STATE HOUSING FINANCE AGENCIES AND PUBLIC PURPOSE HOUSING DEVELOPMENT

by

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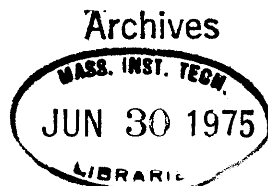

State Housing Finance Agencies and Public Purpose Housing Development
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The major thesis presented is that the state housing finance agencies (HFA's) have been more effective than the U.S Department of Housing and Urban Development (HUD) in producing housing that satisfies legislatively-defined public purposes because on the whole, their role in the development process, position in government, and structure and dynamics of organization have been more consistant with the nature of public purpose housing development.

This conclusion is reached on the basis of an examination of the first six state HFA's to receive full housing development lending powers in comparison with their counterpart local HUD offices. The HFA's included are: the Illinois Housing Development Authority, Massachusetts Housing Finance Agency, Michigan State Housing Development Authority, New Jersey Housing Finance Agency, New York State Housing Finance Agency, and New York State Urban Development Corporation (UDC).

After Chapter 1 provides an introduction and Chapter 2 gives a history of each agency, Chapter 3 then reviews the legislatively-determined public purposes of the various agencies to be used in Chapter 4 for evaluating agency effectiveness. Chapter 4 finds that the HFA's have been as effective as HUD in fulfilling the public purposes that they share with HUD while being clearly more effective in achieving fiscal solvency. In particular, the HFA's are seen to have performed equally as well as HUD in terms of volume of housing produced, location in "slum" areas, and level of rents; better than HUD with regard to promoting racial and economic integration, housing low income families and elderly individuals, achieving good design, and maintaining financially solvent projects and operations. HUD, however, is seen to have housed a higher percentage of minorities and to have provided more rehabilitated housing and a slightly higher percentage of housing for large families. If UDC is excluded from these comparisons because of its unique role as a developer, the financial solvency of the remaining HFA's in comparison with HUD is seen to be overwhelming, although they have produced fewer units and a lower percentage of units in "slum" areas than their counterpart HUD offices.

The remainder of the thesis provides reasons for HFA effectiveness. In Chapter 5 the role of the HFA's as mortgagee rather than as mortgage insurers or developers is seen as facilitating their being able to effectively manage the high risks of public purpose housing through actively controlling certain risks and shifting others to developers. The other part of their mortgagee role, that of obtaining loanable funds, is seen in Chapter 6 to provide both constraints and opportunities for being effective.

The position of the HFA's on a state rather than a Federal is seen in Chapter 7 as being more consistent with the local nature of housing development. Chapter 8 finds that although many of the HFA's have a degree of autonomy from the rest of government which increases their effectiveness, all are subject to controls by local officials and special interests.

As seen in Chapter 9, because of the complexity of the public purpose development process, those HFA's with simple structures and flexible rules and procedures have been the most effective. While Chapter 10 finds that the effectiveness of leadership has had some impact on organizational effectiveness, leadership appears to be less important than other factors discussed in this thesis.

Thesis supervisor: Langley C. Keyes, Professor of Urban Studies and Planning

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BIOGRAPHICAL NOTE ABOUT NATHAN S. BETNUN

Mr. Betnun received his B.A. degree from the University of California at Berkeley in June, 1969. He graduated with distinction in general scholarship and completed his Honors program with great distinction. He received honors at entrance and was awarded a California State Scholarship. The author's honors thesis topic was "The Role of Savings and Loan Associations in Low-Income Areas of Oakland."

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CHAPTER 1

INTRODUCTION

State housing finance agencies have emerged as one of the most powerful new forces in residential development lending. Between 1970 and 1974, state agencies financed a total of nearly 200,000 dwelling units. Their influence has been particularly noticeable in certain of the nation's largest housing markets. During the first five years of the 1970's, state and local housing agency financing accounted for over twenty percent of all starts in the New York City area, about twelve percent in greater Boston, approximately seven percent in the Detroit metropolis, and roughly three percent in Chicago and its environs.

The impact of state housing finance agencies (HFA's) is now spreading geometrically. While in the first half of the 1960's only one HFA existed which could independently provide financing for residential development, in 1966-68 five more agencies gained such powers, and by the end of 1974, a total of thirty-six HFA's were in existence in thirty states.[1] As the number of agencies has expanded, so has their range of programs. HFA's in various states

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[1] New York State has five housing finance agencies of various types including the Urban Development Corporation, Housing Finance Agency, Mortgage Agency, Battery Park City Authority, and New York City Housing Development Corporation; New Jersey has both its Housing Finance Agency and a Mortgage Finance Agency; Massachusetts has both its Housing Finance Agency and Home Mortgage Finance Agency. Twenty-seven other states have one agency each.

now finance single family developments, provide loans to lenders, engage in secondary mortgage purchases, and lend money directly to homebuyers, in addition to providing construction and permanent financing on multi-family developments. Like private lenders, all of the housing financed by the HFA's is privately owned.

What makes HFA's different from private lenders is their powers and their public purposes. State HFA's have the ability to provide below market interest rate mortgage loans using funds they receive from issuing tax-exempt securities and can further reduce rents by passing along Federal and occasionally state subsidies. State agencies have received these special financing aids to enable them to fulfill certain statutorily defined public purposes. Chief among these purposes are increasing the availability of decent housing within the means of low and moderate income families, rebuilding slum areas, and promoting racial integration.

Sharing in most of the same public-purpose goals and in the ability to provide subsidies has been the U.S. Department of Housing and Urban Development (HUD). A developer interested in building subsidized housing in a state with an active HFA has had the alternative of going to

either the HFA or the local HUD office.[1] While the HFA's are mortgage lenders and HUD is a mortgage insurer, projects financed by the HFA's generally are done so without mortgage insurance and subsidized projects insured by HUD generally receive financing from private lenders with scant review on the part of the lender. In both systems, aside from the developer, the public agency is the most important actor in shaping the character of the development. The similarities in the public purposes between HUD and the HFA's invite comparisons between these agencies to not only provide a benchmark for assessing the performance of the HFA's, but also to bring into sharper focus the underlying determinants of agency success.

The six oldest HFA's have now amassed sufficient experience to allow meaningful examination. The Illinois Housing Development Authority (IHDA), the Michigan State Housing Development Authority (MSHDA), the Massachusetts Housing Finance Agency (MHFA), the New Jersey Finance Agency (New Jersey HFA), the New York State Housing Finance Agency (New York HFA), and the New York State Urban Development Corporation (UDC), each came into being with full

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[1] Even though the Section 236 interest reduction program (National Housing Act of 1974) which had been the primary Federal subsidy used by the HFA's has been effectively terminated, the new Section 8 program of the Housing and Community Development Act of 1974 will operate in a similar manner.

financing powers in 1968 or earlier, at least two years before any other HFA.[1] Through the end of 1974, these agencies had been responsible for about 92 percent of the dwelling units directly financed by all state housing finance agencies.[2] The experiences of these six agencies and of their counterpart local HUD offices will provide the empirical basis for this dissertation. Since one of the HFA's, the New York State Urban Development Corporation, has fulfilled the role of a developer in addition to that

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[1] The Delaware State Housing Authority, Vermont State Housing Authority, and West Virginia Housing Development Fund were each created in 1968, although later in the year than the New York State Urban Development Corporation. Unlike those of the more "advanced" agencies, the Delaware, Vermont, and West Virginia statutes at least initially lacked the technical language necessary to allow them to finance privately owned developments without the aid of HUD mortgage insurance. Similarly, the Hawaii Housing Authority, which was originally created in the 1940's, was unable to finance private developments until 1970.

[2] Excluded from this figure and from detailed consideration in this thesis are the 51,400 dwelling units financed by the New York City Housing Development Administration and the 6,750 units financed by the New York City Housing Development Corporation. Unlike the advanced state agencies, the Housing Development Administration financed its housing through general obligation bonds of the city. The primary reason for excluding these agencies from consideration, however, is that they are city rather than state agencies.

of a mortgagee and since these roles cannot always be separated, comparisons between the state HFA's and HUD will be performed both inclusive and exclusive of the experience of UDC.

Major Thesis

The major thesis presented is that the state housing finance agencies have been more effective than the U.S. Department of Housing and Urban Development in producing multi-family housing that satisfies legislatively-defined public purposes because on the whole, their role in the development process, position in government, and structure and dynamics of organization have been more consistent with the nature of public purpose housing development. The HFA's will be seen to have been as effective as HUD in reaching the legislatively-defined housing and housing-related goals they share while being clearly more effective in achieving fiscal solvency. Certain state agencies will be seen to have better fulfilled particular public purposes not shared by HUD, although HUD will be seen to have accomplished more with regard to certain goals it only possesses. The extent to which particular HFA's take advantage of their opportunities to operate in a hand-crafted, non-bureaucratic manner consistent with the nature of the public purpose development will be found to be the critical factor in

determining their effectiveness. The exclusion of the New York State Urban Development Corporation from consideration will be seen to greatly amplify conclusions as to the fiscal solvency of the HFA's but reduce the extent to which they have fulfilled certain public purposes.

In defining the nature of public purpose development, four characteristics will be seen to stand out as being the most significant:

1) Riskiness - The process contains high inherent risks,

2) Debt-dependency - Borrowed funds with high loan to value ratios play a crucial role,

3) Local specificity - Housing markets are local in scope, and

4) Complexity - The process is complex, with each project having its own peculiarities.

While each of these attributes is endemic to all housing development, the public purpose goals held by the HFA's and HUD will be seen to add significantly to the riskiness, debt-dependency, local specificity, and complexity of the process. This characterization of the nature of public purpose housing development provides the context in which differences between the HFA's and HUD in terms of their roles in the development process, position in government, and structure and dynamics of organization have significance.

The HFA's and HUD play different roles in the housing development process. Nominally, the primary difference is

that the HFA's serve as mortgagees and provide financing directly to the private developer, generally without mortgage insurance, while HUD acts as a mortgage insurer and protects lenders against loss on mortgage loans given to private housing developers. HUD and the HFA's both, however, ultimately bear responsibility for any losses on bad loans and must find ways to cope with this risk. A critical difference in the roles played by the two types of agencies will be seen to be the manner in which they attempt to control risk. HUD will be seen to act relatively passively and rely upon the resources of its Special Risk Insurance Fund to pay claimants. The HFA's will be seen to control risks primarily by becoming actively involved in project operations to a greater degree than even most private mortgagees and by passing certain risks onto the developer. The one state agency to experience financial difficulties, the New York State Urban Development Corporation (UDC), will be seen to have done so in large part because it took on the role of a developer in addition to the role of a mortgagee. Rather than be able to pass risks along to developers, UDC has absorbed risks normally taken by private developers.

The other critical difference in the role played by the two types of agencies relates to the debt-dependent nature of public purpose housing. As a result of their ability to

tap the tax-exempt capital and money markets the HFA's have had the ability to provide below market rate mortgages and consequently produce housing at lower rents and/or higher quality than is possible with financing at market rates. On occasion this financing advantage has also determined whether a project could qualify for subsidies. Tax-exempt borrowing, however, will be seen to be an inefficient means of financing housing because of the tax revenues forgone by the U.S. Treasury.

The ability of HFA's to secure loanable funds at a favorable interest rate has also depended upon the perceived security of the bond or note offering. Because the form of state back-up provided to most HFA's has come to be regarded by the investment community as insufficient protection by itself, state agencies have had to provide secure mortgage loans and generate high reserves to sell their bonds at a favorable rate of interest. One of the ways that many of the HFA's have ensured that their loan portfolio is secure, however, has been through the avoidance of certain types of risky loans. Such risk avoidance has often meant the shirking of certain social goals, although generally not those public purposes found in each agency's enabling legislation.

A second type of difference between the HFA's and HUD lies in their respective positions in government. HFA's

operate on a state rather than a Federal level and to varying degrees have the statutory power to function independently of the rest of government. The provision of Federal subsidies for disbursement by state HFA's on particular projects is one of many recent instances of revenue sharing. What is different is the fact that the Federal government has also continued to disburse the same subsidies directly itself. While Federal disbursement has gone through local HUD field offices, it has been subject to national regulations. This competition provides a rare opportunity to compare state and Federal agencies performing roughly the same task in order to address the perennial question of which level of government can best meet particular problems. Given that the jurisdiction of most state HFA's spans only a handful of housing market areas compared with about 250 metropolitan areas and about 3000 non-metropolitan areas for HUD, the HFA's will be seen to have been better able to formulate policies appropriate to varying local conditions.

The other distinction relating to position in government is the degree of independence given to each agency. Most state HFA's, unlike HUD, are public benefit corporations with primary authority resting with a board of directors appointed by the governor. Various controls exerted by regular governmental bodies and influences

exerted by special interest groups will be seen to limit the independence of HFA's and at times to reduce their effectiveness in achieving public purposes. The fact that HFA operating funds generally come from fees generated by agency operations rather than from governmental allocations, combined with the exemption that most HFA's have from civil service, has allowed many of them to be independent with regard to staffing, has allowed many of them to pay higher salaries, and has required them, in a certain sense, to be profit-motivated.

The final major variable in explaining agency effectiveness is organizational structure and dynamics. Theorists have found that the degree of bureaucratization that will lead to the greatest organizational effectiveness depends upon the complexity of the problems that the organization faces. Organizations that work with complex problems, like public purpose housing development, function best with non-bureaucratic organizational patterns characterized by simple structures and relatively informal operations. Most state housing finance agencies will be seen to have taken advantage of opportunities they have had to operate in a relatively non-bureaucratic manner.

The final factor used to explain variations in organizational success, quality of leadership, has frequently been omitted from other studies of organizational effectiveness. This dissertation will measure leadership in terms

of the success of agency heads in satisfying the criteria formulated in what appears to be the clasic work on the subject.[1] These criteria are: (1) defining a mission, (2) institutionalizing it throughout the organization, (3) defending organizational integrity, and (4) ordering internal conflict. Successful leadership on the basis of these criteria will be seen to be an important factor in determining agency success, but less important than the factors discussed earlier.

Organization of Dissertation

Historical introductions of HUD and the six state agencies serve as the subject for Chapter 2. Chapter 3 presents criteria of organizational effectiveness while Chapter 4 proceeds to rate the various agencies according to these criteria. Chapters 5 through 10 attempt to explain differences in effectiveness in terms of the nature of public purpose housing development. Chapters 5 and 6 discuss differences in the role of the various agencies in the development process with Chapter 5 focusing on the manner in which each has dealt with risk and Chapter 6 on how each has facilitated the flow of mortgage credit with

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[1] Philip Selznick, Leadership in Administration (Evanston, Illinois: Row, Peterson & Company, 1957), p.62.

particular emphasis placed on the workings of the bond market. Next, the impact of agency position in government on agency effectiveness is considered, with Chapter 7 taking into account the level of government (State versus Federal) and Chapter 8 looking at the degree of agency autonomy. Chapter 9 discusses how individual agencies have organized themselves in terms of the degree of bureaucratization while Chapter 10 examines the effectiveness of leadership. The conclusion to the dissertation comes in Chapter 11. It brings together the major findings of the earlier chapters and looks at future prospects for state housing finance agencies.

CHAPTER 2

HISTORY OF STATE AND FEDERAL FINANCE AGENCIES

The diffusion of state housing finance agencies among the states has followed a relatively predictable pattern. The political scientist, Jack L. Walker, found that certain states act as leaders for their regions in that they generate new programmatic ideas or are the first in their region to adopt innovations put in practice by leaders of other regions.[1]

As it does with many new programs later emulated by other states across the country, the New York legislature in 1960 was the first to create a housing finance agency. Massachusetts, a co-leader with New York in the Northeast as well as the leader in New England, joined New Jersey in following New York's lead and in becoming part of the second generation of HFA's born in 1966-67. The State of Michigan, which is considered a "leader" state in the Midwest, was the first state to introduce the concept to that region in 1966, followed by Illinois a year later.[2]

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[1] Jack L. Walker, "The Diffusion of Innovations Among the American States," The American Political Science Review, 63 (September, 1969), 880-99.

[2] The diffusion of innovation to and within other regions of the country has a similarly predictable pattern. Colorado, which is considered the "leader" state in the Rocky Mountain Region, in 1973 became the first state in that region to

State housing finance agencies have now been introduced into every region of the country (see Table 1), and the newer agencies are now emulating the experiences of their more advanced brethren. The applicability of the experiences of particular agencies to a new setting, however, depends to a large degree upon the similarity of the historical forces shaping the development of the old and new agencies. A full understanding of the behavior of the particular agencies being considered also requires an examination of their shared histories. Likewise, an understanding of the behavior of HUD requires consideration of its history.

Thus, this chapter begins by recounting the shared history of the HFA's and then relates the history of each of the six HFA's being analyzed in detail in this dissertation: the New York State Division of Housing and Community

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adopt a bona fide housing finance agency despite the fact that Idaho adopted such an agency a year earlier which lacked "moral obligation" language necessary to make it possible to sell bonds. Similarly, Virginia, which along with Louisiana, is the "leader" state in the South, in 1972 was the first Southern state to adopt a bona fide HFA, despite the prior enactment of housing agencies in North Carolina and South Carolina which lacked moral obligation language. Louisiana also created an HFA in 1972, but it too had defective language until amended two years later. The one partial exception to the rule came on the West Coast. There, the vetoes of Governor Ronald Reagan in California in 1972 to 1974 kept the State from playing its traditional leadership role in that region although the Cal-Vet program has been providing low cost mortgage loans to homebuyers since 1921. In 1973, Oregon became the first West Coast state to enact an HFA to promote housing development.

Table 1

State Housing Agencies
Status and Volume of Housing Activity of Major Financial Programs: January 1, 1968-November 1, 1974

				Direct Mort. or Construction Fin. Projects Completed or Under Construction		Secondary Lending	
	Year Created	Debt. Auth. 11-1-74 (Millions)	Debt Outstanding 11-174 (Millions)	Proj. Cost (Millions)	Num. of Units	$ Volume (Millions)	Num. of Units
Alaska Housing Finance Corp.	1971	E	115	B	B	104	2,533
Colorado Housing Finance Auth.	1973	50	None	B	B	B	B
Connecticut Housing Finance Auth.	1971	100	125	40	2,018	53	2,487
Delaware State Housing Auth.	1968	20[b]	None[b]	14	1,092	B	B
Georgia Residential Finance Agcy.	1974	100	None	B	B	B	B
Hawaii Housing Auth.	1970	E	D	128	5,679	D	D
Idaho Housing Agency	1972	E	4	3	164	B	B
Illinois Housing Development Auth.	1967	500	229	209	9,792	17	860
Kentucky Housing Corp.	1972	200	72		75	93	4,700
Louisiana Devel. Auth. For Hsg. Fin.	1972	30	None	D	D	D	D
Maine State Housing Auth.	1969	100[b]	49[b]	10	568	34	1,906
Maryland Comm. Devel. Admin.	1971	9	4	4	160	B	B
Massachusetts Home Mtg. Fin. Agcy.	1974	D	None	C	C	B	B
Massachusetts Hsg. Fin. Agcy.	1966	1,250	522	582	25,614	C	C
Michigan State Hsg. Devel. Auth.	1966	600	397	341	14,971	C	C
Minnesota Hsg. Fin. Agcy.	1971	600	129[b]	47	2,708	80	3,460
Missouri Hsg. Devel. Comm.	1969	200	51	451	2,643	C	C
New Jersey Hsg. Fin. Agcy.	1967	E	408	426	14,915	413	20,000
New Jersey Mortgage Fin. Agcy.	1970	E	408	C	C	C	C
New York State DHCR	1955	150[c]	138	747	20,677	C	C
New York State Hsg. Fin. Agcy.	1960	2,100[c]	1,496			C	C

(continued on next page)

Table 1 continued

	Year Created	Debt. Auth. 11-1-74 (Millions)	Debt Outstanding 11-1-74 (Millions)	Direct Mort. or Construction Fin. Projects Completed or Under Construction		Secondary Lending	
				Proj. Cost (Millions)	Num. of Units	$ Volume (Millions)	Num. of Units
State of New York Mort. Agcy.	1970	750	264	C	C	254	13,249
New York State Urban Devel. Corp.	1968	2,000	1,167	1,233	33,245	C	C
North Carolina Hsg. Fin. Agcy.	1973	200	None	B	B	B	B
Ohio Hsg. Devel. Board	1970	D	D	B	B	B	B
Oregon State Hsg. Division	1973	200	None	B	B	B	B
Pennsylvania Hsg. Fin. Agcy.	1973	E	12	81	3,644	B	B
Rhode Island Hsg. & Mort. Fin. Agcy.	1973	E	71	4	183	63	3,100
South Carolina State Hsg. Auth.	1971	E	None	B	B	B	B
South Dakota Hsg. Devel. Auth.	1973	E	43	17	1,164	9	464 est.
Tennessee Hsg. Devel. Agcy.	1973	150[b]	33[b]	B	B	26	986
Vermont Hsg. Fin. Agcy.	1974	74	14	C	C	11	400
Virginia Hsg. Devel. Auth.	1972	E	156	72	3,072	74	3,927
West Virginia Hsg. Devel. Fund.	1968	130	52	41	2,031	16	900
Wisconsin Hsg. Fin. Agcy.	1972	290	72	21	103	17	1,224
TOTAL			7,436	4,046	144,508	1,264	60,196

K E Y

A - Program implemented but production data was not obtained.
B - Statutory authorization but program not implemented.
C - Non statutory authorization.
D - Information not obtained.
E - No limit

(a) Unlimited for federally insured or guaranteed mortgages.
(b) Data as of December 1, 1974
(c) Housing programs only.

Source: Adopted from Council of State Housing Agencies, "State Housing Agencies; Roles and Accomplishements," Feb. 1975.

Renewal/Housing Finance Agency, the Michigan State Housing Development Authority, the Massachusetts Housing Finance Agency, the Illinois Housing Development Authority, the New Jersey Housing Finance Agency, and the New York State Urban Development Corporation. It concludes with the story of Federal housing agencies. A brief history of each of the state housing finance agencies in each of the other states is reserved for Appendix 1.

Shared History of HFA's

Certain events on a national scale that occurred after the creation of most of the HFA's being considered have had a profound effect on the collective development of the state HFA's. The impact of these events has fluctuated from providing salvation to creating near disaster.

Probably the greatest boon to the HFA's was the enactment of Section 236 of the 1968 Housing Act. It provided both a boost to those agencies already in existence and an additional reason for creating such agencies in those states not possessing them. Basically, the Section 236 program provided for subsidy payments to reduce mortgage interest rates down to one percent so that moderate income families could afford the required rents. While the predecessor Section 221(d)(3) program also provided subsidies for moderate income housing, its reliance on direct Federal

loans precluded state financing on a permanent basis. Subsection (b) of Section 236, however, provided:

> That interest reduction payments may be made with respect to a rental or cooperative housing project owned by a private nonprofit housing corporation or other nonprofit entity, a limited dividend corporation or other limited dividend entity, or a cooperative housing corporation, which is financed under a State or local program providing assistance through loans, loan insurance, or tax abatements, and which, prior to the completion of construction or rehabilitation is approved for receiving the benefits of this section.[1]

Pursuant to this subsection, HUD set aside funds to be applied specifically to state-financed projects. It also set aside Rent Supplement funds providing deeper subsidies for low income families.[2] Initially, the funds were disbursed by local HUD offices to the various state agencies. How much money came to a particular HFA depended both upon how much the Central HUD Office allocated to the local HUD office, and upon how well the HFA could negotiate a share of its allocation. Beginning in 1973, however, allocation of Section 236 funds for most states was shifted to HUD's Central Office. How well the states were able to take advantage of the Section 236 program is the subject of much of the rest of this thesis.

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[1] Housing and Urban Development Act of 1968, Sec. 236(b).

[2] Housing and Urban Development Act of 1965, Sec. 101.

Another event that encouraged the growth of state housing finance agencies was the enactment of the Tax Reform Act of 1969. At a time when certain other tax preferences were being curtailed, this Act created new incentives for developers of subsidized housing. It kept the highly accelerated double-declining balance method of depreciation for all newly constructed housing,[1] created a new five-year write-off for rehabilitation for occupancy by low-income tenants,[2] and limited the amount of tax on the sale of Section 236 developments.[3] Even those developers that have insufficient income to fully utilize tax shelters themselves have been able to profit from the sale of limited partnership interests in the project to welathy investors. Coupled with the high mortgage amounts provided by the HFA's as a percentage of total development costs, tax shelters have enabled developers to realize a substantial profit while accepting limitations placed upon the amount of cash flow they can receive from rents.[4]

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[1] I.R.C. Sec. 167(j).

[2] I.R.C. Sec. 167(k).

[3] I.R.C. Sec. 1250 and Sec. 1039.

[4] See Nathan S. Betnun, "Tax Shelters for the Rich to Rehabilitate Housing for the Poor" (Unpublished M.C.P. thesis, M.I.T., 1972).

The final set of events worthy of mention in stimulating the growth of state housing finance agencies throughout the country were the credit crunches of 1969-1970 and 1973-1974. While credit was more expensive for even the HFA's during these periods, the fact that they could tap the tax-exempt bond market at a time when private lenders were experiencing an outflow of funds meant that in many cases the HFA's were the only available source of funds. Since the 1969-70 crunch came during the infancy of most of the HFA's examined in this dissertation and the 1973-74 credit shortage corresponded with a Federal moratorium on housing subsidies, these shortages have had less of an impact than they would have had if they had occurred at a different point in time.

On the disaster from the point of view of the HFA's, various Federal administrative agencies have floated trial balloons which would have seriously crippled if not completely destroyed the state HFA's. The first of these threats was the proposed rules by the Internal Revenue Service to limit the amount of "arbitrage" profits that states or state agencies could take. State agencies support themselves by borrowing funds in the tax-exempt bond market and relending at a profit on mortgages. Regulations proposed in June 1972, if adopted, would have limited the amount that HFA's could have charged borrowers above their own borrowing rates. The bulk of agency operations would have then had to have come from state appropriations. Pressure

from the HFA's and the Municipal Finance Officials Association was successful in convincing the Treasury Department to back down.

Another threat to the HFA's came with the Nixon Administration's Limitation on Artificial Losses (LAL) tax reform proposal. This proposal would have restricted the transfer of tax shelter benefits to those not directly engaged in real estate operations and thereby would have excluded all developers not receiving substantial profits from conventional developments from benefiting from the primary source of profit on subsidized and state-financed developments. The effect would have been to put most state housing finance agencies out of business. Pressure from HFA's, developers, and others, however, succeeded in delaying action on this proposal indefinitely.

The Federal Office of Management and Budget (OMB) posed yet a third major threat to state housing finance agencies when it attempted to reduce Federal revenue losses on the exemption from taxes of state and local bonds. Section 5(c) of its contemplated Circular A-70 would have prevented the use of any Federal guarantees in conjunction with state and local tax-exempt obligations. Falling under the category of "guarantee" as defined in the circular, would have been such indirect guarantees as Federal debt service assistance (as with the Section 236 program) and lease

contracts (as with the Section 8 Leased Housing Program). After a prolonged lobbying campaign which enlisted the support of the National Governors' Conference, state HFA's were able to overcome this threat to their existence as well.

The final potential disaster for the state HFA's was the Federal moratorium on all subsidized housing programs, announced January 5, 1973, which called for the termination of subsidy funds for all projects not having received a letter of feasibility prior to that date. In fact, state agencies fared relatively well under the moratorium, despite the fact that numerous projects had to be cancelled because of lack of funds. In May 1973 HUD made a special allocation of Section 236 subsidy funds for 15,500 state-financed dwelling units.[1]

The role outlined by HUD for the new Section 8 leased housing program contemplates a strong role for state HFA's. As with the Section 236 program, state HFA's will receive a set-aside of Section 8 funds as well as regulations which are more flexible than those faced by private mortgagees receiving mortgage insurance plus subsidies. At this writing questions remained outstanding as to the feasibility

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[1] Housing and Development Reporter, May 5, 1973, p.A-13.

of conventionally financed or HUD-insured Section 8 developments.[1] The initial emphasis of HUD's field offices has been on implementing the portions of the Section 8 program pertaining to existing housing and leaving new construction and substantial rehabilitation to the state agencies.[2]

New York State Housing Finance Agency

New York State first became involved in encouraging the development of housing for moderate income families with its enactment of the Limited Dividend Housing Companies Law in 1926.[3] A State Housing Board was given the power to condemn land and regulate rents and dividends for approved moderate income developments. Rents in these developments were reduced further through municipal tax abatement, but financing, as well as management, was provided privately.[4] In 1939, the Division of Housing and Community Renewal assumed the functions of the State Housing Board with regard to Limited Dividend housing and also began

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[1] *Ibid.*, March 10, 1975, p.1041.

[2] *Ibid.*, May 5, 1975, p.1247.

[3] Private Housing Finance Law, Art. 4,9, and 10.

[4] Dorothy Schaffter, *State Housing Agencies*, p.641.

administering the newly-created state public housing program for low income families.

The Limited Dividend Housing Companies Law gradually became ineffective in serving even middle income families as the cost of financing through private sources rose. Hence, in 1955, the New York State legislature enacted the Limited Profit Housing Companies Law, better known as Mitchell-Lama, after its sponsors, McNeil Mitchell and Alfred A. Lama.[1] Through the use of tax-exempt bonds backed by full faith and credit of the State of New York, Mitchell-Lama provided the first public low interest, high loan to value ratio mortgage funds to developers of rental housing for middle income families. As with the earlier Limited Dividend Housing Companies Law, the Division of Housing and Community Renewal would regulate rents and profits on this housing and municipalities would provide abatements of property taxes. In two referenda held in 1955 and 1958, voters approved the issuance of a total of $150 million for such housing.[2]

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[1] Private Housing Finance Law, Art. 2,3,9, and 10.

[2] Because these funds were raised in a significantly different manner from that of most HFA's and because they were expended several years before the creation of most of those being considered, their use will not be discussed in this thesis.

As the demand for low interest rate housing financing grew, additional reliance on bonds backed by the "full faith and credit" of the State became less feasible since such large sums would have diluted the credit of the State for its more traditional purposes and required continued voter approvals that might not have been forthcoming. A task force headed by Otto Nelson, Vice President of New York Life Insurance Company, began studying the alternatives. It suggested that a Limited Profit Housing Mortgage Corporation composed of banks and insurance companies match state funds being provided on each mortgage on a two-for-one basis, thus enabling state funds to go three times as far. A fund-raising effort among banks and insurance companies, however, produced only $60 million toward a goal of $200 million.

In this context, the idea arose to create an independent state agency capable of issuing bonds backed by project revenues rather than by the "full faith and credit of the State." State bond counsel and later U.S. Attorney General John Mitchell suggested that the State guarantee that the reserve fund backing the issue always be sufficient to meet the following year's debt service requirements. Since legislatures cannot bind future legislatures to make appropriations, such backing could only be considered a "moral obligation" of the State, but not legally

binding. This arrangement protected the credit-worthiness of the State, avoided the necessity of future voter approvals, and afforded potential investors some measure of protection against defaults. On this basis, in 1960, the New York legislature created the New York State Housing Finance Agency, the first state agency capable of financing the development of housing by private developers.[1]

The role assigned to the New York State Housing Finance Agency, however, in certain respects, is more limited than that given to nearly all of the more recently created agencies. Responsibility for working directly with housing sponsors and approving and monitoring projects remained with the Division of Housing and Community Renewal (DHCR).

The Commissioner of DHCR is an ex-officio member of the Board of Directors of the HFA. When James William Gaynor held that position through most of the HFA's formative years, he served as Chairman of the HFA Board. Charles J. Urstadt, who had been a member of Gaynor's staff, replaced him as DHCR Commissioner in 1969, and Lee Goodwin, who had helped draft the original HFA legislation

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[1] The Pennsylvania Housing Agency was actually created by statute a year earlier in 1959. It did not have a board of directors nor become operational until ten years later. Even then, defective original legislation kept it from financing more than 49 dwelling units.

and had served as an assistant director of the HFA, was named by Governor Rockefeller to that top position at DHCR in 1973. Paul Belica has served as executive director of the HFA throughout most of its history.

Under Belica's leadership, the New York HFA financed a total of 43,450 dwelling units prior to 1970, the year when most of the other advanced HFA's were financing their first units. All but about 1000 of these units were in New York City. Included in this total is the 15,400 unit Coop City development in the Bronx, at the time the largest residential development in the country, the 5900 unit Rockdale Village in Queens, and several other developments with more than 1000 units.

The success of the New York State Housing Finance Agency in providing low cost funds for housing attracted the attention of New York legislators interested in other program areas. Gradually, the role of the NYSHFA expanded to include the financing of state university construction (1962), mental hygiene improvement (1963), nursing homes (1965), health facilities (1968), youth facilities (1969), community mental health and mental retardation facilities (1969), voluntary hospitals (1969), and community senior service centers (1970).

The number of housing programs financed by the NYSHFA similarly expanded. The initial General Housing Loan

Program provided loans of 90 percent of project cost. As further inducement to sponsors, the Legislature created the Nonprofit Housing Loan program, which provides mortgages of up to 100 percent to nonprofit sponsors, and the Urban Rental Housing Program, which provides mortgages of up to 95 percent to limited-profit housing companies.[1] Equity requirements were reduced for individual purchasers of cooperative units under the Home Owners Purchase Endorsement (HOPE) loan program. Under this program, second mortgages are provided by the HFA to enable purchasers of cooperative units to pay the 5 percent equity requirement over a period of five years. The Capital Grant Program,[2] begun in 1964, foreshadowed the Federal Rent Supplement Program by allowing low income families to reside in a limited percentage of HFA-financed, middle income dwelling units. Under the program, state funds reduce a portion of the project mortgage, thus enabling a reduction in that portion of monthly rent that would otherwise be allocated to mortgage amortization.

The original statute authorized the agency to issue $525 million in notes and bonds, all for housing. Subsequent amendments have increased this limit to $6.15 billion

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[1] New York State Housing Finance Agency, Annual Report 1969, pp.12-13.

[2] Private Housing Finance Law, Article III.

by 1973, of which $2.10 billion can go for housing. Through November 1, 1974, the agency had financed a total of 64,131 dwelling units.[1]

Michigan State Housing Development Authority (MSHDA)

The next state to adopt a housing finance agency was Michigan, which created the Michigan State Housing Development Authority (MSHDA) in 1966. The legislation, although taking many provisions from New York statutes, gave the financing and administrative powers carried out by two separate agencies in New York to a single entity. Drafters of the MSHDA legislation also believed that, unlike the New York agencies at that time, MSHDA would be able to utilize Federal subsidies to serve low income households in addition to serving those with middle incomes.[2] Specifically, they envisioned that MSHDA could provide low cost construction financing for developments receiving Federally-subsidized permanent financing under the then-existing Section 221(d)3 and 202 programs, as well as take advantage of new Federal programs then being discussed in Washington. The primary support for the initial legis-

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[1] New York State Housing Finance Agency, Annual Report 1974, p.11.

[2] Telephone interview with Thomas W. White, author of the MSHDA legislation.

lation came from elderly and labor groups with builders and banking interests then being basically indifferent.

After the enactment of initial legislation certain technical amendments were added to make the bonds more saleable. In 1968, the Court declared the revised MSHDA statute to be valid allowing the agency to commence operations that year.[1] The first director, Robert McLain, failed to close any projects in two years, and so was asked to resign by the Board of Directors.

William G. Rosenberg, a 30 year-old bond attorney, succeeded him in early 1970. Partly because of his own youth and partly because the Michigan civil service provides reasonably high salaries for well-educated, inexperienced workers but low salaries in relation to private industry for more experienced personnel, Rosenberg attracted an extremely young, energetic staff. By the end of the year, 17 projects totalling 1786 dwelling units had closed. All of these projects were HUD-insured, all were sponsored by nonprofit corporations, and all but three were outside the City of Detroit. The HUD mortgage insurance allowed MSHDA to establish a track record, gain some experience, and build up some reserves without taking any risks.

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[1] Re: Advisory Opinion on Constitutionality of Act No.346 of Public Acts of 1966, (1968) 158 N.W. 2d 416.

Unlike the Massachusetts agency, MSHDA financed the permanent mortgage as well as the construction loan on its early HUD projects. As a result, the MSHDA management staff as well as the development staff was able to be trained on insured projects. MSHDA did two further joint ventures with HUD, those being Project Rehab and Operation Breakthrough. In both instances HUD provided mortgage insurance while MSHDA provided financing. The Project Rehab venture was, in part, an attempt to placate Detroit legislators who complained of the lack of MSHDA activity in the inner city.

At the beginning of 1973, Governor William G. Milliken asked Rosenberg to become the chairman of the Michigan Public Service Commission and announced the appointment of David L. Froh as the new MSHDA executive director. Froh had been with the agency for two years prior to his appointment, and before that had been the coordinator of state and Federal programs for the City of Lansing.

Further pressure on the direction of MSHDA policy continued into the Froh years. Most outspoken was a broad coalition of interest groups who called upon MSHDA to do more in the way of providing housing for low income families. A part of the coalition, notably the Michigan Committee on Law and Housing (a public interest group from the University of Detroit Law School that had helped draft the original MSHDA legislation), the Archdiocese of Detroit, the

Coordinating Council on Human Relations, the Interfaith Action Council of Metropolitan Detroit, and the Michigan Welfare Rights Organization, took this position for social reasons; the business groups in the coalition, including the Mortgage Bankers Association of Michigan, the Michigan Chamber of Commerce, and the Michigan Association of Home-builders advocated increased low income production by MSHDA in order that it not compete with private interests. While Rosenberg had put off the group by agreeing to meet quarterly with the Governor and legislature concerning the low income requirement, shortly after Froh's arrival, the group succeeded in modifying the MSHDA statute to require that 15 percent of the residents of each development have low incomes.[1]

The controversy, however, over the income levels that should be served by MSHDA continued. The Michigan Office of Program Effectiveness Review criticized MSHDA for serving some families with incomes over $15,000 and not serving enough families with incomes under $4000.[2] Even more controversial, however, was the alleged covering up

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[1] P.A. 1972, No.310, Sec.1.

[2] Michigan Office of Program Effectiveness, Subsidized Housing Program: An Assessment of Effectiveness, (Department of Management and Budget: Lansing, October, 1973).

of the report by the Governor's Office and abolition of the office making the study.[1]

Despite these controversies and despite the Federal moratorium on subsidized housing, MSHDA during Froh's tenure as executive director has succeeded in implementing a number of innovative programs devised by Rosenberg. In conjunction with the Michigan Department of Mental Health, through June 30, 1974, MSHDA had financed or given loan commitments for seven non-institutionalized homes for 150 marginally retarded adults throughout the state.[2] Unlike the other advanced HFA's, MSHDA has become involved with the production of single family housing, having financed over 2000 units.[3] All, however, have been on a HUD-insured basis. MSHDA has continued to expand its multi-family production on an uninsured basis. Through November 1, 1974, it had financed nearly 14,000 multi-family units of which about 2900 were HUD insured and another 3700 were for middle income families.[4]

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[1] Detroit Free Press, November 16, 1973, p.3A; November 17, 1973, p.12-A; November 18, 1973, p.2-B; November 21, 1973, p.10A; November 26, 1973, p.8-A.

[2] MSHDA, Annual Report, 1974, pp.14-17.

[3] Ibid., p.18.

[4] Council of State Housing Agencies, State Housing Agencies:

Massachusetts Housing Finance Agency (MHFA)

The Massachusetts Housing Finance Agency (MHFA) grew out of a proposal by Governor John Volpe based upon recommendations of the Special Commission on Low Income Housing. The Commission, created by the state legislature in 1964, contained a mixture of civic leaders, academics, legislators (including future Governor Michael Dukakis), lawyers, and builders. It looked at the New York HFA as a starting point, but envisaged an HFA in Massachusetts as serving moderate and low income families rather than middle income families by being used as a supplement to the Federal moderate income Section 221(d)(3) program. Not only would an HFA provide additional funds, but it could finance housing in communities that refused to take the overt action of creating a Workable Program which was necessary for many types of Federal programs, including Section 221(d)(3). Also, unlike Federal moderate income programs at that time, MHFA was seen as being able to provide housing for a limited number of low income families in each development. The Commission saw state subsidies through direct appropriations and Agency profits as one means of

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Roles and Accomplishments, Draft, December, 1974. "Middle income families" means those not receiving direct subsidies and corresponds to "moderate income" as generally used by MSHDA.

reaching low income families and rent skewing as another. With rent skewing, rents for most tenants would be set higher than average for the development to enable a few low income tenants to pay low rents.[1]

Before the enactment of MHFA, the legislature requested an advisory opinion from the State Supreme Judicial Court on the constitutionality of the draft of the legislation before it. The opinion suggested that the Court might not approve the contemplated legislation to aid "moderate" income families because it would unconstitutionally lend the credit of the state to private individuals and corporations without serving a valid public purpose.[2] As a result, the legislature amended the proposed legislation to more explicitly incorporate the findings of the Commission. The bill actually enacted by the Massachusetts Legislature declared that the permanent elimination of slums (a recognized public purpose) could best be accomplished through the scattering of "low" income families among higher income families and mandated that the Agency set aside a minimum of twenty-five percent of the dwelling units in each development for low income families. However, the original

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[1] Massachusetts Special Commission on Low Income Housing, Final Report (Boston: Wright and Potter Co., April, 1965), pp.37-41.

[2] Opinion of Justices, 320 Mass. 773.

definition of low income used by the legislature was:

> Those persons and families whose annual income is less than the amount necessary to enable them to obtain and maintain decent, safe, and sanitary housing without the expenditure of over twenty-five percent of such income for basic shelter rent plus the additional cost, if any, of heat and hot water.[1]

Broad construction of this language could define low income families as those unable to afford the market rate housing produced by MHFA, or the majority of the residents of the state.[2] Nonetheless, the Supreme Judicial Court affirmed the constitutionality of the Agency in Massachusetts Housing Finance Agency v. New England Merchants National Bank of Boston et al., 1969 A.S. 987.

While the legislation was approved in September of 1966, the Agency did not become fully operational until after a $300,000 seed money loan was made available to hire a staff in November of 1968 during the term of Governor Francis Sargent. The initial director of MHFA was David Martin, one of the architects of the initial legislation and a former professor at both Harvard and Yale law schools. His primary accomplishment was resolving

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[1] Chapter 708 of the Acts of 1966, Sec. 1(d).

[2] Rents on a two-bedroom apartment in the MHFA development discussed in the case study in Chapter 4 would be $228 per month if no direct subsidies were applied. A household earning the median income in the state would have to pay 29 percent of its income for rent to live there.

the constitutionality question in June of 1969. Yet, before the first loan could be closed, he fell out of favor with the board of directors and, as a result, they named his assistant director, William J. White, to the top position. White's background was primarily in real estate, having been the president of a development firm, executive director of the local real estate brokers' institute and multiple listing service as well as being on the board of several "fair housing" organizations.

Probably the most significant decision made by White in terms of shaping the character of MHFA was that the statutory requirement of 25 percent low income residents be fulfilled by requiring 25 percent of the residents to have incomes low enough to qualify for public housing. This requirement went well beyond the letter of the statute but was consistent with its spirit and the wording of the initial judicial opinion. Without spelling out this rule in any handbook or rulebook, the staff refused to take any project before the board of directors that failed to meet this requirement. Despite reluctance from certain board members, the board backed the staff on this requirement. A letter from the State Attorney General provided additional support against possible legal challenges. Finally, at White's urging, in 1974 the Legislature amended the MHFA Act to specify that at least 25 percent of all residents have incomes low enough to qualify for public housing.

The initial delays in making MHFA operational actually led to its coming into being at an opportune moment. The credit crunch of 1969-70 and consequent high interest rates made it impossible for certain FHA-insured Section 221(d)(3) and 236 developments to close. The provision of below-market interest rate construction loans by MHFA served the dual purpose of making a number of them financially feasible and of providing MHFA with construction lending experience and income with which to build up reserves.

The delays in the start-up of MHFA further had the propitious effect of allowing MHFA to utilize subsidies from the new-born Section 236 program on projects for which it would finance the permanent mortgage on an uninsured basis. Contrary to the expectations of the Commission recommending the creation of MHFA, both the Section 221(d)(3) program and in most instances, rent skewing proved to be infeasible means of HFA participation on a long-term basis.[1] Rather, the Section 236 and the State subsidy program in Massachusetts modeled after it were required to provide housing for moderate income families.[2] The volume of construction starts handled by

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[1] Rent skewing was used as a subsidy vehicle for 101 low income units.

[2] M.G.L.A. c.23A App. Sec. 1-13A.

MHFA increased from about 1400 dwelling units in 1970 to over 5000 in each of the years 1971-1973. While the number of units it produced dipped in 1974 as the result of the Federal moratorium, state housing subsidies enabled the Massachusetts agency to produce more subsidized units than the other HFA's. All told, through November 1, 1974, MHFA had produced 25,600 units. The inauguration of a new governor, Michael Dukakis, in 1975 brought no significant changes to MHFA's operations, at least in the first few months.

Illinois Housing Development Authority (IHDA)

The legislation creating the Illinois Housing Development Authority resulted from findings and recommendations made by a specially created Legislative Commission on Low Income Housing appointed by Governor Otto Kerner in 1965. Their report, while mentioning the existence of the New York and Michigan HFA's, suggested that the Illinois program be "modeled upon the Massachusetts approach, with significant additions of 'seed money' advances for planning and development, and possible condominium and cooperative ownership."[1] Like Massachusetts, the Illinois commission

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[1] Report of the Legislative Commission on Low Income Housing, Robert E. Mann, chairman (Chicago: April, 1967),p.48. (Mimeographed.)

envisioned that low income families could be best served in a mixed income setting. It proposed mixing low and moderate income families together in the same project using such devices as rent skewing and state-funded rent supplements.

The initial director was Daniel P. Kearney, a corporate attorney who later became Deputy Director of Housing Production and Mortgage Credit at HUD and then executive director of the Government National Mortgage Association. Kearney put together an extremely strong staff, judging by their later positions. Included were John McCoy, who later became the executive director of the Pennsylvania Housing Finance Agency; Leonard Crosby, who now serves as director of the West Virginia Housing Development Fund; and Ralph Brown, who went on to head the Technical Assistance Corporation for Housing.

The initial projects completed were all uninsured, often in suburban areas, and largely for middle income residents. IHDA was able to introduce a modest degree of income integration in its developments; however, income integration has generally meant mixing one-third moderate income families receiving Section 236 subsidies along with two-thirds middle income families.

The other major program carried out by IHDA was its seed money loans to nonprofit sponsors through its specially

appropriated development advance fund. With the exception of a mortgage granted to one financially strong nonprofit sponsor, however, all of IHDA's early permanent loans went to limited dividend sponsors. IHDA also received an appropriation of $1,800,000 for the purpose of buying land. It purchased one parcel for about $300,000 which it still holds for future development. Rather than encounter political opposition, it has returned the balance of the funds to the state.

The change in governors at the start of 1973 saw virtually a total decimation of the IHDA staff. After a short period during which an acting executive director ran IHDA, Irving Gerick became the new chief executive. While Gerick had a background as the director of development for Urban America, the bulk of his staff was extremely inexperienced, particularly in comparison with the Kearny staff.

Gerick set as an agency goal the rebuilding of the South Side of Chicago, an ambitious task to say the least. In order to do so, Gerick has been attempting to build up IHDA's reserves through a variety of programs including construction loans on HUD-insured developments. One program aimed at both building up IHDA's reserves and directing mortgage money into inner-city areas has utilized IHDA's loans-to-lenders power, a power possessed by none of the other HFA's being considered in detail in this thesis but

by several other state agencies. Under this program, IHDA makes funds available to private lenders for use as mortgage funds. Unlike other state agencies operating loans-to-lenders programs, IHDA has placed locational restrictions on where the funds can be used. It has required that all mortgage loans made using these funds be on properties located in contiguous zip code areas where at least 60 percent of their depositors reside. Here the risk is all on the part of the lender in that the lender must designate other mortgages as collateral in excess of the amount of the loan.

By November 1974, IHDA had directly financed just under 10,000 units and another 850 units through its loans to lenders. In early 1975 Governor Daniel Walker submitted legislation that would expand the bond limit of IHDA from $500 million to $1.1 billion to allow the production of about 6,000 more units in hopes that the new activity would stimulate the economy and employment situation in the state.[1]

New Jersey Housing Finance Agency (NJHFA)

Passage of the enabling legislation for the New Jersey Housing Finance Agency came in 1967 shortly after the

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[1] Housing and Development Reporter, March 24,1975,pp.1101-02.

arrival of Paul Ylvisaker to New Jersey. Ylvisaker came with a national reputation for work in directing anti-poverty efforts for the Ford Foundation. While the legislation to create both the HFA and a Department of Community Affairs had been formulated prior to his arrival, knowledge that he would become Executive Director of the Department of Community Affairs, and thereby ex-officio chairman of the Board of Directors of the HFA, provided the final impetus to secure passage. Support for the legislation came primarily from blacks, church groups, and planners as well as from developers. Unlike in other states, however, enactment of a housing finance agency in New Jersey required an amendment sponsored by suburban legislators limiting HFA activities to those cities and towns that approve a resolution of need for such housing.

Through Ylvisaker's contacts in Washington, in 1969 New Jersey was able to pioneer the use of Federal subsidies in conjunction with state financing under the new moderate income Section 236 program. The terms worked out between Ylvisaker and HUD allowed state mortgagees not utilizing HUD mortgage insurance to obtain Section 236 subsidy funds with a minimum of HUD review. Most of the New Jersey HFA's early projects were fully subsidized with a combination of Section 236 for moderate income residents and additional Section 101 Rent Supplements to accommodate low income

residents in approximately 20 percent of the units.

In the 1969 gubernatorial election in New Jersey, voters turned away from the social activism of Governor Richard J. Hughes, and replaced him with Governor William T. Cahill. One of Cahill's campaign promises was to remove Ylvisaker from office. With his exodus, much of the staff left as well. Those that remained saw a great change in the goals of the HFA. Many of those interviewed complained that political patronage overcame social idealism as the modus operandi of the agency. The new chairman of the Board, Edmund T. Hume, came to play a comparatively weak role in the agency, as agency policy became identified in the minds of the staff as the policy of the Cahill Administration. The new executive director, John P. Renna, came to the HFA with the background of a developer and the predilection to strike a deal wherever he could.

One such deal proved to be the most controversial project attempted by any state HFA. The New Jersey HFA agreed to finance Kawaida Towers for moderate income families in a racially mixed area of Newark. The sponsor of the project was the black nationalist Temple of Kawaida, headed by the militant playwright Imamu Baraka (formerly LeRoi Jones). The controversy arose when City Councilman Anthony Imperiale decided to contest the development

because of who the sponsor was and its high density.[1] After failing to receive a court injunction to stop the project, in November 1972 Imperiale led a band of white militants to forcibly halt construction. As a result of this action, construction has been held in abeyance. In July 1973, a New Jersey court rejected the claims by Imperiale's group that the tax abatement granted the project by the Newark Municipal Council was invalid, that the project would be a "breeder of crime," and that the sponsoring group was dominated by "an outside power," i.e., Baraka.[2] Still, construction has yet to resume fully.

The more typical projects during the Renna-Cahill years, however, were subsidized, nonprofit developments in urban areas of the state. Half of the projects approved during these years were elderly; two-thirds were sponsored by nonprofit organizations. The total production for the New Jersey agency through November 1, 1974, was about 15,000 units.

The 1974 elections again marked a change in the governorship and a subsequent change in the leadership of

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[1] New York Times, February 2, 1973, p.66.

[2] Ibid., July 11, 1973, p.85.

the HFA. The new executive director, William Johnston, appears to share the social commitments evident in the Ylvisaker years. In early 1975, the new governor, Brendan T. Byrne, proposed giving the New Jersey HFA the power to initiate the development of projects desired by local officials.[1]

New York State Urban Development Corporation (UDC)

The New York State Urban Development Corporation (UDC) was the first state agency with finance powers to utilize development powers as well. In addition to being able to provide tax-exempt bond financing, UDC has been able to initiate developments through the use of its full range of development powers, including in certain instances the overriding of local zoning and the taking of property by eminent domain.

The creation of UDC was the result of the political muscle of Governor Nelson Rockefeller. In proposing UDC in early 1968, Rockefeller called it an "extreme measure" that was needed to save the cities. Because of opposition from numerous mayors and other local officials, including Mayor John Lindsay of New York City, centering around the

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[1] *Housing and Development Reporter*, February 10, 1975, p.953.

issue of home rule, passage of the legislation appeared impossible until the assassination of Dr. Martin Luther King. During the afternoon of April 9, 1968, the proposal passed in the Senate but lost in the Assembly 85 to 48, while Rockefeller was attending King's funeral in Atlanta. The Governor returned to impress upon individual legislators the need to create UDC as a tribute to the slain civil rights leader. Through persuasion, cajolement, threats, log-rolling, and patronage, Rockefeller managed to change forty votes within seven hours.[1] Before the night ended, the Assembly approved the legislation by a vote of 86 to 45.

One month later, Rockefeller named Edward J. Logue as UDC's President and Chief Executive Officer. As later revealed in his confirmation hearings as Vice-President of the United States, Rockefeller induced Logue to take the position by using his personal fortunes to provide Logue with a gift of $31,000 and a loan of $145,000.[2]

The extraordinary powers vested with UDC combined with high salaries and Logue's record of accomplishment enabled UDC to attract a staff that included several people that had already directed agencies themselves. Among the senior

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[1] Samuel Kaplan, "Renewal in New York: The State Tries Its Hand," <u>Washington Monthly</u>, July, 1970, p.68.

[2] <u>Boston Globe</u>, January 26, 1975, p.A-4.

staff were: John G. Burnett, General Counsel, who had been Executive Vice President of Development and Resources Corporation as well as General Counsel to the U.S. Foreign Aid Program; Robert G. Hazen, General Manager, who had been in charge of urban renewal in New York City; Dr. Frank Kristoff, Director of Economics and Housing Finance and a leading housing economist; D. David Brandon, Director of Program Development, formerly Director of the New York State Office of Planning Coordination; Richard H. Pine, President of the UDC subsidiary in the Rochester area, who had been the Director of the Rochester Urban Renewal Agency.

Despite UDC's extraordinary powers, the primary way in which it operated, particularly at the outset, was in partnership with local communities. Before the end of 1969, UDC had signed memoranda of understanding with 12 cities and towns across the state to construct developments having a total of over 22,000 dwelling units. Most of these were projects that private developers found unfeasible with about half being located in urban renewal areas. In addition, UDC has initiated two new communities, one in Amherst in coordination with the planned creation of the State University of New York at Buffalo and one in Lysander (near Syracuse) on the site of a former munitions factory, in addition to one large housing development on Roosevelt Island (formerly Welfare Island) in the East River off of Manhattan that it

bills as a new community.

For the most part, UDC used its zoning override and condemnation powers sparingly and only with the consent of local officials. The one area where UDC encountered difficulties in attempting to use its powers was in Westchester County, a primarily affluent suburban county outside of New York City. The growth rate of jobs and a tight housing market in the County led Westchester officials to conclude that some 46,000 dwelling units would be needed to be built in the County with public assistance during the decade of the 1970's in addition to an equal number by the unaided efforts of private developers in order to accommodate those who could be expected to be employed there.[1] A UDC proposal to build 70 moderate income units, 20 low income units, and 10 elderly units in each of 9 towns in the County encountered an extraordinary amount of opposition from local residents and town officials, despite the fact that all of the housing would have been two-story townhouses or garden apartments, most on wooded tracts of 10 acres or more tailored to each site. As a result, the state legislature amended UDC's zoning override powers in towns and villages (but not cities) so that each town would have the right to veto the override of local zoning by UDC on one project.

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[1] UDC, UDC in '72, 1972 Annual Report, p.54.

More so than the governors in other states with HFA's, Governor Rockefeller became identified with the progress of UDC. He requested proposals for projects from mayors across the state, announced the signing of most memoranda of understanding with local communities, was present for major groundbreaking ceremonies, and defended the integrity of the organization.

In 1973 UDC began to take a more cautious approach to development as the result of the shaking up of UDC's Finance Division by the Executive Vice-President and the bringing in of a new, highly competent financial team. The result was much improved accounting, cash flow projections, and financial reporting, a fact that was recognized by Moody's Investors Service.[1] Nonetheless, as a result of the worsening economy and problems on UDC's earlier ventures coming to the forefront, UDC began to experience severe financial problems.

The first public indication of problems came in the midst of a tight money period in September 1974, when UDC had to pay a record 9 percent net-interest rate on the bonds it issued. As part of the negotiating surrounding this sale, the large New York City banks purchasing many of these bonds urged UDC to sell a substantial part of its existing

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[1] Moody's Bond Survey, September 10, 1974, p. 486.

mortgage portfolio to the New York State Housing Finance Agency and urged Governor Malcolm Wilson to commission a study of UDC operations. Wilson responded by naming State Budget Director Richard L. Dunham to head a task force on UDC and by securing agreement from the UDC board to withhold approval of all new commitments unless approved personally by the Governor on a project-by-project basis.[1] The Report of the Task Force on UDC issued on December 26, 1974, recommended that UDC, because of its difficulty in raising funds, terminate all new projects including $400 million in projects in its pipeline on which UDC had yet to make a legally binding commitment.[2]

The succession of newly-elected Hugh Carey to the governorship in January brought new questions as to the continued vitality of UDC. In one of his first acts as governor, Carey removed Edward Logue from his position as President and Chief Executive Officer and named the Executive Vice-President, John Burnett, to replace him on an interim basis. Carey also appointed a special committee to analyze UDC's financial problems and a "Moreland Act" commission to study all public authorities in New York State with partic-

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[1] Joseph P. Fried, "Urban Development Unit Curbed on New Projects," New York Times, October 5, 1974, p.54.

[2] Report of the Task Force on UDC, Richard Dunham, chairman, Albany, 1974, p.7. (Mimeographed.)

ular emphasis on UDC and the use of moral obligation financing. At the same time, because of UDC's poor credit in the financial community, Carey recommended to the Legislature that the State lend UDC $178 million to enable it to repay $100 million in maturing obligations and finance $78 million in current operations.

On February 25, before the Legislature acted on this request, UDC defaulted on $100 million in bond anticipation notes (plus $4 million in accrued interest). A few days later, it also defaulted on $30 million in bank loans. In the wake of these defaults, UDC was forced to dismiss one-third of its staff, including several officials at the executive level. In an attempt to salvage UDC from bankruptcy, the Legislature first created a Project Finance Agency (PFA) and provided it with $110 million. While this move initially failed to restore the confidence of the major New York City commercial banks, the subsequent allocation of these funds to repay holders of defaulted notes and the additional appropriation of $80 million to help meet debt service on outstanding bonds and $8 million for operating expenses led these banks to commit $140 million in short term loans to UDC through the PFA. In addition, the State Motor Vehicle Insurance Security Fund made a commitment to provide UDC with another $140 million while at this writing the New York savings banks had expressed a strong interest in purchasing long term UDC bonds and were investigating

the viability of UDC's projects further.

Federal Housing Agencies

Because of the strong dependence of state HFA's on Federal subsidies, a thorough understanding of the history of these agencies requires a review of the history of Federal involvement in housing. Such a review is also necessary to understand HUD, the benchmark being used to compare the experience of the HFA's.

The Federal government first became involved with housing finance in response to the Great Depression. In 1932 the Federal Home Loan Bank system was created to lend funds to mortgage lenders; in 1933 the Home Owners Loan Corporation was created to purchase mortgages in trouble; and, more relevant to this thesis, in 1934 the Federal Housing Administration (FHA) was created to insure mortgages and thereby spur new residential construction. FHA insurance enable private lenders to provide mortgages over longer terms and with higher loan to value ratios. To protect its investment and to stimulate the economy, the FHA required that the housing either be new construction or up to new standards. A set of minimum property standards were developed to assure uniformity of FHA housing across the country and to guard against abuses. FHA also refused to insure homes located in declining neighborhoods. The net

result was that FHA enabled middle income homebuyers to be able to afford new housing in the suburbs. Over the years FHA also developed multi-family development programs. As with its single family programs, FHA tended to be quite conservative in its lending patterns throughout most of its history. Early plans for FHA contemplated a degree of supplemental state control of projects. Federal controls, however, became so complete that additional state control then seemed excessive.[1]

Largely concurrent with the growth of FHA was the growth of two other Federal housing agencies, the Public Housing Administration (later to be called the Housing Assistance Administration), created in 1937 to administer low income public housing and the Renewal Assistance Administration, created in 1949 to administer urban renewal. These three agencies were grouped together in a confederation as the Housing and Home Finance Agency in 1961 which evolved into the cabinet level Department of Housing and Urban Development (HUD) in 1965. As members of the different subagencies within HUD began having to work together, a certain degree of competitiveness resulted. According to one observer, staff from the more conservative, hard-nosed

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[1] Dorothy Schaffter, State Housing Agencies, p.618.

FHA seemed to have the upper hand over those from the Renewal Assistance Administration and Housing Assistance Administration.[1] Jealousy also seemed to develop between local offices and the central office in Washington. Those in local offices came to believe that the central office was too far removed from local problems while those in Washington came to believe that the local offices were too parochial.[2] Administrative changes made in 1969 and 1971 took away the autonomy of the older agencies within HUD and folded them into a single, more integrated agency organized by the processes performed rather than by program.[3] In 1970, as part of an overall reorganization of local Federal offices to create uniform, regional boundaries for all Federal programs, HUD added four new regional offices to six of its then existing offices, and created 39 new area offices which together with 34 already existing insuring offices implement HUD mortgage insurance and subsidy programs on the local level.[4] Ten HUD area or insuring offices have

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[1] Richard T. LeGates, "Can the Federal Welfare Bureaucracies Control Their Programs: The Case of HUD and Urban Renewal," The Urban Lawyer, 5 (Spring, 1970), p.236.

[2] Ibid.

[3] Housing Development Reporter, p.07:0003-7.

[4] Ibid., p.07:00007.

a jurisdiction matching those of the six state agencies under consideration in this dissertation.[1]

At about the time of the first reorganization came the enactment of the 1968 Housing Act. This major piece of social legislation was part of the legislative response to the recent inner city riots. The preamble to the Act called for the creation of an unprecedented 26 million dwelling units over a ten year period, with six million of them being for low and moderate income families. Included in the body of the Act was the Section 236 multi-family interest subsidy program. As noted above, a subsection of the program provided an opportunity for state agencies to receive a share of these funds without HUD mortgage insurance. For the projects it did insure, however, HUD was given the advantage of a Special Risk Insurance Fund. The Act authorized to be appropriated:

> Such sums as may be needed from time to time to cover losses sustained by the fund in carrying out the mortgage insurance provisions of sections. . . 235. . . .[2]

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[1] The Chicago Area Office and Springfield Insuring Office divide responsibility for Illinois; the Boston Area Office serves all of Massachusetts; the Detroit Area Office and Grand Rapids Insuring Office have charge of operations in Michigan; the Newark and Camden Area Offices split New Jersey; and the New York City and Buffalo Area Offices and Albany Insuring Office serve New York.

[2] National Housing Act of 1949, as amended, Sec. 238(b).

The Special Risk Insurance Fund meant the abandonment of HUD's historical conservatism in mortgage underwriting and a shift in power to the more socially oriented segments of the organization. Gearing up for the new production goals coincided with the second reorganization. Rather than relocate, many of the most highly skilled HUD personnel who had offers outside HUD chose to take them; many more new inexperienced personnel were taken on. The result was that "the personnel in most local HUD offices have a very poor understanding of the overall development process."[1]

Presiding over HUD during the years of 1969-1973 was George Romney, an appointee of President Richard Nixon. Romney came to the job with no housing experience, having been the chief executive at American Motors and Governor of Michigan. The Romney years saw a high level of corruption in HUD. Six area office directors were indicted. While the most notorious incident occurred in Coral Gables and involved Senator Edward Gurney, two indictments of local HUD office directors were made in the states with active state housing agencies. The Hempstead, New York insuring office director and the Chicago area office director were both indicted.

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[1] Report of the Task Force on Improving the Operation of Federally Insured or Financed Housing Programs, Vol. 3: Multifamily Housing (Washington, D.C.: National Center for Housing Management, 1973), p.121.

The end of the Romney years came with his announcement of the moratorium on all HUD subsidized programs on January 5, 1973. During the two weeks between the leaking to the press of the impending moratorium and the actual announcement, a time of the year when HUD business normally slows down, more projects were granted feasibility letters than during all of the rest of 1972.[1] This flurry of activity by HUD personnel indicated a combination of developer pressures, commitment of local personnel to the programs, and probably most importantly a desire on the part of HUD personnel to assure themselves jobs processing the continuing pipeline.

With the announcement of the moratorium came the appointment of James T. Lynn as the new Secretary of HUD. Lynn, who had been a corporate attorney and an Assistant Secretary of Commerce, had little housing experience. During his tenure was a nine month restudy of national housing programs. The results announced in September 1973 called for the cautious movement towards a national system of housing allowances. In the meantime the study called for the implementation of a revised leased housing program. The

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[1] Interview with John A. Jennings, Special Assistant to the Deputy Undersecretary for Field Operations.

Congressional enactment of a new Section 8 leased housing program as part of the Housing and Community Development Act of 1974 marked a legislative triumph for Lynn. It allows for both the subsidization of existing and newly constructed units and as mentioned above, it provides a substantial role for the state agencies. Implementation of this section, however, has been left for a new HUD Secretary, Carla Hills.

CHAPTER 3

CRITERIA FOR AGENCY SUCCESS

Both the state HFA's and HUD exist to serve public purposes. Legislatures have spelled out many of these purposes in their findings as part of the statutes creating these agencies and in statutes directing these agencies to perform certain public purpose functions. Congress has determined that certain goals are of such national importance that state agencies must implement procedures formulated to foster these goals if they want to receive Federal subsidies for their projects. While certain state and Federal public purposes may have been specified in enabling legislation for public relations reasons, this thesis assumes that because a majority of the legislative body creating each agency approved the language in the act, the legislative intent was that these agencies fulfill these public purposes.

In comparing the HFA's with HUD and with each other, a broad range of legislatively determined criteria will be used. (See Table 2 for a summary.) Each agency will be judged by public purposes set forth by its own legislature, or by Congress. Agencies will be judged by the goals legislatively set for other agencies only when they have administratively adopted these goals in an official statement. This chapter will delineate these goals and to whom they apply, while Chapter 4 will proceed to rate the performance of the various HFA's and HUD in achieving them.

Table 2

Criteria for Success

Goal or Legislative Finding	Operational Measure	Agency
General Public Purposes		
A decent home for all/ Present shortage of decent housing.	Volume of production	IL, MA, MI, NJ, NY, UDC, HUD
Housing within the financial means of low and moderate income families.	Rents/Use of subsidies	IL, MA, MI, NJ, NY, UDC, HUD
Slum rebuilding.	Volume of production in urban renewal and poverty areas	IL, MA, MI*, NJ, NY, UDC, HUD
Accessibility of unemployed to jobs	Moderate income housing built in counties with surplus low skilled jobs.	IL, NJ, MI*, HUD*
Good design and construction	Design awards/room size/amenities/ guarantees	IL*, MA*, MI*, NJ*, NY*, UDC*, HUD
National Public Purposes		
Racial integration	Racial mixture of each project	HUD**
Housing for minorities	Percentage of minority occupants	HUD**
Minority employment	Proportion of minority workers and contractors	HUD**
Environmental Protection	Procedures	HUD**
Equitable relocation	None	HUD**
Housing rehabilitation	Percentage of total units that are rehabilitated	HUD
Housing for families most in need	Percentage of units with 3 or more bedrooms	HUD

*Administratively-determined goal

**Goal that Congress has required HUD to apply to state agencies.

Table 2

(continued)

Local Public Purposes		
Economic integration	Subsidy level mix	IL,MA, MI,* NY, UDC*
Cooperative ownership	Proportion of ownership by coops	NY
Housing for the elderly	Number of units designed for elderly	MA, MI, NY
Efficiency Measures		
Efficiency in achieving public purposes	Administrative costs per unit/Agency fund balances/Rate of "problem projects"/Vacancy rates/ Subsidy costs per unit/ Processing times	

*Administratively-determined goal

GENERAL PUBLIC PURPOSES

The legislation creating each of the state housing finance agencies being considered makes the same basic finding, namely, that a shortage of decent, safe, and sanitary housing exists within the financial means of low and moderate income families.[1] Each statute goes on to state or imply that a primary purpose of the agency being created is to help provide a decent home for all. Congress made this same finding in calling upon HUD to implement the Federal Housing and Urban Development Act of 1968.[2] The primary operational measures that will be used in assessing organizational effectiveness in alleviating these shortages and directing production toward low and moderate income families are volume of production under low and moderate income programs and level of rents.

Another major goal that each agency shares by virtue of its own legislative or administrative proclamation is

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[1] Ill. Ann. Stat. Ch. 67½ Sec. 303; M.G.L.A. c.23A App. Sec. 1-2; M.C.L.A. Sec. 125.1401; N.J.S.A. 55:14J-2; 41 N.Y. Cons. Laws Ann., Sec. 11.

[2] 12 U.S.C. 1701t Sec.2.

the rebuilding of slum areas. The Limited-Profit Housing Companies Act which applies to both the New York State HFA and Urban Development Corporation specifically declares "the rehabilitation or redevelopment of slum ghettos" to be one of its purposes.[1] The Illinois and Massachusetts statutes, while not being as direct in requiring the HFA's in these states to rebuild slums, do make the finding that the spread of slums and blight leads to a shortage of decent housing.[2] They go on to charge the Illinois and Massachusetts agencies with the responsibility of encouraging private enterprise to build (and in Illinois to also rehabilitate) housing to prevent the recurrence of slums. The New Jersey statute, without making any explicit finding on the presence of slums, directs that agency to give priority to developments in urban renewal areas. The Michigan State Housing Development Authority has administratively adopted the goal of alleviating slum housing conditions in inner-city Detroit.[3] Similarly, administratively-adopted criteria for evaluating Section 236 projects coming

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[1] 41 N.Y. Cons. Laws Ann. Sec. 11-a(2).

[2] Ill. Ann. Stat. Ch. 67½ Sec. 303; M.G.L.A. c.23A App. Sec. 1-2

[3] <u>MSHDA Annual Report</u>, 1974, pp.20-21.

directly to the HUD field offices give high priority to developments lying within urban renewal and model cities areas and consequently make the Congressionally determined public purpose of rebuilding slums found in the urban renewal and model cities statutes applicable to the Section 236 program.[1]

All of these goals relating to the abatement of slum conditions will be measured operationally by the extent to which each agency has financed housing in urban renewal areas and in inner city census tracts where over 25 percent of the households have incomes that are below the poverty line. The designation of a neighborhood as an urban renewal area reflects a determination by the locality using Federal standards that the neighborhood is "a slum area or a blighted, deteriorated, or deteriorating area,"[2] and that a public commitment has been made to rebuild it in its entirety. Poverty tracts provide a measure of where those most in need of better housing are living. Because of the lack of recent census data on housing deterioration and because of the close correlation between the concentration

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[1] U.S. Department of Housing and Urban Development, "Factors for Project Evaluation and Determination of Priorities (Section 236)," (249706-P).

[2] Housing Act of 1949 Sec. 110; 42 U.S.C. 1450.

of poverty and slums it also provides the best operational definition of slum areas that can be applied consistently in various metropolitan areas.

One housing-related goal that applies to several (but not all) of the state HFA's and HUD is the locating of new low and moderate income housing near job opportunities. The Illinois and New Jersey agencies have this goal by virtue of statutory findings while the Michigan SHDA and HUD have adopted it administratively.[1] The measurement that will be used in assessing performance will be the ratio of unskilled and semi-skilled jobs to workers already living in the same city or county in which the agency has located low and moderate income housing.

The final set of goals that each of the agencies being considered has individually adopted is the promotion of good design and construction. As part of its "Declaration of National Housing Policy," Congress directed HUD to exercise its powers in such a manner as will encourage and assist "the production of housing of sound standards of design, construction, livability, and size for adequate family

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[1] Ill. Ann. Stat. Ch. 67½ Sec. 303; N.J.S.A. 55:14J-2; Michigan Housing Plan (as cited in Michigan Department of Management and Budget, Subsidized Housing Program, October, 1973, p.23); HUD, "Evaluation of Requests," (FHA Form No.3165), p.3.

life."[1] The existence of the HUD Design Awards Program is an administrative indication of HUD's desire for high-quality design. While none of the statutes creating the six most advanced state HFA's mentions any design considerations, each of these agencies has administratively adopted the same basic goals in this area as HUD.[2] In assessing effectiveness in achieving these aims, the number of design awards, type of amenities, size of rooms, and construction quality standards will be considered.

National Public Purposes

Congress has determined that certain housing-related public purposes are of such national importance that all agencies using Federal funds, whether they be Federal or state agencies, must adopt procedures designed to fulfill them. The five public purposes falling into this category are racial integration, housing of minority families, minority hiring, environmental protection, and equitable relocation. HUD reviews the procedures used by each HFA in

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[1] Housing and Urban Development Act of 1949, Sec. 2 as amended; 42 U.S.C. 1441.

[2] See Illinois Housing Development Authority, Architects' Guide, p.17; Massachusetts HFA, Operations Handbooks for Financing of Multi-Dwelling Housing, 1971, p.1; Michigan S.H.D.A., Townhouse Development Process, 1970, p.ii; New Jersey HFA, Guide for Development of Limited Dividend and Nonprofit Housing, 1973, p.2; New York DHCR, Design Standards for Limited Profit and Limited Dividend Projects, p.1; New York State UDC, Annual Report 1970, p.8.

these areas. Pursuant to Title VI of the Civil Rights Act of 1964, HUD requires that sponsors of all HUD-subsidized projects, including those financed by state agencies, file an Affirmative Marketing Plan for each project showing the measures that will be taken to attract as residents members of minority or majority groups who would otherwise stay away. In addition, since 1972 the local HUD offices have had to review each state HFA Section 236 project to ensure that it adequately satisfies Criterion No.2 of HUD's Project Selection Criteria relating to minority housing opportunities. The stated objectives of this criterion are:

> To provide minority families with opportunities for housing in a wide range of locations.
>
> To open up nonsegregated housing opportunities that will contribute to decreasing the effects of past discrimination.[1]

Title VI of the 1964 Civil Rights Act as well as the provision of the Housing and Urban Development Act of 1968

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[1] U.S. Department of Housing and Urban Development, "Evaluation of Requests for Priority Registration, Early Feasibility, Reservation of Contract Authority (Section 235(i), Rent Supplement, Section 236) or Evaluation of Application for Low Rent Public Housing" (FHA Form 3165), August,1972, p.2. This criterion is made applicable to state HFA developments by HUD, "Non-Insured Assisted Projects by State and Local Government" (HUD No.4530.1), January, 1973, p.3-2.

specifying that opportunities for training, employment, and business contracts on Section 236 and Rent Supplement projects be made available to the greatest extent feasible to lower income persons residing within the project area, led HUD to require the filing of an equal employment certification for every state or Federal development using Section 236 or Rent Supplement funds.[1] The National Environmental Policy Act of 1969 (P.L. 91-190) necessitates that an assessment be made of the environmental impacts of any "major action" involving Federal funds, including state-financed but Federally subsidized multi-family construction. The Federal Uniform Relocation assistance and Real Property Acquisition Policies Act of 1970 (P.L. 91-646) requires that fair and reasonable relocation payments be made, that relocation payments be provided, and that replacement dwellings be made available to those displaced by any Federally-supported housing development.

Unfortunately, operable data is available from HUD and the state agencies only with regard to racial integration and housing of minority families and not concerning minority hiring, environmental protection, or relocation practices. Consequently, conclusions as to the degree to which HUD and

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[1] "Equal Employment Opportunity Certification" (FHA Form 2010), July, 1969.

the state agencies have fulfilled national public purposes will be based primarily upon the extent to which they have provided integrated housing. Since data on minority hiring has been obtained from certain HFA's, comparisons will be made among these state agencies on this criterion using the percentage of minority residents in the state to standardize the data. Environmental protection and relocation will be discussed only in terms of the procedures used to carry out these public purposes.

The other national public purposes enunciated by Congress have been more vague. While HUD interpreted certain of them as applying to the projects it subsidized directly, it has never required similar fulfillment of them by state agencies on Federally subsidized projects. One of these purposes, housing rehabilitation, could just as easily be interpreted as being a program option rather than a goal. The only public purpose language concerning rehabilitation related to programs utilized by the state agencies comes in Congress' reaffirmation of the goal of the "construction or rehabilitation" of 26 million housing units within a ten year period.[1] HUD, however, determined that rehabilitation

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[1] Housing and Urban Development Act of 1968, Sec. 1601; 42 U.S.C. 1441a.

proposals submitted directly to its field offices would have priority in receiving Section 236 funding.[1] While the statutes creating the Illinois, New Jersey, and New York agencies also mention rehabilitation as an optional way of meeting program goals, none of these HFA's have regarded rehabilitation as opposed to new construction as a program goal.

The other public purpose adopted by HUD for its own projects but, at least until the coming of the relatively new Section 8 program, not for state agency projects, is the housing of large families.[2] While Federal (and state) statutes never directly refer to the housing of large families as a public purpose, the declaration of policy found in the Housing and Urban Development Act of 1968 (Section 2) does state that "the highest priority and emphasis should be given to meeting the housing needs of those families for which the national goal has not become a reality." Because of the vagueness with which Congress has established rehabilitation and the housing of large families as national goals, they will only be given relatively

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[1] U.S. Department of Housing and Urban Development, "Factors for Projection Evaluation and Determination of Priorities (Section 236)," 249706-P.

[2] _Ibid_.

minor weight in assessing overall agency performance. The operational measures that will be used will be the percentage of all units financed or insured that are rehabilitated and the percentage of units with three or more bedrooms.

Local Public Purposes

The enabling legislation and administrative proclamations of the various HFA's refer to public purposes that are unique to the state or to a few states. While certain of these statements of public purpose could just as easily apply to other states as well, they will be used as criteria by which to assess the ability of particular state agencies to serve local needs.

A local public purpose adopted by most of the state agencies is economic integration. This goal partially conflicts with the goal of rebuilding slum areas in that housing built in most low income inner city areas has difficulty in attracting upper and middle income families. The Illinois and Massachusetts statutes declare that their agencies shall "assist in the permanent elimination of slums by housing persons of varied economic means in the

same structures and neighborhoods."[1] Economic integration became a goal of the New York State Housing Finance Agency with adoption of the State Capital Grant Program enabling low income families to live in middle income housing.[2] The New York State Urban Development Corporation and the Michigan State Housing Development Authority adopted income mixing as a goal through administrative declaration.[3] The New Jersey HFA and HUD are the only two organizations not sharing this goal during the time period studied. The new Section 8 leased housing program, however, makes economic

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[1] Ill. Ann. Stat. Ch. 67½ Sec. 303; M.G.L.A. c.23A App. Sec. 1-2. The Massachusetts statute uses the word "projects" rather than "structures."

[2] Priv. Hsg. Fin. Law, Art. 3, Sec. 44-a.

[3] The UDC annual report in both 1969 and 1970 (p.8) states "While our lowest income families have the greatest need for housing, in today's market an acute need also exists for families with moderate and middle incomes. However, even if only low income families required assistance, it is our view, based upon long American experience that developments which cater exclusively to low income families are undesirable. . . UDC housing, therefore, seeks to provide for a cross-section of age groups and income levels in a diversified community." The Michigan agency commitment to income mixing is found in State of Michigan, Office of Program Effectiveness Review, Subsidized Housing Program, October, 1973, p.50.

integration a goal for HUD and all state agencies involved with it. The amount of set-asides going to each HFA depends in part upon the extent to which each agency commits itself to and has demonstrated a past record of limiting the number of subsidized tenants to less than 20 percent in each development.[1]

Another local goal that might just as easily be considered a national goal is the provision of housing for the elderly. The Massachusetts and New York statutes refer to the need for housing for the elderly while the Michigan law mandates that preference be given to low and moderate income elderly.[2] The percentage of units that each of these agencies have built for the elderly will be considered for each of these agencies and their HUD counterparts. A more locally specific although relatively minor goal is the provision of cooperatively owned housing by the two New York agencies.[3] Assessments will be made of the percentage of such housing provided by these agencies with HUD performance in New York in this regard being used as an additional benchmark.

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[1] Except for developments that are all elderly, all-handicapped, or have less than 50 dwelling units. 24 CFR Sec. 883.104.

[2] M.G.L.A. c.23A App. Sec. 1-2; N.Y. Cons. Laws Ann. Sec. 11; M.C.L.A. Sec. 125.1411.

[3] 41 N.Y. Cons. Laws Ann. Sec. 11-a(2-a).

The enabling legislation for certain HFA's establishes other local public purposes which will not be used as criteria for evaluation because of measurement difficulties. The statutes establishing the Illinois Housing Development Authority and both the New York HFA and UDC charge these agencies with the goal of promoting "well-planned urban growth."[1] Unfortunately, no generally accepted, readily operationalizable criterion exists for measuring "well-planned urban growth." Such criteria do exist for measuring the extent to which the Massachusetts HFA has conformed to its legislatively-mandated public purpose of reducing the shortage of housing available to Vietnam War veterans and the extent to which it and the Illinois, Michigan, and New Jersey agencies have satisfied their common public purpose of reducing the shortage of housing available to those displaced by public action.[2] Yet, none of these agencies maintains data on the extent to which their housing has served either Vietnam War veterans or displacees. While data is available on the percentage of land area covered by New York HFA-financed buildings to assess the extent to

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[1] Ill. Ann. Stat. Ch. 67½ Sec. 303; 41 N.Y. Cons. Laws Ann. Sec. 11.

[2] M.G.L.A. c.23A App. Sec. 1-2; Ill. Ann. Stat. Ch. 67½ Sec. 303; M.C.L.A. Sec. 125.1401; N.J.S.A. 55:14J-2.

which that agency has succeeded in alleviating the legislatively-defined problem of excessive land-coverage,[1] the lack of comparative data from HUD or other HFA's makes the New York HFA data meaningless by itself.

The only other statutorily defined public purposes of the HFA's being considered are the elimination of the periodic shortages of mortgage money by the Illinois Housing Development Authority[2] and the creation of jobs by the New York HFA and UDC.[3] In each of these instances, however, the agencies expect to achieve these ends primarily through means other than direct residential mortgage lending. The Illinois agency has attempted to counter the cyclical availability of money by making loans to lenders during periods of credit shortages; the two New York agencies have been creating jobs more by constructing new commercial, industrial, and civic facilities than by building housing. Consequently, efforts in these areas will receive only passing reference in this dissertation.

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[1] 41 N.Y. Cons. Laws Ann. Sec. 11.

[2] Ill. Ann. Stat. Ch. 67½ Sec. 303.

[3] McK. Unconsol. Sec. 6252; Private Housing Finance Law Sec. 11a(2).

Efficiency Measures

Any true measure of the success of agencies in achieving public purpose goals, of course, must not only consider the gross amount of goal fulfillment, but also the efficiency with which these goals are met. With this thought in mind, the extent to which an agency or group of agencies has succeeded in alleviating a shortage of decent, safe, and sanitary housing depends upon administrative and subsidy costs per unit, processing times, and vacancy rates as well as total number of units produced. Since attempts at slum rebuilding or racial or economic integration that result in developments with serious financial problems are likely to be more detrimental than helpful to the achievement of these public purposes, measurement will be made of significant arrearages, foreclosure, and vacancy rates for use as added criteria for agency success. Finally, since the ability of an agency to continue to carry out its public purposes and to borrow funds at favorable rates depends on their overall financial viability, an analysis will be made of agency financial statements.

Now that all of the criteria for agency success have been laid out, the next section will evaluate the performance of each of the HFA's and HUD with regard to each criterion in turn.

CHAPTER 4

EVALUATION OF AGENCY EFFECTIVENESS

GENERAL PUBLIC PURPOSES

Volume of Low and Moderate Income Housing

The record of the state housing finance agencies (HFA's) in comparison with that of the Department of Housing and Urban Development (HUD) in alleviating the shortages of housing for low and moderate income families found by the various legislatures depends on the measure used. Between January 1, 1970 and December 31, 1973, the Illinois Housing Development Authority (IHDA), Massachusetts Housing Finance Agency (MHFA), Michigan State Housing Development Authority (MSHDA), New York State Housing Finance Agency, and New York State Urban Development Corporation (UDC) closed a total of 72,810 units of housing under the Section 236 program compared with 69,090 by HUD in the same states. When housing finance agency production under state subsidy programs and HUD production under the Section 221(d)(3) and 235(j) programs are considered as well, state agency production of privately owned multi-family housing for low and moderate income families is seen to be slightly less than that of HUD with the six HFA's having produced 74,937 dwelling units compared with 79,621 units by HUD in the same states (see Table 3).

Table 3

Total Number of Privately Owned New or Substantially Rehabilitated Multifamily Dwellings by Subsidy Level By Agency on Projects Closed between January 1, 1970 and December 31, 1973

	Ill. HDA	Mass. HFA[a]	Mich. SHDA	NJ HFA[b]	NY HFA[c]	NY UDC	Total
Low Income[d]	124	5274[a]	1069	1006	920	7652	16045
Moderate Income[e]	4462	7807[a]	6001	6718	12299	21605	58892
Middle Income[f]	2196	4375	1244	1644	4367	3961	17787
Total	6782	17456	8314	9368	17586	33218	92724
Low & Moderate Income[d,e]	4586	13081	7070	7724	13219	29257	74937
Low & Moderate Per 1000 Population	0.41	2.30	0.80	1.08	0.72	1.60	1.46
HUD Low & Moderate Income[d,e]	15056	15121	21297	5847	23300		79621
HUD Section 236[g]	13571	13802	18788	5642	17287		69090

a. Massachusetts HFA figures include 720 low income, and 1306 moderate income dwellings receiving state subsidies, and 101 unsubsidized units made available to low income families through rent skewing.

b. The New Jersey HFA also financed 2132 dwelling units in 1968-1969 including 207 low income, 882 moderate income, and 1043 middle income.

c. The New York HFA also financed 43450 dwelling units in 1960-1969 including 1382 low income under the state Capital Grant program and 42068 middle income.

d. Low income is defined as rent supplement, Section 23 or 10c leased housing or equivalent state programs. These programs are generally added.

e. Moderate income is defined as Section 236, 221(d)3, or equivalent state program.

f. Middle income is defined as units receiving no direct Federal or state subsidy.

g. Includes units receiving low income subsidy on top of Section 236.

Sources: HFA Figures compiled from information provided by individual state agencies; HUD figures compiled from: HUD, Housing Production and Mortgage Credit, Statistical Operations Branch, "Selected Multifamily Status Reports: Mortgage Insurance Programs," (02 series) As of December 31, 1969, 1973.

Since UDC has produced 29,257 units of Section 236 housing for low and moderate income families, more than any other state agency, the total production figures of Section 236 housing by the five state agencies that are strictly housing finance agencies falls to 43,500 or 25,500 less than the HUD offices in the same. Since HUD, however, controlled the distribution of these subsidy funds, it could be seen as having an unfair advantage over the HFA's in securing the limited funds.

On an individual basis, aside from UDC, the New Jersey HFA was the only HFA to produce more housing for low and moderate income families than its HUD counterparts, while the Illinois and Michigan agencies produced only about a third of the volume of HUD in their respective states. The housing finance agency to produce the most units of low and moderate income housing in relation to the population of their state, however, has been the Massachusetts agency. Between 1970 and 1973, MHFA produced about 2.3 dwelling units of low and moderate income housing per thousand Massachusetts residents, the same ratio as the New York HFA and UDC combined, and over twice as high a ratio as any other state agency.

While only the statutes defining the powers of the Massachusetts and Michigan agencies place greater emphasis on providing housing for low as opposed to moderate income

Table 4

Low Income Occupancy of HUD-Insured
Section 236 Developments that Filed "Occupancy Reports"
As of June 30, 1973
By State

	Low Income Rent Supp. & Leased Units	Total Occupied Units in Project	Percentage Low Income
Illinois	465	4,280	10.9%
Massachusetts	431	2,130	20.2%
Michigan	N/A	N/A	N/A
New Jersey	42	1,535	2.7%
New York	469	3,451	13.6%
TOTAL	1,407	11,396	12.3%

Note: Aggregate figures by state were unavailable for rent supplement or leased housing funds allocated to just Section 236 developments. The available data is based upon information provided by project managers to the Central Office. Often, particularly for projects in Michigan, no reports were filed.

Source: Compiled from HUD "Occupancy Reports," Form 9801, on individual projects, as of June 30, 1973.

families, the state agencies as a group have provided considerably more low income units than HUD as a percentage of all low and moderate income units. Low income families occupy 20.0 percent of the housing built for low and moderate families by the state agencies compared with only 12.3 percent of the Section 236 developments produced by HUD.[1] (C.f. Table 3 and Table 4.) Occupancy by low income families having incomes of about $3,000 - $5,000 has been made possible through the use of Federal rent supplement, Section 23 or 10(c) leased housing subsidies, or equivalent state programs.[2] The Massachusetts HFA, which by statute must provide at least 25 percent of its units in each development to families with incomes low enough to qualify for public housing, clearly has the best record of providing housing for low income families. The 5,274 units it has produced for low income families using Federal or State

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[1] The low income percentage on the state agency projects was based upon occupancy reports for units occupied as of 1974 and allocations made on projects under construction. The HUD percentage of low income units is based upon occupancy reports as of June 30, 1973, only. Since HUD adopted a policy in 1973 of limiting rent supplements to no more than 10 percent of the units in a single project, consideration of more recent data would lower the overall HUD rate.

[2] The Rent Supplement program is Section 101 of the Housing and Urban Development Act of 1965; the leasing subsidies are part of the U.S. Housing Act of 1937; the state subsidies include the Massachusetts 707 program and New York Capital Grant Program (Private Housing Finance Law, Article III). Income limits for the different programs vary slightly from each other and depend upon locality and family size.

subsidies represent 38.2 percent of all of the agency's low and moderate production and 30.2 percent of its total number of units.

The Michigan State Housing Development Authority has been severely criticized for its lack of production for genuinely low income families.[1] As a consequence of this perceived deficiency, in 1972 the Michigan legislature adopted a measure that requires MSHDA over the course of eacy year to provide a minimum of 15 percent of its Federally subsidized units on a priority basis to "low income families and persons receiving their primary incomes from social security or state and federal public assistance programs."[2] As of September 1973, however, 18.6 percent of the households living in MSHDA-financed multi-family dwellings were receiving Aid to Families with Dependent Children, 3.6 percent were receiving other forms of public assistance, and 15.4 percent were receiving pension or Social Security benefits, making a total of 37.6 percent of MSHDA multi-family units.[3]

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[1] See Daniel Pearlman, "State Housing Agencies and the Myth of Low Income Housing," Clearinghouse Review, 7 (March, 1974), 649-55.

[2] P.A. 1972, No.310 Sec. 1.

[3] Michigan Department of Management and Budget. Subsidized Housing Program: An Assessment of Effectiveness, October, 1973, p.49.

Because of the fact that many welfare offices in Michigan would provide AFDC recipients with enough income to pay Section 236 rents, MSHDA has fulfilled its 15 percent legislative requirement without utilizing large amounts of Federal low income rent supplement or leased housing subsidies. In fact, based upon occupancy patterns in developments that have already been fully or partially occupied, MSHDA projects have utilized only 79 percent of their rent supplement allocations.[1] By contrast, Massachusetts HFA projects have utilized more than 100 percent of the rent supplement, leased housing, and state low income subsidies originally allocated to it.[2] The lack of utilization of Federal funds by MSHDA rather than its lack of serving low income families would thus appear to be the more valid criticism against it as it appears to constitute violation of a companion provision to the 15 percent requirement which requires MSHDA to make the "full use" of available Federal

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[1] It has been assumed that utilization of rent supplement funds in partially tenanted developments will follow the same pattern of rent supplement utilization as has already been set for that development. The utilization figure is based upon a mimeographed sheet prepared by MSHDA entitled, "Rent Supplement as of November 1974 for MSHDA Developments That Had Initially Closed by 12/31/74." (n.d.)

[2] Based upon an examination of "MHFA Semi-Annual Occupancy Report(s)" submitted on each project in January and February, 1974.

subsidy programs possible "consistent with sound fiscal management and good housing development planning."[1]

The state agency that has done the poorest job in serving low income families has been the Illinois Housing Development Authority. As of June 1974, a total of 167 units in three developments that had achieved over 90 percent occupancy had received rent supplement allocations. Only 60 of these units had been occupied by rent supplement tenants.[2] Even assuming that all of the funds for the 64 rent supplement units allocated to other IHDA projects that had started construction prior to 1974 become fully utilized by low income tenants, total low income occupancy will amount to only 2.7 percent of IHDA's low and moderate income production and 1.8 percent of its total production.

The difference between the number of units state agencies have produced for low and moderate income families and their total production, of course, consists of housing produced for middle income families. Such housing is intended to serve the social purposes of stimulating overall housing production and in certain projects of providing a mixture of income levels. The only subsidy that the HFA's

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[1] P.A. 1972, No.310, Sec. 2.

[2] Letter to the author by Frank S. Glickman, IHDA Research and Planning Director, June 18, 1974.

pass on to these units is the below market financing they receive through the issuance of tax-exempt securities. In total between 1970 and 1973, the six state agencies under consideration financed a total of 17,787 dwelling units for middle income families, an amount equal to 19.2 percent of their total production. Prior to 1970, however, the New York HFA financed an additional 42,000 middle income units and the New Jersey HFA financed 1000 such units.

State agency production of middle income multi-family housing, particularly since 1970, has been small in comparison with that of HUD. HUD's production of middle income multi-family housing under its Section 207, 220, 221(d)4, 231, 233, and 234 programs in the states of Illinois, Massachusetts, Michigan, New Jersey, and New York between 1970 and 1972 amounted to about 70,000 dwelling units or over five times as many as the six state agencies.[1]

Rent Levels

The other aspect of overcoming the shortage of decent housing alluded to by the National Housing Act of 1968 and the statutes creating the various housing finance agencies

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[1] HUD Statistical Yearbook 1970, Table 168; 1971, Table 170; 1972, Table 161; 1973, Table 177.

is providing the housing at a rent level that low and moderate income families can afford. While the use of subsidies is one way of making housing affordable, the other aspect of reducing housing costs is providing housing at lower rents with the same subsidy level. In this regard, the data received by HUD on rents charged to families moving into two-bedroom, Section 236 subsidized units in 1973 and 1974 shows a statistically insignificant difference between HUD developments and state HFA developments (see Table 5).

Slum Rebuilding

The public purpose of rebuilding slums is the most risky goal pursued by the state housing finance agencies and HUD. Private lenders generally have red-lined these areas because they believe that making loans on properties located there is too risky.[1] Two operational definitions of slum areas have been used: those census tracts where in 1970 over 25 percent of the households had incomes that lie below the poverty line and those tracts that are completely surrounded

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[1] See Nathan S. Betnun, "The Role of Savings and Loan Associations in Low-Income Areas of Oakland," (unpublished honors thesis, University of California, Berkeley, 1968), and Tee Taggart, "Red-Lining: How the Bankers Starve the Cities to Feed the Suburbs," Planning, 40 (December, 1974), pp.14-16.

Table 5

Gross Rent for Two-Bedroom Units
For Families In Section 236 Developments for Admissions

	1973		1974	
	Mean	N	Mean	N
Massachusetts				
MHFA	164	255	170	175
HUD	170	380	170	1036
Michigan -Grand Rapids Area				
MSHDA	145	56	147	140
HUD	152	392	149	443
New York - Albany Area				
UDC	150	169	155	110
HUD	149	166	153	334

Source: Compiled from HUD Division of Housing Management, Computer Print-Out of the Gross Rents by Project, R43IACA 15. The data from this source was limited to no more than two state agency projects within the jurisdiction of each of the other HUD area offices in the states considered in this study.

by tracts with such a high incidence of poverty and those neighborhoods that have been declared to be urban renewal areas (including neighborhood development program areas). The poverty census tract definition of slum areas consists primarily of just the neighborhoods that are traditionally regarded as slums.[1] The urban renewal area definition of slum areas represents neighborhoods that have met certain objective criteria for determining blight as well as those inner city areas where new housing will do the most good in terms of eliminating slums since a public commitment has been made to rebuild the entire neighborhood. The urban

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[1] The sections of the New York City area that fall within the poverty tract definition of slums are most of Harlem, East Harlem, the Lower East Side, South Bronx, Bedford-Stuyvesant, Williamsburg, Bushwick, and East New York, along with scattered tracts in such places as South Brooklyn, Coney Island, Arverne, Jamaica, Long Beach, and Yonkers. Included in the Chicago area are most of the West Side and much of the South and Near North Sides, as well as part of Waukegan. The poverty census tracts in the Detroit area are primarily bounded by the arc formed by Grand Boulevard around downtown Detroit, as well as certain tracts just outside this arc, and in parts of Hamtramck, Highland Park, and Pontiac. The poverty tracts in the Boston area are concentrated in Roxbury, North-Dorchester, and the South End, but also are found in small parts of Mattapan, Jamaica Plain, South Boston, East Boston, Charlestown, Cambridge, Lynn, and Salem. The North-east New Jersey poverty areas include large portions of Newark and parts of Jersey City, Paterson, Passaic, Elizabeth, Hoboken, and Union City.

renewal definition of slum areas is also appropriate, because as mentioned previously, the legislation creating the New Jersey HFA makes slum rebuilding an agency goal by simply directing the agency to give priority to development proposals in urban renewal areas. While large amounts of urban renewal funding have gone toward restoring downtown commercial areas, the low and moderate income housing built in urban renewal areas has generally represented genuine slum rebuilding. The urban renewal sites outside of concentrated areas of poverty selected by the HFA's for construction while being somewhat less risky than the worst areas still involve a fair amount of risk.[1]

Overall, the state housing finance agencies have produced almost exactly the same percentage of Section 236 housing in inner city "slum" areas as HUD. As seen in Table 6, of the housing subsidized by Section 236, located

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[1] The sites selected by UDC in this category have been located in the Coney Island, Arverne, and Flatbush sections of New York City, as well as on E. 102nd St. just outside of Harlem and in deteriorating sections of Yonkers. The Illinois agency has built in the Kenwood and Hyde Park sections of Chicago while the Michigan agency has built in the Jefferson-Chalmers and Lafayette Park sections of Detroit. The Massachusetts HFA's urban renewal, non-poverty area housing has gone in the better sections of Roxbury and the South End as well as in the Fenway. The corresponding areas where the New Jersey HFA has located developments have included the downtown and Clinton Hill sections of Newark and blighted portions of East Orange, Union City, and Paterson.

Table 6

Section 236 Construction Starts in Urban Renewal or Poverty Sections of Major Metropolitan Areas [(a)] by Agency, Projects Closed January 1, 1970-December 31, 1973

HUD Area Office	Units in Poverty Tracts[b]	Units in Urban Renewal Areas	Units in Urban Renewal or Poverty Areas	Total Units in Metro Area[a]	State HFA	Units in Poverty Tracts[b]	Units in Urban Renewal Area	Units in Urban Renewal or Poverty Areas	Total Units in Metro Area [a]
Chicago	3768 35.6%	1360 12.8%	4174 39.4%	10599	Ill. HFA	0 0%	1093 42.4%	1093 42.4%	2579
Boston	1571 27.1%	1499 25.9%	1905 32.9%	5787	Mass. HFA	1472 31.6%	418 9.0%	1858 39.9%	4655
Detroit	1632 14.0%	1901 16.3%	3128 26.8%	11660	Mich. SHDA[c]	0 0%	164 9.3%	164 9.3%	1761
Newark	382 18.9%	693 33.4%	958 47.3%	2073[d]	NJ HFA	1175 19.5%	1193 19.8%	2165 36.0%	6017
New York	5864 53.1%	2928 26.5%	7113 64.4%	11038[d]	NY HFA	200 2.1%	200 2.1%	200 2.1%	9517
					NY UDC	5883	7641 47.4%	11232 69.7%	16124
Total	13,217 32.1%	8381 20.4%	17,278 42.0%	41157[d]	Total	8730 21.5%	10709 26.3%	16712 41%	40653

a. Chicago, Boston, and Detroit SMSA's and New York/Northeastern New Jersey Standard Consolidated Area.
b. Census tracts which in 1970 had more than 25% of households with incomes below the poverty line and tracts totally surrounded by tracts with that incidence of poverty.
c. Mich. SHDA figures are for uninsured loans only. The agency also financed 1, 382 units of insured Sec. 236 housing in the Detroit area, of which 215 units are in poverty tracts and another 169 units are in urban renewal areas.
d. Total excludes 68 units in New Jersey and 84 units in New York where address was unknown.

Sources: Poverty tracts based on mapping of all projects; HUD urban renewal figures compiled from HUD "Selected Multifamily Status Reports: Mortgage Insurance Programs," as of December 31, 1973.

in the New York City, Chicago, Detroit, and Boston metropolitan areas, 41.1 percent of the state agency housing and 42.0 percent of the HUD housing has been located in urban renewal areas or in poverty tracts. The HFA's have provided a significantly higher percentage of housing in urban renewal areas, while HUD has provided significantly more housing in census tracts with a high incidence of poverty. The majority of the units financed by all HFA's in both poverty and urban renewal areas, however, have resulted from the efforts of a single agency, the New York State Urban Development Corporation. UDC has located 69.7 percent of its New York City area Section 236 units in these neighborhoods.

Aside from UDC the state agencies as a group have provided only 22 percent of its housing in "slum areas," a considerably lower percentage than HUD. Two HFA's have performed slightly better than their HUD counterparts, one slightly worse, and the other two demonstrably worse. The Massachusetts HFA and the Illinois HFA were the two HFA's other than UDC to do better. MHFA, which located 39.9 percent of its metropolitan Boston Section 236 units in such areas (compared with only 32.9 for HUD's Boston area office) has behaved more like most of the local HUD offices than like the other state agencies in that it has located most of its inner city developments outside of urban renewal areas. The Illinois Housing Development Authority, on the other hand, has placed 42.4 percent of its Chicago area Section 236

units in urban renewal areas, all of which are outside of poverty census tracts. The New Jersey HFA placed about 19 percent of its Northeastern New Jersey moderate income units in urban renewal areas (where it must give priority) and about 19 percent in poverty areas with few going in neighborhoods meeting both criteria. Neither the New York HFA nor the Michigan State Housing Development Authority have financed more than 200 units of uninsured Section 236 housing in either urban renewal or poverty neighborhoods in the major metropolitan area of their respective states. The New York Agency, however, has financed over 1000 units of middle income, Mitchell-Lama housing (27.6 percent of such units) since 1970 in these areas of greater New York City while the Michigan agency has financed 384 units of HUD-insured Section 236 housing (12 percent of its total) and 114 units of uninsured middle income housing in "slum" areas of Detroit.

Accessibility

Three state HFA's, Illinois, Michigan, and New Jersey, each have the goal of providing low and moderate income housing near low and moderate income jobs. Not only does the close proximity of jobs to residence make commuting easier, but also aids a displaced worker in finding a new job. The success of these agencies in meeting this goal for projects they financed in metropolitan areas was tested in a

somewhat gross manner without producing any significant differences from the success achieved by HUD in these states or the success that would result from a random scattering of projects throughout the state.

The procedure was to assign a value to each development based upon the ratio of low and moderate income jobs in the local area to low and moderate income residents in that same area, presumably competing for those same jobs based upon census statistics.[1] Low and moderate income jobs were defined to be all of those jobs falling into occupational classifications having below average earnings, including laborers, farm workers, service workers, operatives, clerical and kindred workers, but excluding managers and administrators (except farm), sales workers, craftsmen, professional, technical, and kindred workers. The local area was defined as the city where the project was located or the county in the case of projects located outside of cities or the cluster of adjoining cities or counties in the case of projects located on a border. The value assigned to each development varied from 1 to 5 with those areas with

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[1] U.S. Bureau of the Census, Journey to Work, Table 2. "Characteristics of Workers by Residence and Place of Work for Standard Metropolitan Areas of 250,000 or More: 1970."

"substantially more" low and moderate income jobs to low and moderate income residents (a ratio 1.25 or higher) receiving a score of 5; those with job to resident ratio of between 1.10 and 1.25 receiving a score of 4; those with a ratio of between 0.9 and 1.1 receiving a score of 2; and those areas with "substantially fewer" jobs than residents (a ratio of .75 or lower) receiving a score of 1. A weight was assigned to each development based upon the dwelling units available for low and moderate income non-elderly families.

As shown in Table 7, the projects of the Illinois and Michigan HFA's have a higher average job to resident ratio than their HUD counterparts and the New Jersey Agency a lower one. As stated above, however, these differences are statistically insignificant.[1] Consequently, at least on the basis of the measures used, no definitive statement can be made about the relative ability of the state housing finance agencies as compared with HUD in providing housing near jobs.

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[1] In some metropolitan areas such as Paterson, N.J., the number of low and moderate income jobs have moved out of the central city faster than have low and moderate income residents, while other center cities, such as Lansing, have a surplus of low and moderate income jobs to residents.

Table 7

Scoring of Projects Financed by Various Agencies
Based Upon Ratio of Low and Moderate Income Jobs
To Low and Moderate Income Residents

Agency	Mean Job: Resident Score	SD	Number of Developments Considered	Number of Low and Moderate Income Units	Difference[1]	Significance of Difference
Illinois Housing Development Authority	2.95	0.22	29	4,517	0.09	$< .4$
HUD - Illinois	2.86	0.47	102	13,762		
Michigan State Housing Development Authority	3.24	1.09	53	5,293	0.38	$< .2$
HUD - Michigan	2.86	1.22	178	20,151		
New Jersey Housing Finance Agency	3.07	0.91	54	8,813	-0.26	$> .5$
HUD - New Jersey	3.33	1.09	69	5,939		

[1]Positive difference indicates HFA has higher mean job : resident score

SEE TEXT FOR EXPLANATION

DESIGN AND CONSTRUCTION

Significant differences, however, were found with regard to quality of design, level of amenities, size of rooms, and to a lesser extent, quality of construction. In each case the HFA's had the better record. As might be expected, however, the provision of these consumer benefits has led to higher average costs for HFA-financed buildings.

Design Quality

The superiority of design of the developments financed by the state agencies is seen through two methods: a survey conducted of residents of developments in Massachusetts and the number of design awards won by each agency. The resident survey was done as part of a general social audit of Massachusetts HFA by an outside research team.[1] It found that 55 percent of the residents of 16 MHFA developments (n = 197) thought that their development was well designed or fairly well designed (as opposed to poorly designed or no opinion) compared with only 39 percent of the residents of the same economic levels living in HUD housing in the

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[1] William Ryan, et al., All in Together: An Evaluation of Mixed-Income Multi-Family Housing (Massachusetts Housing Finance Agency: Boston, 1974), p.229.

same communities (n = 125). This difference was found to be statistically significant.

Likewise, on the basis of the awards criterion, the state agencies have done better than HUD. Here, as with certain other criteria, the inclusion of UDC changes the overall balance somewhat. While the other state agencies have won slightly more awards than their HUD counterparts, UDC has clearly excelled in financing well-designed developments.

In 1974, the American Institute of Architects (AIA) gave a citation to UDC as an organization for its contribution to good design. Eight of its residential developments have won a total of eleven design awards.[1] Its Twin Parks

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[1] Twin Parks Northwest in the Bronx, designed by Prentice and Chan, Olhausen, and Sea Park East in Coney Island, designed by Hoberman and Wasserman, won the Bard Award; Schomburg Plaza in Harlem, designed by Castro-Blanco, Piscioneri & Feder and Gruzen & Partners, won the N.Y. Society of Architects Award for Excellence in Design; and Twin Parks Southwest, also in the Bronx, designed by Giovanni Pasanella won a Design Award from the New York Chapter of AIA. Grasslands Medical Center Housing in Valhalla, designed by Pokorny and Pertz, won design awards from the New York State Association of Architects and the American Plywood Association; Centreville Court in North Syracuse won a House and Home Design Award for the firm Schleicher and Soper; Ocean Village in Queens brought Carl Koch & Associates the 1974 Annual Award of the Concrete Industry Board.

Northeast in the Bronx, designed by Richard Meier and Associates, won a national AIA Honor Award in 1974 as well as the Bard Award of the City Club of New York for Merit and Civic Architecture in Urban Design and an Award for Excellence in Design by the New York Society of Architects in 1973. Two other UDC developments have won the Bard Award while still others have won design awards from the New York Society of Architects, the New York Chapter of AIA, the New York State Association of Architects, the American Plywood Association, the Concrete Industry Board, and *House and Home* magazine. The list of architects who have designed developments for UDC reads like a "Who's Who in Architecture." It includes Paul Rudolph; Sert, Jackson and Associates; Skidmore, Owings, and Merrill; Venturi and Rauch; and Philip Johnson & John Burgee.

A few of UDC's projects, however, have been poorly designed. An architect hired by UDC scored two projects as being "badly planned from almost every point of view, such as livability, economy, and use of site."[1] His comments on certain other projects, including one award winner, were that aesthetic considerations led to excessive costs. Still, UDC projects have generally been extremely well-designed, far better than those of HUD.

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[1] *Report of Task Force on UDC*, Richard L. Dunham (chairman), pp.D.S. 4-D.S. 5.

In Massachusetts, both MHFA and the Boston area office of HUD have had several of their projects win design awards. Three of MHFA's residential developments received commendation for excellence in design from the Boston Society of Architects, while one received an honorable mention from the New England Regional Conference of AIA.[1] _House and Home_ magazine featured Queen Anne's Gate in Weymouth in its April, 1973 issue in an article on excellence in site planning.[2] It made particular note of the way in which the development preserved the natural topography and provided each resident with a view of the woods. Another MHFA development won an _Architectural Record_ "Apartment of the Year Award."[3] It should be pointed out, however, that the second

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[1] Infill Housing, designed and developed by Housing Innovations, Inc., won commendation by the Boston Society of Architects in 1973, while Taurus Apartments (designed by Richard H. Walwood Architect Inc.) and Cleaves Court Apartments (designed by Bastille Neily and George Stephen) won in 1974. All three developments are located in Roxbury. Hill Homes Model Cities Housing, designed by Stull Associates, Inc., was cited by the New England Regional Conference in 1974.

[2] Designed by Claude Miguel Associates.

[3] The honors went to Pietro Belluschi and Jung-Brannen Associates, Inc., the design architects, in association with The Office of Samuel Paul, Architect.

phase of this development which did not receive an award, was insured by HUD and architecturally is virtually indistinguishable from the MHFA section. Also, another Section 236 development insured by the Boston area office of HUD, Village Park, in Amherst, Massachusetts, received an Honor Award in 1972 from the New England Regional Conference of AIA as well as a HUD Honor Award of Merit for aesthetic distinction in nonprofit sponsored housing jointly from the Nonprofit Housing Center, Inc., the American Institute of Planners, and the American Institute of Architects.[1] Two of its other Section 236 projects have received commendation from the Boston Society of Architects while another won a First Honor Award from the New England Regional Conference of AIA.[2]

The Michigan State Housing Development Authority has won more awards for its design procedures than for the design of its developments. The American Society of Landscape Architects gave MSHDA an award for its <u>Townhouse Development Process</u> which sets forth a process and standards to be followed by designers of all aspects of MSHDA develop-

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[1] The architect was Stull Associates, Inc.

[2] The Boston Society of Architects Award winners were First Lowell Rehabiliation, designed by the Boston Architectural Team (1973) and the Leventhal House in Brighton, designed by Sert, Jackson and Associates (1974). The New England Regional Conference winner was Plumley Village East in Worcester, designed by Benjamin Thompson & Assoc. (1974).

ments. The firm of Beckett Jackson Raeder, Inc., which prepared the guidelines, serves as a consultant to MSHDA in reviewing all architectural submissions. MSHDA also won a HUD award for the management approach to design it used on its Edgewood Village development in East Lansing. It involved collaboration with a nonprofit sponsor, the private sector, various governmental bodies, and the broader community. The one MSHDA-financed development that won an award for the substance of its design, New Horizons in Kalamazoo, was an Operation Breakthrough development for which MSHDA only provided a construction loan, while HUD insured the privately-financed permanent mortgage. The award was for "superior large area planning," and was given by HUD itself.[1]

Two other state agencies have financed award-winning developments. The Illinois Housing Development Authority's Harper Square development won the Chicago Beautiful award and the New Jersey HFA's Kingsbury Towers in Trenton won an award from the New Jersey Chapter of AIA. Based upon a review of all the architectural competitions known to the author, Lake Village East in Chicago, which won an honor award from the Chicago chapter of AIA in 1974,[2] was the only

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[1] Designed by the Perkins and Will Partnership.

[2] Designed by Harry Weese and Associates.

other Section 236 development processed through a HUD office in the states being considered to have won an award.

Amenity Level

The level of amenities which most of the HFA's provide in their developments far exceeds the level that HUD provides. HUD-insured dwelling units generally provide ranges and refrigerators, occasionally include garbage disposals, and only rarely provide carpeting, air conditioners or air conditioner sleeves, or swimming pools. Occupancy reports from 107 HUD-insured Section 236 developments in the states of Illinois, Massachusetts, New Jersey, and New York showed the following distribution of amenities with only slight deviation among states:[1]

Refrigerators	98%
Ranges	97%
Garbage Disposals	17%
Carpeting	7%
Air Conditioners	7%
Air Conditioner Sleeves	4%
Swimming Pools	1%
Other Luxuries	0%

The level of amenities provided by the HFA's for low and moderate income residents, particularly by the Massachusetts, Illinois, and Michigan agencies, far exceeds that

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[1] Taken from HUD Form 9801, "Occupancy Report-Multifamily HUD-Insured and Section 202 Housing, as of June 30, 1973," prepared by individual project managers.

in HUD developments. Part of the reason for this difference is the fact that these three agencies have a number of developments which mix low and moderate income families with tenants paying market level rents. Standard in these developments and available to low and moderate income as well as middle income families are such features as air conditioning, garbage disposals, carpeting or other floor covering, balconies on high rise, swimming pools, and community centers which often have day care facilities. In addition, some developments have tennis or squash courts, sauna baths, bicycling trails, shopping arcades, or roof top gardens. While each of these agencies provides fewer amenities in their fully subsidized developments, several MHFA Section 236 developments have swimming pools, day care centers, and other "luxury" amenities. Also, nearly all MSHDA developments and several MHFA developments are barrier-free for handicapped persons. In fact, each of the six HFA's generally have provided more amenities in their fully subsidized developments than has HUD, particularly in the way of community facilities, although few can be considered "luxury" developments.

Room Size

Room size requirements in HFA-financed housing are greater than in HUD-insured developments. As Table 8 shows,

Table 8

Minimum Room Size Requirements
(In Feet)

	Liv. Rm./ Din. Area	Kitchen	1st BR	2nd BR	Total min. regs. for major rooms	Min. BR Dimension	Reported Avg. Size Low Rise	Reported Avg. Size High Rise
Illinois Hsg. Dev't. Auth.	260	60	130	100	550	9'4"	1028	994
Massachusetts Hous. Fin. Ag.	*	*	*	*	*	10'	909	1118
Michigan State Hsg. Dev't. Auth.	240	80	130	110	560	9'	**	**
New Jersey HFA	250	60	150	130	590	10'	**	**
New York HFA/DHCR	245	74	150	130	599	10'	932	880
New York UDC	210	60	138	120	528	9'4"	1101	1169
U.S. Department of HUD	260	60	120	80	520	*	800	800

*No Standard

**Not Reported

Sources: IHDA, Architects Guide, February, 1973, p. 33; Interview with J.O. Chike Enwonwu, MHFA Design and Technical Officer; MSHDA, Townhouse Development Guide, 1970, p. 41; New Jersey HFA "Minimum Design Standards," no date, p. 7; New York DHCR Design Standards and Procedures for Limited Profit and Limited Dividend Housing Projects, p. 15; UDC, Architects Guide for UDC Projects, 1972, Bulletin #2, p.2; FHA Minimum Property Standards, 197, p. ; Reported average sizes for HFA's taken from responses to UDC questionnaire, March 1973; HUD average size taken from HUD Statistical Yearbook, 1972, p. .

nearly every room size standard promulgated by the HFA's equals or exceeds that of HUD with bedroom sizes being particularly larger. All too frequently, minimum standards are also the maximum that architects use. For this reason, MHFA has refused to write any clearly defined standards. Even the one clear standard that it has cited at several public gatherings, namely that the smallest dimension in all of its bedrooms be at least 10 feet, is flexible. Several of the dwelling units in one MHFA development have no clearly defined bedrooms at all.

Given the general adherence to minimum room size standards at most agencies, however, the higher minimum standards of most of the HFA's are translated into larger actual room sizes. Additional evidence on this point comes from reports by the individual agencies on the average gross residential floor area in their dwellings. While the extent of bias in the figures from individual state agencies is unknown, the fact that they consistently exceed the HUD mean indicates that the HFA's as a group are implementing their higher standards.[1]

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[1] The state figures were taken from responses to a UDC questionnaire prepared in a hurry for public relations. Certain other statistical information found in the responses, particularly regarding processing times, was found to be inaccurate.

Construction Quality

The available evidence on the quality of construction of HFA housing compared with HUD housing shows relatively small differences, although contractors on developments of several HFA's are required to provide significantly longer guarantees. The social audit of MHFA-financed housing found based upon resident interviews, that while construction quality was highly correlated with resident satisfaction, no significant difference was found in the perceived quality of construction of their building between residents of MHFA housing and residents of HUD housing, with both groups being generally satisfied.[1]

The Boston Urban Observatory, however, found significant construction problems in moderate income HUD developments in Boston. Its report stated:

> Managers and sponsors frequently pointed out construction defects, and in several developments, these constituted major problems. Widespread deficiencies included leaks in roofs, windows and doors, allowing rain, snow, insects, and rodents to enter (the leaks were especially common in pre-cast concrete buildings), stairways separating from buildings, crumbling bricks, faulty heating systems, and incompleted finish work.[2]

An audit by the U.S. Comptroller General of HUD-insured Section 236 projects in the Atlanta, Dallas, Los Angeles,

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[1] William Ryan, et al., op. cit., p.231.

[2] Boston Urban Observatory, Subsidized Multi-Family Housing in the Boston Metropolitan Area (Boston Urban Observatory: Boston, 1973), p.51.

and New York City areas found that "the quality of housing was good and most housing defects were minor, such as loose bathroom fixtures, small roof leaks, and loose floor tiles."[1] Of the 40 projects and 517 dwelling units it examined, it found serious problems in one development, that being in a New York area project where improperly installed air conditioning ducts made serious water leakage and drafts in apartments possible.

The Dunham Task Force on the New York State Urban Development Corporation examined 10 of the 50 developments UDC had completed at the time, including most of the developments suffering from financial problems. It found one development with construction problems that were severe enough to cause many tenants to move out and minor problems such as sagging closet shelves, leaking roofs, and rusty water.[2] It found, however, that the severe problems and most of the minor problems had been corrected.

Thus, overall, the two reports found little difference between the construction on UDC projects as opposed to HUD projects.

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[1] Comptroller General of the United States, Opportunities to Improve Effectiveness and Reduce Costs of Rental Assistance Housing Programs (GAO: Washington, 1973), B-17163, p.36.

[2] Report of Task Force on UDC, Richard L. Dunham, chairman, Albany, December, 1974, pp.D.1.19-34. (Mimeographed.)

Little difference between the HFA's and HUD also exists with regard to the stringency of construction quality standards. The indicator used to make this determination was noise transmission requirements. Certainly, well-constructed buildings hamper the transmission of most noise from apartment to apartment and room to room. Unlike most other standards of construction quality, sound transmission ratings provide an objective quality measure.

As seen in Table 9, HUD requirements for sound reduction are about the same as those of the state agencies. The Illinois and Massachusetts agencies have explicitly adopted the HUD minimum property standards in this area.

The one indicator of construction quality where the HFA's clearly surpass HUD is the guarantees required from contractors on construction components. While HUD simply requires the one year warranty standard in most multi-family construction contracts, several of the state agencies require extended guarantees on several critical elements (see Table 10). For example, the two New York agencies require long-term guarantees for waterproofing, roofing, refrigeration, and plaster bonding agents. Such guarantees not only require the contractor to absorb any costs related to any replacements that may be required, but also provides him with a strong incentive to do the job in a manner that will endure.

Table 9

Sound Transmission Class (S.T.C.) Requirements
by Agency for Sound Reduction

	Between Apartments				Within Apartments			
	Wall-Wall/ Floor-Ceiling		Bedroom-Other Rooms		Bathroom-Living Room		Bedroom-Other Rooms	
Degree of Background Noise	Low	High	Low	High	Low	High	Low	High
Illinois HDA	50	45	45	40	NR	NR	45	40
Mass. HFA	50	45	45	40	NR	NR	45	40
Mich. SHDA	NI	NI	NI	NI	NI	NI	NI	NI
New Jersey HFA	40*	40*	40*	40*	NR	NR	NR	NR
New York DHCR	45	45	45	45	45	45	NR	NR
New York UDC	NI	NI	NI	NI	NI	NI	NI	NI
HUD	50	45	45	40	NR	NR	45	40

NR = No requirement NI = No information

* Requirement expressed in terms of a sound reduction of at least 40 decibels at an average frequency of 256-1040 decibels, which is a more performance oriented (and thereby likely to be a slightly higher) standard than an S.T.C. rating.

Sources: IHDA, Architect's Guide, p.6; Interview with J.O. Chike Enwonwu, MHFA Chief of Architecture; New Jersey HFA, "Minimum Design Standards," p.5; New York DHCR Design Standards for Limited Profit and Limited Dividend Projects, p.52; HUD, Minimum Property Standards-Multifamily Housing (FHA #2600), 1971, pp.89-90.

Table 10

Required Contractor Guarantees by Agency

	HUD	Ill. HDA	Mass. MHFA	Mich. SHDA	NJ HFA	NY DHCR	NY UDC
General	1	1	1	1	1	1	1
Waterproofing:							
Integral	NR	NR	NR	NR	NR	5	5
Spandral	NR	NR	NR	NR	NR	3	3
Roofing:							
Built-up	NR	10[a]	NR	NR	NR	20	20
Asphalt Shingle	NR	NR	NR	NR	NR	15	NR
Sheet Metal	NR	NR	NR	NR	NR	5	5
Steel Windows	NR	10	NR	NR	NR	NR	NR
Caulking	NR	NR	NR	NR	NR	2	2
Plaster Bonding Agent	NR	NR	NR	NR	NR	5[b]	5[b]
Plastic Piping	5	5	NR	NR	NR	NR	NR
Bi-Fold Doors	NR	NR	NR	NR	NR	2	NR
Refrigeration	NR	NR	NR	NR	NR	5	5
Water Heater	NR	5	NR	NR	NR	NR	NR

NR No Requirement
a 20 year bondable roofing required
b With insurance

Sources: HUD, "Construction Contract" (FHA Form 2442); IHDA; Architect's Guide, 1973, pp. 34-43; Interview with J.O.C. Enwonwu, MHFA Chief of Architecture; MSHDA "General Conditions for the Contract;" N.J. HFA, "Construction Contract Terms." New York DHCR, "The General Conditions of the Contract for the Construction of Buildings" AB-3 (3-70), p. 10.

Project Costs

The higher standards found in HFA developments, in terms of amenities, room size, construction quality, and design, have resulted in as high or higher total development costs than on HUD projects, despite lower financing charges. Every state housing finance agency showed higher total development costs per unit than did each of the local HUD offices in its respective state for developments within the same substate areas. (See Table 11.) The statistical significance of the differences, however, vary. The most significant differences occur in New York, particularly in the New York City area, where development costs generally exceed HUD limits and HUD has been able to build only a relatively small number of units. Here, the cost of new construction financed by both UDC and the New York HFA have exceeded that of HUD by over $11,000 per unit ($p = .001$).[1]

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[1] The finding that UDC and the New York HFA have had virtually identical average total costs within New York City contradicts the "Report of the Task Force on UDC" (Volume 2, pp.D.S.7 - D.S.11) which claimed that UDC's construction costs were $9,500 per unit higher. The discrepancy is reconciled by the fact that this study includes the Starrett City project and several other projects which the UDC Task Force omitted. The Starrett City project contains 5888 dwelling units, half of the total number of units in projects closed by the New York HFA/DHCR during the years 1970-1973. Total development costs on the project are $55,000 per unit. If this project is left out, total development costs per unit of the New York HFA/DHCR projects within the New York City area are only $30,900, slightly less than the $31,600 HUD costs.

Table 11

Average Cost Per Dwelling Unit by Agency
By Local Area Jan 1, 1970 - Dec. 31, 1973

HUD Field Office	Mean	SD	N (Units)	N (Projects)	State HFA	Mean	SD	N (Units)	N (Projects)
Chicago	$19,564	2,630	9,105	55	IHDA Chicago	22,688	3,316	3,643	12
Springfield	18,134	2,599	2,240	25	IHDA Spring-field	19,158	1,349	1,066	6
Boston	24,669	4,119	12,256	67	MHFA	25,321	6,906	15,265	78
Grand Rapids	17,754	1,723	4,206	44	MSHDA Grand Rapids	19,921	2,112	3,524	25
Detroit	20,096	2,731	13,809	103	MSHDA Detroit	20,319	2,100	3,921	21
Camden	16,913	1,872	3,070	27	NJHFA Camden	25,496	3,884	2,504	12
Newark	25,335	8,664	1,203	13	NJHFA Newark	26,485	4,392	7,530	34
Buffalo	22,647	2,852	2,050	12	NYHFA Buffalo	26,654	8,027	1,801	8
Albany	20,690	2,281	3,019	21	NYHFA Albany	27,203	4,720	3,417	19
NYC	27,899	10,865	147,012	773	NYHFA NYC	42,966	12,616	11,790	29
					UDC Buffalo	26,095	3,427	7,916	32
					UDC Albany	25,861	3,041	4,834	28
					UDC NYC	43,323	7,825	20,768	52

Source: HUD, Selected Multifamily Status Reports, as of December 31, 1973; State HFA's annual reports; New York State UDC, "Report of Actual Construction Starts," July, 1974.

Within the jurisdiction of HUD's Albany insuring office, UDC's and DHCR's costs per unit exceed those of HUD by $5,171 (p = .001), and $6,513 (p = .001), respectively; within the Buffalo area, UDC and DHCR exceed HUD's costs by $3,448 and $4,007. The New Jersey HFA has had costs that exceed those of HUD's Camden Insuring Office by $8,600 (p = .001) but are only $1,150 more than those of the Newark area office, a statistically insignificant difference given the number of projects and variability of average costs.

Comparisons between the two state HFA's in the Midwest with their HUD counterparts regarding costs yield mixed results. Illinois Housing Development Authority had significantly higher costs in the Chicago area ($3,123 higher, p = .005), but only insignificantly higher costs in the Springfield area. The Michigan State Housing Development Authority had significantly higher costs than HUD's Grand Rapids Insuring Office ($2,167 higher, p = .001), but virtually identical costs to the Detroit Area Office.

The only state agency to do as well as their HUD counterpart throughout the state was the Massachusetts HFA. Its average cost for new construction was computed to be $652 per unit higher, a statistically insignificant difference.

NATIONAL PUBLIC PURPOSES

The four primary national concerns on which HUD monitors the performance of the state housing finance agencies are: racial integration of developments, the provision of housing for minorities, equal opportunities for employment for minority construction workers and minority-controlled businesses, and protection of the environment. While comparative data is only available for the first of these, each will be discussed in turn.

Racial Integration and Minority Housing

Each of the state housing finance agencies and local HUD offices providing information have produced housing that has a far greater degree of racial integration than is generally found in conventionally financed housing. The state agencies as a group have created somewhat more highly integrated living environments than HUD, while HUD appears to have provided housing for a slightly higher percentage of minority families. These differences, however, are relatively minor. As seen in Table 12, 90.1 percent of the state agency units are contained in integrated developments compared with 84.0 percent of the HUD units; 66.8 percent of the state agency units compared with 63.6 percent of the HUD units are in developments with more than "token integra-

Table 12

Percentage of Minority Occupants
In State Housing Finance Agency Projects and HUD Section 236 Projects

	Total Mnrty.	All White	1-5% Mnrty.	6-15% Mnrty.	16-25% Mnrty.	26-50% Mnrty.	50-74% Mnrty.	75-84% Mnrty.	85-94% Mnrty.	95-99% Mnrty.	All Mnrty.	Total Units
State HFA's												
Ill.	21.9%		7.2%	39.5%	33.3%		20.0%					
HDA	589		194	1062	895		538					2689
Mass.	15.1%	7.9%	42.2%	26.5%	6.1%	8.0%	3.7%	0.2%	1.1%	2.7%	1.4%	
HFA	725	379	2029	1274	295	386	180	9	54	130	68	4804
Mich.	15.6%	11.3%	27.0%	34.5%	11.4%	6.2%	6.9%	2.7%				
SHDA	308	224	534	681	226	122	136	53				1976
NY	41.8%	7.3%	10.1%	15.3%	7.6%	24.5%	12.4%		10.9%	6.8%	5.1%	
UDC	4526	786	1094	1653	824	2656	1344		1178	738	551	10825
HFA TOTAL	30.3%	6.8%	19.0%	23.0%	11.0%	16.0%	10.8%	3.1%	6.1%	4.3%	3.1%	
	6148	1389	3851	4670	2240	3164	2198	62	1232	868	619	20294
HUD												
Ill.	53.0%	1.3%	8.1%	17.7%	10.0%	14.5%	8.1%	3.7%	14.4%	2.1%	20.2%	
HUD	2313	58	353	771	438	633	353	161	627	90	880	4364
Mass.	21.0%	16.0%	25.1%	17.2%	20.2%	9.0%	0.7%	3.3%	7.0%		1.5%	
HUD	447	340	535	366	430	192	15	71	150		31	2130
NJ	51.3%	7.0%	14.9%	7.6%		20.5%	11.0%	8.6%	7.4%	17.6%	5.5%	
HUD	855	117	248	126		341	184	143	123	293	92	1667
NY	47.2%		13.7%	10.7%	8.7%	21.7%	17.4%	1.6%	5.4%	11.2%	9.6%	
HUD	1545		450	350	284	711	568	54	176	365	315	3273
HUD TOTAL	45.1%	4.5%	13.9%	14.1%	10.1%	16.4%	9.8%	3.8%	9.4%	6.5%	11.5%	
	5160	515	1586	1613	1152	1877	1120	429	1076	748	1318	11434

Sources: HUD "Occupancy Report" for individual projects, Form 9801, June 30, 1973. IHDA, "Resident Profile: Integration Comparison," 1974. Mass. HFA, "Semi-Annual Occupancy Report" for individual projects, January, 1974. Mich. SHDA, "Monthly Development Status Report," July, 1973. UDC, "Resident Characteristics of Projects More than 25% Occupied," December 8, 1974

tion," i.e., with at least 5 percent minority and at least 5 percent white occupants. Overall, 30.3 percent of the residents in state agency developments have been members of minority groups, compared with 45.1 percent of the residents of HUD Section 236 developments. This difference, however, is inflated by the fact that many of the state agency developments, particularly in Illinois and Massachusetts, have a large number of middle income units that are occupied primarily by white families.

The best record for integration belongs to the Illinois Housing Development Authority (IHDA). All of their developments contain a mixture of races, with nearly all of them having a substantially higher percentage of minority occupancy than the community as a whole.[1] Only 7.2 percent of their residents live in developments which have what could be considered "token" integration (less than 5 percent of a single race). By contrast, some 21.5 percent of those living in HUD-insured developments in Illinois live in a totally segregated development, and an additional 10.2 percent live in developments having only "token" integration. Because of the fact that it, unlike its HUD counterparts, has constructed no developments that are completely or predominantly occupied by minority families, IHDA has served a far lower percentage of such families.

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[1] IHDA, "IHDA Resident Profile: Integration Comparison," 1974.

The New York State Urban Development Corporation has had a record of racial integration that is quite similar to that of its counterpart local HUD offices. UDC has had a slightly higher percentage of units than HUD in racially segregated developments (12.4 versus 9.6 percent) but a lower percentage in developments with only "token" integration (16.9 compared with 24.9 percent). HUD has served a slightly higher percentage of minority families (47.2 to 41.8 percent).

In Massachusetts, the only other state with comparable figures for both the state agency and the local HUD offices, judgment as to which agency has performed better is a matter of interpretation. Only 9.3 of the residents in the Massachusetts HFA's developments lived in segregated housing (7.9 percent in all-white ones and 1.4 percent in all-minority ones) compared with 17.5 percent of the residents in the Massachusetts HUD developments (16.0 percent in all-white ones, and 1.5 percent in all-minority ones). Integration in state developments in Massachusetts, however, has more frequently been of a "token" nature (44.9 percent versus 25.1 percent for HUD developments) while integration in HUD developments in Massachusetts has more frequently been of what some have called an "imbalanced" nature (11 percent compared with 5 percent for the state developments)

having over 50 percent minority residents.[1] Consequently, HUD has served a somewhat higher percentage of minority families overall (21.0 versus 15.1 percent).

Minority representation has been virtually identical in the HUD-insured and Massachusetts HFA-financed sections of the case-study project discussed later in this chapter. Both sections have a minority representation of 10 percent, while the remainder of the neighborhood has virtually no minority representation. MFHA efforts, however, appear to have been crucial to the integration of both sections. In the rent-up of the MHFA section, the management agent found that the recruitment of minority families appeared to be proceeding "too successfully" and was fearful that the development would no longer be able to attract non-minority families. At MHFA's insistence, the development opened with the inclusion of all the minority applicants as residents. Six months later, the HUD section opened with the same racial composition. Both sections maintain large waiting lists after two years of occupancy.

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[1] The recently repealed Massachusetts Racial Imbalance Act used the term "imbalanced."

Equal Employment Opportunity

With regard to the two equal employment goals, developers and contractors on both HUD-insured and state HFA-financed projects were required to complete forms attesting to their intention to employ workers and businesses in a non-discriminatory manner as well as to comply with local Hometown Plans for hiring minority workers.[1] Beginning in 1972 with the implementation of HUD's Project Selection Criteria, those HUD-insured projects judged to have superior potential for creating minority employment and business opportunities were, other criteria being equal, to be given priority funding.[2]

An evaluation of the differential success of HUD and the state HFA's in achieving equal employment opportunities can be made only through an examination of data relating to the number of jobs and volume of business which minority workers received on projects regulated by each agency. A related criterion not explicitly mandated by enabling legislation but indicative of agency concern in this area is the

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[1] U.S. Department of Housing and Urban Development, "Assurance of Compliance with Department of Housing and Urban Development Regulations under Title VI of the Civil Rights Act of 1964" (HUD Form 41901); "Equal Employment Opportunity Certification (HUD Form 2010), July, 1969.

[2] U.S. Department of Housing and Urban Development, "Evaluation of Requests" (FHA Form No. 3165), criterion 7.

percentage of minority persons employed by the agency itself. While several state HFA's provided the desired information, requests to the HUD Central Office and several area offices produced no comparable information on HUD-insured projects and HUD personnel. The information available on the state-financed projects (Table 13) shows a strong performance by the state agencies.

The agency which has been the most successful in securing minority employment in its projects and on its staff in relation to the minority population of the state, at least on the basis of available information, is the Massachusetts Housing Finance Agency (MHFA). While Massachusetts has a non-white population of only 3.7 percent, 18 percent of the workers on MHFA projects, 9 percent of its contracting firms, 14 percent of its total staff, and 20 percent of its professional staff have been minorities. The Illinois Housing Development Authority and the New York State Urban Development Corporation have provided employment to slightly higher percentages of minority members in certain of these categories, although Illinois and New York each contain a considerably higher percentage of minority residents. The one state agency providing minority employment information which failed to provide significantly greater opportunities for minorities than their composition in the state was the New York State Division of Housing and Community Renewal.

Table 13

Minority Employment by State Agency

	Mass. HFA	New York DHCR	New York UDC	Illinois HDA	Michigan SHDA
Minority residents as a % of total population of state	3.7%	13.2%	13.2%	13.6%	12.8%
Minority % of construction workers on project	18.0%	12.3%	22.4%	25.0%	16.4%
Number of such minority workers	5540	1299.3 (man days)	1078	164	N/A
Total number of such workers	30887	9954.8 (man days)	4809	661	N/A
Contracts let to minority firms as % of all contracts	9.0%	N/A	7.0%	N/A	N/A
Estimated amount of project construction (millions)	$282	$396	$911	$42	N/A
Contracts let to minority firms (millions)	$25	N/A	$64	N/A	N/A
Total number of agency staff	50	368	501	54	156
Number of minorities on staff	7	60	126	14	41
Number of minorities as total % of total staff	14%	16%	25.2%	26%	26%
Number of minority professionals as % of total professional staff	20%	8%	17.0%	15%	37%
Date	3/73	4th quat. 1972	2/28/73	11/72 (job figs.) 1/73 (staff figs.)	fiscal 1974

Source: New York State Urban Development Corporation survey of state agencies, March, 1973; Michigan State Housing Development Authority, Annual Report, 1974, p. 9.

Environmental Protection

Another national concern which has become a goal for housing agencies in the building of public purpose housing is environmental protection. The extent to which the HFA's and HUD have caused their developments to be built in a manner consistent with protecting the environment can only really be determined through an inspection of each development. Such an undertaking would clearly be beyond the scope of this thesis. What has been considered is the approach taken by the various agencies. All state-financed developments receiving HUD subsidy funds have had to undergo as many as four types of environmental reviews: 1) review by their own office; 2) review by the state or city environmental protection agencies; 3) A-95 review; and 4) review by HUD.

The prevailing attitude of state HFA's with regard to environmental protection is to try to find a way to make projects environmentally compatible rather than to reject them for being environmentally unsound or to ignore environmental considerations. William J. White, executive director of the Massachusetts Housing Finance Agency, stated before a New York Law Journal seminar that housing by its nature should be exempt from environmental control. Nonetheless, his agency does compel developers to take substantive steps to protect the environment. For example,

site plans for MHFA developments must be prepared in a manner so as to preserve the maximum number of trees. Where residue from parking lots might pollute nearby streams, MHFA has required oil and gas traps.

State and local environmental agencies are only beginning to become active with regard to housing. Massachusetts and New York are the only states studied with environmental agencies that formally examine HFA developments. Neither state agency has disapproved an HFA financed development as yet, although the New York City Planning Commission, which acts in lieu of the State in New York City, did require the redesign of a proposed Division of Housing and Community Renewal development to reduce the impact of shadows.

Descriptions of all state and Federal multi-family housing developments having 100 units or more must be circulated for comment among a clearinghouse composed of all affected local, state, Federal, and metropolitan agencies in the area pursuant to Office of Management and Budget Circular A-95. While negative feedback on HFA developments has been rare, it has on occasion led to the rejection of developments. One development which the Michigan State Housing Development Authority planned to finance was denied local zoning as the result of negative comments made during the A-95 review process. The HUD Environmental Clearance Worksheet, first appearing in draft

in 1972, asks for the developer to 1) broadly assess the beneficial and adverse physical, social, and aesthetic environmental impact of the project, 2) identify any adverse environmental effects which cannot be avoided should the project be implemented, 3) outline principal alternatives to the proposed project, 4) determine the relationship between the proposed use of the environment and the maintenance of long-run productivity with reference to the commitment of irreversible or irretrievable resources, and 5) identify all known or potential opposition groups and their views. If the project appears to have a significant impact on the environment, then HUD can require a full environmental impact statement. The intent of the entire procedure is more to bring to the surface potential environmental hazards than to provide standards with which to select projects. Thus, HUD objections to HFA developments on the grounds that they would adversely impact the environment have been rare. Even then, the HFA's have been able to convince HUD to reverse itself.

More common has been HUD's rejection of a proposed site because of the adverse effect it would have on its tenants. Specifically, HUD has rejected proposed sites for both HFA and HUD projects on the grounds that they would be too noisy. Sound level meter readings and other noise

measurements are needed to justify project approval.[1] In these instances as well, the HFA's generally have succeeded in having HUD approve the development either through the provision of additional noise attenuation materials or air conditioning. The other HUD environmental standard is contained in Project Selection Criterion number 5. The objectives of this criterion are:

- To provide an attractive and well-planned physical environment;
- To prevent any adverse impact on the environment resulting from construction of the proposed housing;
- To avoid site locations whose environmental conditions would be detrimental to the success of an otherwise sound project.

As with on all of the other Project Selection Criteria, HUD rates each of its own projects as superior, adequate, or poor; as with on all but criteria number two, HFA's must certify to HUD that each of their projects score an "adequate" rating on this criterion. Projects fail on this ground if they:

1) embody poor land use planning _or_ poor architectural treatment; _or_
2) be subject to serious environmental conditions which cannot be corrected; _or_

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[1] HUD Circular 1390.2 pursuant to the Noise Control Act of 1972, P.L. 92-574; 86 Stat. 1234.

3) will substantially or unreasonably disrupt the environment or ecologically valuable or unique natural areas.[1]

Relocation

The final area of such national concern that HUD has imposed requirements on the states is relocation. The Federal Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1972 requires that all persons displaced by public action receive compensation in an amount equal to their moving expenses plus up to $15,000 for a displaced homeowner or up to $4,000 over four years for renters. Homeowners and tenants both receive payments based upon the cost of relocating to a decent, safe, and sanitary home in a neighborhood generally desirable in terms of public services, commercial facilities, and accessibility to the head of the family's place of employment. The HUD Handbook for state HFA's receiving HUD funds makes clear that these requirements apply to state-financed developments, as well as to HUD-insured developments with private financing.

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[1] U.S. Department of Housing and Urban Development, "Evaluation of Requests" (FHA Form No. 3165).

Few state-financed or HUD-insured developments involve relocation except in urban renewal areas. Relocation benefits for those displaced from homes in urban renewal areas come from urban renewal funds; benefits for those displaced outside of urban renewal areas must come from project mortgages. Since the addition of large relocation allowances to project mortgages will usually make the project infeasible, the few non-urban renewal area state-financed or HUD-insured housing developments involving relocation appear to have rarely conformed to the Federal Uniform Relocation Act. The Michigan State Housing Development Authority has simply provided for the payment of moving expenses. The Massachusetts HFA provides tenants displaced from buildings to be rehabilitated with the first right of refusal on the same apartment once rehabilitation is completed. The agency also requires that the developer submit a relocation plan showing that all displacees will receive decent, safe, and sanitary replacement housing.

Rehabilitation and the Housing of Large Families

As discussed in the previous chapter, HUD administratively adopted two risky goals for itself, property rehabilitation and the housing of large families, as the result of vague legislation language. The state agencies have neither adopted them as their own through administrative

proclamation nor have been required to accept them through HUD requirements. Consequently, as might be expected, HUD has both produced a higher percentage of rehabilitated units and has housed a higher percentage of large families. While the differences have been slight with regard to the housing of large families, they have been great with regard to rehabilitation.

The risk inherent in rehabilitation stems partially from the fact that the process frequently occurs in older, declining neighborhoods and partially from the impossibility of estimating its cost until workmen have removed walls and ceilings to expose the degree to which systems need replacement. Its social value results from the fact that it better preserves the existing character of a neighborhood and it generally costs less than new construction; however it fails to provide as great an uplift to the neighborhood and has a shorter useful life.

Quite apart from these competing claims, as Table 14 clearly shows, HUD has assumed the risks of rehabilitation far more frequently than have the HFA's, with 18.4 percent of HUD's Section 236 units having been rehabilitated compared with only 5.4 percent of the HFA's. The only state agency to come close to matching its local HUD counterpart in terms of the percentage or number of rehabilitated units has been the Massachusetts Housing Finance Agency

Table 14

Percentage of State Agency Units and HUD

Section 236 Units Rehabilitated - Construction

Beginning Between January 1, 1970 and December 31, 1973

	Total Number Rehabilitation Units	Total Number Units	Rehabilitation Percentage
Illinois Hsg. Dev't. Auth.	0	6,782	0
HUD Illinois	2,417	13,762	17.6%
Massachusetts HFA	2,194	17,459	12.6%
HUD Massachusetts	2,509	14,210	17.7%
Michigan State Hst. Dev't. Auth.	71	6,553	1.1%
HUD Michigan	2,136	20,151	10.6%
New Jersey HFA	703	10,269	6.8%
HUD New Jersey	1,666	5,939	28.1%
New York HFA/DHCR	1,463	17,936	8.2%
New York UDC	569	33,037	1.7%
HUD New York	4,456	17,421	25.6%
All HFA's (6 agencies)	5,000	92,036	5.4%
All HUD's (5 States)	13,184	71,483	18.4%

Sources: State HFA Annual Reports and Internal Documents; HUD, Selected Multi-Family Status Reports: Mortgage Insurance Programs, as of December 31, 1973, RR 02 Series.

which has included 2194 (12.6 percent) rehabilitated units in its total production. MHFA has avoided one major risk often attendant to rehabilitation, that of uncertainty as to the scope of the required work, by requiring that all of the rehabilitation it financed be of a gut nature such that all of the non-structural portions of the building be replaced. Still, the incidence of significant arrearages has been over twice as great on MHFA's rehabilitated projects as on its new ones.

The provision of housing for large families involves the risk that the children will destroy the property as well as a greater risk that the community will reject the development. Because of these risks, private developers using conventional financing have often neglected the needs of large families. As Table 15 shows, 21.1 percent of HUD's Section 236 units have three or more bedrooms compared with 18.7 percent of the HFA's. HUD units have had an average of 1.89 bedrooms versus 1.66 for those of the state agencies. Since all of the agencies being considered have similar policies to limit the number of bedrooms allowed to a family of a given size, the fact that HUD has provided a slightly larger share of dwelling units with multiple bedrooms means that they have provided housing for a slightly higher proportion of children than have the HFA's. The agency that has produced the highest

Table 15

Number of Bedrooms Per

Section 236 Dwelling Unit by Agency

	Mean # of Bedrooms	Percentage of Units With 3 or More Bed-Rooms	Number of Units in Sample
Illinois Housing Development Authority	2.00	27.4%	2,433
HUD - Illinois	1.93	26.9%	4,653
Massachusetts HFA	1.72	14.5%	12,586
HUD - Massachusetts	1.70	18.5%	3,270
Michigan State Hsg. Devt. Auth.	1.80	22.3%	11,000
HUD - Michigan	N/A	N/A	0
New Jersey HFA	1.39	13.7%	7,199
HUD - New Jersey	1.95	22.3%	1,966
New York HFA/DHCR	1.47	16.6%	14,117
New York UDC	1.72	20.5%	30,434
HUD - New York	1.95	25.8%	4,035
All HFA's (6 agencies)	1.66	18.7%	77,769
All HUD (4 states)	1.89	21.1%	15,801

Sources: HUD figures based upon HUD Form 9801, "Occupancy Report: Multi-family HUD/Insured and Section 202 Housing as of June 30, 1973" for each project. State figures based upon aggregate information supplied by each agency in New York State Urban Development Corporation survey of state HFA's, March, 1973.

percentage of children-oriented units, even higher than any HUD office, however, has been the Illinois Housing Development Authority which provided three bedrooms or more in over 27 percent of its Section 236 units.

LOCAL PUBLIC PURPOSES

State agency statutes and administrative proclamations have identified certain local public purposes. Among these are the mixing of socioeconomic groups within the same development, the provision of elderly housing, and the promotion of cooperative ownership. While HUD shared none of these goals in its implementation of the Section 236 program, it has adopted each of them in other programs. As will be seen through an examination of each of them individually, the HFA's possessing these goals have generally done a better job than HUD in fulfilling them.

Income Mixing

While only two state agencies have had extensive experience in mixing low income families with middle income families, the state housing finance agencies have clearly produced far more units with varying types of income mixtures than HUD or any other financing vehicle. While the Massachusetts HFA has had the most experience in providing

housing for a broad range of income levels within the same building, the New York State Division of Housing and Community Renewal was the first to accomplish this goal. Its Capital Grant Program, which was begun in 1964, has provided housing for 1,382 low income families in HFA-financed middle income developments. Funding cutbacks, however, have limited the number of Capital Grant tenants living in developments constructed after 1970 to only 134. The Capital Grant Program operates in a manner similar to the Federal leased housing program, in that the State leases the apartment from the owner and subleases it to the tenant. The Capital Grant goes to the State HFA to reduce debt service. The Division of Housing and Community Renewal has selected tenants for the program who are "the cream of the poor, the most middle class of the lower class, the ones with the least distance between themselves and the middle-income group."[1] Generally, Capital Grant tenants have comprised less than 20 percent of all residents of each development. Despite its success with the State program in terms of uplifting low income families from slum housing and absorbing them into middle income developments

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[1] Fred Powledge, New York State's Capital Grant Program, Citizens' Housing and Planning Council of New York, Inc., 1969, p.24.

without resentment from other residents,[1] DHCR has used the Federal subsidies available to it for the purpose of housing low income families in a middle income setting in only one development.

The agency that has clearly been the most active in promoting mixed income housing over a broad range of income levels has been the Massachusetts Housing Finance Agency. By the end of 1973, MHFA had financed over 10,000 dwelling units in developments containing both a minimum of 25 percent of residents with incomes sufficiently low to qualify for public housing ($3,000 - $5,000) and a minimum of 25 percent of middle class residents with incomes sufficiently high to afford market rents ($10,000 - $25,000). A social audit of sixteen of MHFA's early developments conducted by a team of independent social scientists found that:

> Broad income mix "works" in these MHFA developments, producing higher levels of satisfaction at all levels -- market, moderate income, and low income, principally because these developments are superior in design, construction and management. . . . Income mix as such does not seem to be an important determinant of satisfaction and dissatisfaction.[2]

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[1] Ibid.

[2] William Ryan et al., All in Together: An Evaluation of Mixed-Income Multi-Family Housing, MHFA, January 24, 1974, p.24. Some but not all of the developments in this study had elderly households making up the low income population. The conclusions of the study team appear to hold true for the developments in the sample with younger families equally as well. MHFA's more recent developments have relatively

Just as important from the present standpoint is that this finding contradicts all of the conventional wisdom concerning the impact of income mixing. Two years prior to the publication of the MHFA Social Audit, the Social Science Panel of the Advisory Committee to HUD reported:

> There is no evidence from field studies that socioeconomic mixing is feasible. The trend in the movements of urban population is toward increasing separation of socioeconomic categories.[1]

Still, MHFA was able to make it work, despite the risks in going against this wisdom.

The other state agencies and HUD have only been able to achieve income mixing over a relatively narrow range of income levels, except in a few scattered projects. HUD has been providing Rent Supplements to low income families to enable them to comprise approximately 12.7 percent of the residents in each of its Section 236 moderate income developments. (See Table 4.) Certain of the state agencies including the Michigan State Housing Development Authority, the New York Urban Development Corporation, and the New

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few elderly households. The mean number of bedrooms per occupied low income unit in projects with a three level mixture was 1.5 compared with a mean of 1.6 for middle income units in the same projects. (Based upon "MHFA Semi-Annual Occupancy Report" for each project, January 1974.)

[1] Advisory Committee to the Department of Housing and Urban Development, Social Science Panel (Amos H. Hawley, Chairman), Freedom of Choice in Housing: Opportunities and Constraints (Washington, D.C.: National Academy of Sciences, National Academy of Engineering, 1972), p.36.

Jersey Housing Finance Agency, have followed similar practices. (See Table 16.) MSHDA's experience in housing families receiving low income rent supplements in the same development as those receiving no direct subsidy has been limited to the housing of only one low income family. UDC has provided homes for 152 low income families in 5 of its otherwise middle and moderate income developments. The proportion of low income residents in each of these developments with a three level mix, however, has generally been only about five percent. In a few other projects, both MSHDA and UDC have mixed just moderate and middle income residents in suburban areas without low income residents.

This form of mixing has characterized the majority of developments financed by the Illinois Housing Development Authority. While it does require a limited amount of risk and does provide benefits to some moderate income families, this form of economic integration does little to address the real problem referred to by the Illinois Legislature in creating IHDA when it declared one of its purposes to be to encourage the building of housing which will "help prevent the recurrence of slum conditions and assist in their permanent elimination by housing persons of varied economic means within the same structure and neighborhoods."[1]

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[1] L. 1967, p.1931.

Table 16

Total Number of Dwelling Units with Varying Income Level Mixtures[1] by Agency on Projects Closed January 1, 1970-December 31, 1973

	Ill. HDA	Mass. HFA	Mich. SHDA[2]	NJ HFA[3]	NY HFA[4]	NY UDC
Single Level						
100% Low Income[1]	0	451	0	0	0	993
100% Moderate[1]	1762	0	1552	2089	7582	264
100% Middle[1]	0	0	184	1641	4214	1929
Two Levels						
1-10% Low: 90-99% Mod.	120	0	816	1585	3533	9043
11-24% Low: 76-89% Mod.	390	0	3069	3580	1402	4382
25-33% Low: 67-75% Mod.	0	4629	549	203	188	5607
34-50% Low: 50-66% Mod.	0	1868	703	270	120	7671
51-99% Low: 1-49% Mod.	0	307	0	0	242	75
1-49% Mod: 50-99% Middle	2452	0	1242	0	0	0
51-99% Mod.: 1-49% Middle	1736	0	0	0	0	178
Three Levels						
25-40% Low: 0-68% Mod.: 17-24% Middle	0	184	0	0	0	0
25-40% Low: 0-50% Mod.: 25-50% Middle	0	10017	0	0	0	0
1-20% Low: 0-75% Mod.: 25-95% Middle	322	0	200	0	305	3076
Total Dwelling Units	6782	17456	8314	9368	17586	33218
Number of Low Income Households in Developments with 3 level mix	64	2521	1	0	30	152

1. Low income as used here means households receiving rent supplements Section 23 leased housing or equivalent state subsidies, and thereby having an income of under about $5000; moderate income means households subsidized by Section 236 or equivalent state program without further direct subsidy thereby having an income of about $5,000 - $10,000; middle income means households receiving no direct subsidy and thereby having an income in excess of about $10,000.

2. Michigan total includes 2240 units insured by HUD but permanently financed by MSHDA. Included are 571 units in all moderate developments and 283 lows and 1386 moderates in developments with two level mix.

3. Prior to 1970, the New Jersey HFA closed projects having a total of 2132 dwelling units of which 1043 were in all middle income developments and the remainder were in developments with a two level mix and were divided 207 as low income and 882 moderate.

4. Prior to 1970 the New York HFA closed one 303 unit, all moderate income project, and 43,450 units of primarily middle income housing containing 1382 low income Capital Grant recipients constituting no more than 20 percent of any single project.

One of IHDA's most recently completed developments, Jackson Park Terrace in Chicago, does provide a three level mix. Despite the fact that sufficient Section 236 and rent supplement funding had been allocated to allow the entire development to be rented to low and moderate income families, over 25 percent of the tenants will be paying market level rents. Through this mechanism IHDA has achieved economic integration without incurring the risk that the market level units will experience rent-up difficulties.

Elderly Housing

The four state agencies whose enabling legislation has cited the need for housing for the elderly have clearly outperformed their counterpart HUD area offices in this regard. A total of 33.8 percent of all the housing financed by the New York HFA in 1970-73 and 19.0 percent of that financed by the New York UDC was specially designed for elderly occupancy compared with only 10.1 percent of the Section 236 housing insured by HUD in the same state. (See Table 17.) Similarly, the Michigan state agency outproduced its HUD counterparts in this regard (27.7 to 16.6 percent), while the Massachusetts HFA produced a higher percentage of housing for the elderly than HUD in that state (15.7 percent compared with 12.4 percent).

Table 17

Number of Elderly Dwelling Units
With Construction Beginning
1970 - 1973 by Agency

	Total Number of Elderly Units*	Total Number of Units*	Elderly Percentage
Illinois Hsg. Dev't. Auth.	747	6,782	11.0%
HUD - Illinois	2,173	13,762	15.8%
Massachusetts HFA	2,733	17,459	15.7%
HUD - Massachusetts	1,762	14,210	12.4%
Michigan St. Hsg. Dev't Auth.	1,817	6,553	27.7%
HUD - Michigan	3,354	20,151	16.6%
New Jersey HFA	4,185	10,269	40.8%
HUD - New Jersey	613	5,939	10.3%
New York HFA/DHCR	6,063	17,936	33.8%
New York UDC	6,290	33,037	19.0%
HUD - New York	1,751	17,421	10.1%
All HFA's (6 Agencies)	21,835	92,036	23.7%
All HUD (5 states)	9,653	71,483	13.5%

*HUD unit counts include Section 236 units only

Sources: Information provided to author by individual state agencies and HUD RR: 02, Multifamily Status Reports, as of December 31, 1969, and as of December 31,1973.

Including those state agencies that do not have the production of elderly housing as a legislatively-determined goal, the state HFA's have devoted 23.7 percent of their total production to the elderly compared with 13.5 percent of HUD's Section 236 totals in the same states. Because of the relatively low risks associated with elderly housing, however, this record has not been difficult to achieve.

Cooperative Ownership

The other local public purpose being used as a criterion for agency success, cooperative ownership, is undoubtedly the least important. It was also the one local public purpose that HUD satisfied to as high a degree as the state agencies. The one piece of state agency legislation that mentions it is the New York Private Housing Finance Law which makes the goal applicable to both the HFA and UDC.

The volume of cooperative housing financed by the New York State Housing Finance Agency has not been appreciably different from that insured by HUD in the same state, although UDC has provided only a handful of such units. Since the start of its operations in 1960, the New York HFA has financed 33,717 units of cooperative housing, including the 15,000 unit Coop-City development.[1] Of the total, only

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[1] Compiled from New York State Division of Housing and Community Renewal, Statistical Summary of Programs, pp.71-121.

454 units were financed between 1970 and 1973 and none received Section 236 subsidies. By comparison, HUD has insured 31,935 units of Section 213 middle income cooperative housing all before 1970 and an additional 1027 units of Section 236 moderate income cooperatively-owned housing after 1970.[1] Only 378 of UDC's 33,000 total units have cooperative ownership.

FINANCIAL SOLVENCY

As has been seen thus far the state agencies have generally fulfilled their public purposes as least as well as the state agencies. Where their relative effectiveness is most clear, however, is regarding their financial solvency. This difference in performance will be seen in three ways: by comparing their balance sheets, by comparing their percentage of projects with significant arrearages, and by comparing their rate of vacancies.

Analysis of Financial Statements

The relative success of most of the state housing finance agencies compared with HUD in dealing with risk

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[1] 1971 HUD Statistical Yearbook, Table 175, and HUD, Selected Multifamily Status Reports: Mortgage Insurance Programs, 02 Series, December 31, 1973.

becomes apparent by examining their financial statements. Unlike the Section 236 component of HUD's balance sheet, each of the state HFA's has a surplus of assets over liabilities and with the exception of the New York State Urban Development Corporation, each still has a surplus after deducting state appropriations and reserves for projected losses. Nationwide, HUD's Special Risk Insurance Fund, of which the Section 236 program is a part, showed a deficit of over $660 million on June 30, 1974. (See Table 18.) While most of these losses were concentrated in HUD's Section 235 and 223(e) single-family programs, the Section 236 component showed a loss of $105 million. The primary reason for this deficit is the large anticipated loss on foreclosed properties and mortgage notes acquired in lieu of foreclosure. Nationally, HUD income on Section 236 mortgage loans has exceeded salaries and operating expenses by about $20 million. HUD, however, has had to satisfy claims from mortgagees holding delinquent mortgages totaling $ 234 million. While HUD now holds the mortgage on or owns these properties, based on past experience it anticipates that it will be able to sell them for only about $109 million, thereby losing $125 million.[1]

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[1] HUD Office of Finance and Accounting, Financial Statements, June 30, 1974, pp. 116, 121.

Table 18

Special Risk Insurance Fund
Statement of Income and Expenses and
Changes in Insurance Reserves and Borrowings
August 1, 1968 to June 30, 1973 and June 30, 1974
(in 1000's)

	Total Fund		Section 236 Component	
	1973	1974	1973	1974
Income				
Fees	$ 53,498	$ 57,552	$ 49,148	$ 52,997
Insurance Premiums	141,812	213,054	53,255	83,821
Other Income	2,411	1,640	0	3
Total	197,721	272,246	102,403	136,821
Expense				
Salaries & expenses	120,233	183,755	62,404	98,976
Interest on borrowings	40,828	100,764	5,572	16,034
Loss on acquired securities	91,968	220,843	-	1,982
Other expenses	8,615	9,852	1	-
Total	261,644	515,214	67,977	116,992
Income or loss (-)	-63,923	-242,968	34,426	19,829
Provision for valuation allowance for estimated future losses on acquired property & notes	-289,873	-448,402	- 65,101	-125,387
Insurance reserve or deficit (-)	-353,796	-661,370	- 30,674	-105,558
Net borrowings from U.S. Treasury	810,000	1,155,000	70,220*	184,338*
Total Reserves & Borrowings	$456,204	$493,630	$ 39,550*	$ 78,780*

*Section 236 component of net borrowings from U.S. Treasury based upon proportion of section 236 deficits to total fund deficits

Source: HUD Office of Finance and Accounting, Financial Statements, 1973, pp. 114-115 and 1974, pp. 115-116.

The loss that would be attributable to projects insured by HUD in the states with active housing finance agencies would be greater than their proportional share of all Section 236 mortgage insurance written by HUD. While the HUD offices in the states of Illinois, Massachusetts, Michigan, New Jersey, and New York had insured a combined total of 18 percent of all Section 236 units,[1] their projects represented 28 percent of all assignments and foreclosures.[2] Only New York had a lower rate than the national average. Assuming that the HUD offices in the five states with advanced HFA's have had income from fees and insurance premiums and expenses from salaries and operations in proportion to the number of Section 236 units they have produced and will incur losses on acquired securities and related borrowings in relation to the number of units acquired by assignment or foreclosure, then they would have had an aggregate insurance deficit for their Section 236 operations of about $13 million in 1973 ($33 million in 1974).

While Congress had authorized the appropriation of whatever funds are necessary to meet deficits in the Special

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[1] HUD, Selected Multifamily Status Reports: Mortgage Insurance Programs, (0-2 Series), December 31, 1973.

[2] Ibid., June 30, 1974.

Risk Insurance Fund, HUD, thus far, has met its obligations by borrowing from the U.S. Treasury. As of June 30, 1973, it had borrowed a total of $810 million to meet past and future insurance claims, of which approximately $70 million could be considered the share required by the Section 236 program. Undoubtedly, these large borrowings plus the strong likelihood that they would never be fully repaid except through direct appropriations were in part responsible for the suspension and virtual termination of all the programs constituting the Fund.

As seen by their positive fund balance in Table 19, each of the HFA's have assets in excess of their liabilities. In arriving at these balances, accountants for each of the HFA's have deducted reserves for potential loan losses and have included losses on seed money loans and direct development activities in addition to mortgage lending. While the New York State Urban Development Corporation has required state grants to keep it in the black, the positive balance income generated by other HFA's allows a combined balance sheet for all of the state agencies examined at the close of their individual 1974 fiscal years to show a substantial surplus exclusive of state aid.

UDC's balance sheet, as of October 31, 1974, the close of its fiscal year, showed a positive fund balance of

Table 19

Fund Balances, State Appropriations, and Project Losses
(All dollar figures in 1000's)

	Illinois HDA	Massachusetts HFA	Michigan SHDA	New Jersey HFA[a]	New York HFA[b]	New York UDC
Total Notes and Bonds Outstanding at end of FY 1974	$202,150	$485,070	$308,431	$297,384	$1,496,402	$1,147,835
Fund balances at end of FY 1974[c]	9,056	7,777	12,960	8,673	27,455	787
Fund balance available for Mortgage Programs	8,694	7,777	6,815	8,673	27,455	787
Balance over Outstanding Notes and Bonds	4.3%	1.6%	2.2%	2.9%	1.8%	0.1%
Total Net State Appropriations & Imputed Interest Through End of FY 1974	6,190	0	7,797	718	15,000[d]	27,606
Fund Balances Net of Appropriations	2,504	7,777	5,163	7,955	12,455	-26,819
Cumulative Project Losses Included in Fund Balances	572[e]	0	0	1,353	0	11,000
Project Loss Reserves Included in Fund Balances	300[e]	2,400	2,267[f]	3,999	0	25,850

a New Jersey figures are all FY 1973.
b Includes General Housing, Non-Profit, and Urban Rental Housing programs only.
c Excludes Capital Reserve Fund balances created with bond proceeds.
d Total state appropriations to New York State Division of Housing and Community Renewal for administrative expenses related to limited profit housing programs has been about $22,000,000 from 1961-1973 with interest imputed at 5% per year. The $15,000,000 represents the amount going toward HFA housing rather than DHCR housing financed with State Loan funds.
e Housing Development Loan (seed money) losses.
f $167,000 in Housing Development Loan (seed money) losses.

Source: 1974 Annual Reports from each agency.

$787,000.[1] To enable UDC to have this balance required regular fund appropriations from the State totalling $27.6 million, as well as interest-free first instance advances of $55 million.[2] The state-designated purposes for the regular fund appropriations were: $7,310,000 for start-up; $11,189,000 for risky and non-revenue producing projects; $6,300,000 for operating expenses to maintain a pipeline of projects during the Federal moratorium on housing subsidies; and $2,807,000 for reimbursement for costs incurred on projects UDC had to abandon in Westchester County and elsewhere as the result of limitations placed on the use of its zoning override power.[3] (See Table 20.) While only the last category clearly allocates UDC's regular fund appropriations to functions performed in its role as a developer rather than in the residential mortgage lender role it shares with the other state HFA's, the major

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[1] S.D. Leidesdorf & Co., "Consolidated Statements of Assets, Liabilities, and Fund Balance," in UDC Annual Report, 1974. In its cover letter transmitting these statements (dated January 30, 1975), however, the accountant refused to give an opinion on them. It cited uncertainties related primarily to UDC's ability to obtain financing to complete its on-going projects and resultant non-recoverability of deferred costs (p.65).

[2] Ibid. 1970, 1971, 1972, and 1974. By May 1975, it had provided another $200 million to be lent to UDC through the newly created Project Finance Agency.

[3] Ibid.

Table 20

New York State Urban Development Corporation
Loss Reserves and Provisions for Loss at October 31, 1974

	Mortgage Loans	Abandoned Developments	Commercial Leases	Total
Loss Reserves	$18,150,000	$ 5,650,000	$2,050,000	$25,850,000
Cumulative Loss	0	10,300,000	700,000	11,000,000
Total	$18,150,000	$15,950,000	$2,750,000	$36,850,000

Source: S.D. Leidsdorf & Co. "Consolidated Statements of Assets, Liabilities, and Fund Balances," in UDC Annual Report, 1970-1974.

portion of UDC's need for such appropriations has resulted from losses incurred in its role as a developer or as a commercial mortgage lender. As seen in Table 20, through October 31, 1974, cumulative losses and loss reserves on projects abandoned or likely to be abandoned by UDC because of their infeasibility or social undesirability totaled $15,950,000. Losses and reserves on commercial projects, as the result of the bankruptcy of the lessee or other problems, have amounted to $2,550,000. Together, these two categories have represented a majority of all of UDC's losses.

To protect itself against possible losses sustained in its residential mortgage lending role, UDC has provided a reserve fund of $18,150,000. While all of these moneys were still being held in reserve at the close of UDC's 1974 fiscal year, UDC projected that its 62 occupied or partially-occupied projects would suffer a combined total of $3,250,000 in initial deficits in excess of the working capital provided in their respective mortgages.[1] Through staggered rent increases over the first few years of occupancy, UDC expected to make each of its developments self-sustaining. The first round of these increases in 1974 was successful in that despite the increases, occupancy percentages in the problem developments continued to increase

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[1] Ibid., p.78.

through all of 1974.[1]

UDC's potentially most severe problem, however, is its Roosevelt Island development in the East River off Manhattan. UDC expects to finance $350 million of the development's total projected $400 million cost, and has allocated $6 million as a reserve for potential losses. UDC's accountants cautioned, however:

> A worsening of the general economic conditions or other factors may alter marketing plans from those inherent in the projections made by the Corporation. The projections are based on the assumption that there will be rent up periods of from twelve to eighteen months at an average monthly rental or carrying charge ranging from $115 to $150 per room. . . . Because of all of the foregoing, the Corporation is unable to evaluate the adequacy of this reserve, and may continue to be unable to do so until after the projects have reached substantial occupancy.[2]

UDC's provision of $8.9 million in reserve for mortgage losses in addition to its projected losses, however, indicates a reasonably conservative accounting standard.

The agency that is able to show the highest ratio of available fund balances to outstanding debt is the Illinois Housing Development Authority. Much of its reserves, however, have resulted from state appropriations. The

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[1] See Report of the Task Force on UDC, p.D.1.35. Also, c.f. UDC, "Management Status Report" as of September 30, 1974, and as of December 31, 1974.

[2] S.D. Leidesdorf & Co., op. cit., p.76.

State of Illinois provided IHDA with over $5 million in appropriations for its Housing Development Revolving Fund, the primary purpose of which was to provide seed money loans to nonprofit sponsors.[1] IHDA, however, has been able to utilize this fund to pay staff salaries and, beginning in 1974, co-mingle it with what had been its "Mortgage Loan Funds."[2] Nonetheless, despite having to provide for $872,000 in losses on seed money loans, IHDA was able to generate a surplus of over $2,500,000 in its own behalf.

The Massachusetts HFA has been even more successful in producing profits on its own behalf. Without having received any administrative appropriation from the State, except for a $400,000 start-up loan which it repaid ahead of its date of maturity, MHFA has been able to generate a fund balance of $7,777,000. In addition, it has provided a "contingency reserve for potential loan losses" of $1,300,000 (which it actually lists as a fund balance) and an allowance for potential construction loan losses of $1,350,000.

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[1] In addition, IHDA received $1,945,000 to purchase land (most of which it returned to the State); $646,000 for grants to community groups; and $800,000 with which it established a reserve on a particular project.

[2] See Arthur Andersen & Co., "Statement of Assets and Liabilities," in IHDA _Annual Report_, 1973 and 1974.

Another state agency to have done well financially is the Michigan State Housing Development Authority. While over half of MSHDA's available fund balance has resulted from state appropriations, MSHDA has produced a surplus of about $5 million through operations alone. In addition, it has systematically set aside a reserve of $2.1 million for mortgage losses and another $167,000 for seed money loans.

The New York State Housing Finance Agency has elected to reduce mortgage balances and fees rather than to build up extremely large reserves. While its over $27 million in reserves are extensive, they represent only 1.8 percent of the agency's $1.5 billion outstanding in housing bonds and bond anticipation notes issued over a period of 12 years, and represent only a fraction of what they might have been had the agency had profit-making as its primary goal. Between 1970 and 1974, the New York HFA distributed to housing program mortgagors a total of $52.8 million from earnings on investments.[1] Since these distributions

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[1] Ernst & Ernst, "Financial Statements and Statistical Material," New York HFA, Annual Report, 1970, 1971, 1972, 1973, 1974. This use of agency profits to subsidize projects is similar to certain of the many creative suggestions made by Peter R. Morris in his book, State Housing Finance Agencies (D.C. Heath: Lexington, Mass., 1974) for agencies to create their own subsidies. Rather than use surpluses in particular projects to reduce rents for all tenants in the same development, Morris would have these profits go toward helping tenants who are most in need of assistance, regardless of in which project they live.

were applied to just the $628 million in mortgage loans written during the period, they represented the equivalent of an 8.4 percent reduction in the amount of these mortgages.

In addition, the New York HFA charges the lowest fees of any of the HFA's. It requires 0.3 percent of the mortgage at closing compared with between 1.0 and 6.0 percent for the others. (See Table 21.) Its 0.3 percent annual fee over the life of the mortgage, even when added to the $4.20 per room supervisory fee collected by the New York State Division of Housing (the equivalent of about another 0.07 percent of the mortgage), is less than all but one of the other HFA's. A major reason why the New York HFA and DHCR have been able to charge such low fees and still make such large distributions to mortgagors has been the operating subsidies that DHCR has received from the State. During the years of 1961 through 1974, the State paid for about $15,000,000 (including imputed interest) worth of services by DHCR on HFA-financed developments.[1]

Financially, the New Jersey Housing Finance Agency was one of the strongest HFA's in 1973 (with 1974 figures as yet unavailable). Its available fund balances of $8.6 million constituted 2.92 percent of its then outstanding

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[1] See Table 25, footnote C.

Table 21

Agency Fees

	At or Pre-Initial Closing	Construction Loan/Year	Annual
Illinois HDA	1.50%	0.50%	0.50%
Massachusetts HFA	1.00% + $500	0.50%	0.50%
Michigan SHDA	3.50%	0.50%	0.50%
New Jersey HFA	2.50%	0.50%	0.25%
New York DHCR/HFA	0.30%	0.30%	0.30% + $4.20/room
New York UDC	6.00%	0.50%	1.00% + $6.00/room
HUD	4.55%[a]	0.50%	0.50%

a. Includes 2 percent financing fee and 1.75 percent FNMA/GNMA fee.

Sources: IHDA, Developer's Handbook; MHFA, "Operation Handbook;" MSHDA, Townhouse Development Process Manual; New Jersey HFA, Guide for Development of Limited Dividend and Nonprofit Housing; New York HFA, Interview with Edward Bopp; New York UDC, "Schedule A;" HUD, Form 2013.

notes and bonds. Only a small part of the New Jersey agency's favorable balance has resulted from state support, with $442,000 coming from grants by the State Department of Community Affairs for administering its seed money fund and $296,000 coming from interest received on deposits of Housing Assistance Bond proceeds. A total of $128,000 of this interest went to aid sponsors in meeting debt service payments.[1]

The other substantial loss incurred by the New Jersey HFA came as the result of its having to terminate one of its unsubsidized mortgages and was absorbed by reserves created from its profits. In the rent-up of one of its early developments, the Madison House in Atlantic City, the New Jersey HFA realized that continued operation of the project would result in further deficiencies in meeting debt service requirements. This 189 dwelling unit rehabilitation development for the elderly had been saddled with the cost of special services, comparable to those found in nursing homes, which had to be met by rents. Rather than provide the development with a permanent mortgage as it had previously committed itself to do, the New Jersey HFA

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[1] New Jersey HFA, <u>1973 Annual Report</u>, p.26. See p. 202 <u>infra</u>. for a discussion of the New Jersey Housing Assistance Bond program.

accepted a $1,225,000 loss on the construction advances it had made and the sponsor received a far lower mortgage elsewhere.[1]

Problem Projects

The state HFA's, while having a number of "problem" projects, have had far fewer than HUD and their problems have been generally less severe. The data for reaching this conclusion is a listing obtained from each state agency of every development in arrears in meeting current or past due debt service payments by more than 90 days and a listing of all HUD Section 236 projects with equivalent arrearages as shown by defaults, modifications, assignments, and foreclosures. Default on a HUD project simply means that the mortgagee has reported that the project is delinquent in meeting debt service payments. Apparently, however, not all projects that have missed debt service payments are listed as defaults. The Boston Urban Observatory found in its study of subsidized, HUD-insured, multi-family housing in the Boston area that:

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[1] Peat, Marwick, Mitchell & Co., Financial Statements in New Jersey HFA, Annual Report, 1972, p.24.

> While half of the developments in the study sample showed mortgage default, assignment, or foreclosure, detailed cash flow analysis indicated that three-fourths of the projects were losing from $60 - $300 per unit per year. Only three developments (out of 36 in the sample) had positive cash flow.[1]

Still, only those HUD projects that have reported being in default for over 90 days will be counted as being a "problem" project.

The next phase for a "problem" project in the HUD system is assignment. When the mortgagee decides that the project is hopelessly in arrears, it submits an insurance claim to HUD and assigns all rights as mortgagee to HUD as well. Virtually all projects in assignment can safely be assumed to have been in arrears by at least 90 days.

Foreclosure occurs when HUD takes full title to the property and can then sell it on the open market.[2] Once foreclosure occurs, the developer loses all of his ownership interest in the project and all subsidy payments are terminated. While HUD had decided to foreclose on all mortgage notes it had received through assignment, the hardships that loss of subsidies would impose upon tenants

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[1] Boston Urban Observatory, <u>op. cit.</u>, p.165. Since their study sample focused primarily on core area projects financed largely under the Section 221(d)3 program, their data regarding defaults, assignments, and foreclosures differs from that of the same area office under the Section 236 program as a whole.

[2] HUD <u>Financial Statement</u>, as of June 30, 1974, assumes that

has led Congress to successfully pressure HUD to refrain, at least temporarily, from proceeding to foreclose on most of these assigned properties.[1]

The only other category of potential "problem" projects are those that have undergone a mortgage modification. Projects receiving such modifications have been allowed to defer making up old arrearages until some distant future date, provided they continue to meet current debt service requirements.

One adjustment that has to be made in comparing the data on HUD "problem" projects with that on HFA projects relates to the time period over which the loans have been outstanding. At least over the first few years, the longer that a project is in occupancy, the greater the likelihood it will experience problems. Since HUD, with its on-going organization, was able to begin implementing the Section 236 program at an earlier date than most of the state housing finance agencies, data on those HUD projects that began construction prior to June 1970 were ignored despite the fact that they had an extremely high rate of problems,

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HUD can recover about 60 percent of its investment through such a sale (p.115).

[1] Housing and Development Reporter, May 10, 1975, p. 1038.

while all of the uninsured HFA Section 236 developments that had reached initial occupancy were included. Because of differences in the accessibility of data from various agencies at the time the data was being collected, the HUD data is as of January 31, 1975 while the HFA data is as of either February 28 or March 31, 1975. The result of all of these differences in dates is that the average period over which both the HFA and HUD mortgages being compared have been outstanding is virtually identical.

As seen in Table 22 the state HFA's have had significant problems on only 5 percent of their Section 236 units compared with HUD which has had problems on 21 percent. While UDC appears to have had a significantly lower incidence of problem projects than its HUD counterparts (13 percent to 20 percent), the exclusion of UDC reduces the HFA rate of problems to an insignificant one percent.

While most of UDC's problem projects fall into that category because they were currently behind in meeting debt service requirements, certain of their projects fall into that category because of projected future deficits. Rather than set initial rents at a level that will pay all expenses, UDC has adopted a policy of providing a working capital fund of about three percent on each project to artificially lower rents during the initial period of occupancy. The problem, however, is that as the working capital is depleted, rents have to increase to meet on-going expenses. On certain

Table 22

Section 236 Dwelling Units in "Problem Projects" by Agency

	Date of Data [a]	Defaults Arrear-ages Over 3 mos.	Modifi-cations 3 mos.	Assign-ments	Total "Prob-lems"	Total 236 Units	"Problems" as % of Total
HFA's							
Ill. HDA	2-75	0	0	0	0	4,200	0
Mass. HFA	2-75	588	0	0	588	10,400	6%
Mich SHDA	3-75	110[c]	0[c]	0	110	7,300	1%
NJ HFA	3-75	0[d]	0	0	0	7,400	0
NY HFA	2-75	0	0	0	0	11,500	0
NY UDC	3-75[e]	2019[f]	0	0	2,019	15,100	13%
Total		2717	0	0	2,717	55,900	5%
HUD							
Illinois	1-75	821	310	553	1,684	10,200	16%
Mass.	1-75	1205	1040	557	2,802	12,200	23%
Michigan	1-75	1386	700	1,042	3,128	13,200	24%
New Jersey	1-75	49	430	334	813	3,700	22%
New York	1-75	1386	835	460	2,612	12,800	20%
Total		4,778	3315	2,946	11,039	52,100	21%

a. HUD figures exclude projects that began construction prior to June 1970 while HFA figures include all Sec. 236 projects.
b. Projects that reached initial occupancy prior to date data collected.
c. Excludes arrearages and modifications on HUD insured units where HUD has ultimate responsibility.
d. Excludes 523 units receiving subsidies to help meet debt service.
e. Projected arrearages (see note f) and unit count apply to projects with initial occupancy prior to December 1974.
f. Includes projected arrearages upon depletion of working capital on 439 units not currently in default.

Sources: Telephone interviews with state HFA financial officers; information obtained from HUD Office of Management Information Field Support and HUD Multifamily Status Reports: Mortgage Insurance Programs, (02 Series), June 30, 1974.

developments UDC anticipates that it will be unable to raise rents sufficiently to cover operating expenses by the time the working capital is depleted. Consequently, while UDC has allocated reserves for this purpose, certain developments are listed in Table 22 as being "problems" because of anticipated shortfalls. While UDC has scheduled rent increases on virtually all of its projects at about the rate of inflation, if this schedule cannot be implemented, then UDC's rate of problem projects will increase. Still, given the fact that UDC has produced the highest percentage of projects in risky inner city poverty or urban renewal areas of any agency, its rate of problem projects, particularly in comparison with HUD, has been low.

Vacancy Rates

An analysis of vacancy rates again supports the proposition that most of the state agencies have produced developments that are more financially sound than those of HUD. The conclusion can be drawn despite the fact that vacancy information was obtained for every HFA development but for only selected HUD developments. Information was available on only those HUD developments whose managers submitted an "Occupancy Report" (Form 9801) to the local HUD office and subsequently to the HUD central office. Since a highly disproportionate number of HUD projects in

financial difficulty as seen by later defaults, assignments, and foreclosures failed to report occupancy figures, the HUD figures presented in Table 23 present a picture of HUD occupancy patterns that undoubtedly have been underestimated. Nonetheless, vacancy rates on HFA developments are at least two percentage points lower than those of HUD in eight of the eleven area offices where comparisons are possible. The Massachusetts HFA, largely because of vacancies scattered in a number of its mixed developments, has a vacancy rate that is no lower than that reported to HUD (although still a modest 2.7 percent). The New York State UDC is the one state agency to show a significantly higher rate than HUD in any area office. While having a lower rate than HUD in the New York City area and only a slightly higher rate in the Albany area, UDC has encountered severe vacancy problems in the Buffalo area where its overall vacancy rate was 21.4 percent compared with 6.2 percent for projects reporting information to HUD.

EFFICIENCY MEASURES

Processing Time

An examination of the time taken by the HFA's and HUD to process applications based upon dates provided for the submission of the initial application by the sponsor and

Table 23

Vacancy Rates by Agency

HUD-Insured Section 236 Developments

And All HFA-Financed Developments

	HFA			HUD		
	Mean Vacancy Rate*	SD	N	Mean Vacancy Rate*	SD	N
Illinois						
Chicago	.022	.039	44	.044	.045	18
Springfield	.023/.032	.029	44	.086	.065	15
Massachusetts						
Boston	.027	.041	37	.026	.046	12
Michigan						
Detroit	.032	.024	15	N/A		
Grand Rapids	.043	.040	6	N/A		
New Jersey						
Newark	.003	.010	15	.013	.032	7
Camden	.000	.000	1	.020	.030	15
New York-DHCR						
New York City	.008	.021	12	.046	.163	17
Albany	.026	.059	6	.057	.095	8
Buffalo	.000	.000	3	.060	.062	4
New York-UDC						
New York City	.029	.024	14	.046	.163	17
Albany	.068	.043	15	.057	.095	8
Buffalo	.214	.215	7	.060	.062	4

*Includes projects that achieved 95 percent occupancy or have been substantially completed for at least one year.

Source: Occupancy reports by individual agencies, mid-1973 for HUD, late 1973 and 1974 for HFA's.

date of initial closing yields mixed results. Overall, as seen in Table 24, no significant difference was found in the amount of time taken by the state agencies compared with the time taken by HUD.[1] One state agency, the Massachusetts HFA, which processed applications in an average of 12.8 months, was found to be faster than its HUD counterpart to a highly significant degree. Another state agency, the New York Division of Housing and Community Renewal, with an average processing time of 32.0 months,

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[1] This finding contradicts a widely circulated myth that the state agencies invariably operate more expeditiously than their HUD counterparts. This myth began as a result of HFA responses to a questionnaire circulated by UDC in March, 1973, asking each agency how long it took to process applications as well as, if possible, comparable figures for HUD. Given the short amount of time the HFA's had to prepare the questionnaire and the public relations use to which it was to be put, rather than calculate the actual time, each agency made an estimate of their own processing time, all of which were low. The one HFA to estimate HUD processing time, overestimated it. HUD, in its own restudy of national housing during the moratorium, Housing in the Seventies (Washington: GPO, 1974), pp.5-13, also claimed that the state agencies were significantly faster than HUD. While it cited a report prepared for it by Booz, Allen, and Hamilton, the figures it used were taken from the UDC survey. The report of Booz, Allen, and Hamilton, "Comparative Analysis of Federal and Nonfederal Government Housing Program Procedural and Managerial Implementation" (Washington, mimeographed), pp.III(1)-III(3), actually found no significant difference in processing time.

Table 24

Comparison of Average Processing Time in Months
For HFA's and HUD From Date of Initial Application
To Date of Initial Closing

	Mean	SD	N	Difference[1]	Significance of Difference
Illinois					
IHDA	15.2	5.5	9	-1.4	$> .500$
HUD	13.8	5.7	30		
Massachusetts					
MHFA	12.8	7.6	112	8.9	$< .001$
HUD	21.7	10.7	88		
Michigan					
MSHDA	15.1	6.6	47	0.9	$> .500$
HUD	16.0	8.5	46		
New Jersey					
NJHFA	20.2	10.0	35	-4.3	.094
HUD	15.9	7.0	21		
New York					
DHCR	32.0	14.2	20	-14.7	$< .001$
HUD	17.2	8.2	67	0.7	$> .500$
UDC[2]	16.5	N/A	25		

1. Positive numbers indicate HFA's processing time shorter than HUD's.

2. UDC mean based upon information provided by Irving Coloff, UDC Director of Construction, based upon UDC survey which found the average time between awarding of architectural contract and start of construction being 15-18 months.

Sources: Compiled from dates of individual projects provided by each agency and HUD, except as noted in footnote 2, above.

was found to be slower than the HUD offices in the same state by an extremely significant margin. None of the other HFA's had average processing times that were significantly different from those of HUD in the same state, with all ranging from 15.1 to 20.2 months.

Administrative Cost Efficiency

On the whole, the state HFA's have had higher administrative costs per unit and per project on all of their multi-family developments than has HUD on its Section 236 and other Special Risk Insurance Fund multi-family developments, although great variations have occurred among individual HFA's. While Table 25 shows the state agency as having costs per unit and per project during the project development period that are on the order of twice that of HUD, this average includes the costs incurred by UDC. Unlike HUD and to a far greater extent than the other HFA's, UDC generally performs functions normally done by a private developer. Consequently, UDC's administrative costs during this phase have been far greater than those of the other agencies. Leaving UDC aside, however, state agency costs during the development stage have been about the same as those of HUD, being slightly lower on a per unit basis ($348 versus $369) and slightly higher on a per project basis ($64,500 versus $44,500).

Table 25A

Administrative Costs by Agency by Stage for Fiscal Year 1973

	Fiscal Year Closing	General Admin. Expenses[a]	Project Development Period					Project Operating Period				
			Projs. Clsd.[b]	Units Closed[b]	Percent Staff Invlvd[c]	Cost/ Project	Cost/ Unit	Occ. Projs.[d]	Occpd. Units[d]	Percent Staff Invlvd[c]	Cost/ Project	Cost/ Unit
State HFA's												
Ill. HDA	6/30	$ 1,264,000	11	3,160	61%	$ 70,100	$244	7	1,308	39%	$45,100	$242
Mass. HFA	6/30	1,211,000	36	6,742	68%	22,900	122	48	6,111	32%	8,600	63
Mich. SHDA	6/30	2,327,000[e]	19	2,300	63%	76,700	635	28	3,923	37%	31,100	222
NJ HFA	10/31	1,312,000[f]	14	2,663	85%	79,700	419	22	5,017	15%	8,900	39
NY HFA/DHCR	10/31	2,300,000[g]	15	2,750	80%	122,700	669	64	54,669	20%	7,200	8
NY UDC	10/31	10,215,000	40	10,140	95%	242,600	957	23	5,558	5%	22,200	92
HFA Total		$18,629,000	135	27,755	85%	$117,700	$573	192	76,586	15%	$14,200	$ 36
HUD Office												
Chicago	6/30	789,000	20	2,377	83%	$ 32,700	$276	40	5,887	17%	$ 3,400	$ 23
Springfield	6/30	206,000	6	410	85%	29,200	427	21	1,488	15%	1,500	21
Illinois	6/30	995,000	26	2,787	83%	31,800	296	61	7,375	17%	2,800	23
Boston	6/30	1,540,000	22	3,004	88%	61,600	451	36	5,412	12%	5,100	34
Mass.	6/30	1,540,000	22	3,004	88%	61,600	451	36	5,412	12%	5,100	34
Detroit	6/30	499,000	18	2,508	90%	25,000	179	97	10,824	10%	500	5
Grand Rapids	6/30	414,000	11	1,071	82%	30,900	317	30	3,138	18%	2,500	24
Michigan	6/30	913,000	29	3,579	87%	27,400	222	127	13,962	13%	900	9
Newark	6/30	736,000	8	498	76%	69,900	1123	17	873	24%	10,400	202
Camden	6/30	384,000	8	1,053	78%	37,400	284	56	1,803	22%	1,500	47
New Jersey	6/30	1,130,000	16	1,551	77%	54,400	561	73	2,676	23%	3,600	97
NY City	6/30	1,331,000	16	2,238	80%	66,600	476	38	4,306	20%	7,000	62
Albany	6/30	68,000	5	776	54%	7,300	47	11	1,313	46%	2,800	24
Buffalo	6/30	436,000	6	1,014	90%	65,400	387	4	631	10%	10,900	69
New York	6/30	1,835,000	27	4,028	81%	55,000	369	53	6,250	19%	6,600	56
HUD Total		$ 6,413,000	120	14,949	83%	$ 44,500	$357	350	35,675	16%	$ 3,100	$ 30

(Please see following page for footnotes)

Footnotes to Table 25A

a. Includes salaries, benefits, fees, and other overhead (except office rent) attributable to multi-family programs. See Table B for computation of HUD figures.

b. Includes permanent, seed, and construction loans -- HUD projects are multi-family under the Special Risk Insurance Fund including primarily Section 236 but also Section 223(e), 223, and 235(i).

c. HFA staff allocations between stages based upon an examination of organization charts with processing and construction personnel allocated to development period and marketing and management personnel allocated to project operation period. HUD allocations based upon time sheets as stated in HUD.

d. Projects in occupancy by the middle of the fiscal year.

e. Excludes single-family costs based upon percentage of staff involved per organization chart.

f. Excludes expenses for all programs other than limited profit housing by analysis of organizational chart.

g. Total operating expenses including deferred expenses equal $12,777,000. Of this amount about $1,000,000 represents office rent and about $1,562,000 (13 percent) represents costs attributable to commercial projects based upon an analysis of a listing of UDC personnel by division.

Table 25B

Calculation of Manyears for Hud Local Offices
For Functions Comparable to Those Performed by State Housing Finance Agencies

	Boston	Camden	Newark	NY City	Buffalo	Albany	Detroit	Grand Rapids	Chicago	Spring-field
A Hsg. Prod. & Mort. Credit-Spec. Risk Insur. Fund* Projects	52.2	11.0	22.3	36.4	14.3	1.4	19.3	13.1	25.2	7.1
B Hsg. Prod. & Mort. Credit-Rent Supplements	0.9	0.1	0.4	0.7	0.9	0.0	0.8	0.7	0.7	0.0
C Hsg. Mgt.-Spec. Risk Insur. Fund* Projects	5.0	1.1	5.5	6.2	1.4	0.8	0.9	2.4	3.6	1.4
D Hsg. Mgt.-Rent Supplements	2.3	2.0	2.0	3.3	0.3	0.4	1.3	0.7	1.5	0.1
E Total Comparable Direct Functions (A+B+C+D)	60.4	14.2	30.2	46.6	16.9	2.6	22.3	16.9	31.0	8.6
F Non-Related Functions	192.6	116.9	215.5	184.8	113.2	47.6	446.4	66.7	301.1	49.4
G Overhead-Local Office**	15.1	6.5	11.5	19.3	8.4	0.0	17.7	0.7	18.7	1.2
H Total Local Office (E+F+G)	268.1	137.6	257.2	250.7	138.5	50.2	486.4	84.3	350.8	59.2
I Overhead-Regional Office (@ 13.9% of H)***	37.3	19.1	35.7	34.8	19.3	7.0	67.6	11.7	48.8	8.2
J Overhead-Central Office (@32.1% of H)***	86.1	44.2	82.6	80.5	44.5	16.1	156.1	27.1	112.6	19.0
K Total Attributed Manyears (H+I+J)	391.5	200.9	375.5	366.0	202.3	73.3	710.1	123.1	512.2	86.4
L Total Overhead (G+I+J)	138.5	69.8	129.8	134.6	72.2	23.1	241.4	39.5	180.1	28.4
M Percent of Comparable Functions to all Functions E/ (E+F)_/	23.9	10.8	12.3	20.1	13.0	5.2	4.8	20.1	9.3	14.8
N Overhead Attributed to Comparable Functions (L x M)	33.1	7.5	16.0	27.1	9.4	1.2	11.6	7.9	16.7	4.2
O Total Comparable Manyears (E+N)	93.5	21.7	46.2	73.7	26.3	3.8	33.9	24.8	47.7	12.8

*Includes Sections 236, 223 (e), 233, and 235 (j)
**Includes research, equal opportunity, and general counsel
***Based upon national ratios
Source: HUD

The state agency to have the lowest administrative costs during the development period, even lower than those of HUD in any state considered, was the Massachusetts HFA. Its costs were $122 per unit and $22,900 per project closed. MHFA's low costs were consistent with its having the fastest processing time. Also consistent was the fact that New York DHCR/HFA had the slowest processing time, and, aside from UDC, the highest administrative costs both per unit and per project. The other HFA's had development period expenses per project that were slightly above average on a per project basis although the Illinois agency's costs per unit were appreciably below average and those of the Michigan agency were appreciably above average.

During the project operation period, the state agencies on the whole had considerably higher costs per project than HUD ($14,200 versus $3,100), but only slightly higher costs per unit ($36 versus $30). The reason the HFA's have done so much better on a per unit basis, however, is the extraordinarily large size of some of the projects under the control of New York DHCR, including the 15,000 unit Coop City development. Since many of DHCR's developments, particularly their older ones, are unsubsidized and well seasoned, they have required relatively little attention. Leaving DHCR aside, the remaining HFA's have shown considerably higher administrative costs than HUD during both a per project basis ($18,200 versus $3,100) and a per unit basis

($106 versus $30). The Illinois and Michigan agencies have clearly had the highest costs during the project operation period, on both a per unit and per project basis, with UDC having had moderately high costs. The New Jersey and Massachusetts HFA's have had the lowest costs during this period among the state agencies (except DHCR), although their costs have been higher than those for HUD.[1]

A COMPARATIVE CASE STUDY

In assessing the overall effectiveness of the approach taken by the state housing finance agencies and HUD, certain differences in the approach and final product can be ascertained through a case study of a multi-phase development actually financed in part with Massachusetts Housing Finance Agency funds and in part with HUD insurance. In this particular case, the developer applied to HUD for mortgage insurance and 236 subsidy funds for a proposed 400 dwelling unit project on a single parcel of land it had under option. When it became apparent that HUD was reluctant to commit sufficient 236 funds to the whole project,

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[1] The New Jersey HFA has had lower costs than its HUD counterparts on a per unit basis, but not per project basis. Even its per unit costs, however, have been higher than those of HUD in the five states combined.

the developer applied to MHFA. Since MHFA was also limited as to the amount of 236 funds it could commit, the developer decided to break the project up into two and process with each agency simultaneously on each portion. The situation affords an ideal experimental situation where all of the independent variables have been controlled with exception of the agency processing the application. Both projects have the same developer, contractors, architect, manager, and virtually the same site and timing. All differences in outcome can reasonably be attributed to differences between agencies.

From the outside of the buildings, the two sections appear to be part of the same development with both sections being architecturally indistinguishable. The MHFA-financed section does contain a swimming pool, wading pool, and three small community buildings. These facilities are available to HUD tenants at a small charge. On the inside the two developments are similar -- both have electric ranges, refrigerators, disposals, exhaust fans, and air conditioning sleeves. However, the state-financed development has carpeting but the Federal one does not.

Clearly, the basic similarities between the two sections show that the range of architectural quality of the dwellings financed by the two agencies is overlapping. The greater amount of amenities provided by MHFA represents a real difference in what that agency and certain other state

agencies consider to be worthy of inclusion rather than "extravagant."

A clear difference between the two agencies can be seen in looking at the length of processing time. While the developer first submitted an application to HUD five months _before_ it submitted it to MHFA, initial closing and the start of construction on the HUD section occurred seven months _after_ the state section. In all, processing took sixteen months on the HUD project but only four months on the state project. Construction on both the HUD and MHFA sections took seventeen months from start to initial occupancy. The MHFA section proceeded more expeditiously despite the fact that it contained 288 dwellings compared with 114 for the HUD project.

The most interesting basis for comparing the two sections is on the basis of costs. Table 26 give a breakdown of total and per unit developmental and annual costs for the two sections. For all categories of developmental costs, except land, the HUD section cost more per unit. About half of the 11 percent difference in total construction cost can be attributed to the fact that the HUD units are on an average somewhat larger in floor area. Yet, even on a square foot basis, the construction of the HUD section cost six percent more than the state agency section. As stated before, the units are otherwise identical with the exception that the state units contain carpeting, a swimming

Table 26

Comparative Costs of Project Developed in Part Through the Massachusetts Housing Finance Agency and in Part Through U. S. Department of Housing and Urban Development

	Total Costs		Per Unit Costs	
	MHFA	HUD	MHFA	HUD
Development Costs				
Construction	$4,660,000	$2,062,000	$16,180	$18,090
Architecture	207,000	102,000	720	890
Interest During Construction	176,000	136,000	610	1,190
Taxes and Insurance	35,000	33,000	120	290
Legal (including title & recording)	27,000	26,000	90	230
Agency Fees	56,000	144,000	190	1,260
Builders and Sponsors Profit	552,000	250,000	1,920	2,190
Land	409,000	137,000	1,420	1,200
Total Replacement Cost	6,122,000	2,890,000	21,250	25,340
Mortgage Amount	5,510,000	2,600,000	19,130	22,810
Annual Costs				
Full Debt Service	417,100	242,000	1,450	2,123
236 Subsidy	-249,300	-162,800	870	1,428
Net Debt Service	167,800	79,200	580	695
Operating Expenses	214,400	84,100	740	737
Real Estate Taxes @ 20%	104,100	44,600	360	391
Vacancy Allowance	24,700	11,700	90	103
Return on Equity	36,700	17,300	130	152
	547,700	236,900	1,900	2,078
Monthly Rent				
2 Bedroom			156.11	169.12
3 Bedroom			175.11	194.92
Annual Subsidy Costs				
Sec. 236 Subsidy	249,300	162,800	870	1,428
Interest on Bond @ 5.68%	150,200	-	521	-
	394,500	162,800	1,391	1,428

pool, a wading pool, and community buildings. The developer/contractor was clearly able to make a higher rate of profit on the construction of the HUD section than on the MHFA section.

From the point of view of the tenants, the state agency gave those living in the state section more amenities and a somewhat lower cost. The higher architectural costs on the HUD section largely reflect the higher construction costs on which the architectural costs are based. Differences in taxes, insurance premiums, legal fees, and land costs as shown in the mortgage application largely reflect differences in what the two agencies would allow for these items despite the fact that they actually cost the same per unit on each section. The state agency generally allows higher land costs than HUD because it prefers better sites. However, in this case the developer took advantage of MHFA's willingness to pay slightly higher land prices to divide up the parcel in such a manner that more of the land price would be attributable to the state section. Differences in the builders and sponsors profit are wholly attributable to differences in other costs. At both agencies profit was computed at 10 percent of all non-land costs.

The two items on which state agency developments are consistently lower than on HUD projects are interest during

construction and agency fees. In this case the interest during construction was $1,190 per unit for the HUD section compared with $610 for the state section. The primary reason for this variation is the difference in the interest rate on the construction loan. Interest rates on state agency bond anticipation notes which are used to generate construction loan funds is particularly low. Buyers of these notes are attracted by the short term. Unlike the savings in interest on permanent financing, which is balanced by a correspondingly lower interest subsidy, savings on construction loan financing is passed on to Section 236 tenants. The savings in this case represent $1.50 per unit per month.

The difference in agency fees, which is over $1,000 per unit, results largely from the multiplicity of actors involved on the HUD project, each of whom receives a fee. HUD received a combined fee of 1.8 percent for mortgage insurance, examination, and inspection; the construction lender received a financing fee of 2 percent; FNMA/GNMA received a 1.75 percent fee for absorbing the permanent loan at a slightly below market interest rate. By contrast, MHFA received a fee of only about 1 percent for inspecting the site, processing the application, making the construction loan, holding the permanent loan, and self-insuring both of these loans. Since MHFA performs

its functions on a self-supporting basis, its relative efficiency is readily apparent.

The other basis for comparing the two sections is in terms of subsidy costs. While the MHFA-financed section bears the inefficiency to the U.S. Treasury of raising funds through the tax-exempt bond market, the larger direct subsidy costs required on the HUD section more than offset the forgone tax revenues. As seen in Table 26, based upon an assumed average tax bracket of 48 percent for investors buying MHFA's bonds and based upon the actual 5.68 percent interest rate the investors received from MHFA on this particular bond issue, the amount of tax revenues forgone by the U.S. Treasury on the project amount to $521 per unit per year. The amount of Section 236 subsidies required to reduce the interest rate down to one percent equalled $1,428 per unit on the HUD portion. This difference is attributable to a combination of HUD's higher mortgage amount and its higher interest rate. The total annual subsidy per unit has thus actually been slightly lower on the MHFA section. This lower subsidy cost has been seen to have occurred despite the fact that the rents on the MHFA section are lower than those on the HUD section and that the MHFA section has more amenities.

If this same development were built under the Section 8 program, which provides a subsidy based upon the income

level of the tenant, assuming each had tenants with the same average income, both sections would have had the same rents but the HUD section would have required an additional subsidy of about $150 per unit per year to realize these same rents. If rather than selling tax-exempt bonds, MHFA would have received the 33 1/3 percent direct subsidy provided in Section 802 of the Housing and Community Development Act of 1974, the cost of its section to the U.S. Treasury would drop by $158 per unit. Rather than losing $521 in forgone revenues, the Treasury would have had to pay out only $363. Thus, despite the inefficiency in the mechanism used by the HFA's to finance their developments, MHFA's own efficiency was able to provide better housing at a lower cost to the tenant and government. The newly enacted subsidy mechanisms will only increase their relative efficiency.

Chapter Conclusion

In conclusion, this chapter has shown that the HFA's have been generally more effective than HUD in that they have done about as well as HUD in fulfilling the public purposes they share with HUD, while being more effective in maintaining fiscal solvency. The HFA's and HUD were seen to have done equally well in terms of the volume of housing they produced for moderate income families and locating that housing in slum areas and close to jobs.

While the HFA's performed somewhat better at providing racially integrated housing, HUD housed more minority families. The HFA's have clearly provided better designed, larger, and more luxurious housing, although often at a higher cost per unit. Still, this housing has had equally low rents and has more frequently been available to genuinely low income families. In the case study the rents and project costs were actually lower on the HFA-financed section.

While the HFA's were seen to have performed better than HUD with regard to such local public purposes as providing mixed income and elderly housing, they have performed less satisfactorily with regard to such non-statutory national goals as property rehabilitation and to a lesser extent the housing of large families.

In terms of financial solvency, the HFA's were found to have had a better record at meeting their own operating budgets and in avoiding problem projects and high vacancies. The findings with regard to financial solvency were seen to have been far stronger when UDC is excluded. The remaining HFA's, however, have produced a lower overall total number of moderate income units than their HUD counterparts and a lower percentage in inner city "slum" areas.

The next six chapters will discuss reasons for the observed variations in effectiveness.

CHAPTER 5

ROLE IN THE DEVELOPMENT PROCESS AND THE MANAGEMENT OF RISK

Part of the reason for the differences seen in the relative effectiveness of the state housing finance agencies and the U.S. Department of Housing and Urban Development is their respective roles in the public purpose housing development process. The basic role played by the HFA's is that of a mortgagee, while the basic role played by HUD is that of an insurer of mortgages. As a mortgagee, the HFA's provide their own funds to projects, while as an insurer, HUD insures the funds advanced by others. As will be seen in the next chapter, the ability of the HFA's to obtain loanable funds through the tax-exempt securities markets provides them with both special opportunities and constraints.

Despite differences in their basic roles, both the HFA's and HUD must assume full ultimate risk should a project fail. The HFA's must either provide their own funds to keep the project afloat or foreclose on the mortgage and sell it for whatever the market will bring. Should mortgage payments continually be missed on a HUD-insured development, HUD would have to take over the mortgage and reimburse the mortgagee for loss. Unlike most private mortgage insurers, HUD agrees to provide reimbursements up to the full amount of the mortgage.

HFA-financed or HUD-insured developments can fail to meet their debt service requirements for a number of reasons. As in conventionally financed developments, a high vacancy rate, non-payment of rent by tenants, low rent levels in relation to expenses, the inability to raise rents because of low tenant incomes, or mismanagement can all lead to problems. Many of the public purpose goals of the state agencies and HUD magnify agency risks. Slum area rebuilding, racial integration, income mixing, rehabilitation, and the housing of low income and large families are all goals that can increase risks. Consequently, on conventional developments private lenders and developers generally avoid developments that would serve these goals. While the subsidies provided in public purpose developments to reduce rents might appear to lower the risk of high vacancies, the income limitations, at least in the Section 236 program, restrict the available market and require a rent-to-income ratio of at least 25 percent.[1]

In terms of managing risks, as will be seen in this chapter, more important than the basic role of the HFA's

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[1] The new Section 8 program, however, sets the rent-income ratio at 15 to 25 percent, depending upon family size, and maintains it at that percentage even if subsidies have to be increased to meet rising expenses.

and HUD is the way in which they each play their role. Both mortgagees and insurers can utilize the same techniques for controlling risks, although the mortgagee role has made it easier for the HFA's to become actively involved in projects and thereby control the underlying factors creating risk.

The role that has made a difference in terms of ability to manage risk is the developer role played by the New York State Urban Development Corporation in addition to its role as a mortgagee. Prior to the start of construction UDC assumes all of the risks normally taken by a private developer. Because of the large required investment and uncertainties related to establishing the ultimate feasibility of a development, these risks are generally high. By providing loans on unfeasible or high risk projects, a mortgagee can reduce the risk of abandoned projects for the developer. While the twin roles of mortgagee and development initiator played by UDC need not make a difference in the way in which it plays its role as a mortgage lender, as will be seen, on occasion, particularly during its early years, UDC has made mortgage loans on risky projects to preserve its investment made in its role as a developer.

Still, the HFA's as a group, have effectively managed the risks of public purpose development lending. As seen in Chapter 4, they have fulfilled the risky public purpose to about the same extent as HUD while sustaining fewer losses in their role as a mortgagee on uninsured loans

compared with HUD in its role as a mortgage insurer. In particular they have performed as well as HUD in rebuilding slum areas, better in providing low income, economically mixed, and racially integrated housing, but not as well in promoting rehabilitation and housing for minorities and to a lesser degree large families. Leaving aside UDC because of its unique role as a developer, the remaining HFA's, as a group, have taken less risks with regard to slum rebuilding and roughly equivalent risks with regard to the other public purposes, but have had far greater success in maintaining the financial solvency of their developments and operations.

The primary reason for the success of the HFA's in controlling risk rests in the techniques for risk management they have adopted. While their public purpose goals have kept them from using all of the same techniques as private mortgagees, their techniques have largely been a function of their mortgagee role. Generally, lenders, insurers, and developers use five basic means of managing risks, although each actor finds certain means better suited to its role than others. The five means are:

1) Avoiding risky situations;
2) Establishing reserves to meet losses;
3) Spreading the risk over a large number of developments;
4) Passing the risk along to someone else; and
5) Controlling the underlying factors which create the risk through active involvement.

Each of the methods of managing risk will be discussed in turn with the greatest attention focused on the method of active involvement, the method most fully developed by the HFA's.

AVOIDING RISKY SITUATIONS

The avoidance of risky situations is the method of managing risk most frequently used by private mortgagees and insurers. Rather than absorb the risks of lending in inner city areas, for example, private lenders will redline these areas and refuse to lend in them. The legislatively-mandated public purpose goals of the HFA's and HUD, however, limit the degree to which they can avoid risky situations and be successful. Still, certain HFA's have practiced risk avoidance. Rather than satisfy their public purpose of rebuilding slum areas by building in the riskiest areas having the highest concentrations of poverty, the HFA's have more frequently built in somewhat less risky urban renewal areas where a public commitment has been made to rebuild the neighborhood in its entirety. Certain HFA's have even avoided urban renewal areas. As was also seen in Chapter 4, the HFA's have generally avoided the risk of rehabilitation, at times the risk of housing minorities, and to a slightly greater extent than HUD, the risk of housing large families.

To a much greater extent than HUD, however, the HFA's have taken on the risk of housing genuinely low income families and largely,but not entirely through the efforts of the Massachusetts agency,have assumed the previously unheard of risk of providing housing to a substantial number of low income families in a predominantly middle income setting.

One other risk that many of the HFA's have avoided is that of working with incompetent, inexperienced, and underfinanced developers. As will be seen later in this chapter, the HFA's appear to have developed better procedures for eliminating incompetent developers.[1] As seen in Table 27, with the exception of New Jersey, compared with their HUD counterparts, each of the state agencies has provided mortgages to a lower percentage of nonprofit sponsors, most of whom are inexperienced and underfinanced. A primary reason generally given for preferring nonprofit sponsors is that they tend to tackle the more difficult projects, particularly in terms of location and number of bedrooms.[2] Yet, the two state agencies that have utilized

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[1] See p. 217 and p.222, *infra*.

[2] See Langley C. Keyes, "The Role of Nonprofit Sponsors in the Production of Housing," in U.S. House of Representatives, Committee on Banking and Currency, Papers Submitted to Subcommittee on Housing Production, Housing Demand, and Developing a Suitable Living Environment (Washington, D.C.: GPO, June 1971), pp.159-183.

Table 27

Number of Dwelling Units by Profit
Orientation of Sponsor by Agency on
Projects Closed between January 1, 1970 and December 31, 1973

State Housing Finance Agencies

	Profit Motivated	Non-Profit		Profit Motivated	Non-Profit
Illinois HDA	91.3%	8.7%	Illinois	56.8%	43.2%
	61.91	591		7811	5951
Massachusetts HFA	97.7%	2.3%	Massachusetts	74.1%	25.9%
	17049	410		11062	3868
Michigan State	82.1%	17.9%	Michigan	60.6%	39.4%
	5379	1174		12205	7946
New Jersey	41.4%	58.6%	New Jersey	67.1%	32.9%
	4756	6744		3988	1951
New York DHCR-HFA	58.5%	41.5%	New York	48.2%	51.8%
	10797	7674		8485	9115
New York UDC	99.1%	0.9%			
	32737	300			
Total	82.0%	18.0%	Total All HUD	60.2%	39.8%
(6 Agencies)	76909	16893	(5 States)	43551	28831

a substantial proportion of nonprofit sponsors, the New Jersey HFA (58.6 percent) and the New York HFA (41.5 percent), were seen in Table 15 to have financed the lowest percentage of units with three or more bedrooms and in Table 6 to have provided an average or below average percentage of units in slum areas.

The other reason for preferring nonprofits is that they better provide community input. The two state agencies that have worked with the fewest number of nonprofit organizations, however, have found alternative means of providing community input into their developments. The New York State UDC sets up a community advisory board for each of its developments to serve as a vehicle for community input. The Massachusetts HFA has worked with several community organizations that have formed limited partnerships rather than remain as nonprofit entities so that they are able to channel tax shelter proceeds into their projects. Two other state agencies which have also provided mortgage funding for only a relatively small percentage of nonprofit groups, the Illinois Housing Development Authority and Michigan State Housing Development Authority, have provided considerable assistance to nonprofits in other ways. Both operate seed money funds from which they lend money to nonprofit sponsors to enable them to pay the cost of such development expenses incurred prior to construction as land acquisition and certain

architectural fees. While seed money loans are inherently more risky than permanent mortgage loans, the Illinois and Michigan agencies make these loans using funds that were specially appropriated by their legislatures for this purpose. When the same nonprofit sponsors seek permanent financing, however, which would have to come from funds that must be repaid to bondholders, the Illinois and Michigan agencies have generally directed them to HUD.

ESTABLISHING RESERVES

The establishment of reserves to meet losses is a technique of risk management practiced in various ways. In one respect, the public purpose goals of the HFA's and HUD limit their ability to establish reserves. Without mortgage insurance, private lenders generally will provide a mortgage of no more than 70 to 80 percent of the value of the completed development.[1] The 20 to 30 percent equity requirement on the part of the borrower represents a margin of protection for the lender. To preserve its equity investment, the mortgagor will make every effort to meet the debt service payments. Should the lender have to

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[1] Lenders generally include an allowance for the developer's profit in their evaluation, thus allowing the cash equity requirement to be somewhat less than 20-30 percent.

foreclose on the mortgage, it would need to resell the property for only 70 to 80 percent of its original replacement cost to recoup its investment. State agencies and HUD, however, generally provide mortgage loans of 90 percent of replacement cost to limited dividend developers and of 100 percent to nonprofit sponsors.[1] They received the power to do so in order to attract developers and sponsors and to reduce the monthly cost to consumers (since the added debt service is less than would be the additional return on equity). The lower equity reduces their margin of safety.

The state agencies and HUD are able, however, to take advantage of certain other reserves. Each has established reserves based upon the fees it collects from mortgagors for the services it renders. These reserves have taken the form of both the creation of specific funds to meet potential mortgage losses and the accumulation of general fund balances that might be allocated for that purpose.

The New York State Urban Development Corporation, New York State Housing Finance Agency, and Michigan State Housing

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[1] Developers of limited dividend projects receive a Builders and Sponsors Profit and Risk Allowance equal to 10 percent of all costs other than land out of mortgage proceeds on HUD projects, thus reducing their cash equity to at times as low as 1 percent. The state agencies generally make similar allowances. The New Jersey and both of the New York agencies provide 95 percent mortgages.

Development Authority have each included reserve funds in their mortgage calculations.[1] The two New York agencies establish working capital reserves equal to about three percent of the mortgage. UDC uses this allocation more as a means to reduce rents during the initial years of project operation than as a reserve. In calculating the amount of rent charged at the outset of project operation, UDC assumes that most of the working capital fund and net interest earned on it will be available to help meet debt service requirements during the initial years of occupancy. Because the amount of the Section 236 subsidy has depended upon the amount of the mortgage, the addition of working capital funds to project mortgages has increased the amount of subsidy. Still, the amount of working capital included in the mortgage must be repaid. While MSHDA and the New York HFA budget their projects to repay this added debt service over the life of the loan, UDC budgets its projects so that rents will eventually have to be increased to allow all expenses to be met from rents.

State appropriations have enabled the Illinois Housing Development Authority to make a grant of over $800,000 to

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[1] See p. 207 *infra* for discussion of MSHDA Development Cost Escrow Reserve.

one sponsor to use as a reserve fund. The Woodlawn Community Development Corporation received this grant to use in connection with its IHDA-financed Jackson Park Terrace development located in a model cities/urban renewal area of Chicago, at the edge of a census tract with more than a quarter of the households having incomes below the poverty line. Both the Corporation and the Authority must concur on any expenditures of these proceeds. Through the end of 1974, none of these funds had been drawn down. Still, had it not been for the availability of these funds, undoubtedly IHDA would have refrained from making the mortgage investment.

The New Jersey HFA has been able to use that state's Housing Assistance Bond fund as reserves. In 1968 the New Jersey electorate created this fund when it approved the issuance of $12.5 million in State general obligation bonds for the purpose of facilitating the construction of socially desirable but economically marginally-feasible developments.[1] Projects assisted must be located in inner city areas or have a high bedroom count. Two mechanisms have been used to assist these developments, grants and second mortgages. A total of $1.5 million in Housing

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[1] New Jersey voters defeated a similar issue in November, 1974.

Assistance Bond funds were placed in a special reserve account backing an early HFA moral obligation bond issue. A total of $107,000 per year in interest earned on funds in this account has been used to assist project sponsors in meeting debt service payments.

The remaining $11 million of Housing Assistance Bond proceeds have gone toward facilitating marginally feasible developments through the provision of second mortgage loans on a 40-year, non-interest bearing basis to nonprofit sponsors or a 5-6-year, low interest basis to limited dividend sponsors payable out of the return on equity. While these loans have gone to HFA-financed developments, two privately financed projects received a total of $400,000 during the early years of the Housing Assistance Bond program. One of the HFA projects receiving assistance from the program was the Madison House. The $125,000 interest-free second mortgage it received was absorbed as a loss to the Housing Assistance Bond program upon termination of the senior mortgage commitment, thereby reducing the loss occuring to the Agency's general operations accounts.

Should all other risk management techniques fail, each agency presumably can fall back on legislative commitments to replenish reserves. Congress has promised HUD to fund all losses in its Special Risk Insurance Fund while each of the state legislatures with advanced HFA's have promised to restore deficiencies in reserve funds required to meet debt

service on HFA bonds in the coming year. Since legislatures cannot bind future legislatures to make appropriations, these commitments are only "moral commitments." Rather than call upon Congress to honor its explicit commitment, HUD has been meeting deficits in its Special Risk Insurance Fund by borrowing from the U.S. Treasury. Through June 30, 1974, a total of $185 million in borrowings could be attributed to losses in its Section 236 program.[1] While no state agency has had to call upon its state legislature to make up deficiencies in its reserve fund, UDC did receive a loan of about $200 million from its legislature in the wake of its note defaults.

Another type of reserve fund required by HUD and all of the state agencies with one exception is a security deposit made by tenants at the time they move in to guard against breakage or nonpayment of rent. The New Jersey HFA has the strongest requirement in this regard. As advertised in its 1973 annual report as one of many policies the agency has adopted to secure the timely payment by the agency to bondholders, it demands a one month security deposit from senior citizens and a one and one-half months deposit from

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[1] See Table 18 *supra*, p.153.

all other tenants.[1] Each of the other agencies having such a requirement specifies a one month deposit. The New York DHCR, in commenting on a proposed but later rescinded HUD rule forbidding security deposits, stated, "Where there are no security deposits, vandalism increases, moveouts without notice increase, and there are no funds to repair the vandalism."[2]

The experience of the Massachusetts HFA, the one agency to forbid security deposits, however, has been contrary to that in New York. Despite a large number of prior objections from managers, MHFA first instituted the policy on a trial basis for a one year period. During that year, MHFA received not a single complaint, and so extended it indefinitely.

SPREADING OF RISK

The spreading of risk over a large number of developments, the principle behind all insurance, is the primary technique of risk management relied upon by HUD. HUD's

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[1] New Jersey HFA, Annual Report, 1973, p.6.

[2] Housing and Development Reporter, December 12, 1974, p.743.

national jurisdiction presumably has allowed it to spread its risks over a large enough number of developments to achieve actuarial soundness. Yet, as seen by the large deficit in HUD's Special Risk Insurance Fund, the spreading of risk is an ineffective technique if used by itself. It can only succeed if used in conjunction with large reserves or techniques to limit risks.

SHIFTING RISK TO OTHER PARTIES

The risk management technique of passing the risk along to another party is perhaps the most common of all in the development process. Sophisticated developers are constantly shifting risks to other actors. They take options rather than initially purchasing land outright; they hire architects, lawyers, and engineers who will work on a speculative basis; they purchase liability insurance to avoid lawsuits. HUD's role as a mortgage insurer, in fact, is based on the premise that mortgagees will only provide funds for certain mortgages if they can shift the risk. Consequently, HUD has taken the view that with regard to risk, the buck stops here."

Part of the success of the state agencies in managing risk, however, has resulted from their being able to pass some of it back to the developer. Unlike HUD, most of the

HFA's realized that the primary source of profit for developers was from the sale to equity investors of the rights to the tax shelter benefits from the depreciation generated by their projects.[1] Some have found that by restructuring the manner in which the developer receives these benefits, they can increase the financial security of the development.

The Michigan State Housing Development Authority has taken the most sophisticated approach to altering developer incentives in such a manner as to shift more of the risk for unsuccessful projects onto the developer.

MSHDA's operating assurance policy, which took effect in September 1972, requires that developers guarantee that rents will remain level for the first three years that the development is in operation.[2] To the extent of any increases in utility costs or real estate taxes, MSHDA does make an exception and approve a rent increase. During the second three years of operation, the developer must

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[1] Sale of these benefits generally provides investors with an amount equal to 12-18% of the mortgage, Nathan S. Betnun, "Tax Shelters for the Rich to Rehabilitate Housing for the Poor" (Unpublished M.C.P. thesis, M.I.T., 1972).

[2] MSHDA, "Explanation of Authority Program to Provide Operating Assurances Under Its Limited Dividend Housing Program," 1972, unpublished memo.

continue to be responsible for meeting any operational deficits. Security for meeting these obligations comes from a Letter of Credit equal to 2½ percent of the mortgage posted by the developer during the first three years and by deferred capital contributions by the equity investors over the first six years. While the total risk borne by the developer as a result of these requirements equals five percent of the mortgage in the first year, it reduces to zero in equal increments over the six year period.

Operating assurance for years seven through twenty comes from a Development Cost Escrow contained in the mortgage. This Escrow, which equals approximately eight percent of the mortgage in Section 236 developments and three percent in unsubsidized developments, can be used to meet operating deficits, pay for capital improvements, or fund social or physical amenities, whichever is most pressing at the time. Rather than have the tenants pay for this Escrow fund through increased rents, the equity investors must agree to accept a reduction in the budgeted allowable cash dividend from six percent down to three percent.[1]

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[1] Michigan State Housing Development Authority, "Explanation of Authority Program to Provide Operating Assurances Under Its Limited Dividend Housing Program," 1972. (Mimeographed.)

Despite all of the guarantees that the developer and investors must make, the entire operating assurance package works to their net benefit as well as to the benefit of MSHDA and the tenants. The greater security provided to the development protects the investors against their most severe risk, that of recapture of depreciation by the Internal Revenue Service in the event of foreclosure. The extended pay-in period by the investors allows them to retain their cash for a longer period, and the increased mortgage provided by the Development Cost Escrow allows them to take greater depreciation deductions. As the result of these benefits, the investors should be willing to increase the amount of capital they contribute to the developer by more than enough to compensate him in most circumstances for making the assurances required by MSHDA.[1]

The New York State Division of Housing and Community Renewal requires developers to provide a guarantee related to marketability. For all unsubsidized developments, the developer must provide a cash escrow or unconditional letter of credit in an amount equivalent to the loss that

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[1] See letter from Lybrand, Ross Bros., and Montgomery to Mr. William G. Rosenberg, Executive Director of MSHDA, September 20, 1972.

would result from a 50 percent vacancy rate over a two year period. Once the project has been successfully rented, as has occurred in all of DHCR's developments, the developer receives his money back. DHCR, however, makes no similar demands on sponsors of subsidized housing.

Another state agency to alter developer incentives in such a manner as to force developers to assume more risks should they create non-viable projects is the Massachusetts Housing Finance Agency. To assure that the developer has assets available to bail out a project in financial trouble during construction and rent-up (generally the most risky phase), MHFA requires that the capital contributions made by the investors, rather than be taken by the developer immediately as profit, be left available for use in the project to meet unexpected expenses until such time as MHFA has issued its Certificate of Approval and Acceptance of the completed project.[1] Another requirement that MHFA imposes regarding the sale of tax shelter interests by developers is the prohibition of using the management fee as collateral for payment of cash dividends.[2] In addition to receiving a share of the tax shelter benefits generated

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[1] MHFA, "Requirements for Massachusetts Housing Finance Agency Mortgagors Which are Limited Partnerships," no date. The only exception to this rule is for expenses in connection with the sale of partnership shares.

[2] *Ibid*.

from the project, investors also receive a proportionate share of the cash dividends. While cash dividends constitute only a small fraction of the full return going to the investors, developers customarily have subordinated the management fee to guarantee their payment. The result has often been insufficient funds available to pay for competent management and additional pressure by management to raise rents. What the MHFA prohibition of this practice does is to assure the availability of an adequate management budget, particularly when management services are required to shore up a troubled project, as well as to require the developer to either use his own resources to make assurances regarding the adequacy of cash dividends or to accept a slightly lower price from investors.

MHFA has also shifted risk to developers by requiring them to provide some form of guarantee regarding increases in property taxes. Property taxes normally constitute the cost component most likely to increase and trigger an increase in rents which tenants will be unable to afford. MHFA thus requires that the developer secure an agreement with the local assessors office that tax assessments be based upon a percentage of gross rents. Since the majority of the remaining components of rent consists of a fixed debt service charge, a tax formula of this type makes rent increases less volatile. Where such an agreement cannot be reached with the local assessor, MHFA will generally

require the developer to provide an escrow account as a guarantee against the need for a rent increase based upon large tax increases. Since the major risk faced by the investors is from a foreclosure in the early years of the project, imposition of this and any other requirement adding to the security of the project makes it a more secure investment and presumably would increase the amount they would be willing to invest.

Still another way that MHFA has shifted risk to developers and managers has been by requiring them to provide tenants with leases specifying landlord responsibilities that go beyond customary practices. Unlike the standard lease used by HUD and the other HFA's which uses fine print and legal language, like "default of a covenant," "subordinate to a lien," and "possession of the demised premises," to spell out rights (nearly all of which accrue to the landlord) and responsibilities (nearly all of which accrue to the tenant),[1] the "MHFA Model Occupancy Agreement" uses layman's language to balance the rights and responsibilities of both landlord and tenants. In particular, it requires the management to maintain the building and grounds in good condition, and to make necessary repairs within 72 hours or face abatement of rent by MHFA. It also prohibits rent increases more than once a year or within twelve months of the initial occupancy of an indi-

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[1] HUD, "Model Form of Lease," FHA Form 3133.

vidual tenant, but allows the management to secure an eviction order for nonpayment of rent without a hearing. A hearing before an impartial hearing officer, however, must be granted upon request to tenants being evicted for other reasons.

While MHFA, in part, regards this shifting of rights to tenants as satisfying a social purpose, its primary reason for requiring it is because of the protection it provides for its own position. Because of the provisions contained in the lease, the tenants have a strong incentive to complain to the management about maintenance problems without the fear of retaliatory eviction or rent increases. The management has a strong incentive to act on these problems quickly. To the extent that such action maintains the quality of the development and its desirability as a place to live, it protects MHFA's mortgage investment.

While the New York State Urban Development Corporation is able to shift certain risks normally assumed by mortgagees to a private developer after constructin begins, prior to that time UDC, itself, assumes all of the risks normally absorbed by the developer. In its normal course of business, UDC first becomes involved with a project following a request by a municipality for assistance or at UDC's own initiative. Rather than rely upon a private developer to absorb the risk and cost of obtaining control of a suitable

site, drawing the initial plans, preparing a market analysis, and doing all of the other various tasks normally performed by the developer prior to the start of construction,[1] UDC performs these functions itself. Not until just before construction begins does UDC select a private developer to build the project and convey ownership to a limited partnership consisting of the developer as the general partner and private investors interested in tax shelter benefits as the limited partners. UDC transfers the risk of incompletion of construction to the developer by negotiating the sale of the limited partnership interests to the investors parceling out the developer's fee to him in proportion to the requisitions made by the construction contractor. In the event of construction problems, the developer receives no further fees.[2]

DEALING WITH RISK THROUGH ACTIVE INVOLVEMENT

The primary means of controlling risk used by the state housing finance agencies, however, has been to hand-

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[1] See Figure 1, p.326, *infra*.

[2] UDC, "Developement Letter" (UDC-DL 1, 12/71).

craft each project by actively participating in the development process. The HFA's have been able to do so in part because their role as a mortgagee, unlike the mortgage insurer role played by HUD, provides them with a direct relationship to project activities. While HUD also exerts controls over projects, even more control than do many private mortgagees on conventional projects, it does so in a detached, broad-scale manner, primarily through passive regulation and often through the intermediary of a mortgagee or mortgage banker. Its aim in most instances is simply to increase the fulfillment of public purposes rather than to reduce project risks to enable the achievement of these purposes. One HFA, in characterizing its own role in the development process as compared with that of HUD, could have just as easily been describing the role played by all of the advanced state housing finance agencies when it said:

> MSHDA (The Michigan State Housing Development Authority) can differentiate itself from FHA (HUD) in one word -- involvement. MSHDA actively involves itself in design, in marketing, in the choice of sites, and the development team selection. FHA is primarily a reactor to other people's thoughts and ideas. MSHDA attempts to lead, direct, and become a co-participant in development, while recognizing the necessary and valuable skills possessed by the private sector of the housing industry.[1]

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[1] Michigan State Housing Development Authority, Response to UDC questionnaire, March 1973, Sec. IV, Part XIV.

The experience that state housing finance agencies have gained from being intimately involved in a larger number of developments of a similar type than any individual developer allows them to reduce normal development risks by anticipating and avoiding problems that might otherwise occur. Many HFA's become involved in the development process also for the purpose of ensuring that the developments they finance better serve the public purpose goals of the agency. These public purpose goals, however, often add to the riskiness of the venture. What the HFA's hope is that their own involvement will either reduce the normal development risks unrelated to public purposes to such a degree that the additional risks related to public purposes can be safely absorbed, or will ensure that the public purposes will be met in such a manner so as not to appreciably add to the risks being absorbed by the project.

This section will consider through examples how state agency participation has been able to reduce normal development risks and increase satisfaction of public purposes. Each stage of the development process will be discussed in sequence.

HFA Involvement in Site and Developer Selection

Certain HFA's have succeeded in achieving program goals or reducing risks by actively soliciting proposals

from developers. William J. White, Executive Director of the Massachusetts Housing Finance Agency, found that his most important role when he first assumed his position was "hustling business" for the agency. His success in doing so in part explains why MHFA was seen to have produced the highest volume of housing per capita of any state agency. After MHFA became better established White continued seeking new business, but in a more focused manner. When the Agency determined that a strong need existed for new low and moderate income housing on Cape Cod, White phoned several developers and told them that the Agency would be eager to fund projects on sites located in that portion of the state. The result was that several developers took options on land and MHFA funded construction on six sites. Similar efforts produced housing in the Lawrence and Lowell metropolitan areas.

Not only has the "hustling of business" done by MHFA of late been directed toward specified areas of the state, but it has also been directed toward specified types of developers -- those that have demonstrated competence in building quality housing. While MHFA has provided mortgage loans to a number of inner city community groups who have acquired sophisticated technical assistance, a majority of the developers working with MHFA have been experienced and financially strong development firms. White has personally

inspected the workmanship of nearly all potential developers, and has excluded several experienced developers known for shoddy work.

The New York State Division of Housing and Community Renewal has been actively involved in the initial stage of projects through its sponsor development unit. This unit, in conjunction with the state-created Empire Housing Foundation, actively solicits nonprofit groups to sponsor housing developments for the elderly. Using specially appropriated funds, the unit then provides them with technical and financial assistance in undertaking the initial architectural, engineering, planning, legal, and packaging steps necessary to determine project feasibility. While MSHDA and the Illinois Housing Development Authority have also used specially appropriated State funds to provide seed money loans to nonprofit sponsors to pay pre-construction expenses, neither have been particularly active in seeking nonprofit sponsors and both have encouraged these sponsors to apply to HUD for permanent mortgage support rather than risk funds raised through bond proceeds.

Like most of the older HFA's, many of the newer state housing finance agencies have also actively encouraged development in particular parts of their state. The Alaska Housing Finance Corporation has gone into smaller, remote communities promoting loans by local banks which the Corporation could then purchase. Similarly, the West

Virginia Housing Development Fund has asked developers to build in rural areas of that state where housing is needed but not being built.

The ultimate extension of HFA involvement in the selection of site and developer is the initiatory role performed by UDC in its normal course of operation. Rather than wait for developers to come to it with proposals, on the basis of a request by a municipality or on its own initiative, UDC will acquire the site, do all of the necessary planning, obtain all of the required approvals, and seek out a developer to construct and own it. While as seen by UDC's large losses on abandoned projects and more indirectly by its mortgage risks taken to avoid the abandonment of particular projects, the assumption of the role of the developer during the project initiation stage involves high risks. These risks, however, are far less than would be required of a private developer involved in the same project. Indeed, many, if not most, of the projects successfully completed by UDC were projects that developers rejected because of their high risks. Particularly during its early years, UDC frequently worked with municipalities on facilitating development on urban renewal sites where no private developer could be found.[1] Its largest under-

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[1] Report of the Task Force on UDC, p.B.5.13.

taking, Roosevelt Island, has proceeded despite numerous unsuccessful prior attempts by private developers and the City of New York to develop the site.[1]

The reasons why UDC can reduce normal development risks relate to its powers, position in government, and experience. At the outset of the development process UDC will generally sign a memorandum of understanding with the local community that serves to reduce risks with regard to tax assessments, the removal of surrounding blight, and the provision of municipal services. UDC's experience reduces risks concerning the preparation and interpretation of marketability, financing, planning, and engineering studies. UDC's eminent domain power eliminates the risks of title problems and holdouts by individual parcel owners on multi-parcel sites.

Other state agencies have, on a relatively small scale, engaged in planning and development activities similar to the ones performed by UDC on a routine basis. The Massachusetts HFA has worked with tenants, the housing authority, and city officials in planning the rebuilding of two large public housing projects and conversion of them into mixed income housing. While at this writing one of these proposals is awaiting further steps by the City of Boston, MHFA

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[1] See Arnold Yoskowitz, "Roosevelt Island" (unpublished Ph.D. dissertation, M.I.T., 1975).

has secured bids from several prospective developers interested in working on the other site.

Similarly, the New York State Division of Housing and Community Renewal initiated the development of several thousand units of housing in the Inwood-Sherman Creek section of Manhattan during the late 1950's and early 1960's, some of it before the creation of the New York HFA. More recently, DHCR initiated planning for the now defunct 45,000 dwelling unit development on Floyd Bennett Field in Brooklyn.

The Michigan State Housing Development Authority and the Illinois Housing Development Authority have avoided similar opportunities afforded them to actively initiate development. MSHDA has received $2,750,000 and IHDA has received $1,900,000 in land acquisition funds. All of MSHDA's funds have been sitting in bank accounts and similar investments,[1] while $300,000 of IHDA's funds were used to buy a parcel of land on which development has thus far proven infeasible with the remainder of funds having been returned to the State of Illinois.[2]

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[1] Arthur Andersen & Co., "Financial Statements," in MSHDA, Annual Report, 1973, p.28.

[2] Arthur Andersen & Co., "Statement of Income, Expenses and Changes in Fund Balances," in IHDA, Annual Report, 1973, p.11.

In contrast to the activism of many of the state agencies in selecting developers and sites, HUD has played a relatively passive role. The HUD Central Office has attempted to impose an impartiality on local field offices that has hampered the achievement of certain program goals and has required local offices to work with many incompetent or irresponsible developers. The Task Force on Improving the Operation of Federally Insured or Financed Housing Programs found that:

> From the standpoint of HUD Central Office, the local field offices are intended to be passive entities in regard to all multifamily housing projects. Their purported role is to receive, review, and pick from among applications from interested sponsors. They are not to encourage potential sponsors to select specific geographic areas or sites. In general, they are to judge each project as it is presented without making prior determinations about the skill of builders, mortgagees, or architects -- so long as these participants do not fall within any of HUD's "unsatisfactory" or "unacceptable" categories. . . .
>
> In effect, these directives are unworkable. Local HUD offices -- particularly the most competent ones -- have strong beliefs about the geographic areas in which they would like to see projects located and the types of projects they would prefer to have built. They know the local individuals and entities who work on multifamily projects, and they have formed judgments about the skills of these persons and their abilities to perform according to HUD standards. Without any venality or corrupt motives, they will -- where possible -- attempt to impose these judgments on the development of multifamily

> housing projects in the communities under their jurisdiction.[1]

The possibilities for local offices to impose their judgments on the selection of sites or developers in an active way, however, has been relatively limited. While HUD regulations do provide mechanisms designed to eliminate "undesirable" participants, the same task force found some of them to involve "less than risk-slapping" and others as "classic examples of overkill."[2] Consequently, while perhaps a slight exaggeration, one official from the Boston Area HUD Office told the author, "Unlike MHFA, we're stuck with working with all the developers that walk in the door." For the most part, imposition of local office judgments has occurred only in subtle and passive ways.

HFA Involvement in Processing, Design, and Construction

The activisim of the HFA's continues after the selection of the site and developer. Unlike HUD, which in many offices works through mortgage bankers, the state agencies generally work directly with the developer and the architect.

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[1] Report of the Task Force on Improving the Operation of Federally Insured or Financed Housing Programs, Volume III: Multifamily Housing, pp.119-120.

[2] Ibid., p.557.

The Massachusetts HFA plays a strong role in making programmatic decisions, but does so in conjunction with the developer and architect. Agreement on these matters is reached only after negotiation or at times after MFHA redesign. MHFA requirments on these matters vary from from development to development depending upon what appears to be marketable or socially desirable. On occasion, MHFA requirements for particular projects will change from negotiating session to negotiating session in a seemingly capricious manner.

Unlike at HUD, or the other HFA's, however, negotiation with MHFA primarily centers around programmatic matters rather than details, with the details being left to the discretion of the architect. MHFA, however, reserves the right to reject the developer's choice of architect. MHFA reviews estimated construction costs primarily on the basis of aggregate figures rather than, as elsewhere, on the basis of individual line items. Contractors, however, do have to meet MHFA approval based on previous work and do have to certify each individual cost upon the completion of construction. Despite this seemingly casual approach to costing, and despite a much higher level of amenities found in MHFA buildings, MHFA was seen to have been the one state agency whose average development costs per unit were as low as those of its HUD counterparts across the state.

UDC is another state agency to take an activist role in making programmatic and architectural decisions. It will hire the architect, perform a market study, and make such programmatic decisions as the number of units, bedroom count, density, lay-out, building height, non-housing facilities, and subsidy mix even before bringing in a private developer. Because of UDC's activist role in design, some architects have complained to UDC personnel interviewed by the author that at times they are unsure whether they or UDC is designing the development.

The Illinois and Michigan Housing Development Authorities have both been more attentive to details in costing and design, however, largely through third-party review. Both of them contract out the costing function to private firms while MSHDA contracts out review as well. The primary task that these two agencies initiate independently of the developer is a marketability study. The Illinois agency even has a separate Site and Market Division whose primary function is to prepare market studies for each proposed development. This market study serves as the basis for determining the optimal number of units, bedroom distribution, and subsidy mix.

The New Jersey HFA and the New York State Division of Housing and Community Renewal, like HUD, primarily react to the programmatic preferences of the sponsors. Since the

majority of sponsors with which these two state agencies work are nonprofit organizations, more frequently the agencies find themselves in a position of limiting the extent to which their projects will serve public purpose than in inducing greater social concern. During the construction phase, however, where a for-profit contractor is invariably involved, both the New Jersey HFA and the New York DHCR have a full-time inspector on site at all times. Upon completion of construction, DHCR, using its own staff, will audit the contractor's books for the project.

HFA Involvement in Rent-Up and Management

The active involvement of state housing finance agencies is most evident during the rent-up and management phases. Among the most active HFA's during these phases is the Michigan State Housing Development Authority. MSHDA staff people are on site during rent-up, on an almost daily basis, to assist in the preparation of tenant applications and the setting up of reporting and accounting procedures. For new managers, MSHDA provides in-depth seminars on those and other more basic matters. After initial occupancy, the number of MSHDA visits to the site tapers off, although the Authority continues to attend monthly tenant meetings and provide additional on-site assistance where necessary. Once a year, MSHDA makes a thorough inspection of all

buildings, grounds, and systems for items needing maintenance, repair, or replacement. While MSHDA's heavy involvement in project affairs has meant high administrative costs (over $200 per unit per year), it has alleviated problems on certain developments that had begun to experience difficulty in meeting debt service. In one case, for example, it intervened to require the eviction of certain tenants that had been disrupting the successful operation of the project. In another case it determined that utility costs and property taxes were causing the development an undue financial strain and so provided funds to pay for added insulation and negotiated a tax abatement from the local community.[1]

The New York State Urban Development Corporation has also been highly active in the management of the developments it has financed, although with greater emphasis on requiring reports. UDC requires managers to submit three monthly reports, related to finances, occupancy, and operations. On the basis of these reports, UDC will take whatever corrective action it deems necessary. At certain times, it has transferred funds from reserve accounts to pay certain bills, and at other times it has taken over

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[1] Interview with George Fox, MSHDA Director of Finance.

complete control of the management of the property or has required a switch of private managers. Upon visiting several of UDC's most troublesome developments, the Dunham Task Force found that UDC's active involvement in project operations had resulted in such improvements as greater security, better maintenance, and more effective marketing.[1] Problems persisted on certain projects, however, primarily because of undesirable project locations.

Another way in which UDC has been involved in an active way after occupancy has been through its "live-ins." With an eye toward improving both the present development and future developments, UDC senior staff and their families have spent a few days living in several UDC-financed apartments. They slept in the developments, used the laundry facilities, attended tenant meetings, and shared in all of the other activities of the residents. As a result of their experiences, they learned such things as to provide more public telephones and more screens in particular existing developments, and to provide better noise insulation in all future developments.

The Massachusetts Housing Finance Agency has actively been involved in the rent-up and management of developments

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[1] Report of the Task Force on UDC, pp.D.1.23 - D.1.33.

in a manner that on the whole, has worked to reduce normal development risks. As it does with other professionals, MHFA inspects the prior work of management agents before allowing them to be hired. Should any problems occur in rent-up, MHFA's management officer will go out to the site to check on it. On occasion, it will allocate more subsidy funds to a mixed income development having difficulties. As occupancy continues, the management officer will visit the project approximately once a month. While he will generally go for a specific purpose, on each visit the management officer will make an assessment of the quality of maintenance and of how well the office staff relates to tenants. Such assessments have led to changes in management. MHFA has resolved problems in certain buildings by working with the tenants to gain their concurrence to significant rent increases, but only after the completion of repairs by the project owner.

Like the other state HFA's, the New Jersey Housing Finance Agency plays a relatively assertive role regarding rent-up and management, at least in comparison to HUD. The Agency makes a quarterly visit to each development at which time its primary concern is looking at the books. It will also make recommendations in such areas as how to obtain a better price on purchases of materials and how to handle bothersome tenants.

The New York State Division of Housing and Community Renewal has also played an assertive role in rent-up and management despite the fact that it allocates the least amount of dollars per unit to these areas. While the fact that it visits each development site approximately once every four to eight weeks provides a rough quantitative measure of the degree of active involvement in management by the Division, the manner in which it handles rent increases provides a qualitative, but more meaningful measure. New York City law requires that the Commissioner of Housing and Community Renewal (the chief executive officer of DHCR) conduct a hearing in the presence of all interested parties prior to granting any rent increase. One developer related to the author that on one occasion, DHCR informally recommended that his management staff file for a rent increase of $15 per month, despite the fact that the firm had not contemplated any rent increase until a few months later, and then only a $10 increase. By the time the application was filed and proper notice for a hearing given, two months had passed. At the hearing, tenants protested that the increase was too great. The DHCR commissioner agreed, and granted only a $10 per month increase. The outcome, although certainly achieved in a manipulative manner, pleased all concerned. It pleased DHCR and the project owner in that the increase would

provide sufficient funds to keep the development in a financially strong position, and satisfied the tenants in that they had successfully defeated an even greater increase.

While the management staff of the Illinois Housing Development Authority initially maintained a low profile, once Irving Gerick became IHDA's executive director in 1973, it too began to assume an aggressive role. To fulfill its public purpose objectives, IHDA takes the initiative in seeking out minority tenants during the rent-up stage. To reduce normal real estate risks, IHDA will make recommendations on equipment purchases and staffing, and occasionally suggest rent increases. In at least one instance, it required a developer to replace his management agent.

The passivity with which HUD services mortgages is illustrated by one case history related to the author by the ultimate management agent. Here, a speculative developer purchased some inner city buildings, rehabilitated them in a largely superficial manner, and sold them to the residents at a substantial profit. HUD mortgage assistance enabled the residents to meet the monthly payments and a loan from a credit company owned by the developer enabled many of them to meet the downpayment. Despite a complete lack of experience on the part of the resident cooperative, HUD allowed them to serve as the property manager without providing them any technical assistance or even insisting upon normal monthly reporting. The resulting poor management

combined with latent structural defects to force the project into default. The mortgagee then assigned the mortgage to HUD and received the insurance benefits.

HUD, then acting as the mortgagee, began considering foreclosure on the property. At this point, the local HUD office and the resident cooperative agreed upon naming a particular private management firm to both manage the property and serve as an agent for the cooperative in passing title to the project over to HUD. Over the next two years as negotiations continued, the project continued to not pay any debt service. At that point, the management firm dissolved but first assigned all of its contracts to another firm. This second firm began collecting rents on the property and paying all expenses with the exception of debt service on the mortgage. In fact, HUD completely lost track of the property for a period of six months. Finally, in the process of resuming a title search on the property, HUD determined who was serving as the new management agent and asked that they be replaced.

While this case is by no means typical of all or even a large number of HUD developments, it does represent a degree of passivity which would be inconceivable at a state HFA. Not only would any one of the HFA's be more closely involved itself in day-to-day activities, but its relatively small size would have made it easier to maintain control of each development.

Thus, quite clearly, much of the reason that so many of the HUD developments and so few of the HFA developments have experienced significant financial problems, is the techniques by which the HFA's have managed risk. The greater activism of the HFA's in project affairs was seen to have been particularly instrumental. As will be seen in the following chapter, pressures to maintain a high bond rating has provided stronger incentives to the HFA's to straighten out any problems.

CHAPTER 6

SECURING LOANABLE FUNDS FROM THE BOND MARKET

The role of the state housing finance agencies in the development process is different from that of the U.S. Department of Housing and Urban Development in another fundamental way besides their methods of managing risk. Unlike HUD, which insures loans made by private mortgagees, the HFA's borrow funds from the tax-exempt bond and money markets to enable them to provide mortgage financing directly to developers. As shall be seen in this chapter, the ability of the HFA's to borrow tax-exempt money provides them with both constraints and opportunities. The constraints result from the high degree of security required on bond and note offerings. While as shall be seen, state backing can provide some of the security, HFA projects and operations must be secure as well. The opportunities result from the ability of the HFA to provide financing at below market interest rates. This chapter will spell out these constraints and opportunities with the first section containing a regression analysis and discussion of the components determining the net interest rate to the HFA's and the second analyzing the way in which interest savings affect the viability of projects.

THE BOND MARKET

State housing finance agencies, unlike HUD, must periodically go to the bond market to obtain loanable funds. In order to secure funds at the lowest interest rate, HFA's must cater to the needs and goals of potential bond buyers. HFA's can serve some of these needs with little diversion from their own public purpose goals; however, having to go to the bond market does place certain constraints on the maximization of other goals.

To assess the net interest rate that HFA's have to pay on bond issues, a regression analysis was run based upon data from 42 bond offerings between January, 1970, and June, 1974. These 42 sales include all of the long-term HFA bonds issued during the period. Nineteen independent variables related to each issue were regressed against the dependent variable, the net interest rate to the agency. Of these, nine variables were found to be significant (at the 0.5 level) in explaining net interest costs with the others either not being significant enough to enter into the regression equation, or entering into it in an insignificant manner. The effect of each of these variables is summarized in Table 28.

The overall results of the regression equation explain 89 percent of the variation in net interest rates (i.e., the multiple correlation squared equals .893). The standard

Table 28

Regression Results for Dependent Variable: Net Interest Rate

Step 10 of Stepwise Regression

Variable Description	Coefficient	Std Error of Coefficient	Standardized Coefficient	t-test	DF	Significance	Unique Variance
Tax-Exempt Av By Week	1.0996	0.099	0.745	11.11***	31	Under .001	.426
Amount in Millions	0.0027	0.001	0.348	4.83***	31	Under .001	.081
Moodys Rating	-0.1776	0.026	-0.552	-6.79***	31	Under .001	.159
Alaska Special Reserve	-2.1034	0.703	-1.285	-2.99**	31	.006	.031
Term Amt Over Total Amt	0.2588	0.079	0.247	3.28**	31	.003	.037
Fund Bal Over Debt	0.0804	0.036	0.974	2.26*	31	.031	.018
Urb Ren-MC In Tenths	0.0297	0.013	0.152	2.24*	31	.033	.017
Post Or Pre Moody Reeval	0.2213	0.084	0.206	2.64*	31	.013	.024
No. Of Months Aft Mar 70	-0.0052	0.002	-0.210	-2.35*	31	.026	.019
S and P Rating	0.0547	0.044	0.107	1.24	31	.224	.005
Regression Constant		0.143					

Multiple Correlation Squared = 0.893
Multiple Correlation = 0.945
Standard Deviation of Residuals = 0.161

F = 25.88 with 10 and 31 degrees of Freedom
(P under .001)

Partial Correlations with Dependent Variable for Variables not Entered

Variable	Partial Correlation
Average Term	0.008
Bid or Negot	0.025
No Rating from Moodys	-0.153
Purpose	0.022
Total Amt Within Past Yr	-0.038
Moral Oblg	0.229
Single Family	0.009
Secondary or Direct Loan	-0.191
Non-Profits in Tenths	0.157

deviation of the residuals was 0.161, meaning that in about 65 percent of the cases, the actual net interest rate lies within 16 basis points of the predicted value.[1] While as with any regression model, certain observed correlations between any two variables may simply reflect their mutual relationship to a third variable, the fact that all of the variables found to be significantly related to the net interest rate were computed to be related in the predicted direction, provides some measure of confidence in the validity of the results.

Still,the impact of each variable on net interest costs will be examined in the context of a broader discussion of the four basic factors determining these costs: market conditions, perceived security, term, and tax-exempt status. A discussion of each of these factors will follow in turn based upon the results of the regression model, as well as a review of documents and literature on the subject and interviews with security dealers, rating agency officials, and purchasers and issuers of HFA bonds.

Market Conditions

As even common sense would suggest, the strongest determinant of the net interest rate paid by state housing finance agencies is market conditions at the time of issuance. The

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[1]One basis point equals .01 percentage points of interest.

Moody's Weekly Average of interest rates paid on all tax-exempt bond issues was found to explain by itself 43 percent of the variation in HFA interest rates (p = under .001).[1] While the tax-exempt market is distinct from other capital markets, clearly it is interrelated to the general economy. Because maximum benefits from tax-exempt bonds are derived by purchasers who have high tax brackets and who are able to tie up their funds for several years, certain groups of purchasers have come to dominate the tax-exempt market. Between 1970 and 1972, net purchases of state and local debt obligations were divided as follows:

Commercial Banks:	65.3%
Fire and Casualty Insurance Companies:	11.2%
Individuals and Trusts:	22.2%
Others:	1.2%[2]

According to security dealers interviewed, these same groups dominate the market for HFA bonds with commercial banks concentrating their purchases in short term notes and bonds and the insurance companies buying longer and riskier issues. During tight money periods, commercial banks become less interested in new purchases and concentrate their then limited

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[1]Purists might dispute using this measure because the net interest rate on each bond considered, i.e., the dependent variable, is used by Moody's in calculating its index. Still, each individual bond plays an almost insignificant role in determining the overall tax-exempt bond rate.

[2]The Bond Buyer, Statistics on State and Local Government Finance (The Bond Buyer: New York, 1973), Vol. II, p. 17.

resources on meeting the needs of businesses with whom they deal on a face-to-face basis.

The slack in the tax-exempt market is picked up primarily by individuals. In order to attract a sufficient number of individuals into the tax-exempt market, interest rates have to increase significantly. Since conventional mortgage rates also increase during such periods, HFA's maintain a competitive advantage.

Other bond market factors are more specific in impact. The market for HFA bonds varies by locality. Bond purchasers are generally more interested in buying local bond issues than out-of-state issues because these issues are more likely to be exempt from state income tax, because their issuers are more familiar, because these bonds can be used by banks to satisfy pledging requirements, and because such bonds appeal to sentiments for local boosterism. Consequently, local banks whose contacts are also local, generally serve as co-underwriters for HFA bond issues. Undoubtedly, a certain percentage of the unexplained variation in net interest rates results from differences between the local and national market conditions at the time of issuance, an analysis that was not attempted in this dissertation.

The supply side of the market for specific issues, however, was found to have an extremely significant influence on the net interest rate. The bond market has had difficulty in

absorbing large issues. After taking into account all other factors, the net interest rate has been 0.27 basis points higher for every million dollars of bonds contained in the offering ($p = .001$). Thus, the largest offerings, which have been on the order of $250 million, have had to pay a premium of about 65 basis points compared with the smallest offerings, which have been about $12 million. The other measure used of the ability of the market to absorb new issues, the total volume of bonds issued by the agency within the prior year, failed to provide any additional explanatory value.

A final variable related to market conditions that was tested was whether the bonds were sold on a bid or a negotiated basis. Several bond underwriters have argued that on unusual types of offerings like moral obligation bonds, negotiated sales lead to lower interest rates in that they reduce the risk to the underwriter by enabling him to pre-sell the issue in advance of quoting a price. Most HFA's have accepted this argument and have sold their bonds on a negotiated basis to favored underwriters. Arthur Levitt, New York State Comptroller, however, has argued that competitive bidding leads to lower rates.[1] Consequently, in June of 1973, he requested that all New York State agencies begin selling bonds on a competitive basis. The results of the regression analysis reveal an insignificant difference on interest rates between bonds sold on a bid basis and those sold on a negotiated basis.

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[1] Weekly Bond Buyer, June 4, 1973, p. 1.

Perceived Security

The perceived security of the bonds is the determinant of the interest rate that states and state agencies can most easily alter. The market perception of the security of housing finance agency bonds depends in a large measure on the rating given by Moody's Investors Service. Only the largest institutional buyers are capable of making a thorough, independent analysis of the security of bonds. Even they realize that the value of the bond, should they choose to sell it, will depend in part on its Moody's rating. The regression analysis found an average difference in net interest cost paid by HFA's of 18 basis points per rating increment counting an increase in rating from A to A-1 as one increment (p = less than .001).[1]

The rating given by Standard & Poors, however, was found to have had a statistically insignificant independent effect on interest rates. The primary value of a Standard & Poors rating would appear to have been to provide a justification for purchases made of HFA bonds that lack a rating by Moody's. Banking commissioners and many investment committees of banks and insurance companies will forbid or carefully scrutinize purchases that are not rated at least BBB (or for some, A)

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[1]The highest Moody's bond rating is Aaa followed in descending order by Aa, A, and Baa. Moody's also gives the rating of A-1 to bonds between A and Aa, and gives a rating of Baa-1 to bonds between Baa and A. Bonds that are rated below Baa are deemed to be not of "investment grade."

by Standard & Poors or Baa (or for some, A) by Moody's.[1] Thus, the AA rating from Standard & Poors on Alaska Housing Finance Corporation, Missouri Housing Development Commission, and certain New Jersey Mortgage Finance Agency bonds that had been unrated by Moody's has undoubtedly enabled investors to look beyond the ratings in purchasing these bonds. The Alaska Housing Finance Corporation bonds, for example, largely on the basis of their Special Reserve Fund backing, have sold at a rate that is 210 basis points lower than would be expected on unrated bonds, even lower than would be expected on AAA rated bonds.

Because all of the bonds under consideration that have been unrated by Moody's have received an identical AA rating from Standard & Poors, the impact that the Standard & Poors rating has had on bonds like those issued by the Alaska agency cannot be ascertained through regression analysis.

Moody's, Standard & Poors, and individual investors look at the security of a state housing finance agency bond issue from three levels. First, they look at state back-ups for bond repayment. Second, they look at reserves being provided by the agency. Finally, they look at the basic source of repayment of the bond, agency operations including the mortgage loans being made, and the personnel making them. These three levels of security will be looked at in order.

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[1]The four highest Standard & Poors ratings are AAA, AA, A, and BAA which are regarded as the equivalent to Moody's ratings of AAA, Aa, A, and Baa, respectively.

State back-ups

The most common form of state backing of housing finance agency bonds is known as the moral obligation. The mechanics of the moral obligation vary slightly from state to state, but basically all call upon the state to be responsible for debt service payments when the state agency is unable to do so. The state agency generally covenants to place in reserve the full amount of the following year's debt service payment. In certain states, in any year that the agency is unable to meet the debt service reserve, the legislature is directed by statute to approve the appropriation of whatever funds are necessary to restore the debt service reserve; in others, the governor is directed to include the deficit in his budget for consideration by the legislature.[1] The difference simply reflects the manner in which states formulate their budgets. In Virginia, the legislature is simply directed to consider making such an appropriation. Despite these variations in wording, the effect is the same. As has often been spelled out in state court rulings, a legislature creating an HFA generally cannot legally obligate future legislatures to appropriate the necessary funds. In fact, an Oregon court

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[1] The Maine, New Jersey, New York, and Tennessee agency statutes are among those where the legislature must appropriate the funds; the Illinois, Michigan, Minnesota, Oregon, Pennsylvania, Rhode Island, South Dakota, West Virginia, and Wisconsin agency statutes require the governor to budget the funds.

ruled that moral obligation provision backing bonds to be issued by the Oregon Division of Housing invalid because it stated that future legislatures "shall" appropriate the funds necessary to restore deficiencies in the agency's reserve funds.[1] Courts in other states have ruled that the word "shall" really means "may" and consequently, such reserve fund back-ups do not constitute a legal debt of the state and are not charged against the state debt limit.[2] Official offering statements accordingly use language on their cover such as:

> The Agency has no taxing power. The State of Minnesota is not liable on the Series A Bonds and said Bonds are not a debt of the state.[3]

These back-up provisions, however, do constitute a "moral obligation" of the state in the sense that future legislatures are "morally obligated" to respect the intent of their predecessors. The housing finance agencies that currently

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[1]Housing and Development Reporter, Febrary 24, 1975, p. 865.

[2]Massachusetts Housing Finance Agency v. New England Merchants National Bank, 249 N.E. 2d 599: RE: Advisory Opinion on Constitutionality of Act No. 346 of Public Acts of 1966 (Michigan), 158 N.W. 2d 416: Johnson v. Pennsylvania Housing Finance Agency, 9-19-73; Maine State Housing Authority v. Depositors Trust Co., 278 A. 2d 699.

[3]Minnesota Housing Finance Agency, Official Statement, August 23, 1973.

have the moral backing of their states include:

Connecticut Housing Finance Authority
Illinois Housing Development Authority
Maine State Housing Authority
Massachusetts Home Mortgage Finance Agency
Massachusetts Housing Finance Agency
New Jersey Housing Finance Agency
New York State Housing Finance Agency
State of New York Mortgage Authority
New York State Urban Development Corporation
Ohio Housing Development Board
Pennsylvania Housing Finance Agency
Rhode Island Housing and Mortgage Finance Agency
South Dakota Housing Development Authority
Tennessee Housing Development Agency
Virginia Housing Development Authority
West Virginia Housing Development Fund
Wisconsin Housing Finance Agency

The New York City Housing Development Corporation has the equivalent to state moral obligation backing in that New York City has pledged to use the general revenues allocated to it by the State to satisfy any deficiencies in the Corporation's reserve fund. In addition, state moral obligation backing stands behind the bonds issued by the following other agencies:

New Jersey-New Jersey Sports and Exhibition Center
South Jersey Port Authority
New York- Battery Park City Development Corporation
New York City Educational Construction Fund
New York City Stabilization Reserve Corporation
New York State Atomic and Space Agency
New York State Environmental Facilities Corporation
New York State Job Development Authority
United Nations Development Corporation

When Moody's and Standard & Poors began rating bonds backed by the moral obligation of the state, they both assigned them a rating one level below that given on general obligation bonds

of that state. Thus, for example, since the State of Illinois has a "triple A" rating from both agencies, the Illinois Housing Development Authority bonds had been rated as "double A" by both of them. While Standard & Poors has for the most part retained this rating system, Moody's began placing less credence in state moral obligations.[1] In its September 17, 1973, Bond Survey, Moody's cited the burgeoning use of moral obligation bond financing, particularly in the state of New York.[2] Were that state called upon then to simultaneously satisfy all of its moral obligations, it would have had to increase its budget by 10 percent. As of June 30, 1973, New York had $3.3 billion in moral obligation notes and bonds outstanding compared with $6.4 billion in tax-supported debt. Moody's questioned whether any state would raise taxes to meet a moral obligation. It concluded that:

> The analysis of obligations secured by revenues associated with a project must look first and primarily to those revenues. Where the issue is secondarily secured by an opinion that the state may legally appropriate funds to fill a reserve deficiency, that element of security can at best, in our opinion, be regarded as a rating floor in which elements of speculation remain.[3]

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[1] The one exception to Standard & Poors ratings has been the New York State Housing Finance Agency, which maintained its A rating in 1972 when the rating for New York State and other agencies with New York State moral obligation backing was being lowered.

[2] "Backups, Makeups, ard Moral Obligations," Moody's Bond Survey, September 17, 1973, pp. 568-9.

[3] Ibid.

As the result of this reexamination, the rating of the New York State Urban Development Corporation (UDC) slipped from A to Baa-1 (a high Baa) as Moody's made the determination that despite competent management, UDC had the "glaring weakness" of not being able to generate sufficient revenues without state appropriations to meet its debt service payments for at least the following five years.[1] Unlike most other HFA's who tie the repayment of each bond to specific mortgages, UDC's role as a developer has led it to structure its bond issues to enable it to use the proceeds for any corporate purpose without identifying specific sources of repayment. At the same time that Moody's lowered UDC's rating, it also lowered the ratings of the Illinois Housing Development Authority and the New Jersey Housing Finance Agency from AA to A-1, but raised those of the Massachusetts Housing Finance Agency and the New York State Housing Finance Agency from A to A-1.

The impact of Moody's reevaluation announcement on the market for moral obligation bonds was considerably stronger than would be expected by a simple change in a few ratings. While interest rates on moral obligation bonds had been declining at the rate of about one-half of a basis point per month as investors gradually gained more confidence and familiarity with

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[1] Moody's Bond Survey, October 8, 1973, p. 507.

these bonds, all such bonds issued after the date of Moody's announcement have sold at 22 basis points higher than those issued previously after controlling for each of the other independent variables, including the market level for all tax-exempt bonds. Apparently, Moody's questioning of the worth of state moral obligations sent shock waves through the investment community and led investors to make their own reevaluations with the consensus being even more skeptical than Moody's itself.

The next questioning of the worth of state moral obligation financing came in June, 1974, when the New York and New Jersey legislatures simultaneously rescinded the moral obligation backing they had provided to the Port Authority of New York and New Jersey.[1] Since all of the bond offerings examined were issued prior to this revocation, no analysis of its impact on other issues was made. The New Jersey Legislature, however, has maintained its moral obligation backing for the South Jersey Port Authority, the first agency to require state appropriations to fund deficiencies in its reserve fund. On three occasions, the South Jersey Port Authority required state appropriations to restore its debt service reserve fund. In each instance, the New Jersey Legislature made good on its moral obligation.

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[1] Moody's Bond Survey, June 24, 1974, p. 77.

In New York, the initial legislative response to the Urban Development Corporation's default on $100 million in maturing bond anticipation notes was less affirmative.[1] Statutorily, moral obligation backing did not apply to these and all other bond anticipation notes. Nonetheless, the investment community had widely regarded states morally responsible for defaults on bond anticipation notes issued by agencies with moral obligation backing for their bonds. Rather than pay off the notes as they matured, the New York Legislature first voted to create a separate Project Finance Agency and provide it with $90 million to buy UDC mortgages and forbid it to use the funds to repay noteholders. Only after a few months of negotiations when it became clear that the major New York City banks would not support offerings of this agency or by UDC itself, did the Legislature relent and allocate funds toward the repayment of the notes. Still, UDC's default has had a strong negative impact on the market for moral obligation bonds. According to Alan N. Weeden, president of Weeden and Company, the UDC default could increase the net interest rate paid by agencies with the moral obligation backing of New York State by 100 basis and increase the rate paid by agencies in other states with equivalent backing by as much as 25 basis points.[2]

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[1]See Appendix B on "Why the UDC Default."

[2]Housing and Development Reporter, March 10, 1975, p. 1035.

Certain states have provided backing for housing finance agencies in a manner that avoids the ambiguity in the minds of the investors as to whether the state will uphold its moral obligation. Upon certification by its Chairman that deficiencies exist in the reserve fund of the Connecticut Housing Finance Authority, such appropriations are automatically made without any required legislative action.[1] Presumably, however, future legislatures could alter this provision. Consequently, these bonds do not constitute a debt or liability of the State of Connecticut or a pledge of its full credit.[2] Still, this mechanism has enabled the Connecticut agency to receive an Aa rating from Moody's.

Should a deficiency occur in the debt service reserve fund of the Alaska Housing Finance Corporation, the Corporation can turn to a "Special Pledge Fund" held by the Alaska Commissioner of Revenues.[3] This fund consists of cash and mortgages purchased with State moneys having a value equal to 20 percent of the amount of bonds the Corporation has outstanding for about the first five years, and 10 percent thereafter. The State has no further legal or moral obligation to meet

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[1]Connecticut Housing Finance Authority, Proposed Official Statement Dated December 7, 1973, p. 1.

[2]Ibid.

[3]Alaska Housing Finance Corporation, Official Statement, April 24, 1973, p. 13-14.

deficiencies beyond this amount. The Alaska Housing Finance Corporation, however, has covenanted to obtain Federal mortgage insurance or guarantees on 90 percent of its mortgages. As mentioned above, the result of these security measures has been to decrease the net interest rate to the agency by 210 basis points.

The Missouri Housing Development Commission has no moral obligation backing, but does have a mortgage insurance fund of $1 million. This fund was created through an appropriation of revenue sharing funds in 1973. The one Missouri agency bond offering included in the regression analysis, however, was issued prior to the establishment of this fund. Its security rests with the Federal insurance provided on each of its mortgages.

Housing finance agencies in other states, including Georgia, Idaho, Kentucky, Louisiana, and Vermont, still have no state back-up. In order to market their bonds, they have had to agree to use the proceeds to finance only insured mortgages. The North Carolina Housing Corporation, which also had no state back-up, found that at the time it considered going to market, the interest it had to pay approximated the interest on the HUD insured mortgages it planned to purchase leaving insufficient margin to cover its own operating expenses.[1]

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[1] Michael Stegman, The Multiple Roles of State Housing Finance Agencies: The North Carolina Housing Corporation, (North Carolina Department of Administration: Raleigh, May, 1972.)

As a result, it issued no bonds, and the North Carolina Legislature terminated its operation, although they later created a new North Carolina State Housing Finance Agency with moral obligation backing. The Kentucky Housing Corporation, which also lacks the statutory backing of a state moral obligation, has attempted to approximate the security provided by a statutory moral obligation clause. In its bond resolution, the Corporation covenants that it will make a formal request for funds to the Kentucky legislature should its reserves dip below the amount required to meet the debt service required for the following year. This covenant appears to have had little or no effect on the marketability of the Corporation's bonds. The fact that the legislation creating the Kentucky Housing Corporation requires it to secure Federal insurance on each of its mortgages has enabled it to receive an A rating from Moody's. The Missouri and West Virginia agencies, which initially issued bonds without state backing, along with Alaska, were the only ones to do so without a Moody's rating. Their bonds sold at an interest rate indicative of a Baa or Baa-1 rating.

Otherwise, market acceptance of bond issues backed by Federally insured or guaranteed mortgages have corresponded with the Moody's rating. While such insurance and guarantees have had significant influence in determining the rating given by Moody's, their presence has not caused them to perform any differently from other bond issues with the same rating.

Delaware, Hawaii, and Maryland each provide the strongest state backing possible. In these states, housing bonds are general obligations of the state's full faith and credit, including its taxing power. The bonds are issued by the state with the proceeds being turned over to the state housing authority or division.

These state agencies, however, have received proceeds from only a small volume of bonds. Moreoever, except for the Maryland agency which is using part of the proceeds from state general obligation bond issues as an insurance fund to back the issuance of its own revenue bonds and thereby leveraging their impact, those agencies that rely upon the general obligation backing of the state are unlikely to ever receive a large amount of funds through the bond market. The bonds that support these agencies count toward their state's debt limit. Precisely because New York City and New York State borrowing for housing was already pushing these bodies too heavily into debt at a time when they wanted to expand borrowing for housing, they created the New York City Housing Finance Corporation and New York State Housing Finance Agency with moral obligation backing. No analysis was performed on the interest rate on general obligation bonds.

Reserves

In addition to the debt service reserve fund to meet the principal and interest due on their outstanding bonds during

the coming year, the HFA's also maintain funds in other assorted accounts that they can use if necessary to meet their bond obligations. These funds represent an added cushion to bond holders and reduce uncertainty regarding state back-ups. While Moody's often includes an abbreviated financial statement in its credit report on the agencies it rates, it clearly places less importance on the amount of fund balances available to meet debt service than do investors. Data was incorporated into the regression analysis on the ratio of fund balances available to meet debt service to outstanding notes and bonds for each agency at the time of issuing each bond.[1] The resulting regression coefficient was 0.0804 per every one percent of reserves compared with outstanding notes and bonds ($p = .031$). In other words, each one percent of reserves was found to have made a difference of about 8 basis points after controlling for the Moody's rating and the other factors considered. These reserves may have also made a difference in determining the Moody's rating. The high reserve ratio of the Massachusetts Housing Finance Agency at the time of its 1972 Series A issue, which at 2.78 percent of outstanding debt was the highest of any HFA issues, reduced net interest costs to the agency by about 25 basis points in comparison

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[1]Debt service reserve funds accruing from bond proceeds were excluded. The amount of the bonds in the issue being considered was counted as an outstanding debt.

with the 1971 Series A issue of the Missouri Housing Development Commission, which with a reserve ratio at that time of -0.34 percent had the lowest ratio.

Agency operations

The basic source of funds to repay bonds comes from mortgage repayments. Yet, neither the ratings agencies nor the bulk of the securities investment community are real estate experts. Even if they were, it would be difficult for them to examine each project contained in most bond issues. Nonetheless, on occasion, persons from the ratings agencies and their projects are influenced by their impressions. The professional capability and experience of the staff is also regarded as a key factor. While Moody's officials did tell the author that they do recognize differences in the capabilities of the different agencies, each of the HFA's making uninsured loans have been deemed by Moody's simply to be "professional." In retaining the A rating it gave the New York State Housing Finance Agency at a time when it was lowering the rating it gave to other New York State agencies with moral obligation backing, Standard & Poors was impressed by the fact that the agency administered its housing programs with a staff of only five, disregarding the fact that about 200 employees of the New York State Division of Housing and Community Renewal perform the processing, regulative, and managerial functions for the HFA that are done in-house by the other finance agencies.

The ratings agencies as well as investors generally respect the professionalism of housing agency staffs in determining the adequacy of project sites and amenities.

The one aspect of the loans made by the HFA's that investors have looked at more critically than the rating agencies has been the extent to which they have been located in inner-city slum areas. The indicator used to measure slum areas in the regression analysis was whether the property was within the boundaries of an urban renewal or model cities area. Even on the basis of this somewhat crude measure, bonds backed by projects that all lie within such "slum areas" were found to sell at a premium of 30 basis points ($p = .033$) compared with bonds backed by projects lying completely outside of these areas. Other mortgage underwriting policies, including use of nonprofit or limited dividend sponsors, loan-to-value ratios, single family versus multi-family housing, and secondary versus direct lending were found to have made an insignificant difference in terms of interest cost or rating.

The fact that the type of project sponsor, whether it be nonprofit or limited dividend, has had an insignificant impact is revealed by the fact that this variable does not enter the regression equation. Additional evidence of its insignificance comes from the fact that both ratings agencies give individual but identical ratings to the New York State Housing Finance Agency's nonprofit housing program as they do to the agency's other housing programs used by limited dividend sponsors, even

though the reserves backing the nonprofit program are a slightly lower percentage of outstanding debt than those backing their other housing programs. Further, New York State Housing Finance Agency's Nonprofit Housing Series A bonds were initially reoffered to the public on the same day at the identical rate for equal terms as New York State Housing Finance Agency 1971 General Housing Series A bonds.[1] Should nonprofit sponsors of New York Agency projects or of projects of any other state agency, however, show a higher default and foreclosure rate, as they have on HUD projects,[2] then investors will undoubtedly begin to demand a higher rate of interest on bonds backed by projects sponsored by nonprofit organizations.

Likewise, the loan-to-value ratio given on HFA financed mortgages has made no difference on the interest rate. Most private mortgages regard any mortgages with a loan-to-value ratio in excess of 80 percent as highly speculative. They only provide mortgages with high loan-to-value ratios on the soundest projects with the most financially solvent mortgagors, and then only when funds are freely available. They worry that in the event of a foreclosure, they will be unable to sell the

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[1]New York State Housing Finance Agency, Official Statement, Nonprofit Housing Project Bonds and Official Statement, General Housing Loan Bonds, December 3, 1971.

[2]HUD, "Selected Multifamily Status Reports: Mortgage Insurance Programs," (OZ series), as of December 31, 1973.

project for a sufficient amount to recoup their investment. State housing finance agencies, however, provide mortgages with a minimum loan-to-value ratio of 90 percent in order to entice sponsors and investors without having to pay them high profits through higher rents. The New York State Housing Finance Agency allows loans of 90 percent of value under its General Housing Program; 95 percent of value under its Urban Rental Housing Program; and 100 percent of value under its Nonprofit Housing Program. The only significant difference between the first two of these programs is the loan-to-value ratio and the type of sponsor. Despite these differences, both ratings agencies have given each program the identical rating as the other programs. Further, no significant difference in interest rates has been manifest. In fact, the observed interest rate on the one Urban Rental Program issue was actually slightly lower than the predicted value while the reverse was true with regard to two of the three General Housing Program issues. Clearly, differences in the loan-to-value ratio are not a significant consideration to investors because if they had been, the signs of these residuals would have been reversed.

The other two variables considered relating to the character of the mortgage portfolio were single family versus multi-family lending and direct lending to developers or consumers versus secondary lending through mortgage purchases. Secondary lenders were found to be preferred to direct lenders

in the marketplace, although to an insignificant degree. No difference was found between single-family and multi-family lenders.

Term

The effect that the average term of all the bonds within a single issue has had on the composite net interest rate paid by the HFA's was computed to be surprisingly small. In fact, the variable, "average term," failed to enter the regression equation and showed a partial correlation of 0.008 with those variables that did. The reason that this result is surprising is that most issues have consisted of serial bonds with varying maturities that securities underwriters have purchased on an aggregate basis at a fixed price and then reoffered the individual bonds within the offering at a schedule of prices and corresponding yields that depend solely upon the term. With regard to every offering examined, the yield was lower on shorter bonds than on longer bonds. For example, the Massachusetts Housing Finance Agency 1973 Series A issue contained $250,000 in bonds maturing in 1974 and increasing amounts on additional bonds maturing in each succeeding year as expected mortgage debt service repayments are made until 2013 when $2,615,000 in bonds mature. Securities dealers initially priced the bonds maturing in 1974 to yield 4.0 percent and those in each succeeding year to yield an increasing rate of

interest up to 5.7 percent for 40 year bonds maturing in 2013. MHFA sold the entire $43,425,000 issue to a syndicate of underwriters at a price that would require MHFA to pay a net interest of 5.68 percent.

Part of the anomaly of the highly significant difference that the term has made with regard to reoffering yields and the insignificant impact average term is reconciled by the fact that offerings consisting exclusively of term bonds, i.e., bonds with a single maturity date, were found to yield 26 basis points more than serial bonds, i.e., bonds with multiple annual maturity dates and relatively short average terms. The other reason for the insignificant impact that the average term was computed to have had on the net interest cost is the relatively small range within which the average terms of each serial issue considered has fallen. The range has been between 20 and 34 years.

The relative insensitivity of the net interest rate to the average term, particularly among long term bonds within the range already tested in the marketplace, means that many HFA's would be able to reduce the annual debt service on their mortgages by issuing longer term bonds and correspondingly longer term mortgages. The New Jersey Housing Finance Agency and the New York City Housing Development Corporation have demonstrated that 50 year bonds are as salable in the bond market as 40 year bonds. The reoffering yields on the New Jersey Agency's 1972 Series B bonds maturing 50 years after

the date of issue were identical to those on bonds maturing after 36 through 49 years.[1] The reoffering yields on the New York City agency's 1973 Series A bonds maturing 50 years after the date of issue were identical to those on bonds in the same issue maturing after 30 through 49 years.[2] In other words, underwriters perceived no difference in risk in the repayment of bonds due in 50 years than they did on bonds due in 30 or 36 years. As a result, these agencies were able to extend mortgages out to 50 rather than 40 years, and thereby reduce the constant annual debt service from 6.40 percent to 6.10 percent, assuming an interest rate of 5.75 percent in both cases. Based upon an average mortgage of $25,000 per unit, this extension allows a $6.25 savings in rent or subsidy per unit per month throughout the life of the loan.

The extreme difference between the average term on HFA notes as compared with bonds has made a significant difference between the rate on notes and bonds. Bond anticipation notes and construction loan notes have generally had a maturity of between six months and two years, and have been used by HFA's to provide interim financing during the period of construction. Consequently, HFA's have generally been able to finance construction

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[1] New Jersey Housing Finance Agency, _Official Statement_, December 14, 1972, p. 1.

[2] New York Housing Development Corporation, _Official Statement_, November 1, 1972, p. 1.

loans at lower rates than the low rates they provide on permanent mortgages. Only when long-term interest rates are expected to climb markedly do short-term rates exceed long-term rates. Only then do HFA's charge higher rates on construction loans.

The relationship between short-term construction loan rates and long-term permanent mortgage rates on privately-financed housing developments is the reverse of that normally found on HFA-financed developments. Construction loan financing by private lenders is more expensive than permanent financing because private lenders regard it as considerably more risky. Private construction lenders realize that their basic security is the commitment on the part of another lender to provide permanent mortgage financing. Similarly, purchasers of HFA bond anticipation notes must rely on the willingness of other investors to buy long-term HFA bonds to enable the HFA to have sufficient funds to redeem their notes. As illustrated in the UDC default, such investors may not be readily available. Investors in HFA notes (who are generally commercial banks that have a department that makes construction loans) had regarded their investment as being at least as secure as HFA bonds, and had believed that its short-term nature justified a low rate of interest.

Until 1973, neither Moody's nor Standard & Poors provided ratings on note issues, thus investors usually looked at the

bond rating as a guide to security of the bond anticipation note. Finally, Moody's began assigning "MIG" ratings on notes when requested by the state agency. While many HFA's have chosen to continue to market their notes without applying for a rating, those that have asked for an "MIG" rating have generally received a rating at least comparable to their bond rating and often higher. UDC, for example, received a middle level, MIG-2, rating on its notes while it had a relatively low Baa-1 rating on its bonds.

The difference in interest rates between conventionally financed construction loans and state agency-financed construction loans has been marked. As can be ascertained from the above discussion, the differences have been much greater than on the permanent loan. As a typical example, the Michigan State Housing Development Authority provided construction loans at 3.4 percent in November, 1972, after having issued notes at 2.9 percent. At the same point in time, construction loans in the private market in the Detroit area went for about 10 percent on the open market. The UDC default, more than likely, will lower "MIG" ratings and investor perception of the security of HFA bond anticipation notes more than it will lower Moody's ratings and investor confidence in HFA bonds. Consequently, the savings that HFA's have been able to provide on construction loan interest is likely to be reduced more than on permanent mortgage financing. Still, during most periods,

HFA's should be able to provide greater savings on construction loans than on long-term mortgages.

Tax-Exempt Status

The reason that HFA's should be able to maintain their competitive advantage is the tax-exempt status of their bonds arising from the fact that the HFA's are instrumentalities of the states. The legal basis for Federal tax exemption of state bonds goes back to the case of McCulloch v. Maryland, 4 Wheat. 316 (1819), where the Supreme Court enunciated the doctrine of reciprocal immunity between the states and the federal government. Daniel Webster made the telling argument before the court that, "An unlimited power to tax involves necessarily a power to destroy." In Pollock v. Farmers Loan and Trust Co., 157 U.S. 429 (1895) the Court specifically forbid the imposition of a federal income tax on income from state and municipal bonds. The 16th Amendment, however, has since given Congress the power to tax income "from whatever source derived." When Congress began implementing an income tax in 1913, it specifically exempted interest on bonds of states and their instrumentalities from taxation. This exemption has remained in the Internal Revenue Code through the years.

The first Congressional attempt to tax municipal bonds applies only to state housing finance agency issues.[1] The

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[1]Section 802, Housing and Urban Development Act of 1974.

Housing and Community Development Assistance Act of 1974 provides HFA's with a 33-1/3 percent interest subsidy if they opt to issue taxable bonds.[1] Funds, however, have yet to be appropriated, and even when they are, state agencies will still have the option to issue tax-exempts.

The primary reason for Federal efforts to eliminate or reduce the number of tax-exempt state and local debt financing is the high cost to the Treasury in relation to the benefits conferred to the state or state entity. Virtually all of the buyers of state and state entity bonds are in high tax brackets. Commercial banks and fire and casualty companies which account for over three-quarters of all net purchases of tax-exempt bonds each fall into a corporate tax bracket of 48 percent. The precise tax bracket of the only other major net purchaser of tax-exempt bonds, individuals, is unknown. Two studies, however, have shown that in past years, two-thirds of all tax-exempt bonds were held by the upper one percent income group.[2] Given that the top bracket is 50 percent on earned

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[1]The most direct challenge to the ability of state HFA's to issue tax-exempt bonds came from the Office of Management and Budget in its 1974 proposed Circular A-70 (Section 5-C) which specified that all state and local bonds backed by direct or indirect Federal guarantees be denied tax-exempt status. The language clearly implied that Federal interest subsidy payments or mortgage insurance would constitute an indirect Federal guarantee and render any associated bond financing taxable. State housing finance agencies, however, were able to rally sufficient political pressure to eliminate this provision from the final regulations.

[2]Thomas R. Atkinson, <u>The Pattern of Financial Asset Ownership; Wisconsin Individuals 1949</u> (Princeton: Princeton University Press, 1956), <u>The Impact of the Undistributed Profits Tax, 1936-1937</u> (New York: Columbia University Press, 1948), p. 116.

income and 70 percent on other income, an average individual bracket of 48 percent would be a reasonable estimate. In any event, the actual average bracket of individuals holding state and local debt obligations would not deviate from 48 percent by enough to cause the average bracket of all holders of such debt to deviate from 48 percent by more than a couple of percentage points. This 48 percent represents the loss to the U.S. Treasury in forgone tax revenue.

The amount of benefits conferred to state and local entities in general and to HFA's in particular, is considerably less than a 48 percent savings in interest costs. Benefits can be computed by comparing average yields on state and local bonds with those of taxable corporate bonds of equivalent quality and equal terms.[1] During the period of 1970-1973, the interest

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[1]Some economists have argued that if state and municipal bonds were made taxable, they would sell at slightly higher yields than corporate bonds with a comparable rating and term. The reason they give is that most states and municipalities, unlike corporations, issue serial bonds. The small volume of bonds in a serial issue maturing in a given year are said to cause marketing problems. The shorter average term achieved by serializing bonds, however, provides compensating interest savings. Prior to the imposition of an income tax in 1913, corporate bonds sold at about the same interest rate as state and municipals, sometimes slightly more and sometimes slightly less. Thus, it seems fair to say that state and local bonds and corporate bonds of comparable rating and term would sell at the same price if each received the same tax treatment. However, the removal of tax-exemption is likely to cause a shift of some individuals out of debt investments and into equities. The result would be that state and local as well as corporate bonds would sell at a slightly higher price than corporate bonds would if state and locals were kept tax-exempt. The amount of shift to equities resulting from the taxing of interest on HFA bonds while leaving other state and municipal bonds tax-exempt, however, is likely to be imperceptible if it occurred at all. For a more detailed treatment of effect on yields caused by the removal of tax-

rate on long-term corporate bonds with an average of Aaa, Aa, A, and Baa ratings has been between 17 and 41 percent, with an average of about 31 percent higher than on comparable tax-exempt bonds.[2] This 31 percent differential is the interest savings accruing to state agencies. Looking at the matter from a different perspective, an investor in a 31 percent bracket would be equally well off buying a taxable bond as compared with a tax-exempt bond. The difference between the 48 percent bracket of tax-exempt purchasers and 31 percent represents the added inducement necessary to attract sufficient buyers to sell all of the tax-exempt issues. This excess of supply over demand in the tax-exempt sector as compared with the taxable bond sector means that any shift of particular types of tax-exempt issues, such as housing finance agency issues, from tax-exempt to taxable status would lower interest rates on bonds remaining tax-exempt. The 33-1/3 percent compensation provided to HFA's who elect to issue taxable bonds would be in an average market slightly more than enough to offset the higher rate they would have to pay bondholders. The unfamiliarity with which taxable bond buyers would have with HFA issue would, no doubt, increase the rate which HFA's first testing the market would have to pay. Still, particularly

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exemption on state and municipal bonds, see David J. Ott and Allen H. Meltzer, Federal Tax Treatment of State and Local Securities (Washington, D.C.: The Brookings Institute, 1963), p. 18.

[1]Compiled from Moody's Municipal and Government Manual (New York: Moody's Investors Service, 1974).

over the long run, implementation of the subsidized taxable bond provision would benefit both the state HFA's and the U.S. Treasury.

USE OF BOND PROCEEDS

As a result of the ability to issue tax-exempt bonds, the net rate at which HFA's lend money to developers has been about 2 percentage points below conventional rates for 90 percent mortgage loans when such conventional loans have been available at all, and on average, about 0.5 percentage points below HUD-insured loan rates. Between February, 1971, and August, 1973, the maximum interest rate allowed by HUD on Section 236 and other developments it insured was 7.0 percent.[1] Virtually all HUD-insured, privately-financed, 236 loans carried the maximum allowable rate.[2] The average HFA bond sold during that period carried an interest rate of 6.0 percent with the average mortgage loan going for about 6.5 percent. Conventional multi-family loans during the same

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[1] U.S. Department of Housing and Urban Development, Reg. 236.15.

[2] Based upon an examination of the subsidy amounts shown on FHA Form 2088, "Weekly Multifamily Project Status and Control Report" prepared by area offices and mortgage amounts shown in HUD, "Selected Multifamily Status Reports: Mortgage Insurance Programs." [(0-2 Series) as of December 31, 1973] Private mortgages have had no incentive to provide loans at any lower rate than the maximum allowable.

period went for about 8.5 percent. The average amortization period on HFA loans and HUD-insured loans has been about forty years, compared with under thirty years for conventionals. Were all of the difference in debt service between HFA and conventional rates to be passed along to the resident, the savings on a typical $22,000 mortgage would be about $40 per month. While this amount of savings makes a large difference to a middle income family, it is grossly insufficient to bring down the typical $200 - $250 per month cost of a new apartment to a level that a low or moderate income family can afford.

Since a primary purpose of nearly all state housing finance agencies is to provide housing for low and moderate income families, they all have used Federal Section 236 subsidies on the vast majority of the units they financed between 1970 and 1973. These subsidies reduce the interest rate on the permanent mortgage to 1 percent for 40 years. Thus, regardless of the lower borrowing rate that HFA's have, the effective rate applicable to most dwelling units at which developers received mortgage money from the HFA's was the same 1 percent rate as was also available on HUD-insured Section 236 mortgages. In marginal instances, the lower rate HFA permanent financing has made the difference between a development being eligible for Section 236 subsidies and requiring too great of a subsidy to qualify or between qualifying with no amenities and qualifying with the addition of some amenities. HUD regulations require that the Section 236 subsidy cost per unit on HFA-financed

developments not exceed the subsidy level for HUD-insured Section 236 projects which are comparable in terms of bedroom count, type, construction, and location.[1] When no such comparable HUD development exists, as is generally the case, the local area office must formulate a hypothetical development for the purpose of making this test. Under the new Section 8 program where the primary determination of whether a development qualifies for subsidies is whether its rents before applying any subsidies fall below the maximum level fixed for the market area, the interest cost advantage that HFA financing provides in relation to both HUD-insured and conventional financing is even more significant in marginal instances. In non-marginal instances, the lower cost financing translates into higher profits for the developer.

Other advantages accrue to developers and tenants of HFA-financed housing because of the lower interest rate provided on the construction loan and lower financing fees. Both of these types of savings reduce the total amount of the mortgage for a given construction budget. On Section 236 projects where rent levels depend upon the amount of

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[1] U.S. Department of Housing and Urban Development, "Interest Reduction Assistance and Rent Supplement Payments for Projects Developed Under State and Local Programs," HPMC-FHA 4400.46, Paragraph 3-5, February, 1972.

the mortgage, such reductions translate into either lower rent levels or higher allowable construction costs for the same rents; on Section 8 projects where rent levels are a function of only family size and income, lower mortgage levels resulting from cheaper financing can result in higher profits for the developer. The interest rate charged by HFA's on construction loans depends primarily upon the interest rate they must pay on short-term, tax-exempt bond anticipation notes. Generally, these short-term rates have considerably lower than long-term rates. State housing finance agencies have paid between 2.5 and 7.5 percent, or an average of about 3.5 percent, for short-term money. Unlike conventional lenders, who charge a large premium to compensate for the inherent risks involved in construction lending, most HFA's charge only 0.5 percent above their own borrowing, while the New York State Housing Finance Agency charges no premium at all. The result was that during most of the period of 1970-73, the HFA's supplied construction loan money at an average rate of about 4 percent compared with conventional rates of about 9 percent and a HUD-insured rate of 7 percent. Considering that the average life of a multi-family construction loan

is about 15 months[1] and that the average outstanding balance is about 50 percent of the full loan, HFA below market rate construction loans have allowed a savings of a little over 3 percent of the mortgage compared with conventional rates and of a little under 2 percent compared with HUD-insured rates.

The other savings provided by many HFA's to developers, at least in comparison with HUD-insured financing, has been in fees. While the fees charged by HFA's and included in the mortgage vary considerably from the 0.18 percent fee charged by the New York State HFA to the slightly over 4 percent fee charged by UDC, the average has been about 2 percent. In comparison, HUD charges a 0.5 percent per annum mortgage insurance premium, a 0.3 percent examination fee, a 0.5 percent inspection fee, and a 1.75 percent FNMA/GNMA fee. In addition, it allows the lender a fee of about 2 percent which may or may not have to be paid in full. Overall, fees on HUD-insured developments are likely to add up to about 5 percent of the mortgage, or 3 percent of the mortgage higher than on a typical HFA development.

When taken together, the 3 percent savings on fees and 2 percent savings on construction interest which HFA's

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[1] Booz, Allen and Hamilton, op. cit., pp.III(1)-III(2).

provide in comparison with HUD, allow a savings of about 5 percent of the mortgage, or about $1,100 on a typical mortgage of $22,000. While state HFA's have had the opportunity to direct this savings toward reduced rents, as has been seen, the response of the HFA's on the whole has been to procure housing with more amenities, larger room sizes, higher quality, and better design, with rents that about equal those charged by HUD.

CHAPTER 7

LEVEL OF GOVERNMENT:
STATE VERSUS FEDERAL

The issue of which level of government within the federal system should have primary responsibility for administering public purpose housing development programs is part of a larger debate on the optimal workings of federalism which dates back to before the founding of the Union. With the coming of revenue sharing, state and local control has become more fashionable but disputes persist over which functions are best suited for which level of government. With regard to most governmental functions, the resolution of such issues has been either a sharing of authority among various levels of government or a clear delineation of authority to a particular level. Public purpose housing, however, represents a rare instance where, despite a certain amount of sharing of power between levels of government, the states and the federal government have each developed competing systems for delivering essentially the same service.

As seen in Chapter 4, the state HFA's on the whole were found to be more effective in satisfying public purposes. In fact, they did slightly better than HUD in achieving the national goal of providing racially integrated housing and did slightly better than HUD in satisfying particular local goals. Part of the reason for their success relates to the fact that they are state agencies rather than Federal ones. As seen in Chapter 4, because the HFA's are entities of the state governments, they have been able to secure funds

from the tax-exempt securities markets at interest rates low enough to provide below market rate mortgage loans. As will be seen in the chapter on the degree of bureaucratization, the relatively small staff required by an agency serving a single state as compared with the staff required by an organization serving all fifty states has been a primary factor in allowing the HFA's to structure themselves in the relatively non-bureaucratic manner appropriate for public purpose housing development lending.

This chapter will discuss the other way in which their being on a state rather than a Federal level has enabled the HFA's to have been more effective than HUD, namely that being on a state level better enables an agency to formulate policies consistent with the local nature of housing markets. Since the logic of this point parallels that of more general debates on issues of federalism, the chapter will first retrace the general debate concerning which level of government is most appropriate as it applies to the provision of public purpose housing. Following that discussion will be a section that identifies instances where the fact that the HFA's are part of state government has contributed to their success.

The Federalist Debate

The relative power of the States and the Federal government has been in flux throughout the history of the Union.[1]

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[1] Robert L. Merriam, "Federalism in Transition," in Jean Brand and Lowell H. Watts (ed.) Federalism Today (Washington D.C.: Graduate School Press, U.S. Dept. of Agriculture, 1969) pp. 5-16.

The strong state and weak central government views of James Madison and Thomas Jefferson rather than the centralist views of Alexander Hamilton dominated the workings of government during the early years of the life of this country, a time when little government concern was devoted to housing. Gradually, a shift occurred toward more central control. The John Marshall Supreme Court determined that the Constitution had given the Federal government certain "implied powers" beyond those enumerated; the Civil War established the supremacy of the Federal government; the Sixteenth Amendment in allowing a Federal income tax gave the Federal government superior access to revenues; and strong presidents beginning with Franklin D. Roosevelt further enhanced Federal power by using its superior revenue producing capabilities to finance various programs including the subsidization of housing. Early plans of both the Public Works Administration and the Federal Housing Administration contemplated a degree of state control of projects, but Federal controls became so complete that state controls would have been excessive.[1]

The Kestnbaum Commission appointed by President Dwight D. Eisenhower unsuccessfully attempted to reverse what it perceived to have been an unwholesome usurpation of power by the Federal government. As a principle, it suggested that the best way to divide civic responsibilities was to:

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[1]Dorothy Schafter, op. cit., p. 618.

> Leave to private initiative all the functions that citizens can perform privately; use the level of government closest to the community for all public functions it can handle; utilize cooperative intergovernmental arrangements where appropriate to attain economical performance and popular approval; reserve National action for residual participation where State and local governments are not fully adequate, and for the continuing responsibilities that only the National Government can undertake.[1]

Still, the amount of power held by the Federal government continued to increase.

Yet, with increases in Federal power have come additions to the power of the states. The Federal income tax brought the states and their instrumentalities, including HFA's, a competitive advantage in securing capital because of the tax-exempt nature of the bonds they issue. State HFA's have also been able to take advantage of Federal housing subsidies. State power has also increased as the result of the Federally-mandated reapportionment of state legislatures. The new lawmakers have taken a more activistic approach toward meeting urban needs, including multi-family housing. While revenue sharing has further increased the power of the states, the emergence of the state housing finance agencies considered in this thesis actually predates this movement. The 1974 Housing and Community Development Act, which has provided local governments

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[1]The Commission on Intergovernmental Relations (Meyer Kestnbaum, Chairman), A Report to the President (Washington, D.C.: Government Printing Office, 1955), p. 6.

with more discretion in the spending of community development funds, has done relatively little to alter the basic relationships between HUD and the state HFA's in the area of housing development.

In practice, state and Federal relationships have blended together in the form of a marble cake rather than as a layer cake as has often been presumed.[1] Morton Grodzins expands upon this notion by writing:

> From the point of view of the local consumer of government products, the American system of government is not a pyramid, but a range of sometimes supplementary and sometimes duplicating (but rarely alternative) services. Accidents of history, politics, and places have produced bundles of governmental services. No logic can distinguish between the 'local character' of one government's services and the 'nonlocal character' of another's.[2]

In a sense, housing finance functions have taken on marble cake characteristics. State housing finance agencies utilize Federal subsidy dollars as well as, on occasion, federal mortgage insurance. Federally insured developments must conform to state and local property tax policies as well as state and local zoning, building, and land use codes. The governor of the State of New York has even had control over the distribution of Federal Section 236 subsidies among Federal, state, and local agencies operating within that state.

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[1]Morton Grodzins, "Centralization and Decentralization in the American Federal System," in Robert A. Goldwin, A Nation of States (Chicago: Rand, McNally, 1964), p. 3.

[2]Morton Grodzins, The American System: A New View of Government in the United States, ed. by Daniel Elazar (Chicago: Rand, McNally, 1966), p. 121.

Nonetheless, the financing of non-insured developments by state housing finance agencies can rightfully be considered a state function and the insurance of privately financed developments by the U.S. Department of Housing and Urban Development can rightfully be looked upon as an alternative Federal activity. At the very least, the two housing finance systems provide alternative recipes for mixing the marble cake.

The mixture that the state housing finance agency approach provides is akin to the one suggested by John Stuart Mill in his treatise, On Representative Government:

> The authority which is most conversant with principles should be supreme over principles, while that which is most competent in details should have the details left to it. The principal business of the central authority should be to give instruction, of the local authority to apply it.[1]

As described in the chapter evaluating agency performance, the Federal government has set forth certain principles to which the state HFA's must adhere if they desire to use Federal Housing funds. These national concerns relate to equal opportunity for minorities, environmental protection, and equitable relocation. This arrangement conforms to the nature of public purpose housing. Aside from certain generalizable national concerns, the impact and environment are local in scope. Housing markets are limited to single metropolitan

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[1]As quoted in Frank Michelman and Terrance Sandalow, Materials on Government in Urban Areas, p. 222.

areas with submarkets that are even more localized. While increases in the supply of housing in one part of a metropolitan area will affect prices throughout the metropolitan area, they will have no effect in other parts of the country. Programs appropriate for areas with a low vacancy rate may fail in areas with a high rate. Construction costs, operating expenses, and competing rent levels as well as the availability of labor, materials, and professional skills all vary by housing market. Climatic conditions and consumer tastes are matters that differ from region to region if not by subregion. The strength and institutional structure of homebuilders, banks, labor, and other actors vary from state to state. Finally, property tax policy, landlord-tenant relationships, and building and zoning codes depend upon state laws.

Meeting Local Circumstances

As was also seen in the evaluation chapter, certain state agencies have done a better job than HUD in serving legislatively defined local needs. The Massachusetts HFA has done a better job at promoting tenant rights; the New York and Massachusetts HFA's have produced more housing for the elderly.

In addition, the local jurisdiction of the state HFA's in certain ways has allowed them to better serve general housing goals by adapting their operations to local circumstances. For example, as has been seen, each of the six state agencies examined have required bedroom sizes that

are far larger than those demanded by HUD. The HUD Minimum Property Standards allow bedrooms occupied by two children to contain as little as 80 square feet. While bedrooms of this size may be large enough for two children living in the South or Southwest, they are woefully inadequate for children living in areas where cold weather and lack of land limits their ability to play outdoors.

Another HUD regulation that certain state agencies have found to be inappropriate for local circumstances is the maximum mortgage amounts. To avoid having any one of its developments oversaturate a market and avoid taking too great a risk on a single mortgage, HUD has set a limit of $12,500,000 as the maximum it can insure under a single mortgage.[1] Yet, the scale of development in New York State, especially in New York City, far exceeds that in other parts of the country. Thus, 30 of the New York State Urban Development Corporation's 112 developments between 1970 and 1973, representing over 50 percent of its dollar volume of residential construction and 6 of the New York State HFA's 58 developments in those years, representing over 65 percent of its dollar volume of residential construction, have mortgages that exceed the HUD limit. The per unit cost of construction in the New York City metropolitan area, including Northern

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[1] FHA Regulations Sec. 221.514 as incorporated to the Section 236 program by Sec. 236.1.

New Jersey, frequently exceeds the national limits for HUD-insured projects, even after the maximum allowable adjustments are made.

The state agencies have been able to overcome these cost limitations partially through providing construction loans at a lower interest rate and partially through not being subject to maximum mortgage per unit limitations. Consequently, the New York State UDC and HFA and the New Jersey HFA have built far more moderate income dwellings in these areas than has HUD.

Discussions with HFA officials from agencies other than those studied in detail have provided anecdotal evidence that state agencies have been able to build housing in areas with unique local problems that HUD, because of its national regulations, has been unable to tackle. In Alaska, the extreme cold requires an extraordinary amount of insulation as well as frequently building on pilings, a practice precluded by HUD standards. The Alaska Housing Finance Corporation has devised its own standards which are more relevant to local conditions.

In West Virginia, the hilly terrain limits the number of buildable sites. Most sites require extensive site development work. HUD standards require far more work than is customary on conventional developments, are more costly than HUD regulations allow and more expensive than most West

Virginians can afford. The West Virginia Housing Development Fund has been active in providing funds to builders to prepare sites for development and has adopted less stringent site development regulations.

The national jurisdiction of HUD also leads to the imposition of irrelevant paperwork on developers in much of the country. For example, developers in Hawaii must submit all of the same forms directed toward equal opportunities for minorities, despite the fact that members of what is considered minority groups in the rest of the country not only comprise a majority of the population in Hawaii, but also control a majority of the high status positions. The one group which is the subject of discrimination is Filipinos. Yet, developers can comply fully with the HUD forms and still grossly discriminate against Filipinos.

A similar irrelevant requirement is an extensive market survey for fully subsidized developments in much of New York City or Boston where vacancy rates are extremely low. However, the same type of marketing study would be insufficient to measure whether a development will rent in much of Michigan or Illinois where vacancy rates are relatively high.

Despite the fact that HUD area offices span a jurisdiction no broader than a single state, and the personnel working there are generally local residents, HFA's are in a better position to provide housing that is compatible with local circumstances.

Unlike HUD, the HFA's have been able to create rules that have only local applicability or their personnel have been so familiar with local circumstances that they have been able to dispense with making a large number of rules. Presumably, HUD could allow each of its area offices to create its own rules and procedures subject only to the same requirements with regard to national concerns faced by the state agencies and statutory requirements related to mortgage insurance. Such independent local HUD offices, unlike the HFA's, however, would be completely independent of accountability to local officials.

Jerome T. Murphy's description of how such accountability led to a distortion of Federal priorities in the implementation of Title I education funds provides a note of caution on the ability of state agencies to implement housing programs in a manner consistent with national interests. In that program, Federal concerns for spending funds in impoverished areas and establishing parent-teacher councils were neglected locally. Weak enforcement by the U.S. Office of Education combined with the vagueness of language in the statute necessary for passage and Congressional intervention at the local level to facilitated the subversion of the "real" objectives of the legislation by local officials.[1]

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[1] "The Education Bureaucracies Implement Novel Policy," in Allan P. Sindler, Policy and Politics in America, Boston: Little-Brown, 1973.

The clarity with which Congress and the Courts have articulated national concerns with regard to housing has made state control of housing development a different story. State housing finance agencies receiving Section 236 funds have had to satisfy the same Federal standards as have HUD-insured developments with regard to racial integration, environmental protection, and equitable relocation. As was seen in the evaluation chapter, based upon the data available, the states have done as good if not a better job than has HUD in implementing national objectives. Whether this finding would be true in states outside the Northeast and Middle West with different political cultures remains untested.

CHAPTER 8

AUTONOMY AND CONTROLS

In his survey of organization studies, James L. Price found that "organizations which have a high degree of autonomy are more likely to have a high degree of effectiveness than organizations which have a low degree of autonomy."[1] By autonomy, he meant the degree to which a social system has the freedom to make decisions with respect to its environment.

While the amount of freedom that state housing finance agencies have had to make decisions with respect to their environment has varied from agency to agency, on the whole, the HFA's have been more autonomous than HUD. Rather than being a line agency within the executive branch of government, nearly all HFA's have their own board of directors who make basic policy decisions.

This autonomy will be seen to have contributed to the relative effectiveness of the HFA's. Unlike HUD, the ability of most of the HFA's to exist, expand, and to pay high salaries depends more on their own financial success than upon direct governmental appropriations. The first section of this chapter will discuss how this profit orientation has increased HFA effectiveness. As will be seen in the second section, the independence of even the most autonomous HFA is far from complete. Each is subject to certain controls by the governor, other

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[1]James L. Price, Organizational Effectiveness: An Inventory of Propositions (Richard D. Irwin: Homewood, Illinois, 1968), p. 96.

executive bureaus (especially auditors), the legislature, the judiciary, and special interest groups. These outside forces will be seen to direct HFA's toward the fulfillment of their own goals and often, but not always, away from the public purpose goals of the HFA.

PROFIT ORIENTATION

Most HFA's meet their administrative and bad-debt expenses through the generation of arbitrage profits on the sale of their notes and bonds. They issue mortgages at an interest rate of between 0.25 and 1.00 percent above their own borrowing rate in the tax-exempt capital and money markets. In addition, they build into each mortgage one-time fees of between 0.3 and 6.0 percent. (See Table 18 in Chapter 4).

Financially autonomous HFA's can use increased profits to provide increases in salaries or staff size. In 1972 when the Massachusetts Housing Finance Agency generated a sizable surplus after working long hours, the executive director sounded out the rest of the staff as to whether they wanted increases in salary and a continuation of long hours, or an increase in staff size. A consensus favored salary increases which the board of directors approved. Since much of the MHFA staff left private enterprise at middle age to join the agency, the move reaffirmed to them

the connection between employer profits and employee benefits. The relative abundance of MHFA reserves ($9.3 million at June 30, 1974) has further allowed them to engage in planning for the risky rebuilding and conversion of two large scale low income public housing developments into mixed income housing.

For the Michigan State Housing Development Authority and the New York State Housing Finance Agency/Division of Housing and Community Renewal where salaries are set by state civil service regulations and all administrative expenses are met by Legislative appropriations, increased profits or profit potential are reflected in increases in staff size or reduced fees. Between 1971 and 1974, the size of the MSHDA staff increased from 42 to 158. The New York HFA/DHCR charges the lowest fee at closing of any HFA (0.3 percent compared with 1.0 or more for the others) and the second lowest annual fee (0.3 percent plus $4.20 per room or about 0.37 percent compared with 0.5 percent for most of the others).

While all of the more autonomous HFA's are profit oriented, not all of them have been able to generate a profit. The inability of the New York State Urban Development Corporation to generate sufficient profits led to a one-third reduction in its workforce, and has left a cloud over its ability to continue operations. Similarly, as discussed in Appendix A, the inability of the North Carolina Housing Corporation to generate its own income resulted in its formal termination by the North Carolina Legislature.

While HUD charges fees similar to those charged by HFA's (0.8 percent in examination and inspection fees plus an annual 0.5 percent mortgage insurance premium), the generation of these fees has no effect on their administrative budget or ability to satisfy claims resulting from assignments on properties insured under Section 236 and other socially oriented programs. Losses on Section 236 and certain other loans in excess of the amount of premiums paid into the Special Risk Insurance Fund backing these projects, are guaranteed by Congressional mandate. The authorization for such payments has the same legal effect as the "moral obligation" provisions backing state housing finance agency bonds. While the 91st Congress authorized the expenditure of whatever funds that might be necessary to meet any deficits in the Special Risk Insurance Fund, future Congresses have no legal obligation, although they have a definite moral obligation to meet them. While HUD has yet to ask Congress for a direct appropriation, it has frequently borrowed from the U.S. Treasury to meet the deficits in the Special Risk Insurance Fund (See Table 15, Chapter 4).

The reason that HUD has had to do so and the reason that the State agencies, aside from UDC, have not had to do anything similar can be traced in large part to expectations. In creating a separate fund with a title including the words "special risk," Congress clearly enunciated its intent that

mortgages insured under the program be of a risky nature. Most of the HFA's, on the other hand, particularly those that have undergone a court test making explicit the tentative legal nature of the moral backing, have regarded this backing merely as an additional protection for conservation bond investors. Members of HFA board, in particular, have regarded the fiscal soundness of each individual project as the pre-eminent consideration.

In terms of generating large-scale production, however, the bureaucratic incentives to expand found at HUD have been just as successful as the profit incentives found at the HFA's. As seen in Chapter 4, both HUD and the HFA's in aggregate have contributed to the production of virtually the same number of moderate income dwelling units in the states under study. While the number of states examined is too small to make a definitive assertion, the profit incentive of HFA's does seem to have produeced a more optimal distribution of projects than the untempered organizational incentive to expand found at the local HUD office. The HFA's have outproduced local HUD offices in those states where vacancy rates have been low and a large volume of new construction is desirable, and the reverse has been true where vacancy rates have been high. The ability of local markets to absorb new housing has affected the production totals of the various HFA's. The Illinois Housing Development Authority

and the Michigan State Housing Development Authority which operate in states with relatively high rental vacancy rates (6.6 percent and 8.0 percent, respectively) have both been more cautious in financing projects than have been the state agencies in Massachusetts, New Jersey, and New York, three states with low vacancy rates overall (4.8 percent, 3.5 percent, and 3.0 percent, respectively).[1] This caution is seen in the importance IHDA and MSHDA place on market studies.

The untempered drive for high production of the Urban Development Corporation throughout New York State, particularly on sites where in its role as developer, it had made an initial investment, however, was a key factor in causing its financial hardships. While UDC's large volume approach in the New York City area where the rental vacancy rate was only 2.1 percent in 1970 may have been appropriate in most instances, in the Buffalo area where the vacancy rate was 4.5 percent and even the "least desirable" tenants had a wide choice as where to live, the same approach proved disastrous. Although construction had been completed for at least a year on five projects in relatively undesirable parts of the Buffalo area, as of October 31, 1974, they had a combined occupancy rate of only 68 percent (829 out of 1196 units).[2]

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[1] Vacancy rates are 1970 figures for rental units taken from U.S. Bureau of Census, County and City Data Book, 1972, p. 6.

[2] UDC Department of Management and Regulation, "Management Status Report," pp. 3-4.

The resulting losses have led to changes in UDC's procedures in qualifying projects.[1] Clearly, where marketability is a real issue, a cautious approach must be taken to avoid vacancy problems. Where markets are tight, the maximization of production is the correct approach. In either instance, the profit incentives found with the HFA's are likely to induce the use of proper approach.

ORGANIZATIONAL CONTROLS

Despite their autonomy in fiscal affairs and independent board of directors, the HFA's are subject to controls by various actors, including governors, auditors, civil service boards, legislators, courts, and special interest groups. As will be seen, these controls have often but not always limited HFA effectiveness.

Gubernatorial Controls

Governors, by the nature of their positions, have broader concerns than housing, including such matters as state growth policy, the fiscal integrity of the state, and partisan politics. They have been able to exert a certain measure of control over housing finance agencies with regard to these and other matters through their appointments and influence.

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[1] Report of UDC Task Force, p. B.5.13.

The primary control exercized by governors over housing finance agencies is in the selection of members of the board of directors. In most states, however, such selections are subject to the advise and consent of the state senate and other restrictions. While Massachusetts is the only state among those with advanced HFA's which does not require senatorial confirmation, it does require that the governor appoint one member experienced in mortgage banking, one trained in architecture or city or regional planning, and one experienced in real estate transactions. All of the HFA's except Illinois reserve one or more positions on the board for ex officio directors who are specified public officials generally appointed by the governor to serve in other capacities. Illinois limits the number of board members residing in a single county to no more than three out of a total of seven, and, along with Michigan, requires a balance of representation by political party.

The amount and nature of influence that governors have been able to exert through their appointees on boards, however, has varied from governor to governor. New Jersey Governor Thomas Cahill retained strong control over board actions during his years in office between 1969 and 1973. One staff member described the tone of decision making on the board level during the Cahill years as being "political." Whenever a choice had to be made between funding two projects desired

by local communities, invariably the one located in the city or town whose mayor had the ear of the governor would win. In policy areas, Cahill succeeded in blocking the advocacy of low and moderate income housing by the New Jersey HFA in suburban towns. Most other HFA boards have been more independent of gubernatorial control.

Governor Francis Sargent of Massachusetts exerted his influence on that state's HFA in a different direction. He pushed for the construction of low and moderate income housing in Cape Cod. Permanent residents of that resort area had carried out a highly publicized demonstration against their being displaced to make way for more affluent summer residents. The Governor responded to their action by calling upon MHFA to build housing there. While MHFA previously had not built any housing in that section of the state, within a little over a year after the Governor's request, it had begun construction of 570 dwelling units with 230 more committed. These figures compare with an estimated need of 600 units there.

Similarly, Governor Nelson Rockefeller was able to save Griffiss Air Base from being moved outside the state through his influence with the New York UDC Board. In 1970, the Air Force was deciding whether to expand facilities at that base or discontinue operations there entirely. The major problem was the shortage of adequate housing nearby for families. When Governor Rockefeller learned of the

problem, he asked UDC to act upon the problem in concert with the Division of Housing and Community Renewal and the Department of Commerce. The result was the construction of the 500 dwelling units through UDC.[1] Not all of the projects advocated by Governor Rockefeller, however, were pursued. According to UDC staff persons interviewed, UDC rejected several projects initially supported by the governor which it believed infeasible.

In some states, governors have more appointive powers than just the board of directors. With regard to the Illinois Housing Development Authority and the New York State Urban Development Corporation, the governor has the statutory power to appoint the executive director. In other instances, including New Jersey, gubernatorial influence with the board has allowed him to effectively choose the executive director as well. On occasion, governors also have taken it upon themselves to suggest names of individuals for lower staff positions on HFA's.[2] In Massachusetts, the governor has recommended one or two well qualified individuals who did receive positions. In New York, well qualified persons recommended by the governor have often received positions in the field with the Division

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[1]New York State Urban Development Corporation, 1970 Annual Report, p. 47.

[2]All information regarding such appointments is based upon interviews with officials in each agency.

of Housing and Community Renewal while poorly qualified individuals have been rejected. In New Jersey, however, Governor Cahill saw to it that one or two unqualified and inexperienced individuals obtained employment as project directors for the NJHFA at the highest salary grade for the job. While governors in Illinois have refrained from sending job-seekers to the Illinois Housing Development Authority, the Authority did hire one person sent to it by Mayor Richard Daley of Chicago. Otherwise, IHDA has steered clear of the Daley organization.

The Board of Directors structure has preserved for all of the HFA's far more autonomy than is likely to be the case with direct gubernatorial control. In Hawaii, where the Hawaii Housing Authority comes under the direct control of the governor, Governor John A.Burns has limited the housing development staff of the Authority to just four, despite the fact that arbitrage income from the sale of bonds could pay for a far larger staff.

Auditor Controls

Another executive officer who has some control over housing finance agencies is the state auditor. In each of the five states being considered closely, the auditor makes periodic audits of the local HFA. The net effect of these audits has been to keep them slightly more honest and require them to adopt and adhere to more bureaucratic procedures. In

New Jersey and Illinois, these audits have involved only a post-audit of financial statements prepared and audited by an independent accounting firm. In neither of these two states has the state auditor found any discrepancies. The private auditor in Illinois did suggest minor changes in accounting procedures which the Illinois Housing Development Authority adopted. In New York, Massachusetts, and Michigan, the state auditor has made independent investigations into programmatic as well as financial areas. While recommendations of state auditors carry no enforcement authority, the HFA's have accepted most of these recommendations.

The most recent state audit of the New York State Urban Development Corporation was conducted in 1971.[1] The most serious charge which was leveled by the state auditor was that UDC had been purchasing land prior to making the statutorily required finding that all housing developments be located in areas with a need for safe and sanitary housing which private industry cannot provide and that industrial developments be located in substandard or insanitary areas where they can prevent or reduce unemployment or underemployment. UDC replied that suburban solutions are often necessary to solve urban problems, and that limitations on UDC's ability to acquire land and make other expenditures prior to making

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[1]Office of the Comptroller, "Report on Survey of the Initial Financial and Operating Practices: New York State Urban Development Corporation," Report No. NY-Auth-5-71.

the requisite findings would "...impede UDC's ability to act swiftly and effectively, and impose upon the Corporation impractical and inflexible limitations." In November of 1972, the New York State Supreme Court dismissed a lawsuit brought by the Rochester suburb, Greece, which challenged UDC's right to construct housing in suburban areas.[2]

The audit report also recommended that UDC award all of its construction contracts on the basis of bids rather than negotiations. UDC rejected this suggestion as being too time-consuming, too costly, and incompatible with the need to secure equity financing and long-term ownership and management from the builder/developer. UDC however, did accept several recommendations made by the comptroller, including suggestions to use pro forma contracts, to re-use certain pre-existing architectural plans, to devise and install a system of records and internal controls, and to reevaluate its fee structure.

The auditor in Massachusetts has used extremely biting language to make several substantively minor points.[2] One set of criticisms related to the provision of certain fringe

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[1] Annual Report of the New York State Urban Development Corporation: 1972, p. 52.

[2] Massachusetts Department of the State Auditor, "Report on the Examination of the Accounts of the Massachusetts Housing Finance Agency from July 1, 1971 to June 30, 1972," No. 73-A-39.

benefits to employees, like rental cars for private use, which are common in private industry but prohibited in state government. Other criticisms related to the use of more conventional accounting procedures. The Massachusetts HFA accepted these accounting changes.

In Michigan, a state with a strong good government tradition, both the Office of the Auditor General and the Office of Program Effectiveness Review have conducted extensive audits of that state's HFA. The Auditor General reports have come out on a semi-annual basis, and have reviewed virtually every possible deviation MSHDA has made from its established rules on every project. Various reports cited such deviations as:

1) On a few particular projects, MSHDA failed to fully document in the files how it arrived at particular land valuations even though subsequent investigations showed that it had always followed its own rules or had made a conscious but reasonable decision to waive them.[1]

2) Six of twenty reports submitted by management agents were unsigned.[2]

3) Certain documents were not in the files at the time of the audit, although were located subsequently.[3]

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[1]Office of Auditor General, Audit Report: Michigan State Housing Development Authority, Department of Social Services, July 1, 1972 through December 31, 1972, pp. 4-7, and Ibid., July 1, 1971 through June 30, 1972, p. 23.

[2]Ibid., July 1, 1972 through December 31, 1972, pp. 10-11.

[3]Ibid., p. 32.

4) Six of sixteen architectural inspection contracts reviewed were not dated, although properly signed.[1]

As the result of other findings, the Auditor General has pushed MSHDA into creating new rules. For example, he recommended that:

1) MSHDA provide managing and marketing agents with "written policy" to define such administrations criteria as whether an unborn child is to be counted as a minor in computing adjusted income, under what conditions the limitation on number of bedrooms required may be waived, and the proper procedure for certifying incomes of self-employed persons.[2]

2) MSHDA establish policy upon which to base its approvals in allowing expenses to be paid from the replacement reserves of MSHDA-insured developments and designate staff to approve these expenses.[3]

3) MSHDA "maintain time schedules, production logs, and establish goals or standards with which to measure output" on rented magnetic card typewriters in order that the auditor be able to determine if MSHDA has rented too many of these typewriters. This recommendation came despite the fact that secretaries had waited before gaining access to these typewriters when fewer of them were being rented.[4]

As will be seen more clearly in the chapter on organizational structure and dynamics, such requirements to formulate and

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[1]Office of Auditor General, Audit Report: Michigan State Housing Development Authority, Department of Social Services, July 1, 1972 through December 31, 1972, p. 31.

[2]Ibid., July 1, 1971 through June 30, 1972, p. 12.

[3]Ibid., p. 13.

[4]Ibid., January 1, 1973 through June 30, 1973, p. 37.

adhere to formal rules and procedures have had a negative effect on agency effectiveness.

The Michigan Office of Program Effectiveness in its Subsidized Housing Program: An Assessment of Effectiveness raised several important questions relating to the rationale for MSHDA's production programs. The questions it asked are similar to the ones that have been raised on a national level. It asked whether a need exists for the state to continue to stimulate the production of housing, what income levels will continue to need assistance over the long term to afford "standard" housing, and what social problems can be expected to abate as the result of the provision of "standard" housing. In a state like Michigan with a vacancy rate above the national average, these questions are serious ones. The most serious effect of this report on the activities of MSHDA, however, appears to have been to have them perform some analytic soul-searching.

Civil Service Controls

The Michigan State Housing Development Authority (MSHDA) along with the New York State HFA and Division of Housing and Community Renewal are alone among the first and second generation of HFA's in being subject to civil service regulations. These regulations have had an effect in determining the type of person coming to work at these agencies despite attempts to evade them. The overwhelming majority of employees of the Michigan agency are under the age of 35. This fact

reflects the relatively high salary level provided to recent college graduates working in Michigan civil service as compared with private enterprise and relatively low salary level for civil servants with more experience. By contrast, Federal civil service regulations which cover HUD employees provide strong incentives for long-term civil service. The protections given by civil service against firing have further increased the tenure of HUD employees.

MSHDA and the New York HFA have, however, succeeded in hiring employees on the basis of more relevant criteria than civil service ratings. Reportedly, on certain occasions, MSHDA has asked higher scoring but less desirable applicants to step aside for an applicant judged by the agency to be better qualified for the particular job.

Legislative Controls

State legislatures have also retained for themselves a measure of control over the activities of the HFA's. In the extreme case, as exemplified by the North Carolina Housing Corporation, the Legislature can disband agency operations entirely.

Legislative oversight of the operations of most HFA's recurs on a regular basis. With the exception of New Jersey, legislatures have placed limits on the bonding capacities of HFA's. Whenever any HFA comes close to bumping up against these limits, the legislature will embark on a review of

agency actions. Except for the New York State Urban Development Corporation's late 1974 request, legislatures have always acceded to providing higher limits, but frequently have amended HFA enabling legislation in other ways as well.

In Michigan, MSHDA's request to raise its bonding capacity from $300 million to $800 million resulted in an increase to only $600 as well as the imposition of the requirements that MSHDA restrict its operating expense to an amount appropriated annually by the Legislature, and that all future MSHDA multi-family developments provide housing for a minimum of 15 percent low income families.[1]

In Massachusetts, the 1970 increase in MHFA's bonding capacity to $500 million carried the stipulation that $100 million of this bonding capacity be used in municipalities with an unemployment rate of at least 6 percent.[2] The high unemployment rate in a large number of cities and towns in Massachusetts, however, has made this stipulation inconsequential. Since Massachusetts has a state interest subsidy program for which appropriations are required annually,[3] the Legislature reviews at least a portion of MHFA's activities each year.

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[1]State of Michigan, Act 310, P.A. 1972.

[2]Section 9C. 855 of the Acts of 1970.

[3]M.G.L.A. c.23A App. Sec. 1-13A.

The trimming of New York State UDC's zoning override powers represents the clearest illustration of limits being placed on the autonomy of state housing finance agencies. The original enabling legislation gave UDC broad powers to override local zoning. Yet, UDC's first attempt to utilize these powers in defiance of local authorities led to the granting of veto power to villages and towns objecting to a UDC override.

In addition to the control they exert as part of a body, legislators attempt to exert influence as individuals. The Illinois Housing Development Authority used a portion of its specially approprqpriated land development fund to promote the construction of a subdivision in a small town that was the home of an influential legislator, despite the fact that staff members interviewed saw the loan as being a low priority item except for its political ramifications. The Massachusetts Housing Finance Agency has adhered to a policy of merely explaining to an inquiring legislator the status of a particular project and the reasons for any rejection.

Legislative influence on individual HUD-insured projects seems to be more pervasive than on individual projects at state agencies. The Task Force on Improving the Operation of Federally Insured or Financed Housing Programs found in its examination of the HUD decision-making process for multi-family developments that, "Political and market considerations will always affect these decisions. To satisfy a particular

Congressman, it may be necessary to provide an allocation for a project in his district--so long as it meets minimum standards of acceptability."[1] Interviews with HUD officials confirmed that such practices occur, at least at certain local offices. The indictment of Senator Edward Gurney of Florida for improper influence wielding at HUD represents another case in point.

Judicial Controls

A further type of potential control over the independence of state housing finance agencies comes from the state judiciary. Yet, only rarely have the courts blocked action by HFA's. Most HFA's have won court cases brought by "friendly" plaintiffs to test the Constitutionality of the agency and thereby ensure the salability of their bonds. In one "friendly" case and in the two instances where constitutionality tests have been brought for other motives, the outcome was less favorable for the HFA. A South Carolina Court ruled that the moral obligation provision backing bonds that might be issued by that state's HFA "sidestepped" a vote of the people in allocated state tax funds. At this writing, the case was being appealed by the agency.[2] The Massachusetts legislature

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[1]Report of the Task Force on Improving the Operation of Federally Insured or Financed Housing Programs, Vol. III: Multifamily Housing (Washington,D.C.: National Center for Housing Management), pp. 195-96.

[2]Housing and Development Reporter, January 5, 1975, p.1011.

asked its Supreme Judicial Court for an advisory opinion concerning proposed legislation to create MHFA.[1] The Court ruled that the agency would have to serve "low" rather than "moderate" income families in order to be constitutional. The other case is one which occurred in Oregon where a retired legislator acting as a private citizen brought suit against the Oregon Division of Housing claiming that the new financing powers given to it constitute an unconstitutional pledge of state resources. The claim has been upheld by the trial court and is now before an appeals court.[2]

Interest Group Controls

State housing finance agencies affect the economic well-being of several types of powerful interests, including mortgage bankers, savings and loan associations, homebuilders, investment bankers, and bond counsels. Each of these interests have attempted to exert their influence on the activities of state housing finance agencies through input into the enabling legislation. At the same time, the HFA's have attempted to coopt these interests by naming their representatives to HFA boards and special committees.

Despite differences in requirements and in governors, board appointments have followed relatively predictable patterns

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[1] Opinion of Justices, 320 Mass. 773.

[2] Housing and Development Reporter, February 24, 1975, p.865.

with regard to occupations. As can be seen from Table 29, the typical board of directors of state HFA's consists of seven members: a banker (from either a commercial bank or thrift institution), a builder or realtor, a non-real estate businessman, an attorney, the director of the state department of community affairs, a state fiscal officer, and one other member who might be a planner, a labor representative, an investment banker, a municipal officer, a nonprofit housing agency director, or a professor.

Another proposition induced by Price in his study of organization studies was that:

> Organizations which have major elite cooptation are more likely to have a high degree of effectiveness than organizations which do not have a major elite cooptation.[1]

In the classical study on cooptation, Philip Selznick attributed much of the success of the Tennessee Valley Authority as an institution to its coopting of the land-grant colleges, the county-agent system, and the Farm Bureau Federation at the expense of poor farmers.[2]

Similarly, as this section will show, the cooptation of elite by state housing finance agencies has contributed to agency financial success, although in certain instances

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[1]James L. Price, *op. cit.*, p. 110.

[2]Philip Selznick, *TVA and the Grass Roots* (Berkeley: University of California Press, 1949).

Table 29

State Housing Finance Agency
Boards of Directors by Occupation, 1973

	Illinois HDA	Mass. HFA	Mich. SHDA	NJ HFA	NYS HFA	NYS UDC	Conn. HFA	Kent. HC	Maine SHA	Minn. HFA	Mo. HDB	Ohio HDB	Virg. HDA	W. VA. HDF	Total
Bankers:															
Mortgage							a						a		2
Commercial					a	a	Aa	A	a				aa		8
Thrift		a	A				a					Aa		a	6
Investment					a	a									2
Regulatory						e									1
Business:															
Realtors	a	a		a		A					aa	a			7
Builders		A	a					a		Aaa				A	7
Industrialists	a						a					a			3
Commercial	Aa		ae			ee		ae			aa			ae	12
Professional:															
Attorneys/AG	aa			e	Aa			aae			Ae	a		e	12
Planners		a				ae				e		a			5
Educators	a	a													2
Other Public Officials:															
Finance/Treas.		e	e	e	ee		ee	ee		e			e	e	12
Cmty. Affs./Soc. Serv.		e	e	E	e		e					e	e		7
Local				a					aa				A	a	5
Other:															
Nonprofit Developers								a		a				a	3
Labor			a			a								a	3
Other								?	a		a			?e	5

Key: a= appointed; e= ex officio; ?= unknown; Caps. = Chairman.

Sources: Annual Reports and Official Statements

the same elite have managed to use the HFA's as a vehicle toward achieving their own ends rather than the intended public purposes. The reciprocal impacts that the special interest groups and the HFA's have on each other will be examined in turn for each special interest.

Mortgage bankers, who finance over 60 percent of all HUD-insured multi-family developments and a majority of all conventional multi-families,[2] have been the most vociferous opponents of HFA's. While HUD uses mortgage bankers as intermediaries, the HFA's work directly with developers. Robert Lambrecht, President of Lambrecht Realty Company in Detroit, Michigan, appearing at a panel discussion entitled "State Housing Finance Agencies: Customer or Competitor?" at 1974 annual meeting of the National Mortgage Bankers Association, pointed out the mortgage bankers' chief complaint by saying:

> HFA's are a competitor in the sense that they are pursuing an area that has been traditionally held by us, but they have an unfair competitive advantage because they can loan at a lower rate.[2]

Lambrecht and the Mortgage Bankers Association of Michigan had been in the forefront of opposition to raising the bonding

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[1]U.S. Department of Housing and Urban Development, 1971 HUD Statistical Yearbook, p. 175.

[2]Housing and Development Reporter, 1974, p. E-1.

limit of the Michigan State Housing Development Authority from $300 million to $800 million. They succeeded in persuading the Michigan Legislature to restrict MSHDA's bonding limit to $600 million and require them to include 15 percent low income families in each development. MSHDA is now attempting to coopt the mortgage bankers by holding meetings with their leadership on a regular basis and by allowing them to receive a .75 percent fee for submitting applications from developers to them. Similarly, the Illinois Housing Development Authority in a political move began allowing mortgage bankers to receive a 0.7 percent fee for doing similar paper shuffling. By comparison, mortgage bankers can receive up to a 2 percent financing fee on HUD developments, although few receive the maximum amount.[1] In Massachusetts, New Jersey, and New York, where mortgage bankers have less political clout, they receive no such fees.

In several of the states with newer housing finance agencies, mortgage bankers have succeeded in restricting the extent to which the HFA can engage in direct lending. In Louisiana, the HFA can only engage in secondary lending. Mortgage bankers and other private lenders will be able to sell mortgages which they have initiated to the HFA. Mortgage bankers succeeded in inserting into the enabling legislation

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[1] _Report of the Task Force on Improving Housing Programs_, p. 111.

for the Tennessee Housing Finance Agency and the new North Carolina Housing Finance Agency language that restricts the direct lending roles of these agencies to circumstances where they will act in a non-competitive manner. The Tennessee statute reads:

> However, the agency will not make or participate in the making of any insured mortgage loan until it has notified all qualified lenders that the insured mortgage loan program is effective and that the agency is prepared to enter into working agreements with qualified lenders for the making of insured mortgage loans to qualified sponsors, developers, builders, and purchasers; and it has determined that the insured mortgage is not available, totally or in part from private qualified lenders upon reasonably equivalent terms and conditions.[1]

Mortgage banker opposition in the State of Washington has thus far kept that state from enacting an HFA.[2]

All four of the banking institutions who have officials sitting on the Connecticut Housing Finance Authority Board of Directors have participated in the Authority's mortgage purchase program as originators and servicers.[3] Included have been John P. Eveleth, Assistant Vice-President of the New Britain National Bank; Kendrick F. Bellows, Jr., Executive Vice President of the Connecticut Bank and Trust Company;

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[1]Public Acts, 1973, Chapter 241, Section 7.

[2]Interview with H. Milton Patton, Council of State Governments.

[3]Connecticut Housing Finance Authority, Report to the Governor and the State Banking Commissioner for the Period Ending December 31, 1972, March 30, 1973.

Edward K. Sentivany, Jr., Vice President of HNC Mortgage and Realty Investors, a subsidiary of the Hartford National Bank and Trust Co. In addition, Alex L. Glecker, CHFA's Assistant Director for Finance and Mortgage Credit, immediately prior to coming to the Authority served as Vice President in Charge of Mortgage Loans for the Lomas-Nettleton Company,[1] another originator and servicer of CHFA mortgages. The five banking institutions mentioned represented half of the institutions doing business with the Authority in 1972 and 1973.

While the Connecticut Legislature has taken no steps to eliminate such conflicts of interest, it has amended the CHFA statute to provide more of a balance of interests on future boards. All appointments made after May, 1972, must contribute to balancing that agency's board with persons experienced in all aspects of housing design, development, management, and state and local finance as well as housing finance.[2]

The Virginia Housing Development Authority has been more discrete with regard to a potential conflict of interest situation. When it began considering the purchase of a mortgage from the Virginia Investment and Mortgage Corporation,

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[1]Connecticut Housing Finance Authority, Official Statement Dated December 7, 1973, Housing Mortgage Finance Program Bonds, 1974 Series A. p. 6.

[2]1972 P.A. 208, S. 3.

Mr. Richard J. Davis, the President of the Corporation and Commissioner of the Authority, removed himself from the deliberations and vote on the matter. This control over HFA's by mortgage bankers is hardly different from their control over certain HUD offices. According to one high official in HUD's Central Office, mortgage bankers actually selected the director of one of the Tennessee field offices.

Savings and loan associations and mutual savings banks have on the whole adopted a more neutral, if not favorable attitude toward direct lending by the HFA's. They have also had a somewhat greater presence on HFA boards. Unlike with the mortgage bankers, the bulk of the lending done by the thrift institutions is on single family homes, an area largely ignored by the HFA's. The only HFA's that have provided mortgage money for single-family homes have been Michigan (2175 units through June 30, 1974, all of which have been HUD-insured), and the Maryland,[1] Virginia, and West Virginia agencies, which had each financed about 1000 units by late 1974. The only multi-family lending done by the thrift institutions is almost exclusively conventional, generally serving a higher income bracket than the HFA's. More important to these institutions than the competition, however, has been the fact that the HFA's provide secondary loans, and hold out

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[1]The Maryland Community Development Administration requires two letters of rejection from private lenders before it will make a loan.

the possibility of restoring older neighborhoods where the thrift institutions hold mortgages on properties depreciated by general neighborhood decline.

Nevertheless, certain voices within the thrift institution community have urged that these institutions take a cautious approach regarding the HFA's. In a United States Savings and Loan League publication, Kenneth J. Thygerson writes:

> The extremely fast growth of these agencies and the potential arbitrage profits they can generate indicate a strong desire on the part of the state legislatures to increase the level of operations of these agencies. If this occurs, as now seems apparent, the earning position of the specialized lending intermediary will continue to suffer.[1]

Commercial banks have generally supported the creation and continued existence of HFA's, despite the fact that commercial banks in several states have initially objected to the concept. Sources interviewed generally cited the initial opposition of Bank of America as a reason for Governor Ronald Reagan's veto of legislation creating an HFA in California. An intensive lobbying campaign, however, succeeded in changing the bank's official position more recently, but not in changing that of the governor.

While HFA's do provide a limited measure of lending competition for the commercial banks, they also provide

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[1]Kenneth J. Thygerson, The Effect of Government Housing and Mortgage Credit Programs on Savings and Loan Associations (US Savings and Loan League: Chicago, 1973), p. 145.

depository accounts and opportunities to hold and sell tax-exempt notes and bonds. Not only do HFA's deposit a portion of their own funds in accounts in commercial banks, but they also see to it that developers have funds to deposit before paying subcontractors and material suppliers, and that property managers have rent money to deposit before paying bills. Generally, local commercial banks will serve as co-underwriters of HFA note and bond issues. The tax-exempt feature of these notes and bonds provide them with lucrative short-term investment opportunities during loose money periods and profit opportunities on the sale of all maturities of notes and bonds during tight money periods. At the same time they are making money, the commercial banks feel they are performing a community service.

While in most states homebuilders have supported the creation and growth of state housing finance agencies, certain local homebuilder groups have prevented the creation of HFA's in their home states. The basic reasons for home-builder support is that the HFA's provide an alternative means of financing and open up new markets. The prime reason for local opposition is the regulations they can be expected to impose. In Michigan, while homebuilders initially were cool to MSHDA, since the appointment of the Vice President of the Michigan Association of Home Builders to the MSHDA Board, they have become MSHDA's strongest

ally.[1] In Georgia and Wisconsin, homebuilders' support was instrumental in securing the creation of HFA's by local state legislatures. The executive director of the Oregon Division of Housing has overcome latent homebuilder opposition to the fulfillment of his organization's new HFA powers by assuring them that the Division will only require that builders meet local code standards.[2] Opposition by homebuilders on Ohio and Texas to the creation of HFA's with full powers in those states has been strong and effective. The chief complaint of Ohio homebuilders, particularly those from downstate, had been that the HFA's would require the payment of prevailing wages.[3]

The two groups that have most consistently and most strongly supported the creation of HFA's have been investment bankers and bond counsels. Whenever a state legislator or administrator in a state without a housing finance agency files a bill to create one or even begins to consider filing a bill, a whole flock of Wall Street investment bankers and bond counsels will descend upon the state capital with offers to prepare legal language, give expert testimony, and pay for drinks and dinners. The purpose of this generosity is, of course, for the individual firm to be named

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[1] In an interview with the author, David L. Froh, MSHDA's executive director, provided the information that the homebuilders have been MSHDA's strongest ally.

[2] Seminar given by Gregg Smith, Executive Director, Oregon Division of Housing.

[3] Interview with J. Denis O'Toole, Nat'l. Asso. of Homebuilders.

as an underwriter for agency notes and bonds or as bond counsel. In South Dakota, an investment banker even initiated the idea for a state housing finance agency. There, an investment banker who had worked with a particular legislator on establishing a health and educational facilities financing program suggested to him that tax-exempt bonds could also be used to finance housing. The result was that the two of them worked out a draft piece of legislation for creating the South Dakota Housing Development Authority which was quickly passed in 1973 without significant opposition. The investment banking firm then became the managing underwriters for the new Authority.

Bond underwriters for the New York State Urban Development Corporation have secured their right to sell UDC bonds through a slightly different process. After George D. Woods, a director, advisor, consultant, stockholder, and retired officer of the First Boston Corporation and J. Fred Schoellkoph IV, Chairman of the Board and stockholder of Marine Midland Banks, were named to serve as members of the UDC Board, the Board selected the First Boston Corporation and an affiliate of Marine Midland Banks as managing underwriter and co-underwriter, respectively.[1] Both of these board members, however, have

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[1]While Schoellkoph is now deceased, Charles A. Winding, the Chairman of the Executive Committee of Marine-Midland Banks has been named to the UDC Board.

refrained from voting on matters directly related to the sale of bonds. Woods left the Board at the end of 1974 at the expiration of his term.

In conclusion, while the relative financial autonomy of the HFA's and consequent profit motivation has been instrumental in their success, controls imposed by various parties have restricted their autonomy and in certain respects reduced their effectiveness.

CHAPTER 9

DEGREE OF BUREAUCRATIZATION

The organization and operation of state housing finance agencies on the whole has been less bureaucratic than that of HUD. This lesser degree of bureaucratization is a major reason why the HFA's generally have performed more effectively than HUD and why particular HFA's have performed better than others. The first section of this chapter provides a theoretical basis for this conclusion. While the definition of "bureaucratic" has varied from author to author, a majority of those writing on the subject have agreed on five characteristics: hierarchy of authority, division of labor, procedures for work situations, rules, and technical competency for participation.[1] Only with regard to technical competency has HUD generally been less bureaucratic. The second section of this chapter, entitled "Structural Complexity," discusses the impact that two of the characteristics of bureaucracy, hierarchy of authority and division of labor, have had on agency performance. The third section, on degree of formalization, uses the characteristics of procedures for work situations and rules to explain certain aspects of the differences found in agency success. In addition, it gives passing reference to the final bureaucratic characteristic, technical competency.

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[1]Richard Hall, Organizations: Structure and Process, (Prentice Hall: Englewood Cliffs, New Jersey, 1972), page 66.

THEORETICAL PRINCIPLES OF BUREAUCRACY

In many circumstances, organizations that behave in bureaucratic manners are the most effective in reaching their goals. Max Weber, the father of bureaucracy, posited that the more formalized, stratified, and compartmentalized an organization becomes, the more effective it will be.[1] Peter Blau added backing to certain of Weber's propositions in his study of state employment security offices in which he found that those offices with the most extensive regulations were the most efficient in terms of man-hours to perform the task. James L. Price, in his summation of organization studies, concluded that:

> ...organizations which have a high degree of specialized departmentalization are more likely to have a high degree of effectiveness than organizations which have a low degree of specialized departmentalization.[2]

The one caveat that Price placed on this conclusion was that the rule applied "except where there is a high degree of complexity" in terms of the degree of knowledge required to produce the output. Similarly, Charles B. Perrow found that:

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[1] Max Weber, Essays in Sociology (New York: Oxford University Press, 1946), pp. 196-244.

[2] John L. Price, Organizational Effectiveness: An Inventory of Propositions, (Homewood, Ill.: Richard D. Irwin, Inc., 1968), p. 168.

> ...before an organization's problems can be solved, it is essential to determine the nature of the organization. Once the determination is made, some administrative proverbs may apply very well, but others may be irrelevant or even invalid.[1]

Like Price, Perrow determined that the complexity of organizational inputs determines whether a bureaucratic structure will help or hinder organizational effectiveness. Specifically, he found that for organizations working with complex inputs to be effective, they require the informality and flexibility afforded by a minimum of rules and operating procedures and the ease of communications found in a structurally simple organization. The intuitive good sense of these propositions comes through more clearly in the language of William H. Starbuck:

> A highly flexible and informal organization is poorly adapted to a stable set of problems, just as a highly inflexible and formal organization is poorly adapted to an unstable set of problems.[2]

The nature of public purpose housing development is clearly complex, and poses an unstable set of problems. While diagrams, by their nature, simplify relationships, Figure 1 hints at the complexity of the development process from the point of view of the developer, particularly when public

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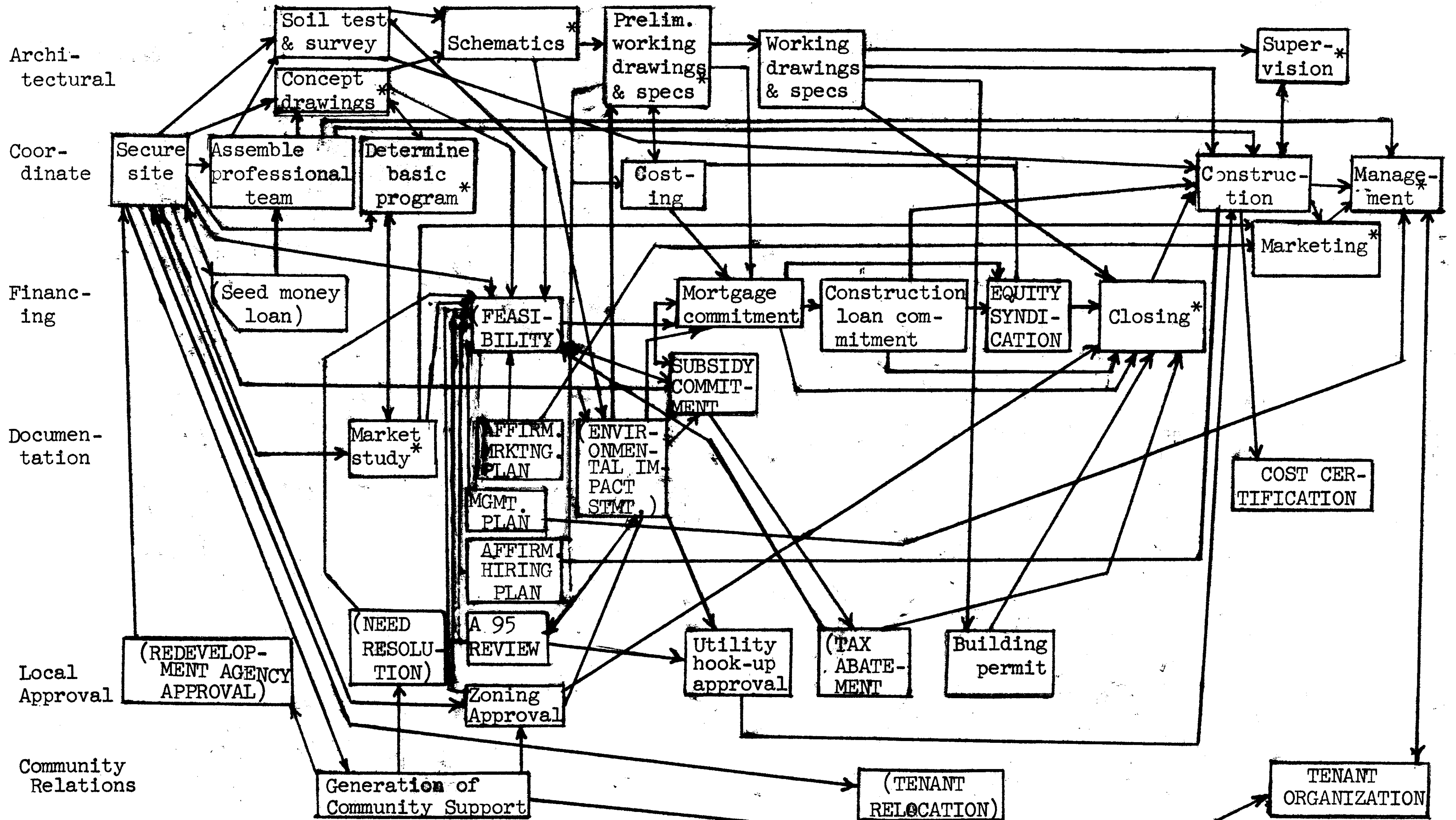
[1]Charles B. Perrow, Organizational Analysis: A Sociological View (Belmont, Calif.: Brooks/Cole Publishing Company, 1970), p. 85. See also Richard Hall, Organizations: Structure and Process (Englewood Cliffs, NJ.: Prentice Hall, 1972), p. 168.

[2]William H. Starbuck, "Organizational Growth and Development," in Handbook of Organizations, ed. by J.G. March (Chicago: Rand McNally: 1964), p. 481.

FIGURE 1
FUNCTIONAL RELATIONSHIPS IN NORMAL AND PUBLIC PURPOSE HOUSING DEVELOPMENT PROCESS



*Normal development functions requiring government review in public purpose development process

→ indicates direction of functional relationship

Lower case letters indicate normal development functions
CAPITAL LETTERS indicate step added in public purpose development process
(Parentheses) indicate step not applicable to all projects

purpose goals are involved. As can be seen in the diagram, the interrelationships between the various steps provides much of the complexity. While certain steps on the chart are inapplicable to many projects, other steps, such as overcoming contractor bonding problems, obtaining financing for ancillary facilities, and clearing of title difficulties might apply. This imprecision in the number of steps involved is another element of complexity. In addition, each step listed is likely to involve numerous sub-steps interrelated to the entire process. For example, the obtaining of community support may require researching the local power structure, appearing at community group meetings, organizing a citizen support group, negotiating problem decisions with them, and engaging in a dozen other similar activities. Obtaining tax abatement may involve engaging the services of a local attorney, securing the support of the mayor and city council through the making of programmatic concessions, submitting applications to the tax assessor's office and state attorney general's office, appearing at a hearing, negotiating the amount of the abatement, and/or any number of similar tasks. Each substep of each step involves uncertainty and risk.

The public purpose housing development lender or insurer, even if not participating directly in each step, must keep in mind the complexities and interrelationship involved in the entire process. It must constantly make intricate trade-offs with regard to such choices as:

> Adding amenities versus reducing rents;
> Increasing the construction budget versus increasing the operations budget;
> Providing good design versus providing quality hardware;
> Meeting the needs of low income families versus ensuring marketability;
> Satisfying programmatic goals versus catering to political realities;
> Maximizing production versus protecting the environment;
> Pushing developers to make concessions versus attracting reputable developers; and
> Allowing developers, architects, and managers freedom to be creative versus controlling against ill-conceived projects.

Each of these decisions must be looked at in the context of the development as a whole, with each development demanding a unique solution. Given this complexity, proper application of organizational theory clearly demands structural simplicity and operational flexibility.

STRUCTURAL SIMPLICITY

The two primary measures of organizational simplicity or complexity used by organizational theorists are span of control and layers of hierarchy. Span of control means the number of divisions or subdivisions an administrator has under his immediate control; layers of hierarchy means the number of levels of command within an organization from the lowest level to the chief executive. Complex tasks require narrow spans of control, generally taken to be less than four. In the words of Charles Perrow:

> But if the tasks are not routine, if they require discretion and if there is considerable interdependence

> and uncertainty surrounding them, the span of control is best kept small. This permits the subordinates and the superior to consult frequently, to exchange information and ideas, and frequently to reshuffle responsibilities in search for optimal solutions to difficult problems.[1]

At the same time, complex problems require direct communication between policy makers and those applying policy. The large number of intermediaries found in overly hierarchial organizations impedes such communication.[2]

As can be seen in Table 30, nearly all of the state HFA's have both narrower spans of control than HUD and fewer hierarchial layers. While organizational size is a primary determinant of both the number of layers and span of control,[3] certain HFA's have taken better advantage of their small size than others in creating organizations which are structurally more simple. The Illinois Housing Development Authority, for example, which has a total staff of only about 50, has a span of control of 8.[4] The executive director and his

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[1]Charles Perrow, op. cit., p. 19.

[2]Charles Perrow, "A Framework for the Comparative Analysis of Organizations," American Sociological Review 32 (1967), p. 198.

[3]Peter M. Blau, "A Formal Theory of Differentiation in Organizations," American Sociological Review 35 (1970), p. 204.

[4]Based on "Departmental Listing," January 25, 1974. The only section not included in prior years was mortgage credit.

Table 30

Measures of Structural Complexity

	Hierarchical Layers	Span of Control	Layers of Offices	% of Employ- ees in Central Office	Number of Employ- ees
HUD	11	7 - 9	3	22%	16,000
Ill. Hsg. Dev't. Auth.	3	8	1	100%	50
Mass. HFA	3	4	1	100%	50
Mich. St. Hsg. Auth.	4	4	2	72%	125
New Jersey HFA	4	4	2	90%	75
New York DHCR	5	3	2	95%	450
New York HFA	3	3	1	100%	40
New York UDC	3	8	2	63%	500

Sources: Agency organizational charts and departmental listings.

assistant must directly supervise the heads of development, architecture, site and market analysis, mortgage credit, construction, management, marketing, and development advance divisions. By contrast, the Massachusetts Housing Finance Agency, which has the same size staff, has a span of control of only four. MHFA's development division performs the tasks of IHDA's development, site and market, and mortgage credit sections; MHFA's management division subsumes the equivalent roles of IHDA's management and marketing sections. The only IHDA function not performed by MHFA is the distribution of development advances. The narrow span of control at MHFA has allowed decisions to be made on the basis of frequent face-to-face communication between those who make and those who implement policy rather than necessitating the use of written memoes, and undoubtedly has contributed to its large production and effective management of the high degree of risk associated with public purpose development.

Specialization within particular divisions has created broad spans of control at lower levels for HUD and the Michigan State Housing Development Authority. For example, MSHDA's management and marketing division has specialists in community affairs, maintenance, and finance, in addition to generalists assigned to each project. HUD has separate architectural reviewers for cost, aesthetics, and other aspects of design. The more specialized the division of labor, the easier it

is to train people, but the less satisfying the work becomes for sophisticated professionals. Such specialization also makes it more difficult to make the proper trade-offs necessary for successful developments. Documents pass from desk to desk in serial, assembly-line fashion. Approvals, disapprovals, and suggested modifications are made on the basis of narrow technical considerations within the jurisdiction of the reviewer. Since a different specialist reviews each line item, a developer cannot readily trade off projected cost savings on certain items with unusually high projected costs on other items.

This process also inhibits good architectural design. In commenting on the 1974 HUD design competition, the _Journal of Housing_ editorialized:

> Well designed projects in the United States require sensitive and sophisticated program mechanisms that fully account for the complex interrelationships between public and private investment activity. Traditionally, HUD programs have lacked this sophistication. As in its public housing programs, design guidelines have been implemented in a piecemeal and over-bureaucratic manner that discourages creative and resourceful designers.[1]

In the HUD system, the developer is supposed to have no contact with the technical staff reviewing his application. Rather, he is supposed to submit the required forms to a multi-family representative who passes them on to the technical

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[1] _Journal of Housing_, December, 1974, p. 507.

specialists for review. Those developers who adhere to this rule, however, find their applications shunted to the bottom of the pile on a technician's desk. While the multi-family representative is supposed to coordinate the flow of paper and keep the developer informed as to the status of the application, the multi-family representative often does not know exactly where an application sits and when he does know and wants to expedite processing on a particular project, he has little leverage to exert.[1] He is in a different division and generally has a lower status. Consequently, experienced developers will attempt to expedite projects by going to the technicians either directly where necessary or through lawyers or mortgagees that have had experience with the local office.

The Boston Urban Observatory's study of HUD Area Office operations in that city found that:

> The unanticipated but major problems fell outside all the carefully drawn bureaucratic cells of responsibility, and frequently no one was prepared to cope with them until they reached crisis proportions...For example, in several projects where construction defects were uncorrected when occupancy began and the HUD management division took over responsibility for such projects from the HUD development division, the development division no longer concerned itself with seeking corrections of the defects, and the management division did not consider uncorrected deficiencies as part of its responsibility.[2]

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[1] Housing development officers at the Michigan SHDA and of late at the Illinois HDA have encountered similar problems.

[2] Boston Urban Observatory, op. cit., pp. 194-195.

By contrast, at the Massachusetts HFA, where spans of control are narrow and only three levels of authority exist, developers deal directly with those who have decision-making authority and each division has broad concerns. The first meeting a developer has with the agency will be with whomever the developer happens to know, possibly the executive director, his deputy, or any one else on the staff. If the development seems worth consideration, the developer will be introduced to the mortgage officer who will have to approve the application from the point of view of financial viability and the design and management officers who will have to approve it from their respective points of view. While each division has its own area of expertise and primary responsibility, each looks at the project in its entirety. Disagreements among divisions or with the developer are resolved through negotiations, sometimes even resulting in arguments between divisions in the presence of the developer. Approval of all loans ultimately must be given by the head of each division, who may have been the person working with the developer on a daily basis. Any questions that the division chief may have will be worked out directly with the developer and/or architect and/or management agent.

Aside from division of labor and size, the other primary reason for increasing structural complexity comes from the number of tasks performed by the agency. While the Massachusetts

HFA limits itself to the sole function of providing multi-family mortgages, the Illinois Housing Development Authority and the New Jersey HFA take on seed money loans as well, and the Michigan Housing Development Authority adds seed money and single family loans to its list of functions. The New York State Division of Housing and Community Renewal administers seed money, public housing, urban renewal, rent control, and building code programs for the state in addition to monitoring private multi-family development, while its companion New York State Housing Finance Agency finances the construction of state universities, youth facilities, mental health and hygiene facilities, hospitals, nursing homes, and senior citizen centers as well as housing. The New York State Urban Development Corporation serves as developer and initiator as well as financier of commercial and industrial property as well as multi-family housing. The broadest role, however, is performed by the U.S. Department of Housing and Urban Development. Aside from its role in insuring and subsidizing private multi-family housing, it insures single family mortgages; provides seed money loans; funds public housing, urban renewal, model cities, neighborhood facilities, water and sewer lines, public facilities, open space and community planning; insures against riots, crime, and floods; and regulates interstate land sales. Each additional major function performed by any agency generally requires an increase in

either the span of control of the top administrator or an additional layer of hierarchy.

Anthony Downs has identified agency size rather than structural complexity as a primary cause of bureaucratic dysfunction. He found that, because of the inherent limitations of the man at the top, no matter how capable he may be, all very large bureaus and relatively small bureaus with high message volume suffer from one or more of the following problems: 1) greater delay in making decisions; 2) poorer coordination of decisions; or 3) more personnel and resources per unit of output in communicating information and orders.[1] While other organizational theorists might attribute these dysfunctions to either the structural complexity or the large number of hierarchial layers resulting from large size, each of the large agencies examined suffer from one or more of the problems that Downs identifies.

HUD and UDC have suffered from relatively poor coordination of decision making as manifest in their relatively high percentage of problem projects. On four of the five projects in the Buffalo area which were seen in the last chapter to have encountered severe vacancy problems, top UDC officials gave scant attention to the problems anticipated by the marketing

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[1]Anthony Downs, Inside Bureaucracy (Little-Brown: Boston, 1967), p. 131.

studies prepared by its own Division of Economics and Housing Finance.[1] Clearly, UDC's large size and large span of control made it difficult for those at the top to spend sufficient time with Economics and Housing Finance Division personnel to understand the magnitude of the marketing problem on these projects, comprehend all of the other problems on these and all other projects, and still produce a high volume of projects in a short amount of time. While UDC's unique role as a developer precludes any definitive statement, UDC's large size and large span of control also appear to have resulted in higher costs in communicating information and orders.

The New York State Division of Housing and Community Renewal has avoided coordination problems by slowing down the approval process. DHCR involvement has slowed processing by an average of about 19 months.[2]

DEGREE OF FORMALIZATION

Aside from structural simplicity, the other primary measure of bureaucratization is the degree of formalization as expressed in terms of the amount of rules and procedures. The more rules and procedures an organization has, the less flexible it can be in handling complex problems. In nearly

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[1] UDC Department of Management and Regulation, "Management Status Report," pp. 3-4.

[2] See p. 344 *infra*.

all cases, the state HFA's have operated with less formality than HUD.

The state agency with the least formality unquestionably has been the Massachusetts Housing Finance Agency. In this respect, MHFA has acted most like a private lender. The few formal rules it does have primarily result from requirements regarding subsidies made by HUD or the State Department of Community Affairs. For example, both of these agencies set income limits on leasing and rent supplement programs, while HUD limits the number of non-elderly, single occupants. The flexibility at MHFA is so great that the chief complaint of the program participants, particularly architects, has been that on occasion, when MHFA looks at a project, it poses new and, at times, contradictory requirements.

Overall, this flexibility has enabled MHFA to be the most effective agency. The lack of rules allows MHFA to negotiate with developers to achieve maximal overall social input consistent with financial security. While a given development may be too isolated to attract a substantial number of minority residents or former slum dwellers, MHFA might then require it to take extra steps to accommodate handicapped residents. In another instance, MHFA might trade off larger bedrooms against additional community play space. MHFA's flexibility has enabled it to successfully undertake several quite unconventional developments. In

one instance, MHFA financed the conversion of an old piano factory located in an urban renewal area into housing geared toward artists. By creating apartments with extraordinarily large living rooms capable of being used as studios and by situating the apartments around an inner courtyard to provide a sense of community, MHFA has created a unique environment out of a seemingly useless old building. In another instance, MHFA financed the rehabilitation of a block of five-story walk-up apartments in an inner city area. To make the buildings marketable, MHFA insisted that the developer provide elevators in new shafts added on to the rear of the structure. Similarly, the New Jersey Housing Finance Agency made the most of its flexibility when it converted unmarketable two-bedroom apartments in a development it had financed to one-bedroom apartments plus storage after finding that a strong demand existed in the local area for large one-bedroom apartments.

One state agency to operate by a relatively formal set of procedures, although with few substantive rules, is the Michigan State Housing Development Authority. At the outset of MSHDA's operation, executive director William G. Rosenberg, whose background as a bond counsel undoubtedly conditioned him to preferring formalized procedures, asked a consulting firm to prepare the Michigan Housing Process. This manual, which serves as the basis for all of MSHDA's processing, divides the development process into thirteen discreet phases

and ninety-seven separate subphases. For example, after the sponsor and Intake Officer have reviewed the suitability of the proposal for processing at the end of the first phase, phase two begins with step 0201 during which time the Scheduling Officer prepares a development processing schedule, suggests assignments, and secures Division Director approval or modifications. Then, in step 0202, the Housing Development Officer and Intake Officer review the preliminary development proposal and documents and identify areas for close attention by the Market Analyst, Community Affairs Specialist, and Site Reviewer in steps 0204 through 0206, when they will screen the proposal. This procedural formality built into the MSHDA Housing Process has meant that more coordinative tasks have had to have been performed and explains in large measure why processing costs per unit developed were seen to have been 50 - 400 percent higher than at other agencies. Positions like Scheduling Officer and Intake Officer have no counterparts at the other agencies. Scheduling binds are handled at the other state agencies by redoubled efforts or at MHFA by flexible shifting of personnel to perform tasks not specified in any job description or process manual. Intake at other agencies is handled by the same personnel who would otherwise have to familiarize themselves with the proposed development and sponsor at a later date. MSHDA's high degree of formality, however, has proven to have the

one advantage of allowing new and inexperienced personnel to readily fit into the development process and know which decisions have already been made and which remain to be made. The high degree of turnover and lack of experience at MSHDA has made this consideration more important than at other agencies.

The state agencies with the most formalized set of rules and procedures is the New York State Division of Housing and Community Renewal. The high degree of formality endemic to DHCR's processing can be readily seen in its design requirements for exterior walls made of brick:

> Section 1711-7.7 Exterior Walls...
>
> (d) All facing brick shall meet A.S.T.M. C-216, latest edition, Grade SW standards.
>
> (e) The Architect, during the preparation of and prior to the completion of his working drawings, shall submit to the Sponsor and the Division for review and approval, samples of the various types of brick that he recommends, together with certified cost proposals from the brick manufacturers and a letter giving reasons for the Architect's recommendations.
>
> (f) Samples submitted for approval shall be accompanied with a test report from an approved laboratory attesting to compliance with the specifications.
>
> (g) All exterior brick and mortar shall meet with the approval of the Architect and the Division with respect to color, shade, type, finish, size, and texture.
>
> (h) The Contractor shall install story height brick panel with a typical window, window sill, and air conditioner sleeve, and obtain approval from the

> Architect and the Division before commencing brick work.[1]

Each of these procedural requirements have been established to make absolutely certain that all parties involved are satisfied with the appearance and quality of the bricks used. Each step has been added over time to close loopholes or potential loopholes found in the development of early projects. Yet, each step adds to the length of time required to process or construct a development. The extraordinary procedural complexity illustrated here provides much of the explanation as to why the elapsed time between initial application and the start of construction was seen to be significantly longer on DHCR projects than on HUD projects done in New York State or on projects processed by other agencies. In fact, a regression analysis shows that while most of the variance in processing time must be attributed to factors unique to individual projects, those projects processed by DHCR have taken an average of 19 months longer than those processed elsewhere, even after controlling for the size of the project, profit orientation of the sponsor, type of construction (new versus rehabilitation), agency staff size, presence or absence of civil service at the agency, and use or non-use of Federal

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[1] New York State Division of Housing and Community Renewal, Design Standards for Limited Profit and Limited Dividend Housing Projects, Form AB-25, January 1, 1968, p. 53.

subsidies.[1] (See Table 31).

The slow processing time on DHCR projects, particularly those requiring the approval of HUD, corroborate the findings of Jeffrey Pressman and Aaron Wildavsky that the more approvals required for the successful completion of a project, the longer it will take.[2] Not only do DHCR regulations add considerably to the number of formal approvals that have to be given by each of the actors normally involved in the process, but the separation of the processing and financing functions between DHCR and the New York HFA adds an additional actor to the process. Even when DHCR has decided that a particular project is feasible, it must convince the HFA of the soundness of its decision. Frequently, the HFA will ask for additional market research or other materials which will slow the process further.

With the exception of DHCR, none of the HFA's have as formalized a set of rules and procedures as HUD. The primary rules and procedures for program participants and HUD staff to follow concerning insured Section 236 housing are contained in a 166-page handbook entitled <u>Rental and Cooperative Housing for</u>

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[1]The extraordinarily slow processing time of DHCR Section 236 applications by the HUD offices in New York State account for 3 to 8 months greater delay than on HFA applications for Section 236 funds in other states. Still, DHCR's average processing time on a sample of unsubsidized Mitchell Lama developments is 22.8 months (n = 5) which is 5.6 months longer than the 17.2 months taken by HUD offices in New York State on their own Section 236 projects.

[2]<u>Implementation</u> (Berkeley, University of California Press, 1973), p. 118.

Table 31

Regression Results for Dependent Variable
Processing Time Fron Initial Occupancy to Initial Closing,
Step 7 of Stepwise Regression

Variable Description	Name	Coefficient	Std Error of Coefficient	t -Test	DF	Significance
# of Units Rehab.	REHAB	-0.0180	0.006	-2.92**	486	.004
Profit Orientation	NP	1.1802	0.886	1.33	486	.184
Civil Service	CIVSER	-3.6152	2.070	-1.75	486	.082
Lack of Fed. Subsidy	FEDSUB	-4.5921	1.831	-2.51*	486	.013
Log of Staff Size	STAFFSZ	3.1322	0.879	3.56***	486	Under .001
Total # of Units	TOTAL	-0.0003	0.002	-0.16	486	Over .500
DHCR or Other	DHCR	19.1903	2.458	7.81***	486	Under .001

Regression Constant 8.347

Multiple Correlation Squared = 0.192
Multiple Correlation = 0.439
Standard Deviation of Residuals = 8.913

F = 16.55 with 7 and 486 Degrees of Freedom
(P under .001)

Lower Income Families: Section 236 Basic Instructions.[1] The June, 1973, version represents a consolidation and updating of nine scattered sets of paragraphs in the FHA Manual, nineteen circulars, one notice, and two FHA handbooks. Still, proper implementation of the Section 236 program requires adherance to the rules and procedures contained in five additional assorted handbooks relevant to all HUD mortgage insurance programs, nine others related to all multi-family projects, and one related to Section 236 fiscal instructions. Should the project happen to have a nonprofit sponsor, be intended for cooperative ownership, involve rehabilitation, or be located in a high cost area, reference must be made to still other handbooks. Developers complain of difficulties in obtaining copies of all of the applicable regulations and in making sure they are current.[2]

Compared with the rules at the state agencies, including at DHCR, HUD rules are cast in concrete. The waiver or alteration of rules at HUD to fit unique or unusual circumstances applicable to an individual project is extremely difficult to

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[1] U.S. Department of Housing and Urban Development, Rental and Cooperative Housing for Lower Income Families: Section 236 Basic Instructions, (No. 4510.1), June, 1973.

[2] Report of the Task Force on Improving the Operation of Federally Insured or Financed Housing Programs, Vol. III: Multi-family Housing (Washington, D.C.: National Center for Housing Management, 1973), pp. 122-123.

achieve, even when, as is often the case, the technician agrees with the developer that the exception would strengthen the project. One experienced developer told the author that he often could obtain HUD waivers he believed necessary, but only after going to someone sufficiently high up in the chain of command to be "willing to go out on a limb" and only after great effort. The facts that HUD rules are made in Washington, are made by personnel several layers higher than those who directly implement them, and must be made to apply nationwide, all contribute to this inflexibility.

Reasons for Formality

The extensiveness of HUD rules and procedures in comparison with those at most of the state agencies results from many reasons. As shall be seen in this section, HUD's structural complexity, method of hiring, history, age, role as an insurer, auditor requirements, and statutory obligations have all combined to limit the ability of HUD to operate flexibly. The state agencies are bound by few such constraints and have had greater opportunity to organize and operate in a non-bureaucratic manner.

Officials making policy decisions at the state agencies have the ability to directly supervise those who interact with developers and managers and thereby assure themselves directly that policy concerns are being met. At HUD, however, the large number of layers of hierarchy and geographic dispersion

of offices has precluded such a possibility, and has required the formulation of rules to guide employee actions. Through the medium of rules, directors are able to provide pervasive, impersonal supervision.

Those at the top of HFA's are generally better able than HUD to staff their organization with personnel who have professional competency and share in organizational values and goals. The employment of such personnel makes an organization less dependent upon having to formulate rules. Numerous studies have shown that the greater degree of professionalization, the lesser the need for formalization.[1] In fact, professionals tend to shy away from and conflict with organizations that impinge upon their professional integrity through formalized rules or procedures.

Most of the state agencies have had an excellent opportunity to attract qualified professionals because their autonomy and ability to generate arbitrage profits has allowed them to pay relatively high salaries. As seen in Table 32, three of the four HFA's with independent hiring power pay significantly higher salaries than do their respective local HUD offices. The New Jersey HFA is the one exception. The two state HFA's having salary levels determined by civil service, New York DHCR and MSHDA, have salary levels which

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[1] See Richard Hall, op. cit., p. 121.

Table 32

Annualized Pay Per Individual
By State Agency and Local Hud Office for Fiscal Year 1973

	Pay Period	Man Years/ Staff Size	Total Salaries & Benefits (In 1000's)	Annualized Salaries & Benefits/ Employee
Ill. Hsg. Dev't. Auth.	FY 72-73	50.0	$1,681	$17,200*
HUD - Chicago	FY 73	350.0	5,451	15,600
HUD - Springfield	FY 73	59.2	830	14,000
Mass. HFA	FY 73	54.0	914	16,900
HUD - Boston	FY 73	268.1	4,159	15,500
Mich. St. Hsg. Dev't. Auth.	April 73	113.0	139	14,400
HUD - Detroit	FY 73	486.3	6,492	13,400
HUD - Grand Rapids	FY 73	84.1	1,272	15,100
New Jersey HFA	Jan. 73	89.0	97	13,000
HUD - Newark	FY 73	257.2	2,271	14,900
HUD - Camden	FY 73	137.7	3,839	16,500
New York DHCR	FY 73	430.0	5,888	13,700
New York UDC	Oct. 72	513.0	882	20,900
HUD - New York City	FY 73	250.7	4,293	17,100
HUD - Albany	FY 73	50.2	812	16,200
HUD - Buffalo	FY 73	138.5	2,043	14,800

*Adjusted by a factor of 102.5% to make equivalent to Fiscal Year 1973.

Sources: Annual totals for states from annual reports except DHCR totals which are taken from New York State Executive Budget, 1973-74; single month totals from fiscal officers; HUD figures from HUD Office of Financial Systems and Services, Administrative Operations Fund Report of Obligations Incurred, Fiscal Year 1973, September 26, 1973.

on average are as low or lower than those for HUD. The result has been the hiring of less experienced or less professional personnel who require more guidance in the form of established rules and procedures.

Similarly, with certain exceptions, the state agencies have had greater opportunity to select personnel who share the values being promoted by the agency. One organizational theorist found that:

> Moreover, as the goals of lower-level members become more like those of top-level members, the relative amount of authority leakage declines...Greater goal consensus, therefore, actually means an increase in the productive capacity of the bureau. Top-level officials can retain the same quality of output as before, but reduce the controls, reports, and other performance checks used to maintain it.[1]

Civil Service restrictions have hindered the ability of HUD as well as of the New York DHCR/HFA and MSHDA to recruit staff members having compatible values.[2] These restrictions require the hiring of personnel on purely objective criteria. As seen in Chapter 8, political patronage has on occasion hampered the New Jersey HFA in hiring competent individuals with compatible goals.

Disparities between agency goals and staff goals also result from abrupt shifts in organizational goals. For

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[1] Anthony Downs, Inside Bureaucracy (Boston: Little-Brown, 1967), p. 223.

[2] Reportedly, however, both the New York HFA and MSHDA have in part circumvented these regulations by such devices as asking those with higher ratings to step aside.

example, Seymour Martin Lipset traced the initial failures to make reforms of the Social Democrats when they held power in Weimar Republic in Germany in 1918-1920 and of the socialist Cooperative Commonwealth Federation in Saskatchewan, Canada, to the lack of compatible values held by entrenched civil servants.[1] HUD has encountered comparable problems. Individuals hired when the primary role of HUD's predecessor agency, the Federal Housing Administration (HFA), was in insuring loans on single family homes in suburban areas, cannot be expected to whole-heartedly share in the newer goals of HUD like affirmative action and slum area rebuilding.

The Douglas Commission found in 1968 that with regard to the rent supplement program:

> ...the rank and file officials, in district and local (FHA) offices were, in many cases, highly unsympathetic. They were accustomed to dealing with the conservative real estate and financial community. They did not feel at home in having business dealings with churches and philanthropists whom they tended to regard as soft and impractical. Nor did they welcome having the poor as their constituents.[2]

Each of the state agencies are sufficiently new or, as in the case of DHCR, have had sufficiently stable goals to have

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[1]S.M. Lipset, "Bureaucracy and Social Change," in Robert K. Merton et. al. Reader in Bureaucracy (Glencoe, Illinois: Free Press, 1952).

[2]National Commission on Urban Problems (Paul H. Douglas, Chairman), Building the American City (Washington, D.C.: Government Printing Office, 1968), p. 19.

had the opportunity to hire individuals with personal goals compatible with the agency's current goals. The relative youth of most of the HFA's has also meant that fewer rules have accumulated through organizational learning. The fact that DHCR is over 35 years old accounts in large part for its high degree of formalism. Rules created by organizations learning how to deal effectively with recurring situations having unchanging inputs can be advantageous. The primary danger in creating such rules, however, is that outside circumstances may change without corresponding changes in the rules. The informal policy at MHFA that no projects will be approved involving electric heat is a good one considering the high cost of electric heat as compared with gas or oil. The danger in formalizing this as a rule is that the comparative economics might change faster than the rule.

Another reason for the relatively large number of rules at HUD is because of its role as a mortgage insurer in a national market. In order for it to facilitate the sale of the mortgages it insures to FNMA, GNMA, or other secondary lenders, it must assure them that each mortgage meets certain standardized, objective criteria.

Still another cause of organizational rules and procedures at both HUD and certain of the HFA's has been the findings of auditors. As seen in Chapter 5, auditors have not only added to financial reporting requirements, but in some instances, particularly in Michigan, have touched on programmatic areas

as well. The Michigan Auditor General, for example, has insisted that MSHDA create written rules regarding the circumstances under which it could waive limits on the number of bedrooms that can be occupied by a family of a given size.

A final source of formalization has been statutory requirements. In particular, the National Environmental Policy Act (NEPA) has required both HUD and the state agencies to determine if significant environmental harm will result from any "major action" they take using Federal funds. While the aims of this legislation are laudable, the required methods of implementation are rigid. One law journal commentary on NEPA's effects on HUD called the law "the purest sort of lawyer's law--a body of procedures governing political decisions."[1] The article went on to say, "As we see it, NEPA's major contribution is that it supplies procedures which legitimize agency decisions."[2]

Thus, while bureaucratization has been in certain circumstances desirable, and in certain respects unavoidable, particularly for HUD and the less autonomous state HFA's, the complexity of the public purpose housing development process generally demands the flexibility that comes from a

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[1] P.D. Durchslag and P.D. Junger, "HUD and the Human Environment," Iowa Law Journal, 58 (April, 1973), p. 889.

[2] Ibid., p. 890.

simple organizational structure and non-formalized rules and procedures. As has been seen, the flexible approach used by the Massachusetts HFA has been a primary factor in its success, while certain bureaucratic elements of the operation of HUD, DHCR, MSHDA, UDC, and IHDA have been seen to have created problems for them. Other differences in agency performance can only be explained by differences in leadership, the topic of the next chapter.

CHAPTER 10

LEADERSHIP

While numerous books have been written on how to be an effective leader, most sociological studies of organizations fail to include any analysis of the quality of leadership provided by its chief executive. Peter M. Blau, for example, dismisses consideration of leadership by stating:

> It is worth repeating that these formal structures exhibit regularities that are independent of the individuals in them and that can be studied without inquiring why individual managers make certain decisions...the structure exerts constraints that limit the alternatives of individuals.[1]

Yet, anyone who has even casually looked at the behavior of organizations, particularly non-bureaucratic ones, knows that some seemingly hard-to-define but easy-to-recognize quality called leadership does make a difference in terms of agency effectiveness. Some observers interviewed in the course of researching this dissertation attributed 95 percent of the success of particular HFA's to the leadership of their executive direcors. If enough HFA's had been in operation long enough to provide a statistically significant sample, then propositions regarding the role of HFA's in the development process, their position in government, and degree of bureaucratization could be tested neglecting the quality of leadership because presumably the good leaders and the bad leaders would counterbalance each other. Yet, the relatively small number of cases

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[1]The Dynamics of Bureaucracy. (Chicago: University of Chicago Press, 1955), p. 325.

and the fact that most HFA's operate in a flexible manner which increases the importance of leadership, make it necessary to discuss this issue in this dissertation.

The best available definition of what constitutes leadership in public agencies comes in Philip Selznick's classic work, Leadership in Administration. Selznick finds four critical tasks of leadership:

1. The definition of institutional mission and role;
2. The institutional embodiment of purpose;
3. The defense of institutional integrity; and
4. The ordering of internal conflict.[1]

Selznick asserts that in defining the institutional mission and role (the first task) leadership "takes account of the conditions that have already determined what the organization can do, and to some extent, must do."[2] Thus, leaders of HFA's must choose a mission that is consistent with the public purposes set forth by the state legislature, the national concerns of HUD, and the powers of the agency. The institutional embodiment of purpose occurs when the organization comes to stand for something meaningful, when it embodies--"in thought and feeling and habit--the value premises of policy."[3] The final critical tasks of leadership, the defense

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[1]Philip Selznick, Leadership in Administration (Evanston, Illinois: Row, Peterson & Company, 1957), p. 62.

[2]Ibid.

[3]Ibid.

of institutional integrity and the ordering of internal conflict involve the reconciling of internal strivings and environmental pressures, respectively, "paying close attention to the way adaptive behavior brings about changes in organizational character.[1]

When defined in Selznick's terms, leadership does correspond with a concept that organizational theorists have found to be directly related to effectiveness. Price concluded in his survey of organizational studies that:

> Organizations which have an ideology are more likely to have a high degree of effectiveness than organizations which do not have an ideology.[2]

Consequently, on the basis of the four critical tasks of leadership presented by Selznick, this chapter will compare the performance of the purported leaders of the various HFA's and HUD.

One agency executive director to show especially effective leadership has been William J. White. White has served as the head of the Massachusetts Housing Finance Agency since 1969 when the MHFA Board named him to replace the first director, David Martin, who it believed had failed to be effective. The mission White has defined for MHFA has been to meet the state's

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[1] Ibid.

[2] James L. Price, op. cit., p. 104.

most critical housing needs by financing the development of housing for low-income families within economically and socially integrated settings which residents find well-designed, well-constructed, and well-managed.[1] While these goals are derived from those found in the MHFA statute, White's role in defining the operative mission of MHFA has been a creative one. The original statute defined "low income families" as all those who are unable to afford decent, safe, and sanitary housing without spending over 25 percent of their income, which, if broadly construed, could be interpreted to include the majority of the Commonwealth who, on an unsubsidized basis, could not afford the new decent, safe, and sanitary housing being provided by MHFA. To clarify the legislative intent to serve genuinely low income families, he succeeded in having the statute amended to redefine "low income families" to be those with incomes low enough to qualify for public housing. He further put into practice the mission of creating economic and social integration within the same structure, and formulated the standard, "The satisfaction of the people we serve is our greatest test."[2]

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[1]Massachusetts Housing Finance Agency, "Operations Handbook for Mortgage Loan Financing of Multiple-Dwelling Housing - New Construction," July 15, 1969, p. 2.

[2]Statement by the Executive Director, Massachusetts Housing Finance Agency, Fourth Annual Report, September, 1972, p. 4.

These goals have been thoroughly embodied among the staff of MHFA. One indicator of this institutional embodiment of purpose has been the fact that MHFA has been able to maintain high goal performance with a minimal amount of formal rules. He has been able to do so by hiring a highly professional staff that shared in the values being promoted by the agency before coming to work for it. The other evidence that White has succeeded in making MHFA stand for a meaningful purpose comes in the responses of staff members to the question of to what extent did they and other personnel see themselves as working to protect the interests of the agency. Virtually everyone questioned responded that they and others saw MHFA as an agency as holding their highest priority, higher than the interests of bondholders, developers, tenants (the second priority), or themselves.

White has also been effective in performing the third critical task of leadership, defending the integrity of the agency. All substantively meaningful bills to alter MHFA in a manner opposed by White including several attempts to have it take on new functions have been defeated, while virtually all legislative actions concerning MHFA that have been desired by MHFA have been adopted. White has responded to all attempts by individual politicians to influence MHFA's decision with regard to the approval of projects or the hiring of personnel simply by explaining the status of the application and the

reasons for approval or denial. Without violating its institutional integrity, MHFA, under White's leadership, has developed satisfactory working relationships with all of the special interest groups with whom it works or who might have reason to regard it as a competitor. Despite its having excluded several developers, managers, and contractors who have demonstrated incompetency, it maintains the respect of the various professional associations. Through the spreading of deposits among a large number of Massachusetts banks, it has maintained the support of financial institutions. Unlike HFA's in certain other states, MHFA has been fortunate in being able to avoid the making of concessions to or incurring the opposition of mortgage bankers primarily because of their weakness in the state.

While conflicts have occurred among MHFA staff, White has succeeded in ordering them in such a way that all significant subgroups have felt represented while White has maintained control over the major decisions.

Using the same criteria, the leadership provided by the executive directors of the Illinois Housing Development Authority has been somewhat less effective. Daniel P. Kearney, the initial head, defined a clear mission for the agency, namely to create economically integrated housing in suburban locations. With one exception, each of IHDA's developments during the Kearney years represented the manifestation of

this purpose. Compared with MHFA's goals, however, the mission set by Kearney for IHDA seems less bold. Rather than economically integrate families with poverty level incomes into a middle income setting as done at MHFA, IHDA was satisfied with mixing moderate income, working class families with middle income level families. The higher vacancy rates in Illinois compared with Massachusetts (6.6 percent versus 4.8 percent)[1] and consequent greater difficulty in renting middle income dwellings account for part of this conservatism. Despite doing one small project largely to appease a powerful legislator, Kearney was generally effective in defending the institution from outside pressures, and despite some complaints of ineffective delegation of power, did succeed in ordering internal conflict.

The election of a new governor in Illinois led to the replacement of Kearney in January, 1973, with at first an acting executive director from within the organization, and then three months later, by Irving Gerick who came to IHDA from the outside. When Gerick took over, he faced not only the Federal moratorium on subsidized construction, but also an organization whose staff had been almost totally decimated. The new mission he set for IHDA was less straight forward than that of Kearney. He sought to build up IHDA's reserves to

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[1]U.S. Bureau of the Census, op. cit., p. 6.

mount an attack on Chicago's inner city housing problems. However clear this mission may have been in his own mind, at least by January, 1974, the time interviews were conducted, the new IHDA staff lacked a sense of purposeful commitment to the organization. The response of IHDA personnel to the question of to what extent do personnel work to protect the interests of the agency was completely the opposite of the answers given by those working at other HFA's. While the staff of the other HFA's indicated a strong loyalty to their organizations, the consensus of responses at IHDA revealed an overall lack of respect for the agency as an institution. Some individuals complained of increasing bureaucratization; others cited the external political changes; and still others mentioned an apparent lack of direction being taken by the organization.

The leadership shown by Gerick in defending the integrity of IHDA has been somewhat better, although apparently, at least one appointment was made for political reasons and concessions were made to allow the participation of mortgage bankers in IHDA programs. Internal conflicts have not all been resolved in a manner that has been satisfactory to all parties. While some staff members have received more responsibility than they ever thought possible, others have complained that a greater centralization of the organization had deprived them of responsibility.

Such failing in leadership, if it be that at all, however, provides no help in accounting for IHDA's greatest deficiency in achieving its public purpose goals, notably its small volume of production, through the end of 1973 for low and moderate income families. Despite the presence of the moratorium, IHDA closed more units during the six month period of July to December, 1973, the period just after Gerick took control, than in any similar period prior to that time and production levels were even higher throughout 1974.

As in Illinois, the New Jersey HFA experienced upheaval associated with a change in the governor midway in the growth of the organization. Thomas Seesel, the initial executive director, and Paul Ylvisaker, the original chairman of the HFA board and head of the Department of Community Affairs, outlined the clear HFA mission of rebuilding inner city areas. The agency became embodied with such a sense of purpose that even four years after John Renna took over as executive director, those who were originally hired by Seesel expressed the belief that while they found little sense of direction coming from Renna, the staff retained a strong allegiance to the New Jersey HFA and its underlying public purpose. While Seesel and Ylvisaker maintained the integrity of the agency even to the point where Ylvisaker's social activism became a campaign issue that helped to defeat Governor Richard Hughes in his bid for reelection, according to many of those interviewed,

Renna allowed the agency to be used for the granting of political favors. During the Renna years, projects were often approved or given higher priority for subsidy on the basis of which mayor had the ear of the governor while project managers and certain other positions were filled more on the basis of political cronyism than competence. With regard to the ordering of institutional conflict, both Seesel/Ylvisaker and Renna seemed to have succeeded in maintaining control over critical decisions while maintaining the loyalty of all major elements to the organization.

In Michigan, after the original executive director, Robert McLain, was fired for failing to move the agency quickly enough, both William G. Rosenberg and David L. Froh, MSHDA's two chief administrators throughout most of its existence, have demonstrated moderately effective leadership. Rosenberg initially defined MSHDA's mission as serving as a purchasing agent for the consumer in the production and management of housing for low income and minority families that will be economically sound and assure repayment of the Authority's investment.[1] Froh has taken a less mission-oriented, more opportunistic approach. Rather than attempt to meet the most pressing housing needs, Froh has attempted to do whatever is possible with presently available resources. Rather than attempt to hire personnel who are

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[1]MSHDA, Annual Report, July, 1972, p. 7.

"planners," he has sought "mortgage bankers." Still, MSHDA personnel respect MSHDA and its institutional purposes. While Rosenberg and Froh were both able to maintain the integrity of the organization with regard to politcal favor-seekers and special interest groups, the Michigan legislature enacted two measures during Froh's tenure in office which restrict MSHDA's autonomy. Despite Froh's opposition, statutes are now on the books which restrict MSHDA's budget to an amount appropriated by the legislature, and which require that at least 15 percent of the units in every development financed by MSHDA be for genuinely low income families. With regard to the leadership task of the ordering of internal conflict, Froh has done a superior job. While Rosenberg, in building the organization, often made decisions on his own, Froh, in taking over an existing organization, has been more collegial in his decision-making while ensuring the fulfillment of key agency commitments.

Edward Logue, the executive director of the New York State Urban Development Corporation from its inception to early 1975, came to UDC with a reputation of being a highly effective leader. In fact, his name and the purposes and powers set forth in the UDC statute were sufficient to attract several staff persons to UDC who had themselves been directors of other large organizations. The basic mission he emphasized at UDC was simply "to improve the physical environment for

low and moderate income families and to improve their job opportunities."[1] Unquestionably, this purpose has been embodied in the behavior of the UDC staff. Despite some complaints by personnel in certain field offices that the Central Office maintained too much power, Logue appears to have ordered internal conflict effectively. Logue's greatest failing in leadership has come in his defense of UDC's institutional integrity. By pursuing organizational goals beyond the limits of the environment, Logue generated opposition among suburban legislators and the financial community. As a result of his aborted campaign to push low income housing in suburban Westchester County, the State Legislature restricted UDC's zoning override powers in towns. As a result of his overemphasizing UDC's role as a developer and neglecting to provide competent financial monitoring until late in the development of the organization, UDC lost the confidence of the banking community and was unable to raise funds to avoid defaulting on the bond anticipation notes due February 25, 1975. These difficulties, however, are as much a result of the role performed by UDC and the risk it took as it is a failure in leadership.

While less information has been obtained on the quality of leadership provided by Charles Urstadt and Lee Goodwin of the New York State Division of Housing and Community Renewal

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[1] UDC, Annual Report, 1971, p. 7.

and Paul Belica of the New York State HFA and while each were in office at a relatively late point in the life cycle of their agency, each appears to have been reasonably effective. Urstadt's primary mission for DHCR as expressed in annual reports was to generate new approaches to providing decent housing;[1] Goodwin's mission has been to foster community development through the linking of housing with community planning.[2] Belica has set the maintenance of low cost financing on a self-sufficient basis as the mission of his agency.[3] The information available indicates that each of these agency directors have performed the other critical tasks of leadership in at least a satisfactory manner.

The leadership provided by George Romney as Secretary of the U.S. Department of Housing and Urban Development has to receive a mixed rating. The mission he set forth for HUD was clear and well-known. It was to maximize the production of housing. The extent to which he succeeded in achieving the embodiment of this purpose within the organization was made clear by the staff response to the news of the moratorium

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[1]New York State DHCR, New Approaches, March 31, 1971, pp. 4-5.

[2]New York State DHCR, Programs for Urban Growth, 1972-1973, p. 5.

[3]New York State Housing Finance Agency, 1973 Annual Report, p. 4.

on subsidized housing. During the last week of 1972 and the first week of 1973 just after news of the impending moratorium became widespread, more applications were granted feasibility than in all of the remainder of 1972. Staff personnel throughout the country worked late at night and over weekends to carry out the purpose of the organization despite instructions from the Central Office not to do so. Where Romney was ineffective was in his defense of the integrity of the organization. During his tenure of office, indictments were handed down against six office directors and hundreds of other individuals for preparing excess property valuations, taking kickbacks, and similar fraudulent activities. This corruption, however, provides only minor explanatory value with regard to the financial solvency of HUD's multi-family developments, the area of its greatest failing. While the Detroit area office was the one HUD office among those in states with advanced HFA's to experience a substantial number of indictments, the incidence of "problem projects" in Michigan was seen in Chapter 4 to have been 24 percent, a rate that was only slightly greater than the 20 percent recorded in the other four examined where little, if any, corruption was revealed. The scandals ultimately led to the national moratorium, an event that except in reducing slightly the total volume of units produced, did little to change the relative ineffectiveness

of HUD as compared with the state agencies during the period of 1970 - 1973.

The other Secretary of HUD during the time period studied was James T. Lynn. The coincidence of the start of his tenure with the beginning of the moratorium made it virtually impossible to provide effective leadership. The mission he set for the agency was to curtail production efforts and devise a new set of programs. For those who had been involved in the implementation of programs, particularly personnel in field offices, the embodiment of this mission would have meant a complete recognition of failure and thus became a source of conflict. The integrity of HUD also came into question as the formulation of new program guidelines came to be more a product of the Office of Management and Budget than of HUD.[1]

Thus, significant differences in the quality of leadership have been found. The leadership shown by William J. White provides an added reason why the Massachusetts HFA was seen to have been the most effective agency. Differences in the quality of leadership, however, offer relatively little assistance in explaining differences in effectiveness between other pairs of agencies or between the state HFA's as a group and HUD. In making these comparisons, differences in role in the development process, position in government, and degree of bureaucratization provide ample explanatory value.

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[1]Housing and Development Reporter, December 12, 1973, p. A-10.

CHAPTER 11

CONCLUSION

GENERAL CONCLUSIONS

In conclusion, this dissertation has shown that the state housing finance agencies as a group have been more effective than the U.S. Department of Housing and Urban Development in that they have generally done as well as HUD in satisfying the common public purposes outlined for them in their enabling legislation, while being more effective in maintaining the fiscal solvency of their developments and operations. The HFA's have better fulfilled certain public purposes, while HUD has better fulfilled certain national goals not shared by the HFA's.

In particular, the state agencies as a group have been seen to have produced a similar volume of privately-owned multi-family housing for low and moderate income families as HUD within the states considered in this thesis, despite the fact that HUD has generally controlled the allocation of subsidies. The HFA's have made available a considerably higher proportion of this housing to genuinely low income families than has HUD. No significant difference was found in the rents charged by the HFA's or HUD on developments with the same number of bedrooms in the same substate area under the same subsidy program, despite the fact that the HFA's have produced units that contain more amenities, have

been better designed, and often have stronger construction warranties. The only significant difference between the HFA's and HUD in terms of slum rebuilding efforts was that most of the HFA's tended to concentrate their efforts in urban renewal areas while HUD has focused upon areas of concentrated poverty. No significant difference was found between the two types of agencies in terms of locating housing near jobs.

With regard to the national public purpose of promoting racial integration, the state agencies examined were found to have more consistently created integrated environments than their HUD counterparts, although HUD was found to have provided housing for a higher percentage of minority families. HUD has clearly outperformed the HFA's with regard to two other national goals for which data was available, both of which involve high risk and both of which are vaguely defined by statute but clearly defined by HUD administratively to apply to HUD-insured Section 236 developments but not to uninsured state agency-financed developments. In particular, HUD has provided housing for a higher percentage of large families and has provided a higher percentage of rehabilitated as opposed to newly constructed units.

The HFA's have clearly done a better job than HUD in satisfying certain locally defined public purposes that were not shared by HUD in its implementation of the Section 236 program but in other contexts would be considered national

goals. In particular, the HFA's have provided a higher percentage of housing for the elderly. Largely as a result of the achievements of a single agency, the HFA's have also created housing having a much broader mixture of incomes within the same development. While the provision of elderly housing has involved lower risk, the mixing of income levels has generally been perceived as involving higher risk.

Despite the financial problems of the New York State Urban Development Corporation, the area in which the state agencies have most clearly performed better than HUD has been in maintaining the financial solvency of their developments. The HFA's have had a far lower rate of significant arrearages on their Section 236 developments and have had a lower vacancy rate. With the exception of UDC, the state agencies have generated substantial reserves from their operations while HUD has operated the Section 236 program at a substantial loss.

Leaving UDC aside, which because of their added role as a developer is quite legitimate, the financial success of the HFA's compared with HUD is overwhelming. Excluding UDC, however, reduces the aggregate fulfillment of public purposes by the HFA's. Specifically, without UDC the state agencies have produced fewer units for low and moderate income families than their HUD counterparts (51,000 versus 80,000 units) and placed a significantly lower percentage of their units in urban

renewal and poverty areas (22 to 42 percent). The difference in production totals can be dismissed in part by the fact that HUD controlled the amount of subsidies. The difference in inner city risks taken is primarily a function of the fact that certain HFA's have almost completely avoided these areas to protect their standing in the bond market.

As has been seen, the primary reason for the superior performance by the state agencies has been the non-bureaucratic, hand-crafted approach that most of them have taken toward public purpose housing development. In taking this approach, the HFA's have actively participated in the structuring of each development, have better oriented their policies to local circumstances, and have usually organized themselves in a flexible, structurally simple manner. By contrast, HUD has taken a factory approach characterized by passive regulation, a large scale, and a bureaucratic method of organization. The hand-crafted approach of the HFA's has resulted from their necessity to control risk to be able to sell bonds at a favorable rate, from the opportunities provided many of them to organize themselves in a non-bureaucratic manner by virtue of their limited jurisdiction and relative autonomy, and from the opportunity to be active by virtue of their mortgagee role.

The hand-crafted approach has been seen to be appropriate because of the risky, localistic, and complex nature of the

process. By actively participating in the development process, the HFA's have been able to structure developments in a manner that allows them to achieve a high level of social purpose but at lower risks than would be incurred by a private developer acting alone or through HUD. The comparatively local jurisdiction of the state HFA's as opposed to that of the Federal Department of Housing and Urban Development has in certain respects enabled the HFA's to better formulate policies consistent with the local nature of housing markets. The smaller jurisdictions of the HFA's have also enabled many of them to organize in the structurally simple and flexible manner appropriate for handling the complexities inherent in the nature of public purpose development. While a more highly decentralized Federal operation would possess these same advantages, such a system would lack public accountability on the local level.

The HFA's have also been better able to relate to the other critical element of the nature of public purpose housing development, its high dependency upon debt financing. By being entities of state government, the HFA's have been able to raise funds in the tax-exempt securities markets and relend them at below market interest rates. This advantage explains why the HFA's have been able to provide larger, more luxurious, and better designed housing at the same rents as that produced by HUD. This mechanism, however, has been costly to the Federal Treasury in terms of forgone tax revenues.

Individual Agency Success

On an individual basis, the Massachusetts Housing Finance Agency stands out as the most effective agency examined. The public purpose that it has served in the most demonstrably superior manner has been the mixing of tenants of varying income levels within the same development. While no other agency was able to integrate more than 200 poverty level families in developments it financed during the period of 1970 through 1973 containing a substantial number of middle income families, MHFA was able to provide housing for over 2,500 such families in a largely middle income setting. In addition, its total production of privately-owned, multi-family housing for low income families in relation to the number of inhabitants of the state it serves has far exceeded that of any other agency. While its total production of low and moderate income housing and of all housing has been no greater than that of HUD in Massachusetts, its production figures per capita far exceed those of any other state agency.

With regard to slum rebuilding, MHFA has placed a slightly higher percentage of its Section 236 units in poverty or urban renewal areas than its HUD counterpart and has ranked above average among all HFA's in this regard. MHFA's record in racial integration, while in certain respects being somewhat better than that of HUD in the same state, has been characterized by a relatively high percentage of developments with only

"token" minority representation. This blemish on MHFA's record, however, is partially removed after controlling for the small percentage of minority households living in Massachusetts compared with that in the other states being considered. While not a public purpose expressed in its enabling act, the promotion of the rights of tenants is another social goal with regard to which MHFA has outperformed the other agencies being considered.

In terms of efficiency, MHFA again has excelled. Besides processing applications more quickly than any other state agency, it was the one HFA to be significantly faster than its HUD counterpart. Its processing costs per project and per unit have been demonstrably lower than those of any other HFA or of HUD in any state. While MHFA developments have suffered a few arrearages, particularly its rehabilitation projects in the inner city, it appears to be on top of its problem and to have devised workable solutions in virtually every case. Also, the reserves it has generated from its own operations have been more than adequate to cover any potential losses.

Consistent with the underlying thesis of this dissertation, MHFA has been the one agency to have most clearly taken a hand-crafted, non-bureaucratic approach to development lending. It has actively participated in every phase of the development process; it has retained a high degree of flexibility by having the fewest number of rules and formal operating

procedures, and has maintained a simple pattern of organizational structure. MHFA's executive director throughout nearly all of its formative years, William J. White, made the most of this non-bureaucratic approach by exhibiting effective leadership in the sense of infusing MHFA with a sense of purpose and successfully defending its integrity.

The two HFA's that have come closest to matching MHFA's overall level of effectiveness, the Illinois Housing Development Authority and the New Jersey Housing Finance Agency, have been the two agencies to most closely approximate MHFA's method of operation, particularly in terms of a flexible, hand-crafted approach. Both of these agencies achieved as much as they did despite sharp disruptions in their staffs as a result of a change in governors midway through the period studied.

The Illinois Housing Development Authority has had an unblemished record with regard to serious arrearages despite having located a respectably high percentage of its Section 236 units (42.4 percent) in urban renewal areas of the Chicago SMSA. IHDA has achieved a superior record with regard to racial integration. It had the highest percentage of developments of any agency or HUD office examined which are integrated in a substantial manner.

While IHDA has prided itself in its record of achieving economic integration, the type of integration it has provided has been the mixing of middle income, unsubsidized families with moderate income families receiving Section 236 subsidies.

Contrary to the expectations of the legislative study commission IHDA has generally failed to provide housing for genuinely poor families in a middle income setting. Altogether through the end of 1973, IHDA had served only about 125 low income families. It had also served the fewest low and moderate income families per capita of any HFA or of HUD in any state examined, having provided less than one-third of the housing for low and moderate income families as HUD in the State of Illinois. IHDA's low production figures have also meant relatively high administrative costs per unit and per project during the project operation stage.

IHDA's limited production totals have resulted from a combination of several factors. First, the relatively high vacancy rate in Illinois coupled with a relatively high volume of conventional construction in the Chicago SMSA has limited the number of opportunities available to IHDA to make profitable mortgage loans. Second, the broad span of control maintained by IHDA's executive directors reduced its capacity to process a large volume of projects. IHDA's policy decision against providing permanent financing to most of the nonprofit sponsors to whom it granted seed money also limited production. Finally, the change in governors at the beginning of 1973 resulted in a change in executive directors, and a nearly complete turnover of staff.

The New Jersey HFA, which has also operated in a reasonably hand-crafted manner, has also been quite effective despite

the occurrence of a certain amount of patronage and internal dissension during much of the study period. The New Jersey HFA has located a reasonably high percentage of its New York-Northeastern New Jersey metropolitan area units in urban renewal areas (19 percent) where it has a legislative mandate and in poverty areas (an additional 17 percent). Still, it has maintained one of the highest reserve ratios of any HFA, and has had no arrearages in excess of three months on its Section 236 projects (although it did provide special state subsidies prior to the occupancy of a few of them to avoid anticipated deficits and has had problems on two unsubsidized projects). The New Jersey agency, aside from UDC, was the only HFA to produce more units for low and moderate income families than its HUD counterpart.

The Michigan State Housing Development Authority and the New York State Division of Housing and Community Renewal, the two most bureaucratic state agencies, have been somewhat less effective in terms of satisfying public purpose goals. Both agencies have placed only a handful of units in urban renewal or poverty areas, and neither was able to produce as many units for low and moderate income families during the study period as their HUD counterparts. Unlike the other HFA's examined, both of these agencies are subject to state civil service regulations. While the Michigan agency has also been subject to stringent procedural controls by the state auditor's office, it has created a considerable body of formalized procedures

of its own as contained in its highly detailed housing process manual. The formalism found at the New York State DHCR includes a large number of substantive rules in addition to procedural controls. These rules and procedures have arisen as a result of a combination of DHCR's size, age, and inability to pay the salary level required to attract experienced, self-directed employees. One clear dysfunctional consequence of its large body of rules and procedures was that its average processing time was 19 months longer than that of any other agency, even after controlling for project size, type of sponsor, and location.[1] At least during the development stage, both Michigan and New York agencies had higher than average administrative costs.

Still another reason for the high degree of formalism at both MSHDA and DHCR undoubtedly has been the conservatism of these agencies in wanting to ensure that all contingencies are covered. This conservatism is also evident in the extremely small percentage of units that each has located in urban renewal or poverty neighborhoods. This avoidance of risk in addition to the activist role played by both agencies and the fact that, particularly in MSHDA's case, they have formulated ways of shifting much of the risk back to developers, has enabled both of them to generate large reserves and to avoid problems on virtually all of their self-insured developments.

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[1]See p. 344 supra.

The New York State Urban Development Corporation (UDC) has been the one state agency to experience substantial financial problems. The culmination of these problems, of course, was UDC's default on $135 million in maturing bond anticipation and bank notes in February, 1975. As can be seen in Appendix 2 of this thesis, UDC was unable to raise cash through the sale of securities or mortgages to meet these debts because of its relatively high incidence of "problem" projects as perceived by the State Division of Housing and Community Renewal, its inability to generate a positive cash flow, its lack of political backing, and the tight money conditions in the economy as a whole.

The evaluation chapter of this thesis showed that UDC's projects have experienced a substantially higher rate of vacancies and incidence of arrearages than each of the other state agencies. To date, however, UDC has had a significantly lower percentage of "problem" projects than HUD. The problems that UDC has had on its projects have resulted primarily from UDC's unique role as a developer, from UDC's size and desire to act quickly, and from the risks that UDC has taken.

This risk orientation is seen in the fact that nearly 70 percent of UDC's production of Section 236 housing in the New York City SMSA has been in urban renewal areas or in census tracts where over 25 of the households have

incomes below the poverty line set for the area. While this percentage was only slightly higher than the 65 percent of units placed in these areas by the HUD area office in New York City, it represents a far higher percentage than achieved by any of the other state agencies or HUD offices examined. UDC's satisfaction of its public purposes is also seen in the 29,000 units produced by UDC for low and moderate income families between the beginning of 1970 and the end of 1973. This total was by far the largest total financed or insured by any HFA or by HUD in any state, and with the exception of Massachusetts it also represented the highest production per capita as well. This high production particularly in relation to that of the HUD area office in New York City, has meant that UDC has clearly had the highest volume of construction in urban renewal or poverty areas of any state agency or HUD office.

The major reason that UDC took these and other risks less oriented toward the achievement of public purposes was its role as a developer. Particularly in its early years before it had a strong financial team, UDC proceeded with every project it could, both to avoid loss of seed money equity invested in these developments and to enhance its own and Governor Rockefeller's political support, particularly among big city mayors. On occasion this support came against the recommendation of UDC's own Division of Housing Economics. UDC's large size and desire to act quickly were

also reasons those at the top of UDC dismissed or failed to fully hear those in the organization urging a more cautious approach. In later years UDC did begin to take a more cautious approach to development lending but also began to amass large losses on abandoned projects.

While UDC was seen to have had significantly higher development costs than those of each of the three HUD area offices in New York State (although not higher than those of the New York DHCR/HFA), its rents were not found to be significantly higher for two bedroom apartments receiving Section 236 subsidies. UDC was seen to have had clearly the best designed developments of any agency or HUD office, at least in terms of number of design awards won, and along with DHCR to have required the strongest guarantees from contractors as to the durability of component parts.

UDC's ability to sustain its high level of production, however, has been crippled by its note defaults. Not only has it made it difficult, if not impossible, for UDC to raise funds through the bond market to finance further projects, but its layoff of 165 employees has eliminated a major segment of its development staff.

IMPLICATIONS FOR FEDERAL POLICY

While this thesis has found that on the whole the state agencies have been more effective in producing public purpose housing than has HUD, the similarity of the states examined prevents the making of a sweeping generalization about the ability of all of the states to perform as well. Illinois, Massachusetts, Michigan, New Jersey, and New York are all located in the North East and North Central portions of the country, and are all among the most urbanized states in the union. While the limited contact that the author has had with the newer state agencies in other less urbanized sections of the country has made him optimistic as to their ability to duplicate the accomplishments of their more advanced brethren, a conclusive assessment in this regard awaits the further development of these agencies and analysis by other writers.

Still, a primary implication of this thesis is that because of their ability to operate in a flexible, non-bureaucratic manner, the state agencies should be allowed to be the primary implementors of public purpose multi-family housing. While as in the field of education, the state agencies were seen to have ignored certain vaguely defined, unenforced Federal objectives, particularly rehabilitation and to a lesser extent the housing of large

families, the experience of the HFA's in implementing those public purpose objectives of the Section 236 program where HUD maintained a certain degree of control, was that they were able to satisfy these objectives as well as HUD on its own projects in addition to better servicing certain local public purposes. In particular, the HFA's were seen to have provided more highly integrated housing although with fewer minorities.

Consequently, Federal regulation of the state agencies with regard to national concerns should remain at about the same level of rigor as under the Section 236 program but broadened to include a few other objectives. Because the complex nature of public purpose housing makes relatively informal approaches more effective, HUD regulations, however, might best be written in terms of performance rather than procedural requirements. Since competitive market forces were seen to have been so successful in forcing the HFA's to effectively manage risk, HUD might create a market for Section 8 funds based upon HFA ability to take public purpose risks. The danger of such an approach, however, would be that those who suffer most would be families living in dilapidated housing in states with relatively ineffective housing finance agencies. Consequently, HUD should retain back-up ability to provide housing where the state agencies fail to perform adequately, or fail to

perform at all. Such an approach would be similar to the manner in which HUD steps in to enforce civil rights legislation in states which lack "substantially equivalent" statutes or enforcement mechanisms.

To a large degree, the final regulations prepared by HUD for state agency participation in the Section 8 program are consistent with the implications of this thesis.[1] The state agencies are given a reasonably free hand to implement the program. As under the Section 236 program, they are given a set-aside of funds to allocate to projects where they must assume the primary risks. Federal procedural controls are limited to the same areas of national concern as under Section 236. HUD has added performance incentives for the achievement of certain other public purposes. Specifically it has based the amount of set-asides going to individual agencies in part upon the ability and performance of the HFA's in promoting economic integration and in housing large families.

The area of regulation where HUD can play a more positive role is in the implementation of Section 802 of the Housing and Community Development Act of 1974. At least

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[1] 40 FR 16934.

at this writing, both HUD and the Treasury Department had failed to formulate regulations necessary to activate the programs contained in this section. What this ection does is increase the financing advantages held by the state agencies while at the same time, reduce the revenue loss to the U.S. Treasury. Specifically, one provision of Section 802 gives the state agencies the option of continuing to issue tax-exempt bonds or to issue taxable bonds with a 33 1/3 percent interest subsidy. Since the HFA's were seen to have received benefits from the tax exemption worth on average about a 31 percent savings in interest (and at times as little as 12 percent), the direct subsidy of 33 1/3 percent will often be of significant value to the HFA's.[1] Since the quid pro quo of this subsidy is the taxing of HFA bonds, the U.S. Treasury benefits by the implementation of this provision to the extent of the difference between the 48 percent bracket of the taxpayers owning these bonds and 33 1/3 percent subsidy it pays out.[2] While the tax-exempt route is highly inefficient in that much of the subsidy goes to wealthy investors, the direct subsidy route would be highly efficient in that all but a small administration cost would go to the project. In order for this

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[1] See p.266 <u>supra</u>.

[2] See p. 268 <u>supra</u>.

provision to be advantageous for the state agencies its implementation must be virtually automatic as is the case with the Federal tax exemption it supplants. Because of the Federal control already provided on individually subsidized projects and because of the fact that implementation of this provision would increase rather than decrease Federal revenues, any regulations more honorous than that provided to tax-exempt offerings would be improper.

The other potential benefit provided the HFA's in Section 802 is the ability to add a Federal guarantee to bonds issued on a subsidized basis if the proceeds are used to finance developments that will contribute to "slum revitalization." The guarantee would allow HFA bonds to sell on a taxable basis at a rate equivalent to that of other Federally-guaranteed bonds, such as those issued by the Tennessee Valley Authority, or only about 200basis points above that of a typical A-rated tax-exempt HFA issue. After receiving the 33 1/3 percent subsidy, HFA's that take advantage of this combination of guarantee and subsidy would benefit to the extent of about 100-300 basis points.

Since aside from UDC which suffered severe financial problems in large part because of its slum revitalization efforts, the state HFA's particularly in certain states, have avoided slum areas, implementation of this guarantee

could have a strong impact on the direction taken by the state agencies. The danger of this provision is that it might allow the HFA's to become so dependent upon this guarantee that they lose their incentive to actively control risks. If such passivity were to occur the result would likely be a high proportion of problem projects and a drain on the Treasury. To reduce the likelihood of such an occurrence, HUD could predicate the provision of future guarantees on agency performance on projects initially receiving such guarantees, although with consideration given toward unusual local economic conditions.

PROSPECTS FOR THE FUTURE

Prospects for the future of the HFA's appear bright. The older HFA's have organizations that have shown themselves capable of effectively implementing public purpose housing programs. The Housing and Community Development Act of 1974 provides them with significant advantages. Provided that this act is implemented in the proper manner on a Federal level and provided that the state housing finance agencies guard against over-bureaucratization, they should continue to be successful in the coming years.

APPENDIX 1

HISTORY OF OTHER STATE HOUSING AGENCIES

In addition to the six state agencies which serve as the primary focus of this dissertation, through the end of 1974, 21 other state agencies have received the power to independently finance the development of privately-owned housing using proceeds from the sale of their own bonds. Each of the agencies having these powers has received or is eligible for a set-aside of Section 8 leasing subsidy funds from HUD. Included in this category are agencies from the states of Alaska, Colorado, Connecticut, Georgia, Idaho, Kentucky, Maine, Maryland, Minnesota, Missouri, North Carolina, Ohio, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Virginia, West Virginia, and Wisconsin. The New York City Housing Development Corporation and the Housing Opportunities Commission of Montgomery County (Maryland) have similar powers on a local level.

Another six state agencies have the primary mission of providing secondary mortgage market funds through either providing loans to lenders or purchasing mortgages. While these agencies might be considered a different breed of agency, they share the same source of financing with the HFA's that provide direct loans and participate as members of the Council of State Housing Agencies. Included in this category are the New Jersey Mortgage Finance Agency, the State of New York Mortgage Agency, the North Carolina State Housing Finance Agency, the Vermont Housing Finance Agency, the Louisiana Development Authority for Housing Finance, and the Massachusetts

Home Mortgage Finance Agency. The HFA's with direct lending powers that can also make secondary loans are Alaska, Colorado, Connecticut, Kentucky, Illinois, Minnesota, Oregon, Rhode Island, South Carolina, South Dakota, Virginia, West Virginia, and Wisconsin.

Finally, certain state agencies have received the power to finance housing using proceeds from the sale of State general obligation bonds. Each of these agencies has carried out unique programs. Among these agencies are the Hawaii Housing Authority, the Delaware State Housing Authority, the Maryland Community Development Administration, and the California and Wisconsin veterans' departments.

This appendix will discuss each of the housing agencies mentioned beginning with those state agencies with independent direct lending powers, then local agencies with the same powers, followed by those state agencies involved in secondary financing, and finally, those having available State general obligation bond financing. Within each section, agencies will be discussed in roughly the chronological order in which they were created. Table 1 in the main text of this thesis provides a comparative summary of the activities of all of the agencies.

STATE AGENCIES WITH DIRECT LENDING POWERS

One state HFA that became operational just after most of those being studied in detail is the <u>West Virginia Housing</u>

Development Fund. The West Virginia legislature passed the enabling legislation for this agency in 1968 and it made its first loan in 1970.[1] Missing from this legislation, however, was a clause to provide state back-up for its bonds. Thus, while the West Virginia Housing Development Fund was able to finance approximately 1,500 dwelling units between 1970 and 1972, successful marketing of its bonds required that all of these units be HUD-insured. With HUD insurance, of course, came HUD controls, thus making the independent impact of the State as compared with that of the Federal government extremely difficult, if not impossible, to assess. In 1973, the West Virginia Housing Development Fund did receive the "moral obligation" backing of the State, but at the time research for this thesis was being conducted, had not had an opportunity to amass a significant track record on uninsured projects. Of late, the Fund has also become active in providing loans to single family mortgage lenders and in making site development loans to overcome West Virginia's hilly terrain.

The history of the Missouri Housing Development Commission parallels that of the West Virginia agency. The Missouri agency came into being in 1969 without any State backing.[2] It financed about 1,500 HUD-insured dwelling units between

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[1] W. Va. Code, Sec. 31-18-1 et seq.

[2] V.A.M.S. Sec. 215.

1970 and 1973, at which time it received a $2 million state appropriation to provide its own mortgage insurance fund. It has also become involved in a mortgage purchase program.

Statutorily, Pennsylvania was one of the first states to create a housing agency for the purpose of financing housing. The Legislature created the Pennsylvania Housing Agency in 1959 to aid homebuyers, but successive governors failed to appoint a board of directors until ten years later. Even then, the lack of state moral obligation backing kept the Agency from helping more than 49 families.[1] In 1972, a new Pennsylvania Housing Finance Agency with the moral backing of the State and a full range of financing powers was created to supercede the earlier agency.[2] Governor Milton J. Shapp hailed the legislation as "the most important piece of housing legislation that has been introduced since I took office."[3]

As in Pennsylvania, the Connecticut Housing Finance Agency grew out of an earlier entity. The original Connecticut Mortgage Authority was created in 1969.[4] It had no direct lending powers and acted as a purchaser of HUD-insured single family and Section 236 multi-family mortgages. In so

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[1]The Weekly Bond Buyer, June 19, 1972, p. 1.

[2]35 P.S. Sec. 1680.

[3]The Weekly Bond Buyer, June 19, 1972, p. 1.

[4]Public Act No. 840 of 1971.

doing, it overcame private lender reluctance in the state to participate in these programs. In May, 1972, the newly created Connecticut Housing Finance Agency subsumed the operations of the older Authority.[1] In addition to having secondary financing powers, it can provide direct mortgage loans insured by its own insurance fund. Unlike in each of the other states, the state backing of its bonds requires no further action by the Legislature, a factor that has increased the salability of its bonds.

Georgia, Rhode Island, and Maryland all created state housing agencies despite voter referenda opposing them or similar agencies. In November, 1970, Georgia voters rejected a housing finance agency with only 38 percent in favor. Nonetheless, in 1972 the legislature created the Georgia Development Authority for Housing Finance with secondary finance powers,[2] and in 1974 the Georgia Residential Finance Agency with direct finance powers.[3] While the earlier agency was never activated, the Residential Finance Agency has a board of directors.

Rhode Island voters turned down both a self-help Housing Agency in 1971 and a Mortgage Authority with insurance powers

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[1]C.G.S.A. Sec. 8-241 et seq.

[2]Code of GA. Ann. Sec. 99-3601 et seq.

[3]*Ibid*.

in 1972. Nonetheless, a year later the Legislature created the Rhode Island Housing and Mortgage Finance Agency with both direct and secondary loan powers.[1] By the end of 1974, the Agency had successfully marketed three bond issues. After receiving initial criticism for the fact that the properties that had received mortgage money from the proceeds of its initial bond sale were all located in suburban areas, the agency began requiring lenders to accept loans in all areas and give reasons for any rejections.[2]

In 1969, the Maryland Legislature enacted a bill to create a state development corporation with powers comparable to those of New York's UDC but not zoning override. As the result of pressure from a citizens' group, the legislature repealed that a year later, but gave housing and community development financing powers to the Maryland Community Development Administration within the Department of Economic and Community Development.[3] The same citizens' group then collected signatures for a referendum to void the new legislation. Although the Maryland electorate approved the measure, the Circuit Court for Baltimore found many of the petition signatures to be invalid, and declared the law to be in full force.[4]

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[1]Chapter 262 of Public Laws of 1973.

[2]Housing and Development Reporter, November 4, 1974, p. 625.

[3]Laws of Maryland Ch. 527 Sec. 266 DD.

[4]Nitzburg v. Wineland, Cir. Ct. for Baltimore County, Proctor, J., March 22, 1971.

The independent power of the Community Development Administration to issue its own bonds is made possible through the mortgage insurance provided by the Maryland Housing Fund under its control. While the primary purpose of this fund through the end of 1974 had been to insure single-family homeowner mortgages,[1] it had also been used to insure an $8.6 million bond anticipation note to be used for the financing of the construction of multi-family housing.

In Wisconsin, the need for a state housing finance agency became apparent when the State Department of Local Affairs and Development rejected relocation plans for six Milwaukee urban renewal projects because of the shortage of housing. Governor Patrick J. Lucey then became a strong advocate of creating an HFA, and generated the support of the Wisconsin Realtors' Association, the Wisconsin Builders' Association, the Wisconsin AFL-CIO, the Wisconsin Alliance of Cities, the Farmers Home Administration, the Northwestern Wisconsin Community Action Agency, Catholic Charities of the Northwestern Diocese, and the Wisconsin Department of Local Affairs and Development.[2] While the legislation creating the Wisconsin Housing Finance Agency was initially approved in

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[1] See p. 411 <u>infra</u>. for discussion of Maryland's single family housing programs.

[2] Wisconsin Department of Local Affairs and Development, Wisconsin Housing Finance Authority, 1973, p. 3. (Mimeographed).

1972, it had to go back before the Legislature in 1974 for amendment to remedy technical deficiencies in the wording of the moral obligation clause.[1]

The Minnesota Housing Finance Agency has also received strong support from the governor's office and others in the state.[2] As a result, it has received not only direct and secondary financing powers, but also an appropriation of $1 million for a reserve fund, funds to make grants to local communities for planning and providing infrastructure for low and moderate income housing, and funds for rehabilitation grants for homeowners. The initial bond offering of the agency marked the first backing of state agency bonds by mortgages guaranteed by the Government National Mortgage Agency as to the timely payment of principal and interest. Since then, the Agency has issued other bonds for the purpose of making direct loans.

The Virginia Housing Development Authority has also been active with both direct and secondary financing.[3] It has been the most active HFA in providing construction loans on single family housing. With 3,500 units of all types of housing under construction or completed by November, 1974, and another 800 units in the pipeline, it promises to quickly become one of the volume leaders among the HFA's in the direct

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[1] W.S.A. Sec. 234.01 et seq.

[2] M.S.A. Ch. 462A.

[3] Code of Virginia Sec. 36-55.24 et seq.

financing of housing. In addition, it has issued $74 million to finance mortgage purchase from private lenders.

Similarly, the Tennessee Housing Development Authority[1] has geared up relatively fast, although on a smaller scale. One year after its creation in 1973, it had issued $33 million in bonds for the purposes of both purchasing mortgages from lenders and making direct loans itself.

Another young HFA to be active in both direct and secondary financing is the South Dakota Housing Development Authority.[2] Established in 1973, the Authority has gained experience quickly by providing construction loans on 47 small multi-family developments for which permanent financing will come from the Farmers Home Administration or private lenders with HUD insurance and subsidies by November, 1974. In addition, it has issued over $25 million in bonds for the purpose of purchasing mortgages from private lenders.

The Kentucky Housing Corporation,[3] another young HFA, has used the proceeds of its bond issue to purchase mortgages from the Federal National Mortgage Association. While the social benefits derived from using the tax-exempt market to make purchases from another secondary lender are questionable,

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[1] 1973 H220.

[2] S.D.C.L. 11-7.

[3] K.R.S. Sec. 198A.

the arbitrage profits derived from the sale are being used for the socially valid purpose of directly providing developers of low and moderate income housing with construction loans at an interest rate of two percent.

The Colorado Housing Finance Authority and the Idaho Housing Agency have also been concentrating on providing construction loans,[1] although directly from the proceeds of tax-exempt notes. Permanent financing has been arranged through the Government National Mortgage Association for the Colorado developments and through the Farmers Home Administration and HUD Turnkey Program for the Idaho housing. On certain of its projects, the Idaho Housing Agency was also instrumental in having the local community agree to donate the land, thereby reducing the rent.

In addition to being active in providing direct Section 236 uninsured mortgage loans and making secondary mortgage purchases, the Maine State Housing Authority has been the pioneer among the state agencies with regard to leased housing.[2] Through March 1, 1973, it had used Section 23 funds to subsidize the leasing to low income families of 130 dwelling units in 8 new rural developments it had financed and in another 115 existing or rehabilitated units. The

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[1] C.R.S. Sec. 69-11-1 et seq.; Idaho Code Sec. 67-6201 et seq.

[2] 30 M.R.S.A. Sec. 4552 et seq.

Authority found the program to be extremely effective in terms of speed and community acceptance, and found that small builders liked it because of the small amount of red tape.[1] Since the Section 23 program was the forerunner to the new Section 8 leasing program which is currently the only Federal subsidy program with substantial funding, Maine's experience bodes well for the new program in rural areas.

The Ohio Housing Development Board, which also has direct mortgage lending authority, has yet to finance its first permanent mortgage. The Board, which was originally created in 1970 with only the power to make seed money loans to nonprofit sponsors, did not receive bonding authority to finance permanent loans until 1974.[2]

The only other HFA's with independent direct lending powers have been unable or unwilling to use them. The Alaska Housing Finance Corporation has confined its activities to secondary lending and is discussed in that section. The Oregon Division of Housing and the South Carolina State Housing Authority have been unable to issue notes or bonds.[3] Unlike HFA's in other states, they both lost and are now appealing

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[1] Maine State Housing Authority, Response to UDC Questionnaire, March, 1973, p. 2.

[2] Page's Ohio Revised Code Ann., Sec.124.01 et seq.

[3] O.R.S. Sec. 456.550 et seq.; Code of Laws of South Carolina, Sec. 36-291.

cases which challenged the Constitutionality of the moral obligation provision necessary for them to issue bonds to finance direct loans.[1] The Oregon agency has also been active in providing seed money loans to nonprofit sponsors from a specially appropriated revolving fund while the South Carolina agency has been active in financing public housing using bond proceeds secured by the Federal contract to make all mortgage payments.

Another state agency to fail completely in its attempts to directly finance housing was the North Carolina Housing Corporation. Having received neither state moral obligation backing nor operational funding, it found that it would be unable to market its bonds at a rate sufficiently low enough to come within the maximum limit for HUD-insured mortgages and still be able to finance its own operations. As a result, it floundered totally during its two years of operation between 1970 and 1972.[2] Upon termination of agency operations by the legislature, a legislative panel began assessing a new role for the state in housing. The recommended result was a new agency to provide mortgage insurance and secondary mortgage financing in the state. Accordingly, the legislature

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[1] See Housing and Development Reporter, February 24, 1975, p. 1011 and January 5, 1975, p. 865.

[2] Michael Stegman, The Multiple Roles of State Housing Finance Agencies: The North Carolina Housing Corporation (Raleigh: N.C. Office of State Planning, 1972), pp. 19-35.

created the North Carolina Housing Finance Agency along these lines in 1973, which at this writing had yet to become active.[1]

LOCAL HOUSING AGENCIES

The most productive housing finance agency not being considered in detail is the New York City Housing Development Corporation (HDC).[2] The reason for this omission is simply that HDC is a city agency rather than a state agency. The history of HDC in many respects parallels that of the New York State Housing Finance Agency. For years, the Housing Development Administration (HDA), the city department directly under the control of the Mayor of New York like the Department of Housing and Community Renewal on the state level, not only has had responsibility for the supervision of such activities as rent control, urban renewal, building inspection, and relocation, but also has had control of the production of middle income, Mitchell-Lama housing by private developers. Also similar to the State history, financing for this housing initially came from tax-exempt general obligation bonds backed by the taxing power of the City. However, once the City

[1] General Statutes of North Carolina, Sec. 122A-1 et seq.

[2] Private Housing Finance Law, Sec. 650 et seq.

bumped up against a Constitutional limitation that no more than 2 percent of its outstanding bonds be devoted to housing, the City had to seek an alternative source of financing from the State Legislature.

The quasi-independent Housing Development Corporation was created by the Legislature in 1971 to fill this role. It has a board of directors and the power to issue tax-exempt bonds backed by the City's "moral obligation" pledge of general revenues coming to it from the State. The City Housing Development Administration still maintains direct control over projects that receive HDC financing, comparable to the way in which the state Division of Housing and Community Renewal controls projects that receive HFA financing. Through November 1, 1974, the HDC had financed 6,756 dwelling units. Like the state HFA, the HDC has piggy-backed Section 236 interest subsidies on most of its projects to serve moderate income families.

The Housing Opportunities Commission of Montgomery County (Maryland), which was originally a public housing authority, has also received the power to issue bonds for the purpose of making mortgage loans.[1] It, however, has yet to implement this power.

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[1]Ann. Code of Maryland, Ch. 44A. Sec. 8A.

MORTGAGE FINANCE AGENCIES

Certain state agencies operate only in the secondary mortgage market by either lending money to mortgage lenders or purchasing mortgages from them. Under loans-to-lenders programs, mortgage lenders are generally allowed a mark-up of about 1.5 percent over the state agency's borrowing rate in the tax-exempt bond market with an additional one-half percent going to the state agency as an arbitrage profit. Under mortgage purchase programs, either the state agency will make forward commitments to buy particular mortgages being considered by lenders which they otherwise might refuse to make or the agency will purchase mortgages from the existing portfolios of lenders and require them to use the funds to write new loans. Under either type of purchase program, the lender is allowed a mark-up of about 0.5 percent. The reason for the higher allowable mark-up with a loans-to-lenders program is that under this type of program, the lender must assume all risks resulting from the new loan, while under a mortgage purchase program, the state agency assumes all risks related to the mortgages it purchases. This difference in the amount of risk assumed by the agency, however, has meant that loans-to-lenders bond issues backed by collateral pledged by mortgage lending institutions have sold at an average net

interest rate of just under 1 percent lower than mortgage purchase issues after controlling for market conditions, size of the issue, and Moody's rating of the issuer.[1] Thus, the interest rate charged the homebuyer is almost exactly the same under a mortgage purchase program as a loans-to-lenders program.

The most active provider of loans to lenders has been the New Jersey Mortgage Finance Agency, which was created in 1970 in response to then-existing credit shortage for homebuyers.[2] Periodically, the agency will survey mortgage institutions in the State to determine if they have requests for mortgages on moderately priced homes which they cannot meet because of limited funds. When the demand is sufficiently great, the agency will contract with these institutions to lend them funds; it obtains these funds by issuing tax-exempt revenue bonds. The private mortgage institutions must secure the borrowed funds with government-insured mortgages or government bonds as collateral, and they must use the funds within a period of 180 days to make commitments to homebuyers to provide below-market interest rate mortgages. Agency rules require that single-family homes purchased with these funds shall not have a value above $28,000 and multi-family homes shall not

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[1]Based on a separate run of the regression analysis included in Chapter 6.

[2]N.J.S.A. C. 17: 1 B-4 et seq.

have a value above $45,000. One effect of these rules is to exclude new construction. In its first issue, the New Jersey Mortgage Finance Agency sold its bonds at 4.5 percent, added 0.5 percent for its own expenses, and allowed institutional lenders a mark-up of 1.7 percent. As a result, individual homebuyers were able to borrow mortgage money at an annual interest rate of 6.7 percent as compared with a conventional rate at the time of 7.5 percent. The homebuyer thus saved about $125 per year on a 25-year, $20,000 mortgage, assuming that a mortgage would otherwise have been available.

The most active HFA in purchasing mortgages has been the State of New York Mortgage Agency.[1] It, too, was established in 1970 in response to the then-existing credit crunch. It uses the proceeds from the sale of tax-exempt bonds to purchase mortgages from the portfolios of private lenders who must re-invest the proceeds in residential mortgages. The agency purchased $95 million in mortgages in 1970-71. As mortgage funds became plentiful late in 1971, it confined its role to servicing the mortgages it had acquired. When shortages in mortgage funds again developed in late 1973 and 1974, it provided private lenders with an additional $160 million in loanable funds through its purchases.

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[1]Public Authorities Law, Sec. 2400 et seq.

The Alaska Housing Finance Corporation[1] has also been active in making secondary mortgage purchases. Between 1972 when it became operational and November, 1974, the Corporation floated four bond issues for this purpose totalling $104 million. Rather than primarily purchase mortgages from the existing portfolios of mortgage lenders like the State of NewYork Mortgage Agency, the Alaska Corporation generally makes forward commitments to lenders to purchase mortgages on specified developments to be constructed. In this manner, the Corporation has been able to induce lenders to make loans in remote parts of the state and in other areas they would not normally lend. Over 90 percent of the Corporation's purchases, however, are insured by HUD with the rest being conventional. While the Corporation has yet to use its limited powers to make direct first mortgage loans, it has on occasion provided junior mortgages to reduce the amount of downpayment required by a moderate income homebuyer.

The Vermont Home Mortgage Credit Agency was created to assist private lenders in providing mortgage financing on favorable terms to individual homebuyers.[2] It guarantees private lenders against loss of interest and principal on the top 25 percent of loans made to homebuyers. This guarantee enables purchasers of homes of $30,000 or less to avoid

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[1]Alaska Statutes, Title 18, Ch. 56.

[2]10 V.S.A. Sec. 601 et seq.

any downpayment except for closing costs and a one percent guarantee fee. While the Home Mortgage Credit Agency had also been given statutory authority to purchase Federally insured loans, when credit conditions made the activation of a mortgage purchase program desirable in 1974, the Legislature decided to create a separate agency, the Vermont Housing Finance Agency to serve as the vehicle for it.[1]

The only other state agencies with secondary mortgage market powers are the Louisiana Development Authority for Housing Finance,[2] which can purchase Federally insured mortgages, and the Massachusetts Home Mortgage Finance Agency,[3] which can provide loans to lenders. Neither agency has become operational as yet.

Housing Agencies with State General Obligation Financing

The state housing agency with the most dynamic statutory powers in the country is the Hawaii Housing Authority. Originally created in 1947 to administer public housing, the authority was given broad new powers beginning in 1970 to attempt to meet the worsening housing crisis on the islands.[4] Among the new powers were the authority to develop projects, override local zoning and subdivision controls, insure mortgage,

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[1]Vermont Stat. Ann. Title 10, Sec. 241 et seq.

[2]M.G.L.A. c. 23A App. Sec. 2-3.

[3]L.S.A.-R.S. Sec. 40: 581 et seq.

[4]Act 105, Session Laws of 1970.

and provide mortgage financing either directly or as part of a co-venture, as well as to carry out a housing allowance program. Unlike with most HFA's, the source for mortgage proceeds for the Hawaii Housing Authority is general obligation issued by the State. Despite legislative authorization in 1970 and 1971 for the issuance of $165 million in housing bonds, the State had issued only $35 million by the end of 1973. As of that time,the Authority had closed only 1550 non-public housing units. The restraining factor has been that the governor, John A. Burns, has made it impossible for the Authority to hire a development staff of more than four.

The Maryland Community Development Administration uses the proceeds from general obligation bonds for the purpose of both mortgage insurance and direct financing. The sale of $7 million in state general obligation bonds for deposit in the Maryland Housing Fund should enable the Community Development Administration to insure $100 million in mortgages.[1] The bulk of the insurance coverage to date has gone for the rehabilitation of single-family housing in inner-city areas of Baltimore, although some has gone for single family housing in other areas and as discussed previously, some has gone for multi-family housing development. Local banks are given

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[1] See Arthur A. Goldberg and Leonard Elenowitz, "Maryland's Housing Insurance Program," The Urban Lawyer, 5 (Summer, 1973).

the responsibility for deciding which properties and which families constitute an acceptable risk. The banks then apply to the Division of Housing for insurance on up to 100 percent of value. Through the end of 1974, the Fund had insured 700 loans on single family homes.[1] In 1972 the Legislature gave the Division direct lending powers. Moderate income Maryland families who receive rejection letters from two or more lenders because of the location of the property or lack of income can apply to the Division for a direct loan. The program has proven quite popular politically with the original $10 million allocation having been increased substantially in both 1974 and again in early 1975.

The oldest and largest on-going state housing finance program in the country began in California in 1921. The Cal-Vet Home Loan Program has provided direct loans on below-market terms to over 270,000 veterans acquiring their own homes.[2] The California Department of Veterans' Affairs authorizes the issuance of tax-exempt bonds backed by the full faith and credit of the State and lends the funds directly to veterans through its local offices. While the loans can be used for the purchase of either newly constructed or rehabilitated housing, the Cal-Vet Program differs from those of the state housing finance

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[1] Maryland Department of Economic and Community Development, Annual Report, 1974, p. 8.

[2] West's Ann. Mil. & Vet. Code, Sec. 984 et seq.

agencies which were analyzed in this thesis in that the HFA's being considered primarily concern themselves with production of housing by developers rather than the purchase of housing by individuals.

In a somewhat similar program, the Wisconsin Department of Veterans' Affairs provides loans to veterans with insufficient resources to make a full downpayment on the purchase of a conventionally built home or mobile home, or to meet the full cost of home improvements.[1] The Department provides direct second mortgages of up to $5000, at least 3 percent interest over 30 years on property with a total value of up to $25,000. The veteran must provide at least five percent equity.

The Delaware State Housing Authority was created in 1968 with the unique ability to make interest-free mortgage loans.[2] Yet, since it received only limited funds to implement this program and no independent source of financing, it has concentrated its efforts on providing interest-free construction loans on Federally subsidized developments. In this manner, it has been able to keep recycling its funds over a short period of time. Its first no-interest permanent mortgage loan was on a 24-dwelling unit demonstration project using $500,000 from a state general obligation bond issue.

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[1] W.S.A. Sec. 45.352.

[2] Delaware Code Ann. c. 31, Sec. 4050 et seq.

APPENDIX 2

WHY THE UDC DEFAULT

In its most simple terms, the reason that UDC defaulted on the $100 million in bond anticipation notes (plus $4.5 million in accrued interest) due February 25, 1975, and $30 million bank loan originally due February 21, was that it lacked sufficient cash on hand. When UDC first issued these notes in 1974, it expected to be in a position to issue long term bonds to repay the notes. Indeed, UDC's 18 month budget dated October 24, 1974, showed that UDC would receive $125 million from the sale of bonds in February, 1975.[1] The same budget also showed that UDC would receive $100 million in December, 1974, from the sale of mortgages to the New York State Housing Finance Agency which it could also use to repay the notes.

Although neither of these sales took place, at the time the budget was formulated, it was reasonable to assume that they would occur. In September, 1974, UDC had sold $125 million in bonds despite the fact that the fire and casualty insurance companies, ordinarily a primary purchaser of low rated bonds, were largely out of the market because of the on-going recession. While the interest rate UDC had to pay was high, 9.07 percent, investors gave no indication that they would no longer purchase UDC bonds. In fact, the issue was substantially oversubscribed at the time of its sale.[2]

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[1]UDC Fiscal Planning and Budgets Department.

[2]Report of the Task Force on UDC, p. C. 1. 7.

The sale of $100 million in mortgages to the New York State Housing Agency was a reasonable assumption in that in response to a request made by investors in UDC's September, 1974, issue, Governor Malcolm Wilson had announced that the HFA had committed itself to buying $190 million in UDC mortgages subject to a review of the projects involved by the New York State Division of Housing and Community Renewal.[1]

When DHCR examined UDC's projects using the same conservative criteria it uses to screen all other developments to be financed by the HFA, it recommended against making any purchases. Not only did this decision directly limit the amount of cash accruing to UDC, it also made the sale of bonds more difficult. Rather than tie the repayment of each bond issue to special mortgages, like other HFA's, UDC has made all of its bonds general obligations of the corporation. While this mechanism enabled UDC to utilize its funds in a flexible manner, it has meant that investors buying new UDC bond issues must more carefully look at the security provided by all of UDC's outstanding mortgages.

Consequently, the determination by DHCR that UDC's mortgages did not meet their own standards gave potential investors reason to more carefully look beyond the security provided by these mortgages to the ultimate security of the

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[1] New York Times, October 6, 1975, p. 1.

state's moral obligation. In the months immediately prior to the default, whether New York State would honor its moral obligations was questioned openly. The revocation of State moral obligation backing for the Port Authority of New York and New Jersey in June, 1974, was prominent in the minds of the investment community. In addition, the Dunham Task Force report on UDC issued in December, 1974, but leaked out before then, created new doubts about the agency's long-term viability. While the report found that UDC's staff were an "aggressive and competent team which appears well-qualified for carrying out the organization's objectives,"[1] the conclusion reached by the Task Force was that UDC should be restricted from making any future mortgage commitments.[2] While implementation of this suggestion might have been viewed by potential investors as limiting UDC's ability to engage in any potentially risky future developments, as mentioned in the accountant's statement in conjunction with UDC's financial statements of October 31, 1974, termination of UDC's on-going programs would mean significant losses, particularly with regard to its new communities developments where substantial costs were incurred for planning and infra-structure that would be wasted if these projects were

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[1] Report of Task Force on UDC, p. 2.

[2] Ibid., p. 7.

not fully completed.[3] In addition, termination of future UDC developments could be seen as making the agency politically more vulnerable to the revocation of moral obligation backing.

The other political cloud came from the governor's office. Once Hugh Carey won the Democratic gubernatorial primary in September and all the polls predicted him to be a certain winner in the November general election, Governor Wilson became regarded as a lame duck. In this status, Wilson was unable to work effectively on behalf of UDC. In particular, he did not have the clout to compel the HFA to buy the UDC mortgages. Carey, being a Democrat, and UDC being so closely identified with a Republican administration, at that time also provided the investment community with little grounds for confidence. In fact, his campaign rhetoric on UDC's mismanagement only exacerbated their concern.

In this context, UDC's bond underwriter, the First Boston Corporation, told UDC that given the necessity to fully disclose all of the risks inherent in a UDC offering and given the large volume of securities UDC needed to sell, any attempted new offering to the public at that time would attract an insufficient number of investors. UDC accepted judgment in this regard, and

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[1]S.D. Leidesdorf & Co., "Accountant's Report," in UDC, Annual Report, 1974, p. 65.

rather than approach another underwriter, turned to the major New York City banks and the State Legislature.[1]

The only success UDC could achieve in its negotiations with the banks was to secure from them a 30-day loan on January 2, on which it also defaulted. The loan did, however, enable UDC to continue operations while it attempted to secure funds from the Legislature. In his State of the State message on January 23, 1973, newly installed Governor Carey gave his first public indication of support for UDC. While announcing the resignation of Edward Logue as President of UDC, Carey proposed that the State lend UDC $178 million, $100 million of which to pay off the maturing bond anticipation note and $78 million to allow UDC to continue operations. In addition, he stated that he was considering asking the Legislature to create a $50 million special reserve fund originally proposed by the Dunham Task Force. The purpose of this fund was to remove any doubts as to whether the Legislature would honor its moral obligation. UDC was particularly hopeful that this suggestion be implemented in that it had received assurances from First Boston that it would be able to sell UDC bonds the

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[1]Moodys Investors Service, which undoubtedly had less information than First Boston, apparently disagreed with First Boston's conclusion in that on February 2, 1975, it revised UDC's rating to Baa. While this revision did reflect a downgrading from UDC's previous rating of Baa-1, it did reflect an investment grade rating and an indication that UDC bonds would be salable.

day after such a measure was signed into law. The Legislature, however, was in no mood to assist UDC noteholders, and turned down the proposals. Consequently, UDC had insufficient funds to meet its debt obligations.

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Alaska Housing Finance Corporation

1972	Series A
1973	Series A, B

Connecticut Housing Finance Agency

1972	Series A
1973	Series A
1974	Series A

Connecticut Mortgage Authority

1971	Series A

Illinois Housing Development Authority

1972	Series A

Kentucky Housing Corporation

1973	Series A

Maine State Housing Authority

1972	Series A
1974	Series A

Massachusetts Housing Finance Agency

1972	Series A
1973	Series A
1974	Series A

Michigan State Housing Development Authority

1971	Series A, B
1972	Series A
1973	Series A, B

Minnesota Housing Finance Agency

1973	Series A

Missouri Housing Development Commission

1971	Series A

New Jersey Housing Finance Agency

1971	Series A
1972	Series A
1972	Series B

New York City Housing Development Corporation

1972	Series A
1972	Series A
1973	Series A, B

New York State Housing Finance Agency General Housing

1970	Series A, B
1972	Series A

New York State Housing Finance Agency Non-Profit

1970	Series A,B
1971	Series A
1973	Series A

New York State Urban Development Corporation

1971	Series A
1972	Series A
1973	Series A, B

New York State Urban Rental Housing

1973	Series A

State of New York Mortgage Agency

1973	Series A

Virginia Housing Development Authority

1973	Series A

West Virginia Housing Development Fund

1971	Series A

INTERVIEWEES

Illinois Housing Development Authority

Daniel Kearney (Exec. Dir.)
Irving Gerick (Exec. Dir.)
Peter Blomstrom
Ralph Brown
Anne Davies
Frank Fallon
Frank Glickman
Mark Golan
Jay Golden
Henry Hyatt
John McCoy
Kenneth Marshall
David Midgley
Birgit Gerdes Nomura
Don S. Samuelson
Steven Theobald

Massachusetts Housing Finance Agency

William White (Exec. Dir.)
Barbara Berger
John Bok
Paul Burbine
Joy Conway
J.O. Chike Enwonwu
Reese Fayde
Ellen Feingold
Pat Geoters
Justin Gray
William Haynsworth
Matthew Hobbes
Richard J. Howrigan
Stephen Rioff
Carl F. Saunders
Thomas Welch

New Jersey Housing Finance Agency

Paul Ylvisaker (Chairman)
Ralph Brown
William Clarke
George Feddish
Raymond Howell
Henry Hyatt
John McCoy
Harris Osborne
George Tuttle

Michigan State Housing Development Authority

David Froh (Exec. Dir.)
Margaret Bruckner
Cullen Dubose
Bernard E. Fedewa
Arthur Fine
George A. Fox
Sol M. Friedman
Kenneth Hance
Isaac Green
J. Michael Jones
Peter Long
Marilyn Meachen
James Roberts
Eric Schneidewind
Otis Will
Thomas White
Katherine Wilcox

New York Urban Development Corporation

John Burnett (Acting Exec. Dir.)
Robert Adelman
Irving Colloff
Laura Denny
Frank Kristof
Robert Mackin
Jane McGrath
George Moskowitz
Fred Truslow
William Vivian
James Wiley
Douglas Wonderlic

New York DHCR/HFA

Lee Goodwin (Commissioner)
Edward Bopp
Milton Duke
Fred Hecht
Myron Holtz
Arthur Shulman

Other State Agencies

John Biasucci, WVA
Thomas Charles, Del.
Robert E. Cooper, Haw.
James Dlugosh, Minn.
Talbert Elliot, Alas.
J.D. Foust, N. Car.
Benjamin Hackerman, Md.
Kenneth Hance, Vir.
Robert Hiatt, S. Dak.
William Hunt, Md.
Robert Lena, Maine
Edward Levy, NYC
John McCoy, Pa.
Steven Mayfield, S. Car.
John Maylott, Conn.
Robert Miller, Md.
Robert Moyer, Del.
Albert Point, R.I.
John W. Polk, Ky.
Barbara Sall, Idaho
George Simos, Wisc.
Douglas Smith, Minn.
M. Gregg Smith, Ore.
Robert Smith, Miso.
William Timmermeyer, Colo.
Yoshio Yanagawa, Haw.
Arnold Yoskowitz, NYC

HUD

John Brady
Andrew Euston
Chester Foster
John Jennings
Gary Kane
Daniel Kearney
James Montgomery
Wayne Nickols
M. Daniel Richardson
Melville Roth
Robert Sacrey
Kenneth Salk
Robert Sangster
James Snyder
James J. Tahash
Eleanor White

Wall Street

Thomas Caine - Paine Webber
Arnold Happeny - Salomon Bros.
Richard Huff - Standard & Poor
Edward Kermin - Moody's
Triff Kroll - Moody's
Robert McDonald - Salomon Bros.
John McDowell - Standard & Poor
Stanley Pardo - Blyth, Eastman, Dillon
Susan Rush - First Boston
Warren Sutherland - State Street Bank

Miscellaneous

Robert Alexander; McKinsey & Co.
Rachael Bratt, M.I.T.
Anthony Downs; Real Estate Research Corp.
Charles Edson; Frosh, Lane & Edson
Roger Evans; Gaston Snow & Ely Bartlett
Margaret Frisby; Fed. Home Loan Bank
Joel Kirschner; Mass. Dept. of Community Affairs
Richard Lincoln; Nat'l. Governors Conference
Peter Morris; Harvard Law School
Vincent F. O'Donnell; Boston Urban Observatory
J. Dennis O'Toole; Nat'l. Alliance of Home Builders
Milton Patton; Council of State Governments
Theodore Schultze; Bolt Baranek & Newman
Manie Seferi; MHFA Social Audit Team
William Wheaton, M.I.T.

Several others who wished to remain anonymous or who may have inadvertently been left out.

CONFERENCES AND SEMINARS

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