MHFA Financed Housing:
Legislative and Economic Forces
That Favor the Development of Housing for the Elderly

by

Alden Howland Drake

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Signature of Author ________________________
Department of Urban Studies and Planning
January 16, 1981

Certified by ________________________
Lynden Sagalyn, Assistant Professor
Thesis Supervisor

Accepted by ________________________
Langley C. Keyes, Professor
Chairman, Thesis Committee
ABSTRACT

MHFA Financed Housing: Legislative and Economic Forces that Favor the Development of Housing for the Elderly
Alden H. Drake
Submitted to the Department of Urban Studies and Planning on January 14, 1981, in partial fulfillment of the requirements for the degree of Master of City Planning.

The purpose of this thesis is to examine the dramatic shift (since 1974 and the passage of the Section 8 Rental Subsidy Program) in the distribution of elderly versus family housing units that are financed through the Massachusetts Housing Finance Agency (MHFA); and to analyse the legislative and economic forces that favor the construction of elderly housing. This thesis does not examine the political process in which many sponsors obtain an allocation of Section 8 subsidies directly from Washington as an explanation of why more elderly developments are being financed and built. This is an element of potentially great significance, but it is an area in which research beyond the scope of this thesis would be required before definitive conclusions could be reached.

The hypothesis states that the decline in the production of family developments and the rise in elderly developments is due to numerous legislative and economic factors:

1) The intent of Congress in formulating the Section 8 Program and relying upon it as the sole vehicle for current housing subsidies was to shift greater risks and rewards for deciding the character, type, and location of subsidized housing onto the private sector. This represented a major departure from the central decision-making philosophy of previous federal subsidy programs, and forced sponsors under the Section 8 Program into a position of being much more discriminating in their housing investment decisions.

2) Elderly housing is usually developed at a higher density and higher costs per square foot. Thus the likelihood of having a higher replacement cost; a higher prospect for long term capital gains; and allowing the BSPRA to reduce the sponsor's actual cash equity—all work together as positive reinforcements for sponsors to prefer elderly housing.

3) From another economic standpoint, elderly developments are preferable since they have higher Fair Market Rents to cover operation and debt service costs. Furthermore, the adaptive reuse of structures like schools, offices, factories, and parking garages (which are eligible for the quickest write-off of all), tend to have development options limited solely to elderly occupants (because of the elevator clause), and these sponsors are earning by far the highest...
profits through the sale of tax shelters.

4) The poor performance of family developments under the Section 236 Program is another reason why fewer family developments are being built. Sponsors, the MHFA, investors and local communities all recognize the inherent higher risks, operating expenses, and rate of project failure that was associated with family housing under previous programs. As a result, sponsors of Section 8 housing are less likely to propose family developments and MHFA is less likely to finance them; because, in the absence of FHA mortgage insurance, both the MHFA and sponsors have their own money at risk in the event of a default. The potential of community opposition—which is also more likely to be associated with family developments and could become the catalyst for a default—is another reason why less family housing is being built.

5) Finally, MHFA's decision-makers and its institutional constraints also have an impact on the type of subsidized housing that is being financed and built. Their recognition that elderly housing is a safer investment and therefore, better serves their objective of being a major catalyst for private investment and neighborhood revitalization is a significant variable in explaining the shift. Data exists to show that sponsors of elderly housing have a much greater rate of success in gaining mortgage financing than sponsors of family housing. But further research is needed to fully appreciate the political process in which a sponsor can obtain an allocation of Section 8 subsidies directly from Washington as an explanation of why more elderly proposals are being financed.

MHFA financing and the various rent subsidy programs were specifically chosen as the focus for this analysis because they are the only programs that have been operating in Massachusetts consistently over the past ten years with an established record of producing multi-unit developments from which a dramatic shift in the type of development taking place can be observed and documented.

Furthermore, the significance of this thesis comes as a timely document for both federal and state policy-makers who stand at a crossroad on the question of whether it is politically necessary to restore the balance between family and elderly housing production. Given current policies and the continuing impact of inflation in both the public and private sectors of the economy, the imbalance in favor of elderly housing can only increase in the absence of deliberate policy alternatives. Such an absence portends a future in which MHFA financed family housing as we know it will become a thing of the past.

Thesis Supervisor: Lynne Sagalyn
Title: Assistant Professor in the Department of Urban Studies and Planning
ACKNOWLEDGMENTS

The author wishes to thank two special individuals who were most helpful in the production of this thesis. Lynne Sagalyn, my advisor and most valuable critic was responsible for providing the most clear and useful suggestions throughout the planning and development of this thesis. Her editorial work also contributed to the style and impact of the paper.

Kirk McClure, former classmate and now an experienced mortgage officer with MHFA also deserves credit for providing the author with invaluable reports and memos from within the Agency which the author used extensively throughout the thesis. His receptivity to inquiries and his personal encouragement are also reasons for being grateful.

There are others of course who made this thesis possible. I owe more than I can ever repay to the generosity of a friend, Wayne Wilson; and to Jennifer, my wife, I am grateful for her love throughout this process which motivated me to complete the task.
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INTRODUCTION

Along with an analysis of the dramatic shift in favor of the construction of elderly housing, it is important to understand some of the history of MHFA--its creation and legislative mandate in 1966; the initial context; and how policy makers in Massachusetts perceived the housing problem.

Following the post-World War II baby boom of the 1940s and 1950s, the urban renewal experience of the 1950s and 1960s, and the Civil Rights and "white flight" movements which followed; both public and private interests began to recognize that a serious need existed for government aid in the development of low and moderate income housing. Federally sponsored public housing in Massachusetts (although very successful in the development of Veteran's Housing) was not perceived as an adequate approach to the overall housing problem. The most obvious reason why public housing was not expected to solve the housing problem was because of its fiscal limitations. The government simply could not afford to build and own enough of a housing stock to meet the housing needs of everyone living in sub-standard housing whose income was too low to afford anything better. Therefore, housing planners and government officials felt compelled to devise new programs with public subsidies and incentives which could leverage larger amounts of private capital and therefore go further towards the goal of producing an adequate supply of safe and standard dwelling units for low-income family and elderly households.
MHFA's Legislative Mandate: A Public Purpose Lending Institution

Out of this environment on September 8, 1966, the Massachusetts Legislature passed Chapter 708, "An Act Establishing the Massachusetts Housing Finance Agency," whose public purpose was to promote the production of decent, safe, standard housing--"which persons and families of low income, elderly persons and veterans...can afford."¹

MHFA's main purpose became that of a public purpose lending institution and was put into operation in 1970 by $500,000,000 bonding authority backed by the full faith and credit of the Commonwealth. The Agency used the authority to issue tax-exempt bonds for sale to private investors and then turn around and lend the revenues from the bond sales at below market interest rates to sponsors of low-moderate income housing. After this had occurred several times and the developments were occupied and had an ongoing operational cash flow; mortgage payments from the sponsors would be returned to the Agency and reloaned.

Many times since then the MHFA has expanded its overall lending capacity by increasing its total bonding authority by increments ranging from $200,000,000 to $400,000,000. The result of this has been to make MHFA one of the most innovative, responsive, and productive State Housing Finance Institution.

¹. Chapter 708, Section 2, Declaration of Public Necessity
Agencies in the nation. The MHFA, by periodically increasing its overall bonding capacity, has been able to utilize numerous federal housing subsidy programs as they are enacted and therefore provide subsidized housing units which would not have otherwise been provided. It is, therefore, here that the analysis of the shift towards elderly housing construction begins.

Housing Needs in Massachusetts

Since the Act creating the MHFA mandated as its public purpose the production of housing for all kinds of low and moderate income households, a determination of housing needs by household type was an important first step. This determination was first done in 1970 and produced an estimate of housing needs by household type, and it has been updated twice; once at the end of 1977 and again at the end of 1979.

---


2. At the heart of the Housing Needs Study is a rather simple housing requirements/housing inventory model for both elderly and family units in every community in Massachusetts. In addition to unit size requirements, household financial resources were incorporated. To estimate supply, owner data was used to develop a rent-unit size matrix with frequencies, and an effort was made to subtract out substandard units from the eligible housing stock. Once the community housing needs and housing supply was established, a matching program was employed to pair each household with an available unit at an affordable price. The shortfall of affordable units in this matching process is the community's-- and together the Commonwealth's-- low-moderate income housing need. (Mass. Department of Community Affairs, "Part I: A Review of D.C.A.'s Needs Methodology", pp. 1,2, 1978)
Table 1


<table>
<thead>
<tr>
<th>Date</th>
<th>Elderly*</th>
<th>Family</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>As of Jan. 1, 1970</td>
<td>208,290 (44%)</td>
<td>260,249 (56%)</td>
<td>468,539 (100%)</td>
</tr>
<tr>
<td>As of Jan. 1, 1978</td>
<td>162,693 (46%)</td>
<td>187,264 (54%)</td>
<td>349,957 (100%)</td>
</tr>
<tr>
<td>As of Jan. 1, 1980</td>
<td>161,969 (47%)</td>
<td>184,370 (53%)</td>
<td>346,330 (100%)</td>
</tr>
</tbody>
</table>

*Elderly defined as over 62 years of age.


The distribution of housing needs in Massachusetts by household type has changed in the last ten years toward a higher percentage of elderly households in need; nevertheless, the basic picture of very nearly equal housing needs between family and elderly households remains the same.

In light of this data, it is against the 1970 estimate of housing needs by household type that the MHFA's earliest goals should have been set, and it is against the 1978 and 1980 estimates of remaining needs that its more recent performance will be evaluated.

The Housing Problem: Unequal Program Utilization

Numerous housing programs have been utilized by MHFA sponsors over various years, but a look at the distribution of units subsidized under each of the programs in Table 2
below prior to Section 8 suggests that elderly and family housing needs were being met at a very equivalent rate.

The Section 236 Interest Subsidy Program was by far the most widely used program (13,825 units) by MHFA sponsors prior to Section 8, and its distribution of benefits did address both elderly and family housing needs proportionally as defined by then-current measures; i.e. 44 percent elderly, and 56 percent family construction. This was determined by compiling data from MHFA's Housing List on every development and separating out the number of units designated for the elderly from the total number of units and further distinguishing elderly from family units by the type of subsidy that was utilized. The result of this research revealed that one half of the mixed E/F production consisted of elderly units and one half consisted of family units. Therefore, the Section 236 program benefitted 44 percent elderly and 56 percent family households and statistically matched the estimated distribution of housing needs in Massachusetts. Very similar results occurred in the author's analysis of the benefits of the Massachusetts Section 13A Interest Subsidy Program; the federal Rent Supplement Program (RSP); and the Massachusetts Chapter 707 Rent Subsidy Program. The data in Table 2 and the analysis which follows has been displayed in three categories, however, to conform with data
Table 2

SUBSIDY PROGRAMS USED WITH MHFA FINANCED UNITS
PRIOR TO SECTION 8: 1970-75

<table>
<thead>
<tr>
<th>Number of Units/ %</th>
<th>Elderly 1.0-1.29 Ave. BR*</th>
<th>Mixed E/F or Small Family 1.3-1.89 Ave. BR</th>
<th>Large Family 1.9 &amp; over Ave. BR</th>
<th>Total #/ 100%</th>
</tr>
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<tr>
<td>Section 236 Federal Int. Subsidy</td>
<td>2,693</td>
<td>6,673</td>
<td>4,369</td>
<td>13,825</td>
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<tr>
<td>Massachusetts Int. Subsidy</td>
<td>1,802</td>
<td>4,009</td>
<td>963</td>
<td>6,774</td>
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<tr>
<td>Massachuse tts Rent Subsidies</td>
<td>1,115</td>
<td>1,724</td>
<td>1,232</td>
<td>4,071</td>
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<tr>
<td>Chapter 707 Federal Rent Supplements</td>
<td>514</td>
<td>1,013</td>
<td>468</td>
<td>1,995</td>
</tr>
<tr>
<td>Section 23 Pre-Section 8 Federal Section 23</td>
<td>485</td>
<td>319</td>
<td>147</td>
<td>951</td>
</tr>
<tr>
<td>Total</td>
<td>6,609</td>
<td>13,738</td>
<td>7,179</td>
<td>27,616</td>
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* Ave. BR means the average bedroom size per unit over the entire development.

Source: Compiled by author from MHFA's Housing List, Feb. 1980 from HUD sources and to shed additional light on the true character of subsidized developments. Clearly a great many developments prior to Section 8 were not just for families or the elderly. They mixed household types prior to Section 8, but after Section 8 this occurred less often.
The exception to this was the distribution of units by household type which was utilized under the federal Section 23 Leased Housing Program. The Leased Housing Program had just gotten underway the year before Section 8 was funded (as evidenced by only 951 units developed through MHFA); and following the Nixon Housing Moratorium, the Section 23 Program was not revived. Its concept of having tenants pay 25 percent of their income on housing costs was so similar to Section 8's guidelines that Congress made Section 8 its same vehicle for additional housing subsidy commitments.\(^1\)

As evidenced in Table 2 above, over 50 percent of Section 23 units with MHFA financing went to the benefit of all elderly developments—not to mention another 17 percent in mixed elderly/family developments. The reasons behind this are that around this time (1972-1974) federal housing policies were being revised under the leadership of the Nixon Administration to shift more of the risks and rewards (site control, site selection, occupancy type, design, density, and professional expertise) for developing subsidized housing onto the private sector\(^2\). As this was accomplished through the RSP and the Section 8 SR/NC Program, "a predominance of units for elderly households" began to occur in the early 1970s.\(^3\) This is evidenced by the fact that (unlike previous programs) the Section 8 benefits are not being utilized

in a way that proportionally addresses the needs of both family and elderly households—either in Massachusetts (see Table 3 below) nor across the nation (see Table 4 below). The imbalance has occurred since the Section 8 benefits are being utilized to meet the needs of elderly households proportionally far more than the needs of small and large family households.¹ And although housing subsidies are not being wasted on the elderly,² it is cause for concern that only 4 percent of the MHFA financed Section 8 units from the beginning of the program through February 1980 have been intended for occupancy by large families and only 17 percent are mixed.

Table 3

DISTRIBUTION OF SECTION 8 UNITS THROUGH MHFA FINANCING
FROM JULY 1975 - FEBRUARY 1980

<table>
<thead>
<tr>
<th>Number/ Elderly 1.0-1.29 Ave. BR %</th>
<th>Mixed E/F or Small Family 1.3-1.89 Ave. BR %</th>
<th>Large Family 1.9 &amp; over Ave. BR %</th>
<th>Total/ %</th>
</tr>
</thead>
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<tr>
<td>Section 8 7,178/ 79%</td>
<td>1,583/ 17%</td>
<td>348/ 4%</td>
<td>9,109/ 100%</td>
</tr>
</tbody>
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Source: Compiled by the author from MHFA's Housing List.

Table 4

ELDERLY/FAMILY ORIENTATION OF NATIONALLY SAMPLED PROJECTS--1977

<table>
<thead>
<tr>
<th>Section 8 NC/SR Program</th>
<th>All Elderly</th>
<th>Mixed E/F</th>
<th>All Families</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>61%</td>
<td>16%</td>
<td>23%</td>
<td>100%</td>
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Many reasons exist to explain why the Section 8 program has been used so heavily for elderly as opposed to family needs, and why this trend is likely to continue in the absence of deliberate policy alternatives; thus, it is the purpose of this thesis to document the economic and legislative forces that have led the MHFA and its sponsors into the current situation.
PART I

THE IMPACT OF HOUSING SUBSIDY PROGRAMS ON MHFA's HOUSING PRODUCTION PRIOR TO HUD's SECTION 8 (1970-1975)
CHAPTER I
THE EARLY YEARS

HUD's Section 236 Interest Subsidy Program

The major vehicle for federal assistance in the construction of multi-family housing through MHFA was the Section 236 program of the Housing Act of 1968. This program was open to both profit and non-profit sponsors and offered an interest subsidy that could reduce the interest rate to as low as 1%. In Massachusetts, 19% of the Section 236 units were built especially for the elderly, and the same was true nationally. The Nixon Administration, however, put a moratorium on new commitments in January 1973 and thus set the stage for his Administration and Congress to revise national housing policies towards a new direction.

The Section 236 interest subsidy was sufficient to reduce tenant rental payments to an average of about 30% of family income, and additional subsidies were occasionally provided on behalf of the occupants of some of the units through Rent Supplement Payments (RSP) specifically authorized for use in conjunction with Section 236. Piggybacking of these subsidies, which were paid to the project owner, permitted tenants' rents for some units to be reduced to 25% of their income without

1. GAO Report to Congress, Section 236 Rental Housing: An Evaluation with Lessons for the Future, January 1978, p. 3
2. ibid.
jeopardizing the financial viability of the projects.

The distribution of both Section 236 and Rent Supplement units financed through the MHFA reflects this piggy-backing kind of relationship, and it demonstrates an equal responsiveness to the needs of both family and elderly households. Almost half, 49%, of its benefits went to mixed elderly/family developments or small family developments, and almost one third, 32%, went to large families¹ (rather than to the extreme of benefitting mostly elderly households).

Despite these multiple subsidies, however, Section 236 was plagued by high default rates. More than 14% of the approximately 4,000 Section 236 mortgages written nationally through 1976 were assigned to HUD by the mortgagee or foreclosed by the end of that year². And, while the MHFA demonstrated a great deal of courage and leadership in their attempt to formulate "workout" solutions for their own troubled projects³, the basic problems of an inadequate tenant selection process, higher operating expenses than anticipated, and insufficient cash flow due to vacancies and non-rent-paying tenants all surfaced in Massachusetts as well as across the nation⁴.

¹ See Table 2 above.
² GAO Report to Congress, Section 236 Rental Housing: An Evaluation With Lessons for the Future, January 1978, pg. 19
⁴ Chuck McSweeny, Massachusetts Executive Office of Communities and Development, interview, Boston, 19 May 1980.
In suspending the program in 1973, the Nixon Administration charged that the assistance was not great enough to serve very low income people, the program was too expensive, and default rates were unacceptably high\(^1\).

GAO's analysis of Section 236 mortgage failures showed however that:

Most Section 236 financial failures occurred in non-profit and cooperatively sponsored projects rather than profit-motivated ones. Roughly 58% of all failures were in non-profit and cooperatively sponsored projects although they comprised only about 30% of total insurance\(^2\).

**Table 5**

<table>
<thead>
<tr>
<th>Type of Sponsor</th>
<th>Percent of Sponsored Projects</th>
<th>Percent of Project Failures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Profit</td>
<td>23</td>
<td>47</td>
</tr>
<tr>
<td>Cooperative</td>
<td>6</td>
<td>11</td>
</tr>
<tr>
<td>Limited Dividend</td>
<td>71</td>
<td>42</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Source: Section 236 Rental Housing, pg. 14.


These failures very likely resulted from lack of experience and limited financial resources in the non-profit or cooperatively sponsored projects which contributed to management problems and made it difficult to meet unexpected expenses during construction or operation.

The basic problem with the Section 236 interest subsidy program was that the subsidy was inflexible. Since the subsidy was a fixed interest subsidy locked in at the beginning of the mortgage to reduce the finance charges down to 1%, the subsidy could not rise to meet increased operating costs brought on by inflation. Increases in operating costs were therefore passed on to the tenants who had a very limited ability to pay higher rents. Collection losses and operating deficits occurred; and if the problem went on long enough, a mortgage default was almost inevitable.

Suspending the program, however, did more than just prevent many new commitments from being made. The mistakes in tenant selection and management of these projects also had a lasting and damaging impact for family developments in the minds of the sponsors and investors who are depended upon for resources that make the development process work. Soon after the moratorium, sponsors of subsidized housing began to equate non-elderly headed households with project failures, since the Section 236 program had the highest percentage of non-elderly headed households and an unacceptably high overall rate of failure.

HUD's Rent Supplement Program (RSP) 1965-1973

The purpose of reviewing the RSP is that contained in its development is the first sign that Congress and the Administration were concerned about whether various housing subsidy programs were being utilized to meet both elderly and family housing needs. The Rent Supplement Act was passed in 1967 to provide payments to the owners of private rental housing on behalf of low-income tenants, but it was used primarily to reduce rental charges in Section 236 and other mortgage subsidy projects. Rent supplements paid the difference between 25% of the tenant's adjusted income and the Fair Market Rent (FMR) and were initially available to no more than 20% of the units in a given project. Tenant eligibility criteria required that the household income be low enough to qualify for public housing; and they must fit into one of the following categories: elderly, handicapped, displaced by government action, victims of natural disasters, occupying substandard housing, or headed by a person serving active military duty.

While it has been said that the RSP program was used primarily to piggyback Section 236 subsidies, an important precedent occurred in 1972 in the RSP regulations which was a reflection of both public and private dissatisfaction with the overall thrust of federal housing subsidy programs. At the heart of the dissatisfaction was the growing awareness that many Section 236 developments were in financial difficulty and that family tenants were more costly to manage.
In response to this situation and with the effect of penalizing the victims in family developments, Congress increased the ceiling from 20% to 60% (and would later increase it to 100%) of the units in elderly occupied developments that could receive rent supplements by passing the Housing and Urban Development Act of 1972.

The significance of this differential comes from the fact that it encouraged developers to perceive family and elderly developments differently in terms of their financial stability and risk factors. With most if not all of the units in an elderly development under a subsidy of one form or another, the owner has less to be concerned about collection losses and tenants being unable to pay. This same reasoning is carried a step further in the analysis in Chapter 2 in which it is argued; since family households tend to have higher incomes and their share of the rent is likely to be larger than for an average elderly household, sponsors prefer developing elderly units since proportionally more of their rental income comes from HUD on time each month. Evidence that sponsors began to favor doing elderly developments began to occur around 1972 and is suggested by the fact that the distribution of RSP benefits began to shift in favor of


2. See Figure 13 below.
more elderly units between the time Section 236 closed out and immediately before passage of the Section 8 program (See Table 6 below).

While this data is not conclusive evidence to argue that MHFA sponsors would begin flocking in to do elderly developments, it does suggest that doing housing for the elderly would increase in popularity. Given the high rates of project failures due to the inflexible interest subsidy under the Section 236 program¹, and a legislated differential that translates into less risk and a project with a greater share of its income guaranteed; one must acknowledge the potential impact of higher subsidy limits for elderly developments over a more extended period of time.

Table 6

<table>
<thead>
<tr>
<th></th>
<th>Elderly</th>
<th>Mixed E/F or Small</th>
<th>Large Family 1.3-1.9</th>
<th>Large Family 1.9 &amp; over</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number and Percentages</td>
<td>Ave. BR*</td>
<td>Ave. BR*</td>
<td>Ave. BR*</td>
<td>Ave. BR*</td>
<td>Total</td>
</tr>
<tr>
<td>Section 236 Interest</td>
<td>2,693</td>
<td>6,673</td>
<td>4,369</td>
<td>13,825</td>
<td></td>
</tr>
<tr>
<td>Subsidies</td>
<td>19%</td>
<td>49%</td>
<td>32%</td>
<td>100%</td>
<td></td>
</tr>
<tr>
<td>Rent Supplement</td>
<td>1,115</td>
<td>1,724</td>
<td>1,232</td>
<td>4,071</td>
<td></td>
</tr>
<tr>
<td>Program</td>
<td>27%</td>
<td>42%</td>
<td>31%</td>
<td>100%</td>
<td></td>
</tr>
<tr>
<td>Difference</td>
<td>+8%</td>
<td>-7%</td>
<td>-1%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Ave. BR means the average bedroom size per unit over the entire development.

Source: Compiled by the Author from MHFA's Housing List.

**HUD's Section 23 Leased Public Housing Program**

Section 23 of the U.S. Housing Act of 1937 is another housing subsidy program that MHFA sponsors used in the early years of MHFA's history. The program is considered to be the "godfather" of Section 8 which is HUD's current major housing assistance mechanism. Its aim was to encourage the construction of low income housing units by providing assurances that low income tenants would be assisted in making their rent payments. When the program was announced on September 19, 1973, it was to provide 200,000 subsidized housing units, three quarters of which were expected to be new construction.
stimulated by the availability of RSP\textsuperscript{1}. The results fell far short of projections, however, as only 4,441 units nationally were approved for leasing and over 36,000 applications remained unprocessed when the program was discontinued to await Section 8\textsuperscript{2} (yet it is a credit to MHFA's readiness that Massachusetts received 951 of those approved units). Of those 951 units, 51% benefitted elderly households\textsuperscript{3}, and herein lies the significance of the Section 23 program in the framework of forces that favor the development of elderly housing. It is that despite the relatively small impact that Section 23 made on housing in Massachusetts, it is interesting that so soon after the troubling experience with Section 236 and low income families, the sponsors of Section 23 units chose to build more than half of their units for occupancy by elderly households.

While such a small sample is not conclusive evidence that sponsors were reluctant to propose family housing as early as 1973-1974, it is consistent with much more convincing evidence that will follow.

\begin{enumerate}
\item U.S. Department of Housing and Urban Development, Programs of HUD, November 1978, pg. 33.
\item See Table 7 below.
\end{enumerate}
Massachusetts' Section 13A and Chapter 707 Enactments

Basically only two housing programs were enacted for MHFA sponsors in Massachusetts, and while they were similar to certain federal housing assistance programs, they enjoyed a relatively quiet existence and ceased operation in 1976. The reason they ceased operation is that they were no longer needed in the face of growing Section 8 commitments. The Massachusetts' Section 13A interest subsidy program, as enacted by Chapter 708 of the Acts of 1966, reduced the rent on low and moderate income MHFA developments by subsidizing the interest rate down to 1% just as did Section 236 of the 1968 U.S. Housing Act.¹

In the same manner, Chapter 707 of the Massachusetts' Acts of 1966 resembled Section 23 of the U.S. Housing Act of 1937 and consisted of a rental assistance program for both low income family and elderly households. Chapter 707 paid the difference between the published Department of Community Affairs' rent schedules and 25% of the tenants' adjusted income².

Interest subsidies and rental assistance were piggy-backed in these Massachusetts programs just as they were on the federal level; however, no apparent differentials were given that favored either elderly or family housing

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¹. Massachusetts Executive Office of Communities and Development, Budget Projections and Needs for Existing State Housing Assistance Programs, FY 1976-FY1980, Chapters 1, 2.

². ibid.
sponsors. Neither do the data appear to have warranted incentives that favored either family or elderly sponsors, since the utilization patterns of both these programs seem to fairly reflect the distribution of housing needs (compare with Table 1 above).

Table 7

STATE SUBSIDY PROGRAMS USED WITH MHFA FINANCED UNITS: 1970-1976

<table>
<thead>
<tr>
<th>Number and Percentages</th>
<th>Elderly 1.0-1.29</th>
<th>Mixed E/F or Small Family 1.3-1.89</th>
<th>Large 1.9 &amp; over</th>
<th>Total Ave. BR*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section 13A Interest Subsidies</td>
<td>1,802</td>
<td>4,009</td>
<td>963</td>
<td>6,774</td>
</tr>
<tr>
<td>Ch. 707 Rent Supplements</td>
<td>514</td>
<td>1,013</td>
<td>468</td>
<td>1,995</td>
</tr>
</tbody>
</table>

* Ave. BR means the average bedroom size per unit over the entire development.

Source: Compiled by the Author from MHFA's Housing List

The significance of these state subsidy programs is also reflected in when they were most heavily utilized. Prior to the Housing Moratorium in January 1973, these programs accounted for a small proportion of the subsidized units that MHFA financed. Following the moratorium, however, and prior to the growth of Section 8 subsidies, these state programs were more heavily utilized to compensate for the loss
of federal support (see Figure 1 below). Notice the increase in 1974 subsidies over 1973, and their decline following 1974 which corresponds to the time when federal subsidies were being reinstated.

Figure 1

UTILIZATION OF SECTION 13A AND CHAPTER 707 PROGRAMS

<table>
<thead>
<tr>
<th>Year</th>
<th>70</th>
<th>71</th>
<th>72</th>
<th>73</th>
<th>74</th>
<th>75</th>
<th>76</th>
<th>77</th>
<th>78</th>
<th>79</th>
</tr>
</thead>
<tbody>
<tr>
<td>Units</td>
<td>300</td>
<td>600</td>
<td>900</td>
<td>1200</td>
<td>1500</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Compiled by the author from MHFA's Housing List

Thus taking the utilization pattern and the years in which each program operated, it can not be demonstrated these programs had any effect in producing the shift which favors the development of elderly rather than family subsidized housing.
CONCLUSIONS

Upon examining the history of MHFA and the distribution of their housing production from 1970-1975, it is concluded that housing needs among family and elderly households were being met at roughly similar rates under both state and federal subsidy programs. Out of this activity, however, emerged experiences and perceptions which would leave a stigma in the minds of private developers about the risks and the disadvantages of developing family housing. It was something that was mostly a perception or an inclination, however, until passage of the Section 8 Rental Assistance Program which enabled private sponsors and developers to translate their preferences and experience into a dramatic shift away from family housing production.

The aspects of the Section 8 program and the economic and investment incentives which combine to favor the development of elderly housing will be analysed and evaluated more fully in the following chapters.

Again, what this thesis does not examine is the political process and the political nature of the elderly housing issue. It is suggested, however, that one would find a better organized and more powerful coalition in favor of elderly housing, and thus greater political rewards for those who help produce it; but such an analysis is not the subject of this thesis.
PART II

THE IMPACT OF HUD'S GUIDELINES IN EFFECT FROM 1974-1980 ON MHFA'S HOUSING PRODUCTION
CHAPTER II
HUD'S SECTION 8 OF THE HOUSING AND COMMUNITY DEVELOPMENT ACT OF 1974

The New Construction/Substantial Rehabilitation Program (NC/SR)

The Section 8 New Construction/Substantial Rehab (NC/SR) Program provides assistance on behalf of low-income households occupying newly-built or significantly rehabbed units that meet certain criteria as to cost, physical adequacy, and location. Under these programs, public agencies or private sponsors develop housing projects in which a portion of the units are made available to low and moderate income renters at reduced costs. The difference between the HUD established allowable rents for each unit and the household contribution is made up by regular payments from HUD to the project owner. Assistance contracts between HUD and project sponsors cover five-year periods and are renewable at the owner's discretion for 20 to 40 years depending on the type of sponsor and the kind of financing used.

Passage of the Section 8 Lower-Income Rental Assistance Program in 1974 marked the beginning of a new era in the low-income housing development process. Sponsors of such developments were again able to secure adequate subsidies and the MHFA responded quickly to the renewed demand for mortgage financing. The nature of the Section 8 program includes aspects that are similar to previous housing assistance programs, but in general Section 8's income eligibility criteria permit households whose incomes are slightly higher than previous subsidy programs to remain eligible for the subsidy to encourage more income mixing
and deconcentration of the poor. By allowing a household who in the future becomes over-incomed to remain in the development and pay the full FMR, the intent of Congress was to create mixed-income housing which developers would perceive as being less risky.¹

The way the program works is that non-profit and profit-motivated developers, alone or together with public housing agencies, submit proposals for substantial rehabilitation or new construction in response to invitations from HUD; or they may apply directly to their State Housing Finance Agency. Since our concern is only with MHFA financed housing, and the vast majority of Section 8 units in Massachusetts are financed by MHFA, we will not deal with the role that PHAs or the Department of Community Affairs plays in the Section 8 development process. Neither is the author able to document the political process in which sponsors respond to invitations from HUD and receive Section 8 allocations independently from MHFA. Surely this is relevant to the question of why more elderly proposals are being financed, but it is outside of the economic and legislative scope of this thesis.

One of the objectives of the Section 8 program states that it should be so used so as to avoid further concentration of the poor in the worst urban neighborhoods; and sample surveys indicate that HUD has applied site selection criteria accordingly for the new construction program, since most new

construction projects are in neighborhoods with stable or rising property values.¹

The allocation of funds is decided upon by a formula which takes into account the following factors to determine the areas' housing needs: population, poverty, housing overcrowding, housing vacancies, substandard housing, and "other objective measurable conditions." Census data on these variables are assembled by HUD staff and combined to determine a single percentage distribution for resources between HUD Area Office jurisdictions across the country.²

The Existing Housing Program

Another aspect of the Section 8 Rental Subsidy Program is the "Existing Housing Program." Eligible households are given certificates and they must find privately owned existing units in standard condition whose rents are within the published fair market rent (FMR) tables. Local public housing agencies administer the existing housing program, certifying eligible tenants, inspecting the units proposed for subsidy, and contracting with approved landlords for payment. Tenants execute separate leases with landlords to pay their share of the rent which is not to exceed 25 percent of adjusted income. HUD thus subsidizes the difference between what a lower-income household

1. Ibid.
2. Ibid.
can afford and the FMR for an adequate housing unit.

The purpose of looking into the existing housing program—even though it is administered by local public housing agencies and not by the MHFA—is to assess whether household participation in that program in any way limits participation in the NC/SR programs of Section 8 that MHFA handles.

The question of whether the existing program affects the demand for NC/SR units is valid, since the existing housing program offers incentives that are not present anywhere else. HUD maintains certain policy objectives within the existing housing program which allow for increases in the existing FMR of up to 32 percent over the FMR lids for units with four or more bedrooms in areas where the housing market is unusually tight; so it is necessary to consider whether these incentives can explain any of the shift in MHFA financed construction from a balance of elderly and family units to mostly elderly construction. These objectives are:

1) Helping large families;
2) Promoting deconcentration of the poor and minorities;
3) Aiding in lower income mobility; and
4) Housing the handicapped.

The reasons for these policy objectives being included in the existing housing program rather than the NC/SR program are


2. Housing Affairs Letter, July 27, 1979, pg. 6, "Section 8 Existing Rents May Be Tighter."
that 1) the existing housing supply offers a larger base from which to improve lower income housing mobility and de-concentration of the poor, and 2) existing units are considered to be equally appropriate but a much less expensive way to provide housing for large families\(^1\).

Given this outlook, it is interesting to consider the policy implications of budgeting greater resources through a mechanism such as the Existing program to meet the needs of households with children. Of course, the Existing program does not expand the supply of housing; but it could be used to increase the number of family households who benefit from HUD subsidies.

The way the existing housing program pursues these policy objectives is that HUD allows the local PHA to approve rents of up to 32 percent over the FMRs for up to 25 percent of their Section 8 allocation\(^2\). For the full 25 percent an agency would have to get HUD field office approval\(^3\).

Whether the incentives offered in the Section 8 Existing housing program in any way limit the participation of large family households in MHFA's NC/SR program is the point in question. Granted, the Existing housing program contains specific provisions which favor large families; the number of households that benefit due to current funding levels

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1. GAO Report, Evaluation of Alternatives for Financing, p.viii
2. Housing Affairs Letter, July 27, 1979, pg. 6
3. ibid.
and the availability of large units in standard condition is so limited compared to the number who are eligible\textsuperscript{1} that the Existing program does not limit the need for large families to participate in the NC/SR aspect of Section 8 which MHFA handles.

The Elevator Clause and Market Comparables

One of the more significant provisions of the Section 8 program affecting the shift between elderly and family construction is known as the elevator clause. This was enacted in the Housing and Community Development Act of 1977 and was intended to prohibit the use of Section 8 assistance to housing units in high rise elevator projects for "families with children unless there is no practical alternative\textsuperscript{2}". The amount of vandalism from youths within the projects and the incidence of extortion and purse snatching on board elevators against older more vulnerable residents became an intolerable situation, so by 1977, HUD "had learned its lesson not to put families with children in elevator structures\textsuperscript{3}".

The effect this had on the shift to elderly construction within MHFA must be viewed from the perspective that Section 8's

\textsuperscript{1} Contract Research Corporation, \textit{FMRs for the Existing Program}, 31 May 1977, Belmont, MA

\textsuperscript{2} "Lower Income Housing Assistance", Sec. 8 (c) (1), Limitations.

\textsuperscript{3} Interview with Bob Flood, Vice Pres. for DiMeo Construction Co., 19 May 1980.
regulations require the FMR's to be based on comparable structure types within each submarket. In Boston, for example, with land costs as high as they are, it makes economic sense to build highrise rather than flats or townhouse developments. Private market residential developers have done this for many years and successfully captured the back-to-the-city luxury residential market.\footnote{1} MHFA sponsors, therefore, have an incentive to build elevator projects in Boston (which can only be occupied by the elderly), since the market comparables upon which the FMR's are determined in large part happen to be luxury units. This is reflected in the fact that the FMR for a one-bedroom elevated unit in Boston is \$479 per month, and it is comparable to what a retired household, widow, or widower would spend if they had an annual income of \$22,944 and spent 25 percent of their income on rent. Because of taxes and the cost of living, however, it is doubtful that a one or two person household would desire to spend fully 25 percent of their gross income on rent. They would seek a less expensive apartment, thus leaving the \$478 per month unit to a one or two person household of an even higher income who could more easily afford such rent.

\footnote{1}{"Conversion of Charlestown Navy Yard into Luxury Apartments," \textit{Boston Sunday Globe}, 22 June 1980.}
This sheds light on the claims that at least in Boston the FMR's have been set at levels which only upper income households could afford in the private market, thus a great incentive exists for sponsors to propose elderly projects.

In other market areas across the Commonwealth, the connection between high FMR's due to the elevator clause and project feasibility/desireability is a more complex situation. Using the 1978 Operating Statements from MHFA portfolio projects, a test was performed to quantify the actual differences in operating expenses in various areas controlling for the influence due to construction type and market area of the projects.¹ This was done to determine how well the difference in the FMR tables reflect the true cost of operation as it varies from region to region. For the purpose of this comparison the amount of income available to a Section 8 project has been listed (see Table 8 below) in terms of the maximum dollar amount per unit per year that a project may receive by FMR area. This has been listed for both a typical one bedroom walkup and a one bedroom elevated unit including the higher than FMR bonus factors which will be discussed later. Beside the revenue column is listed average operating expenses by FMR area, and subtracting the two shows the amount of revenue remaining

available for debt service by FMR area. As indicated, the areas of Boston, Salem, and Lowell are in a much better position to leverage mortgage financing than the remaining areas, and this is true for both elevated and non-elevated structures. As a result, the bulk of activity (MHFA proposals, financing and construction) occurs in the Boston, Salem and Lowell areas. Within these three FMR areas, however, proposals for elevated structures clearly outperform proposals for non-elevated structures in their ability to leverage mortgage financing. This contributes to the argument that there has been a shift towards elderly housing in these FMR areas due to the back-to-the-city luxury market comparables upon which FMRs are based.

Elevated structures in the remaining FMR areas also outperform non-elevated structures in their ability to gain mortgage financing (although by a narrower margin); yet because sponsors of elderly developments in the southeastern and western parts of the state propose non-elevated structure types for elderly occupancy more often than elevated types, it suggests that maximizing the revenue available for financing is not the only variable in predicting the structure and occupancy type preference of sponsors by FMR area.

Another important variable is the impact of what structure types are allowable within certain localities and neighborhoods along with the fact that lower land prices in less urbanized areas would place less of an incentive on developers to build mid and high rise.
The figures in Table 8 below indicate that the FMR rents enable all housing developers (and especially sponsors of elevated building types) in the FMR areas of Boston, Salem and Lowell to leverage significantly higher amounts of mortgage financing than sponsors in the other FMR areas. This partially explains why the overwhelming bulk of sponsor interest, MHFA financing and construction activity occur in these areas. The figures also suggest, however, that FMR impact on mortgage financing is not the only factor in predicting which building types generate the most developer interest. Differences in operating costs ($421/year/unit less for elderly units) are also important, so a need exists not only to look at additional reasons to explain the shift—but for HUD to review the differences between the FMRs in all areas in an attempt to equalize the amounts of mortgage financing that can be leveraged. The reason why this is a desirable policy objective is due to the fact that, although construction costs do vary across the state; the amount of variance is much less than the variance of the FMRs and operating costs on mortgage financing. The FMR and operating cost impact on mortgage financing, for example, provides a sponsor of family housing in Boston with 30 percent more financing than one in Springfield and 34 percent more financing with elderly units. On the contrary, actual construction costs for materials and labor "aren't all that much different" from one FMR area to another.

1. Kirk McClure, MHFA Mortgage Officer, interview, 12 Sept. 1980
2. ibid.
### Table 8

**HOW WELL FMR TABLES REFLECT THE TRUE COST OF OPERATION BETWEEN FMR REGIONS:**

**STUDY OF OPERATING EXPENSES**

<table>
<thead>
<tr>
<th>FMR Area</th>
<th>Annual Revenue</th>
<th>Annual Opr. Expenses</th>
<th>Revenue Available for Financing</th>
<th>Capitalization of Income at 8%</th>
<th>Annual Revenue</th>
<th>Annual Opr. Expenses</th>
<th>Revenue Available for Financing</th>
<th>Capitalization of Income at 8%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Boston</td>
<td>$6,587</td>
<td>$3,216</td>
<td>$3,371</td>
<td>$42,140</td>
<td>$6,853</td>
<td>$2,795</td>
<td>$4,058</td>
<td>$50,731</td>
</tr>
<tr>
<td>Salem</td>
<td>$6,070</td>
<td>$2,975</td>
<td>$3,095</td>
<td>$38,682</td>
<td>$6,170</td>
<td>$2,554</td>
<td>$3,616</td>
<td>$45,198</td>
</tr>
<tr>
<td>Lowell</td>
<td>$5,793</td>
<td>$2,924</td>
<td>$2,869</td>
<td>$35,859</td>
<td>$6,242</td>
<td>$2,503</td>
<td>$3,739</td>
<td>$46,734</td>
</tr>
<tr>
<td>Cape Cod</td>
<td>$5,569</td>
<td>$3,075</td>
<td>$2,494</td>
<td>$31,169</td>
<td>$5,895</td>
<td>$2,654</td>
<td>$3,241</td>
<td>$40,508</td>
</tr>
<tr>
<td>Worcester</td>
<td>$5,787</td>
<td>$2,983</td>
<td>$2,804</td>
<td>$35,053</td>
<td>$5,776</td>
<td>$2,562</td>
<td>$3,214</td>
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</tr>
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<td>Fall River</td>
<td>$5,569</td>
<td>$2,940</td>
<td>$2,629</td>
<td>$32,865</td>
<td>$5,455</td>
<td>$2,519</td>
<td>$2,936</td>
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<td>Pittsfield</td>
<td>$5,195</td>
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<td>$2,467</td>
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<td>$5,036</td>
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<td>Springfield</td>
<td>$5,195</td>
<td>$2,795</td>
<td>$2,377</td>
<td>$29,718</td>
<td>$5,062</td>
<td>$2,374</td>
<td>$2,688</td>
<td>$33,604</td>
</tr>
</tbody>
</table>

**Source:** Compiled by Author from MHFA memo by Kirk McClure, March 31, 1980, to Don Blackman, "Impact of Section 8 FMR Rent Area on Actual Project Operating Expenses."

1. Annual Revenue is based on the Oct. 30, 1979 published FMRs for Massachusetts plus the 20% higher than FMR limits for which all developments are eligible. It does not include the additional 5 percent bonus for elderly units.

2. Elderly units cost $421/unit less per year to operate, and when this variable is capitalized at 8% it accounts for $5,263 of the difference in money which can be leveraged between family and elderly units.

3. 8 percent was the established rate at which sponsors obtained MHFA financing during most of 1979 and 1980.
Income Eligibility Criteria

Although it is known that housing needs in Massachusetts display a certain distribution between elderly and family households--47 percent elderly; 53 percent family as of January 1, 1980 (See Table 1 above)--it is necessary to examine the characteristics of Section 8's target population by household type and size to determine whether income eligibility criteria limit the participation of family households and thus helps to explain the shift towards elderly developments.

HUD economists in each region are responsible for determining median income levels for each county by household size and limiting participation in Section 8 to those households whose yearly income falls under a two-tiered ceiling.\(^1\) Table 9 below lists the Section 8 household income limits based on 1979 median incomes by household size and geographic area.

---

1. Low income households are those whose income is less than 80 percent of the area media, and very low income households are defined as those whose incomes are only 50 percent of the area median.
### Table 9

**SECTION 8 INCOME ELIGIBILITY CRITERIA**

<table>
<thead>
<tr>
<th>AREA</th>
<th>ONE</th>
<th>TWO</th>
<th>THREE</th>
<th>FOUR</th>
<th>FIVE</th>
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<tr>
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<td></td>
<td></td>
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</tr>
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<td>9,750</td>
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<tr>
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</tr>
<tr>
<td>Very Low</td>
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<td>6,900</td>
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<td>8,650</td>
<td>9,350</td>
<td>10,050</td>
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<tr>
<td>Lawrence/Haverhill SMSA</td>
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<td>10,750</td>
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</table>

(continued on next page)
Table 9, cont.

NUMBER OF PERSONS PER FAMILY

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<tr>
<th>Area</th>
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<th>Three</th>
<th>Four</th>
<th>Five</th>
<th>Six</th>
<th>Seven</th>
<th>Eight</th>
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</thead>
<tbody>
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<tr>
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<td>9,150</td>
<td>9,800</td>
<td>10,450</td>
</tr>
<tr>
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<tr>
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<td>8,050</td>
<td>8,950</td>
<td>9,650</td>
<td>10,400</td>
<td>11,100</td>
<td>11,800</td>
</tr>
<tr>
<td>Springfield/Chicopee/Holyoke SMSA Low</td>
<td>9,800</td>
<td>11,200</td>
<td>12,600</td>
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<td>14,850</td>
<td>15,750</td>
<td>16,600</td>
<td>17,500</td>
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<tr>
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<td>9,200</td>
<td>9,850</td>
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<td>9,750</td>
<td>10,500</td>
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</tr>
<tr>
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<td>14,850</td>
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</table>

(continued on next page)
Table 9, cont.

NUMBER OF PERSONS PER FAMILY

<table>
<thead>
<tr>
<th>AREA</th>
<th>ONE</th>
<th>TWO</th>
<th>THREE</th>
<th>FOUR</th>
<th>FIVE</th>
<th>SIX</th>
<th>SEVEN</th>
<th>EIGHT</th>
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<tr>
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<td></td>
<td></td>
<td></td>
</tr>
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<td>11,650</td>
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<td>13,750</td>
<td>14,550</td>
<td>15,350</td>
<td>16,150</td>
</tr>
<tr>
<td>Very Low</td>
<td>5,550</td>
<td>6,300</td>
<td>7,100</td>
<td>7,900</td>
<td>8,550</td>
<td>9,150</td>
<td>9,800</td>
<td>10,450</td>
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<tr>
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<tr>
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<td>15,050</td>
<td>15,950</td>
<td>16,800</td>
<td>17,700</td>
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<tr>
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<td>7,950</td>
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<td>9,550</td>
<td>10,250</td>
<td>10,950</td>
<td>11,700</td>
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<tr>
<td>Hampden Co.</td>
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<td>13,950</td>
<td>14,750</td>
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<tr>
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<tr>
<td>Very Low</td>
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<td>10,800</td>
<td>11,500</td>
</tr>
<tr>
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<td></td>
</tr>
<tr>
<td>Low</td>
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<td>13,500</td>
<td>14,900</td>
<td>15,800</td>
<td>16,750</td>
<td>17,650</td>
<td>18,600</td>
</tr>
<tr>
<td>Very Low</td>
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<td>7,450</td>
<td>8,350</td>
<td>9,300</td>
<td>10,050</td>
<td>10,800</td>
<td>11,550</td>
<td>12,300</td>
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<tr>
<td>Weymouth Co.</td>
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</tr>
<tr>
<td>Low</td>
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<td>13,850</td>
<td>14,650</td>
<td>15,500</td>
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</tr>
<tr>
<td>Very Low</td>
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<td>8,800</td>
<td>9,450</td>
<td>10,100</td>
<td>10,750</td>
</tr>
</tbody>
</table>

Source: U.S. Dept. of HUD, Section 8 Family Income Limits Based on 1979 Median Incomes: Commonwealth of Massachusetts, Boston Area Office, 30 July 1979.
In all geographic areas for low income eligibility there appears to be a slight bias which restricts participation of families consisting of five or more persons. This is evidenced in Figure 2 below by the fact that the income ceiling is increased by $1,250-$1,550 for the second, third and fourth persons; but the income ceiling is increased by only $800-$1,000 for each of the fifth, sixth, seventh and eighth persons.

**Figure 2**

**SECTION 8's INCOME ELIGIBILITY INCREMENTS**

<table>
<thead>
<tr>
<th>Number of People</th>
<th>Income Limit</th>
<th>Increment Per Person</th>
<th>Number of People</th>
<th>Income Limit</th>
<th>Increment Per Person</th>
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<tr>
<td>2.</td>
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<tr>
<td>3.</td>
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<td>$11,650</td>
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<tr>
<td>4.</td>
<td>$15,500</td>
<td>$1,000</td>
<td>4.</td>
<td>$12,900</td>
<td>$ 850</td>
</tr>
<tr>
<td>5.</td>
<td>$16,500</td>
<td>$ 950</td>
<td>5.</td>
<td>$13,750</td>
<td>$ 800</td>
</tr>
<tr>
<td>6.</td>
<td>$17,450</td>
<td>$1,000</td>
<td>6.</td>
<td>$14,550</td>
<td>$ 800</td>
</tr>
<tr>
<td>7.</td>
<td>$18,450</td>
<td>$ 950</td>
<td>7.</td>
<td>$15,350</td>
<td>$ 800</td>
</tr>
<tr>
<td>8.</td>
<td>$19,400</td>
<td>$ 950</td>
<td>8.</td>
<td>$16,150</td>
<td>$ 800</td>
</tr>
</tbody>
</table>

Source: Compiled by the Author from HUD's Section 8 Family Income Limits Based on 1979 Median Incomes: Commonwealth of Massachusetts, Boston Area Office.

On the surface this does appear to be a bias against larger family participation. However, most economists would
agree that certain economies of scale in the cost of living can be realized with a larger family and therefore the drop in the incremental income ceiling increase does not effectively discriminate against families.

Another indication that the Section 8 Income Eligibility Criteria do not limit family participation is found in HUD's own findings that only 22% of all Section 8 eligible households are elderly\(^1\). Yet, since nationally the elderly represent approximately 76% of all Section 8 participants\(^2\) and the experience in Massachusetts is similar\(^3\); it suggests that the most compelling reasons for the shift towards elderly housing are things other than the subtle and almost unnoticeable drop in the incremental income ceiling as family size increases.

**FMR Impact on Replacement Costs and Feasibility**

Another test has been performed at MHFA to translate the most recently published FMR limits into dollars that can be leveraged for building construction in order to determine how adequately they compare with recent actual costs. The usefulness of this test is that it shows how much of a discrepancy exists between the cost of what is actually

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2. ibid.
3. See Table 3 above in the Introduction.
being built, and the amount of money that can be leveraged for elderly versus family structures by FMR Area. Obviously, the amount of construction capital that a developer can leverage from the published FMR tables has a lot to do with his willingness to propose developments in any given area. These figures are especially important in areas where the amount of capital that can be leveraged is less than the amount that builders in the state have already been spending on completed developments. It is no incentive to propose a development if the rent figures indicate that the developer is going to have to build units with less money than in the past.

Table 10

<table>
<thead>
<tr>
<th>FMR Area</th>
<th>Elderly/Elevated</th>
<th>Family/Walkup</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Available</td>
<td>As a percentage of 1979 Average Replacement Cost **</td>
</tr>
<tr>
<td></td>
<td>Replacement Amnt./Unit *</td>
<td></td>
</tr>
<tr>
<td>Boston</td>
<td>$50,731</td>
<td>119%</td>
</tr>
<tr>
<td>Lowell</td>
<td>$45,198</td>
<td>105%</td>
</tr>
<tr>
<td>Salem</td>
<td>$46,734</td>
<td>109%</td>
</tr>
<tr>
<td>Cape Cod</td>
<td>$40,508</td>
<td>95%</td>
</tr>
<tr>
<td>Worcester</td>
<td>$40,172</td>
<td>94%</td>
</tr>
<tr>
<td>Fall River</td>
<td>$36,703</td>
<td>86%</td>
</tr>
<tr>
<td>Pittsfield</td>
<td>$34,118</td>
<td>80%</td>
</tr>
<tr>
<td>Springfield</td>
<td>$33,604</td>
<td>79%</td>
</tr>
</tbody>
</table>

* determined by capitalizing at 8% the flow of net operating income from the FMRs.

**the 1979 average replacement cost per unit was $42,724.

What the figures in Table 10 indicate is that in the next year of processing projects, it will be very difficult to develop any family jobs of typical size and bedroom distribution. Even in the very high FMR areas of Boston, Salem and Lowell, there does not appear to be adequate income to leverage the development of family housing as the increased income is more than offset by the overall rate of inflation leaving less money to build a project than was available in 1979.¹

The same is not the case for elderly projects. Projects developed in Boston, Salem and Lowell will have greater amounts of replacement dollars available than has been the case in 1979 while the other market areas of the state will have less. Thus, these few are able to sustain inflation rates while the others can not².

These differences between market areas in the leveragable funds per unit result directly from the decision made by HUD to grant increases to the FMRs on a straight percentage basis. Although all rents are increased by the same percentage, this increase means a greater operating leverage in those areas with higher original rents. In light of how construction costs tend to increase by constant dollar amounts across the state,³ the areas with the lowest original rents are being penalized as are the prospects for doing family projects in the areas that already cannot pass financial feasibility.

1. Kirk McClure, MHFA, interview, 12 June 1980
2. Ibid.
3. Ibid.
The result is likely to be a continuation of MHFA's 1979 experience in which 5,200 units were financed with 77% of the units intended for the elderly (see Table 3 above). Because the increases granted to the Section 8 rents worsen this problem, the trend towards fewer units for family occupancy will probably continue.

The Impact of 5% Higher FMR Limits for Elderly Developments

Perhaps one of the most controversial and misunderstood aspects of the Section 8 program is the regulation that allows developers to receive as much as a 5% increase in the FMR for a particular unit if that unit is to be occupied by an elderly household. The rational for the 5% differential is that federal laws and regulations require more amenities and more expensive architectural and design criteria for elderly units than for comparable family units. This assumes that all else is constant and that the cost of such features as common rooms, greater fireproofing, ramps, grabbars, and intercoms directly calls for the 5% higher FMR. Whether or not this is true is difficult to prove, but the GAO has recently published a report calling for an end to this "unwarranted" differential. An understanding of its impacts

1. Housing and Community Development Act of 1974, Section 880, "FMR Limits and Exception Rents".


3. The author made repeated and persistent attempts through HUD in Washington and Boston to locate any material that would justify the 5% differential and yet failed to get anything but a bureaucratic "passing of the buck."
will be presented, however, in an effort to explain its role in the shift that favors the development of elderly housing.

Basically there are two reasons why the 5% differential has a significant impact on the developer's decision to prefer elderly housing:

1) the obvious advantage of higher operating revenues,

2) its effect of being able to increase the total replacement costs and the resultant syndication proceeds;

but to understand these it is necessary to perform a financial analysis on two representative projects (see Figure 3 below). Actual and projected MHFA portfolio expenses are utilized to isolate as much as possible the impact of the 5% FMR differential; and the estimates of 1980 operating expenses ($2,795/elderly and $3,216/family unit) were developed by projecting forward 1979 actual operating expenses at an average inflation rate of 7 percent, using a sample of 24 portfolio projects with good management records.

If neither project was eligible for the 5 percent higher FMR limit (line 11), the elderly project illustrated in this figure would have a cash surplus of $173,336 and still remain in good financial condition. Since family developments are not eligible for the 5% bonus, it is not necessary to reduce the after financing cash flow for the sake of comparison.


### Figure 3

**CASH FLOW ANALYSIS FOR TYPICAL ELDERLY AND FAMILY DEVELOPMENTS: 1979**

<table>
<thead>
<tr>
<th>Family Developments</th>
<th>Elderly Developments</th>
</tr>
</thead>
<tbody>
<tr>
<td>in Walkup Buildings</td>
<td>in Elevated Buildings</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Bedroom Distribution (BRs/Unit)*</th>
<th>Bedroom Distribution (BRs/Unit)*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>---</td>
<td>-----</td>
</tr>
<tr>
<td>1. No. of units</td>
<td>100</td>
</tr>
<tr>
<td>2. Max. Boston FMR</td>
<td>$530</td>
</tr>
<tr>
<td>3. GrossMos. Income</td>
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<td>(line 1x2)</td>
<td></td>
</tr>
<tr>
<td>4. 5% FMR Bonus</td>
<td>1.0</td>
</tr>
<tr>
<td>5. Max. Gross Monthly Inc.</td>
<td>$53,000</td>
</tr>
<tr>
<td>(line 3x4)</td>
<td></td>
</tr>
<tr>
<td>6. Conversion to Yearly Gross Inc</td>
<td>$1,521,672</td>
</tr>
<tr>
<td>7. Maintenance, Management, taxes, utilities, reserve &amp; return @ $3,216/unit**</td>
<td></td>
</tr>
<tr>
<td>8. Debt service on $8,459,352 @ 8% over 30 years***</td>
<td></td>
</tr>
<tr>
<td>9. Total Costs</td>
<td></td>
</tr>
<tr>
<td>10. After Financing Cash Flow</td>
<td></td>
</tr>
<tr>
<td>11. Minus the 5% FMR Bonus</td>
<td></td>
</tr>
<tr>
<td>12. Equalized After Financing Cash Flow</td>
<td></td>
</tr>
</tbody>
</table>

*Consistent with MHFA's required mix of 50%-1 BR; 25%-2 BR; 25%-3 BR; Arch. Guide
**Using sample of 24 projects with good management records: Kirk McClure Memo. of Op Costs
***Based on MHFA's 1979 average replacement costs of $42,274/unit for all types of units.
Information is not available on the average by various types.

Source: Compiled by the Author
The lower $69,269 remainder itself is adequate to suggest that attaining financial feasibility with family projects under today's conditions is a much more difficult task. Likewise existing State financed family developments are more likely to risk encountering operating deficits\(^1\); and this contributes to a developer's inclination to propose elderly housing. The weight of the 5 percent differential, therefore, must be acknowledged but kept in perspective by certain constraints. Since all profit-motivated sponsors of MHFA subsidized housing are limited to a 6% rate of return on cash equity, the weight of the cash flow argument is diminished.

But, on the other hand, if the sponsor is able to submit an acceptably designed proposal which "justifies" the full FMR and the 5 percent bonus factor; the advantage of this to the sponsor is that all the financial aspects of the development are increased--the replacement cost, depreciation losses and syndication proceeds.

Conversely, if the architectural design and replacement costs do not "justify" the 5% higher FMR, it is of no benefit to the sponsor of elderly housing.

**Builders' and Sponsors' Profit and Risk Allowance (BSPRA)**

Another reason why building for the elderly is more popular among Section 8 sponsors concerns the 10% Builders' and Sponsors' Profit and Risk Allowance (BSPRA). The BSPRA

has been part of the federal housing laws since 1965\textsuperscript{1}, and it provides an up front one-time profit and risk allowance of 10% over the construction costs of materials, labor, fees and financing. No ceiling is placed on how high the BSPRA can reach, so it is clearly in the sponsor's interest (given a certain number of units) to produce a development with the highest possible overall cost (see Figure 5 below).

The reason why HUD continues to rely on the 10% BSPRA is that in 1973 a HUD policy study\textsuperscript{2} recommended the leasing program be expanded and changed to resemble as closely as possible the direct cash assistance approach then being advocated by HUD and the Nixon Administration. The essence of HUD's recommendation was to get HUD out of the role it had assumed under prior housing supply programs of deciding the quantity and distribution of housing developments for low income families. The change gave private developers the incentive for profit and the risk of loss in the construction and management of such housing\textsuperscript{3}. Thus with greater responsibility, it was inevitable that Section 8 sponsors would seek to minimize their risks and guard investment decisions at every opportunity.

\textsuperscript{1} U.S. Code Congressional and Administrative News, v. 4 1974, "Leased Housing Legislative History," pg. 4314-4317.

\textsuperscript{2} ibid.

\textsuperscript{3} Ibid.
Since their operating return is limited under MHFA, one of the few options for increasing the volume of the sponsor's income is to maximize their one-time gain under the BSPRA through optimizing the use of land and encouraging the use of amenities which result in higher costs/sq. foot.

**Optimizing the Use of Land**

Attempts to maximize the number of units per acre, however, must fall within MHFA density guidelines for new construction, and according to these standards,

Density determinations will be based on several factors including the density of adjacent land and that of community, livability, economic viability, and good management. Ten units per acre is a goal for the maximum successful density for low-rise developments while 12 and 16 units per floor are the respective goals for mid- and high-rise developments.

Furthermore,

All three bedroom and four bedroom units should have private exterior entrances and private yards adjacent to the units. Elderly units are designed to the same spatial and quality standards as all other one bedroom and two bedroom units, but must also meet the requirements for elderly units specified in the HUD Minimum Property Standards (MPS).

Obviously within these guidelines a mid- or high-rise building will allow more units per acre than walk-ups; so, to the extent sponsors are developing elevated structures which only permit elderly occupants (and that is most common) they will maximize the number of units per acre and their BSPRA.

---

Another aspect of elderly housing that lends itself to maximizing the number of units per acre and the BSPRA concerns lower elderly housing parking requirements. Most local zoning ordinances require 200 percent parking accommodations for multi-family housing,¹ and the following represents MHFA's suggested figures:

**Figure 4**

<table>
<thead>
<tr>
<th></th>
<th>Elderly</th>
<th>Family</th>
</tr>
</thead>
<tbody>
<tr>
<td>Urban</td>
<td>1/3 space per unit</td>
<td>2 spaces per unit</td>
</tr>
<tr>
<td>Mid-Sized City</td>
<td>1/2 space per unit</td>
<td>2 spaces per unit</td>
</tr>
<tr>
<td>Suburban/Rural</td>
<td>2/3 space per unit</td>
<td>2 spaces per unit</td>
</tr>
</tbody>
</table>


Typical elderly developments are able to demonstrate a reduction in the need for parking facilities since elderly households tend to own no more than one car per household, and many others do not drive.² Lower parking requirements translate into higher densities and higher BSPRA per acre.³

---

2. Stuart Kessler,"Housing for Who?"Buildings, pg. 64
3. See Figure 9, below.
As examples of the widely varying spatial requirements of elderly versus family housing, Figures 5 and 6 follow. These are followed by Figures 7 and 8 which illustrate the greater amenities and the higher costs per square foot that get built into elderly developments.

**Figure 5**

**EXAMPLE OF SPATIAL REQUIREMENTS FOR FAMILY HOUSING**

"The Hamlet was developed by the Newton Community Development Foundation with a loan of $1,989,200 from MHFA. The development provides townhouse living for 50 families in the Chestnut Hill section of Newton and was designed by Mintz Associates."

Source: 1978 MHFA Annual Report
"A Building at Willow and Blake Streets in Lynn is being converted into 70 units of elderly housing. Built in 1891, the structure formerly was devoted to factory and commercial use. 'Rolfe House,' as it will be known when recycled, will cost $2.5 million. Dimeo Construction Co. of Providence and Boston has been named construction manager and general contractor. A park will be created between the building and an adjacent one, ESO, Inc., of Brookline is the architect."

"Developed by Winn Development Company, Coes Pond Village is a 250-unit housing development in Worcester that respects both the needs of the residents and the area's natural surroundings. The high-rise complex is located on a heavily wooded 10-acre site overlooking Coes Pond and was financed by MHFA with a loan of $7,189,438. Designed by Eisenberg Associates, Inc. and Henry Schadler Associates, the development includes such amenities as individual outdoor garden plots, a greenhouse, health club, putting green and arts and crafts studio." (emphasis supplied by the Author)

Source: 1977 MHFA, Annual Report
EXAMPLES OF THE AMENITIES AND THE HIGHER COSTS PER SQUARE FOOT THAT ARE BUILT INTO ELDERLY HOUSING

"The Blackstone was developed by the State Street Development Company with a loan of $5,965,000 from MHFA. The 145-unit, high-rise apartment complex caters to the needs of elderly persons and was designed by Haring & Associates, Inc. and Archplan, Inc. The development is located on the site of the former Blackstone Junior High School in Boston's West End Urban Renewal Area." (Emphasis supplied by the Author)

Source: 1977 MHFA Annual Report
Assumptions:
- Each project has five acres and involves new construction;
- Fifty percent parking requirements for elderly; 200 percent for family;
- 1.15 Ave. BR/unit for elderly; 1.6 Ave. BR/unit for family;
- Elevated structure for elderly; walkups for families;
- Average construction costs, fees, insurance, and financing costs total $38,840/unit (not including the cost of land);
- Local zoning ordinances limit parking and buildings to cover no more than 40 percent of the land area.

<table>
<thead>
<tr>
<th>Elderly</th>
<th>Family</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of units on five acres..</td>
<td>220</td>
</tr>
<tr>
<td>Average construction cost/unit.</td>
<td>$38,840</td>
</tr>
<tr>
<td>8,544,800</td>
<td>3,107,200</td>
</tr>
<tr>
<td>Plus 10% BSPRA</td>
<td>854,480</td>
</tr>
<tr>
<td>Total Replacement Cost ($42,724 average)</td>
<td>9,399,280</td>
</tr>
<tr>
<td>Minus 90% MHFA Financing</td>
<td>8,459,352</td>
</tr>
<tr>
<td>Equals 10% Owner's Equity</td>
<td>939,928</td>
</tr>
<tr>
<td>Again, Minus BSPRA</td>
<td>854,480</td>
</tr>
<tr>
<td>Equals Actual Cash Equity</td>
<td>85,448</td>
</tr>
</tbody>
</table>

Source: Compiled by the Author.

1. The amount of land that would be necessary to develop and generate a $854,480 BSPRA for family housing with the assumptions in Figure 9 is 12.2 acres; and since problems with local authorities in the initial development process are likely to be greater as the acreage increases; 2 the Section 8 regulations which make higher densities and more comfortable after financing cash flows possible for sponsors of elderly housing tend to inhibit the desires of sponsors to do family housing.

2. Interfaith Housing Corporation, Housing in the Suburbs, Chapter 4.
Since the above figures, regardless of density, demonstrate how the BSPRA reduces the sponsor's actual cash equity down to approximately one percent of the actual construction costs which exclude land; it is important to put the resultant paper equity concept into perspective and understand why there is the desire to build large costly elderly developments. The reasons are because:

1) the subsidy is guaranteed over the life of the mortgage,
2) it is profitable to maximize the depreciation and tax shelter benefits, and
3) they are confident that when the tax benefits wear out the property will have appreciated in value and can be sold for a healthy capital gain.

All this is possible using only a small percentage of one's own money and having a guaranteed cash flow adequate to pay operating and debt service costs.

Costs Per Square Foot

Another way that sponsors of elderly housing are able to maximize their BSPRA is due to how Section 8 architectural and design criteria contribute to higher costs per square foot for elderly construction\(^1\). HUD's Minimum Property Standards (MPS) include:

1) greater fireproofing (4 hour versus 2 hour for family),
2) security and intercom systems,
3) common rooms for social activities,
4) wider doorways to accommodate persons restricted to wheelchairs,

\(^1\) Ronald Derven, "Housing for Who?", pg. 62-68.
5) push bars instead of doorknobs on hallway and firedoors;
6) and night lights and grabbers in bathrooms.

These amenities together with the generally acknowledged fact that additional bedrooms are the cheapest square feet\(^1\) combine to show how elderly projects cost more per square foot and yield the greatest BSPRA (see illustrations of amenities in Figures 7 and 8, above).

One caveat to this situation and something that the MHFA and HUD have no control over is that an experienced developer can realize construction cost savings because of the consistency in the types of units. Unlike family housing:

You are confining yourself to one, two, perhaps three different types of units. This should result in fairly regular structural spans, consistent mechanical and electrical layouts, and standardization of kitchen cabinets and other items. Therefore, you have more money to play with in terms of creating amenities, or just building a better project with fewer future maintenance problems.\(^2\)

Note that the incentive is to immediately put any cost savings back into the project rather than use them to reduce the mortgage. This is directly attributable to the BSPRA being a percentage of the costs rather than a fixed fee. Whether experience has shown, however, that the long-term costs and benefits of a percentage payment schedule is superior to a fixed fee is not the subject of this thesis.

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1. Ibid.
2. Ibid., pg. 65,66.
The point is merely to establish the connection between the ten percentage payment and the preference of sponsors to build elderly housing due to the higher figures from which their allowance is paid.

Higher Limits on the Percentage of Subsidized Units for Elderly Developments

The Rent Supplement Program, begun in 1965, specified a 20 percent limit on the percentage of units which could receive the subsidy within a given development. Since the rent supplements were intended for especially poor and disadvantaged households, and since Congress and the Administration did not want to duplicate the tenantry of public housing, limiting the percentage of households receiving this deeper subsidy was seen as a way of deconcentrating the poor and the resultant morass of social problems.

The same philosophy emerged in the initial formulation of the Section 8 subsidy program in the form of an administrative processing and funding preference given to developments in which no more than 20 percent of the units proposed sought the subsidy.¹ This was believed more likely to assure a reasonable range of incomes and possibly mitigate some of the social problems that are found in neighborhoods where there is a high concentration of poorer households.

The 1974 Housing and Community Development Act, however,

made an exception to this 20 percent limit; and this exception has a direct impact on the shift towards elderly housing. The Act specifically states that the Secretary of HUD can allow up to 100 percent of a project's elderly tenants who are eligible for deeper subsidies to receive them— even when all or substantially all of the project's tenants are elderly.

The exception was made for the elderly because Congress believed the benefits of achieving an economic mix in the projects and avoiding concentrations of the poor are most clearly discernable when families with children rather than the elderly are involved. Their thinking also included the feeling that when applied to the elderly, the 20 percent limit would have little effect other than to render an adequate level of housing assistance unavailable for some households.

The 1974 Act further mandates that 30 percent of the Section 8 funds must go to reach very low income households; and evidence that this provides developers with many elderly to choose from and allows developers to avoid family housing is given by the fact that nationally in 1978 the average income of elderly Section 8 occupants was $3,071. Non-elderly Section 8 households had higher incomes than the elderly, averaging $5,537 in 1978. Thus many elderly whose incomes

were too low to afford even the rents in Section 236 subsidized interest developments are eligible for Section 8 assistance.

The effect all this has on the developer is that he will prefer to build elderly housing for two reasons: 1) He can satisfy the letter of the law without becoming involved with very low income families and the difficulties that are attributed to serving them; and 2) since housing for the elderly is the only project type for which a developer can be assured a full subsidy, many prefer doing elderly simply for the federal guarantee on the flow of income.¹

In light of some bad experiences encountered under the Section 236 interest subsidy program, it is understandable that sponsors desire the highest possible guarantee on the flow of income.² Non-payment of rent and delinquencies took a heavy toll on the financial feasibility of many Section 236 family projects,³ so the 100 percent limit for elderly household subsidies under Section 8 is considered to be a major concession to the development community.

However, despite the stated preference for economically mixed housing by HUD, 90 percent of all Section 8 family projects are completely subsidized.⁴ Since HUD is increasingly forced to compromise its mixed income family policy objective,

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² Chuck McSweeney, interview, E.O.C.D., 30 May 1980.
⁴ Gilmer Blakespoor and Susan Jaffee, Lower Income Housing Assistance Programs (Section 8), pp. 162-63.
the ability of their 100 percent elderly subsidy to explain the shift towards elderly housing is drastically diminished. Nevertheless, the 100 percent elderly subsidy allowance provides sponsors with an open door that the sponsors of family housing cannot take for granted.

The Amount of Subsidy by Household Type

Another argument can be made that the reason sponsors prefer elderly housing is because they know that average incomes for elderly occupants is less than for family households; and therefore, as a percentage of the total rent the management must rely upon a greater share of the rent coming from the tenant in the case of family housing. Therefore, why not do elderly housing and rest on the fact that the federal government's monthly subsidy accounts for almost the full contract rent?

Sponsors naturally desire to do developments that present the least risk and the greatest opportunity in terms of syndication and BSPRA benefits--yet an equally important question is the extent to which the preference of sponsors to do elderly projects results in higher subsidy costs to the Section 8 program. In other words, we should not assume that what is good for the sponsors is good for HUD. The author suggests that the performance of sponsors under the Section 8 program has led not only to inequities that deny family households participation; but to add insult to injury, HUD and the federal taxpayers are paying higher costs than if the program served family and elderly households more equally.
The information in the following illustration is based on October 31, 1979, published FMR's for Boston using a one-bedroom elevated structure for the elderly and a one-bedroom walkup for families. Average elderly and non-elderly tenant incomes for 1978 are also used in this illustration as a relative measure for comparing the amount of Section 8 subsidy by household type.

**Figure 10**

**AVERAGE DIFFERENCE IN SECTION 8 SUBSIDY BY HOUSEHOLD TYPE**

1978 average elderly contribution: $3,701 \times .25 = $925.25
1978 average non-elderly contribution: $5,537 \times .25 = $1,384.25

<table>
<thead>
<tr>
<th></th>
<th>Elderly Subsidy</th>
<th>Family Subsidy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum Annual Rental for One BR Units: Oct. '79 Boston</td>
<td>$6,853</td>
<td>$6,587</td>
</tr>
<tr>
<td>Tenant Contribution</td>
<td>925</td>
<td>1,384</td>
</tr>
<tr>
<td>HUD Subsidy*</td>
<td>5,928</td>
<td>5,203</td>
</tr>
<tr>
<td>Subsidy Differential</td>
<td>725/yr</td>
<td>0</td>
</tr>
<tr>
<td>Tenant's Contribution as a Percentage of Rental Income</td>
<td>$925/6,853 = .135</td>
<td>1,384/6,587 = .210</td>
</tr>
</tbody>
</table>

Source: Compiled by the Author

* FY 1981 subsidies are expected to average $6,250/yr. for SR developments (most often elderly tenant occupied) and $5,300 - $5,900 in new construction. Compared with the estimated cost of public housing at $4,450/yr, "these high costs are causing substantial backlash in Congress and among the public who see that the cost of subsidized housing exceeds the rent that ordinary citizens must pay besides serving only a small percentage of the population." (National Community Development Association Newsletter, Washington, 3 December 1980, pg. 28).
Another illustration (Figure 11 below) shows a more current and complete perspective on whether the preference of sponsors to do elderly projects results in higher subsidy costs to the Section 8 program. The difference is that in Figure 11 it is assumed that all tenants had incomes at the maximum of Section 8's income eligibility criteria for lower income families by household size. This results in a tenant contribution of 25 percent of the full income limit.

Again we see that the preference of sponsors to do elderly developments results in higher per unit subsidy payments from the federal government—and this is consistent with Solomon's findings that many Section 8 elderly housing sponsors participate in the program because the federal government's monthly subsidy accounts for almost the full amount of the rent and the flow of income is guaranteed for the life of the mortgage. 2

1. See Table 9 above.

**Figure 11**

DIFFERENCE IN HUD SECTION 8 SUBSIDY BY HOUSEHOLD TYPE PER MONTH

Number of Bedrooms per Household

Source: Compiled by the Author from "Section 8 Income Limits"
For example, the tenant's contribution as a percentage of contract rent for elderly and family households is quite different. Using 1978 average annual incomes of Section 8 participants and the maximum adjusted FMR for the Boston area reveals the following.

Figure 12

**TENANT'S CONTRIBUTION AS A PERCENTAGE OF 1979 BOSTON FMRs**

<table>
<thead>
<tr>
<th>Bedroom Size</th>
<th>Elderly</th>
<th>Family</th>
</tr>
</thead>
<tbody>
<tr>
<td>Studio</td>
<td>$77.10/mos. = .17</td>
<td>$115.35/mos. = .27</td>
</tr>
<tr>
<td></td>
<td>$467</td>
<td>$428</td>
</tr>
<tr>
<td>One Bedroom</td>
<td>$77.10/mos. = .13</td>
<td>$115.35/mos. = .22</td>
</tr>
<tr>
<td></td>
<td>$574</td>
<td>$530</td>
</tr>
<tr>
<td>Two Bedroom</td>
<td>$77.10/mos. = .12</td>
<td>$115.35/mos. = .20</td>
</tr>
<tr>
<td></td>
<td>$648</td>
<td>$585</td>
</tr>
</tbody>
</table>

Source: Compiled by the author.

The risk of higher collection losses due to delinquent rent payments is clearly less of a factor in elderly housing developments as evidenced above, and the importance of this as a factor for explaining the preference of sponsors to development elderly housing is very significant. Since collection losses vary from development to development it is not possible to say precisely how it ranks among other factors, but the following example which compares a 20 percent collection loss from tenants in each kind of development shows how sponsors would prefer elderly housing.
Figure 13

COMPARING THE EFFECT
OF A 20 PERCENT COLLECTION LOSS BY TYPES OF TENANTS

<table>
<thead>
<tr>
<th></th>
<th>Elderly</th>
<th>Family</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Annual Tenant</td>
<td>$171,600</td>
<td>$273,660</td>
</tr>
<tr>
<td>Contribution*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>20 Percent Collection Loss</td>
<td>x.20</td>
<td>x.20</td>
</tr>
<tr>
<td>Annual Loss of Income</td>
<td>$34,320</td>
<td>$54,732</td>
</tr>
</tbody>
</table>

Source: Compiled by the author.

* Figures were calculated by multiplying the percentages according to bedroom size and type of household in Figure 12 by the rent profiles in Figure 3.

CONCLUSIONS

Various aspects of the Section 8 rental assistance program clearly contain some of the most significant forces which explain the shift towards elderly housing. One of these forces is the legislative intent of Congress to shift more of the responsibility and the risk of subsidized housing onto the private sector. This was brought about by:

1) letting private sponsors decide the location and character of subsidized housing;

2) reducing the insurance coverage provided by the FHA for State HFA financed developments, and

3) encouraging State HFAs to be good managers of risk and to monitor each development's progress.

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1. U.S. Code Congressional, Leased Housing Legislative History pg. 4303.
From a purely economic and legislative perspective, it is easy then to presume that the response of the development community and the response of the MHFA in mortgage lending was the logical and inevitable result of a risky and competitive process. One should be reminded, however, before wholly accepting this conclusion that further research is necessary to measure the impact of the political process as an explanation of why more elderly units are being produced.

Another aspect of the Section 8 program which has a leading role in explaining the shift to elderly housing is the ten percent BSPRA. Since the ten percent BSPRA is figured in the same manner for all types of proposals regardless of structure type or occupancy tenure, the key to making the most of the BSPRA becomes developing proposals with the highest replacement cost dollar amount. Given the constraint of land, and the impact of FMRs on replacement cost and feasibility, plus the inevitable reality that smaller units cost more per square foot (the lower cost of bedroom footage factor), it is generally easier to conceive and propose more feasible and expensive overall packages with housing for the elderly than housing for families. Why it is important to maximize the BSPRA is because the developer wants to:

1) reduce his actual cash equity;

2) maximize the total depreciable basis and the resultant tax shelter opportunity; and
3) realize the highest capital gain if the property is sold.

The elevator clause is another significant factor in explaining the shift towards elderly housing. One reason is that MHFA sponsors have an incentive to build elevator projects in Boston, Lowell and Salem (which can only be occupied by the elderly) since the market comparables upon which the FMRs are determined in large part happen to be luxury units. Another reason is the fact that most of the vacant structures which are suitable for substantial rehabilitation happen to be mid and high rise buildings which can only be occupied by the elderly.

Several other aspects of the Section 8 program also help explain the shift towards elderly housing, but in order of significance these rank considerably below those of the FMR impact on replacement costs, the restrictions of the elevator clause, and the BSPRA on reducing equity and increasing long-term profits. These factors include the following and have less impact on the balance between elderly and family housing production:

- The impact of the five percent higher FMR limit for elderly developments is significant but not a compelling factor in explaining the shift towards elderly housing. Although the five percent differential can be capitalized and increases the financial feasibility of a project, owners of MHFA financed developments are limited to a six percent return on total equity, and in most developments this return goes into operating reserves. The major benefit of the five percent differential
then becomes that in which it permits sponsors to build more quality and amenities into elderly developments and to inflate the mortgage from which syndication proceeds are derived.

- The higher limit on the percentage of subsidized units for elderly developments is another element which is not a compelling force in explaining the shift towards elderly housing. Since virtually all proposals for MHFA financing and Section 8 rent subsidies assume that 100 percent of the units will be subsidized, and neither HUD nor MHFA enforce their stated objectives of promoting mixed income developments by limiting the percentage of subsidized units in a family development; the policy guideline which specifically allows 100 percent of the units in an elderly development to be subsidized has, therefore, become less of an advantage to elderly housing sponsors.

- Also, it can not be argued that the 20 percent bonus FMR for large family units under the Section 8 Existing Housing Program might be reducing the level of family demand for MHFA financed Section 8 SR/NC units. One has to conclude that the utilization of the Section 8 Existing Program has not provided enough housing units for family households in need to justifiably reduce MHFA's production of family units. In spite of the cost saving and mobility factor advantages of using the Existing program to meet more of the remaining family needs in Massachusetts--within current funding levels--
it can not be said that the Existing program compensates for MHFA's poor performance in financing family units.

Finally, income eligibility criteria have no effect in determining the shift from a balanced housing production to one emphasizing mostly elderly housing production. Statistics from HUD and the Massachusetts Executive Office of Communities and Development show not only that the need among family households exceeds the elderly housing need, but that the much-talked-about increase in the number of elderly households in need of housing assistance is statistically small and occurring at a very gradual rate (see Table 1 above).

The impact of the FMRs on leveraging mortgage funds, the elevator clause, and the ten percent BSPRA thus rise to the top among all aspects of the Section 8 program as program elements which help explain the shift towards elderly housing.
PART III

THE IMPACT OF HOUSING MARKET AND INVESTMENT FORCES OPERATING IN CONJUNCTION WITH MHFA's PROGRAM HISTORY
CHAPTER III

HOW SHIFTS IN THE PUBLIC HOUSING PROGRAM AND OTHER COMPONENTS OF THE DEMAND FOR HOUSING MAY HAVE LED TO A SHIFT TOWARDS ELDERY HOUSING

Public Housing Occupancy Characteristics: National and State

Since the public housing program and other housing assistance programs serve similar client income groups (see Table 11), it is necessary to examine any possible shifts in the public housing program that could account for some of the shift in MHFA financed construction. At least hypothetically some circumstances might exist which are either driving the elderly out of public housing or uniquely catering to family housing needs so that the MHFA would be looked to to compensate for the shift in demand.

Table 11

<table>
<thead>
<tr>
<th>INCOME CHARACTERISTICS OF RECIPIENT HOUSEHOLDS</th>
<th>IN CURRENT MAJOR HOUSING ASSISTANCE PROGRAMS IN 1977</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section 8 New/Rehab Median</td>
<td>Public Housing Median Mean Section Rent Suppmrt.</td>
</tr>
<tr>
<td>Median Household Income</td>
<td>$4,376</td>
</tr>
<tr>
<td></td>
<td>$3,691</td>
</tr>
<tr>
<td></td>
<td>$6,285</td>
</tr>
<tr>
<td></td>
<td>$3,544</td>
</tr>
</tbody>
</table>


On the national level since 1937 during its more than
forty-year existence, only 1.1 million public housing units have been built.\(^1\) Twenty-five percent were built specifically for the elderly, but GAO estimates that nationally 42 percent of public housing is occupied by elderly people as a result of their low income,\(^2\) and in Massachusetts the percentage is estimated to be 36 percent\(^3\) (see Table 12 below).

Activity within the program over the past decade has also been limited. In 1973 all capital programs for new public housing construction were discontinued in the Nixon moratorium; and, as reflected by only minimal funding levels in the Housing and Community Development Act of 1974, Congress revealed its opposition to expanding the public housing program.\(^4\) Then again in 1978, despite the shortfall in federally assisted housing for lower-income households under its own ten-year housing goals; Congress provided no major initiatives to spur new efforts in the Housing and Community Development Amendments of 1978. Rather than innovative, the 1978 Act has been described as one that "sought to make the existing housing programs work better."\(^5\)

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2. GAO Report, Section 236 Rental Housing: An Evaluation with Lessons for the Future, pg. 3.
Table 12

ELDERLY/FAMILY OCCUPANCY IN FEDERALLY AND STATE SUPPORTED PUBLIC HOUSING IN MASSACHUSETTS THROUGH OCTOBER 1980

<table>
<thead>
<tr>
<th></th>
<th>Elderly</th>
<th>Family</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Units</td>
<td>64,790</td>
<td>116,075</td>
<td>180,865</td>
</tr>
<tr>
<td>Percentages</td>
<td>36%</td>
<td>64%</td>
<td>100%</td>
</tr>
</tbody>
</table>


Perhaps what is behind the unwillingness of Congress to expand the public housing program lies in the debate over how to achieve racial integration both within projects and within communities. One housing policy analyst claims:

"strong opposition to housing integration and the placement of projects in the suburbs could curtail public housing entirely. There is thus a tradeoff between the level of integration which is sought and the level of funding for public housing which can be obtained from Congress."  

Given this attitude and the minimal funding from Congress for public housing maintenance, it is unlikely that the public housing program will grow to meet new needs or old unmet needs of either family or elderly households.

Public Housing Policies and Tenant's Perceptions

To complete this review, however, it is necessary to look not only at the shortfall in the growth of public housing--but it is necessary to consider whether there are any forces acting upon the current residents of public housing which might lead to changes in the occupancy levels of either household type. Such an investigation, in all likelihood, would reveal that some shifts among the current residents of public housing in Massachusetts is in progress. It is reported that there is a growing fear among the elderly in public housing for their personal safety,¹ and combined with the high level of satisfaction and sense of security among elderly tenants in State (HFA) financed developments,² this could result in a shift in the demand among elderly households.

Coupled with this as yet unmeasured factor is the fact that 22 percent of public housing households consist of families with five or more members as compared with only 6 percent in Section 8 (MHFA) projects.³ The household size/age characteristic is an important factor in understanding the reasons why elderly households may be trying to get out of public housing, since one survey of housing preferences among the elderly revealed that,

not one of the residents from age-segregated buildings indicated that he wanted to move from his current housing because of fear of crime; 42 percent from age-integrated settings said they wished to move. These responses are evidence of more secure feelings of residents of age-segregated buildings.¹

Thus, to the extent that the elderly derive more satisfaction from being in projects with more homogeneous household age and size characteristics, then a shift in the preference of elderly households to live in State HFA financed elderly developments versus public housing is likely to be in process.

As further evidence that a shift may be in process is the fact that Congress increased from 10 to 15 percent the proportion of single, non-elderly, non-disabled persons who may occupy age-integrated public housing projects². One likely reason for this is because the relative demand of elderly households had fallen compared to the demand of non-elderly households which had risen. Thus, as we examine the reasons for the shift to elderly housing, it is concluded that the decline in the role of public housing to provide as acceptable a living environment for the elderly does bear on the shift--but with regard to other forces which impact the economics of subsidized housing, the role of public housing

². U.S. Congress, 1978 Housing and Community Development Act Amendments (P.L. 95-557) Title II, "Housing Assistance Programs."
is not a compelling reason for the shift.

**Demographics and the Increase in Elderly Population Cohorts**

In addition to housing programs and policies, it is necessary to examine trends within the population that translate into impacts on real estate and housing development. Frieden and Solomon analyse six forces in an attempt to forecast changes both in the actual number of households and the net effect on the incidence of households. Their conclusions for the period of 1975-1985 are summarized in the following:

1) **Marital Status**—the effect of later marriages which tends to reduce the incidence of household formation is likely to be offset by increases in the incidence of household formation resulting from more divorces in the older population group with an overall small positive net effect on household incidence.

2) **Family Size**—large families will become far less common in the next several years because birth rates have been falling since the early 1960's. The average age at which women bear their first child has also increased. The birth rate was 96.6 in 1965, 87.9 in 1970, and 68.4 in 1974; an overall decline of 42% since 1960. *(The Statistical Abstract of the U.S. 1976 and Census of the Population: 1970)*

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3) **Relatives**--Through 1975, older adults had fewer and fewer close relatives with whom to live as a result of the historical fall in birth rates before 1940\(^1\). After 1940, the birth rates rose, and people who had children then are now becoming elderly. Overall then, since "large numbers of the elderly who had so few children during the 1930s are still alive,"\(^2\) the incidence of elderly households has risen but is expected to level off in the near future.

4) **Income and Wealth**--While in the past the effect of the growth of the average per capita income in constant dollars was to push up the incidence of household formation; future income changes may remain a positive factor, but are expected to level off as the average per capita income in constant dollars ceases to rise.

5) **Household Separation**--Since it is becoming more costly for households to separate, this factor will tend to depress the incidence of households in the future which is the reverse of the trend in the recent past.

6) **Household-Housing Match**--Mismatches in the supply and demand of different unit types are starting to have a negative effect on the incidence of households. Large houses are in abundant supply because there are fewer large families demanding them; while the middle sized housing units

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required by small families are now falling into short supply because of demographic trends and low production\(^1\).

It is arguable then that a continued lower national birthrate will result in increasing the relative proportion of elderly to non-elderly households. Using this as leverage, the advocates of elderly persons' issues and concerns will have even more courage to argue that the elderly comprise an increasing proportion of households in need--and thus a shift to more elderly housing is justified. Such a view is popularized by statements in the media such as the following:

The really big shift in demographics that we foresee (in the 1980 census) is among the elderly. In general life expectancy has been stretching, and by 1980, the number of residents who are older than 65 will make up about one-eighth of the State's population. Such a shift is bound to produce problems eventually for state programs that support medical care, housing, and other benefits for the elderly\(^2\).

In reality, however, the increase in the percentage of elderly households in Massachusetts in need relative to family households since 1970 has been only 3 percent. The percentage of elderly households in need has risen from 44 percent of the total in 1970 to 47 percent in 1980. Therefore, the elderly do represent an increasing proportion of the total households in need; but the increase has been very gradual and should not be used to rationalize a continued shortage in the production of family units.

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2. Robert Danley, Massachusetts Department of Public Health, quoted in "Waiting to See What the Census Will Show" Boston Globe, 30 March 1980
Unmet housing needs among low and moderate income family households still account for over 184,000 units (see Table 1 reprinted below); so regardless of the recent or impending increase in elderly housing needs, family housing needs should not be forgotten.

**Table 1 (Repeated)**


<table>
<thead>
<tr>
<th>Needs</th>
<th>Elderly</th>
<th>Family</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>As of Jan. 1, 1970</td>
<td>208,290</td>
<td>260,249</td>
<td>468,539</td>
</tr>
<tr>
<td></td>
<td>(44%)</td>
<td>(56%)</td>
<td>(100%)</td>
</tr>
<tr>
<td>As of Jan. 1, 1978</td>
<td>162,693</td>
<td>187,264</td>
<td>349,957</td>
</tr>
<tr>
<td></td>
<td>(46%)</td>
<td>(54%)</td>
<td>(100%)</td>
</tr>
<tr>
<td>As of Jan. 1, 1980</td>
<td>161,960</td>
<td>184,370</td>
<td>346,330</td>
</tr>
<tr>
<td></td>
<td>(47%)</td>
<td>(53%)</td>
<td>(100%)</td>
</tr>
</tbody>
</table>


It is important to remember, however, that because the distribution of subsidized housing is such a political issue— even the perception that the proportion of needy elderly households has risen could be sufficient to assure that policy changes benefitting the cause of family housing are not enacted.
The elderly in this country now comprise a respected political force; and since they are generally perceived by lawmakers and the public as among the most deserving of the poor, anyone who opposes elderly issues "often finds himself perceived as against God, motherhood, and patriotism".

Furthermore, the elderly have had a special staff within the Department of Housing and Urban Development reserved for overseeing that that federal government does not neglect their concerns.


With this kind of attention at the federal level, and a growing body politic, we can be confident that any efforts by HUD or the MHFA to vindicate the cause of family housing at the expense of provisions which benefit the elderly will be met with widespread opposition.

Conclusions

As we examine the reasons for the shift to elderly housing, it is concluded that the decline in the role of public housing to provide an acceptable living environment for the elderly to a limited extent does increase their demand for housing. Likewise the total increase from 1976 to 1980 of three percent among elderly households in need of housing assistance also adds to the prominence and the popularity of doing elderly housing. Compared to the higher ability of elderly developments to leverage mortgage financing from higher FMR's; and to the increased tax shelter and capital gains opportunities associated with the larger and more costly elderly developments; the role of public housing and demographic changes, however, are not compelling reasons for the shift.

Furthermore, the strong opposition to housing integration and the placement of projects in the suburbs could
even further reduce the effectiveness of public housing to provide an acceptable living environment. It appears that Congress is unwilling to fund capital programs to expand the public housing inventory, and unless widespread rehabilitation of existing units occurs, many of the units which have been built will no longer provide housing for the elderly.

Also, as long as the perception persists in the minds of elderly people that public housing is unsafe, there is going to be a preference among the elderly to live in State HFA financed units. Elderly preference, however, as previously stated is not a compelling reason for the shift in MHFA's housing production under Section 8 away from family units.
CHAPTER IV

HOW THE ROLE AND RESPONSIBILITY
OF THE MHFA SPONSORS FURTHER INFLUENCE PROGRAM UTILIZATION

Types of Sponsors

Three types of sponsors are allowed to participate in HUD housing subsidy programs, and each type does so for different reasons.

1) Cooperative sponsored housing is owned by the occupants with each household having one share in the ownership and a voice in the management of the development;

2) Non-profit sponsors, typically a church group, volunteer service group, or other organization receives mortgage financing to cover 100 percent of the development cost, but along with cooperatives receive no profit; and

3) Limited dividend sponsors typically consist of a private developer or investment company. In exchange for a 90 percent mortgage, the sponsor agrees that the annual return on his original 10 percent paper equity will be no higher than 6 percent.

Under the Section 236 program, the non-profit and cooperative sponsors comprised a disproportionate share of project failures compared with the record of limited dividend sponsors\(^1\) (see Table 5 above). These failures were the result of lack of experience and limited financial resources in the non-profit or cooperatively sponsored

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projects which contributed to management problems and made it difficult to meet unexpected expenses during construction or operation\(^1\). In contrast with the Section 236 experience in which 71 percent of all projects were sponsored by the limited dividends, 88 percent of Section 8 developments are similarly sponsored\(^2\). The main reason for this change is because of legislative changes enacted in the H.&C.D. Act of 1974, in which sponsors became responsible for selecting the sites, obtaining control of the site, designing the development's characteristics and having a highly skilled development team in place\(^3\). With greater responsibility and the demand for more capital resources, fewer non-profit and cooperative housing sponsors have been able to participate in Section 8. Another element of responsibility that was shifted onto the sponsor under the Section 8 program was the result of FHA insurance being much less available. This meant that if the development ever foreclosed, both the general partner and his passive investors would loose their entire investment, any outstanding syndication proceeds, and face a tax liability on "the difference between the still high mortgage balance at the time of foreclosure and the sharply reduced tax basis of the property\(^4\)."

The remainder of this chapter will, therefore, deal with the forces (cash flow, tax benefits and futures) which encourage limited dividend sponsors to favor doing elderly housing.

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1. Ibid.
2. GAO Report, Evaluation of Alternatives for Financing, pg. 101
3. Ibid.
Process of Obtaining Local Permits

Perhaps the most sensitive aspect of doing a subsidized housing project from the sponsor's perspective is the process of dealing with local health, engineering, zoning and appeals boards. These boards have the responsibility of administering state and locally determined land use controls established for the public health, safety and welfare of the community. Many communities, however, quite naturally consider the fiscal impacts of growth in their view of public purpose and seek to limit development to that which will generate the most revenue and require the lowest level of public services.

Further research would be required before serious quantitative estimates of Section 8's fiscal effects could be attempted, but the most widely accepted view among local officials and taxpayers is that housing for low and moderate income families with school-aged children is the least desirable in terms of its fiscal impact\(^1\). On the other hand, housing for the elderly is generally perceived as having positive fiscal impacts, since they are perceived as being the furthest removed from local school budgets—traditionally a central concern of cost-revenue analyses for new housing projects\(^2\). Little, however, is known about the impact of increasing concentrations of the elderly on local expenditures for health

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1. Interfaith Housing Corporation, *Housing in the Suburbs*, pg.12.
2. Kingsley and Both, *Pilot Urban Impact Analysis (Sec.8)*, pg.59.
care, transportation and special recreation services. Their needs in these areas are surely higher than the average\textsuperscript{1}; but quantitatively it is unknown how much higher, and it is not the purpose of this thesis to perform such an analysis (see Appendix #1).

In addition to the control that localities possess through land use regulations per se, the Section 8 regulations themselves have given local governments greater control over the type of housing which can be built, its location, and who it will serve\textsuperscript{2}. Section 8 subsidies are prohibited for use except in accordance with the local government's Housing Assistance Plan (HAP) and are indeed contingent on the existence of such a plan. This was not the case when Section 236 commitments were being made and some view it as an all too effective tool for localities to avoid economic and racial integration.

HUD anticipated this difficulty and constructed an elaborate system of checks and balances designed to avoid placing projects in areas of minority concentration or significantly changing the racial mix in a given area while at the same time promoting economic integration. The theory is that if low income households are dispersed among house-

\begin{enumerate}
\item GAO Report, \textit{Section 236 Rental Housing: An Evaluation With Lessons for the Future}, pg. 140.
\end{enumerate}
holds of greater means, the social problems diminish. It is analagous to the idea that coals in a fire burn more intensely when together but die out when dispersed.

To prevent localities from inhibiting dispersion of the poor, HUD staff also spend a great deal of time reviewing the needs and objectives stated in these local HAPs and quite often when compared with census data, the needs of low and moderate income families and minorities are under-represented while elderly housing needs are overstated.

Evidence that sponsors of family housing developments have good reasons to fear the costs of obtaining local permits is suggested by a 1978 task force report that up to 20 percent of the cost of housing is due to the time and effort spent getting local permits. While this estimate may be high, the real impact of local resistance in cases where it does become fully mobilized against a particular project can be fatal. One sponsor group's experience is reflected in the following description:

In its four-year existence, IHC has been severely limited by the practices of local governments in suburban communities. It has suffered capricious zoning, planning, and taxation decisions in communities bent on thwarting a particular housing project. In some instances, these practices were employed because the community wanted to preserve its single-family residential character, in some instances because the community feared the financial and social burden of an influx of large poor families, and, in some instances, because economic and social bigotry persisted in the community.

A more balanced view of the effect of local permitting on the development of family and elderly housing is reflected in the analysis of Elisabeth Ruben and Constance Williams in *Comprehensive Permits: For Housing Lower Income Households in Massachusetts*. Their results reveal that from 1974 through 1979, 111 applications for comprehensive permits were made with local boards of appeal statewide under the provisions of Chapter 774 of the Acts of 1969. Of the 35 applications that resulted in construction 11 were for families and 17 were for elderly households. But the really significant aspect of their research revealed that the proportion of the units proposed for families that were built was 16%; the similar percentage for elderly housing was 29%; and for mixed family and elderly housing, the percent built was 32%.

Based on their analysis it was concluded,

that the effort needed to get a comprehensive permit and carry work through to construction is not easy, and opposition to housing for families has been greater than for housing for older people.

It was also concluded that a gradual change in the response of local appeals boards to all subsidized multi-family housing proposals has evolved in recent years.

In the early years of Chapter 774 many localities refused all multi-family housing proposals; then in the middle years there was a mixed experience; and in more recent years the most common thing to happen is for the locality to approve proposals only

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1. Elisabeth Ruben and Constance Williams, *Comprehensive Permits*, Boston, CHFA, December 1979, pg. 2
2. *ibid.* pg. 10
after negotiations and imposing limiting conditions\textsuperscript{1}.

From the developer's view, however, despite both positive and negative implications cited by Ruben and Williams; the process of proposing and constructing family housing within the local framework is still more difficult than for elderly housing. A thorough review, delays and possibly legal challenges is only the beginning; the financial burden of these conflicts is high and can become the catalyst for the failure of a project\textsuperscript{2}.

In the event that such conflicts cause time delays, additional funds are needed to carry the construction loan for a longer period of time, and the only source of additional funds would be either by income generated from units which have been completed (in a phased development) or by additional sponsor investment. For our typical 220 unit family development with a construction loan of $8,459,352 at an 8\% interest rate\textsuperscript{3}, the sponsor would pay $56,182/month in just interest for the estimated 12-18 month period of time before occupancy. Any delay which extended the construction period interest payments and delayed rent-up would increase the risk of default. It is no wonder then that sponsors of Section 8 housing view the process of obtaining local permits

\begin{enumerate}
\item Constance Williams, formerly of CHPA, interview, 25 Nov. 1980
\item HUD Multi-Family Defaults Before Final Endorsement, June 1974, pg. 3
\item See Figure 3 above.
\end{enumerate}
for family developments with great caution. If additional funds are needed because of a delay at the local level and there are not any units ready for occupancy, the sponsor has no one to turn to but himself to come up with money to pay interest and debt service.

The Psychological Identification Process

Developer preferences also explain some of the emphasis on the participation of elderly households in Section 8.

Most eligible elderly households are white. Many were middle income for most of their lives. They did not live through a culture of poverty; they just happen now to have low incomes.

This suggests that developers see the elderly as people like themselves who will maintain their units and pay their rent on time. It is understandable that just as people tend to be most comfortable in familiar surroundings, they also prefer to develop associations with people who most nearly hold to their cultural, economic and social values. Low and moderate income families who are economically disadvantaged would tend to have very little socially or economically in common with the entreprenurial developer types who sponsor Section 8 housing. One exists in a "culture of poverty" while the other's mind is set on how ingenuity, hard work and "the system" have produced so many rewards for him.

The elderly share much more in common with the psychological framework of a developer. Their earlier years were not known for government programs which allowed millions to become dependent on charity, and the axiom that America was the land of opportunity was still good currency. And, despite the average income of Section 8's elderly occupants being only $3,701 in 1978 compared to non-elderly incomes which averaged $5,537, it should be noted that the accumulated assets of elderly low-income households are typically much greater than those of non-elderly households at the same income level\(^1\).

Developer preferences are, therefore, a force to be acknowledged, and considerable evidence is provided below to show that the majority of proposals and successfully financed projects are for elderly housing.

**Table 13**

**DISTRIBUTION OF MHFA PROPOSALS: YEAR ENDING MAY 16, 1980**

<table>
<thead>
<tr>
<th>Elderly Small Family Large Family</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(1.0-1.29) (1.3-1.89) (1.9 and over)</td>
<td>Ave. BR*</td>
<td>Ave. BR*</td>
<td>Ave. BR*</td>
<td>Total</td>
</tr>
<tr>
<td>In Process</td>
<td>61 (67%)</td>
<td>26 (29%)</td>
<td>4 (4%)</td>
<td>91 (100%)</td>
</tr>
<tr>
<td>Committed</td>
<td>14 (70%)</td>
<td>5 (25%)</td>
<td>1 (5%)</td>
<td>20 (100%)</td>
</tr>
<tr>
<td>Rejected</td>
<td>25 (57%)</td>
<td>17 (39%)</td>
<td>2 (4%)</td>
<td>44 (100%)</td>
</tr>
<tr>
<td>Dropped</td>
<td>12 (35%)</td>
<td>14 (41%)</td>
<td>8 (24%)</td>
<td>34 (100%)</td>
</tr>
<tr>
<td>Withdrawn</td>
<td>5 (38%)</td>
<td>6 (46%)</td>
<td>2 (16%)</td>
<td>13 (100%)</td>
</tr>
<tr>
<td>Total</td>
<td>117 (58%)</td>
<td>68 (34%)</td>
<td>17 (8%)</td>
<td>202 (100%)</td>
</tr>
</tbody>
</table>

* Ave. BR means the average bedroom size per unit over the entire development.
Source: Compiled by the Author from Kirk McClure, memo, *Proposals Year Ending May 16, 1980*

1. Ibid.
In terms of just the number of proposals, the elderly accounted for 58 percent of all proposals submitted to MHFA—but they accounted for 70 percent of all project commitments.

Another dimension to the psychological identification process—that suggests the developer's preference for elderly projects leads to an even greater unit imbalance (than 70% elderly and 30% family)—is given by the fact that elderly projects are typically developed at greater density than family housing (see Figure 9 above).

Developer preferences are, therefore, a significant force to be acknowledged in explaining the shift to elderly housing; but how much of their preference is a preference purely from a psychological/social viewpoint versus how much of the preference is really the result of pure and straight-forward financial advantages to the developer himself is an interesting question. The closing section of this chapter presents insights into exactly how these financial incentives operate and how these incentives are probably by far the most compelling forces in explaining the shift to elderly housing.

Introduction to Equity Syndication and Tax Benefits

Federal housing policy consists of two basic approaches; 1) direct spending programs, which serve only a fraction of the eligible population, and 2) housing related tax incentives
which are available to everyone who meets their criteria of eligibility. One difference between these two approaches is that while direct spending programs can be strictly regulated, government housing policy makers are much less able to control how investors and actors in the private market will utilize the tax incentives. The shift towards elderly housing under the Section 8 program is an example of how the private sector makes selective use of tax incentives to their own satisfaction—and in the process have created a dramatic imbalance towards construction of housing for the elderly.

To begin to understand who it is that makes use of these federal tax incentives and why they are so selective, the income characteristics of two major housing related tax expenditures are given in the following table.

Table 14
DISTRIBUTION OF BENEFITS OF MAJOR HOUSING RELATED TAX INCENTIVES BY INCOME OF BENEFICIARY

<table>
<thead>
<tr>
<th>Annual Income Class of Taxpayer</th>
<th>Accelerated Depreciation for Construction Period Interest and Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0-$9,999</td>
<td>2.2</td>
</tr>
<tr>
<td>$10,000 to $19,999</td>
<td>3.4</td>
</tr>
<tr>
<td>$20,000 to $29,000</td>
<td>3.8</td>
</tr>
<tr>
<td>$30,000 to $49,999</td>
<td>15.0</td>
</tr>
<tr>
<td>$50,000 to $99,999</td>
<td>22.8</td>
</tr>
<tr>
<td>$100,000 and over</td>
<td>52.9</td>
</tr>
<tr>
<td>Revenue loss in $M. (320)</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: CBO Tax Analysis Division, Special Analyses of the Budget of the U.S. Government, FY 1979, pg. 158-160
Notice that over half of all the benefits accrue to taxpayers whose annual income is $100,000 and over. This is in sharp contrast with homeownership tax provisions which more directly aid the occupant of the housing, and it suggests that rental housing tax provisions benefit the developer primarily and the renter secondarily, if at all.

It is also necessary to put rental housing tax provisions in perspective, since the sponsor's desire to maximize the potential tax benefits of a development is the single most important factor in his decision to propose housing for families or the elderly. Three components of the federal tax laws have an especially strong impact on the sponsor's investment decision, and the following is an overview of how each tax provision is utilized to maximize the total benefits.

**Accelerated Depreciation and the Sale of Tax Shelters**

Sponsors of low income rental housing depend upon the sale of tax shelters through equity syndication more than anything else to enhance their overall financial benefits. The way it works is that sponsors of new and rehabilitated rental housing depreciate the depreciable basis of the units at rates that involve deductions in the early years as much as twice those available to investors in other income-producing assets (see Table 15 below). The depreciable basis is figured by taking total "development costs," subtracting land

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1. Arthur Solomon, "Federal Housing Policy," pg. 66
(leaving total "replacement cost"), then subtracting construction period interest and taxes. For our typical development, the depreciable basis can be figured as follows.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Replacement Cost</td>
<td>$9,399,280</td>
</tr>
<tr>
<td>Minus Taxes</td>
<td>$165,000</td>
</tr>
<tr>
<td>Minus Interest</td>
<td>$1,015,122</td>
</tr>
<tr>
<td><strong>Depreciable Basis</strong></td>
<td><strong>$8,219,158</strong></td>
</tr>
</tbody>
</table>

Taxes

\[
\text{Taxes} = (220 \text{ units} \times \$500/\text{unit}) \times (1.5 \text{ years}) = \$165,000
\]

Interest

\[
\text{Interest} = (8\% \text{ of } \$8,459,352) \times (1.5 \text{ years}) = \$1,015,122
\]

One depreciation method is known as the 200% double declining balance method. This is available to investors in new subsidized housing stock and will be utilized in the figures which follow to represent the annual depreciation benefits for sponsors of family housing. Most family housing is new construction, so this is appropriate. On the other hand, a more favorable depreciation treatment is available to investors who acquire existing structures and rehabilitate them into subsidized housing. In these cases, the expenses incurred in rehabilitating rental units for lower income households (most often elderly occupied) may be fully amortized within eight years (in 1980). This was the result of the Tax Reform Act of 1976 which amended Sec. 167 (K) of the 1969 TRA so that in 1978 the five-year amortization period began to increase by one year each year until the depreciation period becomes equal to ten years. This is available only
Table 15

ANNUAL DEPRECIATION BENEFITS BY VARIOUS METHODS
OVER FORTY YEARS FOR SPONSORS OF SUBSIDIZED HOUSING; DEPRECIABLE BASIS $8,219,158

<table>
<thead>
<tr>
<th>Year</th>
<th>Straight Line 8 Years</th>
<th>Straight Line 33 1/3 Years</th>
<th>Double Declining Balance 33 1/3 Years*</th>
<th>Year</th>
<th>Straight Line 8 Years</th>
<th>Straight Line 33 1/3 Years</th>
<th>Double Declining Balance 33 1/3 Years*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$1,027,395</td>
<td>$246,599</td>
<td>$493,149</td>
<td>21</td>
<td>0</td>
<td>$246,599</td>
<td>$143,066</td>
</tr>
<tr>
<td>2</td>
<td>$1,027,395</td>
<td>$246,599</td>
<td>$463,560</td>
<td>22</td>
<td>0</td>
<td>$246,599</td>
<td>$134,482</td>
</tr>
<tr>
<td>3</td>
<td>$1,027,395</td>
<td>$246,599</td>
<td>$435,747</td>
<td>23</td>
<td>0</td>
<td>$246,599</td>
<td>$126,413</td>
</tr>
<tr>
<td>4</td>
<td>$1,027,395</td>
<td>$246,599</td>
<td>$409,602</td>
<td>24</td>
<td>0</td>
<td>$246,599</td>
<td>$118,828</td>
</tr>
<tr>
<td>5</td>
<td>$1,027,395</td>
<td>$246,599</td>
<td>$385,026</td>
<td>25</td>
<td>0</td>
<td>$246,599</td>
<td>$111,699</td>
</tr>
<tr>
<td>6</td>
<td>$1,027,395</td>
<td>$246,599</td>
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<td>$46,972</td>
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<tr>
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<td>0</td>
<td>$246,599</td>
<td>$152,198</td>
<td>40</td>
<td>0</td>
<td>$246,599</td>
<td>$44,153</td>
</tr>
</tbody>
</table>

Total $8,219,158 $8,219,158 $8,219,158

Source: Compiled by the Author.

* "Under the declining-balance method the book value of an asset never reaches zero; consequently, when the asset is sold, exchanged or scrapped, any remaining book value is used in determining the capital gain or loss." (Pyle and White, Fundamental Accounting Principles, seventh ed. 1975, Homewood Illinois, pg. 313.)
to investors in rehab and will be utilized in the figures which follow to represent the annual depreciation benefits for sponsors of elderly housing. Most rehab activity is for the elderly, so this is appropriate.

The difference in tax shelters which profit-motivated developers can realize, however, (despite there being no intention to favor investments in the tax laws per se), can only be approximated with the help of certain assumptions. The following setup represents the first year tax losses that are available given:

- a high rise elevated rehabilitated structure for the elderly,
- a three story new walkup building for families,
- each development consists of 220 units, and
- the replacement cost excluding land is $9,399,280.

The reason why a rehabilitated structure is used in this illustration for an elderly development is because the volume of rehab activity in recent years has steadily grown\(^1\), and the vast majority of rehab activity is intended for elderly occupants\(^2\). These rehabilitated structures cannot be occupied by family households because most re-useable structures (schools, factories, office buildings and parking garages) are mid and high rise and require elevators which are forbidden for use by families with children.

1. MHFA, *Housing List*, February 1980
2. Ibid.
## Figure 14

### ELDERLY VS. FAMILY FIRST YEAR TAX LOSS ANALYSIS

<table>
<thead>
<tr>
<th></th>
<th>Elderly</th>
<th>Family</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest*</td>
<td>$(674,186)</td>
<td>$(674,186)</td>
</tr>
<tr>
<td>Points</td>
<td>(5,200)</td>
<td>(5,200)</td>
</tr>
<tr>
<td>Maintenance and Other</td>
<td>(614,900)</td>
<td>(707,520)</td>
</tr>
<tr>
<td>Operating Costs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>(1,027,395)**</td>
<td>(493,149)***</td>
</tr>
<tr>
<td>Total Deductions</td>
<td>(2,321,681)</td>
<td>(1,880,055)</td>
</tr>
<tr>
<td>Minus Gross Rental</td>
<td>1,609,776</td>
<td>1,521,672</td>
</tr>
<tr>
<td>Revenue*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Size of Tax Shelter</td>
<td>$ 711,905</td>
<td>$ 358,383</td>
</tr>
<tr>
<td>Generated</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* See Figure 3 above.

** An eight-year straight line depreciation period for rehabilitated structures (see Table 15 above).

*** A 40-year 200 percent double-declining balance method for new structures (see Table 15 above).

Source: Compiled by author.
Sponsor's Equity Syndication Proceeds

The difference in the elderly ($711,905) versus family ($358,383) first year tax losses becomes an even greater factor in explaining the shift to elderly housing when we examine the syndication process in which the sponsor can realize great profits through the sale of tax shelters\(^1\). Most sponsors do not have high enough incomes to optimize the use of these shelters\(^2\), so they form limited partnerships through

\[\text{1. Anthony Yudis, "Some are Still Interested in Low-Income Housing,"} \quad \text{Boston Globe} \quad 19 \text{ July 1980} \]

\[\text{2. GAP Report, Section 236 Rental Housing: An Evaluation With Lessons for the Future, Ch. 3} \]
which the sponsor (the general partner) makes money selling tax shelters to persons or corporations with much greater incomes (passive investors) that need sheltering. Each dollar of book loss can reduce the investor's current taxes on other income by an amount varying up to and no more than 50 cents for a corporation and as high as 70 cents for an individual. Accordingly, many housing projects today are directly owned either by corporations, by individuals or by partnerships.

As a rule of thumb the subsidized housing industry prices the sponsors' ten percent equity share for sale according to a percentage of the mortgage which increases as the first year losses increase and the risk of financial trouble decreases. They can sell the shares for between 15 to 25 percent of the mortgage value for newly built subsidized housing, and between 25 to 35 percent of the mortgage value for rehabilitated historic structures. Since rehabilitated structures are often limited to elderly occupancy and the risk of financial trouble with elderly housing is minimized due to the 100 percent subsidy ceiling and the five percent FMR differential (see Chapter 2), the preference of sponsors to do housing for the elderly is to be expected. On the other hand, one wonders why sponsors seem cautious about proposing family developments when there is still a profit

1. Kirk McClure, MHFA Mortgage Officer, Boston, Massachusetts, written correspondence, 12 September 1980.

2. John Blake, Executive Director, MHFA, MHFA Conference, Park Plaza Hotel, Boston, Massachusetts, 12 October 1980.
to be made through the sale of tax shelters.

The explanation is that current syndication practices hold the sponsor accountable to the limited partners for a period of two to four years to provide security that the development's operating costs do not rise faster than rental income. This is accomplished by paying the sponsor his syndication proceeds on an installment basis; so it is in the sponsor's absolute interest to produce a development that is as trouble-free as he can make it. Since elderly housing meets this criterion much better than family housing, only with elderly housing will the sponsor have the greatest confidence of receiving his full syndication proceeds and profits.

For example, an attempt to estimate the sponsor's equity syndication proceeds reveals the following in Figure 15 below.

**Figure 15**

**ESTIMATE OF SPONSOR'S EQUITY SYNDICATION PROCEEDS**

<table>
<thead>
<tr>
<th></th>
<th>Elderly</th>
<th>Family</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Units</td>
<td>220</td>
<td>220</td>
</tr>
<tr>
<td>Average Construction Costs/</td>
<td>$38,840</td>
<td>$38,840</td>
</tr>
<tr>
<td>Unit, Excluding Land</td>
<td>$38,840</td>
<td>$38,840</td>
</tr>
<tr>
<td>Subtotal</td>
<td>8,544,800</td>
<td>8,544,800</td>
</tr>
<tr>
<td>Plus 10 Percent BSPRA</td>
<td>854,480</td>
<td>854,480</td>
</tr>
<tr>
<td>Replacement Cost</td>
<td>9,399,280</td>
<td>9,399,280</td>
</tr>
<tr>
<td>10 Percent Owner's Equity</td>
<td>939,928</td>
<td>939,928</td>
</tr>
<tr>
<td>90 Percent MHFA Financing</td>
<td>8,459,352</td>
<td>8,459,352</td>
</tr>
<tr>
<td>Sale of Tax Shelters</td>
<td>x .35*</td>
<td>x .25**</td>
</tr>
<tr>
<td>Gross Sponsor Syndication</td>
<td>2,960,773</td>
<td>2,114,838</td>
</tr>
<tr>
<td>Income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Syndication Fees</td>
<td>338,374</td>
<td>338,374</td>
</tr>
<tr>
<td>Net Syndication Income</td>
<td>2,622,399</td>
<td>1,776,464</td>
</tr>
</tbody>
</table>

* Based on eight-year straight line depreciation for rehabilitated historic structures.

** Based on 200 percent double declining balance for newly built subsidized housing.

*** Approximately four percent of the mortgage value.

Source: Compiled by the author.
Equity Appreciation as a Function of the Qualities of Amenities, Siting, and Length of Ownership

The difference in the elderly ($2,622,399) versus family ($1,776,464) equity syndication proceeds is of course a reflection of the assumptions and the different methods of figuring yearly depreciation (see Table 15 above). Each method has its advantages and disadvantages from the investors' viewpoint; and even the length of time that an investor would choose to hold onto a piece of property varies with such factors as:

1) whether he would be in a higher or lower tax bracket in the future;
2) whether the property is likely to appreciate or depreciate due to neighborhood conditions;
3) whether he plans to build up or liquidate his real estate holdings; and
4) whether any unusual cash flow risks are associated with the particular kind of tenants that occupy the property.¹

In Figure 14 above, the respective depreciation schedules were selected to represent elderly vs. family first year tax losses after taking into consideration the above four factors. Most structures that are suitable for rehabilitation are at least three stories high and are, therefore, limited to occupancy by elderly households.² These properties are also

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usually located in areas of rising property values; so it is most profitable to the investors to take the quickest write-off which maximizes the shelter of other income and then hold onto the property for some years after that to maximize the capital gain.¹ Since the elderly are not known to be hard on rental property, and the Section 8 FMR schedules favor the elderly anyway,² investors tend to view longer term ownership as being a good prospect.³

The investment decision concerning family developments' is quite different. Because of the uncertainties surrounding the cash flow and operating expenses,⁴ investors tend to view these investments with more caution. Prepayment of the MHFA mortgage is prohibited in less than 20 years;⁵ and operating expenses for family developments are a higher-risk variable, so developers are more reluctant to propose family housing. When they do, the problem of less-than-ample cash flows could lead to delayed maintenance and overlooking capital improvements. Also since local governments are often unwilling to give new multi-family housing priority locations.⁶

¹. Thomas Kingsley and Deborah Both, RAND Corp., Pilot Urban Impact Analysis: HUD's Section 8 NC/SR Program, Ch. 5.
². See Table 8 above.
³. For example, see Figure 15 below and accompanying note.
⁴. See Figure 3 above.
⁵. MHFA Mortgage Security Agreement, Sec. 3.
⁶. Interfaith Housing Corporation Housing in the Suburbs, pg.6
EXAMPLE OF WHY ELDERLY DEVELOPMENTS ARE GOOD LONG TERM INVESTMENTS

Figure 16

The vacant Taber Mill in New Bedford's North End will become an apartment for elderly, shown here with new facade.

Taber Mill for elderly under way

Tabor Mill Company has begun construction on Taber Mill Apartments, a 151-unit housing development for the elderly on Deane Street. It is a conversion of a vacant mill building in a stable older neighborhood of New Bedford.

and because the demand for developable suburban sites suitable for family housing would tend to make large acreage sites more costly and scarce, the Section 8 family developments which are built might have a tendency to locate on sites that are less likely than elderly developments to appreciate in value.

IRS Recapture Provision

Another crucial element of the tax laws which should be an integral part of every investor's decision of whether to invest in subsidized housing is the recapture provision. Owners of subsidized projects who consider selling or who are forced to sell vis-a-vis a mortgage default must face the IRS recapture provisions which reflect the legislative policy that accelerated depreciation should be used to encourage investment in subsidized housing; but upon the sale of the property, the government should recapture some of the advantage which the owner received during his ownership. The advantage which the government chooses to recapture is the excess of accelerated depreciation deductions over straight line deductions, and the recapture rate is 100 percent minus 1 percent for each full month the property is held beyond 100 months from the date placed in service.

The effect this has on sponsors is that it is likely to reinforce the already favorable financial aspects of doing rehab which is often limited to elderly tenants. One reason is that the excess depreciation attainable through the eight-year straight line method (associated with elderly housing) far exceeds that possible from the 200 percent double-declining balance (associated with family housing). The second reason is that because elderly tenants tend to be less abusive of property, the sponsors of elderly housing experience less real property depreciation.

Sponsors of family developments on the other hand receive lower excess depreciation benefits; and if for any reason they decide to sell in less than 17 years, the sponsors are faced with the situation of having to treat the recapture amount as taxable income.
Conclusions

By now we should have a much better appreciation of how federal tax incentives and tax laws have such a powerful influence on the decisions of Section 8 sponsors. We know that Section 8 sponsors are motivated to selectively utilize the federal tax provisions in a way that will increase the profitability of rental housing as an investment. What we do not know is the extent, if any, to which these tax provisions reduce rents and the overall costs of development. The net effect of these provisions may be simply to increase the profitability of rental housing as an investment (and to bid up development costs) as more investors compete for a limited number of investment opportunities. The effect of this higher competition is to put additional pressure on the Section 8 sponsor to produce a bigger asset which will generate the greatest investment opportunity—and the only way he can do that is by proposing the biggest and most costly development.

The potential of family developments to generate prosperous investment opportunities tends to be limited, so elderly developments with more amenities and larger units are the way that sponsors seek to meet the higher demand.


2. See Figure 3 above.
Clearly the most important aspect of being a MHFA sponsor centers around the process of equity syndication and the resultant profitability of developing subsidized housing. With more of the risk and responsibility for developing subsidized housing being shifted onto the shoulders of private sponsors and investors, most actors in the development process prefer the least risky and the most prudent investment strategies.

As one experienced developer/sponsor stated in testimony before the House of Representatives' Committee on Government Operations,

> Developers and investors are building these Section 8 projects to be viable for sale once the depreciation and tax benefits wear out, and if subsidized tenants cannot be found. We feel that the amenities are very important for the long term basis. In the Section 8 projects as everybody knows, the market right now is strong. This is strictly a decision we make on each project, and it's obviously motivated for our own protection.  

Thus, there is a relationship between federal income tax laws and the motives of sponsors who build larger and more expensive units of elderly housing to meet the increase in demand for investment opportunities. It is a relationship that is based on the desire for profits and

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1. Asbury D. Snow, quoted from U.S. Congress, House, Section 8 Leased Housing Assistance Program, Committee on Government Operations, hearings, 95th Congress, pp. 300-01.
bigger tax shelters; and it is much more likely to be satisfied through the process of developing elderly rather than family housing.
PART IV

THE IMPACT OF MHFA'S GOALS AND POLICIES ON THE DISTRIBUTION OF ELDERLY AND FAMILY UNITS
CHAPTER V

A BUSINESS LENDING INSTITUTION WITH A PUBLIC PURPOSE

The Legislative Mandate

The Massachusetts Housing Finance Agency (MHFA) was signed into law on September 8, 1966, and a brief statement of its public purpose and legislative mandate is contained in the following. The MHFA was established to finance housing "which persons and families of low income, elderly persons, and veterans can afford." (Section 2, Ch. 708 of the Acts of 1966.) It was also established to serve a public purpose:

Since the continued inadequacy of the supply of low-income housing results in the continued consequences of disease, crime, injuries, retardation of education, and high costs for municipal services, such as welfare, police, and fire protection. (Section 2)

According to these statements it is clear that the legislative mandate to the MHFA originally was and continues to be for the production of housing which both low income family and elderly households can afford. Both types of households need and deserve support, yet the economic and legislative incentives of recent years have made it very difficult for the MHFA to fulfill its mission.

In the previous chapters of this thesis various incentives of lesser and greater significance have been examined to discover their impact on the recent shift towards elderly housing; and several of these incentives seem to be quite compelling. The effect of the higher amount of BSPRA with
elderly developments and its capacity to reduce actual cash equity is by itself a very significant factor. A more secure cash flow and the possibility of reaping rather large sums through the sale of tax shelters on elderly rehab developments is also a very compelling factor. Other factors such as community opposition to family developments, the management variable, and the psychological identification process together contribute to the lack of interest in family housing.

MHFA's Decision-making Environment

Finally, however, it is necessary to examine the role that the leadership at MHFA, their development policies and financial goals play in explaining the shift towards elderly housing. Despite the legislative mandate which encourages a balance between family and elderly housing, it would be inaccurate to assume that MHFA's policies have a neutral effect while forces from every other direction favor the shift towards elderly housing.

MHFA's governing framework consists of a Board of Directors and an Advisory Committee. The Board consists of seven members:

1) The commissioner of Commerce and Development,
2) The commissioner of Corporations and Taxation, ex officio, and
3) Five gubernatorial appointees:
   a) one experienced in mortgage banking,
   b) one experienced in real estate transactions,
   c) one experienced in architecture or city or regional planning, and
   d) two at-large appointees.
To assist the Board in the discharge of its duties, the Governor appoints from among interested citizens of the Commonwealth an Advisory Committee of 15 persons, including persons with experience or training in urban renewal, building, social work, mortgage financing, the municipal bond market, architecture, land use planning, and municipal government. It is the role of the advisory committee to assist the MHFA and its staff in formulating policies and procedures dealing with site selection, tenant selection, rent levels, design objectives, and other questions relevant to the MHFA's underlying goal of providing housing for low-income households and attaining balanced, attractive communities.

In trying to understand MHFA's decision-making environment it is best to review the circumstances and events in which they operate. The MHFA has been described as a "business lending institution with a public purpose," but the extent to which they operate like a business versus the public purpose of their mandate has varied over time. Prior to 1976 and the New York City's default on their municipal bonds (when the national mood was still supportive of public purpose housing subsidy programs) the questions of economic feasibility and default rates were not as important as they are now. The Section 236 Interest Subsidy Program combined with FHA insurance had effectively insulated MHFA and its sponsors from the inherent risks of developing low income subsidized housing. Sponsors, of course, never intended for any Section

236 developments to go into default; but if they did MHFA could assign the mortgage over to HUD who would absorb the losses.¹

Housing subsidies under the Section 8 program do not provide the same kind of protective insulation. Since 1976 not only are sponsors more concerned about the risks of subsidized housing, but MHFA also has more responsibility in the event of failure. It is quite unusual for a sponsor to obtain FHA mortgage insurance under Section 8 as compared to the Section 236 program²--so instead of choosing foreclosures as an option, most troubled projects owners must strive for a workout solution which could involve additional capital contributions.³

The effect of this on the sponsor is obvious. They won't propose a development that appears to be financially risky⁴ and the effect on MHFA is quite similar. MHFA in its overall attitude towards the financing of low-income housing has become much more concerned with "financially sound investment and management decisions."⁵ An effort has also been made over the past few years at MHFA to develop not only

¹. GAO Report, Section 236 Rental Housing: An Evaluation with Lessons for the Future, ch. 3.
². Long Term Costs of Section 8: Interim Findings.
³.
⁴. See Figure 3 above.
⁵. 1978 MHFA Annual Report from MHFA Chairman of the Board, Edward Lashman.
ways of making new commitments more financially secure, but
developing management techniques that will help insure the
viability of older mortgage commitments. These basically
entail efforts to anticipate problems and act quickly in
seeking rent increases or other measures to prevent minor
problems from "snowballing." 

In situations where a development does get into serious
financial difficulty, rather than foreclose on the property,
the MHFA legal department is more likely to respond, "Come,
let's talk, and bring your checkbook with $50,000." The
MHFA simply is not in the business of running developments
for the owners when things get tough; and to minimize the
possibility of today's mortgages becoming tomorrow's head-
aches, MHFA has committed itself to financing only low-
risk proposals. The extent to which this commitment has
contributed to the shift towards elderly housing is not
fully known, but evidence does exist which shows that the
success rate of housing proposals for mortgage funding de-
creases as the average household size increases (see Table 16,
Rows 1 and 2 below).

Another aspect of MHFA's decision-making environment
that has a direct bearing on the scarcity of Section 8 family
housing developments concerns the past and current system of

2. For a more thorough study of how MHFA developed its system
   of "workouts" see "Distressed Subsidized Housing: Effects,
3. Quoted from telephone conversation with Ed Hick of the
   Boston GAO, June 30, 1980.
Section 8 "set-asides." Section 8 statutory and administrative "set-asides" are funds that must be reserved for use in conjunction with other programs\(^1\) and the MHFA happens to be one agency that receives all of its Section 8 subsidy resources directly from the central HUD office in Washington.\(^2\)

In addition, through the political process, sponsors can obtain an allocation of Section 8 subsidy units directly from Washington which lifts even more of the responsibility from the MHFA to encourage a balance between elderly and family housing production. MHFA policymakers know that their allocation of Section 8 resources does not directly depend on the distribution of mortgage financing that they approve, so there is no incentive to go out of their way to advocate family housing to the development community.

The situation therefore exists, in which unless the allocation process is changed, it is unlikely that MHFA will do anything to upset the status quo.

**Income Mixing Criteria**

In addition to tough management and workout policies for troubled projects, MHFA changed its income-mixing criteria several years ago; and the effect of this change on the shift towards elderly housing must also be examined.

During the years of the Section 236 program (1968-73),

\(^1\) For example, almost 30 percent of Section 8's NC/SR contract authority in FY 1978 was set aside for state agencies. Kingsley and Both, RAND Corp., *Pilot Urban Impact Analysis*, pg. 19.

\(^2\) Statement by Harriet Tee Taggart, CHPA meeting, 19 May 1980.
MHFA proudly supported HUD's policy of limiting the number of subsidized households in any development to 20 percent of the total. The MHFA supported the goal of mixed income developments through their own policy of only financing developments in which units were designated for 25 percent low income; 25 percent moderate income; and 50 percent market rate tenants.

When Section 8 rent subsidies replaced the Section 236 program, however, and sponsors began to appreciate the benefits of seeking the highest possible guaranteed flow of income; MHFA's preference for developments with limited subsidies became meaningless. Most of the proposals that came in called for full subsidies;\(^1\) so MHFA revised their policy of mixing incomes, and the effect of this has been to reduce the desirability and viability of family developments. MHFA's revised policy states that, "In each housing development 25 percent of the residents must be persons or families of low income."\(^2\)

The problem with stating the policy in this manner is that it is misleading. When the problem the MHFA was trying to address was the problem of having too many subsidized tenants in their developments, it is misleading to respond in this ambiguous manner. The statement gives the impression that MHFA has to contend with many proposals which are lacking in an acceptable number of subsidized tenants rather than

1. See Chapter 2.
the real problem of having high concentrations of subsidized units. The revision of their policy effectively opened the door to proposals consisting of 100 percent subsidized units, and this has hurt the cause of family housing developments. Their desirability has been reduced, because the very regulation which was intended to alleviate the social and economic problems that are associated with concentrations of lower income families with children has been abandoned. And, despite efforts to select tenants from the upper range of Section 8 eligibility to offset those nearer the bottom; there is a great difference between this and the former method of mixing incomes. What recent Section 8 family developments represent is precisely what former policy-makers wanted to avoid.

Rehabilitation Guidelines

MHFA's rehab policies have also been modified in a way that reduces their involvement with family housing. The MHFA Board decided in 1974 to pursue the objective of becoming more of a major catalyst for private investment and neighborhood revitalization by confining their efforts to the "gut" rehabilitation of large masonry structures in the "best" locations. Almost by definition this meant that

1. Chuck McSweeney, interview, EOCD, Boston, 19 May 1980
2. MHFA, Report on Rehab, see Figures 17, 18 and 19 below.
The Mercantile Wharf Building in Boston's Waterfront Urban Renewal Area has won many awards. The historic building built in 1857 to serve the shipping trade was converted to mixed income housing and retail shops by Peabody Construction Company with a loan of $5,100,000 from MHFA.

Source: 1977 MHFA Annual Report
The Franklin Square House in Boston's South End has been rehabilitated by State Street Development Company with a $4,920,000 loan from MHFA. Constructed more than 100 years ago as the St. James Hotel, the building now contains 193 modern apartments designed by Boston Architectural Team and Archplan, Inc.

Source: 1977 MHFA Annual Report
The Bowdoin School, located in the Beacon Hill section of Boston, was originally built in 1896. The structure was used as a school until 1936 and for the next 40 years housed the administrative offices of the Boston School Committee. The Continental Wingate Company and its co-developer, the Beacon Hill Civic Association, acquired the structure in 1976 and converted it into 35 units of housing designed by the Boston Architectural Team, Inc. Construction was financed by MHFA with a loan of $1,054,500.

Source: 1977 MHFA Annual Report
rehab financing would be limited to elderly occupied mid and high rise buildings such as converted hotels, factories, schools, parking garages and large multi-unit residential buildings\(^1\). Smaller wood-framed structures such as 3-6 family buildings needing only "cosmetic" rehab were no longer eligible for MHFA's long-term financing—yet these offered perhaps the most widespread opportunities to improve the existing stock of family housing.

MHFA's rationale for limiting their rehab financing was they believed that by making an initial investment in large structures they could create an impact which would encourage banks to provide smaller, less risky loans in the neighborhood for "cosmetic" rehab. Whether this in fact is occurring has not been determined and is a suitable topic for further research; nevertheless, it must be acknowledged that the adoption of their policy of becoming a catalyst for private investment has had a direct although unintended impact in reducing the amount of family housing rehab activity (see Figure 20 below).

One of the more common arguments among sponsors of MHFA-financed rehab developments is that the reason why so few rehab developments are built for families anymore is because the local communities won't allow family developments of any kind\(^2\). On the other hand, MHFA states in

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their "Case for Rehab" that;

1) public support and interest in rehab and historic preservation is high to preserve familiarity and sentimentality;

2) that rehab changes liabilities into assets for cities and towns by adding to the tax rolls;

3) and that rehab eliminates the threat to public safety that unoccupied buildings present.

Distribution of Proposals and Relative Rates of Success In Obtaining Financing

Since MHFA's statements suggest that local opposition is less likely to be directed towards rehab than towards new construction, the burden of explaining the decline in family rehab activity seems to be shifted back to the lack of sponsor interest rather than the result of local opposition. The truth of the matter, however, lies somewhere in the middle of all three forces. For example, it is known that sponsors under the Section 8 program actually propose fewer family developments than under previous programs (see Table 13 above and Table 16 below); but it is also known that the MHFA's policies on rehab have restricted family housing opportunities. And finally, it is a formidable threat to any housing sponsor that if delays in the local permitting process postpone the scheduled rent-up; the result is a potentially ruinous effect on the financial feasibility of the development (see Chapter 4).

Evidence that the combined effect of these forces has
Figure 20
TOTAL MHFA FINANCED FAMILY HOUSING REHAB ACTIVITY

<table>
<thead>
<tr>
<th>Year</th>
<th>71</th>
<th>72</th>
<th>73</th>
<th>74</th>
<th>75</th>
<th>76</th>
<th>77</th>
<th>78</th>
<th>79</th>
</tr>
</thead>
<tbody>
<tr>
<td>Units</td>
<td>53</td>
<td>563</td>
<td>401</td>
<td>649</td>
<td>557</td>
<td>365</td>
<td>332</td>
<td>249</td>
<td>75</td>
</tr>
</tbody>
</table>

Source: Compiled by the author from MHFA's Housing List.

reduced the rate at which family development proposals succeed in gaining mortgage funding is given in Table 16 below. In Row 2, note that while 12 percent of the elderly proposals received mortgage commitments, only 7 percent and 6 percent of the respective small and large family proposals received such commitments. Furthermore, the evidence shows that 36 percent of the elderly proposals were either rejected,
dropped, or withdrawn while 55 percent and 70 percent of the respective small and large family proposals suffered the same fate.

Table 16
ANALYSIS OF WHAT HAPPENED TO THE DISTRIBUTION OF MHFA PROPOSALS, MAY 16, 1980

<table>
<thead>
<tr>
<th></th>
<th>Elderly (1.0-1.29)</th>
<th>Small Family (1.3-1.89)</th>
<th>Large Family (1.9 and over)</th>
<th>Ave. BR*</th>
<th>Ave. BR*</th>
<th>Ave. BR*</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>In Process</td>
<td>61 (52%)</td>
<td>26 (38%)</td>
<td>4 (24%)</td>
<td>91 (45%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Committed</td>
<td>14 (12%)</td>
<td>5 (7%)</td>
<td>1 (6%)</td>
<td>20 (10%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rejected</td>
<td>25 (22%)</td>
<td>17 (25%)</td>
<td>2 (12%)</td>
<td>44 (22%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dropped</td>
<td>12 (10%)</td>
<td>14 (21%)</td>
<td>8 (46%)</td>
<td>34 (17%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Withdrewn</td>
<td>5 (4%)</td>
<td>6 (9%)</td>
<td>2 (12%)</td>
<td>13 (6%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>117 (100%)</td>
<td>68 (100%)</td>
<td>17 (100%)</td>
<td>202 (100%)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Ave. BR means the average bedroom size per unit over the entire development.

Source: Compiled by the author from Kirk McClure, memo, Proposals Year Ending May 16, 1980.

The reasons for the decline in the success rates as the average bedrooms per unit increases are, of course, due to a variety of forces; but for one to have a complete picture of the causes behind the shift towards elderly developments, it is necessary to acknowledge that MHFA's decision to drop the requirement for mixing incomes and their more exclusive rehab guidelines have contributed to the decline in family housing developments.
MHFA's Financial Goals

The MHFA has been described as a business lending institution with a public purpose,\(^1\) and an examination of the pressures and constraints under which the MHFA operates reveals that indeed it is very businesslike in its operation. The MHFA receives no direct allocation of State Tax revenues, and according to its charter it was established as an independent state agency loosely affiliated with the Department of Community Affairs. The mortgage money that MHFA raises arises from the sale of tax-exempt bonds in the private market; and the resources that cover their staff and operating expenses are raised entirely through the fees and charges that MHFA applicants are assessed. It is thus this free market competitive environment that shapes the attitudes, decisions, and goals that come out of MHFA's decision-making Board of Directors.

For the most part this Board consists of men and women who are keenly aware of the "financial tightrope" that must be walked in the process of developing subsidized housing; and they are motivated to make decisions that protect the security and stability of MHFA's portfolio.

How this Agency profile information translates into action that favors the development of housing for the elderly

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1. Interview with Bernard Lynch, May 19, 1980.
is clear. MHFA must compete on the bond market for capital, and the price they pay for that capital is directly related to their bond rating and the perceptions of buyers as to the viability and security of the assets which back-up the bond note. If the MHFA's assets are perceived as risky in the capital market, they will have to pay a higher percentage rate to acquire the capital. Three years ago MHFA's Standard and Poor's Credit Rating was reduced from AA to A.¹ When John Eller, the new Executive Director, came to MHFA in 1977 the Agency soon afterwards put its mind to the task of improving their bond rating and developing new management and financial policies that would strengthen the security of their portfolio.² And since family projects have traditionally been the ones with the greatest financial difficulties,³ it is understandable that members of the Board would at least view family developments with more caution—if, in fact, they did not begin to develop a clear bias against such lending.⁴

One of the principal rules in any business establishment is that the owners must make daily economic decisions which in

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1. MHFA, Annual Report 1979, "Report from the Chairman."
2. Ibid.
the long term result in either a successful or unsuccessful business. MHFA's Advisory Committee--whose members reflect the King Administration's desire to maintain a prudent image--thus naturally think in terms of how they can make MHFA "successful." The most technical measure of success then becomes their bond rating and the interest rate that is largely determined by their rating.

In 1975 unprecedented problems in the nation's securities markets arose in which the financial weakness of New York City and numerous other municipalities were the focus of attention. These problems prevented the MHFA from selling its notes and bonds and forced it to close its doors to new development proposals.¹ In response to this situation the Massachusetts General Court enacted special legislation, Chapter 598 of the Acts of 1975, which put MHFA back in business by pledging the full faith and credit of the Commonwealth to a maximum of 500 million dollars. Enactment of this special legislation, however, was not the end of MHFA's difficulties. Their efforts to re-establish themselves in the financial markets suffered a setback in 1977 when the Standard and Poor's Corporation dropped MHFA's credit rating from AA to A.² This followed the MHFA Study Commission's 1976 Report which cited, "administrative

² Ibid.
matters that were of concern to the investment community."

John Eller, who served as Vice Chairman of the Commission later became MHFA's Executive Director; and since he took office in 1977 the Agency commenced aggressive action to address those concerns. Eller's determination to ensure the success of MHFA in the financial markets is reflected in his statement:

Our access to the note and bond markets for additional loan funds depends on our continuing success in managing our existing investments. The Members and I share the belief that the Agency's future depends on our success in keeping our housing developments alive and healthy. A troubled loan portfolio increases our cost of borrowing money, a cost which is passed on to the developers of future housing in the form of higher interest rates for MHFA loans and to tenants of this housing in the form of higher rents. Accordingly we will take whatever steps are necessary to insure the continuance of a healthy portfolio.

These steps have included such things as: 1) new reporting requirements; 2) analytical procedures; and 3) an early warning system for preventing troubles from developing.

In addition to these, to insure the long term viability of MHFA's loan portfolio, the Agency's operations are carried out, "to make sure only strong development teams, desirable sites, and sound proposals are selected for financing."

The full impact of the above steps and MHFA's commitment to success, on the decline in family housing production,

1. MHFA, 1978 Annual Report, pg. 9
2. Ibid. pg. 15
suggests that MHFA's Board of Directors at least perceives family developments as a potential threat to their vital interests in the financial markets is quite clear.

What has been observed then as something of a reward to MHFA--following the implementation of their 1977-1978 commitments to low-risk investment and decision-making policies--has been the upgrading of their Standard and Poor's Corporation credit rating from A to A\textsuperscript{+} and the upgrading of their non-guaranteed bond anticipation notes from MIG-2 to MIG-1.\textsuperscript{1} Given the incentive that these rewards produce to continue doing more of the same; and given the possibility that Section 8 funds will be reduced;\textsuperscript{2} one wonders what the future holds for family developments. It is unfortunate to think that family housing sponsors could have an even more difficult task gaining mortgage funds, yet indications seem to suggest this is a very real possibility (see Table 10 above).

In the absence of aggressive policies and adequate funding, it may be that the future will find MHFA financed housing, as we know it, will be a thing of the past.

\textsuperscript{1} MHFA 1979 Annual Report, "Letter from the Chairman"

\textsuperscript{2} "By a margin of one vote, Section 8 funding narrowly survived in a battle in Congress in May 1980," Harriet Tee Taggart, MAPC, quoted from a CHFA Conference on Housing, Boston, 12 June 1980.
CONCLUSIONS

The role that MHFA plays in the process of developing subsidized housing is a very significant one; and without their mortgage financing a great many subsidized developments would not have materialized. It is, therefore, essential to understand that the MHFA always holds the last card in making or breaking a proposal. Nevertheless, in all fairness to the MHFA, whether a proposal is ultimately successful or not is often a function of things that are outside the control of the Agency. MHFA does not arbitrarily accept or reject proposals based solely on whether they are for the elderly or families. On the other hand, 1) it is more difficult (but still quite possible) to develop family developments, and 2) when a sponsor of an elderly housing development obtains an allocation of Section 8 subsidies from Washington, it is hard for MHFA to resist providing the mortgage financing.

What makes a proposal attractive to sponsors and most feasible in the long run is the impact of FMRs on cash flow and financing; the process of equity syndication; the prospects for long term capital gains; the extent to which the BSPRA reduces the actual cash equity and whether local opposition is likely to seriously jeopardize completion.

If there are no problems in these areas, and in the words of John Eller, "only strong development teams, desirable sites and sound proposals..." remain and seek financing;
then MHFA really should not care whether it is elderly or family housing. For this reason, the impact of MHFA's policies and decision-making environment on the shift to elderly housing is secondary to the impact of FMRs, feasibility, syndication, the BSPRA, local opposition, and that intangible element of the national and state political process.

The effect of MHFA's policies on rehab to finance only large masonry structures in the best locations does contribute, however, to the shift in the type of proposals "that come in the door." Sponsors of proposals for rehab are almost entirely limited to elderly tenants because of the elevator clause; and unless smaller wood framed structures are made eligible for MHFA's long term financing, it is likely that rehab will continue to be synonymous with elderly housing.

Likewise, when MHFA dropped their income mixing criteria, a subtle but very damaging blow was dealt to the cause of family housing. Their desireability has been reduced because the very regulation which was intended to alleviate the social problems that are associated with concentration of lower income families has been abandoned. And despite efforts to select tenants from the upper range of Section 8 eligibility to offset those nearer the bottom; there is a great difference between this and the former method of mixing incomes. What recent Section 8 family developments represent is precisely what former policy-makers wanted to avoid.
Executive Summary and Policy Recommendations

The purpose of this thesis was to perform an analysis of the economic and the legislative forces which favor the development of elderly housing; and the results of this analysis provide insights and a significant quantitative basis for ranking the impact of various factors. At the same time, it is important to suggest policy recommendations and appropriate incentives to improve MHFA and HUD's ability to meet the housing needs of both family and elderly households.

Of greatest impact is the effect the FMR structure has on replacement costs and feasibility. Without adequate cash flow from the FMR's, it is a moot question to compare the effect of other forces. Everything—from the perceptions of people about the management and maintenance of a development—to the sale of tax shelters to passive investors—is predicated on the impact of the FMR's on feasibility and financing. Within Massachusetts, the FMR rents enable all housing developers (and especially developers of elevated building types) in the FMR areas of Boston, Salem, and Lowell to leverage significantly higher amounts of mortgage financing than sponsors in other areas. This has a great deal to do with why the overwhelming bulk of sponsor interest, MHFA financing, and construction activity occurs in these areas. Thus a great need exists for HUD to review the differences between the FMR's in all areas in an attempt to equalize the amounts of mortgage financing that can be leveraged.
Such a process would involve a careful statistical analysis of the actual differences in the costs of materials, labor, and professional services etc. as a measure of how FMRs should differ--rather than the simplistic notion of "market comparables" which is open to very subjective interpretation.

It is unlikely that HUD field office personnel have the time to undertake such an effort; but until the impact of FMRs on financing is (continued next page)
equalized it is unrealistic to expect major changes in the role and ranking of the other forces which affect the distribution between elderly and family housing developments. Factors such as the lack of sponsor interest in proposing family developments will continue, as will the lower success rate of family developments in obtaining mortgage financing through MHFA. Likewise, local opposition to family developments is unlikely to change until a significant number of existing family developments begin to demonstrate some financial/fiscal strength above their present levels. This is, of course, dependent on providing family developments with adequate operating and capital budgets through higher FMRs.

Among these forces, however, the impact of the equity syndication process must be ranked as the second most important variable in favoring the shift to elderly housing. Since Congress, under the Section 8 program, shifted virtually all of the risk and the responsibility for the success of subsidized housing onto the private sponsors and investors; a direct relationship exists between the financial security of a development and the sponsor's realization of his anticipated equity syndication proceeds. It is a relationship that encourages sponsors to prefer the development of elderly housing; but it should not be used to rule out the feasibility of family housing.
Despite syndication proceeds being approximately one third less, sponsors of family housing developments can also earn large syndication proceeds. Thus it is an interesting phenomena that so few family developments are built. The fact that there really is money to be made through syndication, and that the Section 8 subsidy is flexible to better compensate sponsors who face rising operating costs—both suggest that forces outside the legislative and economic framework (i.e., forces in the state and federal political process) have a significant impact on the development of elderly and family subsidized units.

Major differences in the minds of lawmakers and officials exist between the merits of helping needy elderly citizens and needy younger households with children. For the most part these differences are the result of the fact that lawmakers and officials can more easily identify and sympathize with the plight of poorer elderly persons who are seen as having worked hard and had productive lives but are just now caught in the dilemma of living on a fixed income amidst the ravages of inflation. Needy younger households are not seen in this light. For them, the plight of poverty is seen as the result of their own shortcomings and the failure to "make it" in the land of opportunity.

Such perceptions run deep, and the kind of policy changes that are needed to eliminate the effects of such
bias, unfortunately must come from within the very same political institutions and processes that created the former.

Furthermore, there is a political reward structure for those who work in the process of funding and developing elderly housing which those of family housing do not receive. Votes, power and public recognition belong to those who labor for the causes of elderly services, housing and benefits; while frustration, contempt and often times failure are the wages of those who support housing and public benefits for the young and middle aged poor.

Within this constraint, however, it is possible to suggest some changes which would improve both MHFA's and HUD's ability to meet the housing needs of both family and elderly households. The basis for one of these suggestions takes into consideration the importance of good siting, long term ownership and including various amenities to enhance the realization of capital gains.

Sponsors of elderly housing have found themselves enhanced with these circumstances and are therefore encouraged to exclusively focus on elderly housing.

One experienced sponsor expressed it well when he said, "Developers and investors are building these Section 8 projects to be viable for sale once the depreciation and tax benefits wear out, and we feel that the amenities are very important for the long term basis." Family housing is
less likely to involve these amenities and the long term capital gains which follow; so this contributes to the lack of sponsor interest.

Depending on the political philosophy one has in these matters, the solution to equalizing the impact of elderly developments generally being able to realize larger long term capital gains can take one of two directions. Either deny the sponsors of elderly housing the right to build aesthetics and amenities into elderly housing, or enable the sponsors of family housing to do the same by providing higher FMRs and property standards. Unfortunately it is not a black and white issue, but since we are dealing with public money and the objective is to alleviate housing needs, it seems to be a much more responsible position to curtail some of the expenditures that go into elderly housing developments. When only a small percentage of the eligible population is being served by the Section SR/NC program, it does seem irresponsible to overindulge the privileged few who benefit. One GAO analyst described the Section 8 SC/NC program as "conferring knighthood" on its recipients.

Another suggestion to HUD and Congress would be to study the accelerated depreciation tax provisions which the subsidized housing industry uses to realize most of their profits in the development process. The alleged reason for these provisions is to entice investors with private capital to
to invest in subsidized housing. It is claimed that by giving
the developer a "break" through quicker write-offs of real
property and improvements, somehow these "breaks" translate
into lower rents which benefit the tenants, and a greater
volume of subsidized housing production.

Both of these assumptions are weak. For one, the ac-
celerated depreciation tax benefits benefit the developer
primarily, and the renter secondarily, if at all. There is
no relationship between what the tenant pays in rent and the
rate of depreciation which a sponsor is allowed to take. The
rent ceilings are pre-determined by HUD based on "market
comparables," and the tenant's share is a function of each
individual tenant's income (25 percent). HUD pays the dif-
fERENCE between what the tenants can afford and the agreed
upon rents, and the depreciation rates are not even relevant
at this point.

Secondly, the accelerated depreciation benefits are not
even related to the amount of private cash equity which the
sponsors are required to invest. Private cash equity is a
function of the established formula of the 10 percent BSPRA,
which as an "allowance," (one analyst has referred to it as
"funnymoney") functions to reduce actual cash equity as low
as one percent of the actual development costs. Therefore,
the argument that accelerated depreciation benefits are nec-
essary to induce private investments in subsidized housing
should be reviewed in light of how little cash equity the
private sponsors of Section 8 developments actually invest.
As demonstrated in this thesis, since it is generally easier to find oneself enhanced with more favorable depreciation benefits in the process of developing elderly housing rather than family housing; some efforts should be made to match accelerated depreciation benefits more with the type of developments which would and could be occupied by family households. As things are now, not only is there little risk associated with elderly developments, great political rewards, and long term investment opportunities; but the sponsors of elderly developments tend to find themselves in a position of being able to make greater profits through the sale of tax shelters. If an effort were made to provide family housing sponsors with an especially attractive depreciation rate unavailable to the sponsors of elderly housing, it is more likely that family units would be built.

The next area of policy recommendations concerns some very basic theories of whether the best approach to meeting housing needs is through programs that stimulate the supply of subsidized units or through programs that increase the effective demand of eligible households in the private market. The Section 8 SR/NC program is clearly a supply program. However, despite over 500,000 units being produced nationally, only a small percentage have been helped and the cost of housing all needy households in SR/NC is prohibitive.
No single approach to the housing problem is adequate; neither is one combination of housing programs right for all times. Nevertheless, one recommendation the author wishes to make is that more of an emphasis in the federal budgetary process be placed on programs which integrate both supply and demand theories into practice. The Section 8 Moderate Rehabilitation Program and the Section 8 Existing Housing Program are examples of this idea, and they do not involve the tremendous loss of tax revenues which seem to be the very life-blood of the SR/NC program. Why these programs can be thought of in terms of both how they supply more subsidized housing and increase the economic demand of needy households is that both programs 1) function in a way that effectively reclaims housing units which could disappear from the housing stock and then maintain them properly in the future; and 2) provide eligible households with the economic means to remain in the improved and well-maintained unit.

Section 8 NC/SR allocations on the other hand, should be used more selectively to include the supply of both family and elderly units where it can be demonstrated 1) that moderate rehabilitation and existing subsidies would not be as cost effective and 2) that a mismatch exists between housing needs and the supply of units of a particular size or structure type within a community.
It should also be noted that the annual subsidy cost per unit under the NC program is less than for SR; and the NC program, unlike the SR program, is not inherently limited to elderly occupants. Therefore, if more emphasis was placed on NC with some appropriate tax incentives for family units, it would be reasonable to expect a more balanced production between elderly and family units. At the same time it could reduce HUD's long term subsidy costs.

The question of whether we even need more family housing production in itself is also interesting. With birth rates leveling off at a relatively low rate after the historical decline since 1960, and with the likelihood of fewer and fewer large families, policy-makers should begin to think in terms of how they can meet the rental housing needs of single parent households with fewer children and how to produce more medium-sized units.

According to Frieden and Solomon, an abundant supply of large older housing units exist due to the decline in the number of large families, and the adequate production of such units prior to 1960. On the contrary, production of medium-sized units did not keep up with the demand even prior to 1960; and because of inflation, higher interest costs, and the skyrocketing demand for medium-sized family units, policy-makers should immediately address this shortage.
How this might change the utilization of the Section 8 program is clear. The production of elderly housing units under SR/NC should be curtailed at least until the crisis in unmet family housing needs is alleviated. This should not be viewed as a setback to the supporters of elderly housing and services, but rather it should be viewed as a return to a more equitable and balanced production of elderly and family units.

The last area of policy recommendations concerns the operation of MHFA. The operation of MHFA and their specific policies on new construction and rehab financing also factor into the shift towards elderly housing. One of the principal rules in any business establishment is that the owners must make daily economic decision which in the long term result in either a successful or unsuccessful business. MHFA's board of directors thus naturally think in terms of how they can make MHFA "successful." The most technical measure of success is their bond rating and the interest rate that is largely determined by this rating. The Agency and its management are therefore committed to "make sure only strong development teams, desirable sites, and sound proposals are selected for financing." But in reality, MHFA's policies on rehab to finance only large masonry structures (typically limited to elderly occupants) in the best locations imposes a tremendous limitation on the type of proposals "that come in the door." So, to alleviate the
imbalance between the number of elderly and family proposals, MHFA should restructure its rehab policies to provide sponsors with the opportunity to obtain long term low-interest financing for smaller wood framed structures in which family tenants could live. If large elevated masonry structures continue to receive the bulk of MHFA financing commitments, and low rise wood framed structures remain ineligible, rehab will continue to be synonymous with elderly housing. Thus the MHFA will have done nothing (relative to the forces that are within their control) to reverse the situation in which they have failed to fulfill their legislative mandate "to provide safe and standard housing which families and the elderly can afford."

Another policy recommendation for MHFA concerns their stated "income mixing criteria," and a suggestion that it be reinstated as soon as possible. Prior to the Section 8 program it was common for MHFA financed developments to consist of 25% low income; 25% moderate income and 50% market rate tenants. The purpose of this was both to deconcentrate the pockets of low income neighborhoods and to encourage economic integration.

Both state and federal policymakers supported these goals through a variety of housing programs; but with the passage of the Section 8 program and subsequent amendments,
sponsors and officials in the development community observed the erosion of income mixing criteria.

This erosion, by incrementally increasing the subsidy limits for elderly developments up to 100%, has led to the current situation in which over 90% of all proposals come in looking for a subsidy in every unit. The result has been a very subtle but damaging blow to the cause of family housing. Their desirability has been reduced, because the very regulation which was intended to alleviate the social problems that are associated with concentrations of lower income families has been abandoned. Thus, what recent Section 8 family developments represent is precisely what former policymakers wanted to avoid.

Finally, the Section 8 regulations which require tenants to pay 25 percent of their gross income for housing costs is another factor which has a subtle but pervasive impact on the shift towards elderly housing. For many eligible low and moderate income tenants living in substandard housing, the process of setting their rents at 25% of their income would represent a net increase in their total housing costs. This is especially true of those eligible households at the upper limits of income eligibility. As a result, many income eligible tenants are not interested in Section 8 participation, and in fact neither are sponsors eager to manage units in which the tenant's share of the contract rent approaches
the maximum. Often families can find non-subsidized housing at less cost than Section 8 and in fact prefer such arrangements to keep their total housing costs as low as possible.

The net result is that Section 8 developments have become stratified with the "poorest of the poor" whose share of the rent is lower than what they could find elsewhere; and since the cost and risk of managing and maintaining a unit in which a poor elderly tenant lives is known to be less than for family households, sponsors and the MHFA prefer the elderly.

To intervene in this situation, in addition to the previously mentioned policy recommendation of reinstating income mixing criteria, federal and state policymakers should consider a strategy along the lines of a housing allowance or voucher system. The benefit of this alternative is that, much like the Existing housing program and the Moderate rehabilitation program; both housing supply and demand theories could be satisfied. On one hand the program would increase the household's effective market demand and on the other it would allow landlords to obtain rent increases which are often necessary to prevent existing housing from becoming abandoned.

A housing allowance would also allow more eligible households to participate within current funding limits, and poorer households would not necessarily have to move
from their current residences to qualify. Both of these cost-saving measures are often overlooked by the proponents of new construction and substantial rehab and should be given considerably more weight in the formulation of future housing programs.
APPENDIX 1
Note on the Costs of Increasing the Percentage of Elderly Within the Community, i.e. Importing Elderly People, pg. 94

According to Ed Hick of the Boston area General Accounting Office, in Hempstead, New York, "the community decided to go all out for elderly projects to increase their tax base without the school expense and really made a mess of local businesses. They put places like Corvettes, fast-food franchises, and convenience stores out of business and hurt the new shopping center too. In addition, they found that they had to open nurses' training schools at public expense, enlarge the local hospital, and support it. So you see, the imbalance can swing both ways."

The caveat (to the issue of local governments opposing family housing on the grounds that it is perceived to represent a net fiscal drain on the budget) is that the real impact depends upon the previous residential locations of the project's occupants. If all move from within the same jurisdiction, there should be little or no net change in the demand for services by that jurisdiction. The spatial allocation of services might have to be adjusted, and depending on how adjustments are handled, some net efficiencies might result. Since it is suspected that most movement generated by Section 8 and past subsidy programs has been intrajurisdictional\(^1\); opposition to family housing and the preference for elderly housing solely on their perceived fiscal impacts is, therefore, open to question.

\(^1\) Kingsley and Both, *Pilot Urban Impact Analysis*, pg. 58
APPENDIX 2

Note on Proposed Changes in Tax Legislation

The tax reform proposals submitted by President Carter in conjunction with the 1979 budget included a proposal to reduce the favorable depreciation treatment on new market-rate multi-family rental housing to a 150 percent declining balance rate through 1982, and to a straight line rate thereafter. In contrast, depreciation deductions on new lower-income rental housing projects could be claimed at the 200 percent declining balance rate through 1982, but would be limited to a 150 percent declining balance rate after that.

Stricter rules that would make it difficult for real estate investors to increase their depreciation deductions by claiming artificially short building lives for tax purposes have also been proposed. If enacted, these changes would reduce the potential profitability of rental housing as an investment. Nevertheless, housing would remain relatively more attractive than non-residential investments until 1983; and from a tax standpoint, federally subsidized low-income housing would continue to be relatively more attractive than other residential investments.

2. *ibid.* pg. 72.
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