change, the aging of neighborhood housing

paralleled the decline in income of its residents. In 1960 South Holyoke's family median income stood at 85% of the citywide median. By 1970 it had fallen to 61%. In 1980 it fell still further to 41%. Population fell in the neighborhood by 26% during this decade, almost twice the rate for the city overall. With household formation in the 1960's at its lowest ebb, fewer and fewer job opportunities in the city, an aging housing stock that was increasingly outmoded by newly constructed housing in the suburbs, and an aging class of property owners who were beginning to abandon their properties for lack of a new generation of buyers, South Holyoke was increasingly perceived as an unviable residential neighborhood. And yet most of the original housing was still standing in 1970-- filled with vacancies, but standing.

#### **New Immigrants Fill the Vacuum**

Nineteen sixty-five marks for many the turning point in the post-war history of Holyoke. In this year the flow of Hispanic immigrants introduced them as a major new ethnic group in Holyoke. Their arrival was due to many causes. The high unemployment rate in Puerto Rico, and the massive displacement caused by urban renewal in other urban areas like the South Bronx are cited as "Push" factors for this migration. "Pull" factors include farmworker recruitment and the opportunity to live in cheap housing within a five minute ride of farmlands, fishing, and fresh water beaches.

More specifically, the urban redevelopment that hit the North End of Springfield (less than 15 miles to the South) in the mid 60's displaced many Puerto Rican families.<sup>29</sup> They found that South Holyoke held a ready and affordable supply of substitute housing and the number of Hispanics in South Holyoke grew from 287 in 1970 to 1,879 in 1980.

What they did not find in Holyoke was a stable and expanding source of employment. The agricultural and manufacturing employment that had been their primary sources of income were also the region's most rapidly declining sectors. What jobs they were able to find were not well paid. By 1979 seventy-six percent of all Hispanic workers in the Springfield-Holyoke-Chicopee Labor Market Area worked in janitor or cleaner jobs. They held 90% of all such jobs.<sup>30</sup>

Holyoke's low-grade rental housing may have been considered unviable for many of the working class with expanding incomes and rising expectations. For those whose incomes had not kept pace, who were finding fewer and fewer apartments that they could afford, Holyoke's housing was an opportunity to at least find a place to live and hope that decent employment would follow. For whatever reason,

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<sup>29</sup>Leveille, Karen, "South Holyoke Housing Development Plan", 1985.

<sup>30</sup>Massachusetts Division of Employment Security, Analysis of Employment Trends: Hampden County Service Delivery Area, 1989.

Holyoke's housing vacuum was beginning to fill with the most economically depressed ethnic groups identified at that time.

For investors seeking opportunities in the low-grade rental housing market, these changes did have some rewards. But it would be hard to appreciate the changes in the market without first discussing the role of the local government.

### **The City Intervenes:**

#### **Disinvestment, Demolition and Displacement**

Disinvestment. The 1968 Master Plan for the City of Holyoke observed South Holyoke's rising vacancy rates and abandonment and argued that, "As the standards of living for Holyoke's industrial workers continues to rise many old and obsolete multiple dwelling structures will be abandoned."<sup>31</sup> Therefore, they argued, South Holyoke should be eliminated as a residential neighborhood, demolishing the old buildings to make room for increased industrial use.

Community activists were successful in challenging the Master Plan and halting the elimination of South Holyoke as a residential neighborhood. However, the City chose to ignore recommendations that might have prevented further deterioration. Instead its actions convinced many that it

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<sup>31</sup>Holyoke, City of, Master Plan: City of Holyoke, prepared by Candeub, Fleissig and Associates, 1968.

was attempting to do through neglect what it had failed to do by plan. South Holyoke as a neighborhood simply had no "official" future. Bankers, responding with predictable caution, withdrew the credit that investors sought to make building improvements. Meanwhile the City's housing demolition in The Flats added to South Holyoke's problems. The Flats is another millworker neighborhood just north of South Holyoke. Together they are sometimes referred to as "The Lower Wards".

Demolition. Official neglect of South Holyoke in the face of escalating deterioration was not the only destabilizing influence imposed by the City. As noted above, the 1961 Master Plan for the City recommended that South Holyoke and The Flats be transformed into industrial areas. With their abandoned, vacant buildings these neighborhoods were choice targets for the urban renewal programs that had come into prominence.

The 1968 Master Plan for The Flats was to reduce the population density of the neighborhood while removing substandard housing. The City's designated developer for The Flats destroyed many recently occupied units with typically only two units being constructed for every eight units torn down. Between 1970 and 1980 The Flats lost 41% of its total housing units, 50% of its rental units.

Displacement. Displaced tenants from The Flats began to crowd into South Holyoke, where the conflagration peaked in

August of 1981 with a fire that claimed seven lives and captured the attention of the nation. Holyoke's astounding fire statistics won it the label, "Arson City". Resistance to the establishment of an arson squad; understaffing of the fire department; an aggressive condemnation and demolition effort in minority neighborhoods combined with their efforts against the establishment of emergency housing shelters convinced many that Holyoke's leaders were at war with their poor minorities.<sup>32</sup> Despite the firefighters' union's successful lawsuit against the city (where it finally won funding for a full-time arson squad), by 1985 there were still standing in South Holyoke only one half the units recorded in 1970 and not one new unit built in all that time.

#### **From Obsolete Buildings to Obsolete People**

It is hard in this era of declining expectations to appreciate the confidence in economic progress reflected in the planning documents of the 1960's. With hindsight we can see how the City's planners' predictions of employment and population growth largely overshot the actual growth. But perhaps, at the time, there was some justification for their conviction that the City's "older housing units...are

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<sup>32</sup>Harden, Tom, "Uphill All the Way: The Potential of Community-Based Development in South Holyoke", Master's Thesis, Tufts, 1986, p.80.

difficult to maintain and upgrade" and should be "phased out". In the bright new future people simply would not accept such living conditions. The time had come, they believed, to clear the dead wood and make room for the new growth of modern industry and housing. However, for South Holyoke this meant razing the entire neighborhood. Those who lived in South Holyoke felt personally threatened by these plans and they fought hard to save their homes and their neighborhoods.

During the 1970's the rhetoric of progress changed. By 1983, the President of the Board of Aldermen was calling for the refusal a moratorium on new housing subsidies for the City, "Because chronic poverty also implies an unskilled labor force, it deters high-technology industries from settling in Holyoke."<sup>33</sup> This public explanation for the refusal of housing subsidies was used less publicly to justify the elimination of a much larger source of housing for these households, ie: the unsubsidized low-grade rental housing stock. "Cleaning out the dead wood" had taken on new meaning.

### **Who Would Buy a Building in Such A Neighborhood?:**

#### **Investors Respond**

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<sup>33</sup>Harden, p.66.



For those property owners who could keep up their buildings and avoid condemnation, the elimination of the cheaper competition was a boost to business. Vacancies that had been steadily rising in previous decades fell dramatically during the 1970's. In The Flats, they were reduced by 66%, in South Holyoke, by 24%.

For competent investors in low-grade rental housing in Holyoke during the 1970's this combination of shrinking supply and expanding demand could bring rewards. Landlords who could pick up distressed, but salvageable properties and manage them through the storms of arson, redlining, expanding legal protections for tenants and ethnic tensions found that the new immigrants were willing to pay much higher rents for their units than the native and primarily elderly residents many of whom had paid the same rent for many years. While sellers often based their asking prices on the existing cash flows, enterprising buyers realized that these older tenants would soon be moving on and the new rents would enhance the value of the property. "One thing you could say about these new speculators," commented one housing advocate, "They rarely discriminated. They would rent to anybody." The result was that South Holyoke's median gross rents increased by 144% during this decade, the largest gain of any neighborhood in the City.

## **The Squeeze: Taking More From the Tenants and the Buildings**

During that same period, however, family incomes in South Holyoke increased only 21%. Landlords were fueling rent increases, not with more affluent tenants but with more desperate ones, ones willing to pay a very large share of their income for a housing opportunity. In this case the improved financial viability of the rental housing did not guarantee either financial success or a decent sheltering environment. It would be an understatement to say that such changes were destabilizing. Overcrowding and all the attendant social problems of people living close to the edge were causing serious problems. Maintenance costs were becoming more difficult to control and the "fragile" conditions of these 60-80 year old buildings required more than the "subsistence diet of repairs" that they were receiving.

Building Inspectors reported that, generally, owners of low-grade rental properties increasingly seemed to be waiting to be ordered to make repairs, rarely doing so on their own. It would seem fair to say that these landlords were using the capital represented in the building to subsidize their operations.

## **New Hope for South Holyoke**

The 1980's were a time of fast-paced change. The baby-boomers had been turning 30 and seeking housing. They were beginning to heat up the market around the country, especially in Massachusetts, and Holyoke was about to get warm.

In Massachusetts, Proposition 2-1/2 limited the abilities of Massachusetts cities to raise taxes to respond to the increasing demand for affordable housing while the Reagan administration drastically cut funding for local aid programs. A liberal governor responded by making affordable housing a key part of his program. Increased funding was available for those communities that wanted it.

The City's determination to let South Holyoke deteriorate faced mounting challenges on the local front as well. Community activists, who had successfully obtained an ammendment to the 1968 Master Plan allowing South Holyoke to remain as a neighborhood, were again pressing the city to stop its destruction.

Nueva Esperanza, Inc. (NEI, Spanish for "new hope") was formed by housing advocates in 1982 as a Community Development Corporation with the primary purpose of providing "decent, safe, affordable" housing to the residents of South Holyoke. In the face of overwhelming opposition from City leaders, they actually began to buy and fix up buildings in South Holyoke. Their second and most ambitious project was a 28-unit tax-delinquent property for

which they had just received a preliminary financing commitment from the Massachusetts Land Bank.<sup>34</sup> While the Mayor was assuring the organization's staff that they would not interfere, a wrecking ball was secretly ordered to the site and a large chunk of the building was torn out before a court injunction was obtained. The building was consequently demolished, but not before the City received the condemnation of the local media and local and state officials.

NEI went on to develop 119 units of low and moderate income housing within their 10 block target area in the residential core of South Holyoke. Their mission statement includes these goals:

- 1) To deliver more affordable housing to low-income neighborhood families;
- 2) To develop community leadership;
- 3) To encourage neighborhood economic development;
- 4) To promote the availability of appropriate community education and human service programs.

Community participation and control are at the heart of this agenda. Though they began (and continue) with "bricks and mortar" development projects, many of their most recent efforts have been designed to give residents the skills and resources to determine their own futures. From an

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<sup>34</sup>Harden, p.82.

educational outreach program for pregnant women to the publication of a bilingual community newspaper, NEI has attempted to build social networks in which residents are more able to help themselves and each other.

From the grudging respect of City leaders who recognize their stabilizing impact, to the enthusiasm of participants in the annual Family Day Festival, NEI is today widely seen as a success. At its inception in 1982, however, many wondered if it would be just another in a long line of South Holyoke community groups fighting City Hall.

NEI's struggles with the City reinforced Holyoke's reputation as a place where the poor minority residents were being driven out. This, in turn, lent support to efforts by local housing advocates to circumvent the local government and appeal directly to state and federal officials for housing assistance. In 1984 NEI completed rehabilitation on 16 federally-subsidized units and obtained commitments for rehabbing 32 more under the Massachusetts Chapter 707 program. The City's plan to vacate South Holyoke seemed to be crumbling. In 1985 the Mayor allowed two duplexes to be built in South Holyoke by Olde Holyoke Development Corporation and announced that the City was "coming in to rebuild and rehabilitate" South Holyoke.<sup>35</sup> For investors this renewed commitment was an encouraging sign that they

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<sup>35</sup> Transcript Telegram, 9/5/85.

intended to take advantage of.

### **Federal Housing Assistance**

In the early 1970's the federal Section 236 and 221-D3 programs provided a substantial source of rental housing assistance to the City of Holyoke. In the City as a whole, between 1970 and 1975, 739 new units were built while 289 units were rehabbed under these programs. The value of building permits for assisted housing during these years averaged nearly 50% more than that of the private, unassisted market. This public investment was seen as a significant boost to the City's real estate values which were otherwise declining.<sup>36</sup>

Only one federally-assisted project was located in South Holyoke, just a hundred yards from 558 So. Summer St. This project rehabilitated 127 units for a cost of \$2.5 million. Completed in 1975, the cleaned up buildings were visible signs that South Holyoke might remain a viable residential neighborhood despite the continuing destruction.

This much-needed federal assistance was short-lived, however. The federal commitment to housing that had, in 1968, set a national goal of 26 million new units over 10 years was abruptly curtailed only five years later. In 1973

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<sup>36</sup>Curran Associates, Inc., Reinvestment Opportunities: A Housing Work Program for Holyoke, Summary Report, (Northampton, MA) 1976.

President Nixon drastically diminished the use of federal monies for housing assistance.

The move to Community Development Block Grants and Section 8 housing allowance payments in 1974 was a dramatic shift not only in the amount of monies committed to improving housing opportunities, but also in the form of that commitment. The old Section 236 Program for renters and the section 235 Program for homeowners, placed an emphasis on giving the developer the financial incentives needed to make a project profitable. Developers of large projects were able to make use of these programs, while smaller apartment owners were largely unable to do so. The new Section 8 programs that sought to enhance the effective demand of renters moved away from the previous model of giving subsidies directly to the developer of housing projects to a method of providing rental assistance directly to the tenant, instead. The small, private landlord now could benefit by simply providing a suitable apartment to a subsidized tenant. It also allowed for a deeper subsidy payment for poorer tenants. Whereas the previous programs guaranteed lower than market rents for low income tenants, the rent levels did not vary according to each household's income.

This innovation of deeper, non-project subsidies had three prominent effects for Holyoke's small landlords.

One: it allowed them to rent to households with almost no other source of income, and, thus, independent of the deteriorating household incomes;

two: (since the allowable rent levels were based on the larger, and more expensive, Springfield metropolitan area rental market) it allowed them to charge a rent above what the local market could otherwise support;

and three: it invited the federal bureaucracy and its proxies into the operation of even the smallest properties.

Landlords could, in theory, now house the very poor and still make money. In fact the subsidized very poor were often a better market than the unsubsidized working poor. On the other hand, landlords had to meet often arbitrary standards of housing quality and comparatively complex lease provisions.

Those best-suited to the new arrangements were able to "work the system", bending the rules, and hiring savvy lawyers when the need arose. The fellow handy with a pipe wrench, responsive to his tenants' racist fears of non-white subsidy holders, and dependent upon word of mouth to find reliable tenants was unlikely to take advantage of such a program. On the other hand, there were professional businessmen who saw in the new certificates a way to make seemingly unviable rental housing profitable.



As subsidy programs became more important to the financial viability of the rental property, the costs of management also increased. Subsidies came with numerous new requirements: Detailed leases contained language requiring legal counsel. Appeals procedures added months to the eviction process. Tenant selection procedures had to be well-documented to prove non-discriminatory practices. These and other requirements demanded a more sophisticated and more expensive form of management.

Although this new mediation often meant improved housing for the tenant, the improvements were not necessarily what the tenant wanted, rather they were made to satisfy the administering subsidy agent. From a landlord entering into a private agreement with his tenant to a contractor working for a large bureaucratic government agency, the investor's new role again directed his attention away from the actual resident to a new client-- the state.

Another source of public assistance to the savvy property owner came indirectly through the new Block Grants. Olde Holyoke Development Corporation, the City's designated non-profit agent for housing programs was given responsibility for the administration of the housing programs now funded under the Block Grants. One program, called the Interim Assistance Program (IAP), funded one half the costs of the repairs on residential properties housing income-qualified

households. The rents on these properties could not be raised for five years.

### The Boom

In 1981, a Boston-based real estate developer began to take an interest in what he considered to be an under-valued market. When he tried to buy some apartment buildings in South Holyoke, he found it impossible to get a mortgage. He asked Nueva Esperanza, Inc. (NEI), to help him make a complaint to the Massachusetts Banking Commission, charging redlining by the banks. After finally obtaining financing, he began to buy buildings in 1982 at 2-3 times the going per-unit price. A local bank president angrily called the developer's lender to complain, to no avail.<sup>37</sup> Other investors began to take note of the appreciating market values<sup>38</sup>, the 2% vacancy rate, the extremely low sale prices, the new housing assistance programs being offered by the state, the easing credit market and the increasing likelihood that South Holyoke would survive as a residential neighborhood. South Holyoke's (indeed all of Holyoke's) real estate boom had begun.

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<sup>37</sup> Interview with Ada Focer, 2/10/91.

<sup>38</sup> Mr. Scott was impressed by the ability of a single individual, buying large numbers of apartments to single-handedly drive prices upward. "He made his own market. He could pay those prices because he was setting the comparables against which their value was determined."

Holyokers watched with amazement that turned to disgust as waves of investors began buying up multi-family properties at record prices. The whole city was being turned on its head. The small conservative landlords who reduced turnovers with low rent were replaced by aggressive investors intent on maximizing the resale value by inflating the rent. Minorities restricted from surrounding housing markets paid the escalating premium. While all white buildings with aging, debt-free owner-occupants struggled to rent their apartments by word-of-mouth at rents below \$100 per month, next door, the Puerto Rican tenants in the newly purchased and highly-leveraged building paid over \$300 per month for a comparable unit.

Their landlords were not long term owners. Properties "flipped" as often as once a year. Each time the rent was increased and tenants were always found to pay it, either through subsidies, or, often, through doubling and even tripling-up.

There was one sense in which the real estate industry was also feeding on itself-- in addition to the expanding retail and service sectors, construction jobs greatly increased employment opportunities and drew more households to the area, which in turn stimulated demand for construction. Vacancy rates in 1986 were less than 1/2 what they had been

in 1981.<sup>39</sup> There seemed to be no end to the spiral of housing inflation. Meanwhile, several investors watched as their balance sheets recorded enormous profits.

The story of the Omni Corporation described below is admittedly an extreme example of the problems that occur when credit is easy. It is not isolated, however. Tenant advocates in Holyoke are finding this story repeated in dozens of buildings throughout the City, including 558 South Summer. Where inexperienced investors were allowed to leverage exorbitant acquisition prices with unsupportable debt burdens, the result has been financially stressed properties lacking minimal services and upkeep leading, ultimately, to receivership and foreclosure.

#### **The Omni Story**

Directly across the street from 558 South Summer, investors paid \$26,000 per unit for 563 South Summer in early 1987 at the height of the real estate boom in Massachusetts. They bought 12 buildings and 364 units for \$8 million over a period of 10 months. The owners were young Hartford investors including the head of one of Hartford's largest Century 21 real estate agencies, John Zubretsky. The founder of Omni Group Inc., Mark Shapiro, was only 25 years old when he convinced Zubretsky to join

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<sup>39</sup>Federal Home Loan Bank Board, Postal Vacancy Survey, Springfield SMSA, 1981 and 1986.

him in the winter of 1986 to form a company and buy a Hartford building. At the time Shapiro was a bank loan officer and a recent graduate of Central Connecticut State College. Within two years Omni invested over \$15,000,000 in 35 buildings including those in Holyoke.

Buying buildings in lots that held approximately 70 units each, Omni created separate business entities to hold them. In Holyoke, each building belonged to a limited partnership formed by an agreement that prohibited using the income from one property to be used for another. One of Omni's investor/partners in a Hartford property accused Shapiro of violating that agreement. Curtiss Clemens, a residential investment specialist, found out that insurance on Omni's Holyoke properties was being paid with checks from his Hartford property. Other checks he found were issued to Shapiro and a fictitious tenant. Clemens claimed that Omni milked the property to provide him with cash for his other investments.

In Hartford, apartments must be certified by the city before a new tenant can move into an apartment. Without the certificate, a tenant may withhold the rent. Clemens claims that the 20 unit property had all its certificates when Omni and Clemens purchased the property. When the property was resold in 6 months, there were only 7 units holding certificates. In the meantime the rent had been increased and Clemens felt certain that there was sufficient income to

cover the necessary repairs. When Shapiro told him that the tenants were not paying the rent, he checked tenants' receipts and the partnership's bank account. Rents were being paid, but not deposited. Clemens got back his initial investment after the sale, but he made nothing on the venture. Shapiro's original partner, Zubretsky sued Shapiro and eventually was able to regain half of what he said he was owed.

The banks were not so lucky. One Hartford building Omni purchased for \$750,000. They received a mortgage from one bank for \$450,000. A second mortgage was arranged without the knowledge of the first bank for \$250,000. The Omni partners covered the balance with \$50,000. Not long afterward a third mortgage was obtained for \$350,000 on the property. It wasn't until the second mortgage holder tried to foreclose that the bank discovered that the level of debt on the property was \$300,000 more than the purchase price. This building, by the way, had not benefitted from any serious capital improvements. According to the news reports, the \$300,000 simply disappeared.

In Holyoke, the Bank of New England could not claim deceit. Omni requested a mortgage on 563 South Summer Street for \$22,000 of the \$26,000 per unit purchase price. This same building was bought only two years before for \$12,000 per unit or \$10,000 per unit less than the value of the requested mortgage. The bank, nevertheless, accepted

the new value. At this price, the seller was able to leave \$4,000 per unit in a second mortgage and still walk away with \$10,000 more per unit than he had originally paid for it two years before. Assuming the seller had invested \$3,000 per unit of his own equity two years before, his annual return on equity would have been over 150%, a generous return even if he never saw a penny from the second mortgage. The buyer, by the same token, had no personal equity in the building. Only the bank, of all those involved, had taken any risks and that was with depositors' money.

Another Holyoke property owner was also approached by Shapiro to buy his buildings. By the end of their meeting this owner was amazed to find that Shapiro was going to be able to leave the closing not only without investing any equity, but he would actually pocket tens of thousands of dollars.<sup>40</sup>

#### **Increasing Liabilities: Litigating the Landlord/Tenant Relationship**

Another major factor affecting the small property owner has been the expanding legal protections afforded the tenant under federal and Massachusetts laws, regulations, and judicial decisions. Most lawyers I spoke with traced the

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<sup>40</sup> Interview with Leon Barlow, 5/4/91.

"revolution" in landlord/tenant law in Massachusetts to the 1973 ruling by the Supreme Judicial Court on Boston Housing Authority v. Hemingway. This established the so-called "warranty of habitability"<sup>41</sup> in which landlords were now required to keep their properties "livable" as defined by the State Sanitary Code and local health regulations. It further stated that tenants could withhold their rent while the violations lasted.

In 1978, further regulations outlawed "unfair and deceptive acts by landlords and required separate receipts for security deposits which must be put into escrow accounts, with interest paid annually to the tenant. This year also saw legislation passed that required courts to presume that retaliation is the cause behind any rent increases or evictions occurring within six months of an action by the tenant seeking to enforce housing codes or organize a tenants' union.

The State revised its sanitary code in 1981, setting stricter standards for health and safety. In 1987 the appeals court ruled that utility costs are the landlord's responsibility unless otherwise specified in writing. In that same year a law regarding eviction procedures set

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<sup>41</sup>Mass., 293 N.E.2d 831



further restrictions on exactly how and when a an eviction could be carried out.<sup>42</sup>

Nationally, civil rights legislation has established protected categories of individuals who must be allowed equal access to housing. Recently this list has been expanded. It makes it illegal to refuse housing to anyone, based on their membership in one of these protected categories.

The above is not intended to present a comprehensive list of applicable laws, regulations and judicial rulings. The point is that this body of law is expanding and it is intended to protect the tenant against the improper activities by the landlord. With the availability of legal redress, the landlord is compelled to pay much closer attention to both the intent and the letter of the law. Although many of these new rules are good commonsense and easily obeyed, they do add to the complexity of property management and increase the risks of being sued for a lack of proper care.

One landlord lawyer I spoke with summed this up succinctly when he said,

My advice to anyone thinking about buying rental property today is, "Don't. Unless you are very

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<sup>42</sup>Springfield Sunday Republican, "Court rulings have changed tenant-landlord relationships", 2/5/89.

familiar with the laws and can afford to hire a scrupulous management agent, it's not worth the risk. Technical knowledge, professionalism, administrative precision and risk avoidance take on increasing value in a litigious environment. Although there is still a place for personal attention to the needs of one's tenants, the modern manager of low-grade rental housing will find that he is more likely to survive if he views his tenants as potential plaintiffs than as long-term guests or trusted customers.

This evolving dissociation in the landlord/tenant relationship over the last twenty-five years is illustrated in the following discussion of 558 South Summer Street.

## CHAPTER 5: THE HISTORY OF 558 SOUTH SUMMER STREET

### 1887 to 1923

After Holyoke Water Power Company began to relax its stringent controls on housing development in the 1870's, it then joined in with some housing development of its own. The building that stands at 558 South Summer Street was built in 1887 by the Company and sold immediately to Damasse Chatel, a carpenter employed at a local thread company. At the time of the sale he lived in a house just up the street. Upon purchase, he immediately moved into one of the eight, five room apartments in the new building and stayed there until he sold it in 1910 to Alfred Gelinas, a grocer, who also moved into the building. Sale prices, during those years, were not recorded directly in the registry of deeds. However, the registry does note that Mr. Gelinas did assume a \$4500 mortgage from Mr. Chattel when he bought it. The City Directory begins listing residents of 558 South Summer St. in 1915 and, judging from the surnames, the ethnic mix of tenants was French and German. The job categories listed were "laborer", "painter", "mechanic" (owner of machine shop), and "employee(s)" of a lumberyard and a steamboiler works.

Between 1915 and 1922, when Mr. Gelinas sold it, the building experienced only six turnovers of residents. In 1922 five out of the eight tenants had lived there longer than 7 years and the average length of tenure was over 6

years. In 1922, the tenants included two widows in addition to the painter, laborer, boxmaker, and paperworker.

The next owner only held the building for 5 months. Buying at the peak of Holyoke's population expansion, Phillippe Denis bought 558 S. Summer in the fall of 1922. He obtained financing through two new mortgages, one from a local bank and one from Mr. Gelinias, the seller, in addition to assuming Mr. Gelinias' earlier mortgage. When he sold the building to Napoleon Labrecque, a paper mill employee, the next spring, he had tripled the debt owed on the building. Though it is difficult to determine the exact sale prices at that time, the tax stamp values added to the debt would indicate that Mr. Denis sold 558 S. Summer for 15% more than what he paid for it, five months earlier.

#### 1924 - 1965

During this period of economic stagnation, South Holyoke's shrinkage provided some relief for the overcrowding of the previous 50 years. However, toward the end of that period, the softening demand for apartments turned to a serious vacancy problem and the viability of the entire neighborhood was put into question. In the meantime, this period represents almost a golden age for many of those who lived in the neighborhood.

Mr. Labrecque, the new owner of 558 S. Summer in 1924, also moved into the building-- to an apartment on the first

floor. He lived there for 9 years until his death in 1933, while his wife stayed on for another 11. When she died, her son, a resident in the building, inherited the property and ran it for still another 5 years. In all, the Labrecques' ownership lasted over 25 years. Water utility records and the complete turnover of apartments suggest that the Labrecques made substantial renovations in 1927. From 1927 until the next sale in 1948, there were only 21 turnovers. The average length of tenure grew quite long during the Labrecque's ownership. In 1930 it was only 3 years. In 1935, it was 5 years, expanding to 7, 9, and 11 years in 1940, 1945, and 1948.

The long tenures of tenants in the building peaked in 1960 with an average of 13 years. According to one tenant (1948-1965) the most common reasons for turnovers in the building toward the end of her tenancy were either for older tenants moving closer to their children or younger families purchasing a home in the suburbs. She also recalls that, at most, twelve children lived in the eight 3-bedroom apartments.<sup>43</sup> Judging from the City Directory, there was always at least one single person household in the building. If seven apartments held couples, then we can assume there were 15 adults for a total of 27 persons. That yields a little more than 3 persons per unit. The age when

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<sup>43</sup>Conversation with Mrs. Wilfred Desmarais, 5/23/91.

apartments in that same neighborhood averaged over 20 people per apartment seemed hard to imagine for a resident of that later era.

When Ray Marion bought the building in 1948 he was an oilman with his own business. He was part of a new wave of investors in the neighborhood consisting of young businessmen who bought several adjoining or nearby buildings from aging landlords or their children. He found 558 S. Summer St. available for sale when Napoleon Labrecque's son decided to return to his native Canada. Marion's sister and her husband moved into the Labrecque's apartment immediately and they stayed there until Mr. Marion sold it in 1965. Marion kept an office on Main Street where the rent could be paid once a week, or when Mrs. Marion came around to collect. Marion's sister/tenant, Mrs. Wilfred Desmarais, can't remember problems with rent collection, much less a single eviction, during her seventeen years in the building.

These problems, according to Mrs. Desmarais, were avoided by the traditional tenant recruitment process, in which only those who were personally referred by existing tenants (or the landlord) were considered for the apartments. Communication among the tenants was high where many were related or had lived together for some time. There were often afternoon gatherings on the back porches during the hot summer afternoons. Tenants each bought their own awnings to protect their section of the porch and they sat

sipping iced tea as the children played in the yard below. With a family member in the building, the landlord was also assured a direct line to issues discussed in those gatherings.

Maintenance consisted primarily in the services of an experienced plumber who would respond to emergency calls from Mrs. Desmarais. Cleaning and yard work was shared by the tenants. Mr. Marion was "quite handy" himself and he looked after the small repairs to windows, doors, linoleum, etc. himself. A few major repair jobs required outside contractors and these included the complete renovation of the back porches, the hallways and the roof and the installation of storm windows. Everyone had their own key to the basement where the fuseboxes were kept and tenants were responsible for maintaining their oil or gas stoves themselves, including hot water boilers.

Rents were \$8.00 per week in 1948 and were increased to \$10.00 in 1953 after the hot water was centralized and some major repairs had been made. The rent did not change after that until the next owner bought it in 1965. The 1960 Census reports median income for South Holyoke at \$4,914. With total annual rent at \$520, the rent/income ratio was only 10.6%-- very affordable by today's standards.

In the meantime the property continued to return a reliable income to its owner, Mr. Marion, who claims that, "my rule of thumb was always to make a twenty percent annual

return on my investment". Mr. Marion would not reveal the exact figures, but, according to the registry of deeds, Mr. Marion paid \$7,000 for the building and immediately obtained a \$10,500 mortgage. This he paid off sometime during his seventeen year ownership. Assuming a 6% interest on a 15 year self-amortizing note, his annual debt service would have been \$1,063. Collecting over \$4,100 in annual rents, the balance available for operating expenses was over \$3,000 or almost 75% of the gross income. Assuming the \$3,500 in additional mortgage capital paid for all the major improvements he was reported to have made in the first three years, Mr. Marion could count on this balance to pay for his expenses and to keep whatever was left.

Mr. Marion insists that his keys to success were (1) a low vacancy rate and (2) self-management. Though he acknowledges that the process was very demanding personally, he insists that he was able, so long as he kept the buildings full and he did most of the work himself, to maintain a decent return. His sale in 1975 was for no other reason than he "had grown tired of it." He may have also been feeling the pressure of rising vacancies. The City Directory, which annually surveys the residents at each address, only once recorded a vacancy in any unit between 1947 and 1962. In 1963 and 1964 the Directory reported two

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<sup>44</sup> Interview with Ray Marion, 5/15/91.



vacancies in each year. Of two of the households that left during those two years, Mrs. Desmarais remembers that one left when the father lost his job in a local shoe factory and the other when the elderly mother died.

### **1965 - The Present**

Demolition, abandonment, arson, and City-led efforts to depopulate South Holyoke characterize the 1970's and early 1980's in this neighborhood. However, the late 1960's were remembered as a period of little change despite the ominously rising vacancy rates measured by the 1970 census.

In 1965 Mr. Marion sold 558 South Summer to a couple who lived in nearby South Hadley, Fernand and Margaret Dube. His sale did not remove him from all interest in the property, however. According to registry records, the full price of the building was covered by Mr. Marion's twenty year, 6% mortgage. His sister promptly moved out but the new owners failed to move in. Due to health problems, the Dube's resold the property the following year for under \$100, subject to the Marion mortgage. The new owners, Roland and Ellen Sawyer, held the property for 6 years. They also did not move into the building and their ownership witnessed a period of sharply increased turnovers and high vacancy rates. According to the City Directory's survey, vacancies averaged over two out of the eight units each year. One household that left in 1970, bought a home in

nearby Willimansett after having lived in the building for over 27 years.

The Sawyers sold the building in 1972 to another couple who continued to struggle with the high vacancies. By the time they sold it again in 1975, it was in "poor condition...six months from condemnation", according to the new owner, Charles Desmarais (no relation to Mrs. Wilfred Desmarais). Mr. Desmarais and his partner were school teachers who at one time owned up to 36 units in South Holyoke. They decided to purchase 558 because it was close to the other buildings and this made the maintenance easier. The City's plan to turn the neighborhood into an industrial park did not deter them. "Despite the talk, we could see the drastic shortage of rental units. We didn't believe them." The large three-bedroom units in 558 South Summer were in especially high demand by the new larger families moving into the neighborhood. Unlike all their other purchases, 558 South Summer was acquired by simply assuming the existing mortgage. Their general plan for each of the buildings they bought at this time was basically this:

Step One: Buy buildings in trouble but still salvageable for as little as possible;

Step Two: Make improvements to vacant units and rent for as much as possible;

Step Three: Wait for long-term "elderly French" tenants to move out and repeat Step Two;

Step Four: When cash flow is adequate, then use the City's residential improvement program to make more substantial repairs (eg:roofs, porches, boilers, etc.) After mandated five year limit expires, raise rents to market levels.

This illustrates an earlier point in the discussion about general trends in Holyoke. Even though household income was not keeping pace with the costs of providing shelter, it was still possible to increase rents as long as those households were willing to pay a larger percentage of their income for rent. As low-rent units were being demolished around the country, desperate households emigrated to those cities where such housing remained. They bolstered the rental market and provided investors like Mr. Desmarais and his partner an opportunity to make profits where others, unwilling or unable to open their doors to the new immigrants, had failed.

They did all the smaller repairs themselves and spent much of their summers replacing floors and old plumbing. The first two years they saw little profit from their investments. After that the income was more than sufficient to cover their time and expenses. Retained earnings from the first investments went into buying other properties. The key to success for these investors, as it had been for Mr. Marion before them was low vacancies. Income was generated by the cash flow of the property. They never

refinanced their properties even after the mortgages had been paid off. Mr. Desmarais argues that they couldn't "cash out" on their properties, despite the tax advantages because the interest rates on mortgages had been so high during their time in business. They reasoned that interest payments only cost them money.

558 South Summer received a number of badly needed repairs during the 10 years that Mr. Desmarais owned the building. The roof, the windows, the floors, and the rear porches were replaced with the help of an assistance program provided by the City through the Olde Holyoke Development Corporation. "All the major repairs had been done when we sold it in 1985."

It also experienced a significant shift in tenancy. Nineteen seventy-seven welcomed seven new tenants to the eight unit building. Six of these with Spanish surnames. At least two of these households were living the previous year at addresses in the embattled Ward One. Only one vacancy appears for the following five years, after which the City Directory has no record.

The practice of letting the existing tenants recommend new tenants didn't work, according to Desmarais. "We weren't very good at screening" new applicants, he says. "We had some trouble with bad tenants and we later used a professional screening service to help." The screening service couldn't reduce the wear and tear that these new

households brought to the building. The new households paid more in rent than the older, smaller households that they had replaced, but they demanded more in services too. It was still possible to make a living with the buildings, but it was clear that increasing liabilities from lead paint and other hazards, were going to make it increasingly difficult to manage such housing in the future. It was, therefore, with great surprise that these two partners received an offer in 1985 to buy three of their buildings (holding twenty apartments) at over \$9,500 per unit. By retaining a \$2,500 per unit two year balloon note, they still were able to pocket over \$7,000 per unit at the sale.

We couldn't see how he could make a profit on them. Especially since he wasn't going to manage them himself. He not only underestimated the fragility of those buildings, but he also was depending on increased rents that the market just couldn't bear. Not for long.<sup>45</sup>

The new owner, Mr. Sheedy, was not willing to discuss his investment strategy. Information is available from the Registry of Deeds, however. These indicate that the banks had more confidence in the value of Mr. Sheedy's investments than did Mr. Desmarais and his partner. Examining his mortgages on Holyoke properties for the period between

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<sup>45</sup> Interview with Charles Desmarais, 5/15/91.

January 10, 1985 when he bought his first Holyoke property to November 1, 1989, when he added a third blanket mortgage to his entire Holyoke holdings, I found that the outstanding debt on his buildings as of November 1989 totalled \$2,150,000 in mortgages. This was on properties that he bought for \$921,000, the earliest only four years before. He told one interested buyer that the debt owed on the building at 558 South Summer St is \$15,000 per unit. The tenants can not account for the \$5,500 per unit in additional capital that Sheedy has borrowed since the building was bought for \$9,500 per unit 5 years ago.

The management of the properties was originally contracted out to a "cut-rate" local property management firm, but now it's managed through Sheedy's own company. Residents I talked to in his buildings say that requests for repairs go unanswered for months at a time. The tenants of 558 South Summer St. have begun withholding their rent with the help of local Legal Services attorneys.

According to the bank holding the first mortgage, they have not received interest payments for several months. Their discussions with Mr. Sheedy seem to have failed to reach an acceptable agreement and they are currently seeking to have the properties placed in a receivership. The bank has begun negotiations with a large property management firm and the likelihood is that the properties will be foreclosed and sold once the buildings are stabilized.

Not much is known about Mr. Sheedy's background. He lists his address as Lexington, Massachusetts. It's not known whether he had any real estate or property management experience before coming to Holyoke. The obvious question is whether his interest in Holyoke's rental properties derived, like Mr. Shapiro's, from the availability of risk-free credit and the promise of pyramid-like leveraging.

The deterioration of 558 South Summer St. and other of Mr. Sheedy's buildings attracted the attention of the owner of buildings that stand on either side of his South Summer Street property. That owner was Nueva Esperanza, Inc. (NEI). An organizer for NEI met with tenants and their lawyers to discuss solutions to the crisis. Conversations with Mr. Sheedy and an examination of the building, together with reports of tax and utility company liens, convinced members of the group that Mr. Sheedy did not have the capacity to manage the building. This "Group" was concerned that something would have to be done quickly or the building (and possibly those on either side) might be irretrievably lost.

The next step was to contact the bank and try to gauge their intentions. This brought a visit by a bank officer to the building. He was "shocked" at the state of the building and was concerned that their interest in the buildings was at some risk. The Group then met to determine what the likely course would be for the banks and to see if there was

some way they could encourage the banks to foreclose and then turn the buildings over to them at a nominal price.

The bank instead decided to seek a receivership through a large property management firm that handled NEI's properties. The bank was unwilling to commit any further but its stated intent was to allow the receivership several months to stabilize the buildings and clear up any serious health hazards before it foreclosed.

This bank had also just committed itself to a large piece of the financing of another NEI housing project with units across the street from 558 South Summer Street. The Group felt that interest in that project might enhance their commitment to preserving 558 South Summer Street. That feeling was confirmed when they learned that the bank would put up \$250,000 for financing the receivership. As I write this, the management agent is seeking liability insurance to cover the properties.

NEI's interest in the property stems from their commitment to preserving existing housing resources within South Holyoke. It would be hard to imagine this organization choosing to demolish a residential building unless it was completely unsalvageable. Considerations of residential "density" or competing land-uses are secondary. Furthermore, there is little consideration given to the development of housing or neighborhood amenities that might attract more affluent residents. The focus is on providing



the greatest support for those in the greatest need. In all their housing developments to date they have sought to maximize the numbers of deep operating subsidies and thus the benefits provided to the lowest-income households possible. This redistributive, advocacy role is in sharp contrast to another non-profit housing developer in Holyoke to be discussed in the next section.

### **The Evolutionary Process**

The last seventy-five years at 558 South Summer Street illustrate the evolution of rental property investment in South Holyoke. Originally owned by owner-occupants, these investors were forced by proximity to relate to their tenants as neighbors as well. These earlier landlords were able to obtain a reasonable profit by simply keeping their tenants from moving out. Earlier tenants paid relatively small portions of their income for their rent. These landlords employed informal and personal mechanisms to safeguard their investments. They put a premium on personal contact.

Whereas Ray Marion put his sister into the building, kept the same tenants for long periods, worked in an office down the street and sold oil to others in the neighborhood, later investors were much less connected to the neighborhood they served. They were from out of town and knew little about their tenants and often distrusted them. This evolution

reached its pinnacle in the ownership of Mr. Sheedy who demonstrated little interest in effective management or personal contacts with tenants and other members of the community.

Significantly, Sheedy bought the property in 1985, one year before the new tax laws would wipe out much of his supposed incentives for this investment. Perhaps he was not simply looking to shelter income, reap speculative gains, or cream off refinancing proceeds. Nevertheless, his choice of managers and his failure to respond to the serious deterioration of his buildings indicates that he was thoroughly unprepared for the rigorous demands of a rent-driven rental market.

While Desmarais used little debt, Sheedy loaded it on; while Desmarais kept in close touch with his tenants, Sheedy's tenants had never heard of him; whereas Desmarais kept costs down by doing his own repairs, Sheedy hired a low-budget manager.

In order to be successful Desmarais needed to reduce his vacancies and turnovers. That required tenant satisfaction and prompt attention to the needs of the tenants. Still property owners during those years were finding the business difficult to maintain. As tenants were living closer to the edge in order to make their rental payments, collections became more difficult and, as the overcrowding took its toll on the buildings, maintenance costs soared. The rewards for

hard work for these traditional investors were shrinking and they began to wonder whether the headaches were worth it.

New investors like Sheedy were familiar enough with the credit market and tax laws to see lucrative opportunities available despite the increasing difficulty of managing low-grade rental properties. Their entry into the market allowed traditional owners the escape they were looking for.

The traditional owners' retreat from the low-grade rental market grew out of a long history of deteriorating conditions. Perhaps it was inevitable that some other form of investment would replace it. However, this particular form of investment has made the problem far worse. By redefining the investment value of these properties as a tax shelter, an appreciating commodity, or a piece of collateral, those who were attracted to invest were generally more skilled in financial markets than cost-effective property management. In the meantime, those who had property management skills had gotten out and were unwilling to return. Investors like Sheedy were ill-prepared for the resumption of business-as-usual in a rent-driven market.

These properties had proven very difficult to manage under the best of conditions. Their new owners not only brought few skills to the problem, but they had also created further problems by adding on layers of unsupportable debt. Resale became nearly impossible without foreclosure. With

noone willing to buy them out at any price; with no possibility of being able to work the problem through; these new owners had taken these properties down a dead end road with no way to turn back.

Though the case of 558 South Summer Street may be an extreme example of this evolutionary process, it does offer a convincing illustration of the changing pattern of investment in low-grade rental real estate. As the traditional role of the landlord as one who provides a service to the tenant was weakened by the declining ability of the renter household to contribute to operating costs, the availability of rental properties for marginal profit-making increased. Those who took advantage of these opportunities further weakened the traditional role by emphasizing the use of their buildings as an investment rather than as a home to their tenants.

## CHAPTER 6: CURRENT CONDITIONS AND FUTURE TRENDS

### When The Music Stops

The boom of the mid 1980's could not last. All over the Northeast, the surge of residential real estate development had inevitably overshot the market demand. A slumping economy combined with the continued delivery of housing units put in the pipeline years before, led to a glut of empty rental units. These included units of the relatively new housing product--condominiums--which, originally produced for sale, were then rented out when they failed to sell. Forty-six percent of newly-built apartments in the Northeast in 1988 were still not rented 3 months after completion.<sup>46</sup> This was the lowest rate in at least 8 years. As renters changed their addresses to take advantage of the soft buyers' market, moving up to accommodations in the newly constructed apartments and condominiums, the filtering process eventually left the most marginal properties unoccupied.

In some sections of Holyoke the vacancy rates were nearing 25%. Plywood-covered windows began appearing throughout Wards One and Two. Many landlords whom I talked to wanted "to kick themselves for not getting out in time". "How could I have known?" they often asked. They saw

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<sup>46</sup>U.S. Bureau of the Census, Current Housing Reports series H-130 and H-131.

themselves as losers in a game of musical chairs, left without a chair when the speculative "music" stopped. Many were trying to cut their losses by selling off pieces of their holdings. With very few buyers, landlords were often willing to simply give up title in exchange for a second mortgage. Even that has been difficult to do, especially when the property is in very poor physical condition and has a very high vacancy rate. One investor claimed that there simply is no one willing to buy these properties at this time, at any price.

Tenant advocates in Holyoke estimate that over 50 rental buildings are in some form of serious financial distress. Everyone I spoke with, including landlords with over 50 years of experience, were convinced that these properties represented just the tip of the iceberg. They all could recount other properties "just on the brink" and likely to fail in the coming months.

Overleveraging was mentioned as only one in a series of factors offered by observers for the real estate crash. Overleveraging does have the unique effect, however, of capturing the interest of large and influential players--the institutional lenders. How they and their debtor investors respond to the changing market will have an important impact on the future of South Holyoke and the City as a whole. After a discussion of lenders' strategies this chapter examines investors' strategies and, finally, that of

Olde Holyoke Development Corporation, a non-profit housing developer whose policies are well-tuned to the current climate of conservative government and declining commitments to the housing of the very low income household. Their policies and plans for responding to the current crisis should be instructive of the future role of public officials in many other localities around the country.

### **The Lenders' Options**

As owners fall behind in their mortgage payments, the lenders become increasingly active in the fates of these properties. With no wish to own these troubled properties, they first seek to reach a "workout" with the owner where the bank agrees to reduce the debt service or defer it in exchange for a renewed commitment by the owner to make timely payments. If that fails, the bank may seek to foreclose and sell the properties. When the Bank of New England attempted to auction off the foreclosed Omni properties in 1990, only four out of the six parcels brought a price they were willing to accept. Perhaps that is why there have been few such foreclosure auctions of multi-family rental properties. Buying properties back through a

holding company, as the Bank of New England did, is considered a poor option by bankers I spoke with.<sup>47</sup>

The remaining option is the receivership. The bank may ask the court to appoint a receiver who will protect their investment in the building until they can safely foreclose and sell it for a better price. Stabilizing a property and holding on to it without accepting liability, the receivership option offers the lender a relatively safe means to protect his investment, while waiting for the market to heat up again.

According to one banker, the decision to stay in a workout, file for receivership, or foreclose is based on a calculation of the various returns for each strategy. For example, where the current market value of a property is one third the value of the mortgage balance, a workout that guarantees interest payments on one half of the original mortgage balance may seem the best deal possible. On the other hand, the owner may appear incapable of managing the property, despite the improved terms of the workout. Without a change in management, the property may appear likely to further deteriorate in value. The lender may thus conclude that spending \$3,000 per unit under a new management team would forestall an anticipated \$5,000 per

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<sup>47</sup> Although a former Massachusetts banking commissioner did say that many banks are, in fact, buying their foreclosed properties at inflated values. In this way the banks' balance sheets appear healthier than they actually are.



unit deterioration in property value, yielding a net savings of \$2,000 per unit. In this scenario, spending more money makes sense.

Though the lender could conceivably foreclose and hire its own management team, lenders, as I have said, prefer not to own property. Under receivership, the bank does not assume ownership or liability for damages arising out of the operation of the property. At a time when rental property insurers are severely reducing their exposure to lead paint poisoning claims and new legislation obligates the banks to remove all hazardous wastes before they can resell a property, the banks are especially wary of owning such old rental properties as these. In fact they have been willing to pay thousands of dollars per unit per year to subsidize the continued operation of these buildings as they wait for the market to improve. We have seen how this operated in the case of the property at 558 South Summer.

But what happens to properties when the lender cannot hope to recoup its losses? when adding another \$3,000 per unit will not forestall deterioration and the lender refuses to make additional investments? According to legislative testimony given by Holyoke housing activists and tenants, its State Senator, and the Hampden County housing court judge, Holyoke has suffered a great deal recently from "a vacuum in management" arising from bankrupt investors and

liability-conscious bankers leaving rental properties without basic services.<sup>48</sup>

In one of these cases, during the long period in which we searched for a receiver, the buildings suffered a heavy, and perhaps irreparable toll from vandalism and arson. As a result many were and still are condemned.<sup>49</sup>

The profligate lending of the mid-1980's has ensured a major role for lenders in the immediate future of Holyoke's housing. Although the soft market has put pressure on property values to settle back to a price level more in line with the actual cash flow of the property, the banks may resist a decline to prices that are far below their current investment. We have seen in the case of 558 South Summer how Mr. Sheedy was willing to sell his building for just the

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<sup>48</sup>The Massachusetts legislature is currently considering an "Act Clarifying the Powers of Housing Receivers". Support for this legislation comes, in part, from the difficulties that receivers have had in obtaining the capital necessary to run a building or the protection from damage claims that exceed their insurance coverage.

These problems have been addressed in this bill in two significant ways. One, it grants the receiver the right to place a "priority lien", which allows the receiver a first position (ahead of the banks and other non-governmental lien holders) on the assets. This would provide the receiver some guarantee that the money it spent on the property for the purpose of making necessary repairs would indeed be repaid. Two, it would limit the liability of the receiver to the proceeds of its insurance and "in no instance...for negligence".

<sup>49</sup>Glassman, Rick, "Written Testimony in Support of S.627, 3/15/91". Western Massachusetts Legal Services, Holyoke.

debt that the bank held on his buildings. Selling at a lower price would have been more expensive to him than simply holding on. The combined effect of dozens of highly leveraged investors like Mr. Sheedy is that prices are effectively set by the banks who control the debt.

As large financial institutions with substantial investments in Holyoke's low-income rental housing, the banks are carrying an unusually large share of the financial risk in the future of Holyoke's private, rental housing market. Their decision whether to step in and take over a distressed property has implications for their loan portfolio beyond the immediate property in question. Several rental properties in the same neighborhood may hold loans from the same bank. Neighboring buildings may be put at risk if the bank allows one building to fall victim to vandalism, arson or abandonment. The old adage, "Borrow \$1,000 you've got a creditor; borrow \$1,000,000 and you've got a partner," could apply in this case. Large lending institutions with mortgages on several buildings in a neighborhood will treat a delinquent loan on a building in that neighborhood differently than if the building were alone. Though it is hard to predict how the banks will calculate their investment in a neighborhood, there is at least the possibility that some banks will begin to work more closely with neighborhood-based developers of low income housing, at least until their interests are secure.

In any event, as long as other investors are unwilling to step in and current owners fail to make interest payments on their mortgages, the banks will be forced to carry a great deal of the burden of supporting these properties.

### **Beyond the Bust:**

#### **Investors Adjust to Rent-Driven Financial Management**

Eventually, everyone expects, the business cycle will bottom out and a recovery will bring new tenants seeking low-income housing. Decreasing vacancies will reduce operating deficits; acquisition prices will be lower (in real terms); credit markets will re-open; and some investors may again find that it is profitable to operate low-grade rental real estate. The underlying problems will not have disappeared however. It will still be expensive to finance, insure, maintain and secure a lead-painted, inner-city, family apartment building. Responses from investors asked what they saw ahead were rarely optimistic. A common response from many investors working with low-grade rental housing was that they were "looking to get out of that line of property" or that they were "seeking to upgrade (their) portfolio".

Several successful investors I had spoken with had entered the market when buildings were very cheap, as now, and had cashed in on those investments when they had appreciated. I asked them if they would encourage anyone to

get into the market now, assuming they could get the right price for a building. Most were skeptical. They encouraged new investors to avoid buildings with lead paint; that lacked central heating; that held "bad" tenants who drove out good tenants and drove up maintenance and legal costs; or that had deteriorated too far. They emphasized that the risks of being sued made it dangerous to own much of the low-grade rental housing. One lawyer who specializes in representing landlords told me that he has been advising small investors to stay out of the rental market unless they could afford a very good management agent. "With the loss of real estate tax shelters", said one management agent, "investors will need to be very conscious of their costs. And costs for these properties are high."

Now that the marginal profit-making opportunities for Holyoke's low-grade rental properties are gone, what are the "real" benefits of investing in these properties? Investors will always search for lower prices and more cost effective ways to manage them. To some extent that is happening. One investor described the current situation as a "shakeout" with lots of poor property managers being bought out by tougher managers. However, there are limits to how much they can cut costs and still maintain a building for the long term.

Similarly, there is a wide range of rents that tenants are willing to pay. However, the tenant can not pay more

than he or she earns. Owners of rental properties that sit at the lowest end of the quality scale are going to be particularly sensitive to the earning potential of those lowest on the income scale. How investors view their expenses and their sources of income in these rental properties are important keys to future investments in these properties.

Based on the 1990 operating budgets for five poorly maintained buildings with 38 units in South Holyoke, I have developed what I believe to be a characteristic operating budget for a marginal rental property in Holyoke. This budget includes hot water but no heat, electricity or cooking fuel.<sup>50</sup> By reducing the maintenance expenses to reflect the likely costs of running a more properly maintained building and adding the Section 8 Utility Allowances for heat, electricity and cooking fuel, the overall expenses for a two-bedroom unit in such a building would equal approximately \$3,800 per year. This is in line with other apartment buildings whose managers quoted figures between \$3,000 and \$4,500 per unit for comparable properties. These did not include any deleading (estimated at \$5,000 per apartment), mortgage interest payments, vacancy costs or replacement reserves. Neither do they

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<sup>50</sup>The Community Builders, Inc., "South City Housing 1989 Budget", 1988.

include the costs of major rehabilitation which would be needed for any building with a long history of neglect.

For a landlord who owns the property "free and clear" (without a mortgage), \$3,800 per year is the line below which the property must suffer or he must lose money, either in his unpaid time or the infusion of cash. Assuming that the unit carries \$10,000 in debt at 10%/year, the resulting interest payments would increase the rent by over \$1,000 per year. The breakeven rent that the landlord would have to charge is \$400 per month.

These are the expected operating costs facing today's investor. What about his income? Finding tenants who can pay a rent that covers these costs and still allow him a profit is the obvious challenge. Holyoke currently has approximately 5,000 unsubsidized rental units that must be supported with the rent paid by the households who occupy them.<sup>51</sup> It is also estimated that 1,750 AFDC households are living in them, most of them in South Holyoke and the adjoining Churchill area.<sup>52</sup> Even with doubling and tripling up, which one housing advocate estimated at 30%, this population represents a significant portion of the tenant demand for unsubsidized rental units in Holyoke's lower-

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<sup>51</sup>Donahue Institute for Governmental Services, "Holyoke Housing Study", 1989.

<sup>52</sup>Department of Public Welfare, "ET Managerial Information--Month of July, 1990, Holyoke".

grade properties. A household of 4 on AFDC in Holyoke currently receives \$8,016 per year.<sup>53</sup> The median household income for South Holyoke should be approximately \$8,600<sup>54</sup>. At \$400 per month an AFDC household would pay 60% of their income for rent, twice HUD's recommended maximum affordability ratio for total housing costs (30%). One housing activist in Holyoke familiar with the Department of Public Welfare's efforts to place AFDC households in rental housing states that the department's Placement and Prevention Program is typically placing households in units that rent for 60 to 90% of their income and, on occasion, has actually surpassed their monthly income. One landlord who has a reputation for providing decent units in these neighborhoods reported that he often has welfare households paying 80% of their income to rent one of his apartments (and his rents range only between \$375 and \$525 per month). Department of Public Welfare officials in Holyoke report that there has not been an increase in the payment standards in three years and do not expect one in the foreseeable future.

This suggests that landlords may be reaching the limits of their poorest tenants' abilities to pay for decent housing. It may also explain why the conventional wisdom is

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<sup>53</sup>Conversation with Department of Public Welfare supervisor, July 1991.

<sup>54</sup>Extrapolated from CACI's 1988 Sourcebook of Demographics.



to "upgrade" one's holdings or "get out". Renting to households who are forced to pay 80% of their income is risky business. Allowing them to double and triple-up only adds to the maintenance costs and defers financial failure of the property. Unless one can rent to those at least slightly higher on the income scale, there is little hope for improving cash flow.

There is nothing new in this situation. If anything it is just getting a little bit worse. What is strange is that for over 10 years, investors have been buying and running these rental properties with negative cash flows while still making a profit. They have been riding on income substitutes that are now gone. No longer will banks allow investors in low-grade rental housing to cover their operating losses or pad their profits with refinancing proceeds. No longer will the federal government allow individual investors to reap tax benefits from their passive losses in real estate. No longer can investors compensate for their operating losses with generous gains-on-sale. They have already fully exploited the increased household income and desperate housing needs of a displaced immigrant group. No longer can they expect to find expanding government housing programs with operating subsidies. And for those buildings suffering from decades of deferred maintenance, investors can no longer expect to collect rent without paying for repairs (even were the courts to allow

it). Forced to operate on a strictly cash basis, rental properties at the lowest end of the rental market cannot support a significant portion of the households at the lowest end of the income scale.

Investors are responding to this economic reality by finding a way to upgrade their properties or to get rid of them. Some are trying to gauge the likelihood of one neighborhood "making it" and another "being lost". Returning to the old adage of real estate investment, these investors report their three most important investment criteria as "location, location, and location". Investors seek buildings where the surrounding neighborhood will not "scare away good tenants". They believe that there are still some opportunities for the investor who buys wisely in a good location and is able to "clean-up" the property successfully. But the emphasis here is to move up in the market to a higher grade of apartments in which the tenants will be better able to afford the costs of their own housing.

#### **Olde Holyoke Development Corporation**

This philosophy is nothing new to the non-profit housing development corporation, Olde Holyoke Development Corporation (OHDC) in Ward One. Although nominally a non-profit corporation, this organization strictly observes the bottom line in its real estate activities. Eschewing

operating subsidies for their apartments while at the same time imposing strict minimum income requirements for tenants, OHDC's units are designed to operate at the lowest possible market cost. At \$400 per month with a 40% of income minimum, they are largely unaffordable to AFDC recipients, even while charging some of the lowest rents in the City. Their Director, Dick Courchesne, has no apologies, however.

Holyoke has a high number of subsidized units and it shouldn't be criticized for failing to provide more subsidized housing to the very poor. When people start demanding that Holyoke do more, I ask them, 'What about Chicopee across the river? Why can't they contribute a little?' They say that Chicopee doesn't have the number of poor people that Holyoke has and I tell them that if they provided more opportunities for poor people in Chicopee, then they would move there too.

Holyoke does have a high percentage of subsidized units, second only to Boston in the State. However, it also has one of the highest percentages of AFDC recipients without subsidized housing. According to DPW officials, few of these households live in OHDC's Ward One neighborhood.

As the lead housing developer for the City for over 15 years, OHDC is likely to have a significant role in the

future of the City's housing policy. Their efforts to rehabilitate Ward One are widely regarded as successful and although that review is by no means unanimous, most business and government leaders with whom I spoke were impressed with its work. Even those who have been distressed in the past by the widespread demolition and displacement that OHDC caused in Ward One are expressing reluctant interest in the OHDC model. One affordable housing developer told me that housing sponsors are increasingly asking him to find ways to structure deals without using operating subsidies, like OHDC. In the new era of rent-driven rental property investment, the OHDC model may become an important part of Holyoke's strategy, as the model for how Holyoke's housing problems should be dealt with.

Efficient, cost-effective and unburdened by speculative profit-seeking, OHDC is seen as the cheapest way to provide affordable housing to the greatest number of residents. It is often contrasted with the development efforts of Nueva Esperanza, Inc. (NEI) in South Holyoke with which it competes for scarce CDBG funds. NEI, in contrast to OHDC, funds nearly all its properties with state and federal operating subsidies. The search for housing solutions in the newest of Holyoke's blighted neighborhoods-- Churchill-- has already led to the development of some OHDC properties there. We have already seen what NEI's response has been in the example of 558 South Summer St. What follows is a brief

discussion of the OHDC model and how it has responded, in its way, to a failed rental property in its local Ward One.

OHDC began as a model cities program in the 1970's. Their initial strategy was to start at the perimeter of Ward One and work toward the center. At first they were able to buy buildings at less than \$3,000 per unit. By the time they got to the middle, prices were almost \$30,000 per unit and they were unable to afford them. Though the buildings that remained were more expensive, they were in worse physical condition in many instances and held a number of "bad" tenants who were causing problems for the neighborhood, according to Courchesne. One of the Omni buildings discussed in Chapter 5 belonged to this group. It sat right next to one of OHDC's previously rehabbed rental properties and the deteriorated condition combined with the bad tenants was a source of irritation to OHDC and its tenants. When the Bank of New England foreclosed and brought it to auction, OHDC decided to buy it without knowing how they would eventually rehab it.

The building came with tenants which is not how OHDC normally likes to buy a building, due to expensive and restrictive tenant relocation laws. "We'd rather spend our money on fixing the building than moving the tenants around," said Courchesne. Since they had no specific plans to begin rehab, they were under no such obligation. The bad tenants were consequently evicted for on-premises drug

possession arrests or non-payment of rent. The "good" tenants were offered better units at equal or better rents. Now the building sits boarded up and is kept secure. "It's being landbanked. There are no current plans for development. We're waiting for an opportunity like Cranston-Gonzalez or something. There will always be some kind of housing program. It's just a matter of waiting for the right opportunity."

That meant OHDC had to put up \$156,000, then manage the buildings with virtually no rent for almost a year while they waited for the tenants to leave. Do the existing properties throw off enough cash that OHDC can use the extra income to capitalize such projects? No, according to Courchesne there isn't that much cash from these properties. They have good reserves and the rents are kept at the minimum, around \$400 per month. The capital for projects like these comes not from other housing projects, but from outside contracts. OHDC has a lucrative sideline doing inspections, drafting and design work for banks and other clients. This income is the major source of their capitalization fund.

Though they have no idea where the money will eventually come from for the Omni building, they have a history of getting things done with very little expense. Though large projects funded by major programs constrain the amount of cost-cutting that is possible, the philosophy at OHDC is to

"use every legal means to dodge every legal roadblock" that costs money. "Currently we can put up a two-family for under \$100,000 in construction costs. That's because so much of the costs are in-house-- legal (Courchesne is a lawyer), design, drafting, marketing, construction management and development.

Another reason why they can charge projects and tenants such low costs is the administrative support they get each year from the city. As administrator for a number of city programs, and as beneficiary of a large commitment of CDBG funds each year, OHDC's staff need not charge all their expenses to the individual project. For instance, if this subsidy was not in place, the rents of their units would have to rise an average of 15 - 20% .<sup>55</sup>

But things have changed, according to Courchesne, and it is no longer possible for OHDC to do the kinds of projects it once did. The acquisition prices of the units on the market put the rehabbed price of a property well above what a potential tenant or home buyer would be willing to spend in this neighborhood.

"In 1978 we bought two single family homes and an eight unit block for \$17,000. We did some moderate rehab and

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<sup>55</sup>Though this is a kind of operating subsidy, it amounts to only a fraction of the average Massachusetts Chap. 707 operating subsidy of \$500 per unit, typical of NEI's properties.

sold the single-families for \$10,000 a piece. We then got them into a low interest, home improvement loan program where they borrowed \$10,000 more for each unit and finished the rehab job themselves. The large apartment block was then rehabbed for only \$10,000 per unit. But you can't do that any more."

Not only are the units more expensive, complained Courchesne, they are in worse condition. There were other Omni properties that had also been up for auction in the same neighborhood but the price that the bank wanted had been too great. In one case, the back taxes equalled \$70,000 and the building's condition was such that it might have required demolition at a cost of \$130,000. \$200,000 was too much for an empty lot, according to Courchesne. In the case of the one building that they did buy, they paid \$9,000 per unit for a building that they expected would cost over \$15,000 per unit to repair.<sup>56</sup>

But capital costs were only one of the factors limiting development of affordable housing at OHDC, according to Courchesne. In addition to the high costs of acquisition and rehabilitation, there are now a plethora of regulations

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<sup>56</sup>The bank was holding a mortgage balance of \$22,000 per unit. According to Courchesne, "The bank had no idea what was going on. They didn't know what the property was worth until the day of the auction. I never thought that these properties were worth \$22,000, but somehow Omni managed to get a mortgage."



that cost money to implement and there is no money available to go with them. "Wait till you see what happens with new lead paint regulation in this state," he warned.

With the increasing costs of rental housing, OHDC has done very little rental housing development in recent years, choosing instead to develop low-cost homeownership opportunities, typically duplexes built on lots made vacant when OHDC and others demolished the 4+ unit apartment blocks that once stood there. The construction of owner-occupied duplexes also reinforces the OHDC goals of increasing owner occupancy and resident investment in the City's lower wards. With the least possible restrictions placed on the incomes of buyers and the resale of their units, OHDC also expects to see property values and household incomes rise in Ward One as a result of its activities.

The concern expressed by many of Holyoke's housing advocates is that Ward One's "success" simply displaced their poorest residents, destabilizing South Holyoke and then Churchill. Whoever is to blame for Holyoke's continuing housing problems, displacement is an important concern.

OHDC's success has been attributed to their ability to "clean up" a neighborhood. By reducing density, increasing the household incomes of new tenants (who are now out working during the day and therefore less often at home with children "wearing out" the property), and increasing

homeownership, they have made Ward One a more peaceful and prosperous looking neighborhood. To the extent that the solution to Holyoke's housing problems are founded on the economic principle that residents should pay their own way; that the exclusion of under-income residents, who form a significant part of the existing community, is a necessary step toward neighborhood improvement, then efforts to improve Holyoke will lead to increasing displacement.

On the other hand, one cannot ignore the way that OHDC has come to replace the private, for-profit developer as a source of moderately-priced housing. Private investors who do not have the benefit of OHDC's sophisticated development skills, their CDBG funds, City-donated properties, non-profit status and government subsidized loans will be hard-pressed to develop and operate their properties at nearly what it costs OHDC. At a time of shrinking commitments to subsidized housing, especially in Massachusetts, the efficient use of government funds to create even moderately-priced housing cannot be overlooked.

In this chapter we have seen how three major players have responded to the current crisis. Lenders are committed whether they like it or not. They are waiting and hoping that the market will somehow improve. Private investors are choosing to drop-out of the low-grade rental housing market by either up-grading or abandoning their properties to the banks. The City's lead housing agency is committed to an

upgrading program that it began nearly two decades ago. None of these trends holds out much hope for low-income households. They will likely see fewer housing opportunities and increasing marginalization if these trends continue.

## CHAPTER 7: CONCLUSIONS

The recent transition from marginal profit-making to cash-driven financial management of low-grade rental properties has had and will continue to have a severe impact on the future of those properties and of the households who live in them. We have seen how the crisis in Holyoke's low-grade rental properties began long before the speculative boom of the 1980's.

We have seen how successful rental property investment for the small investor traditionally depended on hands-on management, close ties with the tenants, and minimizing turnovers through competitive rents and reliable (although minimal) service. We saw how tenants in these buildings paid relatively little of their income toward rent during the post-war years while the rent that they paid allowed the landlord a generous return on his investment. Meanwhile, tenants were abandoning these aging buildings in favor of the suburbs. Vacancies were rising and it was becoming harder and harder to attract tenants.

This changed, however, in the late 1960's as low-income households, seeking housing and job opportunities unavailable elsewhere, came to Holyoke. This trend grew through the 1970's and into the 1980's. Increasingly desperate for housing, they were willing to pay high proportions of their income for rent. They would double and triple-up their

households and suddenly units that were going for well under the market rent to a long term tenant, were being rented to these new immigrant households for much more.

During the 1970's prices escalated for many things but especially for the cost of providing rental housing. From fuel costs to waste disposal to fire insurance, fixed housing-related costs were rising well ahead of inflation. The maintenance costs rose steeply as 30 children inhabited aging buildings where for years only a dozen children had lived. Increasing costs, new legal obligations and the deteriorating incomes of renters who were supposed to pay for them, led many small investors to get out. The City's de facto policy of destroying low-grade rental housing (in keeping with the national trend) did tighten up the market, however.

Tax benefits and credit opportunities were expanded briefly in the 1980's. Property values rose sharply. Investors with incomes to shelter and a knowledge of mortgage financing responded by purchasing properties with little attention to their use as shelter for tenants. The loss of those tax incentives and the collapse of the credit markets has recently returned investors to dependency on their tenants' income for operating income. In the meantime, that income has only further eroded and the increased debt burden has made these properties financially unfeasible. The investors are pulling out in one way or

another and the original investors they bought from are unlikely to return.

The "safety net" of state-sponsored housing assistance is currently being unraveled and the threat of homelessness, despite the high vacancy rates, grows every day.

### **Shelter by Ballot**

The traditional market arrangements that allowed the tenant to use a part of the household income in exchange for a decent place to live no longer function for those households with lower incomes. For a while a strange set of arrangements made it possible for those properties to earn income independently of their tenants' income, but that is over now. In its wake we will see a long period of adjustments as investors and their lenders (and the taxpayers who insured them) take their losses. Meanwhile some buildings will be lost and tenants will be squeezed even more tightly. As investors seek to control their costs, they are looking for ways to get out of the low-grade rental market altogether. In the opinions of many investors, it will be those landlords who can successfully market to a higher income household who will make it out of this current crisis.

If housing for the poor is infeasible, at least in the short run, without government subsidies, then tenants must increasingly see their housing as a political benefit to be

won through political means. To be poor and independent of public subsidies is, increasingly, to live in substandard housing. Part of the new social relationship necessary to the survival of housing opportunities for the poor must be the tenants' political organization, built on the realization that decent housing is built with votes as much as bricks and mortar.

Along with this politicization there must come a new set of relationships between landlord and tenant.

### **The Seeds of Change**

Broadly speaking, the seeds for that change have already been sown. As Nueva Esperanza and OHDC move into these neighborhoods; as tenants of publicly-subsidized properties assume tenant ownership; as the courts increasingly move to protect the welfare of lower-income tenants; as political leaders increasingly hold landlords responsible for the activities of their tenants, we may see that ownership of low-grade rental housing may change from "proprietor" to "steward". With more emphasis on providing a service than managing a personal asset, these properties may increasingly fall into the hands of non-profits and quasi-public institutions, accountable to the community at large.

Informal conventions that once served to regulate the tenant/landlord relationship in the past (and have since disappeared) may be replaced with more formal ones. From

mediation services in the courts to housekeeping trainings provided by landlords, to on-site daycare services, group counseling and referral services; from tenant-advisory councils screening applicants and reviewing evictions to revising lease provisions; from co-ops, condos, and co-housing to land trusts, mutual housing associations and non-profit or tenant-owned rentals-- in many ways the new tenant/landlord relationship may be redefined.

The opportunities for speculative gain on these properties may be reduced or erased as communities seek to provide lasting opportunities for affordable housing. The struggles of the small, for-profit landlord hit with hard times may increasingly be ignored by policy-makers and housing judges who see little to be gained by bailing out a profit-seeking landlord when there are non-profit alternatives available. These non-profits, as they demonstrate their viability and commitment to the community may be seen as the only "legitimate" owners (or stewards) of such properties. These and other public/private partnerships will blur the distinction between public and private housing.

The community-based housing organization, like NEI, can provide more than a conduit for redistributive aid. As landlord, these organizations often have an office within easy walking distance of their tenants. Board members are likely to include some tenants. The natural intimacy that



occurs when owners closely manage their properties reinforces the community development goals of the organization. Self-help and leadership development programs are easier to organize when one has a personal relationship with the participants, especially within a context that includes family, neighbors and friends. Conversely, tenants who participate in such programs may be encouraged to develop positive relationships with their neighbors and take more care with the building in which they live. Under these new terms, one's civic duties may include stopping the graffiti in the hallway.

NEI's property management office is on South Summer Street, in one of the residential buildings. Managers explain to the new tenants that an important aspect of their new tenancy is an unwritten obligation to improve the life of the community. They are told that NEI could only offer these apartments because community members pitched in to help.

Another technique which NEI's managers employ is the tenant advisory meeting. All newly occupied buildings hold their first meeting during the first month. The tenants at that meeting discuss what they expect from their neighbors. The title of the discussion is taken from the initial question put to the group (sometimes it is the only question), "What is a good neighbor?" The result is a clearly communicated set of expectations that forms the

foundation of a new set of "traditions" for life in these apartment blocks.

The public nature of the "good neighbor" discussion reinforces mutual accountability. For example, tenants often refer to the list of self-written rules when they complain to each other and the manager uses the same rules when mediating disputes between neighbors.

Perhaps the most important contribution provided by these community-based organizations is their recreation of the traditional commitment made by the owners of rental property to the shelter needs of their residents. By their very definition they have undertaken that commitment. If they fail to live by it then there is recourse to force them back to it.

The de-privatization of low-grade rental housing need not improve housing opportunities for lower-income households, however. The OHDC model could worsen opportunities for those with the lowest incomes. The community-based, NEI model has proven that it can help this part of the population, but only so long as the political will and the economic means remain to transfer wealth into operating subsidies to finance it. Without public financial support, these community-based organizations face the same impossible struggle as any other owner of low-grade rental housing. For without some redistributive effort to equalize incomes and wealth in this nation, the "invisible hand" of the

market is unlikely to do any more than push the low-income renter to the very edges of society.

Aside from this critical commitment to redistribution, there may be some steps that local policy-makers could implement to reweave a social fabric back into these properties and their neighborhoods:

(1) Create incentives for owner-occupancy. Local officials have control over tax rates, tax foreclosure proceedings, block grant funds, housing improvement grants and low-interest loan pools, and fees for city services. In Holyoke and some other cities the utility company is publicly-owned. If owner-occupants have access to lower rates, better services, and priority access to foreclosed buildings, they may be able to improve their cash-flow enough to make investment attractive.

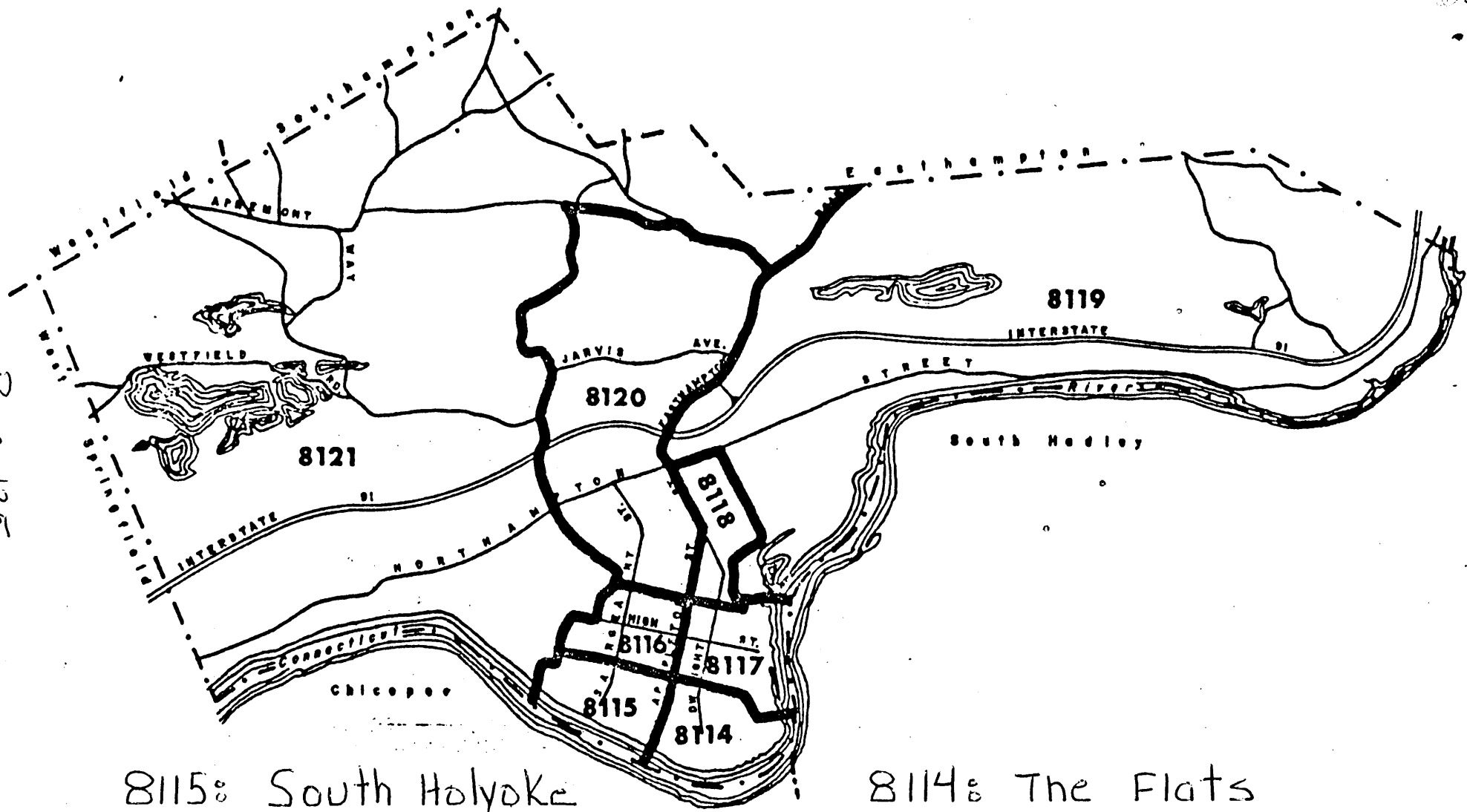
(2) Create and subsidize an owner-occupant rental housing association with pooled legal and administrative services that are provided to members at a price well below the market.

(3) Establish, perhaps through the organization above, a training program capable of turning out relatively sophisticated owner-occupants capable of understanding and using modern property management techniques.

(4) Establish a loan pool specifically directed at owner-occupant acquisitions of properties.

(5) Establish neighborhood block groups which have real input into certain political decisions-- like land-use planning, traffic control, or infrastructure improvements. The key here is to encourage involvement by making it clear that those who do not become involved have something to lose.

Whatever happens, however, the status quo seems very unstable and the future is sure to be dynamic, to say the least. The increasing liabilities facing rental property owners, a sluggish recovery from the current recession, and a lack of new government aid in the foreseeable future suggests that the small investor will continue to face even harder times before they are likely to improve. Without strong intervention, this social resource is likely to be lost and the the security of millions of low-income renters put in jeopardy.



8115: South Holyoke

8114: The Flats

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CITY OF HOLYOKE, MASSACHUSETTS  
COMMUNITY RENEWAL PROGRAM

**CENSUS TRACTS  
1970 & 1980**



