RENT CONTROL OF SUBSIDIZED MULTIFAMILY RENTAL HOUSING

by

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ABSTRACT

Rent control has been a controversial issue in the Commonwealth for the past two years. The purpose of this study has been to examine two hypotheses concerning local rent control of a specific segment of the housing market, the multifamily rental housing developments subsidized by the federal government for low to moderate income families. The city of Boston has been chosen as a case of a city which has attempted to alleviate a continuing shortage of low-rent housing with a program of local rent control over subsidized housing. The focus of this report has been the housing built under Section 221(d)3 and Section 236. Two hypotheses have been examined: 1) Local rent control discourages investment in subsidized housing; and 2) local rent control contributes significantly to financial instability and/or improper maintenance of subsidized housing. These hypotheses were addressed in hopes of determining whether local rent control is counterproductive to the goals of the federal programs.

The first section of this study deals with the contention that rent control acts as a disincentive to construction of housing under the federal programs. This section includes an investigation of incentives to investment in subsidized housing--long term mortgage, reduced equity requirements, tax shelters, and benefits from participation in subsidiary companies serving the development. These incentives are unaffected by the existance of local rent control and are sufficient to encourage investment in subsidized housing as can be seen by an investigation of actual applications for mortgage loans in the years following the institution of rent control in Boston. This investigation is included in the first section.

The second section of this study centers around the factors contributing to financial instability and improper maintenance of existing subsidized developments. There are numerous factors associated with financial and physical unsoundness. The most signficant factors appear to occur during the development phase where high debt service costs and latent defects in construction are predetermined. To determine whether rent control is a significant factor in financial stability, it is necessary to consider not only the cost components of operation in terms of the operation and development of subsidized housing, but also the characteristics of developments now considered to be financially unstable--those development which are in default, assignment and foreclosure. The second section includes such an examination.

Finally, the procedures and practices of the Department of Housing and Urban Development which regulates rents in subsidized housing are compared with those procedures and practices of the Boston FHA Rent Control Board in the third and fourth sections of this study.

The conclusion of this study is that local rent control is not counterproductive to the goals of the federal programs but serves to complement the activities of HUD.

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CONTENTS

LIST OF TABLES & CHARTS

INTRODUCTION

In 1968, the President's Committee on Urban Housing reported that 7.8 million American families, or one family out of eight, could not obtain decent standard housing for less than 20% of their income. In addition, the committee found that 10% of the nation's occupied housing stock (6.7 million units) was substandard.[1] These findings underscored a problem faced by a nation seeking to guarantee a "decent home for every American family".[2] The endemic shortage of low-rent, standard housing has long been recognized as a serious problem. Historically, federal response to this need for housing has been intervention in the private market. A primary means of intervention was established in 1961 when the federal government began to subsidize the development of privately owned multi-family rental housing. This program, Section 221(d)3, and the later 236 program, subsidized the interest rates of mortgage loans and also insured these loans to encourage construction or rehabilitation of housing for the low to moderate income housing market.

State and local governments have also attempted to mitigate the housing problem. Often, local government has attempted to deal with high rent levels through direct regulation of the cost of housing through rent control. When rent controls are imposed on housing built under the federally subsidized programs, local government becomes involved in the federal sphere. Does local rent control have a detrimental affect on federal programs which subsidize low to moderate income housing?

To find an answer to this question, Boston was chosen as a case study of a city attempting to alleviate its shortage of low-rent housing by controlling the rents of federally subsidized housing. Two hypotheses have been examined:

1) Local rent control discourages investment in subsidized housing.

2) Local rent control contributes significantly to financial instability and/or improper maintenance of subsidized housing.

This study concludes that neither hypothesis can be proven with the data gathered in this study. This review of the procedures, policies and mechanisms of 221(d) 3 and 236 housing at both federal (the Department of Housing and Urban Development) and local (Boston FHA Rent Control Board) levels has shown the local and federal schemes of rent regulation to be complementary.

Federal Intervention and the 221(d)3 and 236 Programs

Federal involvement in the housing market includes a wide range of programs such as FHA insurance of single family and rental housing mortgage loans, grants to local housing authorities for construction of public housing, regulation of the capital money markets through the Federal Home Loan Bank Board, tax incentives to real estate investors, direct subsidies to tenants as well as indirect interest rate subsidies on mortgages for rehabilitation or construction of housing for low to moderate income families by private enterprise.[3] Generally, there has been a trend away from direct federal participation in construction of public housing to subsidization of private efforts.

In 1961, Congress passed the 221 BMIR (Below Market Interest Rate Program) which began the federal policy of encouraging production of housing units for low to moderate income tenants through private investment. This program was extended in 1965 when the 221(d)3 program was established. Under both programs, interest rates on mortgage loans were subsidized by the federal government.[4] The intent here was reduction of future amortization costs in order to lower the rental income necessary for covering debt service costs. This subsidy would be an indirect one to low and moderate income tenants.[5] The National Housing Act of 1968[6] extended this program of subsidized housing. Under Section 236, a deeper subsidy[7] would allow for admission of lower income families to housing built with federal subsidy.[8] Sections 221(d)3 and 236 were further elaborated by the Tax Reform Act of 1969, which authorized financial incentives to developers to encourage participation in the programs. Both programs are administered by the Department

of Housing and Urban Development (HUD).

In 1973, a moratorium on appropriations to finance 236 housing was instituted; the federal government has now moved in the direction of direct tenant rental subsidies.[9]

It is clear that the intent of federal housing programs is to provide housing that is satisfactory at a "price which does not limit a family's ability to afford other goods and services, particularly other necessities".[10] The primary objectives of these programs were stated in 1971 by the Federal District Court in Langevin v. Chenago Court:

> The complementary objectives of Congress, admittedly constitutional and laudable, were to encourage private enterprise to undertake the construction of housing for low and middle income and displaced families, thereby dispensing with the rise of government funds for equity investment and to see that an appropriate share of the benefits of federal assistance went to the tenants.[11]

Local Intervention and Rent Control of FHA Housing

States and localities also have long standing interest in the quality and means of provision of housing. The Commonwealth of Massachusetts and the City of Boston evidence such interest. Each has become involved in the regulation of the quality of housing--through housing and building codes, zoning regulations, sanitary and fire prevention codes-- as well as the provision of housing--through such agencies as the Massachusetts Housing Finance Agency, the Boston Redevelopment Authority, the Boston Housing Authority and the Department of Community Affairs. In addition, certain state laws allow for regulation of conditions by permitting tenants to withhold rent in situations where substantial code violations endangering health and safety exist.

In 1969, Boston began a program of regulation of residential rents. Recognizing that a significant portion of the rental housing market was composed of subsidized housing, the city extended rent and eviction control to cover units built under Sections 221(d)3 and 236 and occupied before December 1, 1968.[12] After

accepting the State Rent Control Enabling Act (Chapter 842 of the Acts of 1970) to regulate residential rents in conventional housing, the City Council enacted in December of 1972, a new ordinance under its special home rule provision (Chapter 797) specifically controlling 221(d)3 and 236 housing constructed before January 1, 1972.[13]

The City Council action was based on its view that:

> The deterioration and demolition of existing housing and an insufficient supply of new housing...has resulted in a substantial and critical shortage of safe, decent and reasonably priced housing accomodations.[14]

The stated objectives of both ordinances are to insure that 1) rents will not be increased unreasonably and landlords will receive a fair net operating income from housing accomodations, and 2) evictions would not produce serious threats to public safety, health and general welfare of the citizens of Boston.[15]

The arguments against rent control over subsidized housing are similar to those against conventional housing controls: namely, that rent control discourages investment in subsidized housing and leads to financial instability and deteriorating conditions in existing housing. In addition to these contentions,it is asserted that local rent control of subsidized housing is superfluous, since rent levels and housing conditions are already regulated by HUD. The existence of rent control on the local level is said to add a costly second stage of red tape and delays in the implementation of rent increases. This study addresses these contentions in the sections that follow.

HYPOTHESIS I: RENT CONTROL DISCOURAGES INVESTMENT IN SUBSIDIZED HOUSING FOR LOW TO MODERATE INCOME FAMILIES

This hypothesis can be tested by identifying the incentives to investment in the low-income sector of the housing market and determining if rent control could, in theory or does in fact, discourage investment in such housing. If the primary incentive for such investment is the profit derived from rental income, then rent control would be a hindrance to those who wish to pursue investment in a low-risk venture with a high rate of return. Similarly, it could be concluded

that rent control is a disincentive if, in a given community, investment in such housing has actually decreased after the imposition of rent controls.

INCENTIVES TO INVESTMENT

In order to achieve the federal housing goals set forth in the 221(d)3 and 236 programs certain incentives were created to attract investment to construction of new units or rehabilitation of existing units for low income families.[1] These incentives provide for benefits substantially greater than benefits from investment in conventional housing. (See Chart 1). Among the incentives typically linked with these programs are:

1) Federal guarantee of mortgages
2) Longer term mortgages with interest rate subsidy and a guaranteed 6% limited dividend on initial equity investment
3) Reduction of investor equity
4) Tax shelters
5) Participation in more than one phase of the development

A sample 236 development is analyzed in Appendix A to facilitate the following descriptions.

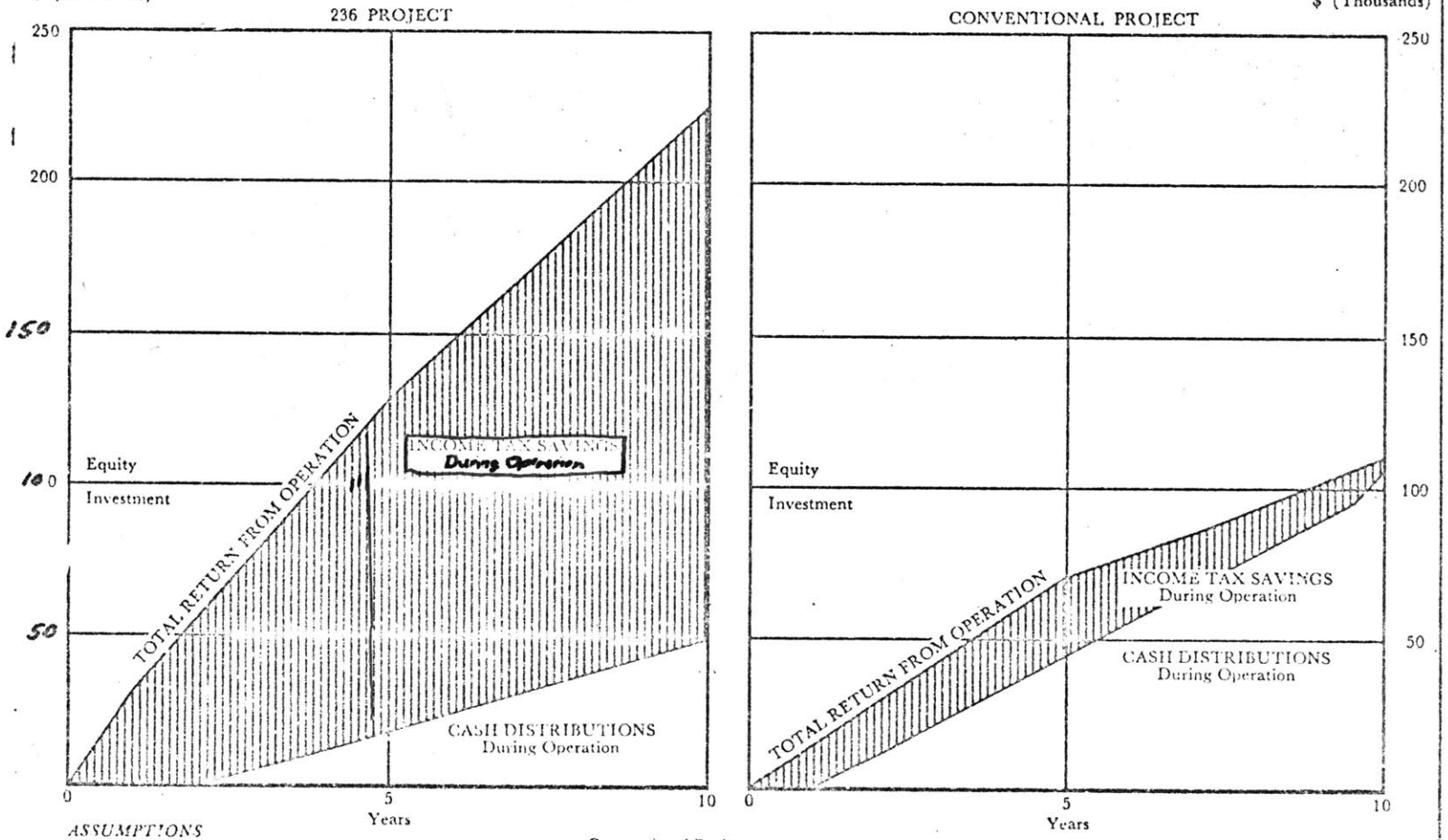
Federal Guarantee of Mortgages

The federal mortgage insurance provisions of both subsidy programs reduce the risk to the lender investing in subsidized housing. If a loss occurs, the lender is repaid by the Federal National Mortgage Association with cash or government bonds. This reduction of risk has broadened the mortgage market and number of lenders willing to commit funds in this area; the greater availability of mortgage money in the area of multifamily rental housing makes the investment more attractive to potential sponsors. In addition, the sponsor of subsidized housing has no personal liability with an FHA insured mortgage.[2]

Longer Term Mortgages with Interest Subsidy and Guaranteed Limited Dividend

Another incentive to investment in subsidized housing is the 40 year mortgage allowed under these programs. Unlike conventional housing mortgages of shorter terms,

Comparison of Forms of Return on Investments from Operations of a "Typical" Section 236 Apartment Project and a "Typical" Conventional Project



ASSUMPTIONS

	Conventional Project	*Federally Assisted Project*
Mortgage:	75% of Replacement Cost, 25 years	90% of Replacement Cost, 40 years
Equity Investment:	$100,000	$100,000
Investors Tax Rate:	50%	50%

COMMENTS

1. As noted in the assumptions, the investment for each project is assumed to be at par, i.e., the difference between the "replacement cost" and the mortgage, which is 10% for the section 236 project and 25% for the conventional project. In practice it is unlikely that the equity investment would be this great for either type of project.
2. Neither projection shows the impact of taxes payable on sale and the resulting recapture of excess depreciation.
3. Neither projection shows any provision for anticipated appreciation of the project or equity build-up from amortization of the mortgage.
4. The comparison above is made for an equal investment in the two types of projects; because of the difference in leverage the section 236 project would be two and one half times larger than the conventional project represented by the same equity.

the forty year mortgage allows for smaller monthly mortgage payments spread out over a longer period. Combined with the interest rate subsidy by the federal government, this provision lowers debt service payments in general, an attractive prospect for the potential investor.[3] Risk to the investor is further reduced by the guarantee of a yearly 6% return on initial cash investment (equity) in a market usually characterized as high risk.

Reduced Equity Requirements

The initial equity required by the 221(d)3 and 236 programs is lower than that of most conventional housing. The federal government permits a loan to cost ratio of 90% for profit-making sponsors of subsidized housing whereas mortgages for non-subsidized housing are typically only 75% of cost.[4] Thus the investor must make an initial cash investment of only 10%. The benefit of this reduced equity requirement to a potential investor is in the smaller amount of front money needed to initiate a development. For the same amount of initial investment capital, a sponsor can make a larger investment in a subsidized multifamily rental housing development.

Not only does the high loan to value ratio of the FHA insured mortgage reduce required equity, but actual equity paid by investors in 221(d)3 and 236 housing is reduced through utilization of non-cash allowances, such as the Builder's and Sponsor's Profit and Risk Allowance and/or markup in land valuation. Under FHA regulations, the builder is guaranteed 6.75% of direct job costs for general overhead and profit.[5] However, if the builder and sponsor have an identity of interest, the FHA programs guarantee them a Builder's and Sponsor's Profit and Risk Allowance of 10% of actual construction costs as well as architectural and legal fees, servicing and closing fees, real estate taxes during construction, plus the builder/sponsor's own general costs.[6] The BSPRA is an incentive to development not only for its higher profit allowance, but also because the government permits the developer to use this amount to offset the equity requirement. Builders

and sponsors usually leave all or part of the BSPRA in the project as a credit towards the 10% equity. Actual cash investment can be reduced to as little as 1.4% of the total cost of the development. (See Appendises A2 & A3).

Actual cash equity is further reduced by the FHA procedure of land valuation. FHA uses the appraised value[7] rather than the actual cost to the developer of the land in calculating the replacement cost which is the basis for the allowable mortgage. Often the appraised value is much higher than actual costs. According to the U. S. Office of Audit in a report on 236 housing, HUD estimates of land values made after sponsors acquired the land often exceed sponsor costs. In 18% of the cases studies, FHA valuation procedures resulted in allowable land costs ranging from 65% to 195% above actual investor acquisition costs.[8] The advantage of this practice is that the developer/sponsor can apply the value of land toward the required equity. This procedure can reduce the actual cash investment in some cases to zero. The developer/sponsor may even receive funds back from the mortgage when land value and BSPRA are used together to offset the equity. (See Appendix A3).

It is important to note that once the mortgage amount is paid to the sponsor, all costs are recovered so that a sponsor's contribution becomes at most land acquisition costs. Although actual equity may be reduced to zero or less through BSPRA and land markup, the developer/sponsor is still guaranteed a 6% profit on imputed equity. It is possible for the return on actual equity to be significantly higher. (In the appended example, A3, return on equity is infinite in one case and close to 18% in the other.)

Tax Shelters

Tax laws provide a variety of tax shelters to investors in subsidized housing. These tax shelters reduce federal income tax liability by allowing real property owners to deduct expenses and decline in property value as losses which are used to offset income earned from both real estate and other types of investment.

Several features of the tax structure for subsidized multifamily housing allow a greater return to subsidized housing investors than to investors in commercial or conventional residential properties. These shelters are available in three phases of the development--the construction phase, the operation phase, and the distribution phase.[1]

Construction Phase Tax Shelters

During construction of a development, a developer/sponsor is allowed to write off certain expenses while at the same time receiving no income from the property. Deductions include deductions for interest on construction loans,[2] real estate taxes, FHA examination and inspection fees and title and recording fees. These deductions can be taken during the construction phase or can be extended over several years[3] and are allowed for both conventional and subsidized housing development. Construction phase deductions are a benefit to investors in that these deductions allow the investor to recoup expenses during construction through sheltering other income. (See Appendix A4).

Operation Phase Tax Shelters: Accelerated Depreciation

The primary tax shelter incentive to investment is the accelerated depreciation allowance. Depreciation is a non-cash expense allocation for a yearly decrease in the value of real property, even though the value of the specific property may, in fact, be increasing. This paper expense is treated as a loss of income for tax puposes so that the same amount of revenue from other sources can be shielded from taxation.

There are several methods of depreciation available to the investor in subsidized housing, the most frequently used being the double-declining balance method.[4] This method permits the owner of a subsidized property to accelerate depreciation expense so that the greatest deductions occur during the early years of the development.[5] (See Appendises A5 & A7).

This tax shelter makes investment in subsidized housing more attractive than investment in commercial or conventional residential properties in two ways. First, the Tax Reform Act of 1969[6] which permits investors in 221(d)3 and 236 housing to use the double-declining or sum-of-the-years-digits methods, limits the owners of commercial properties to the less rapid 150% declining balance method and the owners of used residential properties to the 125% declining balance method. (See Appendix B for a comparison of methods). Second, the ratio of depreciation to imputed equity for subsidized housing is greater than that of conventional housing--9:1 for federally subsidized housing and 3:1 for conventional housing.[7]

This tax shelter is also significant in that the investor receives a depreciation deduction on the total value of the property, not just the 10% or reduced equity actually invested. In general, the importance of the accelerated method is that it provides for increased working capital in the early years of the development due to the small amortization payments (which are treated as income for tax purposes)[8] and large depreciation deductions. The shelter also absorbs the 6% return on equity and creates a tax loss without reducing the actual income of the development, in effect giving a tax free loan. (In the appended example, the investor would be able to shelter over $100,000 of income from other sources in addition to the 6% limited dividend in the first year of operation through use of accelerated depreciation.)

Syndication Proceeds

Often the tax shelter benefits are too large to be used by a single developer/sponsor, as the portion of losses that can be written off is greater than gains elsewhere. In this case, many developer/sponsors find it advantageous to sell tax shelters to other individuals (such as doctors, lawyers, etc.) who wish to shelter their personal income. The developer/sponsor can "syndicate the equity" by selling shares of the development, typically 12 to 18% of the replace-

ment cost of the development.[9] They create a limited partnership which includes both general and limited partners who are entitled to a share of the 6% limited dividend as well as the tax shelter benefits.[10] (See Appendix A9).

Although this procedure is called "syndication of equity", in fact, there are no requirements that the developer/sponsor use proceeds from the partnership as contribution to equity. In cases where actual equity is reduced below 10% through use of BSPRA and land markup, the proceeds are a profit to the developer/sponsor.[11] (See Appendix A10).

Operation Phase Tax Shelters: Five Year Write-off on Rehabilitation

Those developer/sponsors who invest in the rehabilitation aspects of the 221(d)3 and 236 programs are allowed to use straight-line depreciation over a five year period for up to $15,000 per unit on improvements made. This 20% per year write-off is attractive because it allows investors to receive benefits in the early years of operation.

Distribution Phase Tax Shelters: Capital Gains and Special Treatment of Recapture

In the event that the developer/sponsor wishes to sell the property at a later date, taxes must be paid on the excess above depreciation received from the sale.[12] However, for investment in subsidized housing this excess above depreciation is not taxed at the ordinary income tax rate, but at capital gains rate which is one half of the ordinary income tax rate.[13] Even so a certain portion of capitals must be treated as ordinary income if the property is sold in the early years of the development.[14]Even so, the benefits to investors in federally subsidized housing are large. According to a study on Tax Considerations in Multifamily Housing:

> Even that portion of the depreciation which is subject to recapture at ordinary income tax rates is beneficial to the investor. If the investor can make full use of the tax losses generated by accelerated depreciation, they will result in additional tax savings during the early years which can be reinvested. Even if all accelerated depreciation is

later recaptured, the use of additional cash saved in taxes is tantamount to interest free loans.[15]

In addition, tax provisions relating to recapture give the investor in subsidized housing an advantage over investors in conventional housing in that there is no recapture after ownership of the property for 10 years for subsidized housing as opposed to 16 years for conventional housing. There is no reduction in tax on recapture for commercial properties.

Distribution Phase Tax Shelters: Deferment of Taxable Income Through Reinvestment

The investor can avoid capital gains tax altogether if proceeds from sale of a subsidized property are reinvested in another FHA subsidized housing development. If the sponsor performs this "roll-over", he can receive benefits from accelerated depreciation in the early years of ownership, sell the subsidized property and reinvest in a second 221(d)3 or 236 property without being subject to any tax.[16]

Summary of Tax Shelter Benefits and Reduced Equity

The primary incentive for investors is profit. The reduced equity and tax shelter opportunities of the federally subsidized housing for low to moderate income families provides for substantial profits on project equity. Analysis of the sample 236 development (Appendix A) shows that after 21 years of ownership, a developer/sponsor in the 50% tax bracket[17] can receive an internal rate of return[18] on investment of over 100% when all methods of tax calculation discussed above are taken into account. Thus, a developer/sponsor who invests approximately $60,000 or 1.4% of the replacement cost of the development as initial equity, can receive a syndication return of $320,500 after taxes. (See Appendix A10). With retention of interest in the development in the form of a limited partnership this return can be increased. In a similiar analysis, James Wallace has found that internal rate of return on investment approached 190% for a rehabilitated 236 project and 100% for a new 236 development when

ownership was retained for 12 years.[19] (See Chart 2). A comparable analysis indicates that 50% tax bracket investors holding shares of $50,000 each in a development with a $5 million mortgage receive a 22.1% rate of return over the first 23 years of ownership. After 16 years, the rate of return is 20.1%; after ten years, it is 12.8%.[20]

Tax shelter benefits are decided incentives to investment in federally subsidized housing. Return to both developer/sponsors and limited partners is substantial. Benefits are greatest for each type of investor in the early years of the development; the first four years for the developer/sponsor who does not retain interest in the development, the first ten years for the limited partner. These benefits are high when contrasted with average returns on comparable short term investment which fluctuates around 9%.[21] Analysis of benefits of tax shelters also shows that the incentives are significantly greater than the apparent 6% limited dividend. Although this 6% return on equity is included in the tax analysis, it should be noted that even greater rate of return would occur if no cash distributions were made, as every dollar of cash not distributed adds 50 cents to a 50% tax bracket investor's tax savings. Thus not only is return from tax shelters great, it has little relationship to the rental income producing ability of the development.

Benefits from Participation in More than One Phase of Project Construction and Operation

In addition to the identity of interest between sponsor and builder in the initial phases of the construction of the development, it is also permissible for sponsors to take part in other phases of the project. It is possible for the investor to increase profits from the development by contracting with firms in which an interest is held. The following are types of subsidiary companies: accounting firms, maintainance equipment rental companies, management companies, building supplies companies, security companies, architectural and engineering firms and cable TV services. The owner can, in effect, convert expenses of operation into

From James Wallace, A Critique of Federal Income Tax Incentives in the Development and Operation of Subsidized Rental Housing(1972), p. 213.

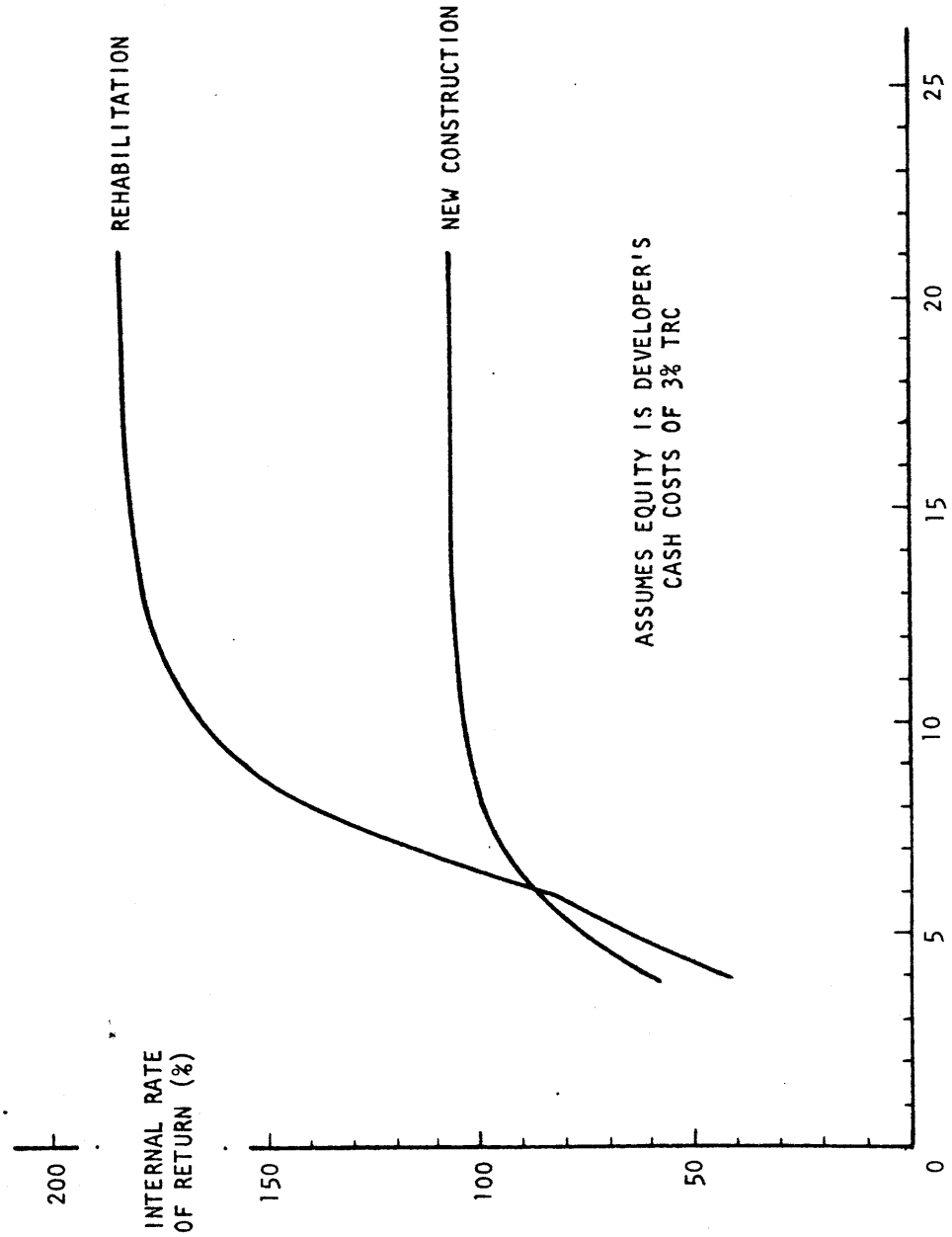


FIGURE V-4: INTERNAL RATE OF RETURN FOR BASE CASES

income from these enterprises. By owning more than one development, the owner can realize some economies of scale and assure continuing demand for subsidiary services, assuring continuing financial success.

Federally subsidized housing programs include incentives to private investors to become involved in development of low to moderate income housing that result in large investment benefits to those who choose to invest in these programs. The major benefits can be realized through reduced equity requirements, tax shelter benefits and participation in more than one phase of operation of the development. Theoretically, then, rent control, which affects only the operational phase, is not a disincentive to investment as it does not affect the most attractive features of investment in federally subsidized housing. Whether, in fact, investors perceive these as major incentives to their investment in subsidized housing and whether this is reflected in actual application trends on a practical level, can be seen by an assessment of the Boston case in the section that follows.

THE EFFECT OF RENT CONTROL ON ACTUAL INVESTMENT IN FHA SUBSIDIZED HOUSING

Data of two types were analyzed in attempting to understand the influence of rent control on investment in federally subsidized housing in Boston. The first source of information was from developers involved in housing built under Sections 221(d)3 and 236 in Boston and other areas of Massachusetts. A series of interviews with nine major developers was conducted in the summer of 1974. Second, data was obtained from the Department of Housing and Urban Development on applications for 221(d)3 and 236 mortgage loans in the Boston area for the time period of 1962-1972.

The interviews were conducted in an attempt to determine what incentives investors in subsidized housing perceived to be most signficant in their decisions to invest in housing catering to the low-to-moderate income market, specifically under the 221(d)3 and 236 programs. The developers were selected

based on their active participation in these programs. The interviews were open-ended; interviewees were invited to comment on the extent of their involvement in subsidized housing, experience with the development process, reasons for investment, financial difficulties in operation of their development and problems in working with either HUD or the Boston Rent Control Board.

Of the eight profit-making developers interviewed, six indicated that tax shelters, specifically the accelerated depreciation benefits, were the most significant factor in their investment decision. One stated that the 6% limited dividend was the major incentive, but that his firm utilized the depreciation as a corporate tax shelter. Two of the first six also cited secondary reasons for investment, those being profit potential in related housing services and a desire to further social progress in the housing field.[1] (See Appendix C).

In theory, rent control cannot affect what investors perceive as the main reason for their particiaption in these programs. However, actual decisions often vary from an investor's espoused reasons for action. While the Boston area developers interviewed were attracted to FHA subsidized housing as investment opportunities, did they and/or other investors continue to invest in such housing after Boston's rent control ordinance was enacted? To determine the practical affect of rent control on new investment in low to moderate income subsidized housing, the application rates for the three year period before the enactment of rent control, 1967 through 1969 are compared with those rates for the three years after the institution of rent control, 1970 through 1972. Although some data for 1973 is available, its usefulness is doubtful due to the moratorium on new 236 commitments declared in January, 1973. The annual change in units for which mortgage applications are made is examined to establish the impact of rent control on investment decisions. Mortgage loan amount figures are not examined due to the difficulty of determining a standard of comparability in times of inflationary building costs.[2]

The hypothesis being tested is that rent control of subsidized housing is

a disincentive to new investment in the subsidized programs. Given this hypothesis, it would be anticipated that the unit application rate for Boston would decline steadily beginning in 1970 and would remain at a substantially lower level than for years prior to 1970. An inspection of the data show that the hypothesis is not supported.

Total units applied for in the three year period before rent control exceeded units applied for in the three years after rent control by about 1,000 units. The bulk of that loss occured in 1971; however, there is a 200% increase over 1971 in units applied for in 1972. (See Chart 3 and Tables 1 & 2).

The high number of units applied for in 1970 and especially in 1972 negate the hypothesis, especially if there are sound reasons other than imposition of rent control to explain the 1971 drop. Indeed, the 1971 drop can be explained by several other factors which had particular influence on the subsidized housing market in Boston at that time. Since the HUD data gives no indication of what these factors were, interviews to obtain information on the 1971 situation were conducted with personnel both at HUD and the Massachusetts Housing Finance Agency. Information from these interviews and an analysis of mortgage market trends in 1970 and 1971 suggest the following reasons for the 1971 decline in applications.

In 1971, the Boston HUD office was in the process of being converted from an FHA insuring outlet to an Area Office. Previously, all subsidized multifamily projects had been supervised from the Area Office located in New York. The transition of personnel and records began in 1970, but the office did not become operational until well into 1971. During the interim period, processing of applications was seriously disrupted; fewer applications were registered than might have been the case had the office been fully operational during the whole period.

The downturn in applications during 1970 and 1971 can also be understood

CHART 3

APPLICATIONS FOR 221d3 & 236 MORTGAGE LOANS --- BOSTON

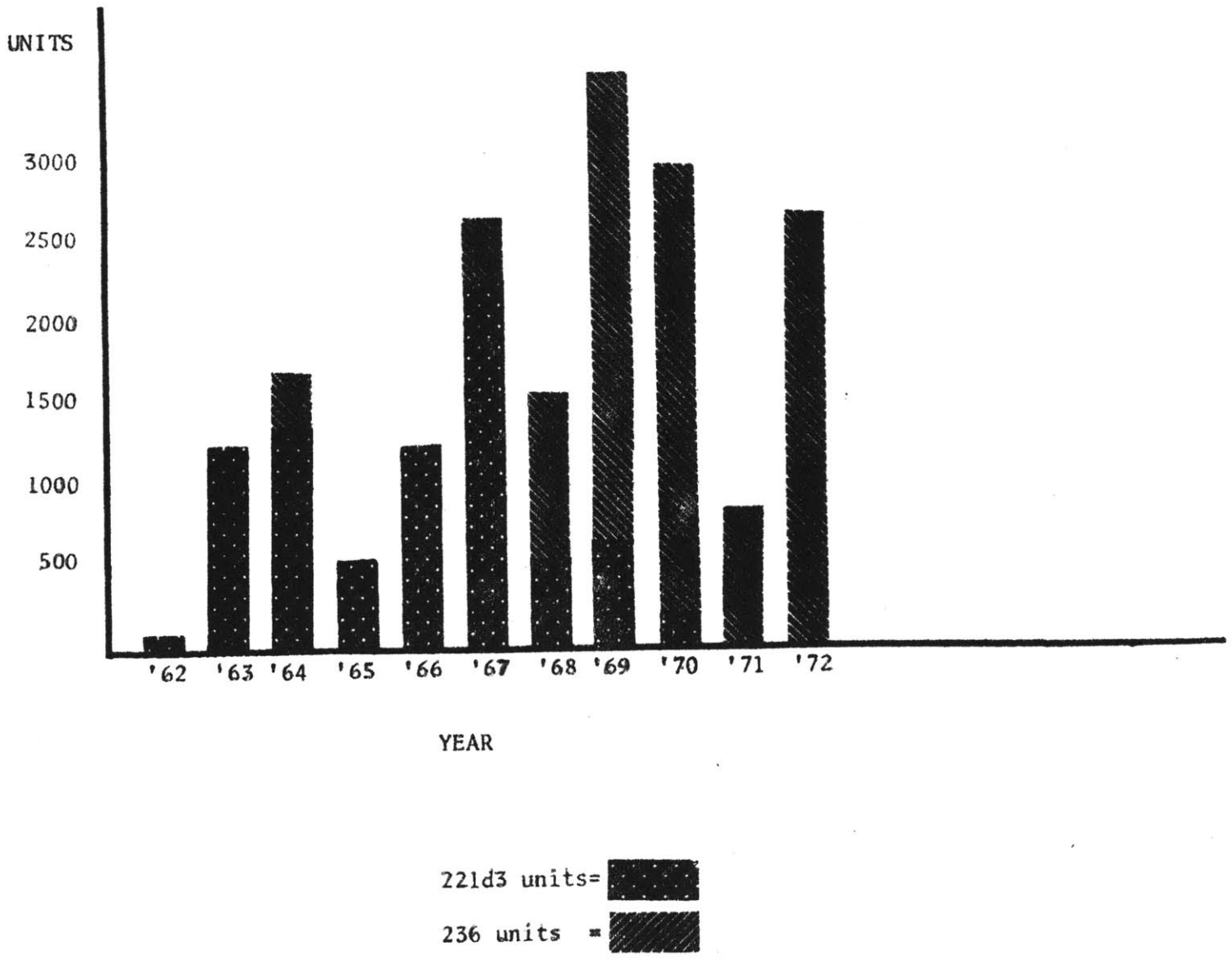


TABLE 1

MORTGAGE LOAN GUARANTEES APPLIED FOR IN BOSTON
Units per year

Year	221(d)3		236		Totals	Percent Change
	New	Rehab	New	Rehab		
1962	--	22	--	--	22	
1963	1,022	106	--	--	1,128	
1964	1,353	--	381	--	1,734	
1965	462	123	--	--	585	
1966	1,031	218	--	--		
1967	313	1,933	128	282	2,656	
1968	380	174	700	226	1,480	-44%
1969	212	497	1,492	1,138	3,339	+124%
1970	195	--	1,796	964	2,955	-11%
1971	--	--	403	430	833	-72%
1972	--	--	1,130	1,557	2,687	+222%
1973	No figures applicable					

TABLE 2

MORTGAGE LOAN GUARANTEES APPLIED FOR IN BOSTON
Aggregate Dollars per year

Year	221(d)3	236	Totals
1962	$120,000	--	$120,000
1963	13,127,333	--	13,127,333
1964	19,644,705	8,046,700	27,691,405
1965	8,859,100	--	8,859,100
1966	21,529,040	--	21,529,040
1967	28,493,600	8,740,200	37,233,800
1968	11,687,600	24,831,500	36,519,100
1969	12,161,200	52,204,603	64,365,853
1970	7,853,600	60,507,256	68,360,856
1971	--	16,119,500	16,119,500
1972	--	62,308,410	62,308,410

in terms of fluctuations in the capital markets at that time. During 1969, 1970 and early 1971, general bank credit was restricted;[3] interest rates on mortgages rose to over 8%. High interest rates appear to have no direct effect on new investment in subsidized housing due to federal subsidy and insurance. However, despite lowered interest rates, the supply of mortgage funds was limited at that time due to the financial policies followed by commercial banks--the primary lenders of multifamily subsidized mortgage and construction loans. In a period of restricted total bank credit, commercial banks shift assets to investment in short term ventures in order to retain sufficient liquidity to cover demand deposits.[4] These short term investments also tend to yield higher returns. Net aquistion of long term residential mortgages, especially the large 40-year 221(d)3 and 236 loans, is curtailed.

This was the situation in 1970 and early 1971.[5] It was not until after wage and price controls in August of 1971 that there was an easing of the credit situation, freeing funds and encouraging further development of rental housing units. The trend of mortgage applications closely follows a pattern predicated on available bank credit as the primary factor in housing investment.[6]

Another important factor in the decline of FHA mortgage applications during this time period was the increasingly active role of the Massachusetts Housing Finance Agency.[7] Although the MHFA was created by legislation in 1966 (amended in 1968), it was not until 1969 that the courts upheld the constitutionality of the Agency. In 1970, the first year in which it was fully operational, the MHFA received applications proposing 18,000 units of subsidized housing, utilizing an MHFA appropriation of about one million dollars in FHA 236 funds. In 1971, MHFA received 169 applications proposing a total of 45,000 new units and appropriated 2 1/2 million dollars in FHA 236 funds. For Boston in 1970, 1370 units in 13 developments were applied for and eventually approved. In 1971, 16 developments (1226 units) were applied for that were eventually committed.[8]

Among the features that attracted developers to MHFA were 1) its program

included marketable units of mixed income developments--thus creating more stable rent rolls and 2) quicker processing of applications. A study of the MHFA development process at this time revealed the following:

> MHFA's closer association with the immediate neighborhoods, housing problems and community needs in the Commonwealth produces a reaction of speedy response in processing of housing development proposals. At MHFA, mortgage loans are processed within an optimum period of three months. That this fast operation of mortgage loan approvals fosters a reduction of the overall production cost of housing can be based on present economics. FHA's processing time has an optimum of 24 months, principally caused by the fact that decisions to provide mortgage loans are made in FHA's head office in Washington.[9]

In addition, the MHFA program was not affected by availability of mortgage funds; projects were financed through sale of short term bonds rather than through funds obtained in the normal mortgage market.

Another factor influencing the decline in 1971 was a reservation to the Boston Redevelopment Authority of an additional one million dollars of FHA 236 funds for units to be developed under the Boston infill housing program. This reservation was held until the end of 1972. This effectively discouraged other applicants knowing that funds were otherwise committed.

Thus the draw-off of FHA appropriations by the MHFA and the BRA combined with complications of establishing the new area office made FHA 236 mortgages difficult to obtain in 1971. In 1972, the area office was operating at full efficiency; MHFA, faced with a backlog of applications, became more selective. In that year, MHFA had only two developments in Boston (172 units) applied for and committed, while FHA applications rose almost to 1970 levels.[10]

These are the factors--administrative inaccessibility, a new state program, unavailability of mortgage funds, pre-existing reservations fo funds--which explain the 1971 slump in FHA applications. It is possible that some real estate investors may have held back applications furing this period in order to assess the effects of rent control on the existing stock. If so the jump in applications in 1972 would seem to indicate the restoration of confidence in FHA subsidized housing

development in Boston. Overall, given the expressed motivations for investment and the information on applications, there appears to be no direct relationship between imposition of rent controls and new investment in subsidized housing in Boston. Rather, fluctuations in investment during the study period are explainable by other factors. Therefore, hypothesis one is not supported by the Boston evidence.

HYPOTHESIS II: LOCAL RENT CONTROL CONTRIBUTES SIGNIFICANTLY TO FINANCIAL INSTABILITY AND/OR IMPROPER MAINTENANCE OF SUBSIDIZED HOUSING

In addition to the argument that rent control inhibits new construction of housing for low to moderate income families, it is also contended that rent control is a significant factor contributing to financial instability and improper maintenance. Rent control on the local level is said to create these conditions in two ways. First, local rent control boards, by denying rent increases limit the rent producing ability of the development. Second, by delay through a lengthy second stage of "red tape", the development loses money that could be used to offset income loss.

The result is twofold. First, due to reduced income through a ceiling on rents or a delay in approval of increases, as expenses rise not all of the obligations of the development can be met. The development is then considered financially unstable and may be forced to default on mortgage payments. The second result is that with limited income, the owner will be forced to reduce expenditures on discretionary costs, typically maintenance, leading to deterioration of the physical quality of the development.

The hypothesis can be tested first by an examination of the complex and interrelated factors involved in the financial and physical "health" of the subsidized housing development--the cost components of operation and the effect of the development process on the ability of the development to cover these costs. If the primary reasons for default and undermaintenance are due to uncontrollable rising expense in the face of limited income, the existance of

rent control on the local level would be in question.

Second, a conclusion about the influence of rent control on the financial stability of subsidized developments could be reached by an analysis of the developments in Boston that are in either default, assignment or foreclosure, categories which are indicators of financial instability. If the developments in these categories are predominately under rent control, then rent control can be said to have a significant affect on the financial stability of subsidized multifamily housing.

FACTORS AFFECTING THE HEALTH OF THE DEVELOPMENT

Operation Phase in General: Cost Components of Operation

The cost components of operation affect the amount of available income to cover mortgage and maintenance expenditures. Some of these costs are fixed and remain at a constant level throughout the life of the project--debt service, reserve for replacement payments,[1] management fee percentage. Other costs are variable--insurance, taxes, amintenance and repairs, utilities, bad debts, vacancies. Of those cost components that are variable, some are externally determined and out of the control of the manager of the development; others are linked to good management practices.

Utilities. Gas, oil, electricity, water and sewer costs have increased substantially in the last several years.[2] The price of utilities is beyond control of the owner. However, there are conditions existing in developments that may contribute to the size of these expenses--poor insulation, construction or design defects, lack of incentive to tenants to conserve use of utilities, inefficient use of common electricity.

Taxes. In Boston, owners of federally subsidized housing either have a "gentlemen's agreement" with the city that tax assessment be a percentage of gross income or they are covered by state law which exempts subsidized housing from property taxes and requires that they pay a percentage of gross receipts in lieu of taxes.[3] Although the percentage paid in taxes is a fixed cost and

relatively stable, at least for the owners under the "gentlemen's agreement", the percentage is subject to change. The reliance of local government on the property tax for revenue makes developments vulnerable to increased costs of operation. In 1972, the percentage of gross income as taxes rose from 15% to 17%.

Insurance. This item is especially significant for rehabilitated developments. These developments are primarily located in the inner city of Boston and are viewed by insurance companies as high risk. Owners are thus forced to resort to the Fair Access to Insurance Requirements (FAIR) plan in order to get coverage for their development. This FAIR plan is nearly twice as costly as conventional insurance.[4] This is a factor over which owners have little control although some "shopping" can result in cost savings.

Maintenance and repairs. These expenses include routine maintenance--extermination, grounds cleaning, normal service calls, repainting vacant apartments, freeing clogged drains, etc. as well as extreme repairs--remedying sewer back-ups and floods, etc. Some of this maintenance work is done by maintenance personnel; more extensive repairs to plumbing and electrical systems often are performed by outside contractors.

Although there may be increases in these expenses due to increases in the costs of labor and parts, in general,this expense category is highly variable, subject to management decision. Unnecessary maintenance expenditures are sometimes intentionally caused by the owner of the development. Rental equipment, charged yearly to the development, has in some cases been rented to the project by subsidiaries of the owner at rates sufficient to purchase equipment twice over.[5] Inefficiency in performing maintenance can also increase costs due to management practices in hiring maintenance personnel. A high turnover in janitorial workers may contribute to higher maintenance costs.

Often increases in repair and maintenance costs are due to the quality of construction. Defects in construction can cause recurring maintenance problems.[6]

Often increases in repair and maintenance costs are due to the quality of construction. Defects in construction can cause recurring maintenance problems.[6] This will be discussed more fully in the latter portions of this study. Whatever the externalities, maintenance is the one cost component over which development owners/managers have substantial control.

Bad Debts. There may be bad debts associated with the development due to tenant characteristics. Often real or available income has been reduced after the tenant's admission to the development for a variety of reasons: unemployment, family break-ups, inflationary increases in other consumer goods. At the same time that income is reduced, rent increases make rental payment more difficult.

A second reason for bad debt losses is mismanagement. The effect of poor construction and greater operation and maintenance expenses have converged and resulted in poor management-tenant relations and rent strikes in some developments. Bad debts are a highly variable income loss component.

Vacancies. There are three major factors which influence the vacancy rate; failure by the developer to adequately assess marketability of units in the particular location of the development; rent levels beyong the tenants' ability to pay; and undermaintenance which according to Michael Stegman "increases the possibility of loss of income through vacancies".[7] The vacancy loss thus varies from development to development and in some instances is tied to management of the project.

Management Fees. The management fee for developments in the Boston area is a fixed 4-6% of the project gross rent collections. The management fee expense increases only upon the increase in rents. This has the effect of giving an incentive to management to increase costs, thereby increasing rental income and thus increasing the dollar amount of the management fee. Rather than giving an incentive for efficient management and proper maintenance, the fixed percentage arrangement encourages management to look for increases in the previously

mentioned cost components in order to justify rent increases.

Overall, these cost components--utilities, taxes, insurance, maintenance and repairs, bad debts, vacancies and management fees are marginal. Some are subject to improvement by good management, others are external to the development. It is clear that at least some of these components--maintenance and repairs, bad debts, vacancies and debt service payments (still to be discussed)--are highly dependent on the general quality of the development which is predetermined during the development state of the federally subsidized project. The major cost component of operation is debt service which is also set during the development stage.[8] It is important, then to examine the development process itself in order to identify other factors which contribute to financial difficulties and physical deterioration of subsidized properties during operation.

Development Process of 221(d)3 and 236 Housing

During the development process of federally subsidized housing built under the 221(d)3 and 236 programs, three situations occur as a result of practices and procedures of HUD and the developer which contribute to the inability of developments to cover expenses upon the opening of those housing units: 1) the mortgage amount is inflated, ultimately resulting in higher debt service costs; 2) the original operating expenses are underestimated, resulting in greater than expected costs upon actual operation; 3) construction defects occur which later lead to increased maintenance and repairs expenditures and income loss through bad debts and vacancies.

A study of 36 developments in the Boston SMSA done by the Boston Urban Observatory for the Boston Redevelopment Authority and National League of Cities shows that "financial problems correlate both with increasing expense during the development process and the underestimation of operating costs".[1] Both of these practices will be examined as they appear in the feasibility, construction

and final closing phases of the development process.[2]

During the feasibility stage of the development process, the potential sponsor must submit a formal application for mortgage commitment proposing construction of a subsidized development to HUD for approval. In order to demonstrate that the proposed development is "feasible", the developer must show that the project will be able to cover all operating expenses and debt service costs once it is in full operation. These expenses must be covered by rental income; however, due to the nature of the 221(d)3 and 236 programs, there is an upper limit on rentals that can be charged once the development goes into operation. These maximum rent levels are based on income limitations on admission to federally subsidized housing. For a 221(d)3 development, initial rent for each apartment cannot be more than 20% of the income of a family earning the maximum income allowed under the eligibility standards. For a 236 development, initial rents cannot be more than 25% of the adjusted maximum income of future tenants.

These maximum rent levels put a limit on total potential rental income that can be generated by a development. This limit in turn restricts the amount of money available for debt service and operating expenses, thus placing a ceiling on the size of the mortgage that can be granted and the amount of the total replacement cost. The mortgage may also be limited by statutory per unit cost limits and statutory total project ceiling costs. In general if the estimated total replacement cost of the development is within 2% of the debt service limit, the project cannot be considered economically feasible. Since HUD will never allow a mortgage over the maximum mortgage amount supported by the project's net income, the developer/sponsor has three options in calculating total replacement cost that would be considered feasible:

1. The sponsor can invest at higher equity levels while maintaining a mortgage that meets the mortgage limitations.
2. The sponsor can cut the cost of construction of the project.
3. The sponsor can lower projected operating expenses.

In general, the sponsor will not take the first option. As investment in subsidized housing is made for the largest return, the sponsor will avoid having to contribute more equity than is necessary.[3]

The second option is a possibility for some sponsors, but for those developer/sponsors with an identity of interest or those developers who syndicate equity, this would also not be a wise investment decision. The Builder's and Sponsor's Profit and Risk Allowance is based on a percentage of construction costs. The depreciable basis of the property and architectural and legal fees are based on a percentage of the replacement cost of the development. A large replacement cost due to higher construction costs will generate a greater return for the developer and future limited partner investors. The larger the replacement costs, the greater tax losses as a result of larger depreciation deductions, and the higher the rate the limited partner would pay to a sponsor for a share of the equity. James Wallace has found that the mortgage amount is the most significant parameter in determining tax benefits.[4]

If the development costs are not decreased, then the sponsor must take the third option to meet the feasibility requirement; the operating expense projections must be underestimated. An underestimation of $100 per unit per year in operating expenses will enable the mortgage to be increased by $3,300 per unit.[5] The immediate effect of this calculation is not felt by the project until it is completed, at which time income must cover actual operating expenses. Once the development is occupied, actual operating expenses exceed original estimates. The rent levels based on those estimates will be insufficient to cover increased costs.

There is substantial evidence to show that the third option is the one most widely chosen by the sponsors of subsidized developments. According to the Boston Urban Observatory assessment of developments in the Boston area:

> Every project in the study sample started out with severe cost overruns. Operation cost overruns in the first full year of operation ranged from $97 per unit per year to $600 per unit per year, 117% of the projected operating expenses figure.[6]

This practice was also found to be wide-spread nationally. The Office of Audit report on 236 development concluded that there was a constant pattern of underestimation of project operating expenses. At one HUD insuring office, underestimation of project operating expenses lead to default for several developments. Outdated and incomplete data at HUD insuring offices has resulted in inaccurate assessment of projected expenses. In addition, the production of as many units as possible was overemphasized, with the necessary data gathering not being performed in many cases.[7] Thus, the terms built into the program for maximizing construction costs coupled with the attitude of the HUD field offices has resulted in the underestimation of expenses, leading in turn to financial difficulties of operation.

During the construction stage of the development process, situations may occur which further inflate the mortgage. At this point in the process, there may be reasons for modification of the original specifications of the proposed development. Any changes which would increase the cost of the development, change the design, or reduce the construction costs by more than 2% of the projected construction costs must be approved by HUD and must constitute "equivalents necessities or betterments".[8] These "change orders" may increase the size of the mortgage by increasing costs of construction.

While some change orders are clearly necessary, others are approved in order to meet FHA minimum property standards and local building and fire prevention codes.[9] These changes are not what one would ordinarily consider necessary changes in that they are required to have been in the original specifications of the development. Typically, instead of pursuing a negligence claim on the liability insurance that FHA requires of the architect, the developer proposes and HUD approves change orders to cover those items. A former consulting engineer for FHA reported that he was not aware of a single instance where the architect was held financially accountable for design deficiencies covered by change orders.[10]

Even approved change orders that do not increase the mortgage amount often result in construction delays which increase costs.[11] When construction is delayed interest and property taxes must be paid during the delay period, thus inflating the final replacement cost of the development and the mortgage amount.

The Boston Urban Observatory found that high cost developments tended to have more and larger change orders; eleven of the twelve high cost developments in the study exhibited financial difficulty. Of the remaining developments, none with change orders amounting to increases of more than $80 per unit escaped financial difficulty.[12]

It is during construction that failure to detect construction defects which later lead to increased operation expenses occurs. FHA inspection personnel are required to visit the project to review the work of the architect and to inspect construction. Many times, these inspectors have failed to report deficiencies that exist.[13] In one development, inspection reports did not acknowledge inadequacy of the heating system which became evident only one momth after occupancy when tenants reported lack of heat.[14] In another Boston area development, repair and maintenance expenses of over $50,000 resulted from repairs made to a defective sewer system. The system was ordered removed by the local board of health two months after the final mortgage commitment was made; it was replaced through a FHA loan which had to be paid back through rental income over and above the original mortgage amortization.[15] Thus FHA inspections often do not serve as an incentive to good construction. Bonding requirements also provide no incentive for quality as HUD and the sponsor rarely take advantage of this insurance.[16]

In the concluding stage of the development process--<u>final closing and cost certification</u>--HUD practices allow for further inflation of the mortgage. Where there is an identity of interest between sponsor and one or more contractors or subcontractors, cost certifications are required from both mortgagor and contractor.

HUD must then review certifications to determine the reasonableness of the amounts indicated which ultimately determines the mortgage amount allowed.[17] At this point, HUD has the authority to declare the project infeasible. In the past, HUD has failed to carry out its responsibilities in this area. First, cost certifications have not been completed in some cases. In one instance involving a Boston area developer, HUD found that the developer/owner failed to certify costs amounting to 1.8 million dollars almost five years after the development was in operation.[18] At the time of final closing, these costs were included as part of the basis for the mortgage. In other cases, inadequate cost certifications were made. Of the 52 finally endorsed developments studied by the Office of Audit, 21 had inadequate cost certifications resulting in about $344,000 ineligible and $281,000 questionable costs.[19] Insufficient scrutiny and laxness on the part of HUD, then allow the owner to "slip in" uncertified costs which can only serve to inflate the mortgage and subsequent debt service payments.

Finally, once the development is constructed, HUD is reluctant to declare the project infeasible and deny the permanent mortgage and interest subsidy to the developer/sponsor. If it is found at the time of final closing that the replacement cost has inflated to such a degree that required mortgage payments and projected expenses necessitate rental levels above the income limits of the locaility, final closing will be postponed until an increase in income limitations makes the development feasible.[20] The reason for this practice can again be explained by HUD's overriding emphasis on production of units.

As a result of the nature of the development process and practices on the part of HUD and the developer/sponsor, mortgage amounts may be inflated, operating expenses underestimated and construction defects undetected. This leads to financial difficulty in the operation and maintenance of developments built under the 221(d)3 and 236 programs. With inflated mortgages, all operating

expenses cannot be covered due to large debt service. Due to construction defects, extraordinary expenditures have to be made for maintenance and repairs. Expenses of operation that are greater than those originally projected may necessitate rental increases; thus, the burden of expenses necessitated by the sponsor's practices and HUD's failure to monitor various stages in the development must be passed on to the occupants of the development.

Development and Operation Phases: Tax Benefits

The previously mentioned practices of HUD and developers can cause subsidized developments to be vulnerable to financial instability. Probably the most important point to be made about the development process, however, is that the tax shelter provisions provide no incentive for maintenance of the financial or physical health of the developments built under the 221(d)3 and 236 programs. The tax shelters which were intended as an incentive to production provide no incentive to proper operation on the part of the owner because 1) these benefits are reaped in the early years of the life of the development[21] and 2) there is no requirement that returns from the tax benefits or syndication proceeds be related to successful operation of the development.

As previously discussed in the section on incentives to investment, the benefits from tax shelters occur prior to and during the first four years of operation for the developer who syndicates equity and the first ten years for the limited partners. Consequently:

> Although it [tax shelter] provides very substantial benefits for developers and sponsors of the projects, these benefits are mostly obtained before the projects are occupied, and in no case are they tied to the successful operation of projects; so long as they manage to avoid being foreclosed...developers and sponsors continue receiving benefits regardless of the scope or quality of services to the tenants.[22]

The primary determinants of financial stability and proper maintenance occur in the development process stages when debt service is set based on inflated replacement costs and when construction defects and underestimated operating expenses lay the foundation for future overruns in operational expenditures. Costs of operation may contribute somewhat to operational difficulties, but many of these costs are within the control of management. In addition, the incentives established to encourage development of subsidized housing, while allowing for substantial benefits to the investor, provide no incentives or funds for proper maintenance of subsidized developments. These are some of the factors which contribute to the financial and physical conditions of many subsidized developments. Rent control, which affects only the operational aspects of subsidized housing, can have no effect on those factors established during the development process which are the basis of many problems in operation. It remains to be seen in the actual Boston case whether rent control significantly affects the financial stability and proper maintenance of subsidized multifamily hsouing. Examination of the indicators of financial instability--default, assignment, and foreclosure--in relation to rent control would indicate the importance of rent control as a contributory factor in financial and physical deterioration of housing built under the 221(d)3 and 236 programs. This kind of assessment will be made in the sections that follow.

THE EFFECT OF RENT CONTROL ON DEFAULT, ASSIGNMENT AND FORECLOSURE OF FHA SUBSIDIZED DEVELOPMENTS

Opponents of local rent control of subsidized housing have contended that rent control is a significant factor contributing to financial instability of existing developments. The Department of Housing and Urban Development also appears to take this position with its issuacne of a regulation exempting FHA subisidized developments from local rent controls.[1] In the preface to this regulation, HUD states that:

> The Department is aware that there are many factors which contribute to mortgage defaults and does not consider local rent control as the sole factor, but rather as a signficant factor in causing owners of FHA projects, especially subsidized projects, to default on their mortgages.[2]

The primary indicator of financial instability used by HUD has been the default rate. Two categories of project status are also appropriate indicators of financial instability: assignment and foreclosure. Developments in all three categories have been examined for the purposes of this study.

Using the default rate as an indicator of financial instability, Boston seems to have faired badly. At the end of January, 1975, 434 of 6,244 (7%) FHA subsidized developments were in default.[3] Boston, with 1.9% of the nation's subsidized housing, had 3.9% of the defaults; thirteen percent of Boston subsidized developments were in default.[4] However, it is unclear whether the default rate can be used as a valid indicator of financial stability. Default status is a monthly determination. It is a transient measure in that one development may remain in default for several months depending on HUD's willingness to cure the default by granting a mortgage modification. This type of measure reveals little of the degree of seriousness in financial instability of the developments.

It is even more difficult to reach the conclusion on the basis of this information that rent control has contributed significantly to default. For example, in August of 1975, HUD regional offices had nine Boston developments in default, eight of which were under rent control. In October, there were three developments in default, only one of these was under rent control.[5]

Finally, there is no evidence that rent control is significantly correlated with default nationally. Although no extensive study has been done by HUD relating default with rent control, a survey by one HUD official of some 846 developments in default from July to October of 1973 showed that only .2% of the developers surveyed indicated that one of the reasons for default of their developments was rent control. No information was given as to what proportion of the developments surveyed was actually under rent control.[6] Other

factors contributing to default noted by one HUD official are economic depression, local jurisdiction increasing its tax base or deciding to withhold tax abatements, vandalism, tenant rent strikes and non-profit sponsors participating more in the subsidized programs.[7]

Two other indicators have been used to assess financial instability. The first, assignment, is the next step in the process of foreclosure in which mortgages formerly held by the Federal National Mortgage Association are assigned to HUD which then becomes the mortgagee. In 1974, 265 mortgages were assigned to HUD nationally with 11.9% of those being Boston developments.[8]

Because assignment is a more firm indicator than default and because HUD's decision to assign represents a more definite statement of financial instability, it is important to make an indepth analysis of the composition of the assigned developments. For this purpose, the Boston assigned FHA subsidized developments listed as of September, 1975,[9] were compared with a list of those developments under rent control.[10] (See Table 3, Section #2).

Of the 102 221(d)3 and 236 developments in Boston, 49 were assigned to HUD; all but two of these developments were assigned after January 1, 1973. Ten of these developments were exempt from rent control.Seventeen had registered with the Boston Rent Control Board but had not approached the board for rent increases from the time of registration trhough February of 1975. Thirteen had received 100% approval of increases that the owners had requested before the Rent Board from 1973 to February, 1975. Information was not available on four developments covered by rent control. Only five developments had not received full approval of requested increases but had received some percentage of their request. In effect,only 10% of the developments in assignment may be said to have been adversely affected in terms of financial stability by rent control. Further examination of these assigned developments indicates that there may be other factors which more centrally explain assignment.

TABLE #3

ANALYSIS OF THE ASSIGNED PROPERTIES IN BOSTON *

					Percent of Column #1
1.	By Program	Assigned	Not Assigned	Subtotal	
	221(d)3	40 (57% of 221d3)	29 (43% of 221d3)	69	68%
	236	9 (27% of 236)	24 (73% of 236)	33	32%
	Total	*49*	*53*	*102*	
	Percent of total	48%	52%	100%	
2.	Rent Control Status--Developments				
	Exempt	10 (20% of assigned)	22 (42% of non-assigned)	32	31%
	Registered only	17 (35% of assigned)	31 (58% of non-assigned)	70	69%
	100% Rent Board approval	13 (26% of assigned)	--	13	13%
	Less than 100% approval	5 (10% of assigned)	--	5	5%
	No information, but covered	4	--	4	4%
3.	Rent Control Status--Units				
	Exempt	1,312	3,182	4,494	37%
	Covered	3,301	4,368	7,669	63%
	Total	4,613	7,550	12,163	
4.	BURP Projects	16	2 (foreclosed)	18	
5.	By Sponsor				
	Non-profit	17 (50% of NP)	17 (50% of NP)	34	33%
	Limited dividend	32 (49% of LD)	33 (51% of LD)	65	64%
	Co-op	--	2	2	2%
	Unknown	--	1	1	.9%

*As of September, 1975.

First, Boston is unique in that much of the subsidized housing in the city (2300 units) is concentrated in the inner city as a result of the Boston Rehabilitation Project (BURP). This program was undertaken by the federal government in 1966 as a showcase for the nation of the speed--eight months--and efficiency with which subsidized housing could be rehabilitated.

Two extensive studies, An Evaluation of the Boston Rehabilitation Program by Urban Planning Aid[11] and the Boston Rehabilitation Program by Professor Langley Keyes,[12] revealed the problems inherent in the program. As a result of attempts to streamline the 221(d)3 program operations, detailed specifications were not required and FHA inspectors failed to extensively monitor the program. Consequently, cost-cutting measures were taken by developers, including the use of substandard materials; construction was of poor quality. This lead to rapid deterioration and consumer rejection of the units, increased heating and maintenance bills, and high vacancy rates. Another problem associated with the program was that large mortgages were used to cover many scattered units, multiplying the effects of financial instability of relatively few units. Compounding these problems was the location of the units in innner city areas where there is difficulty in rent collection and maintenance as well as high insurance rates. The defects of this program are evident in the number of BURP units in assignment. Of the 18 developments rehabilitated under the BURP program in Boston, 16% have been assigned. (See Table 3, Section #4).

A second characteristic of the assigned developments is developer related. Seventeen of the assigned developments (35%) are owned by the same developer/owner/manager, indicating that assignment may have been due in part to poor management on the part of this owner.[13]

Equally significant, seventeen of the developments in assigned status are owned by non-profit sponsors. According to the Boston Urban Observatory, non-profit sponsors that went into the development of subsidized housing

brought with them a certain naivete about the development process. There was a greater tendency for non-profit developments to be subject to construction defects as well as increased mortgages due to construction delay and large change orders.[14] As a result, increased expenses due to large mortgage payments and higher repair and maintenance bills, as well as an unsophisticated approach to management, may have lead to financial difficulty.

The final indicator of financial instability is foreclosure. As of September, 1975, one 236 and seven 221(d)3 developments have been foreclosed in the city of Boston. Data are unavailable as to rent control coverage of two of these developments; two did not register with the rent board. The remaining four were registered with the rent board; however, data are unavailable concerning approval of their rent increase requests. Composition of these developments resembles those assigned in that seven of the developments are rehabs; two of the foreclosed developments are the remaining two BURP developments mentioned earlier.

It appears that there is not sufficient evidence to indicate that there is a causal relationship between rent control and financial instability as measured by default, assignment or foreclosure which are indicators of financial stability. Rather there are other factors which explain adverse financial status, especially assignment--rehabilitation of housing units under the BURP program, mismanagement by one large owner of subsidized housing, and non-profit participation in development of 221(d)3 and 236 housing. In addition, an analysis of the complex factors which contribute to deterioration and unsound developments shows that many of the problems encountered in operation can be traced to the development phase. The importance of these other factors is that they indicate the complexity and range of characteristics which are involved in considering hypothesis two. One factor, rent control, cannot be viewed in isolation.

THE DUAL ROLE OF HUD

As the administering agent of the 221(d)3 and 236 programs, HUD is responsible not only for guaranteeing production of housing units,but also for regulating and monitoring the operation of subsidized developments so that the mandate of Congress--decent housing at reasonable cost for low to moderate income tenants--is fulfilled. HUD fulfills this obligation through rent regulation, monitoring of conditions of the developments and approval of distribution of limited dividends. Those regulatory functions, it has been argued, obviate the need for local rent control. However, HUD must play another role--that of mortgage insuring agent which has the effect of committing the agency more centrally to the financial rather than physical health of the development. This vested financial interest determines HUD policy and biases rent regulation so that factors considered in rent increase decisions "are directed in substantial part to the protection of HUD security interest".[1] Thus, judged by the standards of the Congressional mandate, many of the HUD mechanisms for rent regulation are inadequate. HUD's role as enforcer of social policy gives way to its role as banker.

HUD regulations require that HUD approve all rent increases in subsidized developments before the owner can collect additional rent. The size of the increase approved is to be sufficient to insure a "reasonable return on investment to the owner consitent with providing reasonable rentals to tenants". The HUD Insured Properties Management Guide states that:

> HUD will entertain a written request for a rent increase for any new increases in taxes and operating expenses over which the owners have no effective control.
>
> The mortgagor should carefully consider the local conditions to determine if a rent increase will alow the project to remain competitive...and must also be certain that all unnecessary expenses are reduced to a minimum.[2]

In the past, however, the emphasized phrases of the above paragraphs have gone unheeded, essentially because HUD has "insinuated itself into a

position of interdependence"[3] with the owners of subsidized housing developments. As mortgage insurer, in the event of chronic default and substantial financial difficulty, HUD is obligated to foreclose on the development that it insures and must then repay the balance of the mortgage to the mortgagee. HUD's reluctance to retain ownership of these subsidized developments is understandable in light of the fact that in the past the loss to HUD upon resale of foreclosed 221(d)3 developments was approximately 45% of the acquisition costs.[4] In order to avoid the possibility of foreclosure, HUD has maintained financial stability as its primary consideration. In the words of the director of the HUD Area Office for Massachusetts, "HUD's role is the business end of it. We've got so much federal money invested in these projects that we've got to protect the federal investment".[5] He went on to say that federal money must be protected even if it means that low and moderate income tenants will be forced to move out of the developments.

In practice, HUD's choice of the role of mortgage insurer over that of administrator guaranteeing quality housing at reduced rents and in the early years, HUD's emphasis on production are reflected in the procedures and mechanisms for regulation of rents and conditions. These procedures are inadequate to fulfilling the goals of the programs in the following ways.

HUD's procedures, mechanisms and formulas are characterized by:

1) Insufficient scrutiny of financial information
2) Formulas weighted in favor of manager and/or owner
3) Failure to monitor conditions and quality of the development
4) Failure to consider financial harship of tenants
5) No effective allowance of tenant participation in rent increase decisions.

Insufficient Scrutiny of Financial Information

When an owner of a subsidized development wishes to increase rents, he/she must submit a financial statement of profit and loss (2410) to the Area Office

which then processes that request. In the past, the HUD staff assigned to handle rent increase applications has been inadequate to the volume of applications. In 1971 and 1972, one staff member was responsbilbe for rent increase processing for the Area's 150 subsidized developments. Although the staff has recently been expanded, it is recognized by HUD and others that there is still not enough personnel to properly assess rent increase applications.[6]

Proper assessment also depends on the basis for assessment--the financial information submitted by the owner. HUD requires only an audited statement by a certified public accountant. No other substantiation is deemed necessary. According to Fred Phaender, director of the Loan Management Division of the Department of Housing and Urban Development in Washington, the area office is "not expected to audit those figures. He accepts those figures off of the CPA's certification, but then he makes a determination of their reasonableness as opposed to verifying them which would in my accountant's mind would call for an audit".[7]

In accepting audited statements which organize financial information in a highly aggregated form without further investigation, HUD has often approved rent increases based on unnecessary expenses. In several instances confirmed by an Office of Audit report, HUD has allowed inclusion of double-counted management fees, double-counted maintenance rental and repair expenses among several developments owned by the same developer, as well as excessively high legal fees and expenses for repairs necessitated by construction defects that could have been covered through seeking compensation from the contractor. At the same time, HUD failed to include certain items--application fees, repair fees paid by tenants, late rent fees--as income for the developments in question.[8] In general, according to the Boston Urban Observatory,

> The HUD staff usually reviewed rent applications cursorily and seldom questioned or analyzed the data given to justify a rent increase...Without the time or inclination to monitor..requests

> carefully, HUD staff approved inappropriate rent increases, causing tenants to pay more rent than was warranted under HUD's own guidelines.[9]

If the field office has a reason to suspect the expenses listed in the financial statement, an audit can be requested from the central office. However, a recent study by the comptroller general has shown that in Chicago, Atlanta and San Francisco the HUD Area and Insuring Offices did not promptly tell program participants about the Office of Audit's findings and did not obtain agreements on what would be done to correct deficiencies. There was no adequate follow-up on program participants to insure that corrective actions were being carried out.[10] The report concluded also that:

> HUD officials were not taking full advantage of results of HUD audits of program participant activities. Instead of using these audits as a means of correcting reported problems, HUD officials assigned a low priority to clearing audit findings.[11]

If audit findings were used by HUD perhaps errors in approving unjustified expenses as a basis for rent increases would be corrected.

Formula Bias

The HUD formula for determining the necessity of rent increases is weighted in favor of the developer/owner and/or managing agent and does not take into account actual expenses incurred in four areas. First, HUD allows a standard percentage of gross income--4-6% of gross rent collections--as a management fee. This fee does not include salary for an on-site manager or managing assistant which is allowed as a separate expense.[12] The straight percentage often does not reflect the actual expense of management of the development, especially in cases where the management company, usually a subsidiary of the owner, manages several developments at greater cost efficiency due to economies of scale--a situation typical of Boston.[13]

Second, the HUD formula allows a 7% vacancy rate which can be deducted from gross potential income of the development in justifying a rent increase.

This vacancy factor greatly overestimates the actual vacancy in the Boston area where the average vacancy rate for subsidized housing developments is 1.7%.[14]

HUD also allows the full amount of capital expenditures to be claimed in one year as repair expense when often the investment has a life of several years. Finally, the HUD formula does not allow for inclusion of tax abatements received in previous years as a part of the income of the development. In Boston, the abatement is standard as developments are taxed on the basis of 17% of gross income.[15]

In addition to the four areas where HUD allows either overestimated expenses or underestimated income, the HUD formula is also biased against the tenant in situations where there is commercial space that is part of the property through inclusion in the mortgage. In several developments that have commercial space tenants must bear the burden of mortgage payments for those areas in the event of high commercial vacancies.

Failure to Monitor Conditions and Quality of the Development

According to HUD guidelines, "the Housing Management Division Director has the responsibility for seeing that annual maintenance inspections are made of all multifamily projects under his jurisdiction and further, that such inspections are thorough as well as factual".[16] It is suggested that properties be inspected prior to the date of application for rent increases if the last annual inspection report is not recent.[17] However, in many cases inspections are inferior and perfunctory with increases being approved without current inspections.[18] There is no minimum number of units that must be inspected.

Where thorough inspections are made citing that immediate attention or maintenance is required within one year, there is often no follow-up and the same citations are made the following year.[19] In one Boston development, inspection reports for three consecutive years cited that maintenance was

required within one year for exterior walls and foundation cracks, lack of fire escapes and sunken roads in disrepair.[20]

Insufficient monitoring is evidenced in the poor condition of many of the subsidized developments. In one development, also in the Boston area, inspection by a community health worker disclosed leaks in 191 or 225 apartments, sinking ground level floors, inefficient and inadequate heating systems and insufficient and inferior laundry facilities. In another development built by the same builder, a wall collapsed two months after completion of construction.[21]

HUD officials themselves admit that the Area Office is lax in performing and following up on inspections. Inspectors are not instructed to enforce the laws HUD requires owners to follow.[22] Forms are sometimes signed without conforming to HUD rules.[23]

Even when thorough inspections are done, there are no standards for incorporating findings contained in inspection reports into the rent increase approval process. Although the HUD Insured Properties Servicing Handbook does suggest that HUD may deny rental increases if matters requiring maintenance or immediate repairs are cited in the physical inspection report,[24] there is no requirement that this be done.

Tenant Hardship

Aside from requirements that the rent level for apartments at initial occupancy be no more than 25% of the maximum income limits of the area, there is no HUD requirement that rents be kept at levels which are within the means of low or moderate income tenants residing in those development. In fact, owners are encouraged to apply for rent increases after the opening of the development and at least every two years thereafter.[25] There are also no provisions in the HUD regulations for rent decreases or tenant requests for rent reduction, further indicating that HUD is primarily interested in rent in-

creases.

The Boston Urban Observatory indicates, however, that many tenants living in federally subsidized housing in the Boston area could not afford the burden of additional rent increases. According to their survey, the median annual income of families in subsidized housing is $5,300. More than 1/3 of the households have no wage earners and thus no potential increase in income to pay future increases in rents.[26]

Lack of Tenant Participation in Rent Increase Decisions

New HUD regulations issued in October, 1974,[27] require that developers post notice in their buildings informing tenants that an increase application is being made to HUD. Tenants then are allowed to view the landlord's financial statement and have 30 days to submit comments to the landlord which then must be included in the landlord's statement to HUD. Although this regulation allows more tenant participation than formerly accepted, it does not provide sufficient opportunity for tenants to question the rent increase application. First, because figures on the financial statement are aggregated, it is difficult for tenants to challenge the owner's statement on the basis of their knowledge of specific expenditures. Second, this procedure does not provide for a second chance for tenants to challenge any additional information presented to HUD by the owner after the initial application is made and the audited statement is submitted.

Finally, as with the inspection reports, there are no standards for dealing with the comments made by tenants vis a vis the approval or disapproval of rent increases. It has been the past experience of tenants who have been to HUD to make "unofficial" comments that their complaints have gone unheeded.[28]

Any analysis of the previously mentioned areas of HUD rent regulation and monitoring or conditions is extremely difficult due to the fact that HUD keeps no data on rent increases or inspections for the area as a whole. Any data that does exist is highly inaccessible both in terms of HUD fees for information and in research time. Therefore, in order to support the contention that HUD has failed to fulfill its responsibility of maintaining decent housing at affordable rent levels, it was necessary to rely on interviews, data on Boston Rent Board approval of HUD increases and finally, data on rents actually paid by tenants residing in subsidized developments in the Boston area.

Interviews with HUD officials indicate that HUD's present policy on rent increases is to grant them automatically and as speedily as possible. There is a quota of rent increase requests that must be processed per quarter unless the default rate of the area is below 5% of the developments. There have been no denials of rent increase applications since January of 1974 although officials at HUD estimate that ten to fifteen increases per month have been processed since that time.[29]

An independent review using different criteria for rent increase approval could be used as one indicator of the justifiability of HUD rent increases. The Boston Rent Control Board has found the HUD levels justifiable in only one half of the cases considered. (See Table 4, Line #3).

Finally, it seems clear that HUD is not fullfilling its responsibility to maintain rents at levels low to moderate income tenants can afford based on the percentage of income that tenants in subsidized housing are now paying in rent. Over 40% of the tenants in developments in serious financial trouble in Boston are now spending more than 25% of their income on rent. At least 1/4 of the Boston households in subsidized housing with incomes less than $5,000 pay more than 35% of their income on housing.[30]

While emphasizing the role of mortgage insurer and initiator of production, HUD has relegated its role of administrator of the 221(d)3 and 236 programs to

TABLE 4

RENT BOARD APPROVAL OF HUD APPROVED RENTS*

	Rent Board Approval of HUD Rents			
	100%	Less than 100%	Total	Percent
1. Owner's request less than HUD approved	0	20	20	35%
2. Owner's request more than HUD approved	6	14	20	35%
3. Owner's request equal to HUD approved	9	8	17	30%
Total	15	42	57	
Percent of total	26%	74%		

*As reported January, 1973 to February, 1975.

second place. The practices of HUD have resulted in inadequate monitoring of expenses and conditions at subsidized housing developments in many cases without sufficient consideration of the economic situation or comments of the tenants residing in those developments. This has happened at the expense of the tenants--both in terms of rent levels and housing quality--and in fact may be at the expense of the owners of the developments who may face high vacancy rates due to poor conditions and unmarketable rent levels in the future.

THE ROLE OF THE BOSTON RENT CONTROL BOARD

The central question of this study has been whether local rent control is counterproductive to the goals and purposes of the 221(d)3 and 236 federal housing programs. Given the plural objectives of these programs--provision of an incentive for production of multifamily developments, insurance of the financial viability of developments constructed or rehabilitated under these programs, maintenance of the quality of housing and provision of housing units at rent levels that are not a burden on low to moderate income families--it has been necessary to determine whether or not these objectives are sufficiently exclusive enough to require plural regulatory bodies in order that all of the objectives be fulfilled. It is clear that HUD has emphasized its role in production and as a mortgage insurer over the role relating to the remaining two objectives. The conclusion of this study is that local rent control is not counterproductive to the goals of the federal housing program, but rather serves to complement the activities of HUD by regulating management of developments built under the federal programs. Rents, maintenance and deterioration of units are controlled by regulation of rent levels, thereby providing incentives for decent maintenance and correction of dangerous conditions. This emphasis is indicated in examination of the mechanisms and procedures for rent and eviction regulation by the Boston Rent Control Board.

Owners of subsidized housing that has not undergone substantial rehabilitation or has been completed or occupied before January 1, 1972, are required to register with the Boston Rent Control Board and notify the Board of any rent increases that they seek to implement. The Rent Board then notifies tenants that they have a right to a hearing on the merits of the proposed increase. If a hearing is requested or ordered by the Administrator, such a hearing is to be scheduled within ten days of the date of notice of filing and is held within 30 days after the receipt of the request.[1]

Upon request of the tenants concerned, a city inspector may be sent to inspect the development before the hearing. The inspector is to examine the development for any violations of the state sanitary or Boston Building Code. A hearing is then held at which time the landlord and tenants present evidence justifying their claims before the Board.[2]

After the presentation of the evidence, the Rent Board determines the proper rent levels in accordance with the following considerations:

1. Increases or decreases in property taxes
2. Unavoidable increases or any decreases in operation and maintenance expenses
3. Capital improvement of the housing accomodations
4. Increases or decreases in the living space or housing services
5. Substantial deterioration of the housing accomodations other than ordinary wear and tear or failure to perform ordinary repair or maintenance.[3]

The Rent Board calculates a fair net operating income,[4] taking into account a vacancy factor, payments that must be made to the reserve for replacement, debt service payments and where appropriate, the cash distribution of the 6% limited dividend. Rent levels are calculated to cover these expenses.

Opponents of local rent control have contended that his procedure at the local level has hindered the operation of subsidized housing and is only a costly second stage of bureaucratic red tape and delay. The bulk of those arguments have been discussed in previous sections of this study and have been found to be unsupported. The remaining argument as to the superfluousness of

local regulation in part has been answered upon examination of HUD regulation policy. As to the time delay contended, this study has found that the extra level of bureaucracy does not produce a time delay that is deleterious to the financial stability of the development.

There is no requirement that owners of subsidized developments wait until HUD has approved the rent increase application before they apply to the Rent Board. A simultaneous application would eliminate much of the alleged time delay. Any delay is self-imposed by those owners who delay in preparing their proposals for the Rent Board. As developers interviewed for purposes of this study indicated, there is general agreement on the amount of time the Rent Board usually takes to process an application. (See Appendix C). Given this period of anticipation, most owners could avoid any delay in processing, thus avoiding what losses of income could result from time delay.

Rather than hindering operation of the federal programs, rent control has served to further the programs in the following ways.

The Rent Board provides for:

1) Impartial arbitration
2) Adequate financial scrutiny
3) Monitoring of conditions and quality of the development
4) Consideration of tenant hardship
5) A credible decision-making process

The Boston situation provides evidence on each point.

Impartial Arbitration

Because the Rent Board does not have a financial interest in the operation of the development, the Board can act in an impartial way. The Board, composed of landlords, tenants and disinterested parties,[5] is balanced in such a way that resulting decisions are not heavily biased in favor of any party.

Adequate Financial Scrutiny

The Boston Rent Board has a fully paid staff of 24 which specifically reviews rent increase requests unlike the understaffed rent increase division of HUD.[6] Because the Administration is a local body with more familiarity with both local housing conitions, local developers and the local housing market, their standards for comparability allow a more indepth analysis of the financial statement of the owner.

Finally, the Rent Board requires that the owner submit financial information in a more disaggregated way than required by HUD. This disaggregation of figures as well as routine requests for additional information provides for a more comprehensive basis for rent level decisions.

Monitoring of Conditions and Quality of the Development

The Rent Board has a staff that inspects to insure that state and federal requirements of habitability are met. Each unit that the inspector can gain access to is inspected to provide for a closer monitoring of conditions. In addition, information about the physical conditions of the development is provided by tenants in the public hearing as well as through condition report forms sent to the tenants with the notice of the landlord's increase application.

In addition to providing for informational input as to the physical condition of the development, the Rent Board formula takes into account the actual expenses and financial situation of the development. The vacancy factor allowed by the Rent Board is the actual vacancy or 5% of the development gross potential income, whichever is lower, thus encouraging rent-up of vacant units. Any capital expenditures for improvements are amortized over the useful life of the investment item to provide for a more realistic appraisal of repair and maintenance expenditures than that of HUD.[7]

Finally, and most importantly, by its regulations the rent board procedure

encourages proper maintenance of the development by making rent increase approval conditional on remedying code violations.[8] By withholding the final approval of rent increases until substantial code violations are remedied, the Board attempts to guarantee the fullfillment of the objectives of the federal program to provide quality housing.

Consideration of Tenant Hardship

The Rent Board formula takes into account all the necessary expenses of the development, including unavoidable increases in operating expenses such as increases in utilities,as well as allowing for debt service requirements, loss due to vacancy and also the 6% limited dividend permitted by HUD. In that way the landlord's financial hardship is taken into consideration. In cases where the owner can substantiate necessary and unavoidable increases, the Rent Board grants the increase request.

The hardship of the tenant is also taken into consideration in the Boston FHA Rent Board regulations.[9] Not only is the tenant hardship a part of the mechanisms for rent increase approval, the rent control ordinance also provides the tenant with the opportunity to request rent reductions based on the same considerations previously mentioned. By determining a fair rent, the Rent Board is fullfilling a purpose which, although de-emphasized by HUD, is central to the intent of the federal programs established under Sections 221(d)3 and 236.

Credible Hearing Process

The very concept of hearings involving tenant and landlord as participants imparts a certain measure of credibility to the process. It has been suggested that such hearing procedures are somewhat beneficial in moderating adverse tenant response (rent strikes or move-outs) toward rent hikes that they may regard as unreasonable:

> One purpose of providing procedures is to generate the feeling that justice has been done. Providing a prior hearing might make a rent increase ultimately more acceptable to the tenants by giving them a feeling that their interests have been fairly considered in reaching a decision.[10]

In practice, the operation of rent regulation by a local body such as the Boston FHA Rent Control Board has resulted in full approval of approximately 49% (28 cases) of the 57 increase request cases heard by the Board from January, 1973 to February, 1975. Eighty-four percent of the 57 cases resulted in Rent Board approval of 50% or more of the requested increase base on a more careful review by the Rent Board.[11] (See Table 5).

The reaction of those developers interviewed on the question of rent control was ambiguous. Although all expressed dissatisfaction with the additional complications involved, most agreed with the assessment of one developer:

> Rent control does not really hinder developers from going ahead, although their first reaction is to say that it does. It is a problem, but if the other factors are right we'll swallow the problem.

The existence of local rent regulation does much to further the intent of subsidized housing programs in its emphasis on maintenance and fair rent levels, a function that HUD cannot perform given its interest in protecting its financial position as mortgage insurer. The results achieved by the Board are generally consistent with HUD results. As a local body, the board along with other local agencies and state laws is designed to maintain the quality of the housing stock of the city, while at the same time providing for a measure of equitability to tenants, especially those tenants in low to moderate income brackets intended to be served by the 221(d)3 and 236 programs.

TABLE 5

RENT BOARD APPROVAL OF OWNERS' REQUESTS*

Number of units	Approval Percentage				Subtotal	Percent of Column #1
	100%	80-99%	50-79%	33-49%		
Less than 50	9	2	8	6	25	44%
50-100	9	2	4	1	16	28%
More than 100	10	1	3	2	16	28%
Total	28	5	15	9	57	
Percent in each category	*49%*	*8.7%*	*26%*	*15.7%*		

*January, 1973 through February, 1975.

CONCLUSION

Rent control does not appear to hinder investment in subsidized housing. In addition, there is insufficient evidence to support the contention that local rent control acts counter to the goals of the federally subsidized housing programs by contributing to financial instability and improper maintenance of these developments. Local rent control, rather, furthers the goals of the federal programs in the following ways:

- --The Rent Board procedure allows an opportunity for more rigorous scrutiny of the financial operations of a development by an impartial arbitrator, thus monitoring unnecessary or avoidable costs to keep rent levels within the reach of low to moderate income tenants.

- --Rent control encourages proper maintenance of housing units by making final increase approval contingent on remedy of code violations.

- --Rent control procedures allow for consideration of the financial hardship of both tenant and owner.

- --Rent control hearing procedures lend credibility to the increase decision by providing for tenant participation.

In October, 1975, the Department of Housing and Urban Development issued a regulation purporting to pre-empt local rent control of FHA subsidized multifamily housing. The issue of the validity of this new regulation is presently being contested in the federal district court. The decision will hinge on the extent of federal supremacy that the federal government can claim over federally subsidized housing and whether local rent regulation is substantially different from other local housing standards and regulation. Until the suit in question was filed, HUD had maintained that the Congressional intent of the subsidized housing programs was to allow local rent regulation as long as there was no conflict with the interest of the federal government. This would seem to indicate that, until the recent shift, the HUD position was that local rent control has been consistent with the goals purposes and objectives of the federal programs. This view is supported by this study.

FOOTNOTES

INTRODUCTION

1. Report of the President's Committee on Urban Housing, A Decent Home (Washington, D. C., U. S. Government Printing Office, 1968), p. 8.

2. Housing Act of 1949, 42 USC 1441 (1949).

3. See Robert Taggart, Low Income Housing: A Critique of Federal Aid (Baltimore, 1970) for a listing of federal programs.

   In addition, the federal government plays an important role in the secondary mortgage market where agencies like the Federal National Mortgage Association (FNMA) and Government National Mortgage Association (GNMA) buy and sell mortgages with funds from the sale of government bonds or from the Treasury.

4. 13 USC 1715(d)3.

   The interest rate for 221(d)3 mortgages is 3%. The Government National Mortgage Association holds the mortgage at this below market interest rate.

5. Eligibility standards in the 221(d)3 program are as follows: Upper limits for admission to units equal 160% to 180% of public housing limits established for the area by the local housing authority. See Footnote #8 for the most recent income limits for 221(d)3 in the Boston area.

   As of June 30, 1972, an estimated 180,000 units of 221(d)3 housing were available for occupancy.

6. 12 USC 17152-1.

7. The sponsor--limited dividend, non-profit, cooperative--obtains a mortgage loan from a private bank and the federal government subsidizes the difference between the market interest rate and 1%. The effect of this procedure is to spread the federal appropriations for subsidized housing over the lifetime of the mortgage rather than in a lump sum at the completion of construction as is the case with the 221(d)3 program.

8. The eligibility requirements of the 236 program are: Upper limits for admission equal 135% of the income limits for admission to public housing in the locality. Up to 20% of the subsidy payments may be made on behalf of families whose income upon admission exceed those limits but are below 90% of the limits set by HUD for admission to 221(d)3 housing.

   Income limits for the Boston area as of March 1975 are:

Family Size	221(d)3 Maximum Income	236 Maximum Income
1	$ 8,600	$ 7,740
2	10,450	9,405
3 or 4	12,300	11,070
5 or 6	14,150	12,735
7 or more	16,000	14,400

   As of December, 1973, 451,000 236 units were either available for occupancy or in processing stages.

An additional federal subsidy is available for up to 20% of the units in any development built under either the 221(d)3 or 236 programs. Rather than subsidizing mortgage interest rates, the Rent Supplement program subsidizes rent directly. Tenants pay 25% of their adjusted annual income in rent and the federal government pays the balance. The Leased Housing program (Section 23) is a similar program with the local housing authority providing the subsidy above 25% of the tenant's income. Up to 20% of the units in 221(d)3 or 236 housing can be Leased Housing.

9. The Section 8 Existing Housing Program established by the 1974 Housing and Community Development Act created a housing allo awarded to tenants fullfilling the requirements of this program. Under this program HUD subsidizes, through housing assistance payments, the difference between 15-25% of an occupant's gross income and the agreed upon gross rent of existing standard housing units. For fiscal year 1976, Congress has authorized $625 million to subsidize 400,000 families under this program.

10. Housing in the Seventies (Washington, D. C., Department of Housing and Urban Development document, 1972), p. 4-7.

11. Langevin v. Chenango Court (447 F. 2d 301, 1971). See also: Findrilakis v. Romney (USDC ND Calif., CA No. C-72-801 RFP, 1973); McQueen v. Drucker (317 F. Supp 1122, 1128-37 D. Mass., 1970; 438 F. 2d 781, 1st Circuit, 1971, affirmed).

12. Ordinances of 1970, Chapter 11.

13. Ordinances of 1972, Chapter 19. This ordinance was extended in December, 1975, with a vacancy decontrol provision which has since been under consideration by the Boston Housing Court.

14. Ibid., p. 1.

15. Ibid., p. 1.

HYPOTHESIS I

INCENTIVES TO INVESTMENT

1. There are four types of sponsors of the subsidized housing programs. In most cases (62% of the 236 developments as of 1972), there is a developer/sponsor who remains as the owner or landlord once the project has been completed; these are the limited dividend developer/sponsors. Builder/sellers are another t pe of sponsor. They develop a project in order to sell it when it is ready for occupancy, usually to a non-profit owner. Investor/sponsors develope a project in order to sell it when it is ready for occupancy and then turn it over to a tenant cooperative (7% of the 236 developments built as of 1972 were tenant cooperatives). Finally, there are non-profit sponsors, usually church, labor, or community groups which have a commitment to the community in which the housing is to be built (31% of the 236 developments built as of 1972 were owned by non-profit sponsors). This study will be primarily concerned with the first and last types of developer/sponsors.

2. Philip David, Urban Land Development (Homewood, Ill., 1970), p. 278.

3. Ibid.,p. 277.

4. This is true for all but non-profit sponsors. The mortgage allowed for these sponsors is 100% of the replacement cost of the development. No euqity is required.

5. FHA Manual 72705 3(4), July, 1969. For 221(d)3 developments this figure is closer to 6%.

6. The Office of Audit reports that, "About 4 1/2% of each limited dividend mortgage is available to induce project construction." Report on Audit of Section 236 Multifamily Housing Programs (Washington, D. C., Department of Housing and Urban Development, document no. 05-2001-500, January 29, 1972), p. 41.

7. The HUD procedure is to compare the proposed project site with equivalent sites. Comparable sites are selected from data banks and recordings of sites recently sold or offered for sale and are often dissimilar to the to the land under consideration.

8. Report on Audit, op. cit., p. 41.

Tax Shelters

1. Distribution phase is upon sale or foreclosure of the property.

2. Interest on construction loan is not subsidized but is set at the market rate.

3. If the deduction is taken during the construction phase of the development this deduction must be subtracted from the depreciable basis used to calculate deductions due to depreciation during the operation phase. (See Section on Accelerated Depreciation and also Appendix A5).

4. Also available is the sum-of-the-years-digit method.

   The double-declining balance method works as follows: first, a depreciable basis is determined. This basis is the total cost of the development, which includes construction costs, fees and the Builder's and Sponsor's Profit and Risk Allowance or Builder's Profit, excluding the assessed value of land on which the development is built. Each year this depreciable basis or the assumed value of the building decreases by the annual depreciation deduction for that year. This depreciation deduction is based on a depreciation rate--with the double declining balance method it is two times 1/useful life of the development (usually 25 to 35 years). The rate is applied to the depreciable basis of the previous year to determine the amount of depreciation for that year. (See Appendix A5 for depreciation calculation).

5. Federal income tax is calculated as follows; annual depreciation is deducted yearly from the owner's gross income (gross income being the income remaining after operating expense, debt service and real estate taxes) and the amortization of the debt based on the constant yearly debt service payment. For 236 housing, an eight percent interest rate before subsidy is allowed in calculation of amortization. This gives a taxable income figure.

6. Tax Reform Act Pub L. No. 91-172, 83 Stat, 487 @ 521 (a), 83 Stat. 649.

7. Touche, Ross and Company, A Study of Tax Considerations in Multifamily Housing Investments (Washington, D. C., Department of Housing and Urban Development, HUD contract H-1227, U. S. Government Printing Office, #2300-0191, 1972), p. 81.

8. Due to the long term debt service, the amortization payments included in the constant yearly mortgage payment are relatively low in the early years of operation. In 236 housing where the full market interest rate is treated as part of the constant payment, the amortization is even lower. (See Appendix A6).

9. Note in "Procedural Due Process in Government Subsidized Housing", Harvard Law Review (Volume 86, 1973),p. 884.

10. General partners are responsible for management of the property and have control over the partnership. Limited partners have only limited liability and no control over management or distribution of funds. In the sample development example, 17% of the cost of the development was syndicated making proceeds approximately $700,000. The proceeds were calculated based on the assumption that limited dividend sponsors would pay this amount for a 15% return on investment over 21 years of participation. (See Appendix A9 for Distribution of Profits).

11. Tax on syndication proceeds can be handled in two ways. The developer can treat excess capital either as capital gains or return of capital invested. If the proceeds are treated as gains, capital gains tax--one half of the ordinary income tax rate--is paid by the developer/sponsor as personal income tax. If the developer/sponsor has retained a sufficient claim to ownership through remaining as a general partner, the excess proceeds can be treated as a return of capital in that they are funds not required to complete the project and also belong to him. The developer/sponsor's depreciable basis in the project would be decreased, then, with computation of accelerated depreciation. For a more detailed explanation see James Wallace, A Critique of Federal Income Tax Incentives in the Development and Operation of Subsidized Rental Housing (Phd. Thesis, Massachusetts Institute of Technology, June, 1972), p. 215.

12. The same is true for properties that have been foreclosed. In this case, the amount of the balance of the mortgage at the time of foreclosure is treated as the sales price. This is also the sales price used in the tax calculations in the appended example. (See Appendix A8).

13. A minimum tax preference must be paid on the excluded portion of the capital gain to the extent that it exceeds $30,000. This tax is 10% of the tax preference item.

14. This refers to the recapture provision which requires that gain upon sale or foreclosure is subject to recapture of all depreciation taken in excess of what would have been taken had the straight-line method of depreciation been used in lieu of the double-declining balance method. For subsidized housing, the 1969 Tax Reform Act provides for total recaputre of excess depreciation if the development is sold within the first year of ownership and all additional depreciation is to be recaptured up to 20

months. After 20 months, 100% recapture is reduced by 1% per month of ownership so that after 10 years of ownership there is no recapture and income from resale or foreclosure is subject only to capital gains tax.

15. Touche, Ross and Co., op. cit., p. 19.

16. The owner must sell the property to tenants, a cooperative or non-profit organization and must reinvest within one year from the date of sale of the development in order to qualify for this exemption. Maximum sale price cannot exceed the initial equity plus the amount required to pay the remaining mortgage loan in addition to an amount equal to tax on gain realized from depreciation as a result of sale.

17. This term means that the taxpayer-investor is subject to an average tax rate of 50% of the amount of income which is sheltered by tax loss from the project. James Wallace gives an example: Here an individual with a taxable income of $48,000 a year, except for the rental project in which he/she owns a share, claims a tax loss of $26,000 as a result of his/her share in the project and has a taxable income reduced by $13,000. The tax avoided is calculated as follows:

Income Range	Tax Rate	Tax
$22-26,000	40%	$1,600
26-32,000	45%	2,700
32-38,000	50%	3,000
38-44,000	55%	3,000
44-48,000	60%	2,400

Income sheltered--$26,000 Tax Avoided--$13,000 Average Tax Rate $= \frac{13,000}{26,000} = .50$

18. Internal rate of return is a method used by investors to determine the rate of return on an investment over a period of time given the discounted value of revenue earned in the future. Returns each year are discounted at various rates depending on the desired return and the sum of discounted earnings over the period of investment is compared with the initial cost of investment. For a more detailed explanation of this and other methods for ranking investments see Wallace, op. cit., p. 185-189.

19. Wallace, op. cit., p. 214.

20. This study has not been published. It was done by the Greater Boston Community Development Corporation, November 26, 1974.

21. In August, 1974, returns on shrt term investment in capital instruments were:

$100,000 certificates of deposit (30 Days)	9.1%
$ 10,000 treasury bills (90 Days)	7.0%
$ 10,000 treasury bills (6 Months)	7.5%
Commercial paper (3 Months)	9.2%
Municipal notes (1 year)	4.5%

THE EFFECT OF RENT CONTROL ON ACTUAL INVESTMENT

1. A more extensive study, Tax Considerations in Multifamily Housing Investment, op. cit., showed similar results. Investors from six cities were asked what factors were most important in their decision to invest in low to moderate

income housing under the federal subsidy programs. Of the forty investors who invested or planned to invested in subsidized housing, 20% cited better financing, 20% cited better tax shelters and 18% cited a larger market for this types of housing, while only 12% listed better rate of return. Of the 72 investors who did not invest in the program options, 32% cited a lower rate of return on investment and 28% cited FHA red tape as reasons for their decisions not to invest. However, the study found that approximately 70% of those investors were unaware of the tax shelter and leveraging potential built into the programs. Of those who did not invest, lack of knowledge of benefits appeared to preclude investment.

2. Although a comparison of Boston with the nation would indicate whether the Boston experience was unique or whether it followed a national trend, this kind of analysis was impossible ude to limitations on data. There was no data available on the national application rate for FHA subsidized housing. Only data on national approval of applications was accessible. This was not used due to variations in regional application acceptance.

3. Savings and Loan Fact Book: 1974 (Chicago, U. S. League of Savings Associations, 1974), p. 63.

4. Lyle E. Gramley, "Short Term Cycles in Housing Production: An Overview of Problems and Possible Solutions", Federal Reserve Staff Study: Ways to Moderate Fluctuations in Housing Construction (Washington, D. C., Board of Governors of Federal Reserve System, 1972), p. 17.

5. Savings and Loan Fact Book, op. cit., p. 22.

6. Ibid., Table 13, p. 22*; Table 33, p. 40; Chart 19, p. 42; Table 107, p. 126.

7. Chapter 708, Acts of 1966, as amended.

8. What's Up and Coming: MHFA Closed Projects (Massachusetts, Massachusetts Housing Finance Agency, August, 1975).

9. John Orlando Chike Enwonwu, Development Process in Housing (M. C. P. Thesis Massachusetts Institute of Technology, 1971), p. 76-77.

10. What's Up and Coming..., op. cit.

HYPOTHESIS II

FACTORS AFFECTING THE HEALTH OF THE DEVELOPMENT

Operation Phase: Cost Components

1. A fund used for replacement of items which wear out during the normal life of the development such as refrigerators, water heaters, disposals, paint. The replacement reserve fund is built from yearly payments that typically amount to .4% of the replacement cost of the development. Payments to the fund are made with each mortgage payment and withdrawl of funds is subject to HUD approval.

2. Electric rates rose 23% from 1974 to 1975,with electric space and water heating up by 19% from 1974 to 1974. Gas for rental apartment housing rose by 14% for the same years. However, Massachusetts has a special rating for owners of publically supported housing, Classification #9,which is 27% cheaper

*Assume a time lag of a year between application and construction start.

than the apartment rate. This rate rose by 13% from 1975 to 1975.

3. Chapter 121A of the Massachusetts General Laws. This percentage is tax assessment based on gross receipts after deductions of operation and maintenance expenses, fees, interest and amortization, mortgage premiums, dividends, transfers to reserve for replacement; it is typically about 15% of gross income.

4. Boston Urban Observatory, Subsidized Multifamily Rental Housing in the Boston Metropolitan Area (Boston, Massachusetts, October, 1973), p. 70.

5. An Office of Audit Report, Report on Special Review of Tenants Complaints (Case Number 09-17-3001-5301, August 16, 1972), p. 20, states that for the five Boston area developments reviewed, the following inequitable charges for rental equipment from a subsidiary equipment rental firm were:

	Cost	Monthly Rental
Pick-up	$3,800	$225
Tractor	4,500	300
Lawnmower	750	40
Sweeper	3,200	160

This equipment is typically rented for three to five years.

6. Boston Urban Observatory, op. cit., p. 62-68.

7. Housing Investment in the Inner City (Cambridge, Massachusetts, 1972), p. 56.

Development process

1. Boston Urban Observatory, op. cit., p. 24.

2. In general the stages of the development process are:

Prefeasibility
Feasbility
Conditional Commitment
Firm Commitment
Initial Closing
Construction Period
Cost Certification
Final Closing

3. This option does not apply to the non-profit sponsors. The mortgage amount is 100% of the replacement cost--FHA fees, construction costs, land costs, financing fees, architects fees, etc.--so that no equity is required.

4. Wallace, op. cit., p. 205.

5. Boston Urban Observatory, Note, op. cit., p. 54.

6. Ibid., p. 57.

7. Report on Audit of 236..., op. cit., p. 38-39.

8. "Construction Period to Final Closing", HUD Handbook 4435.1, p. 1-7, paragraphs 1-8.

9. A specific instance was noted by Langley Keyes in the Boston Rehabiliation Program (Cambridge, Massachusetts, 1970). He reports on page 124 that change orders needed to meet Boston Building Department standards resulted in approval of $350,100 in additional costs for one development.

10. Letter from Allister Shepherd to Edie Bilotta, May 10, 1973 . Mr. Shepherd is an independent physical engineer with fourteen years of experience including four years as an engineering consultant to FHA. He also reports in a letter to Barry Brodsky dated October 23, 1973, that in one development change orders approved by HUD increased construction costs by over $300,000. Most of these changes "indicate inadequate engineering in the original design plus poor control and review by FHA".

11. Boston Urban Observatory, op. cit., p. 47.

    The normal construction period assumed by HUD and the sponsor is 18 months. In the author's review of the "Rental Housing Project Income Analysis and Appraisal" for one Boston development, change orders amounting to $253,000 were approved largely because of delay in construction from the estimated 14 month period to 24 months.

12. Ibid.,p. 47.

13. Ibid., p. 51.

14. Author review of Project Inspection Report (HUD Form 2449) for one Boston development--023-55128.

15. Letter from Edward B. Hick, Operation Specialist, Department of Housing and Urban Development to Richard Tyrell, January 29, 1973 refers to the granting of a Supplemental Loan under Section 241 for Project 023-44075.

16. Louise Elving, Public Subsidies and Private Managers: Critical Issues in Management of Federally Assisted Rental Housing (M. C. P. Thesis, Massachusetts Institute of Technology, February, 1974), p. 129-142.

17. Section 227 of the National Housing Act.

18. Letter from William Hernandez, Acting Director of the Area Office of Housing and Urban Development, Region 1, June, 1974.

19. Report on Audit..., op. cit., p. 3.

20. Emily Achtenberg and Michael Stone, Tenants First: A Reserach and Organizing Guide to FHA Housing (Cambridge, Massachusetts, 1974), p. 36.

    Income limitations are changed every eighteen months.

21. Refer to section of this study, Summary of Tax Shelter Benefits.

22. Boston Urban Observatory, op. cit., p. 199.

EFFECT OF RENT CONTROL ON DEFAULT...

1. Chapter IV of Title 24, part 403.

2. 40 FR 49319.

3. "Affadavit of Fred Phaender", City of Boston v. Carla Hill, et. al. (C. A. No. 75-902-C, March 20, 1975), p. 7. Mr. Fred Phaender is Director of the Loan Management Division under the Undersecretary of the Dept. of Housing and Urban Development.

4. Ibid., p. 8.

5. Monthly Default Status lists. Division of Loan Management, Area Office, Department of Housing and Urban Development.

6. "Phaender Deposition--Exhibit #13", Kargman v. Sullivan et. al. (USDC No. 71-27112-F, March, 1974).

7. "Phaender Deposition", op. cit., p. 369-374.

8. "Affadavit of Fred Phaender", op. cit., p. 7-8.

9. Monthly Report on HUD Held Mortgages. Division of Loan Management, Area Office, Department of Housing and Urban Development.

10. Compiled from Boston FHA Rent Board lists of registered and exempt properties and Rent Board data sheet on Rent Board approvals from January,1973, through February, 1975.

11. Cambridge, Massachusetts, September, 1969.

12. Cambridge, Massachusetts, 1970.

13. The Boston Urban Observatory study, op. cit., p. 35, found a correlation between major developers and troubled projects. Six major developers representing about 40% of all subsidized housing units in the Boston SMSA owned developments that were classified a being in financial difficulty.

14. Ibid., p. 41, 51.

THE DUAL ROLE OF HUD

1. Letter from HUD General Counsel Office,September 18, 1973, concerning coverage of FHA multifamily subsidized housing in Prince George's County, Md.

2. Insured Project Managment Guide 209 as required by 24 CFR 221. 531 (c).

3. See Burbon v. Wilmington Parking Authority (365 US 715, 1961).

4. Housing in the Seventies, op. cit., p. 4-69.

5. William Hernandez, Boston Globe, January 30, 1975, p. 10.

6. Boston Urban Observatory, op. cit., p. 110-113.

7. "Phaender Deposition", op. cit., p. 248.

8. Report on Special Review..., op. cit.

9. Boston Urban Observatory, op. cit., p. 196.

10. Greater Benefits Can Be Derived from Improved HUD Audits of Program Participants, Comptroller General of the United States (Department of Housing and Urban Development, GA 1.13; H 81/60, 1974), p. 16.

11. Ibid., p. 24.

    This study went on to cite a specific case of a Michigan subsidized housing development that had been investigated by the Office of Audit. The Area Office in this case had cleared 8 of 9 findings without meeting with the program participants.

12. Compensation for Management Services in Multifamily Housing Projects with Insured or HUD Held Mortgages (Department of Housing and Urban Development HM G 4381.5, July, 1974).

    The management fee can be increased by 1/4% for each award of superior management up to 2% above the initial fee established for that development. The intent of superior management awards is to provide an incentive for better management.

13. Elving, op. cit., p. 45. In an addition, an examination of HUD properties list shows that 58% of the Boston subsidized developments are managed by management companies that manage four or more developments; one company manages 18.

14. Boston Urban Observatory, op. cit., p. 75.

15. Interview with Leo McCuskor, Chairman of the Boston FHA Rent Board, October 7, 1975.

16. Management of HUD Insured Multifamily Projects Under Sections 221(d)3 and 236 of the National Housing Act (Department of Housing and Urban Development, HM G 4351.1, Rev. October, 1974), p. 24.

17. "Phaender Deposition", op. cit., p. 269.

18. "Testimony of Emily Achtenberg", Kargman v. Sullivan et. al., op. cit., Day 2, p. 125-126. Emily Achtenberg is a Housing Specialist employed at Urban Planning Aid.

19. "Testimony of John Mulvaney", Kargman v. Sullivan et. al., op. cit., Day 4, p. 83-99. John Mulvaney is the HUD Area Assistant Engineer for the Boston area.

20. Author review of Annual Physical Inspection Reports(HUD Form 92470) for Project 023-55008.

21. An Evaluation of the Boston Urban Rehabilitation Program, op. cit., p. 54.

22. "Testimony of William Hernandez", Kargman v. Sullivan et. al., op. cit., Day 3, p. 154.

23. "Testimony of Kenneth Salk", Ibid., Day 4, p. 63-64. Mr. Salk is the Director of Housing Management of the Area Office of the Department of Housing and Urban Development for the Boston area.

24. Department of Housing and Urban Development, HM G 4350.1, Chapter 4, Section 3 3b (1), April, 1973.

25. "Phaender Deposition", op. cit. p. 4-81, 4-65, 5-72 and 503.

26. Boston Urban Observatory, op. cit. p. 137, 171.

27. Chapter IV of Title 24, part 401.

28. In one incident, a group of tenants met with HUD officials to present hundreds of complaints relevant to HUD procedure on implementation of rent increases; the rent increase was approved by HUD fifteen minutes after tenants had left the meeting at which they presented their complaints.

    Tenants at another Boston area development submitted signed affadavits challenging the financial information submitted by the landlord, The rent increase was approved December 31, 1975, the day after the affadavits had been submitted.

29. Interview with Mary Noble, Loan Management Division, Department of Housing and Urban Development, November 10, 1975.

30. Boston Urban Observatory, op. cit., p. 74.

THE ROLE OF THE BOSTON RENT CONTROL BOARD

1. Boston Rent Control Regulations, Regulation 3, Section 7, February 1, 1973.

2. The Board consists of "five residents of the city appointed by the Mayor including one tenant who owns no housing accomodations and one landlord who owns or manages at least twenty rental units in the City and three members representing the public interest, none of whom may own or manage more than three rental units in the city". Ordinances of the City of Boston, Chapter 19, Section 2(a), p. 5.

3. Ibid., p. 9.

4. Fair net operating income is the amount of income generated by a development after operating expenses, not including debt service and reserve for replacement are deducted from the gross potential annual income (rent times number of units in each apartment type). A base year is used, usually two years prior to the last full year of operation prior to application. If fair net operating income is between 35% and 60% of the gross potential income, that amount is added to the expenses accepted for the year under consideration to establish a required gross potential income. That income is used to calculate the rent increase necessary for each type of apartment after the level is tested to determine that it does, in fact, cover vacancy, debt service, reserve for replacement and cash distribution of the limited dividend.

5. See Footnote #2 of this section.

6. "Testimony of Bernard Shadray, Jr.", op. cit, Day 3, p. 49.

7. Interview with Leo McCuskor, op. cit.

8. Boston Rent Control Regulations, Regulation 6, Section 8, p. 5.

9. Ibid.,Regulation 6, Sections 4(i), 5(c)4.

10. "Procedural Due Process...", op. cit., p. 900.

11. Leo McCuskor indicated in the previously noted interview that the major reasons for approval of lower rent increases by the Boston FHA Rent Board included lower vacancy allowance, amortization of the capital investment expenditures and owner's insufficient substantiation of reported expenses. Other increase approvals were held until repairs had been completed.

APPENDIX A: Analysis of Tax Shelter and Reduced Equity Benefits

This appendix details an internal rate of return on investment in a sample 236 developemtn. The number of parameters and variable in any general analysis of tax shelter benefits is large. Due to the complexity of tax provisions, the varying components of each development and variations in construction costs and time, partnership agreements and tax brackets of each investor, it is not possible to determine benfits for every federally subsidized development. Therefore, this sample development was chosen to facilitate description of the workings of the incentive provisions discussed in the body of this study. In choosing a sample in order to analyze benefits of the subsidized programs, an attempt was made to construct a representatvie developemtn and to analyze its financial arrangements in a manner typically used by investors. The following subsections of this appendix include:

A1 Assumptions about the Development

A2 Calculation of Equity Requirement and Mortgage Amount

A3 Calculation of Actual Investment and Yearly Rate of Return

A4 Construction Phase Tax Deductions

A5 Calculation of Depreciation

A6 Breakdown: Yearly Interest and Amortization of Mortgage

A7 Tax Shelter Calculations and Assumptions

A8 Taxes Upon Sale

A9 Distribution of Profits to Limited Partners

A10 Return from Syndication Proceeds

APPENDIX A1: Assumptions about the Development

236 housing, new construction, limited dividend sponsor, 200 units

Construction Costs

Job costs		*$3,000,000*
Construction Fees		
Architect & Engineer	*$170,000*	
Builder's Overhead	*30,000*	*200,000*
Carrying Charges & Financing		
Interest during Construction (one year @ 8%)	*160,000*	
Financing Fee	*55,000*	
Real Estate Taxes	*35,000*	
FHA Examination & Inpsection Fees	*30,000*	
Title & Recording Fees	*20,000*	*300,000*
Legal & Organizational Fees		*27,000*
Total Excluding Land & Builder's Profit		*3,527,000*
Builder's and Sponsor's Profit and Risk (Assuming Identity of Interest)		*353,000*
Land (Assessed Value)		*200,000*
Replacement cost		*$4,080,000*

In order to perform the tax calculation taking the reduced equity benefits into account, the mortgage amount was determined by taking 99% of all costs of construction excluding land plus 90% of the land value. The equity is approximately 1.5% of total costs dued to reduced equity provisions of land valuation and application of BSPRA.

Mortgage Amount	*$4,021,000*
Yearly Constant Payment @ 8% Interest	*337,207*
Equity Requirement (11.1% of mortgage amount)	*442,332*
Actual Equity	*59,000*
Limited Dividend (6% of Required Equity)	*26,540*
Replacement Reserve Payments (.4% of Mortgage Amount)	*16,084*

APPENDIX A2: Calculation of Equity Requirement and Mortgage Amount

This calculation has been presented to facilitate description of the reduced equity and land valuation benfits of the federally subsidized housing programs. The mortgage amounts and equity actually advance are not the same as those levels used in the remainder of the tax benefit calculations--the amounts listed in Appendix A1. They do serve to indicate, however, the uses of BSPRA and landmarkup.

Method of calculation:

First, the mortgage amount is calcualted for two differnt cases--in a situation where there is no identity of interest between builder and sponsor and one in which an identity of interst exists. In the first case, the Builder's Profit is 6.75% of the job costs. In the second case, the Builder's and Sponsor's Profit and Risk Allowance is 10% of total construction costs.

Second, the assessed value to land is added to determine replacement cost. The mortgage amount is calculated from this basis. It is 90% of the replacement cost. Required equity is the remaining amount. Limited dividend is 6% of the required equity.

Without BSPRA		*With BSPRA*	
Total Construction Costs	*$3,527,000*	*Total Construction Costs*	*$3,527,000*
Builder's Profit (6.75% of job costs)	*202,500*	*BSPRA (10% of above)*	*353,000*
Land (Assessed Value)	*200,000*	*Land (Assessed Value)*	*200,000*
Replacement cost	*3,929,500*	*Replacement cost*	*4,080,000*
Mortgage Amount (90% of above)	*3,536,500*	*Mortgage Amount (90% of above)*	*3,672,000*
Equity Requirement	*392,950*	*Equity Requirment*	*408,000*
Limited Dividend (6% of Equity)	*23,577*	*Limited Dividend (6% of Equity)*	*24,480*

The limited dividend for the identity of interest sponsor is clearly more than that of the non-identity of interest sponsor. The required equity of the former, however, appears to be greater. In practice, this is not the actual equity put forward by the sponsor. Actual equity will be calculated in the next subsection of this appendix.

APPENDIX A3: Calculation of Actual Investment and Yearly Rate of Return

This calculation shows the benefit to the investor of the BSPRA and land markup allowances of the federally subsidized programs. It utilizes the calculations made in the preceeding appendix subsection, not those figures presented in subsection 1.

Method of Calculation:

First, two calculations are made assuming two different cases. The first case has the builder splitting the BSPRA with the sponsor. This is typical for a builder who is not a wholly owned subsidiary of the owner. In the second case, the builder is a wholly owned subsidiary so the owner can apply the entire BSPRA to the equity. Each profit is subtracted from required equity to indicate application to the equity to arrive at new actual equity (cash investment).

Second, the land markup benefit is shown. The dollar amount returned to the sponsor/(actual equity) is found by subtracting the actual cost of the land. Actual cost of land i assumed to be one half of the assessed value. This figure is consistent with the Report on Audit findings.

Finally, the return on equity is calculated using the limited dividend determined in the previous subsection.

I. Application of BSPRA

BSPRA Split with Builder		*Entire BSPRA Applied to Equity*	
Required Equity	*$408,000*	*Required Equity*	*$408,000*
1/2 of BSPRA	*(176,500)*	*All of BSPRA*	*(353,000)*
New Equity	*$231,500*	*New Equity*	*$ 55,000*

II. Application of Assessed Land Costs

BSPRA Split with Builder		*Entire BSPRA Applied to Equity*	
New Equity	*231,500*	*New Equity*	*55,000*
Land (Assessed Value)	*(200,000)*	*Land(Assessed Value)*	*(200,000)*
	31,500		*(145,000)*
Actual Land Cost	*100,000*	*Actual Land Cost*	*100,000*
Actual Equity	*$131,500 **	*Returned to Sponsor*	*$45,000*

III. Cash Return and Yearly Rate of Return

BSRPA Split with Builder		*Entire BSPRA Applied to Equity*	
Actual Equity	*131,500*	*Actual Equity*	*0*
Limited Dividend	*24,480*	*Limited Dividend*	*24,480*
Rate of Return	$\frac{24,480}{131,500} = 18.6\%$		*Infinite*

**3.2% of Replacement Cost*

APPENDIX A4: Construction Phase Tax Deductions

These deductions are based on losses during construction which can be allowed as deductions. Tax loss allowances include the following fees and expenses:

Interest during Construction (@8%)	*$160,000*
Financing Fees	*55,000*
Real Estate Taxes	*35,000*
FHA Examination & Inspection Fees	*30,000*
Title & Recording Fees	*20,000*
Total Lossess (taxable income)	*$300,000*

Method of Calculation:

The investor is assumed to be in the 50% tax bracket. (See Footnote #17, p. 5 of notes). Income taxes are 1/2 of income received. In this case negative income (loss) was $300,000. This would allow the investor to write-off 1/2 of that loss thus avoiding taxes on income from other sources:

Tax savings=1/2 of Tax Loss=1/2 x $300,000=$150,000

APPENDIX A5: Calculation of Depreciation

This subsection shows the accelerated depreciation or paper loss in value that an investor can claim as a loss for income tax purposes. The Tax Reform Act of 1969 allows the investor to utilize a 200% declining balance method to depreciate the property owned.

Method of Calculation:

First a depreciable basis or initial value must be determined. The initial value is the replacement cost minus the construction depreciation taken minus the cost of land.

Second, the depreciation for the first year and following years are calculated. Each year the building under consideration depreciates by a depreciation rate--200% declining or double-declining balance method-- which is 1/ useful life of the development or 1/25 in this example times 2:

Depreciation rate = 1/25 x 2 = .08

This rate is applied to the initial value of the development to determine the amount of depreciation. In this case it is .08 x $3,580,000 = $286,000. This amount is then subtracted from the initial value or depreciable basis to arrive at a new depreciable basis. The depreciation rate is applied to this new basis to arrive at a new depreciation value for the second year of operation and so on. Depreciation was calculated assuming 21 years of owernship.

I. Depreciable Basis

Replacement Costs	*$4,080,000*
Land (Assessed Value)	*(200,000)*
Construction Phase Deductions	*(300,000)*
Depreciable Basis for First Year	*$3,580,000*

II. Depreciation of Sample Development

Year	*Deduction*	*New Basis*	*Year*	*Deduction*	*New Basis*
2	*$286,400*	*$3,293,600*	*11*	*$135,226*	*$1,555,110*
3	*263,488*	*3,030,112*	*12*	*124,408*	*1,430,701*
4	*242,408*	*2,787,703*	*13*	*114,456*	*1,316,245*
5	*223,016*	*2,564,686*	*14*	*105,299*	*1,210,945*
6	*205,174*	*2,359,511*	*15*	*96,875*	*1,114,069*
7	*188,760*	*2,170,750*	*16*	*89,125*	*1,024,944*
8	*173,660*	*1,997,090*	*17*	*81,995*	*942,948*
9	*159,767*	*1,837,322*	*18*	*75,435*	*867,512*
10	*146,985*	*1,690,336*	*19*	*69,401*	*798,111*
			20	*63,848*	*734,262*
			21	*58,740*	*675,000*

APPENDIX A6: Breakdown of Yearly Interest and Amortization of Mortgage

This breakdown assumes a 40 year mortgage at 8% interest for tax purposes. The yearly constant payment can be determined by consulting any constant payment table.

Year of payment	Interest	Amortization	Balance
2	$321,696.00	$15,511.50	$4,021,200.00
3	320,455.00	16,752.40	4,005,628.50
4	319,114.90	18,092,60	3,988,936.00
5	317,667.60	19,540.00	3,970,848.50
6	316,104.30	21,103.20	3,930,200.20
7	314,416.00	22,791,50	3,907,408.70
8	312,592.70	24,614.80	3,882,793.90
9	310,623.50	26,584.00	3,856,209.90
10	308,496.80	28,710.70	3,827,499.20
11	306,199.90	31,007.60	3,796,491.60
12	303,719.30	33,408.20	3,763,003.40
13	301,040.30	36,167.20	3,726,836.20
14	298,146.90	39,060.60	3,687,775.60
15	295,022.00	42,185.50	3,645,590.10
16	291,146.90	45,560.30	3,600,029.90
17	288,022.40	49,205.10	3,550,824.70
18	284,066.00	53,141.50	3,487,683.20
19	279,814.70	57,382.80	3,440,290.30
20	275,223.20	61,984.30	3,378,306.00
21	270,264.50	66,943.00	3,311,363.00

APPENDIX A7: Tax Shelter Calculations and Assumptions

This portion of the appendix shows the actual tax benefits accruing to the investor in this sample development as well as indicating what amount of money limited partners would invest to receive a 15% return on their investment. The following assumptions are made in the tax calculations:

Investor Characteristics		*Pertinent Column*
Tax Bracket of the Investors	*50%*	*(Column 6)*
Rate of Return Desired by Limited Partners	*15%*	*(Discount rate, Column 9)*
Annual Cash Distributions--Yearly	*$26,540*	*(Columns 1 and 7)*
Reserve for Replacemnt Payments (10 years)	*$16,084*	*(Column 4)*
Amortization	*See Appendix A6*	*(Column 2)*
Depreciation Deductions	*See Appendix A5*	*(Column 3)*
Distribution Conditions		
Sales Date	*After 21 years*	
Sales Price	*$3,311,363 (See Appendix A8)*	

Method of calculation:

First, cash flow (Column 1) is added to amortization (Column 2) for income. Then, depreciation (Column 3) and reserve (Column 4) are subtracted from income to produce taxable income (loss) (Column 5). In Column 6, half of the taxable income (loss) is taken as tax savings in most years as loss is greater than taxable income. In year 21, capital gains upon sale is taxed ($534,090.75--See Appenix A8). Cash dividend for each year is added to tax savings (Column 6 + Column 7 = Column 8). Benefits to the investor are shown in Column 8.

Assuming that the investor syndicates the equity, how much will limited partners invest to receive a 15% return over a period of 21 years? This is calculated by applying a discount factor (Column 9) to the benefits and summing these discounted yearly returns. The limited partners will be willing to contribute $697,687.90.

APPENDIX A7

INCOME TAX STATEMENT

YEAR	1 CASH FLOW	2 AMORTIZATION	3 DEPRECIATION	4 RESERVE	5 TAXABLE INCOME (LOSS)
1	0	0	$300,000	0	(300,000.00)
2	$26,540	$15,511.50	286,400	$16,084	(228,264.50)
3		16,752.40	263,488		(204,111.60)
4		18,092.60	242,408		(181,691.40)
5		19,540.00	223,016		(160,852.00)
6		21,103.20	205,174		(141,446.80)
7		22,791.50	188,760		(133,344.50)
8		24,614.80	173,660		(106,421.20)
9		26,584.00	159,767		(90,559.00)
10		28,710.70	146,985		(75,650.30)
11		31,007.60	135,226	(16,084)	(93,762.40)
12		33,488.20	124,408		(80,463.80)
13		36,167.20	114,456		(67,832.80)
14		39,060.60	105,299		(55,782.40)
15		42,185.50	96,875		(42,223.50)
16		45,560.30	89,125		(33,108.70)
17		49,205.10	81,995		(22,333.90)
18		53,141.50	75,435		(11,837.50)
19		57,392.80	69,401		(1,552.20)
20		61,984.30	63,848		8,592.30
21		66,943.00	58,740		18,659.00

APPENDIX A7

TAX BENEFITS

YEAR	6 TAX SAVINGS (COST)	7 CASH DIVIDEND	8 BENEFITS	9 DISCOUNT FACTOR(15%)	10 DISCOUNTED RETURN
1	$150,000	0	$150,000.00	1	$150,000.00
2	114,132.25	24,540	138,672.25	.87	120,644.90
3	102,055.80		126,595.80	.756	95,706.40
4	90,845.70		115,385.70	.658	75,723.80
5	80,426.00		104,966.00	.572	60,040.50
6	70,723.40		95,263.40	.497	47,345.90
7	61,672.25		86,212.25	.432	37,243,70
8	53,210.60		77,750.60	.376	29,234.20
9	45,479.50		69,819.50	.327	22,831.00
10	37,825.15		62,365,15	.284	17,711.70
11	46,881.20		71,421.20	.247	17,641.00
12	40,231.90		64,771.90	.215	13,925.90
13	33,916.40		58,456,40	.187	10,931.30
14	27,891.20		52,431.20	.163	8,546.30
15	21,116.75		45,656.75	.141	6,437.60
16	16,554.35		41,094.35	.123	5,054.60
17	11,166.95		35,706.95	.107	3,820.60
18	5,918.75		30,458.75	.093	2,832.60
19	776.10		25,316.10	.081	2,050.60
20	(4,296.15)		20,243.85	.070	1,417.00
21	(9,329.50)		(518,880.25)	.061	(31,651.70)
	(534,090.75)	Capital gains on sale			
			$1,991,468.35		$697.687.90

APPENDIX A8: Taxes Upon Sale

Ownership of the development is held in this example for 21 years. At that time it is assumed that the owner will sell the development for the balance of the amortization left on the mortgage. The sale is taxed at capital gains rate.

Method of calculation:

In order to determine the tax upon sale in the 21st year, it is necessary to determine the value of the property at that time. This is done by subtracting the total depreciation from the replacement cost of the development. First, however, the amount of depreciation that has been taken must be determined. This is done by subtracting the remaining depreciable balance (See Appendix A5,basis in the 21st year) from the original depreciable basis (See Appendix A5, Part I).

The value of the development is then subtracted from the sales price (balance of existing mortgage) to determine the gain upon sale. This is taxed at the capital gains rate for an investor in the 50% bracket:

Captial gains rate = 1/2 of ordinary tax rate = 1/2 x .50 = .25

I. Amount of Depreciation

Original Depreciable Basis	*$3,580,000*
Remaining Depreciable Balance	*(675,000)*
Amount of Depreciation	*2,905,000*

II. Value of the Development in 21st Year

Replacement Cost	*$4,080,000*
Amount of Depreciation	*(2,905,000)*
New Basis or Value	*$1,175,000*

III. Gain on Sale

Balance of Mortgage or Sales Price	*$3,311,363*
New Basis	*(1,175,000)*
Gain Upon Sale	*$2,136,363*

Captial gains Tax *.25 x $2,136,363 = $534,090.75*

APPENDIX A9: Distribution of Profits to Limited Partners

It is assumed that there are eleven limited partners; ten partners contribute about 8% of the contribution of the limited partners and one partner contributes about 18%. The general partners make a contribution of $188 but receive 10% of the annual profits and losses. Returns for Year 2 are shown:

Limited Dividend $26,540

Depreciation Deduction Year 2 $228,264

Limited Parnter	Contribution	% of Total L. P. Contr.	Share of Annual Profits & Loss	Share of Dividend Year 2	Depreciation Deduction	50% Bracket Tax Savings
A	$57,250	8.2%	7.3%	$1,937	$16,633	$8,332
B	57,250	8.2%	7.3%	1,937	16,663	8,332
C	57,250	8.2%	7.3%	1,937	16,663	8,332
D	57,250	8.2%	7.3%	1,937	16,663	8,332
E	57,250	8.2%	7.3%	1,937	16,663	8,332
F	57,250	8.2%	7.3%	1,937	16,663	8,332
G	57,250	8.2%	7.3%	1,937	16,663	8,332
H	57,250	8.2%	7.3%	1,937	16,663	8,332
I	57,250	8.2%	7.3%	1,937	16,663	8,332
J	57,250	8.2%	7.3%	1,937	16,663	8,332
K	125,000	17.9%	17%	4,512	38,805	19,403
Total	$697,500	100%	90%	$23,882	$205,435	$102,723
General Partner	$188		10%	$2,654	$22,826	$11,413

APPENDIX A10: Return from Syndication Proceeds

As the calculations in Appendix A7, Column 10 indicate, the investors who wish to participate in a limited partnership would pay close to $700,000 to receive a 15% reutrn on investment in the sample development. This is approximately 17% of replacement cost of the development. If the developer uses a four year installment plan, the internal rate of return on investment would be over 100%.

Method of Calculation:

Assuming that investors contributed $700,000 (this figure is a round-off of $697,688), then the developer would receive$175,000 per year for four years if the installment plan is used. Assuming that the equity actually invested is $59,000 (See Appendix A1), this equity would be subtracted from the first year's installment payment as the payment would be a return on capital.

With a developer in the 50% tax bracket the actual benefits received from the syndication proceeds would be half of the installment payment. Discounting the benefits received over the four years at 100% , the discounted return is still greater than the initial actual cash investment:

Year	*Payment to Sponsor*	*After Tax Benefits*	*Discount Factor*	*Benefits*
1	*$116,000*	*$58,000*	.50	$29,000
2	*175,000*	*87,500*	.23	20,125
3	*175,000*	*87,500*	.14	12,250
4	*175,000*	*87,500*	.06	5,250
		$320,500		66,625
				(59,000)
				7,625

APPENDIX B: Comparison of Methods of Depreciation

Year	Straight Line Depreciation	Cummulative	200% D.B. Depreciation	Cummulative
1	$20,000	$20,000	$40,000	$40,000
2	20,000	40,000	30,000	70,000
3	20,000	60,000	15,000	85,000
4	20,000	80,000	7,500	92,500
5	20,000	100,000	3,750	96,250

Year	150% D. B. Depreciation	Cummulative	Sum of the Years Digits	Cummulative
1	$30,000	$30,000	$33,000	$33,000
2	29,250	56,000	27,000	60,000
3	16,500	72,750	20,000	80,000
4	10,750	83,500	13,000	93,000
5	6,225	89,725	7,000	100,000

APPENDIX C: Interviews with Sponsors of Subsidized Housing

During the course of this study, a series of interviews was conducted with representatives of nine development firms with extensive involvement in subsidized housing both in Boston and elsewhere in Massachusetts. (Some also had been involved in the subsidized programs in other states in the Northeast). Eight of these were private, profit-oriented firms; the ninth was a non-profit consulting firm.

The questions posed in the open-ended interviews were intended to provide a basis for general commentary on the following five topics:

1) *Extent of developer's involvement in subsidized housing ove the last decade.*

2) *Experience with the development process.*

3) *Developer's reasons for investing in subsidized housing.*

4) *Financial difficulties in operation.*

5) *Problems in working with HUD and/or the Boston Rent Control Administration.*

The following is a summary of the developer responses:

All nine developers had a good deal of experience in working with the federally subsidized housing programs; most had become involved in the middle of the 1960's, with two of the developers having participated since those programs first began to be implemented in Boston in 1960. Eight of the nine worked with an identity-of-interest building firm; only one developer participated with an independent builder.

Six of the eight private developers stated that the tax shelter benefits obtainable under these programs provided the chief incentive for their investment in subsidized housing. One stated that the 6% limited dividend was the major incentive, but that his firm utilized the depreciation as a corporate tax shelter. The eighth said that he invested in the program because HUD asked him to participate in the BURP plan. Two of the first six firms also cited secondary reasons for investment, these being profit potential in related housing services and a desire to further social progress in the housing field.

All developers agreed that on the whole, HUD processsing of the various steps associated with the development process was extremely slow. Some felt that this was because of inefficientcy at the HUD area office; an equal number felt that the office was efficient, but that the complexity of the development process was such that faster action would be unreasonable to expect.

Eight out of the nine stated that they had encountered long time lages in getting rent increases for their projects approve by HUD. Estimates of time elapse between application for an increase and final approval indicated an average of seven to nine months in the period before the moratorium on new construction, some delays being shorter and some being exceptionally long. (One developer cited a case where he had to wait thirteen months for approval of an increase.) All agreed that HUD processsing of increases had become much speedier since the moratorium, dropping to around two or three months.

All developers agreeed that slowness in HUD processsing during development and operation of projects was in large part responsible for costly delays, both during construction and after final closing, in the latter case seriously hampering developers trying to make up deficiencies in operating costs with new rent increases. Developers were also unanimous in feeling that the basic financial stability of the subsidized projects was greatly compromised because of unrealistically low HUD limits on projected operation costs. Since

these were built into the initial applications for building multifamily projects, it was felt that developers were therby forced to underestimate operating costs just in order for proposals to be considred feasible.

Most agreed that the presence of rent control in subsidized housing added to processsing delays and therby aggravated financial difficulties caused by skyrocketing costs.

Half of the developers mentioned the city of Boston's tax formula as an additional secondary factor causing financial difficulty. Until 1972, the city had agreed to take 15% of gross annual income in lieu of the assessment under normal procedures. However, in 1972, the city raised this percentage to 17% for all subsidizied developments, including those in operation and those under construction at that time, a move which contributed further to operating imbalance in the Boston projects.

Seven out of the nine indicated that the class of occupants of these developemtns also contributed somewhat to higher maintenance costs than those of conventional housing.

All of the developers interviewed estimated a time lag of six to eight weeks in the processing of rent increase applications by the Boston Rent Control Board (a figure confirmed by officials in the Rent Control Administration); beyond that, perceptions of the Rent Board's role differed radically. Three out of eight (one developer had no experience with rent control hearings) felt that the Rent Board was unduly biased towards the tenants as a matter of political expediency ("they'd never grant an increase before an election.") The other five felt that the Rnet Board was doing a fair job, given the nature of the circumstances under which the Board was operating. Three developers felt that the Rent Board's policy of denying increases to developments with building code violations was both unrealistic and damaging to the financial stability of those developments. They suggested that the Rent Board instead grant requests for the increase and reserve the accruing extra funds to remedy all such violations.

In response to the key question of whether they would consider new investment in FHA subsidized housing in Boston, assuming that the moratorium on new subsidized construction was lifted and rent control retained, developers agina expressed mixed responses. Although most thought that rent control would be a negative factor affecting their decision to invest in the program again, five indicated that they would continue to invest if the subsidized programs were restored. One developer stated that his firm would not invest in Boston again as long as rent control was in effect there; the remaining three said that they would not invest in any type of real estate whatsoever, whether or not the programs were restored. They expressed various degress of dissatisfaction with the general financial climate, HUD's role in the programs and the existenace of rent control as the major factors influencing their decision.