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CASE STUDIES OF THE SECTION 510  
HOMEOWNERSHIP OPPORTUNITIES  
DEMONSTRATION



Contract Number 202C-0034

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DEMONSTRATION

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## Chapter 1

### THE 510 DEMONSTRATION IN BUFFALO, NEW YORK

Buffalo's 510 Demonstration is producing 113 units of elderly housing with Section 8 rental assistance and 35 condominium units under the homeownership component. The Section 8 project is proceeding according to schedule. The ownership component is also proceeding with completion expected in early 1984. At this point, the condominium building has been gutted, new electric and plumbing installed, and three model units have been constructed. Following presale of seven units (expected to occur in June, 1983) the construction loan will be activated and the remaining units will be finished. The average sales price for the units is \$59,000, and all end loans are assumed to be conventional.

In reviewing the implementation of the Demonstration in Buffalo, two aspects of the program merit attention. First, the program is producing extremely attractive and high quality units. The ownership site is an historic structure located in a neighborhood that has seen considerable new investment and preservation activity over the last decade. The program is geared towards moderate-income professionals.

Second, the Special Purpose Organization created by the Demonstration appears to work extremely well. The three parties which comprise the SPO (the City is a voting member of the SPO board) have established good working relationships and participate in the project as a team. The result is a "working SPO", faithful to the original 510 Demonstration design.

## 1.1 The Neighborhood Setting

The site of Buffalo's 510 Demonstration is the Allentown neighborhood. Located one-half mile, or five minutes walk, from the downtown business district, Allentown is a predominantly residential neighborhood with steadily rising property values. As one of the few neighborhoods which is attracting families back into the city, the revitalization of Allentown is an important component in the city's greater downtown redevelopment strategy.

Much of Allentown's charm is due to its architectural character and successful efforts on the part of local preservationist groups. The neighborhood is a local and state historic district and most of its structures are listed on the National Register of Historic Places. These include a large number of wood-frame Victorian houses, the majority built between 1840 and 1870. Because of Allentown's historic character, as well as its proximity to commercial and other amenities, the area became a prime target for gentrification, beginning in the early 1970s. Since that time, substantial numbers of properties have been purchased and rehabilitated. As a result of this influx of private and commercial capital, the area now shows definite signs of economic strength.

While Allentown is increasingly capable of attracting private investment, the neighborhood has also benefited from substantial city investment. In 1979 the more deteriorated, southwest portion of the neighborhood was designated a CDBG Neighborhood Strategy Area. Funding for public improvements, rehab grants, and 312 loan money, coupled with a systematic exterior inspection program, helped to stabilize this portion of the neighborhood and increase ownership rates. Since 1979, approximately three quarters of a million dollars in CDBG funds have been used to this end.

Despite the fact that Allentown appears to be flourishing, the area is still considered to be transitional. While many of the area's smaller buildings which had been converted into multiple dwellings are now being converted back to single and two family

homes, the larger multi-unit apartments remain vacant.<sup>1</sup> In selecting the Allentown neighborhood for the 510 Demonstration, the City hopes to encourage rehabilitation of these structures to support and serve its downtown revitalization program. The City also hopes to preserve and broaden housing opportunities for the area's low and moderate income residents who comprise about one-half of the total neighborhood population.

## 1.2 The Sponsors

The three participants in the Buffalo 510 Demonstration are the City of Buffalo's Department of Community Development, the M.J. Peterson Sales company (developer) and the Allentown Association (community sponsor). The special purpose organization created for the Demonstration is incorporated as the Allentown Opportunities Corporation and is composed of a representative of each of the above-named entities. Buffalo's application to the 510 Demonstration was prepared jointly by the three sponsors.

Administration of the Demonstration is the responsibility of the Division of Neighborhood Revitalization within the Department of Community Development. Prior activities of the Division have included administration of the 312 loan program, a \$3.2 million interest subsidy program, demolition of dilapidated structures, a housing rehab grant program, urban homesteading, concentrated code enforcement, and neighborhood commercial programs. The Division is currently operating a new program which entails the construction of 90 units of turnkey infill housing which will be resold by the city to low- and moderate-income owners at written down prices.

In general, the City appears to be quite committed to the 510 Demonstration and has provided approximately \$400,000 in CDBG funds to the homeownership component. At the same time, however, it

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<sup>1</sup>In 1980 a total of 461 of the neighborhoods 2786 housing units were vacant. See generally: Buffalo 510 Application, Feb 1981.

should be emphasized that the City's current priorities focus on downtown and waterfront revitalization, including the construction of a light rail rapid transit line along the Main Street corridor. The 510 Demonstration is seen as another component in the redevelopment of the greater downtown area and an important element in attracting families back to the City.

The developer selected for the Demonstration is the M.J. Peterson Sales Corp., established in 1958 as the real estate brokerage arm of the M.J. Peterson Co. The experience of the Peterson companies includes development, construction, and management of single-family and commercial properties throughout western New York, including some 2,800 units of Section 236 and Section 8 housing as well as new construction, luxury condominiums. The company was selected for the Demonstration on the basis of its experience, reputation, and Buffalo location. Mr. Dennis Penman, a vice-president of the firm, represents the company's interests in the 510 Demonstration. He has been active in a number of planning and development projects for the City and is currently constructing 90 units of infill housing which will be sold to the City on a turnkey basis.

Finally, the community sponsor chosen for the Demonstration is the Allentown Association, a 20 year-old, non-profit organization dedicated to the stabilization and preservation of the historic Allentown neighborhood. The Association has over 300 members, and an active board of directors composed of 24 persons. The organization is primarily volunteer; current staff positions include an executive director and a secretary.

The Allentown Association's activities are broad, ranging from historic preservation work to organizing a community center and producing a quarterly newsletter. The Association's housing-related experience includes administering a code inspection program for Allentown and a CDBG rehab loan program. The organization also manages a facade improvement program and a commercial loan program. The Allentown Association was considered to be the only experienced

community organization in Buffalo capable of undertaking the 510 Demonstration.

## 1.2 The SPO

Buffalo is one of the few 510 Expansion sites which can boast a "working SPO." The SPO Board is composed of three voting members: Dennis Penman (of Peterson Sales), the Director of the City's Division of Housing Revitalization,<sup>1</sup> and a Board member from the Allentown Association. The City's vote on the Board was intended to be used as a tie-breaker. Although it was acknowledged that the City carries substantial weight in the Demonstration, most decisions appear to be made with the agreement of all parties.

The relationships among the SPO Board members appear to be extremely cordial and comfortable. As the community representative put it, the relationships are professional, rather than personal: all parties focus their attention on the common goal of producing a good project. Although SPO members acknowledged a certain amount of tension and "politics" at the beginning of the Demonstration, they have developed into an excellent working partnership. A number of reasons come to mind.

First, there appears to be a healthy division of labor on the SPO board. While the members meet weekly and work in concert, each has his or her own "sphere of interest." The community representative, for example, is most concerned with issues related to the exterior restoration of the condo project. The Association's position upon entering the Demonstration was that 1) the project

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<sup>1</sup>The Director, Susan O'Connor has recently left City employment. This appears to have produced considerable confusion among City staff, since O'Connor had handled the demonstration virtually alone. It was stated that the Commissioner of the Community Development Department would take her place on the SPO board. However, the new Housing Director sat in at the last SPO meeting.

should comply with historic code and preservation principles and 2) the community should have control over the tenant mix and number of units. In fact the community group helped push for a revised architectural plan that provided for a smaller number of larger and generally more attractive units. The organization also initiated an effort to purchase a triangle of city land between the two streets bordering the project. This area will be used for parking and as greenspace, consistent with Buffalo's master greening plan.

The City's interest in the project is primarily administrative and financial. City representatives focused on such issues as ensuring that federal regulations and requirements were adhered to and that all program funds were accounted for. The City--in the person of the former Director of Community Development--was also responsible for the decision that the developer should not participate in the project as the contractor for the condo project. It was felt that this would produce a conflict of interest and could lead to controversy over the costs of construction.

Finally, the developer has taken responsibility for all construction and development related activities. His advice appears to have been well taken and his opinions are respected by the other SPO members, primarily because of his reputation for producing high quality projects. Though it was suggested that Penman was disappointed to be precluded from bidding on the ownership component, he seems to be satisfied with his current role. Moreover, although he receives no compensation for his services, he also appears to have been extremely generous with his time commitment to the ownership project.

In general, much of the success of the SPO in Buffalo has to be attributed to the personalities of the SPO board members, their civic orientation, and the maturity with which they have approached the Demonstration. While there have been areas of disagreement, the overriding concern has been to complete project. As an example, the community representative expressed some disappointment about the

amount and intended use of the syndication proceeds.<sup>1</sup>

Nevertheless, the organization believes that to pursue the issue would hold up the development. For his part, the developer tends to view the Demonstration as a learning experience, particularly with respect to the historic rehab aspect of the program. As a result of the project he has become genuinely interested in the Allentown neighborhood and has indicated a willingness to pursue other Allentown projects without subsidy. The community representative, who had not worked with Penman prior to 510, echoed her willingness to undertake another joint project.

In addition to the three SPO partners, several other organizations and individuals are participating in the Demonstration. These include among others a training consultant and a real estate firm which will handle the marketing of the ownership units. Both have been very involved in the last few months, and consider themselves part of the project team.

Finally, the work of the Buffalo SPO has been facilitated by the early hiring of a SPO coordinator, whose role is to facilitate communications, handle program paperwork, and deal with various administrative aspects of the Demonstration. This individual is physically located in City Hall. Several participants indicated that the Demonstration has required a considerable amount of coordination among City departments. The presence of the SPO staff person at City Hall has thus been quite helpful in promoting the smooth operation of the Demonstration.

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<sup>1</sup>The syndication proceeds dedicated to the ownership component come to \$180,000 or about 3 percent of the current Section 8 mortgage amount. The first year's installment (\$45,000) will be used to writedown the condo fee. The community representative suggested that the amount should be renegotiated, based on a higher Section 8 mortgage, and that she would have wished all funds to be used for a reserve account to cover exterior maintenance and repairs.

### 1.3 Ownership Component

The building being developed for the homeownership component of the Demonstration is a designated historic structure which originally housed a school for the deaf (1863 to 1899) and was subsequently converted to apartments. The four-story brick building, which has been vacant for the last five to six years, had been the object of several prior rehabilitation attempts. At the time of its purchase for the Demonstration, the building had been heavily vandalized. Plumbing had been removed or disconnected and electric lines were broken or ripped from the walls. The building's roof was in bad condition and there was some water damage. The choice of this site for the Demonstration was largely made by the Allentown Association which, as one participant put it, had been watching the structure crumble before its eyes. The building is located at the southern tip of the neighborhood and is generally considered to be a good choice because of its visibility and because it is located close to areas which have already been renovated.

The original plan for the structure was to create 45 new units. The proposed unit count was consequently revised downward to 35 units of between 652 and 1,242 square feet. The current design calls for three one-bedroom units, 24 two-bedrooms, 7 two-bedroom duplexes, and a two-bedroom townhouse with fireplace. None of the units is alike in floor plan, and most incorporate an open-plan design. To date, the building has been cleaned and gutted, plumbing, wiring, and a new roof have been installed and three model units have been constructed. Both the quality of design and workmanship appear to be superior.

Financing for the ownership units is being provided by a \$1.2 million construction loan from a Buffalo bank and a \$400,000 contribution of city CDBG funds. Originally the CDBG funds were issued as a loan, to be covered by the construction financing and returned to the project for use as mortgage writedown funds. However, during the filing of the condo prospectus (submitted April

16, 1983) it became necessary to forgive the loan and treat the funds as a construction writedown. The \$400,000 is now exhausted, having been used as follows: acquisition, \$90,852; architectural plans and drawings, \$71,000; construction of three units, \$238,000; purchase of the triangle, \$8,000.

While there is little concern about the ultimate success of the ownership component, the project does appear to show a "mortgage gap" of about \$350,000. At the time of the site visit, the City had prepared an application for UDAG funds in this amount. The proposal was not submitted, however, since it was decided that federal requirements associated with the grant (e.g. Davis Bacon) would push project costs above budget. As an alternative, the bank may be persuaded to increase its construction loan. The City, however, has adopted the position that no additional CD funds will be used. Explanations of the cause of the gap include the revised architectural plans and costs associated with historic rehab, such as the need for custom window work, more expensive exterior treatments, etc. A number of participants noted that securing approvals from the State Preservation Commission has been the most difficult aspect of the project.

At the time of the site visit the specifics of permanent financing had still not been finalized. The construction lender had committed to providing permanent mortgages contingent on presale of seven units. However, it was unclear whether all financing would be conventional or whether bond-financed mortgages through SONYMA would be available for qualifying buyers. The participants were also somewhat unclear about whether any income limits or resale restrictions would be imposed. It appears at this point that the only limitation on purchase will be that buyers actually reside in their units. No resale restrictions will be applied.

Marketing of the units is being handled by a local real estate investment firm with substantial experience in the condominium market. As noted above, seven units must be pre-sold before the construction loan can be used. So far, approximately sixty expressions of interest have been received. Sales, on a first-come

first-served basis, will be officially opened at a reception and cocktail party scheduled for June 10, 1983.

Sales prices for the units range from \$40,000 for one-bedroom units up to \$86,300 for the two-bedroom townhouse. The average price of a standard two-bedroom unit is about \$55,000, though each unit is priced individually according to its features. This requires that the prospective purchasers make at least \$25,000 per year. A market study conducted early on in the Demonstration showed strong demand for this type and price of housing, primarily among starting professionals and young couples of moderate income. Purchasers will benefit from the \$400,000 construction writedown and the use of one installment of syndication proceeds (\$45,000) to write down the first year's condo fees. The use of subsequent syndication installments will be up to the condo association. Total syndication proceeds will be \$180,000, which is 3 percent of the current Section 8 mortgage amount.

Training for purchasers will be conducted by a qualified training consultant under contract to the SPO. Once most of the units are sold, the consultant will prepare a building specific booklet containing relevant documents and procedures and conduct workshops, probably with the assistance of other local experts. Some follow-up will be required if there are late subscribers. However, all participants and observers consider the condo units to be highly marketable, in fact an exceptional opportunity. The units are expected to sell quickly and experience very little turnover.

At this point in the Demonstration, the marketing phase has just begun. It is hoped that construction of the remaining units can begin quickly, with the total construction period estimated at about nine months.

#### 1.4 Section 8 Component

The Section 8 building selected for the Demonstration is located on Main Street, at the edge of the Allentown neighborhood built in 1914 as a hotel. The Roosevelt is a seven-story structure with marble facade and brick underlay. Converted into 129 apartments during the thirties, the structure eventually fell into

the City's hands through tax foreclosure. At the time of the Demonstration, the City's Urban Renewal Agency was in the process of seeking bids for the building's rehabilitation. Penman's proposal was selected, based in large part on his participation in the 510 Demonstration. The building will be converted into 113 large one-bedroom units and will contain commercial space on the first floor.

According to all descriptions, the Roosevelt was in poor shape at the outset of the Demonstration. Since the original proposal, construction costs have risen, due primarily to historic code requirements, the need to replace large sections of water damaged flooring, and the need to resupport sections of the interior court to meet seismic standards. The current mortgage amount is \$5.8 million. Both permanent and construction financing are being provided by the state housing finance authority at 11-7/8 percent and 13 percent, respectively. The project is HUD-insured; FAF was received.

Despite upward revisions of the mortgage amount, the Section 8 project is proceeding on schedule. Construction is underway and is expected to be complete by the end of the year. The only issue surrounding the development appears to have been its original designation as 100 percent elderly housing. Buffalo's performance in producing family units was apparently challenged by HUD's area office. However, both the City and the developer insisted on elderly units and eventually won HUD's approval. As several parties pointed out, the building is well suited to elderly occupancy, particularly in view of its proximity to the soon to be completed light rail rapid transit line. It was also noted that many of the larger homes in the neighborhood are currently occupied by low- and moderate-income elderly owners. It is hoped that the availability of alternative housing may induce these owners to relinquish their properties to younger buyers who will then restore them.

#### 1.5 Demonstration Problems/Issues

The Buffalo 510 project has not suffered from any major

problems, and in fact appears to be operating quite successfully. As noted earlier, the presence of a mortgage gap is a potential problem, but the sponsors are confident that a solution can be found. Although the ownership component is slightly behind schedule, the sponsors expect to begin marketing units in June 1983. If seven units can be presold at this time, construction can begin on the remaining 32 units, which, assuming a 9-month construction period, would push the project completion date into early 1984.

With respect to the original objectives of the Demonstration (as shown in the City's application) it should be noted that there has been a reduction in the number of units and an increase in the costs. Original development costs were estimated at \$1,356,000 or about \$30,000 per unit. Changes in the number of units as well as unit design have led to a revised development cost budget of \$2,062,000 or about \$59,000 per unit. By the same token, the application suggested that CDBG funds would be used both as an interest free loan during construction and as equity loans to help reduce the costs of selected units. (These funds would be recaptured on resale.) The result of this proposal was that almost all units would be affordable to persons making between \$900 and \$1,300 per month, with monthly housing expenses (excluding utilities) between \$300 and \$433.

As the program has evolved, this preliminary financing plan has changed substantially, though without apparent controversy. At this point, the construction loan has been converted into a construction grant with no additional writedown proposed. Looking at the least expensive one-bedroom unit, monthly expenses are estimated at \$507/mo.<sup>1</sup> Based on 28 percent of gross income (assuming no

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<sup>1</sup>We calculated this amount by assuming an 80 percent mortgage at 12 percent on a sales price of \$40,000. This results in monthly interest and principal payments of \$337. Condo fees will be \$70/mo. during the first year and taxes are assumed to be \$100/mo.

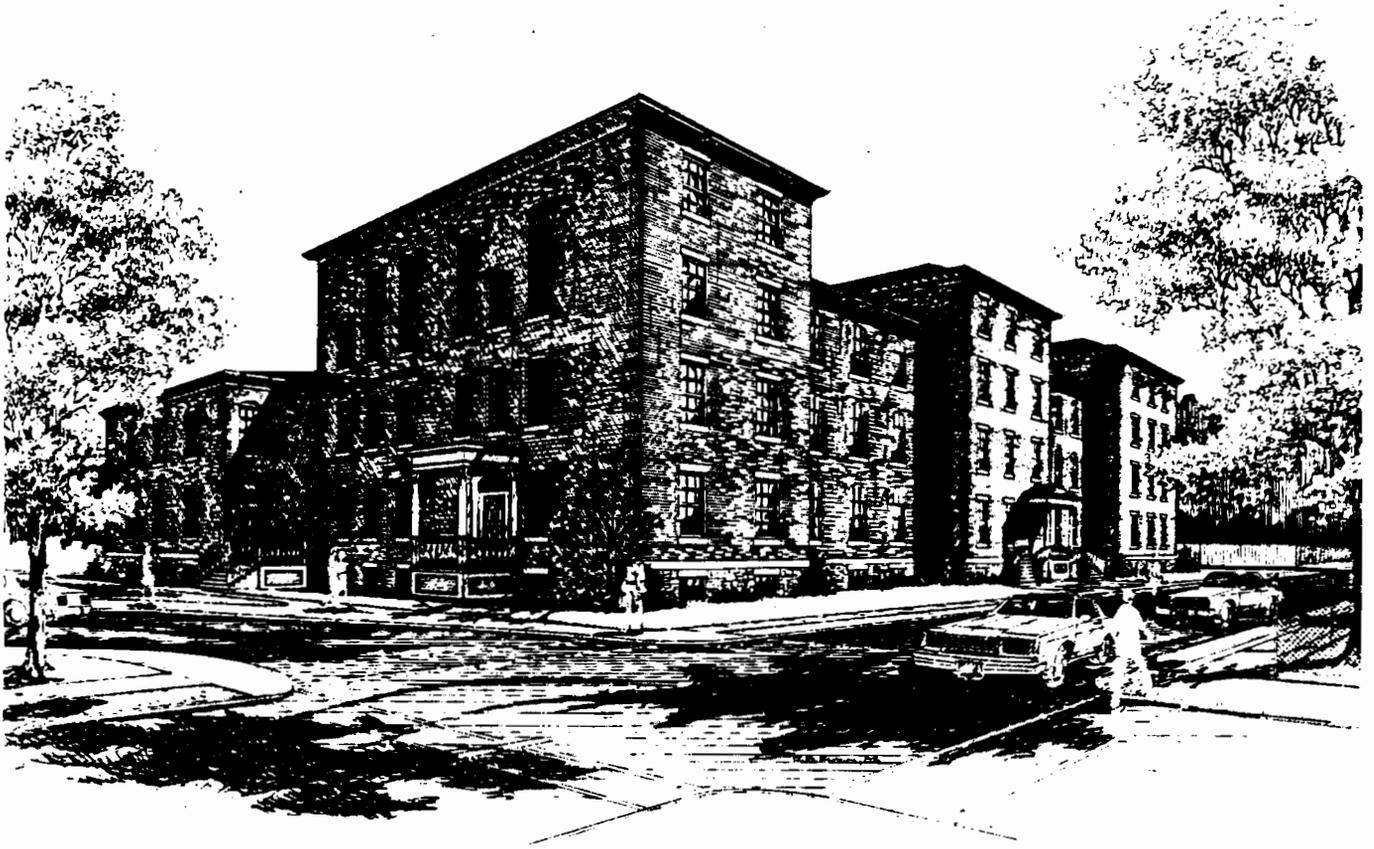
other debts), the buyer would have to have an annual income of over \$21,000 or \$1,800 per month. For the "average" unit (at \$59,000) the buyer would require an income of close to \$30,000. Unless SONYMA bond-financed mortgages are used, there will be no limitations on the purchaser's income.

Despite these changes, the sponsors believe that they have produced an extremely attractive project at relatively low cost. The units are designed to appeal to moderate-income, starting professionals and young couples and, based on all indications, should be very marketable.

Issues for the upcoming quarter will include filling the "mortgage gap" and working out final arrangement for permanent financing (i.e. Will bond-financed mortgages be available or will all end loans be conventional?). At the same time it should be noted that construction has not begun on the remaining 33 units. However, given that all building systems are in place and three model units have been finished, it is unlikely that any unforeseen construction problems will jeopardize the project budget. One issue may arise, however, concerning the sponsors' plans to phase occupancy and use the proceeds of each sale to help cover construction costs. There is some concern that initial occupancy may not be permitted until all 35 units have been completed.

510 DEMONSTRATION PROJECT

BUFFALO, NEW YORK



Historic Rehab Condominium Project

## Chapter 2

### THE 510 DEMONSTRATION IN CHICAGO

To date, the Chicago 510 program has been the least successful of all the Demonstration sites. Two years after the program started, the sponsors have yet to acquire the properties that will be converted to condominium apartments. The Section 8 proposal was submitted for HUD processing just two months ago. Finally, the SPO does not appear to be an effective organization for conducting the development of the homeownership project.

There are a variety of reasons why the Chicago project has been unsuccessful. Among them, the City chose a very deteriorated neighborhood -- South Austin -- in which to conduct the Demonstration. The quality of multi-family buildings in South Austin is very poor and many properties are tax delinquent and thus expensive to acquire.

In addition, the original developer dropped out of the program a year after the Demonstration started. When the current developer was selected, new agreements had to be negotiated. Underlying these problems is a lack of strong administrative direction to the program. Neither the City nor the developer appear to be strongly committed to the development of the homeownership component, in part because they question the marketability of condominium units in the South Austin neighborhood. The community sponsor is anxious for the project to succeed, but does not have the expertise to implement the project without extensive assistance from the developer.

The discussion that follows focuses in detail on the characteristics of the Chicago 510 program, the neighborhood and program sponsors, as well as the problems that the Chicago sponsors

have faced and the likelihood that the project will be implemented.

## 2.1 The Austin Neighborhood

The community of Austin is located in Chicago's West Side, approximately five miles from the center city. Austin was first settled in the 1860's with the advent of the railroad industry in this part of the City. Employment opportunities at nearby railroad yards and the attractiveness of this residential community fueled Austin's growth in the late 19th and early 20th centuries. The population of the neighborhood, which was over 4,000 by 1890, reached 131,000 by 1930. The population was relatively stable between 1930 and 1960 -- many residents were blue collar workers of Italian descent.

Today, the residential make-up of Austin is very different from what it was 25 years ago. The southern portion of the neighborhood, which is the target area for the 510 Demonstration, is composed primarily of young black households, many with children. The current population of South Austin is approximately 58,000. Approximately 74 percent of residents receive some form of public assistance.

South Austin remains a primarily residential community, despite the fact that large-scale property demolition occurred in the late 1970's.<sup>1</sup> The existing stock, approximately 26,000 units, is mostly renter-occupied. About 14 percent of all units are in structures that contain at least ten units. According to a City survey, larger multi-family buildings in the area are in greatest need of repair. Overall, the City estimates that approximately 20 percent of all structures in South Austin are in need of major repair; another 10 percent are dilapidated or abandoned.

Generally, 510 program participants are not overly optimistic

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<sup>1</sup>According to Chicago's proposal, approximately 1,534 units were demolished between 1975 and 1978 or 5.7 percent of the housing stock.

about South Austin. The neighborhood was described as deteriorated with little chance of improving in the near future. In fact, South Austin was not the first choice of the City's Housing Department for the 510 program because of neighborhood conditions.<sup>1</sup> The City's 510 program director noted that there has been little private investment in the neighborhood; on the contrary, a large number of properties are currently in tax arrears. Public investment has also been minimal. A Section 8 project is currently under construction; but expenditures of other funds, particularly Block Grant money, have been minimal.

Perhaps the one hope for South Austin is that it lies adjacent to a very attractive and popular community known as Oak Park. One respondent noted that the residents of Oak Park have a vested interest in seeing conditions in Austin improve. However, it will require more than the interest of these neighbors and probably more resources than the 510 Demonstration can provide to foster extensive improvements in this neighborhood.

## 2.2 The Chicago Sponsors

The three sponsors of the Chicago 510 Demonstration -- the City, the developer, and the community group -- are all participants in the SPO. In this section, the expertise of each sponsor and how they became involved in the program are described. In the next section, the operation of the SPO is discussed.

The City of Chicago's Department of Housing is the local government agency responsible for the administration of the Demonstration. At the time the IFCAA for the 510 Demonstration was issued, the City was exploring the concept of leveraging syndication proceeds from developers. The 510 Demonstration presented a good opportunity to test this idea and to acquire some additional Section

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<sup>1</sup>As will be seen shortly, the Housing Department wanted to conduct the 510 Demonstration in a neighborhood that was undergoing substantial revitalization as a result of both public and private investment.

opportunity to test this idea and to acquire some additional Section 8 units.

In its application to HUD, the City proposed to conduct the 510 Demonstration in two very different neighborhoods--the South Austin neighborhood just described, and another community, known as South Shore, which is undergoing revitalization. For a variety of reasons, HUD requested that the City select one community in which to conduct the 510 Demonstration. The Mayor of Chicago chose South Austin.

The selection of the community groups was part of the overall process of neighborhood selection.<sup>1</sup> There are two non-profit organizations that operate in South Austin, the South Austin Realty Association (SARA) and the South Austin Coalition Community Council (SACCC). The City proposed initially to involve both groups in the Demonstration. Both organizations had some housing-related experience prior to the start of the Demonstration, although SARA's mandate specifically concerns the improvement of housing conditions in the neighborhood. Since it was formed in 1970, SARA has coordinated block clubs and other civic organizations in order to upgrade housing in the neighborhood. SARA's other major activity is the management of multi-family properties under receivership.

SACCC's mandate is somewhat broader--to solve community problems. SACCC has worked to organize residents around selected neighborhood issues, such as redlining. Although SACCC and SARA had worked together on other projects, neither had substantial experience in housing development or rehabilitation. It should be noted that a year after the program started, SACCC dropped out

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<sup>1</sup>The Chicago proposal states that "the South Austin Community was selected because it not only fits the 510 Demonstration criteria, but organizations in the neighborhood experienced strong interest in the program...". In reality, the decision to choose South Austin appears to have been politically-motivated; a close friend of the Mayor's lobbied to have this neighborhood chosen.

leaving SARA as the sole community group with responsibility for the Demonstration and a single vote in the SPO.<sup>1</sup>

The developer-sponsor also changed after the Demonstration began. The original sponsor proposed by the City was a Boston developer, Housing Dynamics, that had been selected, according to the proposal, by SACCC and SARA.<sup>2</sup> This firm had significant experience in subsidized housing development but had not worked in the State of Illinois previously.

While Housing Dynamics went through the formalities of forming a SPO with SACCC and SARA, the firm never made a serious attempt to develop a Section 8 proposal. A year after the program started, they indicated that the project was too small to be of any interest and dropped out. They were replaced by a local development company, Burnham Development, who at the time was constructing an elderly Section 8 project in South Austin. Because of their involvement in the neighborhood, the firm was aware of problems with the 510 project. A principal of Burnham approached the City about taking over the project.

Prior to the South Austin projects, Burnham had constructed two other Section 8 projects and had built market-rate housing. The company has also developed some relatively large office complexes in the Chicago area. Thus, Burnham could lend to the 510 project a substantial amount of expertise in addition to the presence of a local developer that the program had lacked thus far.

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<sup>1</sup>SACCC dropped out following the selection of the second developer, Burnham Development. At the time, they had a disagreement with Burnham about a building that Burnham wanted to demolish in South Austin.

<sup>2</sup>According to the City's program administrator, Housing Dynamics was brought in by a friend of the Mayor who was also working with SARA and SACCC--the same friend who had successfully lobbied to have South Austin declared the target neighborhood for the Demonstration.

### 2.3 The South Austin Housing Corporation

In March 1982, after the original SPO was dissolved, SARA, Burnham Development and the Department of Housing formed the South Austin Housing Corporation (SAHCORP). Under the agreement reached by these parties, Burnham was assigned responsibility for the development of both the Section 8 and homeownership projects. In the case of the homeownership development, Burnham was to select and acquire the buildings, arrange financing, supervise the construction, manage the buildings until a condominium association could be formed, and implement a marketing and sales program. The joint responsibilities of the sponsors (the SPO) included: identifying properties suitable for the program; managing and disbursing the HUD Demonstration grant; training the tenants; developing tenant profiles; developing a resale policy; reviewing work performed by architects and contractors; assisting with the relocation of the tenants; and acting as a liaison with the community. The SPO agreement documents gave SARA no explicit responsibilities, while the City was specifically required to pay for all relocation costs, in addition to providing CDBG funds for the Section 8 and homeownership projects.

The contents of the SPO agreement clearly suggest that the sponsors in Chicago did not understand or were not interested in carrying out the SPO model as had been envisioned by HUD. The Invitation for Cooperative Agreement Applications (IFCAA) issued by HUD stated that the SPO was to be a partnership between a community group and developer that would have responsibility for acquiring the properties, preparing and managing the rehabilitation, obtaining financing, etc. The role of the City as a partner in the SPO was never envisioned by HUD, since the purpose of the SPO was to reduce the level of City resources necessary to carry out the program. Furthermore, HUD intended that the developer and community group would share in the responsibilities of development. While it was understood that the developer might take the lead in acquiring

financing or that the community group might assume primary responsibility for tenant training, it was expected that the partners would share equally in development responsibilities.

The agreement reached by the sponsors in Chicago accurately reflects the relative power wielded by various participants in the Demonstration and how the SPO operates. Decisions about the homeownership program are not made jointly by the sponsors. To some extent the lack of decision-making at the SPO level is a result of the lack of progress of the homeownership component--i.e., there have not been many decisions to make. Nevertheless, when decisions are required they are generally made by the developer who, as the SPO agreement states, is responsible for development of the homeownership component. The developer-sponsor admits that SARA's involvement has been minimal, but defends that he will be ultimately liable for the project and consequently should be making the decisions.

Thus, for all intensive purposes, SAHCORP is not a functioning entity. Its principals meet rarely. One result of this, as we discovered during our interviews, is that the sponsors have very different ideas as to how the homeownership project will develop. For example, the City and the community group representatives stated that existing tenants would probably not buy their apartments after they are rehabilitated. The developer indicated, however, that the tenants would be relocated temporarily and moved back in, simply because it would be difficult to sell these units otherwise.

No one we spoke with, except perhaps SAHCORP's project director, a former community organizer, viewed the SPO with much enthusiasm. The developer described the community group as a "highly splintered" organization which had contributed little to the project. He was also somewhat critical of the City, and indicated a reluctance to participate in a City program again. The City staff suggested that SARA was inexperienced and that it was necessary to watch the developer closely. The SPO's project director is frustrated because he feels the City and the developer are leaving the community out of the decision-making process. At the same time,

he recognizes that the SPO is a vehicle through which the community can gain valuable development experience. He is hopeful that this learning process will begin before too long.

#### 2.4 The Ownership Project

Chicago is far behind any of the other Demonstration cities in implementing the 510 program. Approximately two years after the Demonstration started, the sponsors have yet to acquire properties for the homeownership component. Consequently, the discussion presented is primarily a description of what the City proposed to do and why the City and private sponsors have not been able to implement the ownership program.

In their application to HUD, the City indicated that 75 condominium units would be produced under the 510 Demonstration.<sup>1</sup> The City chose a condominium development rather than a cooperative because Chicago had had little experience with cooperative ownership. They were particularly concerned that private lenders would be reluctant to finance a co-op project.

At the time of the application, the City had not selected buildings in which condominium units would be developed. Instead, they identified 29 properties (containing 1,010 units) from which the homeownership buildings would be selected. According to the proposal, most of these were vacant, multi-family properties (averaging 24 units per property) with a mix of one-, two-, and three-bedroom units. The City indicated that actual selection of the properties would be based on two factors. First, moderately-sized buildings containing 16 to 18 units would be given preference because they were thought to be more marketable. Second, buildings that could be acquired at lower cost or that required less extensive rehab would be preferred so that the units would be

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<sup>1</sup>In the City/HUD agreement documents, the City changed the number of units to be produced to 50.

affordable to low-income families.

Based on a City-estimated rehabilitation cost of \$19,600 for a one-bedroom unit, the cost to the buyer (after CDBG write-downs) would range from \$8,700 for a one-bedroom unit to \$18,600 for a three-bedroom unit. The proposal indicated that these prices would be affordable to low-income and moderate-income residents of the South Austin area.

As stated in the proposal, financing for the condominium rehabilitation would be secured from a private lending institution and supplemented with CDBG funds. Later documents show that the City also planned to secure low-interest mortgages for qualified buyers under the 235 program. Through this program interest rates on private loans would be subsidized down to a base level of 6 3/4 percent. According to a City/HUD agreement dated September 1981, rehabilitation of the condominium project would begin in July 1982 and end in March 1983. (Construction of the rental project was to lag approximately three months behind the condominium project.) Unit sales were to be completed by July 1983.

Unfortunately, little of what was proposed by the City has been carried out to date. As of June 1983, the SPO is still in the process of acquiring buildings for the homeownership component, a process which is expected to be completed by July.

There are a number of reasons why this project is so far behind those in other cities. First, program participants point to the fact that the original developer lost interest in the program and finally dropped out in January 1982. The City brought in Burnham Development soon thereafter, but the overall progress of the program was delayed while new agreements were negotiated and a new SPO was formed. Second, the sponsors have had major problems with property acquisition. Most of the properties that were on the list originally submitted to HUD were privately owned and in tax arrears. Since taxes are collected by Cook County rather than by the City, the City could obtain the properties only through negotiations with the landlords (and paying the back taxes) or by waiting for Cook County to hold a scavenger sale. The sponsors

attempted to negotiate with landlords but were unable to find buildings that could be obtained at a reasonable price. After two years of inactivity, the County finally decided to hold a scavenger sale in May 1983. The sponsors are now hopeful that they will be able to complete property acquisition in the next few months.

A third reason why the homeownership project has not moved forward is that both the developer and the City believe that the development of the condominium project should be delayed until the Section 8 project is approved by HUD. The linkage of these two projects is critical because of the dedication of syndication proceeds. Also, from the developer's perspective, the Section 8 is the more lucrative of the two projects. If that does not go forward, he is not interested in carrying out the homeownership component. By waiting for approval of the Section 8, the homeownership project is delayed indefinitely, since the Section 8 proposal was only submitted to HUD for conditional commitment in April 1983.

There is no question but that all these problems have had important effects on the progress of the Demonstration. But in talking with the program participants one gets the sense that the problems may, in part, be symptoms of what is a lack of strong administrative direction to the Chicago program. This observation can be supported by the remarks of the program participants. For example, the City program administrator for the 510 Demonstration indicated that the Housing Department staff had lost enthusiasm for the program after the Mayor selected South Austin rather than South Shore as the target neighborhood. He also noted that after the program began, the City became less willing to devote such a large amount of CDBG funds to a single project. Obviously, the Housing Department's lack of enthusiasm for the 510 program did not encourage strong central support for or control over this program.

The interests of Burnham Development regarding the program are very clear. Their primary concern is the Section 8 project. They recognize their responsibilities regarding the homeownership component and plan to assume them, but until the Section 8 is

underway this will not be a priority.

Perhaps the only individual who is strongly committed to the homeownership project was the project director of the SPO, a one-time community organizer, whose salary was paid out of HUD's 510 administrative grant. Unfortunately, this individual does not have the expertise to guide the development of the condominium project without substantial assistance from the developer and the City.

## 2.5 The Section 8 Project

As noted above, the Section 8 project is not much further along than the homeownership component. Although Burnham became involved in the Demonstration in early 1982, it was not until April 1983 that a proposal was submitted to HUD. According to the developer, two major problems have delayed the project -- financing and acquisition. Apparently, the Housing Authority promised initially to provide a tax-exempt bond, but that fell through after long negotiations with the developer. Now the Illinois Housing Development Authority has agreed to issue an 11(b) bond. Acquisition problems for the Section 8 project were similar to those that occurred in the case of the homeownership project although the developer was able to negotiate successfully with owners of four multi-family buildings and now has options to purchase these properties. The buildings were constructed in the 1920's and will contain 102 assisted units after rehabilitation.

The developer has promised to provide a portion of the syndication proceeds to the homeownership project although this contribution is not as meaningful as it will be at some of the other Demonstration sites. The developer will pay approximately 2.5 percent of the Section 8 mortgage amount (approximately \$100,000) rather than the 5 percent originally required by HUD. At the same time, the City is assisting the Section 8 project by providing a grant of \$150,000 in CDBG funds. In effect the developer is getting \$50,000 more from the City than he is contributing to the homeownership project.

At this point, the progress of the Section 8 project is of

paramount importance to the future of the homeownership project. The multi-family housing representative at the Chicago Area Office believed that the Section 8 project will go forward. Burnham appears to have a good reputation at HUD, and the proposal that was submitted in April was described as "complete" and "quite reasonable." If no problems arise, the HUD representative indicated that the Section 8 project could be under construction by the Spring of 1984.

## 2.6 Future of the Chicago Demonstration

Given the record of the Chicago program, one wonders whether the homeownership project will be implemented. The answer is not clear, although it is evident that a great deal will depend on the Section 8 project. However, even if the Section 8 project moves quickly through HUD processing, there are a number of issues that must be resolved before the condominium project can proceed. For example, neither the City nor the developer have identified a financing source for the project. The City and Burnham did approach HUD in early 1982 to secure interest subsidies under the 235 program. HUD set funds aside for the project, but they have since been recaptured. At present, the City says it will contribute \$9,000 per unit to rehabilitate the condominiums. The remainder will probably be financed through a mix of tax-exempt bonds and conventional financing.

Assuming that the sponsors are able to acquire the buildings they had targeted in the scavenger sale, they will face another problem. The buildings that they want to acquire are fully occupied. Thus, an extensive amount of temporary and perhaps permanent relocation will have to occur before rehabilitation can begin. The City has agreed to pay for relocation; even so, the task of relocating 50 families is a difficult one.

Finally, there is the issue of whether condominiums are marketable in South Austin. The City and the developer clearly expressed concern that marketing the units would be a problem, although the developer believes that the problem might be addressed

paramount importance to the future of the homeownership project. In talking with the multi-family housing representative at the Chicago Area Office, we were given every indication that the Section 8 project will go forward. Burnham appears to have a good reputation at HUD, and the proposal that was submitted in April was described as "complete" and "quite reasonable." If no problems arise, the HUD representative indicated that the Section 8 project could be under construction by the Spring of 1984.

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by selling apartments to current residents. This assumes that they can afford the units and are willing to buy them. Unfortunately, the SPO project director is not convinced that the current residents of the targeted buildings would make good homeowners. Thus, if the developer's plan is implemented, an extensive amount of homeownership training must accompany the conversion effort.

510 DEMONSTRATION PROJECT

CHICAGO



Potential Buildings  
for Section 8 Rehab



## Chapter 3

### THE 510 DEMONSTRATION IN BALTIMORE

The 510 Demonstration is operating in the Franklin Square neighborhood, an urban renewal area located west of downtown Baltimore. The Demonstration consists of three projects: the substantial rehabilitation and construction of an annex to an old elementary school (65 Section 8 units for the elderly), infill construction and substantial rehabilitation to create 72 rowhouses for Section 8 families, and 68 units of substantial rehabilitation and new construction which will constitute the rental/co-op project. It is expected that the three projects will be ready for occupancy by the end of 1983.

The most unique feature of the Baltimore 510 Demonstration is that the ownership project will operate as a "leasing co-op" for the first ten years of occupancy. This will allow the developer to take advantage of the tax benefits associated with renovating historic properties for rental use. Also, the cast of characters is large in this Demonstration; three development entities are involved, two community groups are representing the neighborhood, and the City has two voting members on the SPO board. The group has not worked harmoniously, and the last formal SPO meeting was held nearly a year ago. Nevertheless, the key Demonstration sponsors are determined to successfully complete the projects and have expended time and financial resources to ensure its success.

#### 3.1 The Franklin Square Neighborhood

The Franklin Square area was annexed to the City in the early 1800's. The area developed rapidly in the second half of the century. By the 1880's, it contained large numbers of elegant

townhouses occupied by affluent Baltimore families. The establishment of heavy industry immediately to the south of this community and the construction of working class housing on the smaller side streets changed the neighborhood's character in the first half of this century. By the end of the 1960s, Franklin Square had experienced a serious deterioration in housing stock, a decline in homeownership, and an increase in the number of vacant and abandoned properties.

During the 1970's, the exodus of homeowners continued and the conversion of numerous properties to multi-family units resulted in a further decline of the neighborhood. According to the 1980 Census, the population of Franklin Square declined by nearly one quarter between 1970 and 1980.

The existing housing stock in the Franklin Square area is primarily pre-1900 three-story brick rowhouses. According to a 1980 market study of the area, 84 percent of the housing was renter-occupied and about 450 housing units (23 percent) were vacant. Abandonment continues to be a major problem, although speculators have begun to stockpile vacant structures as gentrification occurs in nearby neighborhoods.

Franklin Square was chosen as the site for the 510 Demonstration for a variety of reasons: first, the area contains many City-owned properties and abandoned buildings that could easily be acquired through condemnation and quick-take procedures; second, the 510 Demonstration would help to economically integrate the community by providing moderate-income ownership units and federally-assisted rental units; and third, the neighborhood was already targeted for considerable CDBG expenditures in 1982 and 1983. The City believes that the Franklin Square neighborhood would not improve in the near future without substantial public investments and that once publicly-supported housing rehabilitation is underway, the private sector will be attracted to the community which offers such amenities as the Square itself (a park landscaped with lawn, trees, and benches), a new high school, and a community recreation center.

Additional reasons for selecting this neighborhood included the strength of the neighborhood improvement association and a community umbrella organization known as COIL, as well as the consistency of the 510 program design with the community's housing priorities.<sup>1</sup> Because the Franklin Square neighborhood readily fit the requirements of the Demonstration as well as City and community goals, it was the only neighborhood considered for this Demonstration.

### 3.2 The Sponsors

The design of the Baltimore 510 Demonstration is somewhat unusual in that the SPO includes two developers and two community groups. Each developer is undertaking a Section 8 project (one for the elderly, one for families), and one of the Section 8 developers is participating in rehabilitation of the leasing co-op. A neighborhood improvement group and an umbrella community organization are also participating in the project. Finally, the City's Department of Housing and Community Development is represented on the SPO. Each of these sponsors is described below.

#### The City of Baltimore

The City of Baltimore's Department of Housing and Community Development has had considerable experience with housing development

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<sup>1</sup>The Franklin Square Neighborhood Association had developed a housing plan which requested that the City provide the following, in order of priority: first, scattered site public housing; second, Section 8 housing for the elderly; third, Section 8 housing for families; fourth, subsidized homeownership units with low-interest rate mortgages for tenant conversion; fifth, revitalization of the commercial district; and sixth, rehabilitation of a local recreation center and landscaping of selected vacant lots. At the time of the 510 application, the City had 104 scattered site public housing units in the neighborhood which were under construction or already occupied, thus the first priority was being satisfied. It was clear that the 510 Demonstration could satisfy the community's second, third, and fourth priorities.

and rehabilitation, and claims to have participated in virtually all new construction and rehabilitation activity in the City in the last eight years. For example, Baltimore has operated the urban homesteading program through which abandoned houses are sold to households willing to rehabilitate and live in them. Through the Urban Development Action Grant Program, the City constructed or rehabilitated about 1,200 housing units. The City has also sponsored several loan programs to help homeowners fix up their houses. These include the Section 312 program which provides loans at 3 percent interest for owners in designated urban renewal areas, and the Rehabilitation Easement Program which provides grants to very low-income homeowners in areas where community development activities are underway.

The City also has more experience with cooperative development than any of the other expansion sites. In all, three cooperative conversions have been undertaken, including the very successful Waverly Terrace Cooperative, which is across Franklin Square from the 510 cooperative project.<sup>1</sup>

Baltimore's Department of Housing and Community Development has taken a very active role in the 510 Demonstration. Two deputy commissioners represent the City on the SPO board and one City staff person performs many of the SPO's administrative tasks. The City's commitment is also quite considerable in monetary terms. In addition to over \$2 million in CDBG funds for the co-op, the City is providing \$775,000 to the Section 8 projects.

#### Community Groups

Two groups representing the interests of the Franklin Square community are participating in the Demonstration. Founded in 1974, Communities Organized to Improve Life (COIL) is an umbrella

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<sup>1</sup>Waverly Terrace is a 51-unit co-op that was rehabilitated by the City in 1978 using CDBG and EDA funds.

community agency that operates throughout southwest Baltimore. COIL represents 43 neighborhood organizations and each group has one delegate on the COIL Board of Directors. COIL has attracted a number of resources to southwest Baltimore including a Youth Diversion Project for young first-offenders, tutoring in educational basics for school drop-outs, a senior citizen multi-purpose center, and the COIL Housing Service, which provides technical assistance in housing conversion and management. With an annual operating budget of nearly \$500,000, COIL employs more than 30 people, many of whom were recruited from the community.

COIL has worked with the City on several housing projects and is participating in the SPO at the request of the City. Originally, DHCD proposed that COIL would be the sole community organization represented on the SPO; however, the HUD Task Force argued that a "true" neighborhood group also needed to participate.

The group brought in at HUD's request was the Franklin Square Neighborhood Association (FSNA), which was founded in 1977 by long-term community residents who were concerned about the problem of property abandonment in the neighborhood. This group represents both homeowners and tenants and has an active base of approximately 150 members. The first task undertaken by FSNA was establishing Franklin Square as an urban renewal area and procuring block grant and bond revenue funds for the revitalization of the neighborhood. In June 1979, the Department of Housing and Community Development provided funds for the Association to open an office and employ three full-time staff members.

The Association is governed by a volunteer Board of Directors consisting of twelve community residents who meet at least once a month. FSNA worked with the City to develop a housing plan for the Franklin Square area, but had no housing development experience prior to their participation in the 510 Demonstration. Because the Demonstration so closely matched this groups' goals for their community, they entered the project upon the City's invitation with enthusiasm and a strong sense of commitment.

### The Developers

From the outset, DHCD planned to develop two separate Section 8 projects as part of the 510 Demonstration and had selected the properties to be rehabilitated. The Franklin Square Neighborhood Association assisted the City in the selection of the developers.

Seven applications, submitted in response to a City-issued RFP, were reviewed for the first Section 8 project (a 72-unit family project) and the selection process took place in April 1981. The City and the community had each developed criteria which they applied to the proposals. Examples of the community group's criteria included: developer's knowledge of the neighborhood and its needs, ability to work with the community, and past experience with developing housing for low-income households. The City's criteria were similar, but they placed more emphasis on past Section 8 experience, rehabilitation experience, and strength of the financial package. The winning developer's proposal (Otis Warren) was basically sound, although the developer had no actual development experience. Demonstration sponsors candidly admitted that this particular developer was attractive to the community group because he is a minority. The City raised no objections to this choice, although they had some concerns about the developer's lack of experience.

The developer for the other Section 8 project (a 65-unit elderly project) was selected approximately three months later through the same process of competitive bidding and interviews. This time Joint Venture Associates, formed expressly to participate in the Demonstration, was awarded the contract. Joint Venture consists of three partners: the National Housing Partnership, which is syndicating the project ; Harry Prushansky, a former Chief of Design for DHCD; and Alvin Blank, a local developer. Prushansky was appointed to the SPO to represent Joint Venture. Prushansky and Blank, as local general partners, are more involved in the Section 8 project and are acting as general contractors.

Unlike most of the other Demonstration sites, where the Section 8 developer was automatically responsible for the development of the

homeownership component, the City of Baltimore decided to issue a separate RFP for this project. ASH Development Limited Partnership (whose principals include Prushansky and Blank), was awarded the rental/co-op project after ASH and Otis Warren submitted bids on the project to the SPO. The ASH partners showed extensive rehabilitation and construction expertise and a willingness to work with the community group.

### 3.3 The Operation of the SPO

At the start of the Demonstration, the Franklin Square SPO included nine members: two DHCD Deputy Commissioners (Randy Evans and Mark Sissman), two COIL representatives, two developers (Otis Warren and Harry Prushansky), and three representatives from the Franklin Square Neighborhood Association. When the SPO was formally incorporated in July 1981, a representative of FSNA became President and one of the developers, Otis Warren, was elected Vice-President. The SPO did not hire staff to assume the administrative duties associated with the operation of the SPO. Instead administrative tasks have been performed by Michael Seipp, the City's project manager for the Demonstration. Both the City and the community group agreed that a full-time staff person was not required to operate the SPO. They preferred to apply the HUD administrative grant to co-op development costs.

The SPO met once a month during the first year of the program and, in addition, construction and design committee meetings and finance committee meetings were regularly held. During this period, the SPO operated according to the HUD model; that is, decisions were made in SPO board meetings and representatives of all the sponsors were active participants in the decision-making process. A number of board members were credited with making valuable contributions to the project during this period. According to the City's program director, one of the DHCD Deputy Commissioners, the developer from Joint Venture, and the SPO President devoted considerable time and energy to the project. Despite their contributions, however, the SPO did not operate smoothly and SPO Board meetings were often

fraught with conflict. According to two of the sponsors, there were numerous rivalries and disagreements among board members. For example, the developer who was not selected to do the rental/co-op project resented that he had not been chosen and was frequently uncooperative. There were also rivalries between the two neighborhood groups and among the staff of each community organization. As a result, the decision-making process was continually disrupted by in-fighting among Board members.

In August of 1982, the President of the SPO decreed that there would be no more formal board meetings. Since then, those individuals that had been most active on the SPO--the President (a FSNA representative) and the developer from ASH--as well as the City's program director, have assumed primary responsibility for the implementation of the program. This informal "mini-SPO" has worked very well thus far. The developer has provided the expertise necessary to carry out the project. The developer and the City have made every effort to involve the community group representative in the decision-making process and to bow to the concerns of the community whenever possible.

#### 3.4 Baltimore's Leasing Cooperative

As of May 1983, the construction of the 510 "leasing co-op" was roughly 20 percent complete. The site of the project is the 1600 block of West Lexington Street which faces Franklin Square. This block is prime real estate in the Franklin Square neighborhood and is well served by public transportation, a community center and a public school. The two Section 8 projects are only a few blocks away.

The structures that are being rehabilitated under the Demonstration are predominantly circa 1800 brick buildings originally constructed as single-family townhouses and since converted to multi-family use. All of the buildings had been abandoned and subjected to considerable deterioration and vandalism. The rehabilitation plans call for complete interior gutting and restoration of the exterior facade.

Three empty lots on West Lexington Street will also be developed as part of this project. The new buildings (in-fill housing) have been designed in a style which will blend with the existing brick structures. Interior features will be similar to those in the rehabilitated structures. In all, 68 new units will exist when the project is completed.

The total development cost for the leasing cooperative is approximately \$3.2 million. The City is loaning the developer \$2.05 million in CDBG funds at 12 percent interest on a 30 year term. An additional \$1,045,000 is being provided by the one of the ASH partners. Finally, \$100,000 in HUD administration funds will be applied to legal fees and to marketing the units.

As will be discussed shortly, the developer plans to syndicate the project and will contribute \$100,000 in proceeds to the co-op's replacement reserve. These funds will be available for building maintenance and repairs. Syndication proceeds will also flow to the co-op from both Section 8 projects. These proceeds, in the amount of \$293,000 will be placed in an interest bearing "extraordinary reserve account" to be utilized only in the event that the replacement fund is depleted.

Perhaps the most interesting aspect of this project is the sponsors' plan to create a "leasing cooperative." During the first ten years of the project's operation, the buildings will be maintained as a rental project, owned and managed by ASH Development. At the end of the rental period, the City plans to buy the project from the developer for \$6 million and then sell it to the tenants who will form a cooperative corporation.

The idea of the leasing co-op was initiated by staff at DHCD, who were looking for ways to stretch the City's CDBG dollars. According to the City's 510 program director, all the sponsors gain by structuring the project in this fashion. First, if the project remains a rental and is designated by the Department of the Interior as an historic property, the developer can take advantage of lucrative tax benefits under the Tax Act of 1976. Second, because of the value of an historic rental project, the City is not required

to provide an outright grant to make the project feasible, but rather a loan which will earn interest at 12 percent over thirty years.<sup>1</sup> The community organization is pleased that CDBG money is a loan rather than a grant because they can then persuade the City to reinvest the loan money in the Franklin Square neighborhood. In other words, their allocation of CDBG funds has not been "used up."

The developer expects that he will be able to begin marketing the units by September 1983. Generally, the target population will be young professional couples and singles, with household incomes of \$15,000 or more. It is expected that renters will be primarily black. While current neighborhood residents will receive priority it seems unlikely that many will be able to afford the rents; apartments will rent for \$266 to \$350 per month, not including utilities.

During the initial rent-up, potential tenants will be carefully screened to determine their willingness to join a cooperative sometime in the future and their ability to make good cooperators. Selected tenants will be informed that the project will convert to a cooperative in ten years and that they will have the option to buy the property. While no one expects all the original tenants to remain during the rental period, the sponsors are hopeful that some will. Sometime during the ten year period, tenants will be trained to operate a housing co-op.

### 3.5 Section 8 Projects

#### "School 100"

Joint Venture Associates, Inc. is undertaking the substantial

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<sup>1</sup>Note that over a ten-year period, the City's loan is worth \$4 million. The agreed upon selling price of the project at the end of ten years is \$6 million. In essence, the City will forgive the loan to the developer, purchase the property and then sell the project to the tenants, thus recapturing the initial investment.

rehabilitation of a 3-story structure that was originally a public elementary school. After conversion, the school will contain 65 one-bedroom units for the elderly. The developer is also constructing an annex building that will contain 13 Section 8 units. As of May 1983, construction of the project was about 35 percent complete.

Total development costs for the school are \$2.6 million, financed with local housing authority bonds and insured under HUD's 221(d)(4) program. The City sold the property to Joint Venture for about \$2,000 and contributed \$125,000 in CDBG funds to help pay upfront development costs including architectural and legal fees and initial construction costs.

According to the developer, there have been very few problems associated with the development of the project. HUD processing proceeded very smoothly and Joint Ventures received a FAF from HUD without difficulty. Perhaps the only critical issue was the timing of the bond issue. The City's Housing Authority wanted to delay issuance because interest rates were falling, yet the developer was faced with a time constraint in order to take advantage of tax incentives available for the rehabilitation of historic properties. In the end, the bond was issued and the project proceeded on schedule.

National Housing Partnership (one of the partners of Joint Venture), will syndicate the Section 8 project. Joint Ventures will contribute \$125,000 in syndication proceeds to the leasing co-op (5 percent of the mortgage amount). This money (along with the syndication proceeds from the other Section 8 developer) will be placed in an "extraordinary reserve account fund."

#### The "1500 Block"

The "1500 Block" is the name of the Section 8 project being developed by Otis Warren in the 1500 block of West Fayette Street. Half of the project was originally designed as a rehabilitation of a group of historic properties. Unfortunately, the exterior brick walls of several buildings collapsed. Thus, this project is now

primarily new construction, although the style is classic Baltimore brick rowhouse.

The total development cost of this project is about \$3 million. The City sold the properties to Otis Warren in 1982 for about \$7,000 and also contributed \$650,000 in CDBG funds to the project. The project is being financed with 11(b) bonds issued by the City's Housing Authority.

Upon syndication of the project, Warrent will provide approximately \$170,000 (5 percent of mortgage amount) to the co-op. The first payment, equal to 20 percent of the total, is due at final settlement for the co-op.

Construction on the "1500 Block" project commenced in the Fall of 1982 and is proceeding on schedule; as of April the project was 50 percent complete. It is anticipated that occupancy will begin in January 1984.

### 3.6 Issues of the Baltimore Demonstration

Although the Baltimore Demonstration appears to be headed for successful completion by the end of this year, there are several unresolved issues or problems that merit attention. The aspect of this Demonstration that has caused the sponsors the most concern, as well as a large amount in legal fees, has been the structuring of the leasing cooperative to comply with IRS regulations. While the sponsors are satisfied that they have structured the project so that it qualifies as a rental property under the Tax Act of 1976, the concept is untried and thus there is some risk to the co-op developer and the City.

A more immediate concern is that the developer of the co-op has begun construction of the project using ASH Development funds, despite the fact that the \$2 million CDBG loan has yet to be approved by the Board of Estimates. Furthermore, while an application has been made to the Department of the Interior to have the buildings declared historically significant, and thus eligible for tax benefits, the application has not been formally approved. While the developer is certain that both the CDBG funding and the

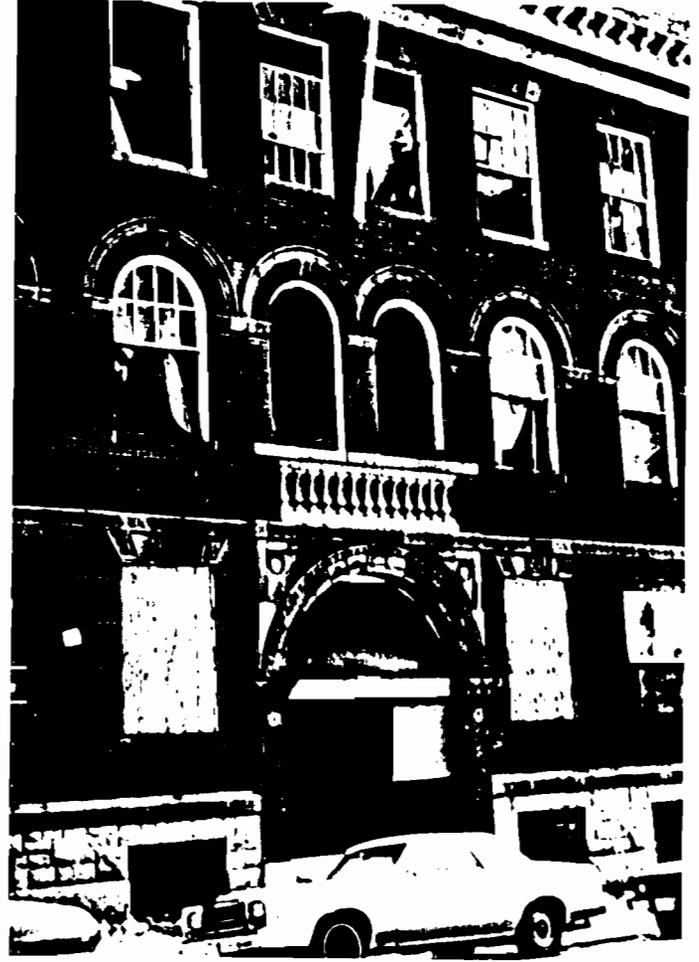
historic designation will come through, he readily admits that he is in a somewhat precarious position. He has taken this risk because the construction of the co-op project must be completed by the end of 1983 if the developers are to take advantage of the tax breaks afforded to renovators of historic buildings.

A final concern is the marketing of the 65 leasing co-op units. The rent structure is too high for the area's primarily low-income population. Although the Waverly Terrace Co-op sold out very rapidly, it is questionable whether moderate-income households will be attracted to rental units in this neighborhood (even with long-term ownership potential) until more signs of revitalization are apparent.

BALTIMORE



Co-op Project



Section 8 Elderly



Co-op project

## Chapter 4

### The 510 Demonstration in Phoenix, Arizona

The implementation of the 510 Demonstration in Phoenix has been both difficult and time-consuming. In particular, problems associated with the acquisition and development of the Section 8 project have resulted in serious delays in the homeownership component. More importantly, controversy over the role of the developer in the ownership project has led to a situation in which the community members of the SPO are now undertaking this development independently.

Despite the generally poor relationships observed among the program participants, as well as the large number of problems and disagreements which have emerged, considerable progress has been made in recent months. Fifty-six units of Section 8 substantial rehab have been completed and are ready for occupancy. The homeownership component, which will involve 72 new construction townhouse units appears to be gaining momentum. While a number of issues remain to be addressed, the prospects for successful completion of the Demonstration have improved substantially during the last quarter.

#### 4.1 The Neighborhood Setting

The neighborhood selected for the Phoenix 510 Demonstration is one of three Phoenix planning districts and is known as Target Area B. Originally the City had selected a downtown neighborhood which contained numerous properties suitable for rehabilitation. However, in June, 1981 the community organization representing this area voted to reject the Demonstration, based on its disappointment with the City's performance in carrying out existing revitalization

plans. In the meantime the City had reviewed other suitable sites and proposed Target Area B as an alternative.

Target Area B is located in South Phoenix, three miles from Downtown and two miles from the Sky Harbor International Airport. It is a three square mile area annexed by the City in 1960. The neighborhood is characterized by a mix of old and new structures with considerable variation in architectural style and quality of construction. Although the housing stock is primarily single-family detached, it contains approximately 450 units of multifamily housing as well as several mobile home parks. Nearly one-third of the land in the area is vacant or in agricultural use; most of these undeveloped parcels are under five acres in size.

Due to low land prices in south Phoenix and rapid growth of the City itself, Target Area B is considered to be ripe for development in the near future. After ten years during which almost no new development took place, several major private ventures are in progress, including a \$350 million luxury resort and a planned development of 900 single family units. In the City's master plan, Target Area B constitutes the core of the South Phoenix Village, one of nine urban villages envisioned in this document.

The City has been active in South Phoenix for the last three years. The neighborhood is a CDBG NSA, and over \$8.5 million has been committed to various capital improvements, housing rehabilitation, and other activities and services. The neighborhood was also a homesteading area and had benefited from the availability of Section 312 loans.

The residents of Target Area B include an elderly population of about seven percent, an under-18 population of over 40 percent and an adult population which is largely minority and low-income.<sup>1</sup> Approximately 45 percent of the area residents are Black; the remaining 56 percent are Chicano or Anglo. The area has

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<sup>1</sup>Population characteristics are based on City figures derived from the 1970 Census.

traditionally had a higher level of unemployment than the City as a whole.

As described by city staff, South Phoenix has tremendous growth potential. Nevertheless, while Target Area B has benefited from considerable City intervention over the past few years, the area still needs a lot of work. From the standpoint of the Demonstration, the principal drawback of Target Area B is the relative scarcity of multifamily properties suitable for rehab. Given this, and the City's overall emphasis on new multifamily housing, the City requested and received a waiver to do new construction under the homeownership component of the Demonstration.

#### 4.2 The Sponsors

The City of Phoenix, through its Department of Housing and Urban Redevelopment, is responsible for administering Phoenix' 510 Demonstration. The City's application was spearheaded by one of the Department's Housing Development administrators who has had experience in co-op and multifamily development in other cities. While there appears to have been some initial resistance on the part of City officials--principally because of the unfamiliar co-op component and the requirement that community organizations actively participate in the Demonstration--it was ultimately agreed that the program could provide a good learning experience for Phoenix, and the application was completed. The tangible benefits of participation--additional Section 8 units and the City administrative grant--were described as a "small carrot." The principal objectives of the City were to try a new approach and to obtain additional housing for the City's low- and moderate-income residents.

In general, the City of Phoenix has not had a great deal of experience with multifamily rehab projects. Given its low density and the availability of vacant land, the City has primarily opted for new construction, although it is currently pursuing single-family rehab and public housing modernization in the South Phoenix area. By the same token, Phoenix has not received a great

deal of Section 8 production. However, for the last year, City staff have been involved in a new Section 202/8<sup>1</sup> project under construction in the 510 neighborhood. Finally, cooperative conversions are extremely rare in Phoenix. Although the City's 510 administrator urged the SPO to consider the cooperative form of ownership, the more familiar fee-simple title arrangement was chosen for the ownership component of the Demonstration.

The community organization selected for the Demonstration is the Area B Citizens Advisory Council (CAC). The CAC was established by the City in 1978 to review and advise on the use of CDBG funds. It is composed of 14 members, two from each of the area's seven sub-districts. The group lacks any housing development experience but has been very active in its advisory capacity. Although the City recognized that the CAC was weak, there were no other organized neighborhood groups from which to choose. City staff indicated that the City had briefly considered teaming up with the Urban League or a NHS organization, but the CAC was selected because it represented neighborhood interests.

The developer selected for the program was also inexperienced. He is Mr. Pat Garrity, who founded his development company (Commonwealth Development, Inc.) specifically for the Demonstration. Garrity is a former school principal with a background in real estate management and some single-family construction. At the time of the Demonstration he had no prior experience in multifamily or assisted housing development. According to City staff, he was selected for the Demonstration because he claimed to have site control on the property favored for the Section 8 development. Program participants and observers tend to agree that Garrity's inexperience very nearly resulted in the loss of the Section 8 project.

#### 4.3 The SPO

The Special Purpose Organization set up for the Phoenix Demonstration consists of six members, each of whom has one vote. These include Garrity and five community people hand-picked by the

City. Until 1982 the SPO had no staff and this role was largely filled by City personnel. An executive director and a secretary have now been hired.

Relationships between the SPO members and between the SPO and the City are extremely strained. This situation has existed since the early phases of the Demonstration and shows little chance of improving. At this point the SPO, including Garrity, still meets as an organization, but is completely controlled by the community members. The community members are developing the homeownership component themselves and the developer has been effectively excluded from participating in this activity.

The difficulties among program participants can be traced to the earliest stages of Section 8 site acquisition. According to City staff, Garrity was selected as the 510 developer primarily because he had already obtained site control for the favored Section 8 site. However, after he was selected for the Demonstration, the City determined that certain verbal commitments he had obtained were unacceptable. City staff then recontacted the various owners who offered new commitments but at substantially higher prices. This led to controversy over the proper role of the parties in negotiating with the buildings' owners. Ultimately, the property was acquired, but still above the developer's original price. The difference was made up by the City, with the concurrence of the other SPO members, using some \$113,000 of the City's \$600,000 CDBG commitment to the Demonstration.

While Section 8 site acquisition marked the beginning of bad relations among the parties, new areas of conflict continued to develop every step. In general, the community members of the SPO believe that the developer has continually sought to obtain payment for providing assistance which was to be volunteered under the Demonstration. For his part, Garrity believes that he is still technically and legally the developer for both the Section 8 and the homeownership projects, though the "SPO" has frustrated his attempts to participate in the latter. He views the community members as unqualified to undertake the ownership development alone and

believes that the City's intervention in the project has robbed him of his expected profit on the Section 8.

While Garrity's conflict with the City was a direct result of issues surrounding Section 8 site acquisition, the community representatives are also displeased with the City, based apparently on personality conflicts with the City's project administrator. Community representatives also expressed doubts about the City's level of commitment to the Demonstration and knowledge of applicable regulation. While this problem has been eased somewhat with the introduction of a new City staff member who is on better terms with the SPO members, it is clear that the entire Demonstration is being carried out in an atmosphere of recrimination and distrust. Miscommunication among the parties was evident at the time of the site visit and the developer was apparently initiating legal action over his exclusion from the ownership component.

Given this level of hostility, it is remarkable that anything has been accomplished under the Demonstration. However, as will be described in the next sections, the Section 8 project is currently available for occupancy, the ownership site has been acquired, and the plans and drawings for the ownership project are now complete. The community sponsors have prepared an RFP in order to select a "contractor" who will agree to secure interim financing and undertake construction of the ownership units.

#### 4.4 Ownership Project

The City purchased a vacant 9 acre site near the core of the target area for the homeownership project. This site has many advantages, including close proximity to shopping and public transportation, evidence of new construction on surrounding sites (including a Section 202 project for the elderly), and infrastructure investments in the neighborhood. The site, located about one mile from the Section 8 project, had the necessary multifamily zoning and was available at an excellent price. The only delay in the City's acquisition of the land was caused by difficulties in satisfying the HUD site excavation requirement.

Much of the land in the area was used at one time as Indian burial grounds and the City estimated that it would cost \$200,000 to satisfy the HUD requirement. Ultimately, the SPO developer was able to arrange for the excavation for a nominal fee and the City proceeded to purchase the property in December of 1982.

The SPO developer (Pat Garrity) is not the developer or the construction contractor for the ownership project. The City insisted that the SPO issue an RFP for a general contractor that specifically excluded Garrity. This RFP was to be issued by May of 1983 in hope that construction could begin by early summer. The contractor will be required to provide the interim financing for the project. In order to secure the loan, the land will be transferred to the SPO, which will then deed it to the contractor (with a City reverter and performance bond).

The townhouse project will include 72 units plus a community building. The project, to be called SPO Estates, will be built in four phases, the first to include 18 units representing each of six different floor plans plus the community building. The townhouses will contain two or three bedrooms and will be one and two stories tall. Unit size ranges from 1,095 square feet to 1,247 square feet. The design includes amenities such as individual garages, atrium entryways to provide security and privacy, and attractive tile and stucco style construction. The project will not include a swimming pool (which is a standard feature in Phoenix housing developments) because of the high insurance costs.

The SPO, acting as developer for the project, hired Architect P.E. Buchli to prepare the plans and specifications. Buchli's current estimates of the development costs are as follows:

Hard Costs	\$2,021,500
(including general conditions, bonds and insurance)	
Contractor Fee (6 percent)	121,300
Permits and Development Fees	8,000
Sewer and Waste Development Fee	43,000
	<u>\$2,193,800</u>

Based on livable area of 85,000 square feet, construction costs are \$25.80/sq.ft. or \$30,500 per unit. These figures do not include architects fees (\$195,000 paid with CD funds), soft costs, or offsite costs. According to Buchli, the City will provide almost \$345,000 in CDBG funds for offsite and other improvements:

Off Site:	\$ 154,600
Landscaping:	50,000
Sprinkler System:	40,000
Community Building:	<u>100,000</u>
	\$ 344,600

Adding these to other costs, along with architectural fees, SPO grant, and site acquisition, produces a per unit cost of \$40,575. However, this still excludes soft costs which were unknown at the time, and marketing expenses.

There is some concern regarding the affordability and marketability of these units. The City expects to target marketing to two worker families who earn at a minimum the median household income for Phoenix, which is \$25,000. Current sales price estimates for the townhouses average \$45,000 to \$50,000.<sup>1</sup> Few residents of the South Phoenix target area have the income to qualify for these homes, and it is questionable whether it will be possible to attract others into this neighborhood, particularly given that homes in the same price range are available in better Phoenix neighborhoods.

The SPO has not yet resolved the issue of permanent financing. The City had looked into IRB financing at 11-5/8 percent; however, as rates began to drop, the SPO decided they could do better elsewhere. They now envision that buyers will obtain individual

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<sup>1</sup>Since there are no syndication proceeds from the Section 8 project, the SPO expects to add a reserve contribution to the sales price.

financing (conventional, VA and FHA 203(b), 245, and 243 were mentioned). The SPO has asked the City to approve an additional appropriation of \$175,000 in CD funds that can be used for interest reduction or mortgage write downs for some purchasers.

Finally, at the time of the site visit, there was some confusion regarding who would be marketing the project. The City indicated that a marketing firm might be hired, or that the contractor would assume this responsibility. The SPO said that their Executive Director had already been given the assignment (as well as the right to the commissions on sales).

#### 4.5 Section 8

When the City and the HUD Task Force canvassed the Target Area for suitable sites for the Section 8 project, less than a half dozen suitable properties were identified for rehab. The City favored the Rossier Road site because it was a blighting influence on the neighborhood and because it was surrounded by homesteading houses and new infrastructure investments; the drawback was that there were nine separate owners.

As described above, after accepting Garrity's proposal for this site, the City was obligated to renegotiate site control whereupon the properties' owners quickly upped their sales prices. Thereafter, HUD appraised the buildings at a price much lower than what the owners were asking, and the SPO received an independent appraisal still lower than HUD's. Both appraisal figures were higher than the price the developer had negotiated. Finally, however, in the fall of 1982, the property was acquired with the City paying the difference between the sales price and the price negotiated by Garrity. This sum was \$1.2 million.

In addition to the site acquisition problems between the City and the developer, other problems with the Section 8 project have included high rehab costs and a potential law suit by the Section 8 contractor regarding late payments. With respect to rehab costs, upon inspection, each of the 16 project buildings had to be completely gutted. In addition, several of the first units to

receive rehab were vandalized and required reconstruction.

As a result of these problems, the developer will not be contributing any syndication proceeds to the townhouse project. At the time of syndication (executed by the National Housing Partnership which was brought in to market the investment and assist in closing), the City decided that no syndication proceeds could be obtained from the developer and requested a waiver from HUD. The \$80,000 which would have come from syndication will be made up by tacking a building reserve fund contribution onto the sales price of the townhouses.

The Section 8 project consists of 56 units in 28 single-story buildings. Rehab on over half of the units was completed in March 1983 and rental of the units began in April. The remaining units were scheduled to be completed within several months. The project is FHA insured; the permanent financing was provided through a City 11(b) bond issue.

#### 4.6 Demonstration Problems/Issues

Many of the major problems of the Phoenix Demonstration have been discussed in detail previously. In general, the Phoenix SPO is characterized by continuing controversy over the role of the developer in the ownership project and a great deal of miscommunication and distrust. Relationships between the City and SPO members are also rather poor. At this point, the community representatives of the SPO are aggressively pursuing the ownership component and are receiving assistance in this effort from the City. The developer has been effectively excluded from the project.

In addition, the Section 8 project has produced a number of controversies and disappointments. Renegotiation of site control, for example, raised acquisition costs resulting in reduced feasibility. As a result, the City used CDBG funds to assist in Section 8 acquisition and ultimately waived the dedication of syndication proceeds. It is also maintained that the Section 8 project would not have closed if the National Housing Partnership had not been brought in to syndicate the project. While many

program participants, as well as observers, attribute these problems to the inexperience of the developer, it was also suggested that the Section 8 project was only marginally feasible to begin with. HUD officials indicated that it was difficult to justify 100 percent of FMR for the site and that it was relatively unattractive to outside investors.

The lack of progress in the homeownership component can be in part attributed to the tremendous amount of energy that went into finalizing the Section 8 development. Given the impasse between the community group and the developer, the ownership project is now being developed by a small group of community activists who are completely inexperienced in this type of activity. While the project appears to be getting underway, several issues remain for the future.

First, a number of observers have expressed doubts about whether the SPO can find a contractor willing to provide interim financing and begin construction on the townhouses for a reasonable fee. The risk associated with the project is compounded by the SPO's intention to permit its Executive Director to act as the marketing agent for the project. At the time of the site visit, City staff were strongly opposed to this idea. However, throughout the Demonstration the City has been reluctant to dictate to the SPO.

Second, several observers have expressed doubt about whether the project can be completed for between \$45,000 and \$50,000 per unit as expected by the SPO. In large part this will depend on the costs of interim financing and contractor fees. At the time of the site visit, the project architect was in the process of preparing the final cost estimates, exclusive of financing charges and builders profit which were unknown. According to the architect, the timing of the RFP was very favorable and it was hoped that the project could be put to bid immediately in order to take advantage of market conditions. SPO members indicated that they hoped to select a contractor and begin construction by June 1983.

While construction costs remain an issue, an even more serious question relates to the marketability of the completed units. At

least one observer indicated that units of the proposed type and cost would be difficult to market, since similar units could still be purchased in better neighborhoods. Unfortunately the SPO has not conducted any form of marketing study to support its program, despite the urgings of City staff. A number of related issues also remain unaddressed, including purchaser income limits, resale policy, (if any), tenant training, and the amount and type of additional writedown to be provided with the units. On the latter point, SPO members appeared to assume that funds would be available for selected mortgage writedowns and city staff indicated that approximately \$175,000 in additional CDBG funds were likely to be approved for the project. However, none of these aspects of the program has been thought-out in advance, and the SPO appears to be proceeding with a "seat-of-the-pants" approach.

Overall, the implementation of the Phoenix Demonstration has been difficult. However, considerable progress has been in the last several months. The Section 8 project is now opened for occupancy and construction on the ownership units could begin this summer, While the SPO's performance in the "paper planning" aspects of the Demonstration has been disappointing to the City, the program administrator nevertheless expressed confidence in the SPO's ability to complete the project. At this point, the project appears to be building momentum. Given the City's apparent willingness to provide additional financial and technical support, the prospects for successful completion of the project are definitely improved.

510 DEMONSTRATION PROJECT  
PHOENIX, ARIZONA



Section 9 Rehab Project



Site for 1000 sq ft. Toward the Project

## Chapter 5

### The 510 Demonstration in Los Angeles, California

The 510 Demonstration in Los Angeles is producing Section 8 and co-op units in two neighborhoods: the Hollywood NSA and the Crenshaw section of south Los Angeles. The Section 8 projects are producing 61 and 83 units respectively, both in scattered site buildings. Rehab is being completed in phases at both sites and a portion of the units are available for occupancy.

The ownership component will produce 98 cooperative units in Hollywood and 33 co-op units in Crenshaw. Both sites are using occupied buildings. While construction has not yet started at either site, permanent financing has been arranged and cooperative associations have been formed.

The co-ops are being established as limited dividend housing cooperatives under a 1979 California state law. As such, they will be subject to a strict resale policy which limits profits on sale to 10 percent of initial equity. Cooperators will pay between \$318 and \$860 to purchase their cooperative shares, with most tenants paying \$500. Almost all units will be subsidized through the Section 8 program.

Development of the co-op units is being undertaken by the non-profit Los Angeles Community Design Center (LACDC). Due to irreconcilable differences between this organization and their developer partners, LACDC has taken control of the co-op component and, at LACDC's insistence, both developers have relinquished all responsibility for this aspect of the program. Despite the dissolution of both SPOs, and the attendant disruption of the Demonstration, the program is proceeding and, assuming that no

unforeseen problems arise, the projects should be completed early in 1984.

### 5.1 The Neighborhood Setting

Los Angeles selected two target neighborhoods for the 510 program: the Hollywood Section 8 NSA and the Crenshaw Apartment Improvement Program (AIP) area.<sup>1</sup> Separate 510 rental and homeownership projects are being developed for each neighborhood. The two neighborhoods differ significantly in terms of building types and ethnic/racial composition, yet both share the inner-city neighborhood problems of increased crime and housing deterioration.

The Hollywood target neighborhood is characterized by a predominance of very small (0-1 bedroom) apartment units, spread among 40-50 year old small apartment buildings. The neighborhood originally developed around the Hollywood movie industry and its small unit housing stock reflects the transient nature of the people who cast their luck with the movie production studios. The area has a wide ethnic and racial mix, including numerous Latin American nationalities. The housing stock, while old for Los Angeles, remains in generally good condition, despite trends toward an overall deterioration in condition. Hollywood has received considerable prior attention from the City, including designation as NSA and MORE target areas.<sup>2</sup>

The Crenshaw neighborhood is a large (7,500+ units) post-war

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<sup>1</sup>In Hollywood, the NSA boundaries are Sunset Boulevard to the north, the Hollywood Freeway to the east, Melrose Avenue to the South, and Seward Street to the west. The Crenshaw neighborhood boundaries are Rodeo Road/Santa Barbara Avenue/Santa Rosalia Drive, Stocker Street, Santo Tomas Drive, and La Brea Avenue.

<sup>2</sup>The Multi-Family Opportunity Rehab Effort (MORE) program is a City housing rehabilitation program which combines the financial resources of CDBG and the California Housing Finance Agency.

apartment zone located in south Los Angeles. The area is characterized by numerous garden apartments with enclosed courtyards built approximately 20 years ago. These buildings, while showing signs of deterioration, generally remain structurally sound. The area has been subjected to increased street crime, including drug dealing and prostitution, and has received the uncomplimentary nickname "The Jungle." Originally an affordable blue collar bedroom community, the neighborhood has undergone a dramatic racial transition from white to black and is now a predominantly black neighborhood. Turnover of building ownership was reported to be high. The City Housing Division has committed an average of \$600,000 to \$800,000 per year to Crenshaw, a figure consistent with its investments in other multi-family areas.

The actual selection of these target neighborhoods was strategic: the matching Section 8 units required by the City came from the Hollywood NSA allocation, permitting the HUD Demonstration units to be targeted to Crenshaw. Thus, by using its Hollywood NSA units as leverage, the City was able to obtain much needed Section 8 units and a homeownership project for Crenshaw, its acknowledged priority area.

## 5.2 The Sponsors

There are five principal actors in the Los Angeles 510 program: the City, two developers -- Vadehra Enterprises in Hollywood and The Weinstock Construction Company in Crenshaw -- a non-profit community organization serving both the Hollywood and Crenshaw projects (the Los Angeles Community Design Center), and a Hollywood neighborhood organization (the Route 2 Community Housing Corporation).

### 5.2.1 Participation of the City

Responsibility for the administration of the Demonstration rests with the Housing Division of the Los Angeles Community Development Department. Central coordination and program management had been retained by the Division director, Kathleen

Connell.<sup>1</sup> Day to day program monitoring has been delegated to Ralph Esparza, Community Rehab Manager for the MORE program. The Department maintains field offices in each target neighborhood and utilizes on-site staff for monitoring and technical assistance.

The Division has had considerable previous housing development and rehabilitation experience, as might be expected for a City of this size. This experience is tempered by two qualifications. First, the City had no prior experience working with cooperatives.<sup>2</sup> Second, the Housing Division has worked predominantly with for-profit developers. It had only limited experience with non-profit community groups as developers.

The City commitment to the program has been substantial. The City's principal contributions have been financial and have included:

- o a substantial land write down for the Crenshaw co-op;
- o payment of relocation expenses;
- o negotiating with the PHA for Section 8 moderate rehab units;
- o arranging a 312 loan for Crenshaw; and
- o providing City rehab specialists for work write-ups for Crenshaw.

City representatives indicated that the program had been more expensive and more time consuming than they had initially envisioned.

#### 5.2.2 The Developers

The developer selected for the Hollywood portion of the program

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<sup>1</sup>Ms. Connell has recently resigned as Division Director to accept another job. A successor had not been named at the time of the USR&E visit (May 1983).

<sup>2</sup>The City's participation in the 510 program and involvement with the Route 2 CHC has resulted in several subsequent cooperative projects supported by the City.

was Vadehra Enterprises.<sup>1</sup> Formed in 1979, Vadehra Enterprises has a professional staff of three, headed by Devinder Vadehra. The company has specialized in Section 8 housing development and subsequent syndication of projects. Prior to creating Vadehra Enterprises, Vadehra was a co-partner in the American Development Corporation, a real estate development firm that operated throughout the West. With that firm, Vadehra was responsible for the development of over 30 Section 8 and Section 236 projects, representing some 6,000 units. He also served as a consultant to a 61 unit elderly project developed under the Hollywood NSA program. While Vadehra's firm has management experience, it has never previously worked with a community sponsor.

Vadehra's participation in the Demonstration was based on the apparent attractiveness of the City's NOFA. Part of this attractiveness was based on the misconception that the developer would contribute 5 percent of the syndication proceeds -- as opposed to 5 percent of the Section 8 mortgage amount -- to the co-op. Vadehra further believed that he would be entirely responsible for the development of the co-op project. As the project evolved, however, the entire development of the co-op was assumed by the community group, while Vadehra's responsibility remained only the development of the Section 8 project. Given similar circumstances, Vadehra would not choose to participate in a future 510 Demonstration.

The City selected the Weinstock Construction Company to develop the Crenshaw 510 project. Weinstock Construction is one of the largest developer/builders in the State of California and has operated throughout the greater Los Angeles area for 36 years. The company has developed both conventional and Section 8 projects, including conventional co-op conversions. The firm, however, had no prior experience working with limited equity co-ops or with

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<sup>1</sup>According to Dave Vadehra, Vadehra Enterprises was the only developer to respond to the Hollywood NOFA.

non-profit community groups. The 510 Section 8 project also represented Weinstock's first syndicated project.<sup>1</sup> Within the firm, responsibility for the 510 project was assigned to Thomas Bell, a company Vice President.

The Weinstock Company had originally intended to respond to the Hollywood 510 NOFA. However, the firm eventually settled on the Crenshaw site because they were unable to locate suitable units in Hollywood. The company chose to bid on the 510 project because other Section 8 business had been slow. In general, they expected the 510 development process to be much faster and less complicated. However, as it turns out, their allocation of staff resources to the Demonstration has been over and above their other Section 8 projects. Bell also originally envisioned that his company would take a lead role in the construction and marketing of the co-op project. Nevertheless he was amenable to allowing the non-profit community group to assume this responsibility once their desire to do so became clear.

### 5.2.3 The Non-profit Community Organizations

The City of Los Angeles selected its program participants by means of a NOFA. Responding developers were required to select community group partners and submit a joint proposal. To facilitate this, the City provided the handful of developers who expressed initial interest in the NOFA with a short list of community groups for consideration. Both Vadehra and Weinstock independently selected the LA Community Design Center (LACDC) as project partners.

The LA Community Design Center (LACDC) is a citywide, rather than neighborhood based, organization that provides housing related

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<sup>1</sup>Weinstock has always retained full ownership of its projects on the grounds that syndication typically results in the buildings deteriorating due to poor management. The company currently owns 2,000 units of Section 8.

technical assistance to other non-profits as well as local governments. LACDC began as an advocacy group which provided design and architectural services to low- and moderate-income projects. It has since expanded its program to include project administration and financial packaging. The City had worked with LACDC in the past on several other activities and perceived the group to be experienced in city politics/bureaucracy. The organization has had prior experience in limited equity cooperative housing and was one of only a few area non-profits perceived to be experienced in both cooperatives and tenant training. The organization hired a new program manager, Onka Dekker, to coordinate LACDC's participation in the program. Ms. Dekker was recruited from the east coast, where she had considerable experience with co-op conversions in Washington, D.C.

In addition to LACDC, two other neighborhood-based organizations have been involved in the Demonstration, at least briefly. In Crenshaw, the California Association of Tenants (CAT) was originally proposed as an additional project sponsor. However, this group eventually perceived their participation in the 510 project to be a conflict of interest, since they were acting as both developers and tenant advocates. As a result, they withdrew from any formal participation in the project.

In Hollywood, a local neighborhood based organization has assumed a key role in the co-op development process. This is the Route 2 Community Housing Corporation (R2CHC) which serves as a subcontractor to the SPO and is the owner of the co-op properties. Route 2 is a non-profit organization created to represent the interests of some 300 residents of the Route 2 corridor whose homes had been acquired by the California Department of Transportation (Cal Trans). Cal Trans began its property acquisition in the Route 2 area in the late sixties in the expectation of the construction of a new freeway connector. Intense community pressure eventually defeated the construction plans, but not before Cal Trans had acquired a number of residential properties in the area. Over the past ten years the Department has rented the properties, often to

their original owners. In 1979, however, the legislature approved a law requiring Cal Trans to dispose of the properties at original acquisition costs for use as cooperative housing.

Under Route 2 CHC's contract with Cal Trans, the organization is developing 350 units of co-op housing in six projects. Five of these are rehab, and one is new construction. The Hollywood 510 co-op is actually Route 2 CHC Co-op II. The small subcontract with the SPO covers outreach, training, marketing, and inspections of the rehab work for Co-op II. Route 2 staff is primarily funded from a Cal Trans grant and has also contributed work write-ups, architectural plans, and a bidding package to the co-op project.

### 5.3 The SPO

Each of the Demonstration's Special Purpose Organizations consists of two partners: the developer and LACDC. LACDC controls a majority voting position on each Board of Directors. In Hollywood the Route 2 CHC is not formally represented on the SPO board due to City reluctance to become involved with a cumbersome amendment process. However, a Route 2 area resident does serve on the Board as a representative of LACDC.

The City of Los Angeles initially assumed the role of a broker in the Demonstration, assisting the developers to locate acceptable non-profit partners and helping to set up the SPO organizations. Once the SPOs were organized, however, the City adopted a hands-off approach to SPO conflicts, preferring to let LACDC and the developers resolve issues themselves. The City expected each SPO to negotiate a common position and to speak to the City with one voice.

As it turns out LACDC has assumed a dominant role in each of the SPOs, vigorously pursuing its preferred policies and strategies. LACDC serves as the co-op developer for both sites, despite original private developer original expectations that they would take responsibility for all development activities. At the insistence of LACDC, Vadehra and Weinstock have essentially bowed out of the ownership component and participate solely as Section 8 developers.

Particularly in Hollywood, the SPO remains little more than a paper formality. Deep philosophical differences separate Vadehra and LACDC. Vadehra has withdrawn from the cooperative project altogether and turned the development of co-op entirely to LACDC and R2CHC. Relationships between the two parties are tense, and the SPO meets only infrequently.

In Crenshaw, relations are somewhat better between LACDC and Weinstock (Tom Bell), although the developer again does not take an active role in the co-op project. There has been an amicable agreement between the parties to go their own ways. Bell has been active in SPO meetings and did provide assistance in building selection.

Differences between SPO partners tended to revolve around three issues:

- o Building Selection: In Hollywood, LACDC refused to accept several buildings proposed by Vadehra;
- o Developer Role: LACDC preferred that the developer refrain from participating in the co-op projects;
- o Resale Policy: Both developers opposed the strict resale provisions preferred by LACDC.<sup>1</sup>

#### 5.4 The Homeownership Projects

##### 5.4.1 Hollywood

Known as the "Four Streets Co-op" the Hollywood 510 project consists of 31 separate buildings which will be converted into two, three, and four family residences. The structures are concentrated in a four block area adjacent to the Hollywood NSA. The buildings are generally in good structural condition and require only limited rehabilitation -- typically partitioning and exterior improvements. Buildings tend to be two story residences: several had been single

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<sup>1</sup>Under state law, shareholders in limited-equity co-ops are limited to 10 percent appreciation on their initial equity investment.

family homes while others had been used as rooming houses. While not located in the Hollywood NSA, the buildings were selected due to their favorable acquisition costs.

A total of 98 units will be developed. These units will include 10 four bedroom or larger, 24 three bedroom, 22 two bedroom, 36 one bedroom, and 6 efficiency units. All buyers will be required to pay an up-front buy-in fee of \$500 and subsequent fair market rents (FMRs). Most cooperators will also receive Section 8 subsidies: the City has received commitments under the Section 8 Moderate Rehab program for 90 of the 98 units in the project.

Financing for the project has been arranged by LACDC through the Savings Associations Mortgage Co. (SAMCO), a consortium of S&Ls located in San Francisco. SAMCO will write a mortgage for \$2,415,000 at 12.5 percent over 15 years. SAMCO is providing combined construction and permanent financing. The City has committed \$351,000 for gap financing but now believes that another \$100,000 will be needed. A June 30, 1983 closing is expected and the entire project should be completed within one year.

The costs of rehabilitation are projected to be \$2,132,000 or an average of \$21,755 per unit. Project viability has been assisted by the low acquisition costs obtainable through Cal Trans. Total acquisition costs were \$1,099,653 or an average of \$11,221 per unit. Architect fees, taxes, insurance, interest and loan fees total an additional \$499,079 or an average of \$5,093 per unit. Administrative costs for the Hollywood SPO are estimated to be \$59,706, including additional operations funds recently granted by the City. Total average per unit cost is \$38,976.

Section 8 syndication proceeds contributed to the Hollywood co-op amount to \$146,240. All but \$29,248 of this capital reserve has been used for property acquisition financed through a short-term loan from the City.

Marketing is not a concern for the Four Streets Co-op project since all cooperators will be drawn from the R2 CHC constituency of area residents, including existing building tenants. Route 2 CHC has developed a scheme for relocating tenants into appropriately

sized units, whereby tenants are given the opportunity to select preferred units from a master site plan. Nearly all existing tenants will remain as cooperators.

Tenant training, rather than marketing, will be a major activity for the SPO. Route 2 CHC, with assistance from LACDC, will conduct the training. Tenant training will be comprehensive, covering all aspects of cooperative living, homeownership, leadership development, consensus building, management, and how to run meetings.

#### 5.4.2 Crenshaw

Known as the "La Ronde" Co-op, the Crenshaw homeownership project consists of a 33 unit two-story garden apartment building with a landscaped, enclosed courtyard. The building is in very good condition and will require only minimal rehabilitation. The unit mix will remain unchanged, with 19 one-bedroom units and 14 two-bedroom units.

Initial co-op membership fees will depend on the income of the cooperators: Section 8 households will pay \$318 for a one bedroom or \$430 for a two bedroom unit, while non-Section 8 households will pay \$634 and \$860 respectively. Nearly all of the units--29 of 33--will have some form of Section 8 subsidy, including 19 units of Section 8 moderate rehabilitation assistance obtained by the City from the housing authority.

The financing for the La Ronde Co-op has been assembled from several sources, including a \$351,000 City land writedown, a \$100,000 zero interest CHFA loan, \$60,000 in Section 312 loan funding, \$41,000 in syndication proceeds, and \$10,000 from the sale of units. The remaining \$620,000 balance will be financed by SAMCO at 11 percent. No interim financing is needed since the construction costs (\$160,000) will be covered by CHFA and Section 312 funds. Financing was expected to be closed by June 1983 and the project completed by the end of the year.

The major cost associated with the La Ronde co-op was acquisition, which totalled \$947,000. This purchase price included

a special discount offered by the resident owner, Oscar Gibson, who intends to remain as a cooperator. Administrative/operations costs for the SPO total \$61,760, including add-on funds provided by the City. Including SPO operations, capital reserve costs, and relocation, total development costs are \$1,428,110 or \$43,276 per unit.

The Section 8 syndication proceeds provided a total \$184,000 to the homeownership project. A portion of these funds (\$50,000) were used for property acquisition; the remainder will serve as a capital reserve.

Marketing does not appear to be a major concern for the La Ronde Co-op since 19 of the 33 existing tenant households have already agreed to continue on as cooperators. A board of directors has been created from these initial participants. Policies for recruiting and selecting additional households are yet to be determined by the co-op board of directors. Board members are also uncertain about how to handle cases where existing tenants choose not to become cooperators. LACDC will provide tenant training to the La Ronde Co-op similar in scope and content to the assistance extended to the Four Streets Co-op.

## 5.5 The Section 8 Projects

### 5.5.1 Hollywood

The Hollywood Section 8 project is a five building scattered site project designed to develop a total of 61 family and elderly units.<sup>1</sup> The buildings are two story walk-up apartments between 40 and 50 years old. They are not located close to the proposed Four Streets Co-op. The level of rehabilitation varies by building.

At this point, one building for elderly tenants has been completed and is in the process of rent-up. The four family unit buildings are currently under construction. Tenant

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<sup>1</sup>Family units will outnumber elderly units by a 2 to 1 margin.

selection/rent-up for all buildings will be handled by Vadehra Enterprises. Management services will be provided by a separate firm with a prior working relationship with Vadehra.

The Hollywood Section 8 received GNMA tandem financing based on an Area Office lottery. Construction financing was provided through an 11 percent bond issued by the City Redevelopment Authority. Even with this favorable financing, the City had to contribute \$517,000 for land write-downs. An additional \$300,000 was also contributed by the City for temporary and permanent relocation of existing tenants. Vadehra manages the relocation, but will be reimbursed by the City.

#### 5.5.2 Crenshaw

The Crenshaw Section 8 project consists of 83 family units in four scattered site buildings containing 24, 22, 17, and 20 units. The buildings are two story garden apartments with enclosed courtyards.<sup>1</sup> All were occupied, often by large families which increased the costs of relocation. All buildings require substantial rehabilitation. The per unit cost is estimated to be \$40,000; \$27,000/unit for acquisition and \$13,000/unit for rehabilitation.

Rehabilitation is proceeding in phases. Two sites are almost completed while two other sites have only receive exterior repairs to date. Work in the Crenshaw area is difficult due to crime problems and the temperment of some tenants who have not been friendly toward the project. Relocation is a major issue, both financially and logistically. Turnover will be nearly 100 percent in one building which was formerly a center for drug dealers.

The Crenshaw developer attempted to obtain GNMA financing but was unsuccessful in the lottery. Eventually, the project received a

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<sup>1</sup>Each building had a swimming pool located in the courtyard. These have been filled and will probably be used as sandbox/play lots.

FAF and bond financing from the City.

#### 5.6 Demonstration Problems and Issues/Assessment

The experience of the 510 Demonstration in Los Angeles has been mixed. In terms of production, the project has been successful and is only slightly behind schedule. Much of this delay can be attributed to uncertainty surrounding the GNMA Tandem lottery and the receipt of FAF for the non-Tandem Section 8 project. Throughout the program the City had insisted that co-op development was not to proceed until the Section 8 projects were locked in. While this was based on the City's reluctance to raise tenant expectations too soon, it proved to be highly frustrating for LACDC which was solely interested in the co-op component of the Demonstration.

The co-op developments themselves appear to be proceeding well. Both have now received permanent financing commitments and construction should begin over the summer. Cooperative associations have been established at both sites and the majority of tenants at each will participate in the co-op. It may be noted that the Los Angeles Demonstration is the only one of the six expansion sites to develop co-ops in occupied buildings. Thus considerable effort had to be devoted to canvassing tenants as a part of building selection and to organizing them into viable cooperator groups. In Crenshaw particularly, the tenant cooperators appear to be enthusiastic about the project and seem to be prepared to undertake cooperative management. Certain issues remain to be addressed, however, including how to handle tenants who do not choose to join the co-op.

Overall, the 510 Demonstration has required a substantial infusion of public funds. As noted above, the City has contributed CDBG funds both to the Section 8 and the ownership projects.<sup>1</sup>

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<sup>1</sup>The City has used CDBG funds to provide acquisition write-downs and cover relocation expenses for the Section 8 projects. In Hollywood, the acquisition write-down was \$517,000 and a similar amount was provided for Crenshaw. Section 8 relocation expenses were \$300,000 and \$500,000 respectively. For the homeownership projects, the City is providing roughly \$350,000 per site. However, it appears that the Hollywood project may require an additional \$100,000 for gap financing.

In addition, the vast majority of the cooperators will receive rental subsidies through the Section 8 moderate rehab program, and additional cooperators will be certificate holders. While the use of rental subsidies adds to overall program costs, the City believes that this is a necessary component of the program, both to benefit existing low- and moderate-income tenants and to ensure that the units remain available for low-income occupancy for the foreseeable future.

An additional means of maintaining the units for low-income occupants is the strict resale policy associated with limited dividend cooperatives. As provided under a 1979 state law, profit on resale of the unit is limited to 10 percent of initial equity. The merits of this restriction were hotly debated by the SPO participants, who divided along predictable lines. Consistent with its overall housing philosophy, LACDC was well disposed to the limited resale policy. The private developers, by contrast, believed that it undercut the principle of homeownership, where equity build-up is an important motivation. The Hollywood developer in particular suggested that the program as implemented provides no ownership benefits. Had he been permitted to undertake co-op development as he had planned, it is likely that the resulting project would have been designed to serve more moderate income purchasers who could benefit from the tax benefits associated with owning one's residence.

Perhaps the most interesting aspect of the Los Angeles Demonstration is the wide philosophical gulf which separates the non-profit community groups and the for-profit developers. While relationships between the two have remained cordial in Crenshaw, neither site maintains a working SPO. In Hollywood, the developer is largely unsympathetic to the approach taken by the non-profit, and major controversies arose over the selection of the co-op building and the way communications with tenants were handled. The developer was also frustrated with the pace of the non-profit's work. For its part, the community organization believed that the developer was attempting to interject profit into the Demonstration

at every step. For this reason, they felt compelled to divorce themselves from the developer and undertake the project alone.

Given the nature and intensity of the conflict, the SPO was incapable of functioning as intended. While this result can be at least in part attributed to site-specific factors of personality and outlook, the broader implication may be that where community sponsors believe they are capable of developing projects alone, the requirement for joint sponsorship can be counter-productive. Certainly in Los Angeles, competition for the co-op developer role has produced conflict and strain throughout the Demonstration.

For its part, the City has remained aloof from the controversy, insisting that the SPOs resolve their own problems. While program administrators appeared to be more comfortable with the private developer's way of doing business than the advocacy style which characterized LACDC, they appear to be satisfied with the output of the Demonstration. Specifically, the projects are proceeding to completion and they will primarily benefit existing low and moderate tenants, a major City objective for the program. Despite some dissatisfaction with LACDC's administrative performance under the Demonstration, the City also appears to have become more favorably disposed to supporting similar non-profit co-op development projects; soon after approving the Four Streets co-op as the Hollywood ownership site, the City agreed to fund two additional R2 CHC co-op projects which it had originally been reluctant to back.

510 DEMONSTRATION PROJECT

LOS ANGELES



Hollywood Co-op - One of 31 Rehab Buildings



Hollywood Co-op - Section 8 Rehab Project



Crenshaw - Section 8 Rehab Project



Crenshaw Co-op - Moderate Rehab

## Chapter 6

### THE 510 DEMONSTRATION IN ST. LOUIS

The St. Louis site, Union Sarah, is one of the most successful of all the Demonstration cities. Construction has begun on the Section 8 project and in three of the five condominium buildings. Both components of the program are expected to be completed by the Fall of 1983. In fact, some of the condominiums are already being marketed, and five have been sold. The program has gone quite smoothly, with few discernable stumbling blocks. As a result, the City has not had to provide much technical assistance to the SPO.

There appear to be several reasons for St. Louis' success. To begin with, the City relied on two groups that had already worked together on several projects in the neighborhood. As a result, the basic partnership was in place before the program ever began. Moreover, both the developer and neighborhood group -- which is really a community based, for-profit development firm -- had previous experience in both housing rehabilitation and Section 8. Thus, neither group had to be educated as part of the program start-up.

Another factor related to the program's success is that many important elements of the 510 program were already part of the City's housing policy. For example, the City has been doing homeownership programs since 1976, some of which involved the use of block grant monies to write down construction costs. The City has also encouraged the establishment of joint ventures between community groups and developers as part of its programs. As a result, it is not surprising that private sponsor expertise was in place and readily transferrable to the 510 program.

Despite St. Louis' performance in the Demonstration, not all of the elements of the Demonstration design have been successfully implemented. First, there is no formal SPO in Union Sarah. While the developer and community group do work together, the developer makes most of the decisions regarding the homeownership project. In addition, due to poor market conditions, the City's ability to leverage syndication proceeds was disappointing. These and other issues of the St. Louis project are explained below.

#### 6.1 The Union Sarah Neighborhood

The 510 target area in St. Louis is the Union Sarah neighborhood. It is located adjacent to the Central West End, an area that has experienced substantial private redevelopment activity in recent years. Union Sarah has been the focus of a great deal of public attention since it was designated a NSA Section 8 neighborhood in 1979. A large elderly housing project was recently completed under the Section 8 Substantial Rehabilitation Program, and a number of scattered site housing projects have also been developed in recent years under the Section 8 program and City-funded CDBG programs. In addition, the City has committed over \$1 million to support capital improvements in the area. Currently, a large grocery store, financed with UDAG funds, is under construction. Much of the public development activity that has occurred is concentrated in a Section 8 set-aside target area within Union Sarah which overlaps slightly the 510 target area. Thus, the 510 Demonstration represents an extension of public development activity further into the neighborhood.

Union Sarah developed as a middle- and upper-middle income residential community during the latter part of the nineteenth century. Most of the homes built during this period were large, single-family dwellings. After the turn of the century many of these lots were subdivided, although the neighborhood remained a primarily White, middle-income community until 1920.

From 1920 to 1940, the area began to see an influx of moderate- to middle-income Blacks. Primarily as a result of migration to war

industry employment in St. Louis, the Black population in Union Sarah increased to over 50 percent in the early 1940's. By the end of the 1950's the Black population of Union Sarah was over 90 percent.<sup>1</sup> During this period, a urban renewal project led to the displacement of a nearby Black community to Union Sarah, spurring the breakup of a number of large, single-family homes into apartments.

According to City estimates, as of 1980, approximately 32 percent of Union Sarah's 6,500 housing units were in need of major rehabilitation. An additional 37 percent required moderate rehabilitation. The vacancy rate in 1980 was estimated at 15.1 percent. Approximately, one-third of all households are below the poverty level.

Union Sarah was the logical choice for the 510 Demonstration for a number of reasons. Most important, it was a NSA target area; therefore, the City was already committed to provide to the area the Section 8 and CDBG resources that were required by the 510 Demonstration. Second, the neighborhood had a track record of successful homeownership and rental developments. The presence of additional units would enhance and reinforce the positive effects of these recently completed projects. Third, a local community organization and private developer had already agreed to joint venture a Section 8 project in the neighborhood. Thus, the required vehicle for the development of the homeownership project was in place. From the City's perspective, Union Sarah was tailor-made for the 510 Demonstration, and no other neighborhoods were considered before making this selection.

## 6.2 The St. Louis Sponsors

The Residential Development Division of St. Louis' Community

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<sup>1</sup>Between 1950 and 1960, the City experienced a substantial loss in overall population, while at the same time the Black population grew by 40 percent citywide.

Development Agency is the administering agency for the 510 Demonstration in Union Sarah. Since 1976, the City has operated programs to stimulate homeownership in St. Louis. Among these programs is the St. Louis Mortgage Plan which was designed to increase the attractiveness to private lenders of home mortgage lending in high risk communities. The plan guarantees 10 percent of a conventional 20 year loan for an owner-occupant. St. Louis has also developed such programs as: (1) an interest reduction program for home buyers which reduces the effective investment rate by 2 percent over the life of a loan; (2) a short-term loan program to small developers whereby 50 percent of construction financing is guaranteed with CDBG funds; and (3) a Housing Implementation Program through which CDBG funds are used to fill the gap between development costs and feasibility for a variety of types of projects from for-sale developments to Section 8 Substantial Rehabilitation projects.

According to the City, all of these programs are designed to encourage housing development in a depressed market and to encourage moderate- to middle-income households to buy homes in the City. Thus, the 510 Demonstration, with its emphasis on making homeownership opportunities available to moderate-income persons, fits in very well with St. Louis' housing goals. It was this factor as well as the opportunity to gain some additional Section 8 units that prompted the City to apply for the 510 Demonstration.

The choice of the developer and the community group for the 510 Demonstration was made by the City in conjunction with the selection of the Union Sarah neighborhood. As noted before, one criteria for selecting Union Sarah was the fact that a local community group and developer, who worked together in Union Sarah previously, had already agreed to joint venture a Section 8 project under the NSA program. With the advent of the 510 Demonstration, it was decided that the project would be developed through this program, and in conjunction with the development of the homeownership component.

The Research Institute for Community and Economic Development (RICED), a non-profit subsidiary of the for-profit Union Sarah

Economic Development Corporation (USED C), is the community sponsor of the homeownership program. USED C is a partner in the Section 8 project.<sup>1</sup> USED C was founded in 1969 to improve services and upgrade housing in the Union Sarah community. In recent years, USED C has concentrated primarily on physical development activities, such as the development of a 154-unit, elderly Section 8 project and the rehabilitation of a 142,000 square foot office building. In conjunction with the 510 developer, USED C developed a six-unit condominium project. All in all, USED C is a fairly sophisticated and ambitious community organization, with a level of development experience that is unique among the 510 neighborhood sponsors. At the same time, this group is anxious to expand their development activities beyond the Union Sarah neighborhood. Thus, their role as a "neighborhood representative" may be weaker than it is at the other sites.

Given the experience of the community group, one might question whether the presence of a for-profit developer is necessary to carry out the 510 program in St. Louis. USED C's staff believe that they could do the project alone. However, while the City program administrator regards USED C as a sophisticated community organization, she did not equate their development expertise with that of the for-profit developer. The City felt that the developer was necessary to lend credibility to the project, especially in securing financing and overseeing construction activity.

The developer sponsor for the project is the City Equity Corporation, a local firm that had worked in Union Sarah previously and with USED C. City Equity's portfolio includes a wide range of residential projects ranging from new luxury townhouse condominiums to the rehabilitation of historic rowhouses for moderate-income

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<sup>1</sup>USED C typically does housing development, but because the Demonstration required a non-profit sponsor RICED was used. The two organizations are basically the same -- they share the same offices, staff, and president.

rentals to Section 8 substantial rehabilitation projects. In the Union Sarah neighborhood, City Equity has developed a six-unit townhouse condominium project (with USEDC) and has developed 12 units under HUD's 312 program. The firm was the construction contractor for USEDC's elderly Section 8 project. In addition to its construction and development activity, City Equity is also involved in property management.

Together, USEDC and City Equity present an experienced team with a record of successful joint ventures in the Union Sarah neighborhood. Given their level of expertise, the 510 program in St. Louis will not be a mechanism for capacity-building at the neighborhood level. At the same time, the experience of the team has enabled the project to proceed very smoothly. Their experience has also allowed the City to remain relatively uninvolved in the Demonstration. The City's program director oversees the progress of the Demonstration, but does not participate in day-to-day development decisions.

### 6.3 The St. Louis Special Purpose Organization: 510 Inc.

Soon after the Demonstration began, USEDC and City Equity formed 510, Inc., the special purpose organization that would implement the 510 homeownership program in St. Louis. The Board of 510 Inc. has three members: the president of City Equity, the president of RICED and USEDC; and a local church leader. According to the SPO agreement, City Equity was to be the contractor for the homeownership project. In addition, the Union Sarah City Venture III, a general partnership formed between USEDC and City Equity to develop the Section 8 project, would have responsibility for providing administrative services to the SPO and would be given the opportunity to market the homeownership units.

While the organizational arrangements appear somewhat complicated, the actual operation of the Demonstration is fairly straightforward. In reality, City Equity has assumed primary responsibility for the development of the Section 8 and the condominium project. As a result, although City Equity and USEDC

staff are in frequent communication, the SPO per se does not operate in St. Louis. There are no formal meetings of the SPO and the sponsors never hired project staff for the Demonstration. Instead, the bulk of the HUD administrative grant was split 70-30 between City Equity and USEDC.<sup>1</sup> USEDC's funds were devoted to overseeing property acquisition, the only task assigned to the community group.

Overall, the community group and the developer are relatively satisfied with the way responsibilities have been divided and agree that while there have been some arguments, they have worked together fairly well. Of the two sponsors, the developer seems somewhat less satisfied with USEDC's contributions than vice-versa. The developer believed that what USEDC had contributed to the project did not approach what it had received, namely 40 percent equity in the Section 8 project. At the same time, he felt that further involvement on USEDC's part would not add to the project.

As noted earlier, the concept of joint private developer-community group ventures was not new to St. Louis. City Equity and USEDC had been partners prior to the start of the 510 Demonstration and the City had been encouraging such ventures through its programs for some time. Thus, there were precedents for the the roles that participants played in such ventures. This may explain, in part, why the partnership model designed by HUD was never really followed in St. Louis.

#### 6.4 The Homeownership Project

The 50-unit condominium program in St. Louis is a scattered site project involving substantial rehabilitation of four large single-family properties and an old hotel and the construction of 12 new townhouse units. All of the properties are located at the western end of the neighborhood -- as part of the City's plan to

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<sup>1</sup>Some of the grant money paid for architect's fees.

concentrate program resources in order to make a visible impact on the community. Thus, these buildings were selected because of their proximity to one another and because they were vacant, enabling the sponsors to avoid tenant relocation. Acquiring the properties was somewhat of a problem since about 30 percent were City-owned. USEDC took the lead in property acquisition.

City Equity has assumed full responsibility for all remaining development tasks. Originally, they expected a fee for assuming this role in the condominium project. However, during initial negotiations, HUD refused to allow a development fee. Ultimately, the developer settled for an inflated builder's fee, about 12 1/2 percent compared to the 7 to 10 percent typically given, as reimbursement for the risk assumed in marketing the units. This fee is a major incentive in City Equity's participation in the program.

The total development cost of the condominium project is \$2.6 million. Construction and permanent financing is being supplied by the Missouri Housing Finance Agency. In addition, the City will contribute to the condominium project by writing down the sales price by \$8,500 per unit (a total CDBG contribution of \$425,000).

While obtaining financing from the state HFA was not a big problem, some of the regulations imposed by the Missouri HFA did present difficulties. To begin with, the sponsors had to keep the sales prices of the units under the HFA's \$44,000 ceiling. The City's CDBG contribution alleviated this problem somewhat, but the sponsors still had to reduce the size of the units in order to limit sales prices.

In addition, the HFA required that the loan was FHA-insured and HUD processing for FHA insurance proved to be problematic. The developer wanted to conduct a phased development and sale of the condominiums. But under FHA regulations for large condominium projects, 51 percent of all units had to be pre-sold before the first deal could be closed. To avoid this pre-sale clause, City Equity decided to do six small condominium projects which will be

organized under an umbrella homeownership association.<sup>1</sup>

Unfortunately, the HUD Area Office had never processed small condominiums before and as a result obtaining FHA insurance was quite time consuming.

No other major problems have arisen in implementing the program thus far. As of May 1983, the condominium project was complete and the developer had begun marketing the new townhouse units. The units will sell for up to \$44,000 for a two-bedroom unit. This translates into a monthly mortgage payment of \$469, assuming a 5 percent downpayment.<sup>2</sup> It is estimated that condominium fees will be about \$65 per month, although during the project's first three years, these fees will be paid from syndication proceeds supplied by the developer.<sup>3</sup>

While the costs of the condominium are a little high when compared with current rents in the neighborhood, the sponsors do not anticipate problems in marketing the units since they involve homeownership.<sup>4</sup> Expected buyers will be predominantly young, small, minority households -- either singles or married couples -- within the moderate- to middle-income range.<sup>5</sup> No income restrictions will be imposed, nor will the City impose restrictions regarding length of residence or resale value.<sup>6</sup>

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<sup>1</sup>Ultimately, City Equity would have been forced to do small condominiums anyway since this was a scattered site project and under Missouri Law, condominiums must be on contiguous properties.

<sup>2</sup>Buyers will receive HFA loans at 12 1/2 percent.

<sup>3</sup>Buyers will also receive property tax abatements. Taxes will be frozen at their current level for ten years. At that point, they will be reassessed and owners will be required to pay 50 percent of the market rate tax for the next 15 years.

<sup>4</sup>In fact, the condominium sales office has been open for only a few weeks, and five units have already been sold.

<sup>5</sup>The size of the units -- one- and two-bedrooms -- effectively limits household size.

<sup>6</sup>Given the depressed property values in the area, the City feels that the likelihood of windfall profits to buyers is minimal.

## 6.5 The Section 8 Project

The Section 8 project, which is now under construction, involves the substantial rehabilitation of five vacant buildings at the eastern edge of the neighborhood. Upon completion (expected in the Fall of 1983), the project will contain 100 units; 50 are from the City's NSA allocation. As with the condo project, the Missouri HFA will finance the project. In addition, because of high interest rates, the City was required to write-down the cost of the Section 8 project with \$500,000 in Block Grant funds.

USEDC is a co-developer of the Section 8 project, with a 40 percent equity share. However, most of the development tasks have been the responsibility of City Equity. Overall, the development has gone fairly smoothly, and has required little participation on the part of the City. The biggest problem was in structuring the syndication package. Basically, the developer wanted to include the City's CDBG grant as part of its syndication base. The problem was solved by making arrangements to repay the grant on a 30 year, 12 percent basis, which looked enough like a loan from the City to incorporate it into the syndication package. Another problem involved securing FAF, which ultimately enabled the developer to raise rents by between 8 and 12 percent.

The developer will direct \$185,000 in syndication proceeds to the condominium. However, since the City was forced to contribute Block Grant funds to the Section 8 project, what had been a means of generating money for the condominiums became a complicated mechanism that involved no significant transfer of funds.

## 6.6 Participant's Assessment of the St. Louis Demonstration

As noted in the introduction to this chapter, a number of elements of the 510 program were not new to St. Louis. The City had been promoting homeownership programs for moderate-income families for a number of years and had also encouraged partnerships between developers and community groups. Because of the City's prior experience as well as the expertise of the private sponsors, both the Section 8 and condo projects have proceeded very efficiently.

However, also because of this in-place capacity, the participants have viewed the program as overly complex and restrictive. Generally, the participants regarded the 510 model in the same light that they viewed other local homeownership programs that involved joint ventures. Thus, certain elements of the program, such as requiring incorporation of the developer and community group partners in the SPO, were never fully accepted by the participants. The diversion of syndication proceeds to the SPO was also regarded as a complicated transfer of funds since the City was supporting the Section 8 project with CDBG funds. To the St. Louis sponsors, the 510 program was a funding mechanism, and not an advancement in housing policy.

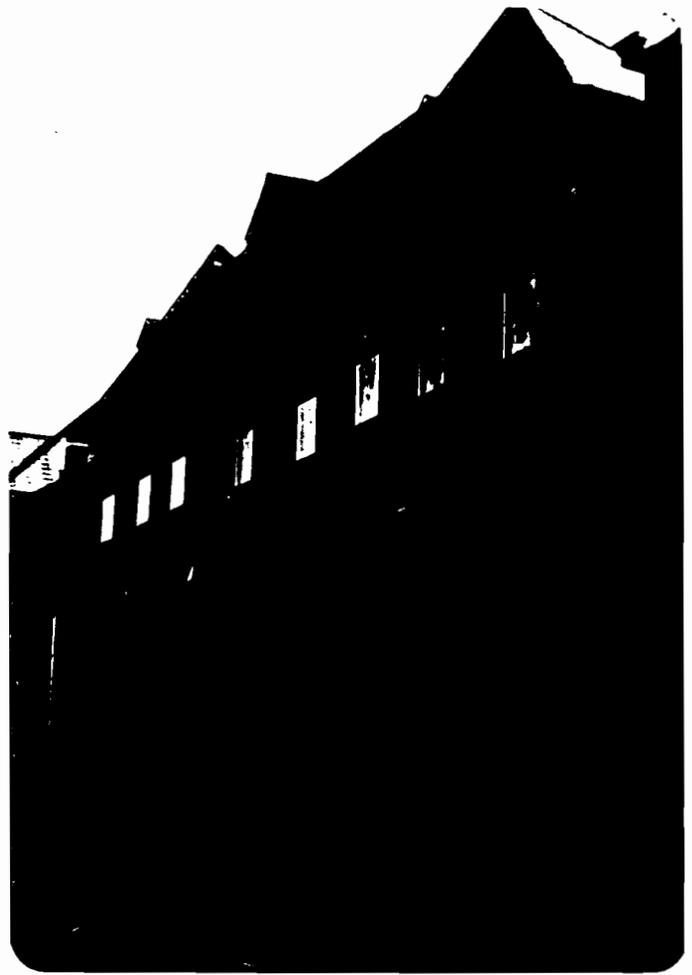
Despite these criticisms, the St. Louis participants are pleased with the way the Demonstration has worked. None of the participants anticipate any difficulties in the remaining months of the Demonstration. The St. Louis program should be completed on schedule, in the Fall of 1983.

510 DEMONSTRATION PROJECTS

ST. LOUIS



New Construction - Condo



Rehab - Condo



New Construction - Condo



Section 8 Rehab



Condominium  
Rehab Project