PUBLIC SUBSIDIES AND PRIVATE MANAGERS

Critical Issues in the Management of Federally Assisted Rental Housing

by

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SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF CITY PLANNING at the MASSACHUSETTS INSTITUTE OF TECHNOLOGY

September, 1973

Signature of Author
Department of Urban Studies and Planning, June 22, 1973

Certified by Thesis Supervisor

Accepted by Chairman, Departmental Committee on Graduate Students

FEB 1 1974
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ABSTRACT

In the past two years, increased attention has been devoted to the management of subsidized housing. From being the forgotten factor in the economics of housing, management has acquired a central role in policy affecting the future of federally subsidized developments. This study concerns two issues related to the costs of managing publicly-assisted, privately-owned rental housing: 221d3 and 236. The first is an issue of expense: what are the costs to projects of administrative requirements imposed by public agencies with authority over subsidized housing? The second is an issue of income: what are additional sources of revenue which could be tapped by projects with inadequate operating funds, and how much money could they yield, under what circumstances? The first, then, details an unintended and often expensive side effect of American housing subsidies, while the second analyses deliberate strategies to alleviate one deficiency in existing projects—insufficient income.

Public agencies which subsidize housing act as regulators when they monitor, review and control housing management. In Boston, agencies with these dual functions are HUD-FHA, Boston Housing Authority, Welfare Department and city Assessing Department. The study describes the problems and expenses, in time and dollars, encountered by housing managers while satisfying the administrative requirements and red tape imposed by these agencies and by another agency which only regulates housing: Boston Rent Board. It also details the conflicts and costs that arise when two or more agencies demand supervision of the same managerial activity such as rent increases or tenant evictions. The total of all these expenses varies considerably among projects, ranging from $35 to more than $215 per unit per year. At the higher end, projects are spending more than their entire HUD allowed management fees. The study attempts to pinpoint some causes of the discrepancies, including kind of housing development, size and attitudes of management entities. After presenting difficulties that are inherent in public regulation of subsidized housing, the study projects some alternatives to existing subsidy regulatory patterns that might reduce housing managers' costs and friction of doing business with public agencies.

The second major portion of this study begins by outlining three
major sources of operating cost overruns in 221d3 and 236 projects: 1) costs internal to housing projects such as excess utility bills attributable to tenants' or managers' actions; 2) costs external to projects such as rising prices for insurance, utilities or taxes; and 3) underestimation of expenses during development, particularly due to HUD-FHA procedures. Then, twenty-five potential sources of additional operating funds for existing projects are discussed. These fall into two broad categories: funds internal to developments which could be made available immediately by restructuring their finances, for example, ballooned mortgages or residual receipts; and funds external to projects which would require further direct or indirect subsidies such as operating subsidies or mortgage refinancing. The costs and benefits of each are examined in light of the amount of money involved, the time pattern of benefits, and the possibility of broadening fiscal responsibility for projects. The analysis concludes that the most profitable sources entail additional public subsidies and restructuring financial liability for operating and maintenance costs to include project sponsors and investors. It distinguishes between projects which could be saved by these incremental additions of funds and projects with such severe fiscal or operational problems that they cannot be helped sufficiently by tinkering with the existing housing subsidy system. Thus, this portion of the study tries to define the financial limits of existing federal rental assistance programs: the limits to the dollars which could be leveraged through these programs and the limited kinds of problems which these dollars could resolve.

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Acknowledgements

This paper relies heavily on the help and information of others. Several housing developers and managers gave me repeated interviews. Since a few of them gave me data with the stipulation that their exact source not be revealed publicly, I thank them all, namelessly.

Vince O'Donnell of the Boston Urban Observatory, Emily Achtenberg and Michael Stone, both of Urban Planning Aid, generously shared information and insights which they gathered during their own work on subsidized housing. Without their help, this study would be much poorer.

Invaluable assistance was also given by the staff of Greater Boston Community Development Corporation, particularly Robert Whittlesey, Dotti Rosetts, and Gail Schubert.

The many other people who consented to be interviewed are too numerous to enumerate here. They are all acknowledged in the "List of Interviews" at the end of this paper. My thanks to all of them.

Finally, I thank my advisor, Langley Keyes, whose perception and suggestions helped me throughout the preparation of this study. His enthusiasm gave encouragement whenever I needed it.
Table of Contents

Introduction 5

Section 1: Public Subsidies and Private Housing Projects

Chapter 1: Public Regulators and Private Managers 8
Chapter 2: Operating Costs and Public Policies 17

Section 2: The Friction of Doing Business with Public Agencies

Chapter 3: The Cost of Dealing with Public Regulators 26
Chapter 4: Federal Regulator - HUD 34
Chapter 5: Local Regulators
  Boston Housing Authority 63
  Welfare Department 76
  City Assessing Department 79
  Boston Rent Board 84

Chapter 6: Managements' Response to Public Agencies 102

Section 3: Alternative Sources of Operating Funds

Chapter 7: Alternative Sources of Funds for Managers 118
Chapter 8: Available Funds Internal to Projects 127
Chapter 9: Available Funds External to Projects 156

Afterword 181
Bibliography 185
List of Interviews 190
List of Tables

Section 1, Chapters 1 - 2

Table 1-1: Operating Cost Increases, 1966-1971, in five Boston Subsidized Housing Projects 18

Section 2, Chapters 3 - 6

Table 2-1: Managements' Dealings with HUD and Their Costs 36
Table 2-2: Summary - Costs of HUD Requirements Compared to Management Fees 62
Table 2-3: Managements' Dealings with BHA and Their Costs 65
Table 2-4: Comparative Cost of Leased Housing and Rent Supplement 77
Table 2-5: Managements' Costs of Obtaining Tax Abatements 81
Table 2-6: Managements' Dealings with the Boston Rent Board and Their Costs 85
Table 2-7: Eviction Proceedings in Boston: The Actions Required to Evict a Tenant 96
Table 2-8: Summary - Managements' Direct Costs of Dealing with Public Agencies 104

Section 3, Chapters 7 - 9

Table 3-1: Alternative Sources of Operating Funds 125
Table 3-2: Summary of Major Differences Between the 221d3 and 236 Programs 168
Table 3-3: Alternative Sources of Operating Funds at Meadowbrook 172
Introduction

In the past two years, increased attention has been devoted to the management of subsidized housing. From being the forgotten factor in the economics of housing, management has taken on a central role in policy issues affecting the future of federally subsidized developments. Escalating costs in public housing, the financial impact of the Brooke Amendment, rising levels of defaults and foreclosures of Section 221d3 and 236 developments resulting from soaring operating expenses have all been instrumental in highlighting the critical significance of management.

Until the recent management crisis, both public and private housing interests focused almost exclusively on production. This was encouraged by repeated Presidential and Congressional statements pronouncing construction of new housing as the solution to American housing problems. It was fostered by a traditional indifference to management on the parts of both the real estate industry and independent, public spirited housers. Their joint awakening to the importance of management paralleled a widespread arousal of interest in the larger question of how the existing housing stock can be conserved. Increasing abandonment in the central cities focused attention on the need to save and use existing housing. Since the total inhabitable housing stock at any given time is 97% old and only 3% new construction, the existing stock must be maintained adequately if all Americans are ever to be decently housed. Management is the key to properly conserving housing.

Successful management is the product of many factors. It is affected by many cross-crossing lines of responsibility and influence among all the participants in the housing process: tenants - managers -
owners - builders - buildings themselves. In subsidized housing, public agencies add another crucial component. In all housing, another critical ingredient for management is money. The sources and amount of income, the causes and size of expenses - all affect the interplay among the participants in housing management.

Last year, while investigating the management and operation of rehabilitated, 22ld3 housing in Boston, I became especially concerned about two issues related to costs. The first was the impact that HUD and other public agencies have on operating expenses. The second was whether subsidized projects with inadequate operating budgets could avoid eventual foreclosure by finding additional sources of revenue.

Discussions with housing managers made it clear that public agencies - HUD-FHA, Boston Housing Authority, Welfare Department, and Boston Assessing Department - which are subsidizing housing are also unintentionally increasing management costs by the regulations they impose. Agency requirements that drive up operating expenses include paperwork and meetings. They also, again unintentionally, include the need for housing managers to mediate conflicting rules among agencies. Large expenses are frequently incurred by managers who are caught in the middle of disputes among agencies with different ideas about how managers should operate subsidized housing.

It was equally clear to me that while everyone - managers and agency personnel alike - complained about bureaucratic red tape, no one really knew how much it costs managers. One intention of this thesis is to detail these costs and the problems managers incur while dealing with public agencies. This discussion is taken up in Section 2, "The Friction
The second intent of this thesis is to explore additional operating budgets. My previous study showed me that much of the financial crunch in 221d3 and 236 housing is attributable to the way it was developed. I began asking whether the subsidized housing system could mend the problem it had created: insufficient operating funds. Section 3, "Alternative Sources of Operating Funds", examines the implications of various sources, including whether they are sufficient to salvage financially troubled projects.

This thesis, then, concerns two cost-related issues in subsidized rental housing. The first is an issue of expenses: what are the costs to subsidized projects of doing business with public agencies? The second is an issue of income: are there additional sources of revenues which can be fruitfully tapped by projects?

Since both these questions are products of the public-private housing partnership designed into many federal housing programs, I will begin in Section 1, "Public Subsidies and Private Housing Projects", by discussing some facets of this partnership.
Chapter 1: Public Regulators and Private Managers

During the past fifteen years, federal housing policies have sought to increase the participation of the private sector in publically subsidized housing. Beginning with Section 202 of the 1959 Housing Act (low interest loans to non-profit sponsors of housing for the elderly and handicapped), an increasing number of federal programs have been designed to attract private business into developing, sponsoring and managing subsidized low and moderate income housing. A public-private partnership has been envisioned, with the public side providing programs and funds, including profits, and the private side providing expertise to create and operate housing for families unable to afford decent, standard dwellings in the market. A concise statement of the government's rationale was given by the Kaiser Committee's study, *A Decent Home*:

American private enterprise, working at its peak efficiency, cannot and will not succeed in building shelter for those left behind by our economic system, so long as private enterprise is working alone. The economic gap separating millions of deprived families from adequate housing can only be bridged by government subsidies. Such subsidies can create an effective and real market demand to which private enterprise has proved it will respond with volume production, providing that there is opportunity for earning a reasonable profit.*

This concept is part of a century-long American tradition that deficiencies in the market should be corrected by government support and regulation of private economic interests, rather than by government control and

*A Decent Home, p.47. The Declaration of Policy, Housing and Urban Development Act of 1968, further specified: "There exist in the public and private sectors of the economy the resources and capabilities necessary to the full realization of this goal [of a decent home and suitable living environment for every American family.]"
ownership. The consensus behind public housing policy is that the private housing market cannot supply adequate housing services, at a reasonable price, to many American families. The government's programs are, then, an attempt to rework market operations so that all families can purchase adequate housing with a reasonable fraction of their income. With the exception of public housing, the government has shied away from direct ownership, preferring to use subsidies as incentives for private developers and managers to supply needed housing.*

This approach has been embodied in a number of multi-family, rental housing programs, including 221d3, 236, leased housing and rent supplement. All use private business as the vehicle for distributing subsidies. Under 221d3 and 236, private interests build and manage housing for which HUD-FHA subsidizes mortgages, thereby reducing rents for tenants in the housing. Under the leased housing and rent supplement programs, private owners manage apartments for which local housing authorities (LHAs) and HUD, respectively, pay part of the rent, while again tenants benefit from lower rents.**

In all these programs, the government is more than a funder of private interests. It also controls recipients' use of public monies. HUD not only pays part of the mortgage interest for 221d3 and 236 projects, it also

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* During the last decade, even the public housing program has been modified to encourage private business participation. Turnkey I (private construction of housing bought by LHAs), Turnkey II (private management of housing owned by LHAs), and leased housing (private ownership and management of housing leased by LHAs) are the latest public housing programs. They are intentionally planned to reduce the dominant role of local housing authorities as intermediaries.

** The origins and operation of these programs are described in A Decent Home and Building the American City. Their statutes are collected in Basic Laws and Authorities on Housing and Urban Development. (See Bibliography for complete citations).
regulates their sponsors, developers and managers. Local housing authorities not only guarantee rents in leased housing, they dictate certain administrative procedures to its managers. After giving subsidies, the public agencies watch to make sure the money achieves its intended purpose. They monitor private recipients to make sure they do not abuse public funds. In effect, the agencies turn into public watchdogs, safeguarding the purposes of government programs. Thus, on the one hand the public agencies act as subsidizers of private managers, on the other hand they act as regulators. This dual role is shared by other distributors of public funds, such as the welfare departments.

Some of HUD's and LHAs' regulatory activities are analogous to those commonly undertaken by government bureaus such as the Interstate Commerce Commission and the Federal Communications Commission which are more frequently regarded as regulatory bodies. Like these commissions, HUD restricts charges which can be levied on consumers: just as ICC fixes train fares, HUD fixes rent levels. Like these bureaus, it limits business profits in order to keep the price of essential services at levels which consumers can afford: just as public utility commissions circumscribe electric companies' profits to ensure that most families can afford light, the dividends taken by 221d3 and 236 sponsors are limited to 6% in order to keep housing costs within the reach of many low to moderate income families.

HUD's primary interests as a regulator of subsidized housing are:

1) ensure that public monies are well spent, by establishing specifications for the production and operation of projects;

2) obtain the maximum return on publically invested funds, by
limiting owners' profits and fixing projects' rent;

3) prevent itself from becoming owner of housing projects.

While the first two general goals are shared by many public bureaus, the last is unique to HUD. Unlike most regulatory and subsidizing agencies, HUD must take over supervised projects which can no longer survive under its rules. It can never wash its hands of them. This is not true of bureaus such as the ICC: if its rate structure forces a railroad into bankruptcy, the ICC does not have to run the railroad. If a welfare department's subsidies are insufficient for a family, it does not necessarily have to give more assistance. But if 221d3 or 236 housing needs more operating funds, HUD either has to relieve its financial distress or become its owner. This is a foreboding prospect for an agency without the capacity or desire to manage real estate. It would always prefer having private interests retain projects than be forced into taking them over itself. Thus, it is not an unbiased regulator who can hold the general welfare above private interests: its own interests intervene. Furthermore, like most regulatory agencies established to promote the public interest, its neutrality is further eroded by over-exposure and deference to the private interests being regulated.* For example, the higher a subsidized project's mortgage, the higher the profits of sponsors and contractors and the higher government subsidies; while the lower the mortgage, the lower tenants' rents and the lower subsidies.** The announced public purposes of housing programs suggest

* For further discussion of how regulators serve those being regulated see, for instance, Bernard Schwartz's "Crisis in the Commissions" in Krislov's The Politics of Regulation.

** The reason why higher mortgages mean higher profits for limited dividend sponsors is discussed in Chapter 2, p.22.
that given a choice about the size of a mortgage, HUD should negotiate a lower price in order to serve tenants better and reduce public costs. But HUD often fails to do this when sponsors' interests would be threatened. It frequently approves mortgage increases to cover construction costs that are the liability of contractors and architects rather than forcing sponsors to sue them for the money. It fears that if it forced sponsors into suing, they would walk away from projects, leaving HUD to own them. It accepts higher mortgages with the accompanying higher rents and subsidies as the price for avoiding ownership. In effect, HUD illegally shifts a financial burden onto tenants, in spite of its own rules to the contrary. * It is prompted by desires both to follow the easiest course of action and, more importantly, to give sponsors financial incentives to retain ownership. Keeping owners satisfied may thus take precedence over tenants' interests in low rents and the public interest in the best possible use of public funds.

The conflict between serving tenants and serving sponsor-managers permeates HUD's intervention as a regulator due to its functions as a subsidizer. As a subsidizer, in addition to benefitting tenants, HUD must make it financially worthwhile for private enterprise to participate in housing programs. Sponsors' benefits come through tax shelter subsidies ** and development fees, particularly the so-called builder's and sponsor's profit and risk allowance. *** Their tax shelter benefits are contingent

* See Section 3, Chapter 8, pages 144 ff, for a detailed discussion of this issue.

** Large tax shelter subsidies are possible under the Tax Reform Act of 1969.

*** The BSPRA is a fee equal to 10% of construction costs in 221d3 and 236 projects. It is included in their mortgages but given to builders and sponsors as soon as mortgages are drawn down. It is essentially a means to reduce sponsors' actual cash equity to as little as 1-2% of a project's replacement cost.
upon successful management of housing projects, with successful defined as keeping the projects out of foreclosure or, in other words, out of HUD ownership.

HUD, then, is motivated by at least three potentially contradictory goals: promote sponsors' interests, keep projects out of foreclosure, and provide adequate housing services to tenants. The latter two are the only goals publicly acknowledged, and sometimes only the last one -- housing services for tenants -- is admitted. In order to attain the last two goals, HUD dictates rules for the administration of subsidized housing and scrutinizes housing operation. Management functions monitored by HUD include all fiscal activities, upkeep of buildings, and management-tenant relations. HUD specifies procedures for such activities as accounting, rent increases, and tenant selection. To facilitate its regulatory role, it requires that managers submit specified information, including annual financial statements and tenant income certifications.

HUD is not the only public agency which jointly subsidizes and regulates rental assistance housing. Local housing authorities, welfare departments, and assessing departments also undertake these dual functions. They often do so in HUD assisted housing when federal subsidies cannot lower rents sufficiently for families within the income limits designated by the 221d3 and 236 programs. In this situation, they may supply additional subsidies to reduce rents. LHAs, for instance, may provide leased housing subsidies. Introduced in the 1960's, leased housing (along with HUD's rent supplement program) was originally intended to shore up private housing markets by enabling low and moderate income families to pay reduced rents in private dwellings. Both programs were advertised as ways
of increasing the number of low and moderate income families who could afford decent, standard market housing. However, both are now more frequently piggy-backed on top of 221d3 and 236 production subsidies, reducing the total number of families which benefit from government programs but deepening subsidies for those families which do participate. Other secondary subsidies have come from local, rather than federal, government. State welfare departments sometimes provide extra direct rent subsidies for welfare recipients. Many cities' assessing departments reduce the real estate taxes paid by federally subsidized housing, as a local contribution in foregone tax revenues.

Each additional subsidizing agency further regulates housing projects. When subsidies are doubled up, two or more agencies may assume supervision of the same management function, leading to inter-agency conflicts. For instance, if leased housing is added to 221d3 or 236 projects, both HUD and LHAs demand the right to review and approve rents in the same dwellings. They sometimes disagree about the amount or timing of rent increases, forcing managers to mediate between them. If their dispute occurs in a city like Boston where local rent control exists, a three-way agency battle may ensue.

Thus, many agencies can intervene in the management of subsidized housing. Many actors have "acquired legitimate roles in regulating resources spent on behalf of the poor."* It has often been noted that these public personnel soak up much of the money allocated for subsidized housing programs. This was described caustically by Rutledge Walker, the director of Low Cost Housing, Inc., in Boston: "For every $10 put into the

*Quoted in Rolf Goetze, *Conserving the American Housing Stock.*
pipeline by the government, only $1 of housing for the poor comes out. Those cats get the rest."*

But the money in agencies' operating budgets is not the only overhead expense of the subsidizing and regulatory process. Regulatory requirements also impose overhead costs on housing project managers. Each procedure they must complete, each form they must fill out takes time and money. When public agencies disagree, managers are sometimes caught in the middle, unable to obtain approval for desired administrative actions such as an eviction or a rent increase. Annoyed by regulatory requirements and delays, some managers have retaliated by abusing subsidies, swindling agencies out of unearned subsidies. Their abuse convinces regulators that they haven't kept close enough watch on projects. They may demand that managers submit still more reports on their activities and fiscal arrangements.

Disgruntled managers in Boston often complain that they are being forced out of business by over-zealous government officials and requirements. They say their management budgets are overwhelmed by the overhead cost of complying with agencies' requirements. These costs include both the direct expenses of filling out forms and attending mandatory public hearings, and the indirect expenses of rents or subsidies lost or delayed through agencies' proceedings.

For all managers' griping, none have ascertained how much time and money are actually expended responding to public requirements. A central concern of this thesis is to detail the costs incurred by private housing managers while complying with the rules of public agencies. In Section 2, *Quoted in Rolf Goetze, Conserving the American Housing Stock.*
I will quantify the costs to managers of dealing with public agencies. While both their direct and indirect costs will be detailed, this study is not a cost-benefit analysis in any formal sense because it does not attempt to determine the net cost of administering subsidized housing. It concentrates on gross management costs. Thus, while it details the cost of administering a real estate tax abatement, for example, it does not then subtract the ensuing tax savings to determine the net cost or savings of an abatement. Similarly, I have neither quantified nor discussed management savings linked to subsidy programs. For instance, I do not discuss whether, as is sometimes alleged, subsidies lead to a reduction in tenant turnover, reducing management overhead. I focus on the costs and problems of dealing with public agencies. These are the unintended side effects of American housing programs. They are the frictional costs of public regulation of subsidized housing.
Chapter 2: Operating Costs and Public Policies

The overhead cost of dealing with public agencies is only one of many problematic operating expenses for private managers of subsidized housing. It is only one of many attributable to the design of government housing programs. The federal rental assistance housing programs--221d3 and 236--are designed such that operating costs tend rapidly to outstrip rental income. The procedures for increasing rental income are such that it can almost never catch up with expenses. The ensuing lag between income and expenditures tends to increase over time, and it contributes to the fiscal problems of many projects.

In Boston, average operating expenses, exclusive of taxes, in 221d3 and 236 projects rose 14.5% between 1969 and 1970. They crept up another 13% between 1970 and 1971.* In a few projects, they increased by almost 300% over a three to four year period. (Average operating costs and percentage change for five representative projects of different sizes are given in Table 1-1.) Rapidly rising costs can be attributed to three causes. One group of causes is internal to projects, while another is external to housing itself. A third cause is the development process dictated by HUD itself.

The internal causes may be ascribed to any or all of the three direct participants in housing projects: tenants - managers - structures. Tenants may be guilty of poor housekeeping which contributes to higher repair, decorating and cleaning costs. They may be responsible for consuming excessive amounts of utilities--electricity, gas, oil, and water--through failing to turn off lights, using stoves for heating, running

* Data from the Urban Observatory's Subsidized Housing Study.
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<th>(b) Project &quot;B&quot;-18 d.u.</th>
<th>(b) Project &quot;C&quot;-43 d.u.</th>
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Notes to Table 1-1:
(a) Project operated by Greater Boston Community Development Corporation. Figures not available for 1966.
(b) Projects developed under the Boston Urban Renewal Program—BURP—during which HUD-FHA sacrificed all other considerations for the sake of production.
(c) Tenants pay for their own maintenance, with few exceptions.
(d) Oil heat; all other projects are gas heated.
water continuously, or opening windows to cool apartments during the winter rather than turning down the heat. Since utilities are included in the rent in most subsidized projects, these tenant actions send up total project operating costs.

Managers may escalate costs by poor maintenance or repair programs which eventually lead to large deferred maintenance costs. If, for instance, they fail to clean halls regularly, they may have to spend larger amounts to paint them frequently. Managers, too, may push up utility bills by failing to operate heating or water systems properly, or by failing to instruct tenants in the proper use of appliances. Either tenants and/or managers may not take care of buildings adequately.

Finally, buildings themselves may contribute to rising costs. Shoddy construction, improperly designed or installed physical systems may lead to excessive utility or repair expenses. Badly hung windows, for example, may leak heat in winter, causing excess fuel consumption. Poor design can also influence operating and maintenance costs. Public spaces may be unnecessarily large, consuming too much heat, or they may attract vandalism by being hidden from public view.* If adequate access to trash disposal is not designed, garbage may be scattered around the property, leading to high collection costs.

Many of these costs might be cut by better planning, design, or communication between tenants and managers. However, another group of operating costs increases cannot be controlled by changes internal to projects. They are caused by institutions or changes external to projects. They include:

* Oscar Newman's recent book, Defensible Space, discusses this concept at length.
1) **Increasing Tax Rates** have been described as the fastest rising expense in subsidized housing by a recent independent study of federal housing by the Carter Burgess Task Force.* Because there is no federal policy on tax rates for subsidized housing, projects are taxed at the discretion of local assessing departments. Most projects try to obtain special, low tax assessments on the grounds either that they supply a special housing service, like public housing, which the city should help subsidize; or that the projects have little real market value and should be taxed accordingly. While many special tax deals are arranged, few are legally binding. (One exception is the so-called 121A Corporation in Massachusetts). Many cities eventually feel that special deals are undermining their tax base,** and they raise taxes. In Boston, for instance, a gentleman's agreement to limit taxes on subsidized housing to 15% of gross potential income was unilaterally upped by the city to 17%, beginning in 1973.

2) **Increasing utility rates** have also been described as the largest operating cost increase in subsidized housing, by the Acting Director of HUD Housing Programs, Fred Pfaender.*** In Boston, at least, rising prices for gas, electricity, oil and water & sewer have strained the budgets of most projects. All four went up in less than four years. Water and sewer rates rose 67% in April 1972. Oil rates doubled, partially due to clean air requirements which forced the burning of higher grades of oil. Electric rates were twice adjusted upward, again as a result of clean air regulations that forced Boston Edison to use more expensive fuel. Gas rates also increased.

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* Interview with Larry Gandel of the Carter Burgess Task Force.
3) **Escalating prices for the services of private vendors, especially insurance**, also troubles many projects. Insurance is generally the most expensive service purchased privately. During the late sixties, most developments in inner city areas could not purchase any insurance on the private market. Insurers were afraid that riots, crime and community opposition would quickly destroy structures. The only alternative for many projects was the government sponsored FAIR plan, which guaranteed insurance coverage but at a price two to four times that of private companies. One project in Boston, for example, had budgeted $3,300 annually for insurance, while its FAIR premiums ran $12,700.

Fortunately, during the last 18 months, insurance costs have begun to drift down as insurers realize their fears were unfounded and subsidized housing is not more risky than conventional housing. The project mentioned above, recently lowered its insurance costs $40 per unit per year by going off the FAIR plan and onto private coverage that costs only $10,100 per year. Nevertheless, this amount is still almost three times its original allocation for insurance.

4) **Vandalism has increased repair and replacement costs in many projects**. One 300-plus unit inner city development in Boston recently spent $7,700 to replace almost 400 light fixtures destroyed by vandalism, $32,000 to replace 86 doors wrecked by a combination of vandalism and the weather, and $14,800 for security screen in first floor apartments; or a total of almost $320 per unit in extra repair costs.

5) **The cost of dealing with public agencies**, as discussed in Chapter 1, is also rising with the large number of public agencies that have some authority over subsidized housing.
But the most common reason why operating costs outrun rental income is that these costs were underestimated during development. During the production of a project, operating costs and mortgage amounts are computed. Rents must be sufficient to pay for both. Under 221d3 and 236 production procedures, rent limits are set independently of mortgage and operating expenses, so that if either cost increases, the other must be reduced in order for rents to cover both.

HUD-FHA housing programs implicitly encourage developers to bring in the highest possible mortgages by linking the amount of developers' profits to the size of their mortgages. Three profits tied to mortgages are (1) the Builders and Sponsors' Profit and Risk Allowance (equal to 10% of construction costs); (2) tax shelter benefits (tax savings depend on the amount of depreciation allowed, and depreciation is a function of mortgage amount); and (3) income from the sale of syndication (the price of syndication is a percentage of the mortgage; hence a larger mortgage means a larger price and larger profit). As a result, many developers try to overestimate their construction and mortgage costs, while underestimating operating costs. Frequently they run up additional mortgage expenses during construction through community opposition, labor strikes, contractor mismanagement or misrepresentation, or general inflation. Whenever mortgages increase, for whatever reason, a greater portion of rents has to be devoted to debt service and less is available for operating expenses.

In the past, HUD-FHA officials have permitted developers to increase their mortgages, while correspondingly underestimating operating costs in order to keep developers satisfied and make projects appear financially feasible on paper. HUD urged developers to make projects feasible for
construction even when it knew they couldn't be managed on projected budgets. Deficient operating budgets are widespread in projects planned during the 1960's and very early 1970's because HUD focused almost exclusively on production, practically ignoring management issues in subsidized housing. It permitted construction of many projects whose operating budgets were deficient by the time the first tenant moved in. The result is glaringly evident in Boston where a representative sample of 30 221d3 and 236 projects had initial operating cost overruns that ran from a low of $105 per unit per year to a high of $622 per unit per year.*

In addition to approving projects with insufficient budgets, HUD approved still more whose operating budgets were sufficient on opening day but which lacked any financial cushion to absorb increases in operating expenses. In these projects, the slightest inflationary increase or extraordinary expense can set off a downward spiral that is likely to destroy projects' financial viability. A nationwide HUD Audit of the 236 program in 1971 concluded that operating costs generally were 20% above advance estimates.** The five Boston area projects presented in Table 1-1 had costs which rose 51% to 179% over projected costs during the first four years of occupancy.

Around 1971, the HUD Audit, coupled with an alarmingly steady rise in defaults and foreclosures of subsidized housing, shocked HUD-FHA into paying more attention to management issues throughout the planning and development of 221d3 and 236 housing. HUD's own national audit of the 236 program in 1971 revealed that insufficient management planning was threatening the

* Urban Observatory data.
viability of many projects around the country. HUD moved to correct its earlier programmatic deficiencies by requiring new housing developments to be planned with realistic operating budgets. While in 1967 it had approved projects with budgets as low as $333 per unit per year, in 1973 it speaks about budgets of $850-1,000 per unit per year. But what about existing projects, already occupied, whose budgets are frozen?

On numerous occasions, government officials have acknowledged the need for more operating monies. Former HUD Assistant Secretary for Housing Management, Norman Watson, once listed half a dozen possible sources of additional operating funds for 221d3 and 236 housing, * but he never pursued them before leaving office. In the third section of this paper, I will examine potential sources of additional operating funds for 221d3 and 236 projects. I will discuss their implications in some detail, outlining their costs, both immediate and long-term; identifying who would ultimately pay for the funds; describing their potential secondary effects on housing projects; and citing those which could attack some of the causes of cost increases. This examination will test whether it is possible to restructure existing housing projects to yield sufficient operating monies, or whether they are inescapably trapped in a cost squeeze that will inevitably move them toward foreclosure.

This discussion is not meant to imply that money alone is the solution to all problems in federal rental assistance housing programs. Clearly, the government and housing sponsors cannot simply buy their way out of all the problems of subsidized housing or even out of all the management problems. The first chapter of this study raised the issue of difficulties

* Norman Watson, Remarks . . ., p.5.
inherent in public regulation of private housers: money alone will not solve these considerations. Furthermore, as the Urban Institute's extensive management studies conclude, good management is the product of many factors, key among them being relations between management and tenants. This study shows that when relations between the two are good, operating costs tend to be less than when they are bad.* This observation means that better managed housing tends to have lower O & M costs than poorly managed housing. Nevertheless, many housing projects clearly need more money in order to operate adequately. Unless managers have sufficient funds to provide tenants with decent services, it is hard to imagine that relations between them could be harmonious. If inflation continues, the number of even well-managed properties that need more operating funds will also increase.

Section 2: The Friction of Doing Business With Public Agencies

Chapter 3: The Cost of Dealing With Public Regulators

Private developers and managers of publicly assisted housing are regulated by public agencies which administer and oversee the private application of housing subsidies. These agencies include HUD, local housing authorities, city assessing departments, and local rent control boards. They supervise not only initial decisions about projects' location, design and financing, but also continuing management of the housing. As additional subsidies and their administering intermediaries are linked to projects, an increasing number of managerial functions become subject to public scrutiny and control: tenant selection and eviction, rent levels, maintenance, decisions on renovation, and bookkeeping. Agencies have intervened in these functions in an attempt to control the use of subsidies. They watch over private housing managers in publicly assisted projects to ensure that the intended goals of subsidy programs are achieved. While this intent is laudable, considerable regulation ensues, and satisfying all regulatory requirements is very costly to subsidized projects.

Not only do projects sustain large costs to obtain and administer individual subsidies, but when subsidies are doubled one on top of another the costs of coordinating them further increase. Since each subsidy is under the jurisdiction of a different public department or agency, each has a separate set of rules and regulations, not to mention other administrators. The manager of any subsidized housing project must fulfill the requirements of each intermediary and then orchestrate his dealings with all of them. For instance, the manager of a 236 housing project with leased

-26-
housing and rent supplement has to screen his tenants according to three
different sets of requirements, complete three kinds of application and
income certification forms. If he wants to increase rents, he has to go
to both HUD and the local housing authority for approvals; if he is in a
city with rent control, such as Boston, he may also have to submit the
rent increase request to the local rent board. All these submissions
demand much paperwork and energy to chase through the bureaucracies.
Furthermore, if all the agencies do not give the same ruling on his
request, he may have to turn mediator and attempt to make them cooperate
on his behalf. Since agencies are often jealous of their own perogatives,
this may be a difficult, aggravating and time consuming task. For instance,
one 300 housing unit project in Boston was granted a rent increase by HUD
after nine months of petitions only to spend another 24 months persuading
the Boston Housing Authority to pay the increased rents for leased housing
tenants. In the interim, it spent three months justifying the increase to
the Boston Rent Control Board. During the 33 months it took to get the
increase, its cash flow was destroyed and five to ten hours of the manager’s
time, each week for two-and-a-half years, was consumed by the negotiations.
These constitute part of the friction of doing business with public agencies.

While the federal government has assumed that private ownership in
partnership with public subsidies could be successful,* it has not asked

*See, for instance, the Kaiser Committee report, A Decent Home: "The Principal
charge of this Committee was to find the necessary incentives and mechanisms
for attracting more private participation in the development of subsidized
housing." (p.5) And the "Declaration Policy", Housing and Urban Development
Act of 1968: "There exist in the public and private sectors of the economy
the resources and capability necessary to the full realization of this
goal [of a decent home and suitable living environment meant for every
American family]." (Complete citations are in bibliography).
what costs this partnership imposes on management. No one has examined how much time managers spend dealing with public agencies; how many hours they use, for instance, to gain federal and local agency consent for rent increases or renovations. No one has questioned how long it takes managers to receive payments for leased housing from local housing authorities. In short, no one has examined the expenses that managers incur in order to fulfill the requirements of public regulators.

The government has structured housing programs to contain sufficient financial incentives to attract private developers, and then assumes that developers are "economic men" who will participate only if the financial rewards are worthwhile. Their participation is taken as sufficient proof that the costs of handling public subsidies are not too high. However, no one has examined the costs borne not during development but rather throughout the operation of housing projects. These are the unintended, external costs of present housing subsidies -- their invisible price. They are expenses to managers of doing business with special subsidy programs.

The overhead cost to the government of subsidy programs has frequently been described.* It has been quantified, in some detail, by at least one writer, Arthur Solomon in The Cost Effectiveness of Subsidized Housing. He points out that the real expenses for each subsidy include not only the amount of benefits given to the recipient, but also the amount spent by the government to administer them. My contention is that the real price also includes the amount spent by housing managers to administer subsidies within housing projects. These costs are not incurred by managers of private, market housing which does not receive subsidy benefits. They are

*See, for instance, Bernard Frieden Improving Federal Housing Subsidies, p.15; and The Economics of Federal Subsidy Programs, p.113 ff.
felt only in subsidized projects.

Doing business with the government may bring benefits to projects, sometimes very sizeable ones. In many cases, housing developments would never have existed without public agencies and their subsidies. But these benefits come at a price.

This price is one contributor to the operating squeeze of subsidized housing described in Chapter 2. It adds large administrative costs to projects, costs that are almost never accurately assessed when projects are initially planned. For one Boston non-profit sponsor of 221d3 and 236 rehab., the cost of dealing with public agencies has run as high as $170-$215 per unit per year, or two to three times the amount initially allocated for management fees.*

The intent of this section is to outline the expenses to subsidized housing projects, in Boston, of dealing with public agencies. It examines the costs and benefits of doing business with each intermediary that provides a subsidy. Costs are given in the form of time and dollars actually expended by managers: they are not reduced to the limited amounts acceptable to HUD for accounting purposes. This study, however, is not a formal cost-benefit analysis since it does not compute the savings or net costs of public subsidies and regulation. It focuses only on the gross costs of doing business with public agencies. Since this study was undertaken in Boston, these agencies are the Department of Housing and Urban Development, the Boston Housing Authority, the Massachusetts Welfare

*All figures on management expenses, except where noted, are based on an average cost of $5 per hour for administrative time and overhead.
Department, and the City of Boston Assessing Department.* Each managerial function that they regulate will be discussed. Under HUD, these functions include, for instance, projects' financial record-keeping and management-tenant relations. One public authority that does not give a subsidy is also discussed: the Boston Rent Board. The overhead expenses attributable to the Rent Board are not unique to subsidized housing. They are incurred by all housing under the Rent Board's jurisdiction which encompasses the great majority of rented dwellings in Boston. Although the costs associated with Rent Board requirements are shared by much market housing, they are discussed nevertheless, because they are very costly to managers of subsidized housing and complicate their dealings with subsidizing agencies.

For example, when managers want to raise rents, they must obtain approval from the Rent Board in addition to HUD and, if leased housing is involved, BHA. The existence of a Rent Board review can affect approval procedures at the other agencies.

Data on the actual costs of dealing with public agencies is generally difficult to ascertain since HUD permits projects to take only 5% or 6% of rents for general management and administrative expenses. No managers whom I contacted kept records of real administrative time costs because under HUD's regulations they have no way to recoup that expense. Since most

*Public utility departments provide subsidies to some housing projects in the form of special, low rates, but since they are quasi-public businesses, rather than actual government bodies, I will not discuss them.

In Boston, the number of other public agencies whose functions touch housing without providing any subsidies has recently proliferated. These agencies, with the noted exception of the Rent Board, will not be discussed here, even though subsidized projects sometimes have to do business with them. They include: Board of Appeal, Boston Redevelopment Authority, Building Department, Health and Hospitals, Housing Inspection Department, Office of Public Services, Public Facilities Department, Public Improvement Commission, Public Works Department, Real Property Department, and the Zoning Commission.
managers share their administrative staff and resources with non-project activities, they do not record separately the time consumed while working on public agencies' requirements. Managers with multiple parcels often centralize their administrative functions and cost accounting, so they lack records of overhead expenses in individual projects. In order to determine real management costs on a per project and per unit basis, I drew on six main sources. Three of these are management entities whose staffs I interviewed repeatedly and at length to ascertain their real expenses. They estimated the number of hours and any direct expenses (such as legal fees or postage) associated with regulated, administrative activities. (In general, administrative time was estimated to be worth $5 per hour). From this information, I complied a base of comparative costs in three different kinds of projects. Each represents a distinct kind of development and a distinct kind of management organization. The three are:

1) Greater Boston Community Development - a public interest organization that manages small (3-25 unit), non-profit projects.

2) Mr. Brown* - an independent manager who handles, on a contractual basis, medium-sized limited dividend projects with 50-150 units.

3) State Management* - a wholly owned management subsidiary of a large development company with large, 500-1,000 unit, limited dividend developments.

The information from these three was complimented by less intensive interviews with other managers in the Boston area - the fourth major source.

*"Mr. Brown" and "State Management" are pseudonyms. They stand for an individual manager in a small management company and a management team in a large company who asked that their real names not be used.
for this paper. In particular, two sponsor-managers who participated in the Boston Urban Renewal Program (BURP) in the late 1960's were questioned about a variety of issues.

The fifth source for data about projects' costs is the Boston Urban Observatory. With principal investigator Vince O'Donnell, it is conducting a study of government assisted private housing in Boston, The Subsidized Housing Study. This study is examining "the extent of and reasons for financial and social difficulty in federally subsidized rental housing projects". It has interviewed managers and owners in a sample of 27 projects and conducted a financial analysis of the projects' development and operating costs. Vince O'Donnell has kindly allowed me to review this material, and I have drawn on it for many examples and figures.* The Urban Observatory study will be finished in September, 1973.

Another major source of information about public intervention was the staffs in public agencies. I interviewed people in HUD, BHA, MHFA, and the Boston Rent Board in order to get their side of the picture. (See "List of Interviews", p.190 for a complete record of officials interviewed).

Based on these diverse sources, I have compared the costs of different low and moderate income subsidized projects and tried to ascertain why management costs vary greatly -- as they do -- among different developments. A fuller understanding of these costs would depend on knowing comparable overhead expenses in market and middle class housing. While this study shows that subsidized housing managers must undertake many costly, regulated activities which market managers do not encounter, the formers' expenses

*Since this data has not been published yet, it will be footnoted simply as "Urban Observatory data."
could be seen in better perspective if the latters' costs were available. Useful comparisons between subsidized and market housing would be, for example, the cost of obtaining a tax abatement versus the cost of administering tax payments at standard assessments. Still more interesting would be comparisons between overall administrative costs in low income and middle income housing. While there is speculation that overhead management costs are always higher in low income than in middle class housing --even when both are on the private market--actual discrepancies do not seem to be documented. If they were, then it would be possible to know whether the costs discussed in this study are part of a consistent pattern of high overhead in low income developments or whether they are atypical.
Chapter 4: Federal Regulator: HUD-FHA

Although 221d3 and 236 are considered housing production programs, the federal government's involvement in them does not end when construction of buildings is completed. If anything, its intervention increases once buildings are finished and occupied. The government always remains heavily involved financially and politically. Financially, it pays major subsidies for tenants and for developers throughout the life of the mortgage. For tenants, it reduces the interest paid on mortgages to 1% (in 236) or 3% (in 221d3), effectively decreasing rents. This amounts to an annual subsidy commitment of approximately $450 to $1500 per unit per year for the forty year term of mortgages, with an average yearly subsidy in Boston of $975/unit in 236 projects and $722/unit in 221d3.

This lowers the monthly rent on a typical unit by $81 in 236 and $60 in 221d3. For developers, a major attraction is the possibility of substituting foregone development fees for any real cash equity. Then they can "mortgage out": "borrow enough to cover all out-of-pocket costs - and sell to final owners having made little or no investment in cash".* Final owners receive substantial government subsidies in the form of tax shelter benefits under federal income tax laws, particularly the 1969 tax reform act which greatly increased the tax value of depreciation on low and moderate income housing.

In return for these benefits, tenants and sponsor-managers, but especially sponsor-managers, agree that HUD can regulate certain managerial functions in the housing projects. These functions include:

*Henry Aaron, Shelter and Subsidies, p.132.
1. Keeping records on projects' financial status: HUD dictates the format for projects' financial accounts and then reviews them periodically.

2. Changing projects' fiscal arrangements: HUD reviews and must approve any changes in projects' financial status, including rent increases and mortgage modifications.

3. Maintaining projects' physical condition: HUD inspects projects periodically and must approve any major renovations.

4. Maintaining management-tenant relations: HUD puts certain restrictions around these relations, requiring the use of approved leases defining eligibility rules for tenants.

In some projects, HUD provides a double subsidy in the form of rent supplement payments. Along with the payments come additional HUD regulations for the management of projects. However, while the basic 221d3 236 programs institute subsidies and regulations which are binding on all tenants in a given project, rent supplements lower rents only for selected tenants and accordingly carry regulations which apply only to a portion of the tenants in any project. Managers have the job of keeping track of which tenants receive the second subsidy.

Table 2-1 summarizes the tasks which management must perform in order to satisfy HUD regulations under mortgage interest rate and rent supplement subsidies. It also presents the costs in administrative time and overhead that GBCD, Mr. Brown and State Management have incurred while fulfilling each requirement. As the totals indicate, GBCD is spending more than its total management fees simply in order to fulfill all HUD's regulatory
### Table 2-1: Managements' Dealings with HUD and Their Costs

<table>
<thead>
<tr>
<th>Management's Dealing with HUD</th>
<th>Management firm and costs*</th>
<th>State - large projects</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>GBCD - small projects</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Brown - medium projects</td>
<td></td>
</tr>
<tr>
<td></td>
<td>State - large projects</td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 - 25 units avg: 10 units</td>
<td>40 - 140 units avg: 60 units</td>
</tr>
<tr>
<td></td>
<td>per project per unit per year</td>
<td>per project per unit per year</td>
</tr>
<tr>
<td>records financial status according to regulations:</td>
<td></td>
<td>$2500 $2.50-6.25</td>
</tr>
<tr>
<td>keeps accounts in accordance with format in FHA 2230</td>
<td>negligible, provided books are initially established according to HUD regulations</td>
<td></td>
</tr>
<tr>
<td>keeps monthly accounts available to HUD, on demand</td>
<td>negligible</td>
<td>$2000-2500 $18-50</td>
</tr>
<tr>
<td>has yearly certified audit &amp; prepares profit &amp; loss statement</td>
<td>$300-500 $21-30 $2500</td>
<td></td>
</tr>
<tr>
<td>computes, collects &amp; records residual receipts</td>
<td>$84 or $7 1-1/2 hr/mo.</td>
<td>$90 $7 $0.50-1.00 2-3 hrs/mo.</td>
</tr>
<tr>
<td>keeps separate bank accounts for rents &amp; security deposits</td>
<td>$120 or $5-24 2 hr/mo.</td>
<td>$180 or $1.30-3 hr/mo. 4.50 $350-400 $0.40-.95</td>
</tr>
<tr>
<td>maintains up-to-date rent schedule</td>
<td>$5</td>
<td>$5</td>
</tr>
<tr>
<td>send escrow accounts for taxes, insurance &amp; replacement reserve to GNMA; request them when expenditure required</td>
<td>$15 $0.60-3 $30 $0.20- .75</td>
<td>$10-20 negligible</td>
</tr>
</tbody>
</table>

*All costs are computed on a basis of $5 per hour for management time, including overhead such as typing, etc.
Table 2-1, Con't.

<table>
<thead>
<tr>
<th>Management's dealing with HUD</th>
<th>GBCF's cost</th>
<th>Brown's cost</th>
<th>State's cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>formally requests changes in</td>
<td>project's financial status:</td>
<td>$500-700 for</td>
<td>$2000-5000</td>
</tr>
<tr>
<td>requests rent increases &amp;</td>
<td>10 small projects, or</td>
<td>$5-10*</td>
<td>$2.50*</td>
</tr>
<tr>
<td>pursues them</td>
<td>$100 if done singly</td>
<td>N.A.</td>
<td>N.A.</td>
</tr>
<tr>
<td>requests expenditure of</td>
<td>replacement reserve</td>
<td>$50-100 per request</td>
<td>N.A.</td>
</tr>
<tr>
<td>requests mortgage modifi-</td>
<td>cation</td>
<td>N.A.</td>
<td>N.A.</td>
</tr>
</tbody>
</table>

has physical condition of buildings monitored:

| HUD inspects buildings yr'ly | negligible | negligible | $25 | negligible |

deals with tenants according to regs:

| rents-up according to regs, | $500-2500 | $100 | $2000-7000 | $2000-7500 |
| including tenant certification | $20 or 20 hours | 10 hours | $50 or 10 hours | $100 or 100,000 |
| recertifies tenants - | $12-62 | $2.50** | $100-350 | $100-350 |
| bi-annually in 221d3 | $50-250 | $2.50 | $100-210 | $5-7 |
| annually in 236 | $10 | $7-10 | $210-700 | $2100-10,000 |

administers rent supp. program***:

| certifies tenants as eligible | $100-150+ | $10-15 or 2-3 hr. | $100-350 | $100-350 |
| recertifies tenants | $50-150* | $5-15 or 1-3 hrs. | $75 | $1-4 |

* pro-rated as one increase every two years
** pro-rated across two years to get yearly figure
*** assumes half of tenants on rent supp. Per unit costs only for units with rent supp.
+ assumes 10 tenants on rent supp.
Table 2-1, Con't.

<table>
<thead>
<tr>
<th>Management's dealing with HUD</th>
<th>GBCD's cost</th>
<th>Brown's cost</th>
<th>State's cost</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>project/yr.</td>
<td>unit/yr.</td>
<td>project/yr.</td>
</tr>
<tr>
<td>Administrates rent supp.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Program</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Certifies tenants as eligible</td>
<td>$100-150**</td>
<td>$10-15 or 2-3 hr.</td>
<td>$100-350</td>
</tr>
<tr>
<td>Recertifies tenants</td>
<td>$50-150**</td>
<td>$5-15 or 1-3 hr.</td>
<td>$75</td>
</tr>
<tr>
<td>Keeps records of tenant occupancy</td>
<td>$50 or 10 hr.</td>
<td>$4-10</td>
<td>$50 or 10 hr.</td>
</tr>
<tr>
<td>Bills HUD monthly</td>
<td>$60</td>
<td>$4.50-11</td>
<td>$60</td>
</tr>
<tr>
<td>Receives HUD payments a month late</td>
<td>5% of value of rent supp. payments lost</td>
<td>negligible</td>
<td>negligible, but cash flow disturbed</td>
</tr>
<tr>
<td>Keeps tenants in appropriately sized units</td>
<td>$400-700 per move</td>
<td>$50-200</td>
<td>$116-120 + $15 in mgnt. time</td>
</tr>
</tbody>
</table>

* Assumes half of tenants on rent supp. Per unit costs only for units with rent supp.

** Assumes 10 tenants on rent supp.
requirements. Its total fees for nine small projects run $6,445 per year, while it needs $825 - 1,125 annually to cover each project's federal requirements. For GBCD, fees are not sufficient to cover all its obligations to public agencies; they hardly cover GBCD's federal dues. In contrast, Brown and State can pay for all their regulatory obligations out of management fees, although in Brown's case insufficient money is left over for other management duties such as supervision of housing services and rent collection.

**HUD Regulates Projects' Financial Status**

When HUD commits a federal mortgage interest subsidy to a 221d3 or 236 project it guarantees that subsidy for forty years, the life of the mortgage. Having locked itself into a subsidy for four decades, it maintains the right to oversee the project which is benefitting from reduced rents. It keeps track of the recipient's financial status and records, first, by dictating an accounting format which provides HUD with all the information it desires. (This format is given in Handbook of FHA Requirements Governing Fiscal Operations, Accounting and Financial Reports for Multi-family Housing Projects, FHA No. 2230.*) All three managers interviewed at length said this requirement had negligible costs, since their books were initially set up according to HUD outlines. However, if any had first organized its books on different accounting principles, it would have had to shoulder the expense either of converting its books or keeping two separate sets of books, one for the government and one for its own in-house use. A few developers have chosen the latter option.

*Cooperative projects use a slightly different format.
Second, in addition to stating that these books must always be available on demand, HUD requires that 221d3 and 236 projects be audited annually, again in accordance with its format. This has imposed extra costs on GBCD. If HUD's format were waived, GBCD director Bob Whittlesey estimates that its audit costs would be halved, reduced from $300-500 per project -- depending on size -- to $150-300 per project. Mr. Brown's audit costs have been considerably higher, up to $2050 in a 65 unit project and as high as $2,500 in larger projects. The four reasons for his higher costs are, one: his projects are larger; two: his projects are not non-profits, so audits include more computations to determine and certify limited dividend distributions; three: his audits include the completion of tax returns for the limited dividend partnership; and, four: he employs a prestigious auditing firm which charges high overhead rates. When asked what this company would charge to audit small, non-profit projects like GBCD's, Mr. Brown replied, "Around $1000" -- still two to three times GBCD's costs. If an independent auditor were employed, he said the cost might go down to $500, or the same as GBCD's costs with a large, national auditing firm. The conclusion I draw from this is that it would pay project managers to shop around for outside vendors, like auditors, because their costs are not always comparable. State Management, whose projects are far larger than Mr. Brown's, quoted a similar figure for audit and accompanying legal costs: $2500 per project. State's bookkeeper said that approximately $1000 of this amount could be attributed to the audit itself, while the rest went for legal fees. Evidently, it has not had to pay more than Mr. Brown for larger projects. State's costs were echoed by another large development-management company which has
rehabilitation projects in many cities.

State's director disagrees with Whittlesey's statement that auditing costs would be halved if HUD rules were eliminated. His costs for audits of for-profit housing projects are the same irrespective of whether they are HUD subsidized or private financed.

One of the primary difficulties with audit costs is that in the vast majority of subsidized projects, little or even no monies are allocated for audits in initial operating budgets.* FHA-HUD's form for the calculation of operating and mortgage costs, #2264, does not even contain a line for audit expenses. If a project has budgeted nothing, its first audit may cause a mad scrambling of the budget to identify the needed $500 - 2,500.

A third fiscal matter under HUD's control is residual receipts. Residual receipts are net income from: 1) unexpended ANPO funds, 2) net rents received prior to cost certification, 3) in 221d3 projects the portion of rent paid by an over-income tenant which exceeds the basic rent.**

Residual receipts must be recorded on particular HUD forms and then deposited in a special bank account. A manager is not allowed to spend them without HUD approval. In 236 projects, excess rents are not part of residual receipts. Instead, they must be recorded on special HUD forms and then remitted monthly to HUD.***

* Urban Observatory Data.
*** The different handling of excess rents in the two kinds of projects is not whimsical. The difference is based on the distinction between 221d3 and 236 subsidies. In 221d3 projects, the federal government provides a fixed subsidy amount per dwelling unit, regardless of who occupies a unit, while in 236 projects its contribution decreases as the income of tenants
Since residual receipts impose extra obligations on management, Mr. Brown has tried to prevent them. That is to say, he has avoided over-income tenants in order not to have the administrative expense of handling excess income. Surely HUD did not intend its administrative rules to turn into a tenant screening device!

GBCD has not consciously avoided over-income tenants. But it has only one and hence only one residual receipt of $7 per month. GBCD's bookeeper, Dotti Rosette, estimates that almost the same amount, $7, is needed to pay for the administrative time used in processing the residual receipt. Approximately an hour per month, or $60 per year, is absorbed by recording, depositing and notifying HUD of the receipts. Because it seems absurd to spend the equivalent of the residual receipt administering it, GBCD does not deposit it in a special account, as officially required. It leaves the $7 with other rent receipts and spends it like any other income. Although this is technically illegal, it seems the more sensible action, particularly since the project is losing money.

With twenty times as many units as GBCD under management, State has many tenants paying residual receipts. Approximately two to three hours per month, or $500 per year, are its estimates of the cost of handling this income according to the book.

HUD's books* also detail the handling of two other kinds of project income: residential rents and security deposits. Each must be placed in separate bank accounts. The individual record-keeping for each

Cont'd.

increases. Thus, as tenants' income and then their rents rise, the increase in rent is to be remitted to the federal government to reduce its contribution.

account probably adds to administrative costs two hours per month or $120 per year at GBCD, while Mr. Brown's cost runs slightly higher: 3 hours per month or $180 per year. For State's large projects, this cost increases to $350-$400 per year. State's higher cost is partially attributable to a more complicated in-house financial system. Each of its projects sends all receipts to the main office which makes all deposits and draws all checks. This centralized disbursement of funds is not uncommon in large management companies, nor is it unique to subsidized projects. State's director pointed out that his market projects also have to keep separate accounts for rents and security deposits because recent court decisions make it mandatory to pay interest on security deposits.

Projects' expenditures, as well as their income, are subject to HUD rules. Procedures are specified for paying insurance, real estate taxes, replacement reserves, and water and sewer bills. Escrow accounts for each must be established with Government National Mortgage Association (GNMA)* in Philadelphia, and deposits made monthly. When a project wants to expend funds in the escrow accounts, it must formally request GNMA to disperse them. Since GNMA does not pay any interest on these accounts, projects are deprived of the 5% of their value which could be earned if funds were deposited in ordinary bank accounts.** At GBCD, roughly one hour per project per year has gone into each escrow account, or a total of $15 per project, at a minimum. The time is used to arrange for GNMA

*GNMA is the final mortgagee for 221d3 projects, while FNMA (Federal National Mortgage Association) is usually the final mortgagee for 236 projects.

**GNMA recently changed its rules so that projects can earn interest, but only if they specifically request it.
to make the appropriate disbursements. Sometimes this turns into a complicated procedure, and then the cost increases. For instance, GBCD deposits its tax escrow reserves at GNMA. The City of Boston annually issues tax bills to both GBCD and GNMA. Since the tax bills are often computed incorrectly, GBCD has officially requested GNMA not to pay the tax bill directly, but to remit the tax escrow funds to GBCD which can then negotiate the proper bill with the city and pay only the correct amount. Unfortunately, GNMA has not always honored this request; sometimes it has gone ahead and paid the tax bill which it received. Then GBCD has had to spend considerable time at City Hall trying to have any over-payments returned or credited against the following year's accounts. Straightening out the tax bill has been further complicated by GNMA's consistent failure to notify GBCD when it paid the bill, despite repeated GBCD requests that it be informed whenever GNMA disperses any of its escrow accounts. These same difficulties repeat themselves when insurance companies submit bills. Thus, although the escrow deposits are supposed to improve subsidized projects' financial balance and simplify their bill payments, in fact they have caused GBCD considerable administrative expense.

GBCD's bookkeeper, Dottie Rosette, points out that the small size of GBCD's projects is a disadvantage in dealing with GNMA because they cannot absorb the expense of long distance calls to Philadelphia when problems arise. A large project could afford a phone call to settle problems because the call's expense could be spread over a large number of units.

GBCD disputes with GNMA over handling of water and sewer escrow
accounts finally prompted it to withdraw this escrow from Philadelphia and maintain it in a local, private bank account.

These problems with GNMA do not seem to be typical of subsidized housing, however; neither Mr. Brown nor State nor any of the managers interviewed by the Urban Observatory has been perturbed by GNMA. They seem to have been able to rationalize disbursements from GNMA-held escrow accounts. State has all tax and insurance bills sent directly to itself; it pays them, and then requests GNMA to reimburse it from escrowed deposits. The State staff say that the cost of this procedure is negligible, perhaps $5 to $10 per year for the time spent writing the reimbursement request to GNMA. It can afford to advance payment because its large projects produce sufficient cash flows. While Mr. Brown's medium sized projects do not generate enough revenues to pay in advance, he has all bills sent to him, and he reconciles them before forwarding them to GNMA for payment. He estimates that perhaps $15 per year is spent on each escrow account in his projects.

It is worth noting the discrepancies among GBCD's, State's, and Mr. Brown's costs and problems in meeting HUD's fiscal requirements. The larger projects have a lower per unit cost for each requirement because they can amortize costs over a large base. (See Table 2-1 for figures). GBCD seems to have had more difficulty dealing with GNMA and HUD, perhaps because no single staff person there has had continuing responsibility for dealing with public authorities.

**HUD Reviews and Approves Changes in Projects' Financial Arrangements**

No subsidized housing project can increase its rents until it obtains approval from HUD. Once rents are set at initial occupancy, they
can be raised only to cover documented cost increases such as higher utility bills, increased tax assessments, or increased repair and maintenance costs. As I indicated in the previous chapter, the majority of subsidized housing projects (in the Boston area) have suffered from increased costs that cannot be covered by project income. In order to obtain HUD approval for a rent increase, managers must submit documentation of increased costs, along with projects' annual profit and loss statements. Because increases are granted only for costs already incurred and documented, they never catch up with present costs. HUD's rules require that projects incur operating deficits before they can obtain more rental income. While HUD's procedure is based on an understandable desire not to permit unnecessary rent hikes, it enforces a considerable time lag between rises in expenses and approval of additional rents to cover them. Since costs are rising constantly with inflation, the effect of HUD's requirements is that project income is always behind current expenses. The result is a constant shortfall in operating funds. This is one of the major administrative problems for subsidized projects. It is aggravated by the lengthy amount of time required to obtain HUD approval for rent increases once costs are documented.

Although HUD regulations state that all rent increase requests shall be handled with utmost speed, obtaining approval is a long and expensive procedure, according to managers. Managers say that requests are frequently delayed in local HUD area offices.

Bob Whittlesey estimates that it has cost GBCD $500-700 to obtain a HUD-approved rent increase, or over 100 hours of management time in order to chase a rent increase through the HUD bureaucracy. These costs are not
atypical: a manager of a 140-unit, limited dividend 236 project says it costs him $600-700 to file for a rent increase. State claims costs of $2,000-3,000, and occasionally up to $5,000 in its largest projects, to obtain and implement rent increases. Implementation includes computing new rents for each tenant, notifying him, and preparing new bills and rent schedules.

The energy and persistence required to push a rent increase through HUD are even larger than the dollar costs. Mr. Brown, for instance, recently spent eight months obtaining a rent increase. He filed the required papers in May and sat back to wait for HUD's ruling. When he had heard nothing by July, he called the local HUD area office to see what was happening. After being reassured that he'd hear soon, he waited again. When HUD's silence continued into September, he tried calling HUD repeatedly to no avail. So he finally called the HUD area Director, whom Brown knew from other activities, and demanded a meeting. This was speedily arranged, and Brown urged the Director to put some pressure on his staff. Then within a couple of weeks, Brown's request was processed in Boston and forwarded to the central HUD office in Washington.* By November, Brown felt Washington had had a long enough time, so he called the Boston office to see whether his request had been returned. When informed that no one there knew, he angrily called Washington only to learn that his application had been approved and sent back to Boston. Another call to the Boston area office. After he said he'd spoken with the Washington staff and knew his request was okayed, someone in Boston found it. Brown asked how much of an increase he'd

*It is not a typical procedure for rent increases to go to Washington, but it was necessary in this case due to the extraordinarily large amounts being sought by Brown.
been granted, but the HUD bureaucrat refused to tell him over the telephone. So Brown repeated the figures he'd been given by Washington; the HUD person admitted they were accurate. In that case, asked Brown, could he implement the increase immediately, since the project was losing money? No, came the reply, not until he was officially notified in writing by the Area Office. That letter finally came a month later, on December 28.

I have recounted this episode at length in order to suggest the amount of paperwork and politicking sometimes required when dealing with an inflexible bureaucracy.

Despite the lengthy period HUD holds requests for increases, it generally subjects them to only a cursory examination. Neither cost submissions nor the future impact of rent increases are carefully scrutinized. For instance, new rents are computed on the basis of the previous year's real estate taxes, in spite of the fact that higher rents will push up the tax bill.* Sometimes HUD has approved increases based on double entries for the same item.**

While reviewing manager's submissions, HUD does not give equal weight to all cost categories in deciding whether a rent increase is justified. A management showing significant losses from administrative expenses would not be granted an increase as readily as one that showed loss resulting from operating or maintenance costs.*** Developers and managers are aware of this. They sometimes knowingly juggle their figures

** Urban Observatory data.
*** Karlis Zobs, Study of Management Operation and Administrative Costs of Moderate Income Rental Housing, p.5.
to conform with HUD's perception of need. Thus, some administrative expenses may be passed off as operating or maintenance costs in the interests of securing a rent increase. This occurs because HUD does not acknowledge the real costs of administering subsidized housing.

Given this attitude of HUD and rapidly rising costs, GBCD and many other subsidized housing managers around Boston file for rent increases continually. As soon as one increase is granted, they file for another, anticipating that 12 months will elapse before the second one can be implemented. The longer the processing time, the greater the gap. With rapidly rising costs, approved rents are always behind actual project expenses, according to Whittlesey. Continual filing for increases is the only way he can hope to keep project income close to actual costs.

Several other housing managers said that they do not file so frequently only because their tenants could not afford to pay rent increases if they were approved. Caught in a squeeze between rising costs and tenants on fixed or limited incomes, the managers are reluctant to undertake the expense of obtaining a higher rent if much of any increase will be consumed in the process. State Management claims that often half the yearly value of an increase will be spent to obtain it.

The Director of Management in the Boston HUD Area Office, Irving Solomon, acknowledges that rent increases have been terribly delayed in his office. But he blames the delay on insufficient staff and says that recently the Management Department hired several new people who can help speed up the process. He also reports that as of May 15, 1973, a

* Karlis Zobs, Study of Management Operation and Administrative Costs of Moderate Income Rental Housing, p.5.

** Urban Observatory data.
directive from the HUD central office ordered that all rent increases be processed within 30 days.*

Another change in projects' financial status which must have HUD approval is expenditure from their replacement reserves. These reserves are "designed to assure that funds are available to replace installed items in a project."** These items include stoves, heaters, floor tile, roofing, and so forth. In order to spend replacement reserve funds, projects must file a statement on why the funds are needed and how they will be used. In addition, if a manager wants to suspend deposits to the replacement reserve, either because the project is short of funds or because a substantial reserve has already been compiled, he must request permission. GBCD has expended between $50 and $100 on each request to use part of its reserves.

A third change in project financial status that requires HUD approval may, unlike the previous changes, bring special benefits to subsidized projects. This is a modification of the mortgage.

If a subsidized housing project cannot cover all its operating costs, it may request a temporary suspension or reduction of mortgage principal payments in order to use the money to correct its operating problems. Projects around Boston have been granted mortgage modifications in order to repair such latent construction defects as leaky roofs and foundations, in order to repair damaged units in compliance with housing codes, and in order to pay accumulated, outstanding bills.***

***Urban Observatory data.
Obtaining a mortgage modification is no simple matter. It may require up to six months of negotiations, according to Brown. HUD often delays its response to requests, leaving managers puzzled about their obligations. Before a modification is granted, managers must pay for an updated title search, which adds a couple hundred dollars of expenses. Mortgage payments must be current when a modification begins, so if any payments have been skipped, they must be made. One of Mr. Brown's projects was granted a 12 month modification, but only after its general partners contributed $19,000 to bring the project current on its mortgage, pay the management fee, and hire someone to repair the project during modification. Brown estimates that $200 worth of his time was expended obtaining the modification from HUD.

Although mortgage modifications entail costs, they also bring special benefits to subsidized projects. Ordinary market housing could not get permission to waive principal payments. If it ever failed to pay the mortgage, it would be foreclosed. But HUD is very anxious not to own subsidized housing. So it established modification procedures as a way of enabling projects to ride out temporary periods of financial difficulty. HUD is not the only party which must consent to a mortgage modification. Mortgages must also approve them since they are the institutions which will not be paid during the modifications. Since GNMA is the final mortgagee for 221d3 and FNMA for most 236 projects, their consent has not been too difficult to obtain in the past; although as the number of projects requesting modifications increases nationwide, they may become more reluctant to give approval. Both them and HUD have been anxious to accommodate mortgage modifications when they seemed the only way to remedy
operating problems because all three agencies have considered keeping projects out of foreclosure a higher priority than consistent mortgage payments. HUD, in particular, does not want to be saddled with foreclosed housing projects that would revert to its ownership. With an increasing number of foreclosures in many HUD assisted housing programs, it is doing everything in its power to avoid becoming the owner of last resort. So housing projects may benefit from HUD's fears, even though this benefit comes only at the expense of considerable management effort. As mentioned earlier, non-subsidized market housing is not eligible for either the costs or the benefits of mortgage modifications. With few exceptions, if a market housing project defaults on its mortgage principal payments because the money is needed for repairs, its mortgage will be foreclosed.

**HUD Monitors Projects' Physical Condition**

A third aspect of subsidized housing projects which HUD regulates is the physical condition of projects. During the development and construction of projects, it approves their plans and specifications. It sends out its own inspectors to ensure that construction is completed according to plan. (See Section 3, pp.144 ff. for further discussion of HUD's involvement in construction). After occupancy, HUD is supposed to make an annual physical inspection of all projects. If any defects are seen, it is supposed to push management to repair them. However, according to GBCD and other managers in the Boston area, these inspections often do not occur. When they do, they do not themselves cost projects anything, since they are made without notifying managements. (Of course, if defects are turned up, their repair will involve maintenance costs.) In several
Boston projects, HUD inspections occurred only after tenants went to HUD to protest inadequate conditions in their apartments. (Section 3, pages 144ff., discusses other ramifications of HUD inspections.)

**HUD Regulates Management-Tenant Relations**

Management-tenant relations are conditioned by some HUD regulations. When projects open initially, rent-up must be done according to HUD rules. These include provisions for equal opportunity advertising, cooperation with local public service agencies which might know potential tenants, HUD approval of all leases signed with tenants, selection of tenants according to HUD determined priorities, and screening of tenants according to HUD rules for income eligibility. Management is also responsible for certifying that tenants are within income limits for subsidized projects. In 221d3 projects, a two page FHA form (No.1705, Total Family Income Certification) and in 236 projects, a three page FHA form (No.3131, Application for Tenant Eligibility) must be completed for each applicant.

One manager of many 236 projects in the inner city of Boston estimates that his firm spends an average of 20 hours renting each apartment or double the time required to rent a market apartment in the absence of HUD rules and requirements. GBCD's Bob Whittlesey and State Management concur with this estimate. However, Brown said that his rent-up time averages only 10 hours, or $50 in administrative costs. A large firm which handles rehabed projects nationwide cites still lower costs: $21 or $22 per family, or around 4-5 hours. Its lower costs may be attributable to a specially trained staff person who works primarily on rent-up.

After rent-up, management is also responsible for re-certifying tenants' incomes every two years in 221d3 and every year in 236 projects.
If management really sits down with each tenant to verify his current income, it might spend half an hour to an hour with each 221d3 tenant and an hour to two hours with each 236 tenant, according to Whittlesey. (The difference in time is attributable to more complex forms for 236 tenants.) Even more time might be required if management had trouble contacting a tenant and had to visit or call several times before obtaining the required information. Again using a basic administrative cost of $5 per hour, recertification would cost between $2.50 and $10 per unit. In a 100 unit project, this is a cost of $250 to $1000.

These figures are echoed by State Management, while Brown finds them a bit too high. He seems to have less trouble completing forms with tenants than either of the other two managers. Another manager of a large 236 project said that he spends $3.50 per apartment to verify tenant incomes, a figure more in line with Brown's cost. Still other managers have said that they refuse to spend the time and money re-certifying tenants when they have no way of knowing whether the information obtained from tenants is accurate. They admittedly fudge the information. They point out that tenants have no incentive to be honest. If their incomes have risen, they are supposed to pay more rent. Few families will willingly pay more if they think they can pay less. If tenants' family size has changed, they may have become eligible for a different sized apartment, and management then has the responsibility of trying to have them move into an appropriately sized unit.

If family size has decreased, what incentive does a family have for telling someone who will then ask it to move into a smaller unit? Of course, the reverse situation may exist: a tenant's income may have
declined or his family size increased. In these cases, he would have an incentive to recertify his financial status.

One manager summarized the recertification process: "it's tedious, expensive and embarrassing." In the opinion of many managers, these same three adjectives could also be applied to another HUD form, the annual occupancy report, form 9801. This form asks for information which is not permitted to be part of tenants' applications and income certifications, according to federal guidelines on these forms. The right hand of HUD seems not to tell the left hand what it is doing. As a result, the information for 9801 is difficult to compile. Bob Whittlesey also regards it as an infringement on tenants' privacy and so he refuses to submit it. Another manager's complaint was that filling out the form was a waste of time "because the government pays no attention to it". He says he's tempted to write "ridiculous information" just to see whether anyone in HUD ever notices.

Another management obligation, mentioned above, is to keep tenants in appropriately sized units. HUD specifies how many people can live in apartments with various numbers of bedrooms. GBCD's Whittlesey reports that he does not abide by these HUD rules. Many of GBCD's units have extra tenants after their initial residents take in family or friends who need a place to stay. He regards his projects as "housing of last resort" for these families and refuses to force them out or pay more rent for larger units when they cannot afford the cost.

HUD officials are not unaware that its program requirements impose extra costs on management. As its concern with housing management has increased in the last several years, more words and time have been given
to these costs. For instance, when it changed the re-certification of 236 tenants from a biennial requirement to an annual one, it announced:

It is recognized that it may be necessary to adjust management fees to compensate for additional work-load resulting from more frequent recertifications. This matter will be covered by a separate issuance after sufficient experience is obtained to make possible a realistic evaluation of the actual costs. (HUD circular HM 4442.22, 9/26/72)

Unfortunately, the rhetoric of this statement was never implemented, according to the Boston Area HUD Office. Irving Solomon, Director of Management, in that office, said that no other circular has ever been issued. He acknowledges that the 5% or 6% management fee approved by HUD is not sufficient to cover management's costs, but he "takes a hard line" on any request for additional fees because he is "reluctant to increase tenants' rents to put more money into the hands of management."

In particular, he is unwilling to increase management fees for limited dividend projects: their sponsors are receiving enough benefits from tax shelters, Solomon believes. They can dip into their own pockets to cover administrative costs. When I asked whether he would allow increased management fees for non-profit or cooperative projects, whose sponsors presumably do not have their pockets lined with tax shelter benefits, Solomon replied that he might, "if he were pushed to the wall."* But no one has yet pushed him to the wall, so he has not approved more funds for any project. (The related issues of whether and how more management funds could be made available to projects is discussed further in Section 3.)

HUD Provides and Regulates Rent Supplement Subsidies

HUD provides double subsidies to some housing projects. These take

the form of rent supplement payments. In the Northeastern part of the United States, the rent supplement program is used primarily in 221d3 and 236 projects. Here it has not untangled the federal government from housing production programs, as it was originally intended to do.* Instead, it has become a means of assuring that the construction programs could serve the low and moderate income families for whom they were designed. It also has become a means of assuring federally assisted private developers that they would receive sufficient rents to sustain carrying charges. It became, in effect, an operating subsidy. One program was used to mend the defects of another, without any thought about what administrative problems would be created.**

*The rent supplement program originated in 1965, when it was offered as a substitute for the 221d3 program. Under rent supplement, a family pays 25% of its income toward rent, while the federal government pays directly to the landlord the difference between the rent and the tenant's contribution (A Decent Home, p.64). However, rather than becoming a substitute for mortgage interest subsidy programs, rent supplement became an addition to them. This shift in its use came in the late sixties, when it became apparent that many tenants in 221d3 and 236 projects were spending a higher percentage of their incomes than they could afford (See HUD Audit Report of 236). Construction and operating costs in 221d3 and 236 projects rose so high that many tenants whose incomes fell within prescribed limits could not sustain the rents on 25% of their incomes. So HUD piggybacked rent supplement onto the production programs, in order to lower rents to 25% of tenants' incomes.**

And also without much thought about whether the proposed mend was sufficient to repair the gap between incomes and rents. Rent supplement has not been sufficient. First, it still does not enable the lowest income families to live in 221d3 or 236 projects because it stipulates that no tenant may receive a supplement which exceeds 70% of the fair market rent of the unit. If 25% of a tenant's income is not sufficient to cover 30% of the rent in an assisted unit, he cannot afford to live in the unit. For a typical 2-bedroom unit with a rent of $140, no one with an income below $2016 could pay the price, unless he paid more than 25% of his income.
Second, as operating costs have climbed, rent supplements have not increased fast enough to cover them.
The administrative burden for management increased with the double subsidy. Every tenant who receives rent supplement support must be screened, certified and re-certified annually according to rent supplement guidelines, in addition to being screened and certified and re-certified according to 221d3 or 236 guidelines. During rent-up, managers are also responsible for verifying all information supplied by rent supplement tenants and for determining whether they are eligible for rent supplement under any of the five criteria specified by HUD:

1. Displaced by government action
2. Living in substandard housing
3. Had a dwelling destroyed by a disaster in a SBA declared disaster area
4. 62 years of age or older
5. Physically handicapped.

At GBCD the initial certification of rent supplement tenant adds an hour or two onto initial rent-up time. The annual recertification of tenants takes another one to three hours at GBCD. Both Brown and State Management cite less time for recertification, half an hour to an hour, although they agreed that initial certification takes one or two hours per family.

Management must also keep separate occupancy records on rent supplement tenants, filed according to specific HUD procedures. GBCD spends approximately ten hours per year per project to maintain these records, or another $50 per year in management expense.

Unlike interest rate subsidies, rent supplement subsidies are not remitted automatically by HUD. Management must submit a bill for them at the end of each month, specifying how many days each rent supplement tenant was in residence. Then HUD pays for the previous month. While the actual billing cost is negligible at GBCD, receiving payment six
weeks late, rather than in advance, disrupts projects' cash flows.

Another cost of the rent supplement program is that HUD pays its share of the rent at the end of the month, not the beginning as does the individual tenant. Whittlesey complained about this, saying that he was losing 5% of the value of all his rent supplement subsidies: this is the amount of interest he could get if HUD paid the rents on the first of the month, and he deposited them in a bank account for the month. Instead, HUD gets the use of the money for that month.

State Management was not bothered by this loss, but it did say that late receipt of rent supplement payments disturbed its projects' cash flows and made it impossible for them to pay bills on time, causing them to lose any available discount for early payment.

Late payment of rent is not the only HUD rule that has unintentionally created costs for projects. A seemingly innocuous rule is that tenants should be kept in appropriately sized apartments, that is, in apartments with no more bedrooms than they need. However, both GBCD and State said special expenses grew out of this requirement. GBCD recently had a rent supplement who moved in with his wife and two children. After two years, the tenant's children left home and his wife died. Suddenly, one man was living in a three bedroom apartment. Since he then only qualified for a one-bedroom apartment, GBCD waited until a one bedroom unit was vacant and asked him to move there. He refused. After several discussions failed to persuade him to move voluntarily, GBCD is evicting him, hoping that legal proceedings will prompt him to move. Meanwhile, it has had to keep the one-bedroom apartment vacant for two months, losing rent. If and when the man does move, it
will have to pay to redecorate his old apartment, so another tenant can move in, producing more management costs. (See discussion of Boston Rent Board, pages 94 ff, for costs of eviction.) Whittlesey estimates that GBCD is losing between $400 and $700 in the attempt to move this one tenant into an apartment which is appropriate, according to HUD regulations.

State Management has never had an instance of a tenant refusing to move, but it computes that each move made to keep a tenant in the right sized unit costs $116-120 – the cost of normal apartment turnover – plus $15 in management time to explain the move and process accompanying paperwork.

While it is understandable that HUD does not want to subsidize empty bedrooms, it does not provide any way for management to cover the overhead costs of participation in the rent supplement program.

For three different management entities these costs average:

<table>
<thead>
<tr>
<th>Entity</th>
<th>Cost per Project per Year</th>
<th>Cost per Unit per Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>GBCD</td>
<td>$160-260</td>
<td>$16-26</td>
</tr>
<tr>
<td>Brown</td>
<td>$185</td>
<td>$3-10</td>
</tr>
<tr>
<td>State</td>
<td>$710</td>
<td>$1.45</td>
</tr>
</tbody>
</table>

**HUD-Summary**

After providing the subsidy which enables 221d3 and 236 housing to exist, HUD watches over occupied projects to ensure that they are managed in accordance with federal rules. Managers must file numerous reports, requests, claims and certifications to demonstrate their compliance with HUD's requirements. These filings impose large time and dollar costs. In small projects they can consume more than the entire HUD-allowed 5%.

*See page 74 for a discussion of the discrepancies among these figures.*
management fee. Larger projects can spread overhead costs across a large number of units. This is illustrated in Table 2-2 which gives the management fees and the administrative costs for three managers.

This table cannot show the non-pecuniary costs imposed by HUD requirements. There is no way to measure the frustration and anger aroused by a large, sometimes cumbersome, and often slow bureaucracy. Nor is there a measure to assess how much management energy is diverted by HUD away from the provision of services to tenants. This last, non-quantifiable cost may be one of the most detrimental side effects of HUD's many requirements.
### Table 2-2: Summary - Costs of HUD Requirements Compared to Management Fees

<table>
<thead>
<tr>
<th>management firm (avg. no. of units per project)</th>
<th>cost of fulfilling basic HUD requirements*</th>
<th>cost of rent supplement requirements</th>
<th>total cost of all HUD requirements</th>
<th>management fees</th>
</tr>
</thead>
<tbody>
<tr>
<td>GBCD (10 units)</td>
<td>$825-1,125 per project/year $82.50-112.50 per unit/year</td>
<td>$160-260 per project/year $16-26 per unit/year</td>
<td>$985-1,385 per project/year $98.50-138.50 per unit/year</td>
<td>$560-960 per project/year $56-96 per unit/year</td>
</tr>
<tr>
<td>Brown (60 units)</td>
<td>$2,850-3,350 per project/year $47.50-55.80 per unit/year</td>
<td>$185 per project/year $3.10 per unit/year</td>
<td>$3,035-3,535 per project/year $50.60-58.90 per unit/year</td>
<td>$5,040 per project/year $84 per unit/year</td>
</tr>
<tr>
<td>State (500 units)</td>
<td>$6,365-7,925 per project/year $12.75-15.85 per unit/year</td>
<td>$710 per project/year $1.45 per unit/year</td>
<td>$7,075-8,635 per project/year $14.20-17.30 per unit/year</td>
<td>$42,000** per project/year $84 per unit/year</td>
</tr>
</tbody>
</table>

Notes to Table 2-2:

* Cost of rent increases pro-rated as one increase every two years; does not include rent-up costs; does not include occasional costs such as mortgage modifications or expenditures of replacement reserve; therefore these figures represent minimum costs.

** Estimated cost; exact figures not available.
Chapter 5:  **Local Regulators**

Although 221d3 and 236 are federal subsidy programs, local government agencies are also often extensively involved in particular projects. For most Boston area manager, local public authorities have been the source of three additional subsidies. The first is leased housing subsidy which comes from the Boston Housing Authority; the second is direct rent payments from the State Welfare Department; and the third is a special, low tax assessment fixed at only 17% of gross potential rent by the city government.  * Like the federal subsidies, these have had a double-edged impact on subsidized housing. On the one hand they have been essential enablers of projects: without them, rents could not be held to prices within the means of low and moderate income families. Furthermore, as will be explained below, the first two guarantee a portion of the rent roll for housing managers. On the other hand, they have been a source of problems, including increased administrative costs.

The Boston Housing Authority and Leased Housing Subsidies

Like the rent supplement program, the Section 23 leased housing program was originally promoted as a means of subsidizing low-income families in privately owned real estate. Again like the rent supplement program, in Boston the leasing program has been diverted from its original goal of shoring up private rental markets. In Boston it is usually piggybacked on top of federal interest rate subsidy programs.  ** However, while the rent supplement program is administered directly by HUD, the leased housing

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* Until April 1973, the tax assessment rate for subsidized projects was only 15%.

** Interview with Pat Claire, former director of Leased Housing, BHA, March 28, 1973.
program is in the hands of local housing authorities (LHAs) which receive annual contributions from HUD. The LHAs are responsible for selecting units, negotiating contracts with housing managers, and disbursing the subsidy. The subsidy is calculated as the difference between a unit's rent and the amount of rent which a tenant would pay in public housing. The tenant pays his share of the rent directly to the housing manager, while the LHA pays the manager the difference between the tenant's contribution and HUD approved rents. Nowhere in the private housing market could they obtain such secure rental income. While many housing managers in Boston have complained about the administrative costs connected with leased housing, their gripes must be tempered with the fact that they, as well as tenants, are benefiting from the subsidy.

Insofar as the leased housing program lowers rent for tenants, it is a consumer rather than a producer subsidy. However, the program does not enable tenants to shop for the best possible housing. The payments, like 236 payments, are linked to particular units as well as to particular tenants. The units must be certified as adequate by the BHA, just as the tenants must be certified by the BHA as within prescribed income limits. Furthermore, the subsidy is tied more closely to the unit than to the tenant, for if a certified tenant moves out, he cannot take the subsidy with him. The subsidy remains linked to the unit. If another qualified tenant is identified and moves into the unit, the subsidy continues coming to the manager and the new tenant benefits from the lower rent. Thus, the manager has more assurances than tenants that he can continue benefiting from the leased housing program.

* Since passage of the Brooke Amendment, his share is 25% of his income.
Table 2-3: Managements' Dealings with BHA and Their Costs

<table>
<thead>
<tr>
<th>management's dealings with BHA</th>
<th>management firm (avg. size project) and costs</th>
<th>State (500 units)</th>
</tr>
</thead>
<tbody>
<tr>
<td>must have inspections of units before occupancy &amp; at BHA request</td>
<td>GBCD (10 units)</td>
<td>negligible</td>
</tr>
<tr>
<td></td>
<td>project/yr. unit/yr.</td>
<td>$60</td>
</tr>
<tr>
<td></td>
<td>1 hr./mo.</td>
<td>$12</td>
</tr>
<tr>
<td>negotiate leases and contracts</td>
<td>$200-300 or $40-60 40-60 hr.</td>
<td>$60</td>
</tr>
<tr>
<td>review BHA bill each month</td>
<td>$125-150 or $41-50 25-30 hr.</td>
<td>$2</td>
</tr>
<tr>
<td>receives BHA payments during the month, not in advance</td>
<td>$60</td>
<td>$2</td>
</tr>
<tr>
<td>may be owed arrears by BHA</td>
<td>5% of payments value lost</td>
<td>negligible</td>
</tr>
<tr>
<td>must submit rent increase requests; BHA may not pay a HUD approved increase</td>
<td>$200</td>
<td>negligible</td>
</tr>
<tr>
<td></td>
<td>$40</td>
<td>negligible</td>
</tr>
<tr>
<td></td>
<td>$320 owed by BHA</td>
<td>N.A.</td>
</tr>
<tr>
<td></td>
<td>$64</td>
<td>N.A.</td>
</tr>
</tbody>
</table>

* Assumes half the units per project are under rent supplement; per unit costs computed only for that number of units.
BHA Inspects Apartments

To obtain these benefits, what costs must a manager bear? As suggested above, he must have his units inspected by the BHA before initial occupancy, when tenancy changes, and when he asks for a rent increase. Gail Schubert of GBCD has estimated that GBCD staff spend as much as five hours a month or $25 per month per project showing units to BHA inspectors and making whatever repairs are necessary. Mr. Brown, however, says that his staff probably spends only a third to half this time handling BHA inspections. While several managers interviewed by the Urban Observatory complained about these inspections, Brown said that they are never unreasonable, although they are often annoying because the inspectors demand that even the smallest repairs be completed before new tenants can occupy apartments.

On a few occasions, BHA's inspections have brought it into conflict with other public agencies, while managers have been caught in the middle. One large Boston project recently had many construction problems with a modular, concrete slab structural system. After many construction delays, the buildings were finally completed, and HUD approved them for occupancy. But when BHA inspectors examined the premises, they refused to approve them on the grounds that too many leaks remained. So new leased housing tenants could not move in, even though other tenants were arriving and the project had been finally closed in HUD-FHA's books. The manager acknowledged that buildings could be in better shape and so he felt BHA's determination was fair. But meanwhile his mortgage had been drawn down following HUD's approval, so he needed rental income in order to meet his

*Table 2-3 itemizes managements' costs of dealing with BHA.
debt service payments. Without leased housing tenants, he was short of money. HUD did not regard the shortfall as a valid reason for not meeting mortgage payments. The result was that he slipped into default before full occupancy could be attained. This episode had a happier ending than many, for eventually units were approved and leased tenants did move in.

**BHA Negotiates Leases with Managers**

Managers also need to negotiate and sign leases with BHA. Different managers have painted very diverse pictures of this task. A negative view is given by GBCD's Whittlesey who has been trying to sign a lease with the BHA for four years while disagreements over its terms have prevented its signing for that entire time. State's managers also complained that it was "almost impossible" to negotiate a satisfactory lease with BHA. One of them claimed to have spent $10,000 over two years, trying to draw up a mutually satisfactory lease.

A contrasting positive view is given by Mr. Brown, who says he has never had any trouble arranging leases with BHA staff, provided he gives them a reasonable amount of time to do their necessary (bureaucratic) paperwork.

**BHA Pays Rents and Tenant's Arrears**

Other managers have protested BHA's payment policies. According to its regulations, BHA is supposed to pay its regular rental contributions by the 15th of the month for which they are due. Managers are supposed to bill BHA for tenant arrears at the end of every month, and BHA is supposed to remit payment the following month. However, according to Brown, State Management and other managers, the arrears are generally two months late, so that even if a manager does not actually lose any rent on them, his
cash flow is temporarily destroyed. If the arrears are past due at the end of the year when project accounts are being audited, the late payment makes it difficult to reconcile books, increasing audit costs. GBCD estimates that it spends an hour per month per project ($5/month or $60/year) billing BHA for arrears and checking bills submitted by BHA for regular leased housing payments. These figures are corroborated by Brown. However, while Brown says he has never had trouble collecting arrears from BHA, given the two month late payment, GBCD staff say that BHA has sometimes failed to make up tenant arrears. In addition, they say that BHA has failed to pay for vacancies in BHA leased units, even though one of BHA's guarantees to management is that it will pay for vacancies if it selects the tenants who move into leased units.* Approximately $2,000 is owed by BHA to GBCD for tenants arrears incurred between September and April 1973. Another $3,200 is due on a rent increase HUD approved in September 1972, but BHA never paid. Whittlesey claims he has spent "hours" trying to collect this $5,200 and that even if BHA pays up, perhaps a third of it will have been spent in the process of collecting it.

BHA Pays "Waste" Claims

Other housing managers have complained to me about the cost of collecting waste payments from BHA. "Waste payments" are the monies paid by BHA for damage caused by tenants. BHA and managers have sometimes been unable to agree who is responsible for damages.** For instance, if a

* Alternatively, managers can retain the right to select tenants for leased units, but then BHA does not guarantee reimbursement for vacancies.

** This problem loomed large in the BURP projects several years ago. BHA staff thought managers were trying to squeeze it for funds to repair items which were improperly installed during rehabilitation. Managers claimed tenants were destroying their property.
disposal is broken, is that the tenant's fault, as the manager claims, or is it management's fault for failing to instruct the tenant in the proper use and care of the disposal, as BHA claims? Who is to blame if tile falls off bathroom walls: was it installed improperly or did tenants break it? GBCD staff related that once after a "particularly messy" tenant moved out, BHA demanded that the apartment be repainted before a new tenant moved in. GBCD felt that painting was needed only because of the previous tenant's poor housekeeping and that BHA should pay for the painting as a waste claim. BHA regarded it as a normal turn-over cost and declined to pay.

There used to be no way to negotiate such disputes. Recently, BHA has tried to institutionalize a third, independent party to rule on them. Before this, several large managers complained that they had to shuffle operating funds to pay for repairs for which BHA never compensated them.

But, as with most matters concerning BHA, another perspective is presented by other managers. A few managers have said they never had trouble settling waste claims with BHA; the need for them seldom arose, and when it did, BHA made a reasonable settlement.

BHA Approves Rent Increases

One administrative cost which cannot be collected from the BHA is the cost of obtaining its approval for rent increases. BHA has reserved the right to approve rent increases in leased housing units, even when the increases are approved by HUD. It maintains this right since it usually picks up the increased tab for leased housing tenants. Furthermore, BHA staff feel that HUD often fails to inspect units and approves increases when buildings are in unsatisfactory physical condition. BHA
personnel believe that their own inspection of units, when rent increases are requested, safeguards tenants' interests in safe and decent housing. Some housing managers complain bitterly that the BHA should be bound by HUD rent approvals, just as the ordinary tenant is. They protest the cost of filing for a rent increase at the BHA and then chasing it through BHA hierarchy after they have spent much time and energy drawing an approval out of HUD. Naturally, they become particularly annoyed when their request is not granted. Sometimes BHA's denial is voluntary and sometimes involuntary. In the voluntary situation, BHA has sometimes refused to pay rent increases when it thought that managers had allowed subsidized housing to deteriorate. In 1969, a number of rehabilitated 221d3 projects in the Boston Urban Rehabilitation Program requested increases which HUD had granted. BHA officials denied the increase, declaring that managers would have to repair their units up to housing code standards and certify the increased operating costs with which they were justifying their requests. The BURP developers refused. A long political struggle resulted. It is worth noting that following its refusal, BHA received conflicting pressure from different HUD sources. The local HUD Area Office (which had given the initial approval) pressured BHA to pay the increase, while the national Audit Division of HUD told BHA not to pay until projects were brought back up to standard. The Boston Mayor's office also intervened, and pushed BHA to approve the increases. In this confused political situation, most developers tried expediently to get the increases without repairing their units. Eventually, after several months of negotiation, they did make some repairs, and eventually the BHA did approve the increase. Meanwhile, the projects'
overhead costs for management time, legal advice, and repairs increased.

This situation is not atypical of the disputes which arise when subsidized housing is under the jurisdiction of several public agencies. The agencies disagree among themselves, and managers try to minimize their costs. The tenants' interest may or may not be represented. On most occasions, tenants lack any direct way of influencing the official network of public-private decisions that determines what housing service they receive, at what price. In the BURP case, BHA tried to represent tenants' interests to the extent that it insisted units be repaired. But during negotiations with managers, this representation became secondary to BHA's attempt to remain independent of pressures from other agencies. Tenants eventually paid the price for repairs through increased rents.

I mentioned earlier that on occasion BHA's refusal to pay rent increases has been involuntary. These were the times when BHA failed to get sufficient federal or state appropriations. Now Brown, for example, has just spent nine months getting a rent increase from HUD, only to find that BHA has no money to pay its share of higher rents. Since the increase is in a project where 57% of the apartments are leased by BHA, the project is now receiving less than half the newly approved funds. Brown does not blame BHA, but neither can he stop pressuring its staff to find the money for his rent increase. Even though BHA is not at fault, the costs to the project of dealing with BHA's problem will be considerable. This is not an isolated case. One of the five largest sponsor-managers of subsidized housing in Boston claims that his firm was once owed $50,000 in arrears by BHA. BHA wanted and intended to pay, but it had run out of money itself. Unfortunately for the manager, the
$50,000 represented roughly one month's combined debt service on his more than 1,000 units of subsidized apartments. Without BHA payments, he was forced to default on his mortgages. When HUD asked why he hadn't paid his debt service, his reply was that the fault began with HUD's own failure to allocate sufficient funds for BHA. This kind of vicious circle has trapped many managers whose projects subsequently slid into default.

Other BHA dealings

From time to time, extraordinary circumstances further complicate managers dealings with the BHA. Sometimes problems arise which are outside the control of either, and which neither can readily resolve. For instance, in January 1972, a leased housing tenant in one 221d3 project died leaving no next-of-kin. In the absence of any heir, the manager was unable to remove the former tenant's possessions from his old apartment until a court order authorizing him to do so could be obtained. Now the manager wants BHA to reimburse him for the rent during those four months. But BHA has no policy covering such a contingency, and it has declined to make the payments. The manager acknowledges that BHA hasn't had any policy or procedure for this situation, but he insists that the BHA must, as a minimum, share the rental loss with him.

Another example: a woman with several children moved out of her unit turning it over to her daughter and the daughter's children, without telling the landlord. For several months, neither the manager nor BHA realized the change had occurred. When they did find out, BHA did not want to pay rent for the daughter, since she had never been certified as a leased housing tenant. But the manager did not want to lose rent on
the unit.

The BHA has been slow to respond to such complex, individual problems that inevitably arise when a large number of tenants are subsidized. For their part, BHA officials point out that in these cases, a landlord of private housing would never have any chance of collecting rent, whereas the manager of leased housing at least has the possibility of reimbursement through the BHA. The former director of leased housing at BHA, Pat Claire, has also indicated that some developers managers have abused the BHA subsidy. In the past, two managers dunned both the BHA and the Welfare Department for tenants' arrears with neither agency knowing the other was being billed. In several cases, the two agencies both paid the arrears, which the managers quietly pocketed. Only later, did the agencies accidentally discover what had happened and demand reimbursement of the double payments. On other occasions managers failed to notify BHA when leased tenants moved out, moved in a tenant who could afford the basic 221d3 or 236 rent, but continued collecting BHA subsidies. This practice has incensed BHA and convinced it that projects must be closely scrutinized to ensure that tenants in leased units are, in fact, eligible.

Sometimes housing managers have abused the leased housing subsidy with less malice but the same result. Once a manager bills BHA for tenants' arrears, he is supposed to forward to BHA any payments made by tenants toward the arrears. However, some managers, frustrated by BHA's slow payment, have kept tenants' money. Then, when BHA finally paid the manager and tried to collect the arrears from tenants, tenants could not understand why they were being dunned for money already paid
to managers. GBCD has been guilty of this, complicating its negotiations with BHA for other monies.

In summary, five major problems have arisen between BHA and subsidized housing managers. These are disputes over leases, BHA payments for "waste", rent increases, management abuse, and evictions; (evictions are discussed later on pages 99 ff.)

**BHA-Summary**

Brown has estimated that 25-30 hours per year are spent dealing with BHA. This time includes negotiating leases, filing for rent increases and arrears, following up any problems which develop with BHA, and so on. Translated into dollars, this is $125 to $150 per year. A higher estimate comes from GBCD which has had more difficulties at BHA. Whittlesey estimates that GBCD staff spend between 40 and 60 hours per year, or $200 to $300, on BHA business.* The total cost of obtaining and administering leased housing subsidies is still greater due to administrative costs within the projects. The costs claimed are:

- **GBCD** - $560-660/project/year or $56-66/unit/year plus $390 in lost rent
- **Brown** - $245-270/project/year or $410-450/unit/year
- **State** - $5,560/project/year or $11-12/unit/year

The great differences in the average per unit cost are attributable to three factors:

1) The better personal contracts a manager establishes within an agency, the lower his costs of dealing with it. Brown appears to have

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*An interesting comparison is a figure on the government's cost of administering the leased housing program. It has been estimated at $12/unit/month or $144 per year. (*The Economics of Federal Subsidy Programs*, p.650.)*
worked harder at this than either of the other two.

2) The larger the number of units administered, the lower the per unit costs since costs can be spread over a large base. It costs just as much, for example, to negotiate a rent increase for five units as it does for five-hundred. State's large projects (400-1,000 units) give them an edge over Brown and GBCD.

3) Different managers experience different problems with BHA and have different perceptions of the expenses caused by the housing authorities. Thus, GBCD's Whittlesey sees himself losing 5% of the value of BHA paid rents, while the other two managers do not. State feels it has lost much money due to BHA's failure to reimburse waste claims, while a few managers have been able to negotiate compensation.

Managers' overall perception of BHA varies as much as their costs. State, along with many other large sponsor-managers, criticizes BHA for an "outmoded pro tenant bias."* They say that BHA is overly sympathetic to tenants' complaints about, for instance, conditions in apartments, while it fails to understand the manager's difficulty in getting enough income to cover all expenses. One sponsor-manager of two-thousand subsidized apartments in Boston is so incensed at BHA and its paperwork that he is trying to charge BHA extra rent. He says this is the only way he can hope to recoup his expenses. In constrast, Whittlesey and Brown both compliment BHA's attempt to represent tenants. Whittlesey thinks BHA's stance is appropriate even though he criticizes its administrative procedures. He has suggested that the cost of the leased housing program could be reduced for both managers and BHA if the agency would change its rent payment procedure; BHA should collect all rents directly from

*Urban Observatory data.
tenants and pay the total rent to managers. This would simplify payment of arrears, rent increases and waste claims. It would clarify eviction procedures. It might enable BHA to cut down on manager's abuses of leased housing. But it is uncertain whether this change could ever be negotiated through the BHA bureaucracy.

In closing, it may be useful to compare the costs to managers of both the leased housing and the rent supplement programs since both are direct rent subsidies. (See Table 2-4).

Despite the lower overhead cost of the rent supplement program, some managers prefer leased housing which gives them some back-up guarantees for their rent roll. With leased housing, they at least have the potential of collecting tenants' arrears and vacancies from BHA. With Rent Supplement, the tenant is the only recourse for collection. Thus, the managers favor the program which gives them the greatest subsidy benefits.

The Welfare Department

Another local source for double rent subsidies is the Welfare Department. It makes direct rent payments for some welfare recipients. That is, it takes the amount of their rent out of their regular welfare support and sends it directly to the person's designated landlord. Since these monies never pass through the hands of their beneficiaries, they are subsidies direct to projects' management. In order for direct rent payment to be made on a welfare recipient's behalf, he or she must request the Welfare Department to do so. Usually tenants make this request only after they have frequently been unable to make their rent. They conclude that the best way to ensure full monthly payment is to have the Welfare Depart-
Table 2-4: Comparative Cost of Leased Housing and Rent Supplement

<table>
<thead>
<tr>
<th>Management</th>
<th>Leased Housing</th>
<th>Rent Supplement</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Per project,</td>
<td></td>
</tr>
<tr>
<td></td>
<td>per year</td>
<td>Per project,</td>
</tr>
<tr>
<td></td>
<td>Per unit,</td>
<td>per unit,</td>
</tr>
<tr>
<td></td>
<td>per year</td>
<td>per year</td>
</tr>
<tr>
<td>GBCD</td>
<td>$320-420*</td>
<td>$160-260**</td>
</tr>
<tr>
<td></td>
<td>$32-42</td>
<td>$16-26</td>
</tr>
<tr>
<td>Brown</td>
<td>$245-270*</td>
<td>$185**</td>
</tr>
<tr>
<td></td>
<td>$8-9</td>
<td>$5.70</td>
</tr>
<tr>
<td>State</td>
<td>$5,560*</td>
<td>$710**</td>
</tr>
<tr>
<td></td>
<td>$22-25</td>
<td>$2.40</td>
</tr>
</tbody>
</table>

* Does not include BHA arrears, which for GBCD now average $104 per year, or the money lost thru late monthly payment of rent, which averages $39 per unit per year for GBCD.

** Does not include extraordinary cost of moving rent supplement tenants when family size changes.
ment pass the funds directly to their landlords. Once they submit such a request to the Welfare Department, six months to a year may elapse before the Department processes all its required paperwork.

Managers' reaction to Welfare payments is generally favorable. GBCD and State find that they are the best way for them to receive Welfare tenants' rents on time and in full. They noted that once direct payments are arranged, Welfare pays promptly, without exception. Mr. Brown also acknowledged the efficiency of the Welfare Department. But he added that although in the past he sometimes encouraged tenants to obtain direct payments from Welfare, a while ago he realized that he was essentially asking tenants to give up control over their own finances. He decided that this was not an appropriate position for him to advocate. Since then, he does not encourage tenants to shift to direct payment, although he will accept it if they so choose.

The Welfare Department's record is not entirely unblemished in the eyes of managers. GBCD related that one of its tenants used to consistently pile up arrears over each six month period, and then request the Welfare Department for a special hardship grant to make her rents up-to-date. This practice used to bring GBCD her rents, however inconveniently late they arrived. Then, in the Spring of 1973, Welfare finally decided it was tired of making repeated special grants for rent on her behalf, and they said they would not do so anymore. A Welfare worker suggested that she request direct grants for her rent. While the tenant agreed to this, she still owed several months back rent. GBCD was threatening to evict her, so the Welfare Department agreed to pay her arrears in order to give her a clean record. But after GBCD spent many
hours filing vouchers for the money, the Welfare Department is now saying that it will not pay the arrears. Meanwhile, too much time has elapsed for GBCD to be able to evict the tenant through the Boston Rent Board on the basis of these arrears.

Another GBCD tenant with direct Welfare rent payments initiated another round of paperwork for the GBCD when she listed her rent with Welfare as $170 per month, rather than the actual $177 per month. In order not to be underpaid, GBCD has had to complete a lengthy series of forms, in addition to arranging for the tenant to re-submit her statements to the Welfare Department.

Such managerial requests may be subject to more scrutiny than managers like because of past abuses of the Welfare system by a few managers. A few Boston managers have collected rents from Welfare for tenants who had moved out of their projects. Apparently the tenants never notified Welfare that they had left, so the managers continued, illegally, to accept money on their behalf. One manager ended up owing the Welfare Department $30,000. Such exploitation of a subsidy system prompts the administering agency to establish more controls and regulations of its benefits. The vicious circle is perpetuated: controls lead to management costs lead to resentment and abuses lead to more controls.

The City Assessing Office and Tax Abatements

The third local government subsidy that comes to subsidized housing is reduced tax assessments. Since 1965, the City of Boston Assessing Department has informally agreed to limit real estate taxes on all federally subsidized limited-dividend, non-profit and cooperative housing --
including 221d3 and 236 -- to 15% of gross rental income. This percentage was increased to 17% in the Fall of 1972. This compares with the usual tax rate of approximately 22-25% of income for privately-owned, multi-family dwellings. The difference between the two tax rates amounts to about $11 per month (or $132 per year) on an apartment that rents for $140 per month, an average price for a subsidized two-bedroom apartment. By applying the lower tax rate, the city has helped keep down rents and thereby has subsidized the year-to-year provision of housing service to tenants.

The lower tax rate is not fixed by any formal, written agreement. Instead, it represents a gentlemen's agreement between the City and housing projects. To qualify for the lower tax rate, managers must formally file abatement papers each year. The annual cost of filing is between $30 and $50 per project, according to GBCD and Mr. Brown. (Table 2-5 itemizes this cost). This figure covers the time for the four steps needed to obtain a yearly abatement. These steps are:

1. In early spring, obtain (from Assessing Dept.) and complete a form estimating gross potential rent in the project. Also compute estimated tax based on 17% of gross potential rent.

2. Submit this form to city which reviews it and computes its tax bill. (City assessors are supposed to check the structures to determine whether the abated amount represents an appropriate assessment.)

3. In fall, receive actual tax bill.
Table 2-5: Managements' Costs of Obtaining Tax Abatements

<table>
<thead>
<tr>
<th>Steps Required of Management to Obtain Abatement</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>In spring, file forms giving projected project income and estimated tax</td>
<td>$5-10 or 1-2 hr., depending on size of project, negligible.</td>
</tr>
<tr>
<td>Submit this form to city</td>
<td></td>
</tr>
<tr>
<td>In fall, obtain tax bill and amend it, if necessary</td>
<td>$5 or 1 hr.</td>
</tr>
<tr>
<td>Pay the bill, processing it through GNMA and City Hall, as needed</td>
<td>$20-35 or 4-7 hr.</td>
</tr>
</tbody>
</table>
4. Pay the bill by either (1) sending money to the city and requesting reimbursement from mortgagee GNMA or FNMA (where tax payments are escrowed) or (2) forwarding the bill to the mortgagee and requesting it to disburse the money to the city or (3) requesting the mortgagee to return the money and then pay the tax bill directly at City Hall.

State Management has cited far higher costs for yearly tax abatements. It claims $2,500 to $3,000 are spent by each project, every year to get its tax abatement.

Such a high cost is partially attributable to the fact that it hires a lawyer to do all its legal work, and lawyers command high prices. It can afford counsel because legal fees can be spread over many apartments. In contrast, GBCD and Mr. Brown never hire legal assistance for tax abatements. They complete all forms and do all the leg-work themselves. While this increases their personal aggravation, it helps keep down costs.

Another manager with four medium-sized projects in Boston (70-170 units apiece) estimates that it costs him $100-225 per project initially to obtain tax abatements from the city. These figures include the time needed to document the subsidized status of the projects and to arrange appropriate taxes during the first year of partial occupancy. Once projects are established, his yearly abatement costs go down to $50-75 per project per year.

In the past, abatement procedures and costs in Boston were higher for all managers. Before 1972, the City required that subsidized projects
pay full taxes (at a 22-25% rate). Then the City abated an appropriate amount and returned the excess. This procedure meant that projects had to pay out more money, losing its use for several months until the City returned the excess payment.

Occasionally subsidized project managers have forgotten to file abatement papers. While the fault has been theirs, remedying it has been a long, expensive process. For example, when the BURP program was starting, two managers failed to file formal tax abatement papers for 1968, when buildings were undergoing rehabilitation. But the managers, nevertheless, paid taxes only at the low, abatement rate.

In the Spring of 1970, the City threatened to foreclose BURP properties for which abatement papers hadn't been filed. Foreclosure could have been legally warranted for failure to pay the full 1968 tax bill. The managers, however, refused to pay the formally owed back taxes out of their own pockets, and the taxes could not have been taken out of rents without causing rent increases that tenants could ill afford. Furthermore, it is doubtful whether HUD would have approved rent increases for this purpose. The managers accused the City of not honoring its commitment to them and to HUD; (the City had confirmed its then 15% tax policy with HUD while the projects were planned so that mortgage commitments and rents were predicated on this rate). In reply, the Assessing Department claimed that managers had failed to meet filing requirements of which they were fully aware. The issue was finally resolved only after two other city agencies, the Mayor's office and the Boston Model City Agency, were called into arbitrate. The resolution required the Mayor's office to write the City Commissioner of Assessing,
Theodore Anzalone, authorizing Anzalone to ask the State Tax Commissioner to let him invoke the state law* that would permit the city to waive the formal abatement procedure. This was done. The managers paid the taxes at the 15% rate, and everyone was satisfied.

This episode illustrates the extraordinary costs that occasionally are incurred in order to maintain public subsidies.

The Boston Rent Board

Since 1970, a third city agency has been involved in subsidized housing projects. Although it provides no subsidy, all managers agree that it has demanded much time. Many managers claim that it has been the source of problems that, in the words of GBCD's Whittlesey, "are driving us out of business". This is the Boston Rent Board. After being established by the Boston City Council, the Rent Board claimed the authority to approve all rent increases and all evictions in the city, including those in federally subsidized housing. It has also claimed the right to overrule HUD approved increases. This means that managers of subsidized housing must go through two and possibly three public agencies to obtain rent increases: HUD and the Boston Rent Board, plus BHA if leased housing units are involved. They have to go to two or even three authorities before evicting tenants: the local courts and the Rent Board, plus BHA in case of leased housing tenants. Since a reorganization in early 1973, the Boston Rent Board has also required that all rental apartments in Boston, again including those in subsidized housing be registered with it. (Table 2-6 summarizes costs of dealing with the Rent Board.)

Unlike the agency requirements discussed previously, those of the

* Section 8 of Chapter 58 of the General Laws of Massachusetts.
Table 2-6: Managements' Dealings with the Boston Rent Board and Their Costs

<table>
<thead>
<tr>
<th>Managements' dealings with BRB</th>
<th>Cost per project</th>
</tr>
</thead>
<tbody>
<tr>
<td>registers apartments:*</td>
<td></td>
</tr>
<tr>
<td>prepares appropriate records</td>
<td>$50 or 10 hr.</td>
</tr>
<tr>
<td>completes and files forms</td>
<td>$200 or 4 10-hr. days</td>
</tr>
<tr>
<td>postage and zerox</td>
<td>$50-75</td>
</tr>
<tr>
<td>requests rent increases</td>
<td></td>
</tr>
<tr>
<td>prepares and files request</td>
<td>$150 or 30 hours</td>
</tr>
<tr>
<td>goes through hearings &amp; appeals</td>
<td>$35-70 or 1-2 days</td>
</tr>
<tr>
<td>requests eviction of tenant:**</td>
<td></td>
</tr>
<tr>
<td>files request for eviction</td>
<td>$25-50</td>
</tr>
<tr>
<td>goes through hearings &amp; appeals</td>
<td>$25-50</td>
</tr>
<tr>
<td>legal costs</td>
<td>$75-200</td>
</tr>
<tr>
<td>rent loss, 1-4 mo.</td>
<td></td>
</tr>
</tbody>
</table>

* At GBCD, cost of registration is for all nine small projects.

** Costs given here are compiled from GBCD and Brown. However, other costs from other managers have varied considerably. They have run as low as $15, and as high as $200 in legal fees plus rent loss up to $600-700. Such high legal fees are experienced by managers who will not handle evictions themselves but hire a lawyer to handle the entire proceeding.
Rent Board also fall on most market rental housing in Boston. None-theless, they are significant for this study both because they are very costly in and of themselves and also because they complicate managers' dealings with subsidizing agencies.

Registration of Units

Registration is required so that the Rent Board has records of apartments' financial status on which to base its response to requests for rent increases or reductions, evictions, or other action. "Recording apartments is a time-consuming, expensive procedure," says Mr. Brown. In order to register rents, managers must complete a three-page form on the financial status of each building they rent, plus a two-page financial statement on each apartment in every building. Copies of both forms must be retained in their files and submitted to the Rent Board, while a copy of the second form must also be sent to each tenant for the tenant's verification. GBCD staff estimate that they needed fifty hours to register 21 buildings with 93 apartments. This figure includes 10 hours to prepare the data requested on the forms. Much of this time was spent searching for the required information that was not kept by GBCD and that, according to Whittlesey, is not usually recorded by any housing manager. For example: how many square feet of grass are outside a building, or when was an apartment last painted? Whittlesey resents such questions as "an imposition of a set of accounting procedures." He insists that if new records must be maintained for the Rent Board, then the Rent Board should raise rents to pay for them.

Once information for registration was collected at GBCD, forty hours (or four ten-hour days) were spent typing registration forms,
duplicating them, addressing envelopes and mailing them. The fifty hours amounts to $200 in administrative salaries and overhead. In addition, between $50 and $75 was spent on postage and xerox. This comes to about $2.80 per unit. These costs were corroborated by Mr. Brown. The Administrator of the Rent Board, John Grace, realizes that registration requirements adds management costs although they are small on a per unit basis. He has said that the Rent Board would be willing to consider them as a legitimate management cost in projects which request rent increases. This is an important consideration because the Rent Board grants increases only on the basis of documented costs. While projects can easily document external cost increases such as rising taxes or utility or legal bills, they are often hard pressed to certify that internal administrative costs have risen. The certification requirement is especially hard on small landlords who often do not maintain formal books on their projects. But for any manager, it is difficult to document in-house cost increases, such as those resulting from a new set of government requirements. Even if the Rent Board granted more rents to cover such costs, they could still only be recouped a year after being incurred. For at least a year, management would have to finance them out of fixed project income, straining available funds. Thus the Rent Board, like HUD, legislates a gap between project expenses and income. The lag between the two causes one of the most serious management problems arising from public regulation.

The procedure for obtaining a rent increase is this: projects fill out a 4-page financial form, showing past and present operating costs. Managers file this at the Rent Board and send copies to all affected
tenants, along with a form letter which explains that they have the right to contest the rent increase if they believe the figures are wrong or conditions in their buildings have slipped below housing code standards, in which case management must repair the building up to code standards before the rent increase will be approved. GBCD staff said that filing for a rent increase at the Rent Board took them approximately 30 hours, or $150 in administrative costs.

If neither tenants nor the Rent Board contest a rent increase, it is accepted on the recommendation of the Rent Board. However, if either questions the increase, a hearing is held at which the landlord may be required to document his claimed cost increases.

Rent Increases

Why does the Rent Board insist on controlling rent increases in subsidized housing when, according to law and regulation, all such increases must be reviewed by HUD? Rent Board administrator, John Grace, has said that the Rent Board regulates federally subsidized housing because HUD review procedures do not sufficiently protect tenants' rights. HUD does not give tenants an opportunity to question either a proposed increase or the quality of services or conditions in buildings; while Rent Board proceedings do provide such an opportunity. Grace has said that if HUD would institute an adversary proceeding for tenants, then the Rent Board might be willing to de-control subsidized housing because "it really doesn't make sense to have two levels of
public control."

*" Conversations with Grace and Rent Board staff have convinced me that the Rent Board's control of subsidized housing also stems from their perception that HUD does not seriously examine the figures submitted by managers to justify rent increases. The feeling at the Rent Board (and, I might add, among some housing managers) is that HUD officials do not thoroughly investigate managers' claims of increased costs. This contention has been substantiated by several Boston area tenants groups which have found large errors in financial statements submitted to HUD. For instance, they have identified double entries for the same administrative costs, excessively high claims for legal fees, double entries for utility bills, ** and high fees paid to contractors wholly owned by projects' developers. The Rent Board does not intend to permit rent increases based on such costs. The Rent Board also takes a harder line than HUD on costs incurred to repair latent construction defects. While HUD has usually accepted these as legitimate operating expenses for which rent increases will be given, the Rent Board feels that tenants should not have to pay for construction defects attributable to developers' bad judgement. * The Rent Board staff think that it is developers' responsibility to check that subsidized housing is properly built or rehabilitated in the first place. If

** For example, one project that failed to pay its water and sewer bill in 1970, received a tax bill in 1971 that included both the 1971 tax bill and the 1970 water and sewer bill. On its submission to HUD, the composite bill was listed as its tax bill, so it appeared that the projects' taxes had risen. Increased taxes would have justified a rent increase, while late payment of a water and sewer bill would not. The mistake was not caught at HUD, until by chance an outside researcher noted the error. Except for this chance, a rent increase would probably have been approved.
structures are not adequate, they contend, developers should get their builders to make repairs as part of their contractual obligations. The Rent Board does not want to saddle tenants with costs which are developers' or managers' fault, an appropriate distinction which HUD has been less willing to make.

(The question of who will pay for latent construction defects -- tenants through rents or managers-developers through pressure on contractors -- is important in Boston where a number of federally subsidized housing projects have had serious problems with construction defects. This issue is discussed further in Section 3, pages 144 ff.)

While some managers contend that they will be driven out of business if they have to subsidize the cost of repairing latent defects, the Rent Board has acknowledged that sometimes rent increases are the only way to get funds for repairs that will bring buildings up to housing code standards. It has usually made this concession for non-profit and community managements that have no other sources of income.

The Boston Rent Board is the public agency most criticized by housing managers. They have voiced a number of different objections to it. A couple have said that it is inappropriate for a city agency to intervene in a federally assisted program. GBCD's Whittlesey, for one, has said, "The Rent Board has no right to police FHA". This sentiment is shared by HUD staff who feel its reviews of rent increases adequately protect tenants.

Whittlesey and other managers have pointed out that most rent increase requests take six to eighteen months to gain HUD approval. By the time this period has elapsed, projects are desperately in need of funds, since increases are granted only retroactively, that is, on costs already incurred, not on projected costs. If managers have to file another request for another approval, an additional one to five months will elapse before the increase can be collected. By that time, seven to twenty-three months may have passed since the need for more operating funds was first documented. This delay undoubtedly contributes to the operating cost squeeze in some subsidized housing projects. Even though the extra delay is designed to protect tenants and often does give them a needed opportunity to question management, it contributes to projects' financial decline. This delay is probably more the fault of HUD than of the Rent Board, since the latter is usually faster to review rent increase requests. Nevertheless, managers often complain more about the Rent Board than HUD. Some managers can accept HUD reviews more easily than Rent Board reviews because HUD is the agency which grants them subsidies. For instance, while Bob Whittlesey resents accounting procedures imposed by the Rent Board, he has not objected to those required by HUD. He complains about Rent Board reviews of his projects' finances, yet he wishes that HUD would institute stiffer reviews of all subsidized housing. He thinks HUD should become a more active participant in the operation of subsidized housing, while the Rent Board should get out of it completely. Furthermore, although it may take much time to get a rent increase approved at HUD, managers are rarely questioned as intensively there as they may be at the Rent Board. Naturally, some managers
are going to object to having their records closely scrutinized.

One manager has also accused the Rent Board staff of not understanding that fiscal arrangements in subsidized housing do not allow developer-managers to make money from operating projects; the profit is only in development fees and tax shelters. Nevertheless, he continues, the Rent Board tries to squeeze money out of managers for operations when the money isn't there. There may be money in tax shelters, but the Rent Board, as its own staff acknowledges, cannot examine those proceeds as an alternative source of operating money. A more temperate opinion of the Rent Board comes from Mr. Brown, who again seems to have less trouble dealing with public agencies than most managers. He thinks the Rent Board has gradually become quite knowledgable about subsidized housing and handles it fairly.

Other objections come from managers who dislike dealing with any public intermediary, especially one which sees its goal as protecting tenants' rights rather than management or developers' rights. The Rent Board has undoubtedly served as a vehicle for tenants' questions and complaints in subsidized housing. Sometimes these have been minor queries that were cleared up at the Rent Board's hearings. For instance, one tenant of Mr. Brown protested a rent increase because she didn't understand why her rent was higher than a neighbor's. The woman had not known that her neighbor was receiving leased housing as well as 221d3 subsidy. Once this was explained to her, the protest was dropped. One GBCD tenant protested a rent increase, not because she did not want her rent raised, but because she wanted GBCD officially to acknowledge that she, not GBCD staff, had painted her apartment. When GBCD gave her
verbal credit for doing so, the protest was dropped. Bob Whittlesey has complained that such trivial protests are too time consuming and expensive because any time a hearing is called at the Rent Board, someone on the staff must spend a day preparing detailed records for the hearing, plus a couple of hours attending the hearing, for a minimum cost of $35. Although his complaint is understandable, the Rent Board's assistance to tenants would be lost if it pre-screened for trivial complaints.

Some subsidized tenants have used the Rent Board to seek redress for substantial grievances. Usually their protests have focused on conditions in buildings, rather than rent increases per se. Some tenant objections have concerned items which are probably latent construction defects, such as: exposed hot water pipes, poor drainage outside buildings, inadequate plumbing, leaky roofs, cracked foundations. Others have concerned conditions that might be attributed to either construction defects or poor maintenance by management or poor housekeeping by tenants. These include: rates and roaches requiring exterminations; holes in floors and walls; radiator leaks; broken windows; peeling walls and ceilings; inadequate lighting.

A number of tenants in buildings rehabilitated during the late 1960's through the BURP program have gotten managers to repair such deficiencies by protesting at the Rent Board. Tenants in several projects owned by one large Boston real estate developer, First Realty, are using the Rent Board to obtain repairs of leaky roofs, buckling floors, bad drainage, and heaving tile. Representatives of the tenants union have said that when they took these complaints to HUD, they got not response. Since
HUD approved rent increases anyway, First Realty tenants have questioned rent increases as well as building conditions at the Rent Board. Meanwhile, First Realty is complaining that the Rent Board is driving it out of business. But if its business cannot provide adequate housing to subsidized tenants, perhaps its participation in subsidy programs should be questioned.

Eviction Proceedings

As much as managers complained to me about Rent Board action on rent increases, they complained even more about its eviction procedures. One manager of a 150-unit project voiced the feelings of many managers when he said, "The City is forcing projects to go under with its eviction policies that don't help us to collect rents."

Under the state and city laws which authorize the Rent Board, no landlord or housing manager is allowed to evict a tenant until he obtains a certificate of eviction from the Rent Board. A landlord applies for a certificate by submitting a form which specifies why the tenant must leave. A copy of this form is sent to the tenant who may request a hearing to contest the eviction. A hearing is supposed to be scheduled within twenty days. Within 30 days after the hearing, a Rent Board officer decides whether or not the certificate shall be granted. If he finds that the facts presented by the landlord are valid and he has a valid reason for the eviction, the certificate is granted. If either facts or reasons for the eviction are invalid, the certificate is denied.

* Urban Observatory data.
** Chapter 19 of the Boston City Ordinances of 1972 spells out the circumstances in which a tenant may be evicted. They include non-payment of rent, violation of a provision of his lease, illegal use of rented space, etc.
If landlord or tenant is dissatisfied, he can appeal the decision to the Housing Court or to the District Court. If the certificate of eviction is issued and not further contested, the landlord cannot yet evict a tenant. He still must go to District Court and seek a legal notice of eviction which formally, legally gives the tenant 14 days in which to vacate. If he does not leave this apartment then, the landlord can send a constable to forcibly evict the tenant. (A more complete description of the eviction process is found in Table 2-7).

Before the Rent Board existed, tenants could be evicted solely on the basis of a court order, and tenants could protest only by suing a landlord in court. Part of the Rent Board's rationale for assuming control of certificates of eviction was to establish an adversary proceeding in which tenants could confront landlords. Many housing managers claim, however, that this proceeding doubles the amount of time required to complete evictions thereby causing them to lose twice as much rental income as formerly when a tenant has to be evicted. Since most evictions are for non-payment of rent, lengthening the time required to move out a tenant represents a serious financial loss for managers. One manager of BURP buildings claims that the time to evict a tenant increased from two-and-a-half to five months once the Rent Board entered the picture. Bob Whittlesey said that the Rent Board lengthened the time from six or eight weeks to three or four months.

He claims that most tenants who contest evictions are already seriously in arrears on their rent, and that they make no economic decision to protest eviction in order to gain more "free" time in an apartment. This is a perception shared by a number of large managers in
Table 2-7: Eviction Proceedings in Boston: The Actions Required to Evict a Tenant

1. When a tenant is in arrears on rent or has given other cause for eviction, manager sends him a legal notice terminating tenancy, along with form E-0 from the Boston Rent Board, notifying him of his right not to move out until after formal eviction proceedings are brought.

If the tenant moves out or pays his rent at this time or any other point in eviction proceedings, the proceedings are terminated. Otherwise they continue as long as the manager pursues legal eviction.

2. After 14 days have elapsed, manager files an application for certificate of eviction at the Rent Board, Form E-1, stating the reason for eviction.

3. Simultaneously, he sends a copy to the tenant by registered or certified mail, receipt requested or he has it delivered by a constable.

4. On receipt of an application for certificate of eviction, Rent Board sends tenant Form E-2, notifying him of his right to oppose eviction proceedings and giving him an opportunity to file a reply.

5. Tenant can file a reply within 7 days, requesting a hearing.

6. Upon request from tenant or manager, Rent Board schedules a hearing with 7 days to be held within 20 days. However, if its schedule is busy, more time may elapse before a hearing is held.

7. At the hearing, either tenant or landlord can request a continuance. Within 30 days of the hearing, a decision is handed down. A Certificate of Eviction is granted if the landlord has cause, as determined by a hearing officer of the Rent Board.

8. Within 7 days of a decision, the losing party may request a reconsideration if he has acceptable grounds for a new hearing such as new evidence

or, within 7 days, either party can appeal the decision to District Court or the Housing Court.

9. If a Certificate of Eviction is granted and no appeal is made, the manager can go to District Court and request a court hearing. 3 weeks to 3 months are required to schedule a hearing.

10. At the court hearing, manager presents his cause for eviction. If the court determines he has cause, an eviction notice is granted.

11. The notice must be served on a tenant by a constable.

12. If tenant still refuses to move out, manager can request legal service of a notice of forcible eviction.
13. This notice is served on tenant. If he still does not leave, then his possessions can be 'forcibly removed' from his apartment. Manager is required to store his possessions and pay for their storage up to three months. If any of the tenants' possessions are damaged while being moved or stored, the landlord is liable. After three months, damage and storage are the tenant's responsibility.
Boston. Even those managers who feel that the Rent Board is acting appropriately in giving tenants a hearing say that it has not been able to act quickly enough on eviction requests.

Figures on eviction costs vary considerably among housing managers. They also vary according to how far proceedings must be carried before a tenant leaves or pays his back rent. GBCD's costs include:

$25-50 to file a request for an eviction at the Rent Board: Includes the time to prepare papers, file them, deliver them to the Rent Board and to the tenant.

$25-50 to prepare for and attend hearings: Includes the time to prepare the case, attend the hearing, file any follow-up papers needed, possibly attend a second or a re-scheduled hearing.

$75 for a lawyer and legal fees in court if the Rent Board's Certificate of Eviction is not sufficient to persuade a tenant to move or pay up, and a court notice of eviction must be obtained.

$50 for a constable to deliver a notice of forcible eviction if a tenant does not quit when served an eviction notice.

$300-500 for furniture storage if a tenant still refuses to vacate and his possessions must be moved out and put in storage.

Total: $25-225, plus up to $500 for storage costs, depending on how far the tenant protests the eviction.

In addition, this process may take one to four months, equalling one to four months rent lost, in addition to the loss of any arrears owed by the tenant at the time eviction proceedings began. These figures have been corroborated by Mr. Brown.

Higher figures come from a manager who does not handle evictions himself, but who turns them over to a lawyer as soon as it becomes necessary to go to the Rent Board. Due to legal costs, he estimates
that evictions cost him a \textit{minimum} of $200 plus lost rent. One housing manager claims to have lost more than $5,000 in rent due to slow Rent Board eviction procedures.* Sidney Insoft, with more than 2,000 subsidized apartments in Boston, claims that one man on his staff spends almost full time filing for evictions and going to the Rent Board hearings. As for the paperwork involved, he says, "We fill eight file cabinets every six months with papers for the Rent Board."

The Rent Board has sometimes tried to encourage landlords to keep tenants who have gotten in arrears by arranging for tenants to pay back rent over reasonable periods of time. For instance, if a tenant is three months behind in rent for a total of $375, it might arrange for him to remit it at the rate of $25 per month, in addition to his regular rent. Managers say that such deals rarely work out because if a tenant could not afford to pay rent initially, he usually can't afford to pay an extra sum each month. Although the Rent Board issues a certificate of eviction as soon as one of these deals breaks down, managers may lose still more rent while going through court for a notice of eviction. If they can't move out non-paying tenants quickly, they are stuck with large deficits. One Boston manager feels so strongly about the inequity of lengthy Rent Board procedures that he is refusing to pay city real estate taxes on apartments for which he lost rent during eviction proceedings. He says he is willing to go to court to make this point to the city.

If eviction proceedings are brought against a leased housing tenant, they become even more complicated and more expensive as another public agency intervenes: the Boston Housing Authority.

* Urban Observatory data.
Both local BHA and federal regulations on leased housing specify that no leased tenant can be evicted without BHA approval. These regulations contravene the Rent Board's authority to issue certificates of eviction. They fail to specify how a local housing authority should act in the presence of a rent board with legal control over evictions.

In theory, no leased housing tenant would ever have to be evicted for non-payment of rent if the BHA's policy of paying tenants' arrears were fully realized. However, as I pointed out in the earlier discussion of BHA, this guarantee has sometimes broken down, and landlords have failed to be reimbursed for arrears. In such cases, they have occasionally instituted eviction proceedings. Eviction notices have also been sought against BHA tenants for other reasons, such as prostitution or refusal to move into an appropriately sized unit.

After managers have obtained certificates of eviction against tenants, BHA has sometimes intervened, trying to stop an eviction which it hadn't approved. This BHA action left landlords holding the bag for unpaid rents, unless and until BHA paid arrears. If the cause of eviction was tenant behavior other than non-payment, managers were stuck with a bad situation.

In the past, BHA had a tradition of never evicting a leased housing tenant. This made its staff unsympathetic to managers' problems with tenants. Hoping to avoid being caught between BHA and the Rent Board, several landlords have recently invited BHA to attend eviction hearings. Unfortunately, according to Rent Board staff, BHA has usually failed to show up in this situation.** On other occasions, neither the BHA nor the

Rent Board has been aware that the plaintiff in an eviction case was a leased housing tenant because the manager bringing suit failed to mention this fact to the Rent Board, and BHA did not intervene on its own initiative.

Neither the Rent Board nor BHA nor managers know who is responsible in these complicated situations. They could be simplified if BHA rather than tenants were the party evicted. This change would accord with the BHA's acknowledgment of responsibility for tenants' arrears. However, the change is unlikely to occur until the BHA agrees both that it will pay up or move out tenants if eviction proceedings reveal arrears or illegal tenant activities, and also that it will not pull all its leased housing units out of a project, in retribution, if it is evicted from one apartment. Greater cooperation between BHA and the Rent Board, along with new lease agreements between BHA and managers would also be needed. These changes do not seem imminent. Simplifying relations with BHA does not seem to be a priority at the Rent Board.* Neither BHA nor managers appear anxious to take the time to renegotiate leases. It is a classic dilemma in which no one can spare the time to make the changes which, in the long run, would save more time and money for everyone.

Chapter 6: Managements' Response to Public Agencies

In this section, I have described the friction of doing business with public agencies. Although I have concentrated on the costs of dealing with public intermediaries, it is important to underline that they also bring benefits. Most obviously, they provide subsidies which enable low and moderate income tenants to afford 221d3 and 236 housing, and which enable sponsors to benefit from tax shelters and syndication of proceeds. Two agencies, the Boston Rent Board and at times the Boston Housing Authority, also benefit tenants by providing them recourse against inadequate or illegal management performance. When the BHA's leased housing program functions properly, it also provides management with a guaranteed rent roll. The Welfare Department also guarantees full, prompt payment of some rents.

The extensive intervention of public agencies in subsidized housing has been detrimental to management for two primary reasons.* The first is simply the costs to projects of this intervention. Since the budgets of most subsidized housing projects in high priced areas like the North-east are written without any leeway for increased expenses, the cost of

*Public intervention may also have had a strong impact on tenant-management relations. It may have altered management's perception of how responsive it needs to be to tenants. It has certainly given tenants new means of contesting management decisions and actions. An agency such as the Rent Board has altered management's traditional right to evict tenants without coming before an adversary proceeding. Many managers, including GBCD's Whittlesey and State Management, feel that tenants have abused this and other public proceedings such as the BHA's review of rent increases. Whether this sentiment simply reflects manager's strong self-interest or whether, in fact, tenants often do abuse them, I am not prepared to say because I did not study particular cases in detail. Certainly some managers have been guilty of abusing the subsidy programs.
dealing with public agencies has considerably strained their budgets. (A summary of typical direct expenses is given in Table 2-8.) Second, public agencies' requirements have absorbed large amounts of management time. Most managers feel aggravated and hassled by public agencies. Consequently, they have less time and energy left for the direct operation of the housing itself.

Most federally subsidized housing projects are allowed 5% (of net rental income) for management fees. Under the best circumstances, this figure would be skimpy. When managers have to deal with many public agencies, as in Boston, it is totally inadequate. With permitted management fees of $59-96 per unit per year, GBCD is spending $162 to $215 per unit simply to do business with public intermediaries. As high as these expenditures are, they do not even include the cost of extraordinary, non-recurring activities such as evictions or moving recalcitrant tenants into appropriately sized apartments. Nor do they cover all indirect costs caused by public intermediaries, such as loss of cash flow due to slow payment by HUD. If these expenses were added, the total costs resulting from public intermediaries might be even higher in some projects.

GBCD's necessary, minimum administrative expenditures actually run far higher than $162-215 per unit per year. Many essential management activities are unrelated to public regulation. They include rent collection; supervision of repairs, decorating, janitorial services, and contractors; administration of housing services, and so forth. These activities are also supposed to be covered by management fees. Clearly, fees are way out of proportion to GBCD's actual administrative expenses.

The disparity is less great for Brown. His management fee, averaging $84 per unit, could cover his routine direct, intermediary-related costs, which run between $59 and $68 per unit. However, a single extra-
Table 2-8: Summary - Managements' Direct Costs of Dealing With Public Agencies

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<tr>
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</table>

Notes to Table 2-8

* Includes BHA arrears and rent lost due to BHA
** Figures do not include evictions
*** "N.A." means not available.
+ These totals should not be read as exact annual summaries of cost, since they include the non-recurring cost of registration of units with the Rent Board but do not include occasional costs such as evictions. Nor do they include all indirect costs such as rent lost due to slow payment by HUD. Furthermore, in reality, a given project might incur a minimum cost at one agency but a maximum cost at another. There are then typical figures, rather than precise ones.
ordinary event could easily absorb the rest of the management fee in a project. One eviction can run up an administrative bill of $200 plus $500 for storage of a tenant's furniture, eating up most of the remaining management fee. Even without evictions, the $16-$25 left over would never cover all other ordinary management expenses.

State alone expends a reasonable portion of its management fee in handling its public business. Roughly 40-50% of its management fee goes toward these costs which average $35-45 per unit per year. However, it should be noted that it has not yet negotiated a rent increase or an eviction through the Boston Rent Board, two expensive processes. State has lower per unit costs than the other two managers because it can spread expenses over a large number of units. If, for instance, it has to call FNMA in Philadelphia about its escrow accounts, the phone tolls can be amortized over 500 or 1,000 units, while GBCD would have to support such calls on the rents from only 5 or 10 or maybe 25 apartments. This and other economies of scale benefit all large projects.

How have managers coped with high administrative costs? How have they sustained these expenses? Many different ways. Some projects, of course, have not survived. Many managers rhetorically blame public agencies, especially the Rent Board and the Boston Housing Authority, "for driving us out of business." While this overstates the case, the costs of dealing with public agencies, along with other cost increases have contributed to defaults and foreclosures.

Some managers sustain increasing administrative costs by tapping other sources of funding. This is particularly true of non-profit and cooperative sponsor-managers. GBCD, for instance, has funding from the
Ford Foundation for its other activities in housing. Out of these funds, it pays the salaries of its bookkeeper, secretaries, and director. While all these people spend many hours working on the requirements of public agencies, their time is almost never paid out of rental housing income.

Limited dividend managers dip into other housing related income: profits on non-subsidized housing or profits on tax shelter syndication. State Management indicated that it supported its management team from these sources. One of the three largest sponsor-managers in Boston has just begun to reserve all his syndication sales proceeds against operating cost increases.

A few managers try to pick up extra dollars from rent increases. But rent increases have to be justified to HUD, and its regulations do not permit managers to get a larger management fee for administrative expenses. So they tinker with their cost submissions to HUD to make it appear that other costs have gone up. One Boston manager, for instance, reported that he paid $20,000 legal fees the year when he went to HUD and the Rent Board for rent increases. He insisted that these fees were incurred during his dealings with the agencies, but it appears that his actual legal costs were much lower and he was trying to pick up extra dollars to cover his own time.* Another manager reported both a 5% management fee and individual salaries for his management staff.** According to HUD regulation, the salaries should not have been entered as separate items if the 5% fee were claimed.

While these and other managers have clearly been guilty of misrepresentation, the misrepresentation is unintentionally encouraged by HUD's

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* Urban Observatory data.
** Boston Rent Board data.
refusal to admit certain real administrative costs as legitimate bases for rent increases or other adjustments in projects' financial arrangements. Some managers have fudged their figures in an effort to circumvent HUD's unrealistic fee limits.

On one occasion HUD did respond to management costs by making more money available. In 1972 it established the Supplemental Management Fund. This provides money, up to $100 per unit, in the mortgages of 236 projects for extra administrative costs during rent-up. The money can be used for: the development and implementation of certain supplemental management services during the construction and initial rent-up. These services may include tenant counseling and organizing, supportive economic and social services, efforts to achieve socio-economic mix of tenants, and so on. If the fund is not exhausted on these expenses, it cannot be applied toward other management expenses. Also, it may be used to prepay the mortgage. Unfortunately, managers have not always been able to obtain even this limited sum, for limited purposes. According to Larry Gandel of the Carter Burgess Task Force, a number of sponsor-managers around the country who asked to include this in their mortgages were turned down by local HUD-FHA Mortgage Departments that did not feel it was an appropriate mortgage item. Despite the existence of a HUD statement authorizing the expenditure, the individual Mortgage Departments were unwilling to relinquish their traditional views on the acceptability of mortgage items. Managers thus were caught between divisions of HUD: the Management Division told them they were

* Supplemental Management Fund, HUD Circular HM4381.1, Supp.2, p.3.

** Interview with Larry Gandel, April 19, 1973.
entitled to $100 per unit for rent-up costs, while the Mortgage Division said they had no such right. Managers were forced to try mediating between HUD officials.

On paper, additional HUD regulations also seem to indicate that managers needing more money to administer its programs can ask for compensation. Its publications do acknowledge that some requirements impose extra costs for which management should be compensated. Its rules for the Rent Supplement Program state:

> Allowance will be made in the operating and managerial cost for expenses incurred by management in certifying and recertifying of tenants for rent supplement eligibility and for other administrative expenses imposed by the rent supplement program in connection with housing for low-income tenants.*

And, as mentioned earlier, when it changed guidelines for the 236 program to require that tenants be recertified annually rather than biannually, it said:

> It may be necessary to adjust management fees to compensate for additional workload resulting from more frequent recertifications.**

But these statements have never been implemented. According to Joe Caliguri, who used to administer the Rent Supplement Program in the HUD Boston Area Office, no manager has ever been allowed extra money to support his participation in the Rent Supplement Program or to cover his increased costs due to the annual recertification of 236 tenants. Nor does Mr. Caliguri anticipate that extra money will be provided in the future.***

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* FHA pamphlet No. 2509, "Rent Supplement Program: Management Outline", p.16.
** HUD Circular HM 4442.22, 6/26/73, p.
The Director of the Management Department in the HUD Boston Area Office has defended HUD's refusal to allow a management fee larger than 5%. Irving Solomon has said, "I find it very hard to justify raising tenants' rents in order to give management more money." Solomon says that he tells non-profit managers who complain about inadequate management fees to "get another 100 units to manage. They can manage another 100 units with the same staff while collecting more management fees." And he tells limited dividend managers to talk to the projects' sponsors: the sponsors can kick in some of their profits for the administration of the housing.

While Mr. Solomon finds it hard to raise tenants' rents to provide higher management fees, he does not find it hard to raise tenants' rents in order to pay higher taxes, higher heat bills or to repair latent defects. Somehow he does not conceive that administration, like heat and repairs, is a housing service, and it is not going to be provided adequately if it is not paid for. Or, if it is provided, other things will slip, such as the time and energy management gives to maintenance. Or, at some point in time, managers may decide they have no more alternative sources of money to defray administrative expenses, and they will pull out of the housing. The cost squeeze and the hassle of dealing with public agencies are strong disincentives to many managers.

Sometimes managers try to reduce the costs of dealing with public agencies by using personal or political influence to bypass legal regulations or official procedures. Thus, Mr. Brown has expedited requests

for rent increases at HUD by using his personal connections with HUD Area Director Richardson. Through Richardson he has pressured the local HUD management office. Some developer-managers who contributed heavily to the Boston Mayor's campaign funds have occasionally asked him to intervene at BHA on their behalf. They have gotten the Mayor's Office to pressure BHA to pay them rent increases.

The managers who seem least frustrated by public agencies are those who have worked the hardest to cultivate personal contacts with agency personnel. This is not to say that they try to illegally influence the agencies, but that they try to find someone inside the agencies who will be on their side: someone at HUD or BHA who can take a rent increase request and move it from the bottom of a pile to the top; someone in the City Assessing Office who will amend a report when the city delivers an incorrect tax bill. Without such contacts, managers are more likely to view the agencies as hostile. Brown and Whittlesey illustrate this point. No single staff person at GBCD has consistently dealt with public agencies, so the organization has few long term contacts within them. Most of the GBCD staff consequently feel that the agencies are unsympathetic to their needs. In contrast, Brown has admittedly worked hard to develop contacts within the agencies. Through repeated conversations with the same personnel, he has both gotten a better understanding of their problems and also gained a more sympathetic and responsive reception for himself. Brown seems to be exceptional in this matter. Other managers who have made the same attempt have not always been so successful, perhaps because they were never willing to admit that good intentions could exist within the agencies, or that bureaucrats
sometimes were stymied for reasons beyond their own control.

A few managers, for whom working with public intermediaries is distasteful and expensive, have considered reducing their dealings with public agencies. While in theory this seems like a potential solution, it is not an actual possibility. If managers are to benefit from subsidies, they must respond to the regulations of the organizations that provide them. They cannot opt out of the Rent Board's jurisdiction, except by leaving Boston. The only agency they might extricate from their projects is the Boston Housing Authority. They could get it out, if they gave up leased housing subsidies. A couple managers, especially one or two in the BURP program, have said they would like to reduce their number of leased housing tenants in order to lessen their business with BHA. But they are worried that if leased housing subsidies were not used to lower rents below the basic 221d3 rents, they could not find enough tenants to fill the units. Other projects have such high rents in relation to residents' income limits that many people with prescribed incomes could not afford the housing without leased housing subsidies. Some projects in Boston have been filled only by providing many tenants with double subsidies and allowing all other tenants to have exceptionally high incomes. A recent HUD Audit report of the 236 program nationwide found that the basic rents in most 236 housing are not competitive with comparable market housing.* Only the addition of leased housing

*"The market rents for Section 236 projects were generally higher than for comparable conventional projects, because of certain allowances permitted by law or regulation and ineffective administrative and operating practices. As a result, HUD's interest assistance liability has been significantly increased." (Report on Audit of Section 236 Multifamily Housing Program, p.7).
(and rent supplement) with accompanying lower rent for tenants attracts residents.

Conclusion

The intervention of public intermediaries is an inextricable part of existing housing subsidy programs. The programs provide narrow subsidies—specific, limited devices—which are too specialized to attain the broad, announced purpose of housing low and moderate income families. The inadequacy of each individual subsidy has prompted federal and local governments to piggy-back additional subsidies. Each addition brings along the regulation and intervention of another public agency. Thus, when HUD's 221d3 and 236 programs couldn't reduce operating costs far enough, city governments applied tax abatements. When rents were still too high for many intended residents, direct rent subsidies were requested of local housing authorities, HUD, and state welfare departments.

Each agency feels obligated to watch carefully over its donation to ensure that its intended purpose is realized. Because the subsidies are frequently insufficient, managers are tempted to abuse them. Their abuse proves to the agencies that they must act as watchdogs. More rules to prevent abuses are written; more rules lead to more supervision; and more supervision leads to more costs in agencies and housing projects alike.

Not only do agencies supervise projects' managers, they also try to monitor other agencies. The Boston Housing Authority reserves the right to review and reject HUD approved structures and rent increases. The
Boston Rent Board also examines them regardless of HUD or BHA approvals. It may demand repair of buildings or it may rescind a rent increase which either or both of the other agencies sanctioned. One department in HUD may even contravene the action of another HUD department, as when the mortgage division refuses to permit a supplement management fund requested by the management division.

These agency actions are too often protective and self-righteous. Each agency sees itself as the one proper administrator of the public interest in subsidized housing. Housing managers are caught in the middle of agencies' disputes. For every public authority that claims jurisdiction over subsidized housing, administrative costs within projects increase. Managers see themselves "wasting thousands of dollars dealing with callous, inflexible and incompetent bureaucrats."* One manager recently lamented that he was "surrounded by controls" which prevented him from doing the best possible job. * In his view, repeated public attempts to repair the deficiencies of on-going public programs create as many difficulties as they resolve.

Given the costs to both public agencies and private managers of existing multi-tiered regulatory patterns, perhaps the federal government should consider a policy of de-regulation.

De-regulation should begin with a consolidation of responsibility among the agencies which oversee the same functions in subsidized housing. Perhaps HUD should relinquish regulatory activities to local jurisdictions when local agencies are willing to handle them. If a city rent board is able to process rent increase requests, then perhaps HUD could stop handling them. If a city inspection department is willing to

* Urban Observatory data, interviews with managers.
monitor buildings' physical conditions to ensure they meet housing code standards, then perhaps HUD could turn its inspectors to other tasks.

Another approach to de-regulation would be for HUD to exempt small projects from some reporting requirements. Projects with mortgages under $200,000 might be relieved of financial reporting, except for certification of tenants' incomes. They might be freed of most HUD scrutiny as long as rents were kept within maximum limits for their geographic areas and as long as debt service were paid. GBCD's Whittlesey promotes this as the best approach to reducing unduly high administrative costs in small developments. "If we could just have HUD go away," he has said, "then we'd have a better chance of keeping our very small projects alive."

De-regulation would turn-around HUD's habit of promulgating new rules and reviews when problems arise. Like many other public bodies, it has become accustomed to thinking that only its own staff can adequately monitor subsidized housing. This approach has become so costly that it seems time for HUD to share responsibility with other organizations.

Any movement toward de-regulation is bound to be slow. It challenges each public agency's self-image as the only one which performs adequately and its self-interest in the jobs and power which accompany regulatory activities. It also challenges many years of liberal thinking about the proper relationship between government and private businesses. The traditional liberal distrusts the perceived self-interest of the private business sector when it becomes involved in government funded programs. Traditionally, the government is regarded as the representative of the "public interest" that can keep private interests from ripping off public programs. This attitude has encouraged the growth of HUD's supervisory
functions, especially after a loosely monitored housing development program, 608, in the early fifties was abused by many developers. Unfortunately, like most regulatory agencies, HUD is as likely to sway under the pressure of the organizations which it is supposed to control as it is to represent tenants, tax payers, or any other less well organized public. Furthermore, it is probably overly optimistic to assume that federal regulation has the power and perspicacity to prevent, or at least repair, all abuses by private interests. As will be discussed in the next section, HUD too often fails to enforce its own rules about the obligations of private contractors and developers of housing. Too often, it accepts private activities that are less than legal when they are in HUD's own self-interest.

Transfer and consolidation of regulatory authority at the local level would not be a panacea for existing costs and conflicts. Local agencies are as susceptible to abuse as federal bodies. But they might be a first step toward reducing both projects' expenses of dealing with public agencies and disputes among agencies. Implicit behind this suggestion is a critique of the federal system of regulation which is beyond the scope of this paper. The question of which level of government can best regulate a publically subsidized activity is open to major dispute and cannot be discussed here. Nevertheless, it does not seem appropriate for housing projects to pay the price for the existing, multi-tiered regulatory and subsidy system.

The intervention of public agencies in subsidized housing might also be reduced by substituting a single subsidy for the many present public supports. One proposal for a single subsidy program has come
from William J. White, Executive Director of Massachusetts Housing Finance Agency. He has recommended a rental allowance program geared to production. "Under this program the rent charged for a housing unit would be based solely on a person's ability to pay using 25% of a person's income as the guide to housing expense. The difference between the market rent and the person's percentage of income would be subsidized through the single subsidy program."* Anyone with an annual income below, say, $15,000 would be eligible. This program would save public money on construction and regulation. It would also reduce housing managers' costs of dealing with public agencies to the expense of negotiating with one intermediary. The friction among agencies would be eliminated. Potential friction within the single agency could not, however, be eliminated. Intra-agency disputes would doubtless sometimes cause problems for managers, just as disputes within HUD now do. The agency would probably institute extensive certification of tenants' incomes. If the job of monitoring incomes were passed on to housing managers, as in the present 221d3 and 236 programs, then managers' administrative expenses would begin to climb. Disputes between managers and the agency might arise over income certification, just as they do now. Nevertheless, insofar as the agency would demand fewer forms, reports and certifications from managers, housing administrative costs could be reduced; and insofar as the agency had a single program sufficient to provide housing for low and moderate income families, intra-agency conflicts could be reduced.

A single subsidizing agency and a single regulatory authority

would be more efficient than the present pattern of multiple subsidies and multiple intermediaries. Cutting down the number of agencies and actors with legitimate roles in regulating subsidized housing would cut the overhead costs of government and managers. These savings could, hopefully, be passed along to taxpayers and tenants. If the friction of doing business with public agencies were reduced, everyone would save.
Chapter 7: Alternative Sources of Funds for Management

The steadily rising foreclosure rate is ample evidence that many projects are suffering from inadequate operating funds and cannot survive with their present operating budgets. As discussed in Chapter 2, the deficiency of operating budgets can be attributed to any of several causes. Some of these causes are external to projects; others are internal.

The most widespread external reason is underestimation of operating costs during the development phase when initial financial projections are made. This has been given as the most prevalent cause nationwide for foreclosure in all HUD subsidized programs.* It can be blamed on HUD-FHA development procedures which reward developers who have the largest possible mortgages. The reward takes the form of larger front-end profits: bigger BSPRAs and higher profits from the sale of "ownership" to limited partners. In areas like Boston with high construction costs, even developers who do not try to exploit these profits may be tempted to underestimate operating costs in order to make projects feasible. In either case, larger mortgages mean higher debt service, and the higher the debt service, the less rental revenues left for on-going management services.

Cost increases external to projects have also squeezed operating budgets. Increasing rates for taxes and utilities cannot be accommodated by the limited revenues from allowed rents. Inflation has pushed up expenses for labor and supplies. The impact of price rises is exacerbated by the original underestimation of operating costs which deprives projects of any margin to absorb price rises. Inadequate construction can also

*Stegman, Critical Issues in Property Management, p.17
be blamed for causing operating expenses which frequently cannot be covered by rents.

Cost increases internal to projects may be ascribed to any or all of the direct participants in the housing: tenants - managers - builders - developers. Tenants may be guilty of poor housekeeping, managers of poor maintenance or operation, builders of latent construction defects, and developers of insufficient budgets or structural problems.

Recently, the insufficiency of operating funds in 221d3 and 236 has been recognized by HUD. It is moving to prevent operating deficiencies in future projects by more accurate cost certification and review during development. But what about existing projects? Will they inevitably move toward foreclosure, or can more money for operating and maintenance be found? Any of several actions could be adopted by the government and housing managers. They could:

- Do nothing but operate projects as in the past, allowing them to be foreclosed when costs became overwhelming. Then a new way of managing and owning them would have to be identified.

- Actively encourage foreclosures as a conscious strategy. Then projects could be refinanced or turned over to new owners with more realistic operating budgets, and perhaps without the cost of debt service (if the government were willing to sustain the loss) and without the indirect, public expense of tax shelters.

- Re-structure the programs in mid-mortgage, perhaps changing the ownership or management of projects.

- Cut operating costs within the confines of existing programs and owners, hopefully lowering them enough to avoid foreclosure. This might involve cutting services, which does not seem desirable, or finding vendors with lower prices for insurance, auditing, heat, and
so forth, which does seem a likely possibility.

Find alternative sources of funds for operation and maintenance.

Combine two or more of these strategies.

In this section, I will explore the fifth of these strategies: additional sources of funds for operation and maintenance of existing projects. There are potential sources of money in housing subsidy programs; some could be tapped immediately, others would require minor administrative changes; others would demand additional congressional funding.

This strategy deals with symptoms—i.e., the need for more money to pay increasing bills—rather than causes—i.e., why costs are increasing and why projects lack the income to support them. But it includes a broad examination of who should take financial responsibility for projects' economic difficulties. Builders and architects should be forced to make good on construction guarantees that now are often meaningless. Perhaps project owners and contractors should have greater liability for resolving projects' problems than at present. Perhaps owners, who receive returns on their investments, and developers, who benefit from tax shelters and syndication proceeds, should share the burdens of financial problems. Shifting financial responsibility to these people would amount to an implicit restructuring of housing programs. But it would not depend on new housing programs or new Congressional legislation. It would only require that HUD redo its rules and regulations for the management of subsidized housing.

Although in the past HUD has not looked upon builders, architects, owners or developers as financial resources, it has examined some other potential sources of additional operating monies. A number of these were
listed by former Assistant Secretary of Housing Management, Norman Watson, just before leaving office.* Presumably the present HUD moratorium on housing development will yield further suggestions for salvaging financially troubled projects. There are strong incentives for HUD to find ways of maintaining housing projects. If projects cannot cover operating costs and are foreclosed, HUD becomes the owner. If more operating funds cannot be found, HUD could become the owner of hundreds-of-thousands of dwelling units that it lacks the capacity to manage. Private sponsors and investors stand to lose millions of dollars through recapture of tax depreciation benefits.

More operating funds would provide benefits to most actors in the housing system:

- More or, at least, continued housing services for tenants.
- More funds to work with for managers.
- Greater assurances of financial return for sponsors and investors.
- An up-side potential for mortgagors.
- More work and, therefore, more jobs for public intermediaries.

Lest this list paint too rosy a picture of the outcome of increased operating funds, let me underline that the alternatives discussed here continue many of the questionable characteristics of present subsidies, since they are variations on existing schemes, not totally new designs for public investment in housing.

- These are supply side, rather than demand side, strategies.
- They are linked to units, rather than tenants, thereby tying tenants to a particular housing stock.

*Norman Watson, Remarks . . ., p.5.
Public agencies have an intermediary role between subsidies and projects, which would sometimes create large unintended costs of the kind documented in Section 2 of this paper.

Subsidies are regressive because families with larger incomes are eligible for larger subsidies, even while they pay a larger rent.*

They are so specifically defined that their application would be strictly regulated, causing high costs of dealing with public agencies.

Investors in high tax brackets would continue benefitting from the indirect subsidy of accelerated depreciation.

For the purpose of this discussion, I accept the presence of these features, since my intent is to examine whether the existing system can be amended to mend its problems, rather than to question whether a different system, such as housing allowances, would eliminate its difficulties. But I will examine in some detail the implications of alternative proposals for making available more O & M funds. Their costs and benefits will be examined in light of several questions:

- How much money can each alternative provide, under what circumstances?

- Can sufficient funds be made available to meet inflationary costs, or can operating monies be increased only marginally and thus remain ahead of costs only temporarily?

- Who would pay for the funds: tenants through immediate or delayed rent increases; taxpayers through government subsidies; sponsors, or investors?

*The maximum interest subsidy on a given unit is a direct function of the unit's mortgage amount. The units' rent is also a direct function of mortgage size. Since rent is also correlated with income, the larger a family's income, the more rent it can pay. And the greater the rent on a unit, the greater the interest subsidy paid by the government. (Cf. Jim Wallace, Federal Subsidies in Rental Housing, p.10.)
- When would funds be made available: immediately after construction, throughtout the life of the project, or at some other point in time?

- What would be the trade-offs: would the friction of dealing with public agencies increase; would some existing reserve funds be foregone?

- What would be the secondary affects? For instance, would owners lose their tax shelter benefits, or would rents go up?

Hopefully, some of the sources discussed might even be able to attack some of the causes of excess costs, reducing them while providing more dollars. One of the most obvious sources of money, rent increases, will not be considered. I presume that most tenants cannot afford to pay more rent and, furthermore, that where they can, project sponsor-managers have already requested rent increases. I do assume that since O & M has the dual function of giving housing services to tenants and maintaining the housing as an investment, that it is appropriate for investors and sponsors, as well as tenants, to bear some of the costs.

Two broad categories of funds will be discussed:

- Funds which are internal to existing programs and could be made available immediately through administrative reallocation of their finances; for example, ballooned mortgages, or residual receipts.

- Funds which could come from sources external to existing programs; for example, operating subsidies or operating loss loans.
Whether or not these funding sources would be sufficient to keep projects financially solvent would depend on the amount and the causes of their financial deficiencies. Projects needing only modest, limited increments in operating funds probably could be helped. So could those whose excess operating expenses are caused by repairable problems, such as construction defects or insufficient building security, which can be solved by a single input of funds. Projects whose initial operating expenses are greater than projected during development could be helped only if initial cost overruns leveled out because most of the proposed funding sources yield fixed sums which do not increase over time. So they cannot keep pace with inflationary expenses. In projects experiencing an every widening gap between income and expenses, inflationable sources of income are needed. This quality is not found in most of the funding sources discussed here.

Figures in the text on the potential dollar costs and benefits of these alternatives have been taken and extrapolated from many sources.

* Other sources of funds could be applied to new projects by changing their mortgage and fee structures during development. For example, management fees could be re-done on a cost-plus basis or extra management fees could be subsidized during the early life of a project. Mortgages could be reduced if the government subsidized outright certain non-recurring expenses such as fees (for architects, builders, FHA, and so on). The government might also indirectly reduce operating costs by subsidizing the cost of higher quality construction materials. However, I will not discuss these strategies for new projects, since my concern is whether existing projects can survive.

** See pages 31-32 of Section 2 for a list of my primary sources.
Table 3-1: Alternative Sources of Operating Funds

I. Funds internal to existing projects
   A. Funds within projects' fiscal structure and held in the name of projects
      1. Replacement reserves *
      2. Residual receipts
      3. AMPO funds
   B. Funds within projects' fiscal structure but held privately by sponsors
      1. Limited dividend distributions
      2. Syndication proceeds
      3. Excess profits to wholly owned subsidiaries
   C. Funds available through changes in mortgage financing
      1. Ballooned mortgage delinquencies or principal payments.
      2. Moratorium on principal or principal and interest payments
      3. Operating escrows built out of deferred mortgage payments.
   D. Funds available early in the life of projects, during and after construction
      1. Construction cost savings
      2. Liquidated damages
      3. Performance and payment bonds
      4. Completion assurance funds
      5. Construction guarantees
      6. Escrow deposits for incomplete items

II. Funds external to existing projects
   A. Operating subsidies
      1. Straight operating subsidies
      2. Tax payment subsidies
   B. Federal mortgage subsidies
      1. Partial payment of claims on mortgage insurance *
      2. Assignment of mortgage to HUD-FHA
      3. Temporary substitution of HUD for project mortgagor
      4. Operating loss loans
   C. Refinancing of mortgages
      1. Refinancing for longer periods
      2. Refinancing at lower interest rates
      3. Refinancing 221d3 projects as 236 projects
   D. Development cost escrow

*These were suggested by Norman Watson in Remarks ..., p.5.
In order to show their comparative dollar benefits, they have all been computed for a single project. This is an actual 221d3 project outside Boston, in Fitchburg, Massachusetts, that was completed in August 1971.*

Most of the basic data on Meadowbrook came from Urban Planning Aid which has been working with the tenants in the project. A summary chart of the funds which could be earned by this project is given in Table 3-3, pages 172-173.

* Although Meadowbrook was completed in August 1971, final closing was delayed for 16 months. The delay occurred because cost increases during construction made the mortgage larger than could be supported from allowed rents. Since HUD did not want to foreclose on the project, it permitted the sponsor to postpone final closing until after the next increase in HUD limits for rents and tenants' incomes. Then the new rents were sufficient to support the required mortgage. Because of the delay, no operating statements were prepared for 1971 and 1972, even though apartments were occupied.
Chapter 8: Available Funds Internal to Existing Projects

Funds present within projects' fiscal structure and held in the name of projects

The existing fiscal arrangements of 221d3 and 236 projects contain several accounts which might be tapped for O & M. These include replacement reserves, residual receipts and AMPO funds.

Replacement reserves are monies taken out of rental income and escrowed in a fund that can be used to replace and repair "installed items in a project. This may cover a broad variety of items . . . ranges, refrigerators, water heaters, air conditioners, floor tile, bathroom tile and roofs among them. * Since reserves are taken monthly out of rents, they are paid by tenants. They are a percentage of the value of a project's structures, as determined in the initial mortgage, and so their monthly cost does not increase over time. ** However, no replacement reserve is required in projects whose mortgage is less than $200,000. This means they are not found in most small projects, such as those managed by GBCD.

Only one of GBCD's projects has a replacement reserve. It amounts to $105.33 monthly in a 24-unit project whose mortgage is approximately $380,000. During four and a half years of occupancy, a total of $5,584 has accumulated. At Meadowbrook, the replacement reserve is $10,852/year, or $47.60 per unit per year. *** (It is interesting to note that when the


** This percentage used to be 0.5% of total improvements; but in 1970, it was changed to 0.6% of the value of structures alone.

*** Other typical replacement reserves are: $1,182/yr. in a 28 unit rehabilitation project, with a mortgage of $368,000; replacement reserve was based on 3% of estimated gross income, rather than on the value of structures because it was part of the BURP program which was trying to reduce operating costs as much as possible. Other BURP projects' replacement reserves were as low as $24 per unit per year.
cost of Meadowbrook's structures increased during construction, the replacement reserve did not increase. While technically it should have gone up, HUD did not insist that it be increased since additions to other operating expenses exhausted Meadowbrook's available rental income.)

Expenditures from replacement reserves must be approved by HUD. While, in theory, they are used to replace major capital items, HUD can exercise wide discretion when deciding how they may be expended. One sponsor-manager of BURP buildings was allowed to use his replacement reserves to convert new gas heating systems back to cheaper oil heat (which had been in his buildings before rehabilitation) because gas prices had risen so much during three years operation that he could not afford the gas bills. One large management company in Boston requested HUD's permission to apply replacement reserves toward the purchase of trucks which it used to rent (profitably) from its own wholly owned subsidiary leasing company. The same company is also asking that replacement reserves be applied against the repair of latent defects.

HUD's management guide says that replacement reserves can be used not only for specific operating and maintenance items, but also

on occasion to avoid default when the financial difficulty is not the result of mismanagement or diversion of funds. When unavoidable financial difficulties arise, the owners may request that the Fund be used or deposits to the Fund be suspended for a period of time for a specific purpose. **

Often when mortgage principal payments are temporarily deferred, payments into replacement reserves are waived to make additional funds available for current operating expenses.

* Urban Planning Aid data.
If replacement reserves were cancelled and the money were instead made available for general O & M, between $24 and $50 per unit per year, depending on the project, would be freed. This could not, by itself, make a significant dent in operating deficits in most projects. In addition, its expenditure for routine O & M would leave projects without reserves for extraordinary expenses. Therefore, unless they were combined with other funds, replacement reserves are probably better left as reserve funds.

Residual receipts are rents and other specified monies collected in excess of basic project requirements. They include: (1) AMPO-Allowance to Make Projects Operational-funds unexpended during rent-up; (2) net rents received prior to cost certification, that is, rents from tenants who move in during construction, minus the costs of providing them services such as heat and light; since debt service is not paid out of rents during construction, a considerable portion of these rents are unexpended; (3) excess rents which exceed basic 221d3 rents. The third of these is the most prevalent source of residual receipts, particularly since net rents from the construction period are first used to offset certified construction cost overruns, before they become available for residual receipts. Even then, net rents may be used for pre-paying the mortgage rather than for residual receipts.

As mentioned in Section 2, many projects do not have residual receipts. Projects which do have them are supposed to deposit them in savings accounts, until they request HUD's permission to spend them. Residual receipts can be used for "additional amenities or capital improvements for tenants' benefit...or...up to 50% of the residual receipts account can go to prepay the mortgage."* HUD also considers residual

receipts from over-income tenants as a possible asset for 221d3 projects in financial difficulty. It allows projects with financial problems to waive income limits in order to move in over-income tenants who will pay higher than basic rents.*

236 projects differ from 221d3 in that they cannot deposit excess rents from over-income tenants in residual receipts accounts. They are supposed to remit excess income to HUD which then uses the money to offset the federal government's payment of the mortgage interest. This procedure implements the original intent of the 236 program. The intent was that the government's cost of subsidizing the mortgage interest rate should be reduced as tenants' income increased and they became financially able to pay higher rents. The government's original cost projections on the 236 program estimated that over twenty years, its subsidy could be reduced to zero, with tenants paying the full interest rate.

Now it does not seem to make sense for the government to insist that 236 projects relinquish extra income when projects are sliding into default. The rules of the 236 program should be changed, to accord with the present regulations on 221d3 that stipulate:

> a project which is legitimately in financial difficulty or facing default could not realistically be required to deposit funds in the Residual Receipts Account [or remit them to HUD], which if held could help alleviate the critical situation. **

What would be the impact of this change? Projects without residual receipts clearly would not benefit at all. However, it seems possible that if increased rents were used to provide better housing services, then

*Insured Project Servicing Handbook, Chapter 4, Se.2, p.3.  
some over-income tenants who presently conceal that fact in order to avoid paying more rent might admit their incomes and pay. Unfortunately, it is also possible that this change would encourage managers to select over-income tenants in preference to other applicants in order to increase their rent roll. This result would be unfortunate because any large increase in the number of over-income tenants would subvert the intent of the program to house low and moderate income families.

Nationwide, the percentage of over-income tenants ranges from zero to 25%. On the average, 14% of all tenants pay between basic rent and market rents, while 1% of all tenants pay market rents. In Boston, a tenant paying full market rent could provide between $625 and $1100 extra per year; higher rents would be linked to larger mortgages and 236, rather than d3 projects. If tenants' incomes in Meadowbrook were distributed according to the national average, and they paid appropriate extra rents, approximately $1,215 more per year would be available for O & M.

Allowence to Make Project Operational, or AMPO for short, is a fund of 2% of the mortgage which is supplied to non-profit sponsors. It is intended to be working capital during final closing and initial rent-up. After final closing, any unexpended AMPO monies go into the residual receipts account, where they lose their identity as separate funds. In a recent $1.6 million non-profit Tenants Development Corporation project in Boston, $7,970 in unexpended AMPO funds were transferred to residual receipts at final endorsement. AMPO funds are jointly paid for by tenants and public subsidies since they are part of mortgages. They are not available to limited dividend or cooperative projects.
Funds within projects' fiscal arrangements but held privately by owners

The three previous sources of funds are financed by tenants' rents. There are other potential sources inside projects' fiscal arrangements that would not come out of tenants' limited incomes. Instead, they would come out of the profits of limited dividend projects' owners. They would not be available to non-profit and cooperative projects.

Limited dividend distributions equivalent to 6% per year of sponsors' presumed 10% equity are available as a cash profit to the partners of a limited dividend project. In Meadowbrook, with a $4,056,000 mortgage, annual limited dividend distributions could reach $2,435. However, the sponsors of many projects subordinate dividends to basic operating needs: they are not paid if the project needs the money for operating expenses. This subordination is often formally included in partnership agreements. Most limited partners consent to waive the 6% distribution since they have invested primarily for the sake of tax shelter benefits. HUD could state that all operating expenses must be given precedence over the 6% dividend. This is already required by the Massachusetts Housing Finance Agency, although it is only beginning to be enforced.* The one obstacle to this change might come from the Internal Revenue Service which legally does not permit investments made solely as tax dodges. 236 limited investments are legitimized in the eyes of the IRS by the 6% distribution. If it were legally waived by HUD, the IRS might object, although it has not yet protested partnership agreements which relinquish it.

Syndication proceeds are a second source of income for limited dividend projects' sponsors. Syndication proceeds are the monies earned

by sponsors when they sell "ownership" of a project to limited partners.* These proceeds are often very large sums of money, since sponsors typically sell 95% of the ownership for, in the case of rehabilitation, 20-25% of the mortgage value and, in the case of new construction, 12-17% of the mortgage. On a $2 million rehabilitation project, this amounts to $400-500,000, while on a new construction $2 million project, it is $240-340,000. This money is all profit for the sponsor, unless he sold the syndication through a broker who might take 10-20% of the syndication proceeds as a fee; or unless he incurred unanticipated development expenses that could not be met through other sources.

Since developers are required to put up little cash, over and above the government provided mortgage loan, in order to cover construction and start-up costs, syndication proceeds represent a rather handsome fee, earned at the outset of a project. The amount earned is arbitrary in that it is "primarily a function of the tax laws and not of the amount which [a developer] could demand for his services in a competitive situation."** It bears little relation to the quality of the structures or the services provided to tenants.

*Current federal income tax laws permit owners of new or rehabilitated multifamily housing to take depreciation deductions on the entire costs of depreciable improvements, even though improvements are financed largely with borrowed money. Most sponsors of subsidized housing sell part of the ownership to wealthy limited partners who can then use part of the depreciation. The limited partners play no role in the operation of a project—they are often prohibited from intervening at all in the day-to-day management. Their links to the project are simply financial; they buy title to a fraction of the ownership, then they declare depreciation of the project against their other income. They can claim depreciation regardless of the project's economic or physical condition, as long as it is not foreclosed. Depreciation continues even when projects are in default, in poor physical condition, or are assigned to HUD.

If these proceeds, or a portion of them were re-invested in a project, then its sponsors as well as its tenants would bear some of the rising cost of O & M. It seems appropriate for sponsors to share these costs, since they also benefit from proper upkeep of a project. Adequate care of a project maintains sponsors' investment, while sufficient O & M monies ensure that projects won't be foreclosed, thus safeguarding investors' tax shelter benefits from recapture. They also safeguard sponsors from being black-listed by the FHA (i.e., forbidden to package any more subsidized housing projects). Since sponsors, not tenants, are the ones who benefit from avoidance of these penalties, they should pay part of the price.

Unlike most the funds discussed earlier in this chapter, syndication proceeds are fixed, limited amounts. They are only available once. They do not accrue over time as do rents, replacement reserves, or residual receipts. Although they could cover large cost increases for limited periods of time, they would be exhausted with no potential for renewal. In Meadowbrook, for example, syndication proceeds were $328,125.* This is equivalent to $1,483 per unit, or $12.35 per unit per month for ten years (without computing any interest on the money). If syndication proceeds were held in a 6% savings account, almost $19,680 could be generated annually.

One tenant-owned limited dividend project in Boston with almost identical syndication proceeds - $320,000 on a $1,700,000 mortgage - is setting aside $100,000 of the proceeds for operating reserves. Placed

*This is only 8.1% of the mortgage because Meadowbrook's sponsor himself kept a large portion of the project's ownership for his own tax deductions.
in an 6% escrow account, a minimum of $6,000 will be available annually before the $100,000 principal has to be tapped.

Excess profits to wholly owned subsidiaries are another potential source of O & M funds that would be paid by sponsors. Many large developers own both management companies and service companies which are employed by their projects. The latter subsidiaries are contracted for such services as snow removal, trash collection, trucking, repair, and/or decorating. Since HUD rules do not limit the profits which can be paid to vendors, sometimes wholly owned subsidiaries are given work at non-competitive rates which permit them to make excessive profits. These subsidiaries become a ploy for developer-managers to earn extra profits, over and above the 5% management fee. It has been alleged that at least one developer-manager in Boston has profited by paying non-competitive prices to his own companies.

The residents in this company's projects formed a tenants union to protest rent increases. While reviewing the company's financial data in preparation for a rent strike, they discovered how its subsidiaries were paid. Then they pushed it to disengage these subsidiaries from all projects under its management in order to reduce operating costs. In one project, tenants pressured the company to sell a wholly-owned laundry which had produced a handsome profit. The proceeds from this sale were used to offset some large repair expenses, delaying a rent increase which was in the offing and saving tenants money.* An outside laundry franchise, Maytag, was brought in once it agreed to pay the project a slice of its proceeds. $3-5000 of tenants expenditures will be coming back to the

*Urban Planning Aid data.
project yearly. This sum can be used for extraordinary expenses or amenities which tenants could not afford.

Managers should be prevented from making extra profits on the business of wholly owned subsidiaries. If they need this income in order to cover their regular management costs, then more direct payment should be made in ways which are less deceptive. While this is not an issue in many projects, in those where it does arise, the savings should be passed along to tenants. Whenever legal kick-backs like that with Maytag can be arranged, they will channel tenants' expenditures back into projects, supplying needed operating funds.

Funds available through changes in mortgage financing

Balloon mortgage delinquencies or part of debt service payments. Debt service is the largest single item paid out of rental income. It could be reduced, freeing a larger portion of rents for daily O & M expenses, if HUD and projects' mortgagees gave their approval. They could agree that part of a project's mortgage principal could be deferred until the end of the mortgage term; interest might or might not also be deferred. In effect, part of the debt service would be ballooned, its due date postponed. Then it could be due in one lump sum, or the term of the mortgage could be extended—perhaps by the addition of a second mortgage—until the deferred amount was paid. Current mortgage delinquencies could also be balloonied in this manner.

According to Larry Gandel of the Carter Burgess Task Force, which recently completed an extensive study of HUD FHA mortgage processing, HUD has already unofficially agreed to reduce principal payments in a few
projects in order to keep them out of foreclosure. This has been done with
the consent of the mortgagee, GNMA. However, HUD's most common practice,
to date, has been not to reduce principal payments for the life of a mort-
gage, but rather to defer them for a limited period of time, six to thirty-
six months. During this time, projects are supposed to correct the finan-
cial problems which prompted the need for more operating funds. This type of
mortgage modification has two drawbacks which my proposal does not. First,
it only works if problems can be corrected with a brief input of extra
funds, and second, it presumes that projects can afford higher debt
service at the end of the modification period.

At the end of modification as currently allowed, projects are
supposed to begin repaying the deferments by increasing debt service. The
pertinent HUD regulation states that any request for a deferment should be
accompanied by:

   a workable, realistic reinstatement plan...showing
   (a) the operational improvements to be made, and (b)
   the manner and time-frame in which the project can be
   expected to reach an income level sufficient to meet
   operating expenses, full debt service, and start to
   repay delinquencies and advances.

   In one $9 million project that was granted a 36 month deferment,
   debt service increased $5.47 per unit per month, or a total of $23,893 per
   year for the entire project. This can be covered only by a rent increase,
   was requested to
   causing tenants to underwrite the full cost of the deferment. This deferment

** According to Joe Caliguri in the HUD Management Office, the most common
repairable causes of mortgage modifications are construction problems,
such as leaky roofs or inadequate piping, and rent strikes! He said that
modifications have been given to projects while they waited out a rent
strike and obtained Boston Rent Board approval for higher rents. (Tele-
***

Insured Project Management Guide
+Urban Overvatory data.
release project income for repair of major, latent construction defects. Since these are non-recurring costs, a deferment can probably resolve and eliminate them. However, other kinds of financial problems cannot be solved by mortgage modifications. One very large project, after a year-long deferment, was still unable to meet both full debt service payments and operating expenses because all costs had been drastically underestimated in the mortgage. The project manager says that the local HUD Management Office told him off-the-record not to bother making any more mortgage payments, since it was clear that the project would eventually be foreclosed by HUD. Following this covert advice, the manager is putting all income into O & M, on the grounds that it is better for the project to be in good physical condition than to stay out of HUD ownership for a few additional months. Projects such as this might benefit more from a permanent reduction in the principal, although in this particular case even ballooning the principal might not by itself be sufficient to make it financially viable.

The amounts released by ballooning principal payments would vary over the life of a project because early in the mortgage, most of debt service goes to repay interest, while later on, increasing amounts go to prepay the principal. Meadowbrook's annual debt service payment is $174,666 on a $4,056,000 mortgage. After one full year of amortization, only $54,300 of this will be principal, while after 10 full years, $71,000 will be principal. A comparative figure of $1,000 a month or $12,000/year comes from a much smaller 65 unit project, with only a $1,123,400 mortgage, that actually is in modification for one year after 18 months of occupancy.
Ballooning debt service could occur only with the consent of both HUD and projects' mortgagees, which in subsidized housing is usually GNMA or FNMA. HUD has been eager to promote mortgage modifications because it thereby avoids becoming the owner of assigned projects. Although GNMA and other mortgagees have usually consented to mortgage modifications in the past, it is unclear that they would continue doing so if many projects tried to balloon a portion of their mortgages. If a large number of projects reduced their principal payments, mortgagees' income would also be reduced. Any large reduction in GNMA's income or FNMA's income would disrupt their cash flow, interrupting their ability to function in the mortgage market and purchase new mortgages. GNMA and other mortgagees might demand projects' foreclosure or assignment to HUD-FHA, particularly if interest rates rose and they could earn more by putting out their funds at a higher rate. If interest rates were to remain constant or fall, mortgagees might be more amenable to deferrals, especially if they were convinced the deferrals would secure their investments in the long run.

Another, even larger uncertainty is what would happen at the end of mortgages when the ballooned payments become due. Undoubtedly, few projects would be able to afford a lump sum reimbursement at that time. Projects might pay by extending their mortgages or taking out second mortgages, but this alternative would be feasible only if projects were still habitable and capable of attracting tenants. At this time, predicting the marketability of subsidized housing projects after the year 2000 seems speculative at best and perhaps foolish. One might try
predicting that by the time mortgages are due, the government would be willing to make the balloon payments, but this is only a speculative possibility. If ballooning of principal were adopted as a strategy to free more money for operating costs, probably the method of financing re-payment would be left for a future decision.

A moratorium on principal or principal and interest payments has been proposed by at least one observer of federal housing, Michael Stegman. He has proposed that "all developments should have a three-month interim after final closing before debt service begins. Funds accumulated during this period would be used as an operating reserve funds."* At Meadowbrook, a $43,666 fund could have been compiled this way. Stegman has also suggested a moratorium--resembling the bank holiday of 1933--be declared until a thorough investigation is conducted on the operation of each subsidized development. The investigation should begin with those developments that currently are experiencing difficulties and continue until it encompasses even the most solvent developments. The funds accumulated by the individual developments during the moratorium would become an operating reserve that should be subject to use--with Secretary approval--in various, specified emergency situations.*

The idea of operating escrows built out of deferred mortgage payments may be more likely to happen than a formal holiday on payments. It has also been suggested by former Assistant HUD Secretary of Housing Management, Norman Watson, ** and at one time was also considered by the Carter Burgess Task Force.***

*Stegman, Critical Issues in Property Management, p.3.
Before operating escrows could be built out of mortgage payments, HUD and managers would have to make the following arrangements:

1) deferment of mortgage payments, plus the creation of escrow accounts for the deferred funds. The approval of HUD and mortgagees would be required. It might be hard for HUD to back a policy which promoted defaults, albeit temporary, technical defaults, because mortgagees might object, as discussed earlier. Mortgagees would have to be persuaded that temporary deferrals would secure their investments for the next thirty or forty years.

2) re-payment of missed mortgage payments. Payments might be ballooned until the end of mortgages; they might be amortized over the life of the mortgage by increasing all future mortgage payments; the mortgage term might be extended; or the government might agree to subsidize them. (Further implications of these re-payment strategies were discussed earlier under "Balloon mortgage delinquencies or part of principal payments."

3) a set of rules for the use of operating deficit escrows. It is highly unlikely that HUD would agree to turn operating escrows over to management without any restrictions on their use, since the escrows would have been built at the expense of mortgagees. But if this could occur, it would save HUD the expenses of watching over accounts and reviewing expenditures; it would save projects the expense of requesting permission for expenditures. If HUD kept the intermediary role, it would have to write regulations concerning what expenses could come out of operating escrows; when the escrows could be expended; where they would be deposited; who would approve them, and so on. It might want to consider giving tenants some say in the expenditure of the escrows, since their rent monies would have provided the dollars.
The funds in escrows could be substantial if an entire year's debt service were devoted to them. The average debt service on a 221d3 project in Boston is $800/unit (based on a per unit mortgage of $18,600*), while the average on a 236 unit is also $800/unit (based on a per unit mortgage of $26,400*). In the representative 221d3 project, Meadowbrook, the annual debt service is $766/unit, or $174,660 for the entire project. Invested in a 6% account, this could throw off $10,480 annually.

One objection to these operating escrows is that it seem illogical to let projects go into default to guard against future defaults. While the logic may seem peculiar, the numbers make it appear a good way to build a hedge against future operating overruns.

Funds available early in the life of a project, during and immediately after construction

Existing HUD-FHA regulations on construction financing contain several potential sources of funds for operating expenses in occupied projects. Several of these sources—escrow deposit agreements, completion assurance agreements, and construction guarantees—are already available, but they are not pursued with much vigor by either project sponsors-managers or HUD. Other sources could be made available with only minor, administrative changes in HUD rules; for instance, construction cost savings.

Construction cost savings, according to present HUD rules, are supposed to be deducted from the originally committed mortgage, to result in a reduced final mortgage. This produces lower fixed debt service payments, releasing more rental income for current operating costs. It also reduces the government's contribution for interest subsidies. However, if HUD would allow construction cost savings to be included in the mortgage, then

*Urban Observatory data.
they could be applied toward operating costs in several different ways.

When construction on a recent TDC project was finished early, the resulting savings were $96,932 on a $1,731,600 mortgage. TDC proposed to HUD several applications of construction cost savings:

1) Establishment of a "Special Management Fund," set up so that expenditures would be made semi-annually, with the authorization of the HUD Area Office, for special management costs of a temporary nature, such as management staff training, special tenant social services, capital equipment, and payment of amortization (if ever required).

2) Prepayment of the replacement reserve. "This would make additional funds available for a number of years (14.7 if the entire savings were used in this manner) for management costs."*

3) Creation of a management fund. "This would enable TDC to use that money for extraordinary management expenses as permitted by the Commissioner."**

HUD did not allow any of these uses of the savings. It insisted that the money could go only to offset the originally approved mortgage.***

In the interest of securing the project's financial stability for forty years, HUD's refusal seems short-sighted. While a reduction in the mortgage does release a larger amount of rental income for other operating expenses, in this case the funds released were small on a yearly basis: $3,000 or $30 per unit. In contrast, if the construction savings had been included in the mortgage and then escrowed, almost $100,000 would have been available for unanticipated operating costs. Since this $100,000

* Unpublished letter from Marion Dawson, TDC President to M. Daniel Richardson, HUD Area Director, June 20, 1972.
** Letter from Dawson to Richardson.
*** Unpublished letter from Richardson to Dawson, June 27, 1972.
was computed in the project's original mortgage, presumably it could have been amortized without increasing tenants' rents. With inflation, a large lump sum of money in-hand during the first few years of operations, when most financial problems arise, would probably have been worth more to the project than the slight increase in operating funds which did occur.

There are other potential sources of funds from the construction period which would not need to be amortized by rents. These include construction guarantees, escrow accounts for incomplete items, and escrows for latent defects. These three are designed to guarantee that contractors finish all construction work and mend any latent defects which appear after buildings are occupied. Contractors' liability is supposed to ensure that construction related repairs do not have to be paid out of rents. However, if the experience of Boston is typical, many subsidized projects are plagued by incomplete work and latent defects which contractors are never required to fix. Instead, repairs are charged against rents, frequently straining projects' budgets so much that they have to seek relief by large rent increases or waivers of mortgage principal. Incomplete work in one recent project included insufficient flashing on the roof and inadequate calking of prefabricated wall panels.* Latent defects in another project, found by FHA inspectors after one year of occupancy, included sagging drainage pipes which were backing up, improperly installed sub-flooring in bathrooms which caused heaving of floor tiles, and improperly laid exterior concrete walks where ice accumulated at entrances to buildings.**

* Urban Observatory data.
** Urban Planning Aid data, including a copy of the FHA annual physical inspection report of the project discussed.
Still other, even more serious latent defects and incomplete construction items have been recorded at this development by an independent physical engineer with twenty years experience, including four within FHA, Allister Shepard. After inspecting the premises, Mr. Shepard reported that:

- heating systems were inadequate to provide "uniform, safe and proper heating of the living units" in "violation of FHA-HUD [Minimum Property] Standards.
- gas vents have been installed within one inch of combustible material. FHA-HUD Standards and the State Code "requires a minimum clearance here of six inches." This constitutes a fire hazard.
- broken and loose bathroom floor tile could be related to inadequate anchoring of toilets to the floor. "Paragraph M714-1.4 of the FHA-HUD Minimum Property Standards is intended to prevent the problem that is being encountered".
- some interior walls are not anchored properly at the floor. "It would appear that construction complying with FHA Minimum Property Standards paragraph M713 would not result in the conditions that were noted."

These are only a few of the many inadequate constructions items which Shepard noted. As the quotations from his report indicate, most of these items should not have been present if FHA-HUD had enforced their own minimum property standards as required by law. Nor should they have been

present if the sponsor's HUD-approved contracts with builder and architect were enforced. These contracts hold builders and architects liable for constructing buildings in accordance with FHA-HUD property standards. Although buildings deviated considerably from these standards, neither FHA-HUD nor the project sponsor-manager pressured contractor or architect either to make repairs or else provide the funds for repairs. Tenants are now resisting a rent increase which the sponsor-manager says is necessary to get the needed money. The bill would amount to many thousands of dollars. It should not be treated as a legitimate operating cost: it is attributable to construction problems which could be resolved if HUD regulations on contractors and architects were enforced.

HUD requires all architects on FHA insured projects to carry professional liability insurance. This insurance is supposed to pay for any design defects identified during or after construction. Any item in an architect's specifications which proves inadequate or illegal is supposed to be remedied by tapping his insurance. However, this does not happen in many subsidized projects, according to Allister Sheperd and my own examination of HUD construction documents. Instead, construction change orders and additional mortgage money are frequently requested for inadequate items. For example, if a heating system is incompletely designed on the architect's specifications, does not meet local health or fire codes, or does not satisfy FHA minimum property standards, the architect's insurance should pay for any extra expenditures needed to make the system adequate. Instead, nine times out of ten, the contractor requests FHA to approve a construction change order amending the original plans. And nine times out of ten, FHA gives its consent, increasing the mortgage and thereby
increasing the cost which tenants must pay. These mortgage increases represent a double burden to tenants: first, they are expenses which should be paid by someone else, i.e., the architect's insurance or the builder; and second, the FHA underwriting division usually allocates enough money in the initial mortgage for construction up to code standards. This means that sufficient money is usually included in the mortgage in the first place. If contractors are able to have additional funds approved in order to bring items up to code, very often they are asking for double payment.*

In one recently completed 221d3 project outside Boston, change orders amounting to many thousands of dollars were approved for construction grade lumber, insulation, weatherstripping, and fireproofing—all of which by law had to be included in the original construction specifications and for which the FHA underwriting division had provided money in the original construction contract. Thus, the mortgage was increased to pay for "changes" already paid for once and which, furthermore, were the architect's responsibility if they were not provided for the first time around.

This is a common practice at FHA, according to Sheperd. The FHA department which approves change orders never considers whether requests should be disallowed based on original mortgage specifications or whether the money should be obtained elsewhere. The result is that mortgages are increased at the expense of tenants and taxpayers who must jointly pay the debt service. Contractors and architects save accordingly.

Tenants suffer yet another disadvantage from increased construction costs due to the way cost increases cycle through a project. Higher construction expenses cause larger mortgages. Larger mortgages lead to

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* Interview with Allister Sheperd, June 1, 1973.
higher rents. Higher rents push up the income limits of families which can afford the housing. A 30% construction cost increase can push up both rents and income limits by 14%. Thus, everytime HUD approves additional construction expenses, rather than forcing sponsors or builders or architects to come up with the money, it effectively excludes more low income families from the housing.

Numerous conversations with personnel in the Boston HUD Area Office* have convinced me that there are four major reasons why HUD and sponsors sometimes fail to move against contractors and architects. First, in many projects sponsors and contractors establish an identity of interest which permits them to take advantage of the BSPRA, builders and sponsors profit and risk allowance. Once this identity of interest has been established, a project sponsor loses incentive to move against the builder when he fails to perform adequately. Thus, HUD's own creation, the BSPRA, may mitigate against the satisfactory completion of construction. This problem has been acknowledged by officials of the Massachusetts Housing Finance Agency which uses the 236 program. In at least one project, MHFA knows that the sponsor has failed to push the contractor to repair construction defects because of their financial partnership.**

Second, sponsors are reluctant to sue architects for money from their professional liability insurance because of the legal costs involved. Having HUD approve additions to the mortgage is much cheaper. It has the added attraction of increasing the potential profits from sale of syndication, since the sale price is based on the size of the mortgage.

* See list of Interviews, p. 190, for names of all HUD staff contacted.  
** Interview with Anne Bromer, May 9, 1973.
Third, HUD officials find it hard to move against contractors because they perceive this as the responsibility of sponsors. If sponsors do not bring complaints about contractors' performance to HUD (and as I stated above, many are unlikely to do so for business reasons) then HUD does not take the initiative to seek redress from contractors for inadequate work. HUD personnel are reluctant to act, despite regulations in their own manuals which clearly make this a responsibility of the HUD Management Division.*

Fourth, responsibility for enforcing some of the HUD regulations seems to fall between the lines of responsibility which are so clearly drawn among the various HUD departments. Each department assumes someone else is taking care. One example: HUD requires that every contractor of a subsidized housing project either be bonded or sign a completion assurance agreement with the owner and the construction lender. HUD regulations further stipulate that 2-1/2% of the value of the construction contract will be held by the bonding company or the construction lender out of either the bonds or the assurance fund. This 2-1/2% is held for one year after construction is completed. ("Completed" is defined as the date of the 100% compliance inspection.) The 2-1/2% is to:

be held as a fund to guarantee against defects in construction due to faulty materials or workmanship or damage to the mortgaged premises resulting from such defects, which defects or damage become apparent within one year after the date of the aforesaid substantial completion. Said sum may be used for the correction of such defects or damage in the event the contractor's liability for such corrections is not limited by the amount of such sum.**

*Insured Project Servicing Handbook, all of Chapter 4, Section 6. Also confirmed by Norman Babb, Area Chief of Finance and Mortgage Credit, on May 29, 1973.

**Completion Assurance Agreement, FHA Form No. 2450, p.2.
The handbook used by HUD personnel when servicing insured projects further states:

Completion of on-site and off-site facilities shall be diligently pursued, both as to items to be completed and as to time of completion, as assured by the escrow agreements. Not until satisfactory completion will the mortgagee be notified that all escrow funds may be released. The Housing Services and Property Management Division Director may extend the time for completion, if, in his opinion, an extension is warranted.*

Both the Chief Inspector and the Chief of Finance and Mortgage Credit in the Boston HUD Area Office said that these regulations plus their own knowledge of HUD clearly indicated that the Director of the Management Department would be responsible for determining when and if the 2-1/2% escrow against latent defects could be expended on behalf of a project. But, the Director of Management in the Boston Area Office does not even know what this escrow is! On two occasions he has said he does not know anything about this escrow and has never used it,** although he does acknowledge that a number of subsidized projects under his jurisdiction have had serious latent defects and problems finding the funds to repair them. The outcome of this man's ignorance is that no one in the Boston HUD office watches for this escrow, so it can never be utilized to benefit projects.

If HUD wanted to pursue funds for projects more aggressively, it could tap them from the following construction-related sources:

1) liquidated damages
2) performance and payment funds
3) completion assurance funds

* Insured Project Servicing Handbook, chapter 4, section 6, p.3.
4) construction guarantees  
5) escrow deposits for incomplete items

1) **Liquidating damages clauses** are found in construction contracts on subsidized projects. They stipulate that if construction is not finished within the time specified in the contract (or amended), then the contractor must pay a fine of a stipulated amount per day. This amount is set by HUD regulation at 24¢ per day for each $1,000 of the construction contract or, for example, $900 per day at Meadowbrook with a construction amount of $3,184,000. A one month unapproved construction delay would have yielded $27,000 for Meadowbrook.

Any penalty levied under a liquidated damages clause takes the form of a reduction in the amount paid to a contractor. In effect, it reduces the price of structures. It is not intended to provide the funds for finishing construction. Rather, it offsets other cost increases which result from delayed completion. These cost increases might include interest on construction loans and construction insurance. The structural costs offset by liquidated damages are at least sufficient to compensate for these other costs. In theory, they might even be enough to produce a decrease in the final mortgage, which would mean a reduction in debt service, but in fact few large benefits in the form of reduced mortgages and rents have come from enforcement of liquidated damages.

If any tenants have moved into a partially completed building before liquidated damages are invoked, the net rental income (i.e. rent after paying operating expenses such as utilities) is used to offset the amount of damages charged against the contractor. His liability is reduced by the total of net rents on the grounds that since he did sufficient work for the
building to be partially habitable, he should not be penalized for the work he did finish.

This seems a weak rationale since tenants will continue to suffer the inconvenience of living in an incomplete structure and since someone will have to pay for the costs entailed by unfinished construction. The net rents are monies which otherwise would go into residual receipts from which tenants might eventually benefit. If the rents are used to offset the contractor's penalty, then it works against the tenants two ways: one, they lose the benefits of a reduced cost for structures and, two, they lose the future benefits of residual receipts.

Liquidated damages have not been enforced often, in the past, according to the chief of HUD Finance and Mortgage Credit in Boston. It seems apparent that sponsors who have an identity of interest with a contractor would not be likely to press their claims, and HUD has not acted as a claimant in behalf of tenants or its own interest in projects.

2) Performance and payment bonds are supposed to provide the funds for completing construction in case a contractor does not finish the job. The payment bond is supposed to cover any outstanding liens against the contractor, such as unpaid bills from sub-contractors, while the performance bond is supposed to pay for someone else to finish construction. The amounts of these bonds are set by HUD regulation. They are percentages of construction costs, varying according to the type of structure:

<table>
<thead>
<tr>
<th>type of structure</th>
<th>performance bond</th>
<th>payment bond</th>
</tr>
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<tbody>
<tr>
<td>non-elevator, under $2 million</td>
<td>25% of construction</td>
<td>10% of construction</td>
</tr>
<tr>
<td>non-elevator, over $2 million</td>
<td>25% of construction</td>
<td>25% of construction</td>
</tr>
<tr>
<td>high-rise, elevator</td>
<td>50% of construction</td>
<td>50% of construction</td>
</tr>
</tbody>
</table>
Again, HUD should offer assistance to sponsors or tenants, to ensure that collections are made against these when construction is not finished. HUD inspectors should be more careful not to certify as completed structures which still need extensive work.

3) **Completion assurance fund** is used by some contractors in lieu of construction bonds. It, too, is a percentage of the construction cost. It is a cash deposit or an irrevocable letter of credit equal to half the performance bond of 10% the cost of construction, whichever is greater.* As mentioned earlier, both assurance agreements and bonding regulations specify that 2-1/2% of the value of construction should be held for one year after work is completed as an escrow to cover charges for repairing latent defects.

4) Construction guarantees, in HUD's words, "cover defect, deviations from approved drawings and specifications and faulty materials or workmanship, or damage resulting therefrom.** Legal action by HUD or project sponsors can be brought during the two years following the end of construction for defects discovered during the first year following the end of construction.*** Thus, construction guarantees are not deposits of money, like the other sources of funds. But they constitute the legal basis for seeking whatever funds are needed. Several projects in Boston that have tried to get repairs made under construction guarantees say that HUD has been uncooperative and unwilling to help them press their claims against contractors. If this allegation is true, HUD should change its posture to one which is more helpful to sponsors. For instance, it might identify latent defects while inspecting occupied projects. The change would be in HUD's own best

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* Completion Assurance Agreement, FHA Form No.2450.
** Insured Project Servicing Handbook, Chpt.4, Sec. 6, p.2.
*** Insured Project Serviccing Handbook, Chpt. 4, Sec. 6, p.3.
interest, since it would reduce the likelihood that projects would go into default in an attempt to pay for construction related repairs.

5) Escrow deposits for incomplete items are created by HUD when it makes an inspection at the end of construction. After this 100% compliance inspection, it takes out of the contractor's payment double the amount which it estimates is needed to finish all incomplete items, up to a maximum of 2% of the construction cost. If incomplete items total less than 1% of the value of construction, double their cost is withheld; if they are valued between 1 and 2%, their simple value is withheld; if they are valued at more than 2%, their full value cannot be escrowed, although then the HUD Inspection Department might consider not granting a final construction inspection. According to Stanley L'Esperance, a chief inspector for HUD in Boston, the items most commonly found incomplete are decorative or finishing, such as landscaping, carpeting or interior painting. He avered that in 12 years as a housing inspector, he had never known a sponsor who wasn't able to have all construction finished by the contractor. Since this contradicts the reports of numerous housing managers in Boston,** it appears that HUD is not making escrow funds available to sponsors and managers who need to get construction finished. The manager of one large 227-unit project has further criticized HUD for releasing a $19,000 escrow fund to a contractor before incomplete items were finished. He also claims that as a result of HUD's action, approximately $10,000 had to be taken out of rents for the finishing work.** If his story is true, HUD was

*Insured Project Servicing Handbook, Chpt. 4, Sec. 6, p.3.
**Urban Observatory data.
responsible for making the $10,000 expenditure an operating cost.
Chapter 9  Funds External to Existing Projects

Additional funds for O & M could come from sources outside projects, as well as from inside their finances. Federal or local governments could further subsidize projects experiencing financial difficulties. One advantage to subsidies is that they would not be paid by tenants who cannot afford to spend a higher portion of their income on housing, except insofar as tenants are taxpayers and funds from the government finally come out of taxes.

Operating subsidies could have many possible designs. One would link them to tenants' incomes, as the Brooke Amendment did in public housing, so that no one pays more than a fixed percentage of his income for rent. However, after its experience with the Brooke Amendment, the government would be extremely reluctant to establish a similar subsidy in 221d3 or 236 projects because it sees this kind of subsidy as an endless bog which soaks up an ever increasing number of federal dollars. Norman Watson, former Assistant Secretary for Housing Management, also criticized this subsidy form for creating "adverse side effects that act as a disincentive to economical and efficient management."* He implied that this subsidy takes away tenants and managers' incentives to keep costs down. Why would either be motivated to conserve on O & M if the government were picking up the tab, whatever the price? A more extended critique of the public housing operating subsidy was made in a recent Real Estate Research Corporation report:

It radically alters the normal relationship between management and occupants in a way that reduces the

management's ability to help sustain viable environments in public housing projects. Many tenants pay no rent at all; and in some cases, the management actually pays the tenants each month (when very poor tenants pay their own utility bills). This situation removes nearly all economic incentive for careful property maintenance. It also disrupts tenant morale by causing variable rental treatment of tenants in identical units.*

Some of these problems could be avoided if operating subsidies were linked to cost increases, rather than tenants' incomes. This second kind of operating subsidy could take off from basic rents and operating budgets established when projects were initially occupied. Subsidies could be given for specific cost increases such as higher utility or tax rates.

Three drawbacks to this form of subsidy are that it would pile another layer of paperwork and cost certification on both managers and HUD; it would be a disincentive to keep down operating costs; and it might encourage managers to underestimate costs while preparing operating budgets, with the rationale that cost increases could always be covered by the government. The latter problem could be avoided if HUD really insisted upon accurate cost projections. This is a task HUD is already undertaking in an attempt to negate existing incentives for sponsors to underestimate operating budgets.

The amount of money which could be allocated through operating subsidies is limited only by Congress' willingness to appropriate funds. HUD might limit them by setting a ceiling on how much a project or a unit could receive. For instance, it might say that it would pay up to a maximum of $10 (or $50) per unit annually for certified cost increases.*

*Anthony Downs, Federal Housing Subsidies, p.23.
It might establish separate limits in different parts of the country in accordance with varied local expenses, just as it now approves diverse mortgage and income limits in different places.\footnote{The Urban Observatory's Subsidized Housing Study has documented operating cost increases ranging from $12 to $125 per annum per apartment. If HUD agreed to pay for all increases which couldn't be covered by, say, a 5-10\% rent hike per year, then it would end up financing anywhere from $0 to $118 per unit, in these projects.}

Another option for determining operating subsidies would be for HUD to pay any cost increases over, say, 5\% per year.

Still a fourth variation on operating subsidies would be for the government to provide a fixed amount per unit per year, nationwide. This is essentially what was done when HUD approved the addition of a$100 per unit supplemental management fund for all projects, only in this case, the tenants and not the general public paid most of the cost through mortgage payments. HUD could compute the average annual cost of particular tasks in subsidized housing—recertification of tenants would be one possibility—and then donate this amount yearly to all projects. Let me give a more detailed example, using recertification of tenants: the average cost of recertifying a family in a 221d3 unit in Boston appears to be around $5. In a 228 unit project like Meadowbrook, this would require an annual subsidy of $1,140.

\textbf{Tax payment reforms} could constitute a special class of operating subsidies. Increasing property taxes are a major cost increase nationwide. Under federal pressure, city governments might agree to collect only a fixed amount of taxes from subsidized housing, if the federal or state government paid the difference between that amount and the full taxes due. However, it is unlikely that the federal Office of Management
and Budget (OMB) would support such a proposal because it could turn into an open-ended subsidy once tax rates began rising. Cities might exploit federal or state funds by upping projects' assessments. As I noted during the discussion of the Boston Rent Control Board (see Section 2, pages 76), some public officials adopt the attitude that if an expense in subsidized housing is going to be paid by another public agency, not by tenants, then it is appropriate to increase that expense since the burden will be spread over the general, unidentifiable tax-paying public. It seems likely that city assessors, who generally are charged with the job of increasing city tax rolls, would increase the bill for subsidized projects if they knew the federal or state government, rather than local taxpayers and voters, were going to foot the bill.

If the opposition of OMB and/or states could be overcome, a subsidy for taxes could lead to large savings within projects (and, simultaneously, large expenses for taxpayers).

Like most operating subsidies, tax supports would entail much paperwork for projects and governments alike. Both city and state or federal officials would have to maintain records on every project's tax status, and the projects would have to coordinate the reimbursement of their taxes by the state or federal government to the city.

A variation on tax support would be for cities to collect only a payment-in-lieu-of-taxes (PILOT) from 221d3 and 236 projects, just as they do from public housing. A possible precedent for this may come from Washington, D.C., where the Linda Pollin Memorial Housing Foundation is suing the city for the right to pay only a PILOT. The housing project contends that the city should extend to 221d3 and 236 projects the implicit
subsidy of foregone taxes given to public housing. As of May 1973, the Linda Pollin project had won its case in district court, but the city was appealing the decision.

Federal mortgage subsidies could be applied in a number of ways. If mortgages were ballooned, as described earlier, and the federal government took over liability for the ballooned payment, that would be one form of mortgage subsidy. If all the principal on Meadowbrook, for example, were ballooned, it would need a subsidy of $4,056,000 (the total cost of the mortgage), although if this amount were paid at the end of forty years, its discounted present value would be less than $900,000 at a 5% discount rate.

Partial payment of claims on mortgage insurance could be a variation on balloon payments. FHA could pay off part of projects' mortgages by dipping into its reserve pool. This would not only reduce the amount of debt service owed by projects, it would also cut down the government's subsidies for interest. If Meadowbrook's mortgagee were reimbursed for half the project's outstanding loan, it would receive $2,028,000 from FHA. Meadowbrook's debt service could then be reduced either in amount or in term: its monthly payments could be cut from $174,666 to $87,333, or the term of its mortgage could be shortened, while debt service payments remained constant. The government's total subsidy cost would be halved. HUD's Acting Director of Housing Programs, Fred Pfaender, believes this strategy could save a majority of the housing projects in fiscal difficulty.*

A third strategy by which the government could prevent foreclosure when projects couldn't meet debt service payments would be for HUD to take title from the mortgagee, paying off the mortgage with insurance premium funds, while allowing the owner to retain title. The mortgage could, in effect, be written off and the project's entire income devoted to operating expenses. HUD has already done this with at least one large project in Boston. While taking title from the mortgagee is considered a preliminary step to foreclosure, HUD could decide not to foreclose. Alternatively, if HUD did not want the current owner to keep the project, it could sell the project at a low cost. With lower mortgage, the new owner might better be able to handle the project's operating cost overruns.

A fourth way that HUD might subsidize mortgages would be for HUD to take title temporarily from the mortgagor. Currently, whenever HUD acquires ownership of a project, FHA pays off the mortgagee and HUD receives the mortgagee's title to the property. Instead, HUD might take over from the mortgagor, paying debt service out of public funds until the project became financially solvent. Then the housing could be returned to its former owner, or a new owner could be found. This approach would be successful only with projects whose fiscal problems could be mended by a temporary input of funds. It is similar in this respect to present mortgage modification practices, but it would leave projects better off financially, since they would not afterward have to pay increased debt service to compensate for missed principal payments, nor would they have to sustain interest costs if HUD paid the entire debt service. In Meadowbrook, this approach would free $174,666 per year. This amount would not vary, no matter when during the life of a project
HUD took over the debt service, since debt service has constant level payments.

Whether or not legislative changes would be required before HUD could substitute for mortgagors is disputed. A former HUD lawyer, Larry Gandel, says that existing laws would permit this, but HUD General Counsel has not interpreted the law like Gandel. It has said that new legislation would be required.* A more extensive legal review would be needed for a definitive opinion. A legal review would also need to determine how HUD's take-over for the mortgagor would affect the position of limited partners in a for-profit corporation. If the ownership switch were regarded as a sale by IRS, then limited partners would lose their depreciation benefits and previous benefits would be subject to re-capture. Under these circumstances, HUD would come under great pressure not to remove the original mortgagor, and this strategy would probably not be feasible until 236 projects were at least ten years old. (After ten years there is no re-capture of accelerated depreciation in 236 projects).

Another federal mortgage subsidy could be obtained through a little used provision of the National Housing Act, Section 223(d), which authorizes HUD to issue operating loss loans.** These loans can cover losses experienced during the first two years of operation of a multi-family project.

Recoupment is limited to the amounts by which disbursements for taxes, interest, mortgage insurance premiums, property insurance premiums, and expenses for maintenance and operations (exclusive of all capital improvements) exceed the income from the property.***

** Basic Laws and Authorities on Housing & Urban Development, pp.82-82.
*** Insured Project Servicing Handbook, Chpt. 4, Sec. 16, p.1.
These loans at first appear to be a sound device for helping projects survive the problematic first years of operation when most fiscal difficulties emerge. But there is one hitch to their utilization. They must be coterminous with the original mortgage; they cannot be tacked onto the end of the original loan. Nor can they increase a project's debt service above the statutorily established limit. Therefore, projects whose mortgages are already up against statutory ceilings cannot avail themselves of operating loss loans. In high-cost areas like the Northeast, almost all projects are excluded by these provisions. To date, no operating loss loans have been issued by the Boston Area Office of HUD for this reason, although one is now being tentatively considered.*

The benefits of an operating loss loan would not be available to Meadowbrook, because it is at mortgage limits.

Re-financing mortgages could leverage more monies for O & M. It could be done by extending mortgage terms or lowering their interest rates. A special form of re-financing could be used in 221d3 projects: they could be re-financed as 236 projects.

The Chief of HUD Finance and Mortgage Credit in Boston has said, "If there is one thing sacred in FHA, it is the mortgage term."* But if FHA would give up its attachment to forty years as the maximum mortgage term and projects could be re-financed for longer periods, then monthly effective debt service could be lowered. If Meadowbrook were re-financed for fifty years but kept its 3% interest rate, its debt service would fall by almost $18,000 to $156,720 per year, or $13,060 per month.

The term of FHA mortgages is supposed to represent three-quarters of

buildings' economic life. Since the allowed term for multi-family dwellings has gradually been extended from twenty to twenty-five years, then to thirty, and finally to forty, FHA's concept of economic life has been malleable. At the present time, forty year mortgages are often politically determined, rather than practically. For instance, sixty year old buildings in declining neighborhoods may survive another fifty-five years after rehabilitation, but the odds are sufficiently long to make the forty year term a gamble. It is permitted simply in order to facilitate production's economic feasibility. A decision to extend mortgage terms to fifty years would be political, rather than economic.

Lowering the interest rate would also be a political decision. If HUD and Congress ever wanted to, they could subsidize the entire interest rate on 221d3 and 236 mortgages. If interest paid by projects were reduced to zero, but principal were still repaid at the rate of a 3% mortgage in 221d3 projects, an average of $558/unit would be released during the first year. If the same conditions were applied to 236 projects, except that amortization were at the rate of a 7-1/2% mortgage, then an average 236 unit would have $789 released during the first year. In later years, less money would be released, for principal payments increase over time. Meadowbrook is a 221d3 project; under the conditions specified above, its debt service could be reduced to an average of $131/unit during the first year, freeing $635/unit. If the government paid all the interest but applied level annuity payments to the project's amortization of principal, debt service would become $101,420 per year, $73,246 less than at present.
Refinancing 221d3 and 236 projects for more funds does not seem a possibility in most projects because it would lead to higher debt service, given that little of their principal has been amortized. But after ten years of operation, refinancing for more money might be possible because 15% of the initial principal would have been re-paid in 221d3 projects and 6% in 236 projects (with market interest rates of 7-1/2%).

One special way to lower the interest rate on 221d3 projects would be to convert them to 236s. (Table 3-2 summarizes the major differences between the two programs). This conversion would lower their effective interest rate from 3% to 1%. On a typical 221d3 unit with a mortgage of $18,600, the annual debt service would be reduced from $800 per year to $555 per year. In Meadowbrook where the mortgage averages $17,789 per unit, the annual debt service would be reduced from $766/unit to $540/unit per year, a savings for the entire project of $51,428 per year. This savings could go toward either O & M or reductions in rents. A recent 221d3 project which contemplated conversion estimated that rents could be reduced by $19 to $39 dollars per unit. Projected rents were:

<table>
<thead>
<tr>
<th>type of unit</th>
<th>221d3 rent</th>
<th>236 rent</th>
<th>savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>low-rise:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2-bedroom</td>
<td>$164</td>
<td>$145</td>
<td>$19</td>
</tr>
<tr>
<td>3-bedroom</td>
<td>190</td>
<td>166</td>
<td>24</td>
</tr>
<tr>
<td>4-bedroom</td>
<td>214</td>
<td>188</td>
<td>26</td>
</tr>
</tbody>
</table>

| high-rise:   |            |          |         |
| 1-bedroom    | $154       | $115     | 39      |
| 2-bedroom    | 176        | 144      | 32      |

The federal government would also benefit from conversions. They would initially bring a new flow of dollars into the U.S. Treasury. The inflow would result from differences in federal financing for the two kinds

* Urban Observatory data.
of projects. In 221d3 projects, the entire mortgages are purchased outright by FNMA (now GNMA), so the entire mortgage amounts are counted as expenditures by the federal government when they reach final closing. In 236 projects, the government does not purchase mortgages outright. Instead, it makes an annual contribution to the mortgagee as an interest subsidy: the difference between the market interest rate on the mortgage and the 1% paid by the project itself. This annual contribution decreases over time, as more of the interest is paid off. So, if 221d3 mortgages were prepaid and new 236 mortgages were taken out, the government would recoup its initial outlay for the 221d3 mortgages, substituting an annual contribution for the 236s. Politically, this change might be very appealing due to the initial net return to the government. Political mileage might also be earned from the fact that 236 subsidies are adjustable, linked to tenants' incomes. As incomes rise, they pay more rent which is returned to the government to cover a part of the public interest subsidy; while in 221d3 projects, increased rents resulting from higher tenants' incomes do not reduce the public subsidy.

Conversions are already permitted under existing FHA rules, but only in projects which have not yet been finally endorsed. The conversion rules are quite simple for a project after initial endorsement: it merely requests that the change be made, and if the project is feasible under 236 requirements and 236 funds are available, the conversion is affected.*

If occupied projects were converted, a number of difficulties would have to be resolved. First, 236 projects pay mortgage insurance premiums, which 221d3s do not, so their cost would have to be added into the expense

* FHA pamphlet 4442.1, pp.9, 23-26.
of the conversion. (A summary of major differences between 221d3 & 236 is given in Table 3-2.)

Second, income limits in the two projects are different. They tend to be higher in 221d3 than in 236 since in the former they are established by HUD as "the lower of either median income for families in a project's area or the income necessary to sustain the carrying costs of a unit which is minimally acceptable in the market,* while in 236 they are 135% of the local limits for public housing occupants. For example, a two-bedroom 221d3 apartment could house a family with an income of $7,972, but an identical 236 unit could only take families whose incomes were under $7,052. If 221d3s were converted, families who were above the 236 limits might be able to stay as "over-income" tenants, although this status would force them to pay more than the basic 236 rents. They would need to pay 25% of adjusted gross income, or the so-called market rent, whichever was lower. (The market rent is that needed to cover amortization of the mortgage at its full market interest rate.) This might result in rent increases for many families. The project whose comparative rents for 221d3 and 236 are given on page 152 also estimated how many families would be eligible for basic rents. Of 126 families in its low-rise buildings, 63 would have been eligible for basic rents. But the remaining 63 tenants would have been subject to rent increase of $2 to $128, with an average increase of $57! ** Faced with these increases, many families might have left.

Third, projects might end up having higher management costs, since the 236 program is more complex administratively than its predecessor.

* A Decent Home, pp. 62-66
** Urban Observatory data.
Table 3-2: Summary of Major Differences Between the 221d3 and 236 Programs

<table>
<thead>
<tr>
<th></th>
<th>221d3</th>
<th>236</th>
</tr>
</thead>
<tbody>
<tr>
<td>mortgage interest rate</td>
<td>3%</td>
<td>market rate: 6-9%</td>
</tr>
<tr>
<td>interest paid by project</td>
<td>3%</td>
<td>1%</td>
</tr>
<tr>
<td>avg. mtg./unit*</td>
<td>$18,600</td>
<td>$26,400**</td>
</tr>
<tr>
<td>level mtg. payment</td>
<td>$800</td>
<td>$800***</td>
</tr>
<tr>
<td>average govt. subsidy/unit</td>
<td>$671</td>
<td>$1,288</td>
</tr>
<tr>
<td>time of govt's expenditure</td>
<td>at final closing</td>
<td>annual contributions, over the life of the mtg.</td>
</tr>
<tr>
<td>final mortgagee</td>
<td>GNMA</td>
<td>FNMA or private lender</td>
</tr>
<tr>
<td>mtg. insurance premium</td>
<td>waived = $0.00</td>
<td>1/2 of 1% of mtg. = $132/unit</td>
</tr>
<tr>
<td>basic income limits</td>
<td>established by HUD</td>
<td>135% of public housing</td>
</tr>
<tr>
<td>extraordinary income limits</td>
<td>established by HUD</td>
<td>90% of 221d3 limits</td>
</tr>
<tr>
<td>additional rent paid by over-income tenants</td>
<td>25% of adjusted excess income up to 20% of the amt. of basic rent</td>
<td>25% of adjusted excess income, up to the amt. needed to support full market interest rate on mtg.</td>
</tr>
</tbody>
</table>

* In Boston

** The higher cost of the average 236 unit results mainly from inflation: most were built later in time than 221d3 projects.

*** A similar level payment on a larger mortgage is brought about by a larger federal subsidy.
For instance, 236 tenants' incomes need to be re-certified annually, while 221d3 are only re-certified bi-annually; excess income in 236 projects must be remitted to HUD, while 221d3 projects can keep it in residual receipts. The conversion process itself would be expensive, requiring coordination of all the public intermediaries involved in projects and much planning by project sponsors. Final endorsement of new mortgages would also entail expenses. These costs would, to some extent, offset the additional funds made available for operations.

Fourth, the IRS would have to determine whether conversion constituted a sale of the project for the limited investors. If it would constitute a sale, limited partners would lose their accelerated depreciation benefits and earlier benefits might be subject to recapture. If this were the result, then investors and sponsors alike would doubtless try to prevent the conversion.

Fifth, more 236 funds would have to be allocated by Congress. Until and unless the present moratorium is lifted, this will not be possible.

All these issues would have to be resolved before conversions could occur. Nevertheless, conversion seems a likely strategy for salvaging 221d3 projects with operating cost overruns.

Escrows for operating overruns could be built out of funds ordinarily used to repay the mortgage, as described above, or they could be built into mortgages if and when they were refinanced. The Michigan State Housing Development Authority already inserts them into new limited
dividend mortgages by establishing a 'development cost escrow'. This escrow is equal to approximately 8% of the mortgage amount, or approximately $1,700 per unit. The debt service on the escrow is paid by reducing the return to limited investors from 6% to 3%. Thus, there is no rent increase for residents. The reduction in cash flow to investors is sufficient to pay the added debt service cost for the escrow.

If the development cost escrow is not needed for operating costs, it will be available to fund social and physical amenities, as well as to provide for necessary future capital improvements for the development.**

Although the higher mortgage would tend to increase HUD's subsidy costs, it does not since the MSHDA has significantly lower interest rates than does FHA.

The escrow has potential benefits for the developer, investors, residents and HUD. For the developer; because it is a mortgageable item, the total mortgage amount is increased and, therefore, the syndication price (as a percentage of the mortgage amount) also increases. "In

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* MSHDA also seeks two assurances against rising operating costs from a developer. First, he must guarantee to operate a development within the agreed budget for a three-year period without any rent increases, except for increases to cover rising real estate taxes and utility costs which are beyond the developer's control. Second, the developer must establish an 'equity escrow': he must arrange for 5/6% of the mortgage amount received from syndication proceeds to be available each year for six years to meet operating deficits. "In addition, he must post a letter of credit in the total amount of 2-1/2% of the mortgage to cover any operating losses occurring in the first three years. The exposure of the developer is a maximum 5%, reduced by 5/6% for each year of successful operation over a six-year period." (Explanation of Authority Program to Provide Operating Assurances under Its Limited Dividend Housing Program, p.3.)

** Ibid, p.4.
addition, it is a fair expectation that a higher price will be paid by investors who understand that the . . . development cost escrow provides significant protection." For the investor who is concerned primarily with securing his tax shelter benefits, security against a project's foreclosure also protects him against serious losses under recapture provisions of the IRS code. Since the primary incentive for investors is tax shelter benefits, rather than cash flow, a 50% reduction in the cash dividend is not a material deterrent to most investors.

For residents, the escrow gives assurance that their rents won't be increased as soon as costs rise. For HUD, the escrow supplies a good chance of program success, decreasing the likelihood that it will become the owner of foreclosed projects.

MSHDA has been relatively successful in obtaining developers' and HUD's consent to this escrow. HUD has always been enthusiastic about it. While developers were initially less eager to support it, the security it brings has won their support.

Similar development cost escrows could be built into re-financed 236 mortgages which lacked them initially, if the Internal Revenue Service would consent (1) not to treat the re-financing as a sale of the property, (2) to allow depreciation benefits on investments with only a 3% cash return, and (3) to permit the original syndication agreement to remain in effect even though the mortgaged value of the property would have changed. Investors would also have to agree (1) not to take any cash benefits from re-payment of the first mortgage and (2) to waive half of the 6% cash flow distribution.
### Table 3-3: Alternative Sources of Operating Funds at Meadowbrook

A 228 unit, 221d3 project in Fitchburg Massachusetts, with a final mortgage of $4,056,000 and annual projected operating costs of $920 per unit per year.

<table>
<thead>
<tr>
<th>Source of Funds</th>
<th>Funds Available Only Once</th>
<th>Funds Available Annually</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I. Funds Internal to the Project</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A. Funds held in the name of the project</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Replacement reserves</td>
<td>$10,852</td>
<td></td>
</tr>
<tr>
<td>2. Residual receipts</td>
<td>1,215</td>
<td></td>
</tr>
<tr>
<td>3. AMPO funds</td>
<td>not available</td>
<td></td>
</tr>
<tr>
<td>B. Funds held by project's sponsor</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Limited dividend distribution</td>
<td></td>
<td>$2,435</td>
</tr>
<tr>
<td>2. Syndication proceeds</td>
<td>$328,125 or 19,680*</td>
<td></td>
</tr>
<tr>
<td>3. Excess profits to wholly owned subsidiaries</td>
<td>not available</td>
<td></td>
</tr>
<tr>
<td>C. Funds available thru changes in mortgage financing</td>
<td>$54,300 or 71,000</td>
<td></td>
</tr>
<tr>
<td>1. Balloon mortgage principal payment - after 1 year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. 3-month moratorium on debt service</td>
<td>43,666 or 2,620*</td>
<td></td>
</tr>
<tr>
<td>3. Operating escrow built out of 1 yr deferred debt service</td>
<td>174,666 or 10,480*</td>
<td></td>
</tr>
<tr>
<td><strong>D. Funds available early in a project</strong></td>
<td>not available</td>
<td></td>
</tr>
<tr>
<td>1. Construction cost savings</td>
<td>not available</td>
<td>$900/day, but not available</td>
</tr>
<tr>
<td>2. Liquidated damages</td>
<td>$900/day, but not available</td>
<td></td>
</tr>
<tr>
<td>3. Performance &amp; payment bonds</td>
<td>not available</td>
<td></td>
</tr>
<tr>
<td>4. Construction guarantees</td>
<td>$79,600**</td>
<td></td>
</tr>
<tr>
<td>5. Completion assurance funds - escrow for latent defects</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Escrow deposit for incomplete items</td>
<td>38,000**</td>
<td></td>
</tr>
<tr>
<td><strong>II. Funds External to the Project</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A. Operating subsidies</td>
<td>1140-11,400</td>
<td>@$5-50/unit</td>
</tr>
<tr>
<td>1. Straight operating subsidies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Tax payment subsidies</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Assumes available funds are deposited in 6% savings account; this figure is annual interest.

** These funds could be spent only on specified items, e.g. repair latent defects.
B. Federal mortgage subsidies

1. Payment of half the claims on mortgage insurance
2. HUD take title from mortgagee
3. HUD take title from mortgagor
4. Operating loss loan

C. Refinancing of mortgage

1. Refinancing for 50 years
2. Refinancing at zero interest rate
3. Refinancing as 236 (1% interest)

D. Development cost escrow

<table>
<thead>
<tr>
<th>B. Federal mortgage subsidies</th>
<th>C. Refinancing of mortgage</th>
<th>D. Development cost escrow</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Payment of half the claims on mortgage insurance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. HUD take title from mortgagee</td>
<td>174,666 or not available</td>
<td>324,480 or 19,469*</td>
</tr>
<tr>
<td>3. HUD take title from mortgagor</td>
<td>87,333 or 0-174,666*</td>
<td></td>
</tr>
<tr>
<td>4. Operating loss loan</td>
<td>10,480**</td>
<td></td>
</tr>
</tbody>
</table>

* Amount made available would depend on how much HUD would subsidize.
** Assumes available funds are deposited in 6% savings account; this figure is annual interest.
Although escrows would increase mortgages and thereby theoretically increase the replacement value of projects, they would not really increase FHA's insurance risk since the escrows would remain assets of projects. If projects were sold, escrows would be transferred to new owners along with the physical property. Therefore, FHA should be able to maintain its insurance on projects that incorporated operating escrows.

At Meadowbrook, a development cost escrow of 8% of the mortgage would contain $324,480 or $1,425 per unit. If this escrow were invested in an ordinary savings account with 6% interest, the annual yield would be $19,469, which could be used for operating overruns without even touching the principal of the escrow.

**Conclusion**

The central concern of this section has been to examine the implications, financial and otherwise, of alternative sources of operating funds for 221d3 and 236 projects. The sources examined vary in their level of assistance, the time pattern of their benefits, and the amount and timing of additional public subsidies required. But all of them share one quality. They all depend upon tinkering with the existing housing subsidy system. They would further complicate the already complex 221d3 and 236 programs. They would continue a long American pattern of trying to correct deficiencies in the market, in general, and in housing programs, in particular, through incremental changes which push and pull at institutionalized financial arrangements, rather than drastically re-structuring them to eliminate the problems which initially caused the deficiencies. Whether or not it is worthwhile to tinker further with 221d3 and 236 programs depends on how
much money is actually needed to help projects survive. If projects can be saved with small increments in available funds, then further tinkering with their financial arrangements might be useful. (Provided, of course, that it is deemed desirable to maintain projects under their present ownership and subsidy arrangements, in general). But if projects need very large sums of money, then they also require cataclysmic changes in their subsidy and financial arrangements. Further convolutions of the existing subsidy system would not relieve their financial distress.

Given the marginality of proposed changes, the greatest financial benefits would come from those which depend upon more external intervention in projects. They rely on the application of additional subsidies by the federal government, which makes them further dependent on public funds. By reference to Table 3-3, which summarizes the monies that could be generated on behalf of a 228-unit 221d3 project near Boston, it can be seen that the largest, continuing sources of additional funds all entail mortgage modifications. Modifications would require the cooperation of both HUD and mortgagees, primarily GNMA and FNMA. HUD would have to supply additional mortgage subsidies, picking up a larger tab for interest or part of the principal, while mortgagees would have to accept deferred payment. The greatest additional sums of operating money would come from:

- partial payment of claims on mortgage insurance, amounting to a pre-payment by HUD of half the mortgage. At Meadowbrook this would free $383 per unit per year, of 41% of the projected annual per unit operating expenses, exclusive of debt service and bad debts.
refinancing the mortgage at a lower interest rate, either zero percent or one percent, the latter representing conversion to 236 financing. Approximately $321 per unit per year (equivalent to 35% of projected operating costs) or $226 (equivalent to 24% of projected operating costs), respectively, would be released by these changes.

Whether or not these amounts would be sufficient to keep Meadowbrook our of financial difficulty would depend, of course, on how greatly its operating expenses increased. No figures are yet available on Meadowbrook's actual operating costs since its mortgage was closed less than a year ago. Nevertheless, some representative costs are available from a national HUD audit of the 236 program and from The Subsidized Housing Study now being conducted by the Boston Urban Observatory. The HUD audit showed that, nationwide, the majority of projects' estimated operating costs were 20% under actual costs during the first one to three years of occupancy. The Urban Observatory study of 221d3 and 236 projects in Boston found that average costs rose 14.5% between 1969 and 1970, and another 13% between 1970 and 1971, or 27.5% during the first three years of occupancy. If Meadowbrook's cost increases paralleled these typical figures, then they could be covered by the 20-40% additional operating funds released by mortgage modifications. However, if Meadowbrook's costs escalated at 45% annually like the more sorely pressed developments around Boston, then mortgage modifications would not suffice. Given that Meadowbrook's projected operating costs were reasonably set at $920 per unit annually, cost increases would probably not be more than could be covered by mortgage modifications.
Because mortgage modifications' large benefits come only at the price of extra government subsidies, they would probably be more difficult politically to institutionalize than many of the other less profitable sources of operating funds. Congressional approval of more subsidy funds would be prerequisite to refinancing mortgages at lower interest rates. Congress would have to commit annual appropriations for the next 35-40 years. During that 35-40 year period, more subsidy dollars would be expended in toto than would be spent on outright repayment of half the value of mortgages. However, pre-payment would require immediate federal expenditures which are usually less palatably politically than larger deferred expenditures. The issue of immediate payments could be kept out of Congress if HUD-FHA had sufficient funds in its mortgage insurance pool to repay partial mortgages on projects which wanted to tap that money. But if HUD-FHA tried to salvage all projects in financial trouble, its insurance pool would be severely depleted, and it would probably have to seek special funding on Capital Hill.

Before mortgage modifications could be effected, many layers of government would have to be pierced:

- HUD would have to decide how to implement the modifications;
- FHA would have to reckon the figures involved;
- Congress would have to appropriate more funds;
- GNMA or FNMA would have to agree to defer receipts;
- IRS would have to rule on how these changes would affect investors.

Additional red tape and operational controls would have to be borne by project sponsors and managers. Their costs of dealing with public agencies would doubtless increase as they maneuvered modification requests through the various bureaucracies.
The other strategies for obtaining more operating funds would require less public subsidies, but individually they would yield fewer dollars. The largest of them, syndication proceeds, would produce roughly $19,700 or $86 per unit per year, enough to cover a 9% rise in operating costs. If it were combined with all other funds now available through projects' financial structure (i.e., replacement reserves, residual receipts and limit dividends), $34,100 annually or $150 per unit per year could be found without the addition of any public monies. This amount could cover a 17% increase in operating costs. Before all these funds could be tapped, both HUD and project owners would have to consent to anticipated income. Their consent would probably not be too hard to obtain, since they both currently forgo these monies under some circumstances.

The practice of combining a number of sources of income might be fruitful in some projects that need more funds than could be provided through a single source of income. However, it would never be possible to combine in a single project all the potential sources discussed in the preceding chapters. Some of them are mutually exclusive. For example, if a development cost escrow whose debt service took half the dividends normally given to project's owners, were included in a mortgage, then the dividends could not be applied toward operating costs; they would be needed for debt service.

If 221d3 mortgages were refinanced as 236 mortgages, they could probably not then be refinanced at a zero interest rate. If mortgages were refinanced, HUD and mortgagees would probably not then consent to balloon mortgage principal payments. Such an involution of a convolution
would likely seem too baroque. Furthermore, while the existing subsidy programs already seem very complicated, they would appear simple compared to the intricate ramifications that two successive, complex mortgage modifications would have on the status of limited investors, on mortgagees' trading position in the mortgage market, and on managers' dealings with public agencies.

The most sources that would likely be feasible at Meadowbrook are:

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>replacement reserves</td>
<td>$10,852</td>
</tr>
<tr>
<td>residual receipts</td>
<td>1,215</td>
</tr>
<tr>
<td>limited dividend distribution</td>
<td>2,435</td>
</tr>
<tr>
<td>syndication proceeds</td>
<td>19,688</td>
</tr>
<tr>
<td>refinancing as a refinance</td>
<td>236</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>$85,618</strong></td>
</tr>
</tbody>
</table>

Since this total amount could cover a 40% operating cost jump, at Meadowbrook, it would probably be sufficient to cover operating cost increases for several years. If they increased annually at 13-14%, which is the general trend in Boston, this $85,618 would be sufficient for 3-4 years. If gradual, moderate rent increases were also instituted during that time, operating costs could be kept under control even longer. But in projects whose operating costs are rising much more rapidly than 13-14% per annum due to initial underestimation of expenses, marginal tinkering would probably only delay foreclosure. With one exception: projects whose expenses are increasing due to the repair cost of major latent construction defects could be saved by tinkering if the object of the patching were to have contractors, builders, and architects make good on the various construction guarantees and escrow accounts which already
exist. This would not supply more general operating funds, but it would avert one of the more serious causes of operating cost increases in Boston.

As this discussion has suggested, the ramifications of diverse sources of operating funds are many and complex. Their details are beyond the scope of this paper, although they would have to be thoroughly investigated before any changes could be implemented. Nevertheless, I have tried to suggest the costs and benefits, plus the limitations of these alternative funding sources. They are incapable of saving from foreclosure projects whose operating monies are grossly inadequate. Because they are only marginal changes in the present subsidy system, they are insufficient to mend projects which are suffering from larger operating deficiencies. These projects are being bankrupted by the present subsidy system. Only drastic alterations which attack the causes of extreme expense increases can help these projects. However, projects whose operating cost squeeze is less severe can be salvaged by tinkering with existing subsidies, particularly if all the people involved in housing development—HUD, FHA, sponsors, builders, contractors, and managers—accept increased responsibility for projects' fiscal problems.
Afterword

This thesis has examined two areas in which the existing housing subsidy system does not function adequately. Both are related to the costs of managing publicly-assisted, privately-owned rental housing: 221d3 and 236. The first was the cost to projects of regulatory actions by public agencies with official authority over subsidized housing. The second was the need for more operating funds in many 221d3 and 236 projects, along with potential sources of revenue which could provide additional monies. The first, then, concerned an unintended and often expensive side effect of housing subsidies, while the second concerned deliberate strategies to alleviate the pinch of high overall operating costs.

For relief in both areas, I suggested the possibility of restructuring existing patterns of responsibility for subsidized housing. Given the management costs and problems resulting from many public regulators, it seems desirable to lessen the amount of government intervention, perhaps by consolidating the agencies which oversee subsidized projects. This would, hopefully, cut down projects' friction of doing business with public agencies. Doubtless this friction could never be eliminated entirely, for the combination of private ownership and public regulation leads inevitably to some conflicts. Housing sponsors and managers looking for successful businesses, on the one hand, and public agencies seeking complex public policy goals, on the other hand, are not always going to agree on their mutual rights and responsibilities. Nevertheless, present housing programs have laid an excessive administrative burden on developments, particularly the smaller ones. Exacerbating managements' expenses are the number of agencies which claim jurisdiction over them. Inter-
agency disputes cause costs that are inappropriate for projects to bear. While behind the disputes each agency has at least some praiseworthy motives -- to ensure that housing managers and other public bureaus give adequate services to tenants -- it is time for projects to stop paying the price for agencies' good intentions.

This is not to say that public intervention should be eliminated. Instead, I am advocating that public funding and regulation of housing be rationalized and coordinated. In some instances, this might even entail increased supervision of developments. For example, as suggested in Section 3, it is apparent that greater watchfulness is needed to secure adequate construction of buildings in 236 projects. But the large overhead costs of a multi-tiered system of subsidy and regulation should not be perpetuated.

Behind this statement lie larger public policy issues concerning the nature of the federal system that allocates responsibility among different levels and branches of government. While these issues are beyond the scope of this paper, changing the regulatory pattern of subsidized housing, nevertheless, seems desirable.

It also seems desirable to restructure the financial liability of other participants in subsidized housing: owners, sponsors, builders and architects. At a minimum, HUD should pressure sponsors, builders and architects to fulfill their present, often unsatisfied requirements to design and build housing adequately. Preferably, HUD should restructure both their and limited investors' financial obligations, so all four share in providing adequate operating funds for 221d3 and 236 projects. O & M outlays maintain sponsors' and owners' investments just as much as
they supply housing services to tenants. Perhaps the cost should be
shared accordingly.

A number of changes that would spread financial liability were
outlined in Section 3 of this paper. The potential sources of operating
revenue discussed in Section 3 represent the financial limits of current
federal rental assistance programs: The limits to the dollars which can
be leveraged by tinkering with these programs. Although more operating
funds could be released by reworking 221d3 and 236 projects' fiscal
arrangements, these funds are finite. They are probably not sufficient
to save projects in the worst fiscal condition, that is, projects whose
operating deficits are increasing much faster than can be absorbed by
regular, modest rent increases. Because most of the funding sources
are fixed amounts that would not increase with time, they generally could
not offset continuing, large, inflationary cost increases. They could
more likely erase deficits due to operating problems that can be solved
by a single input of money, such as defective heating systems or
inadequate building security. In other projects whose projected operating
budgets were underestimated before occupancy, these funding sources could
cover the discrepancy between projected and initial operating expenses--
provided that most on-going cost increases could be covered by rent
increases. Thus, these incremental additions of funds could not save all
projects from foreclosure. Since they bring only marginal changes in
revenues, they could only resolve certain kinds of operating problems.
There are projects whose incomes are so far below actual expenses that
they could not be saved from foreclosure even by tapping all available
sources of operating funds. With these projects, the existing housing
subsidy system has failed. In them, it has created problems that cannot be resolved except through cataclysmic alteration of public-private housing activities.
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List of Interviews

HUD-FHA personnel

In the Boston Area Office
Irving Solomon, Director of Management
Joseph Caliguri, Office of Housing Management
Norman Babb, Chief, Mortgage Credit and Financing
Peter MacDonald, Mortgage Credit
Stanley L'Esperance, Chief, Housing Inspection Department
Stephen Wasko, Technical Standards Department

In Washington, D. C., HUD central offices
Fred Pfaender, Acting Director, Office of Housing Programs
Eli Zietz, Office of Research

Massachusetts Housing Finance Agency
Anne Bromer, Tenant Selection & Relation Specialist
Bryan Frawley, Mortgage Officer
Robert Page, Management Analyst
Stephen Rioff, Management Services Officer

Michigan State Housing Development Authority
Issac Greene, Director
Thomas White, Chief of Production

Boston Housing Authority
Patricia Claire, former Director, Leased Housing Program

Boston Rent Board
John Grace, Administrator
Mark Snyder
Deborah Archer

Greater Boston Community Development, Inc.
Robert Whittlesey, Executive Director
Dotti Rosette, Bookkeeper
Gail Schubert

Urban Planning Aid
Emily Achtenburg
Michael Stone

Urban Observatory, Univ. of Mass., Boston
Vincent O'Donnell
David Judelson, planner for CATA housing project
Larry Gandel, member of Carter Burgess Task Force
Allister Shepard, consulting engineer
Sidney Insoft, Gem Realty
Pemberton Management
North American Development Corporation

Other managers and developers who asked to remain anonymous