MULTIFAMILY FAILURES
CASE STUDIES

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evaluation report:

MULTIFAMILY FAILURES

Case Studies

Prepared by: Berkeley Planning Associates
for the Department of Housing
& Urban Development, Region IX

Michael B. Teitz,
Study Director

July 1975

VOLUME 2

THIS STUDY WAS PREPARED BY BERKELEY PLANNING ASSOCIATES AS INDEPENDENT CONTRACTORS UNDER CONTRACT H-2148 WITH THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, (HUD) REGION IX, OFFICE OF PROGRAM PLANNING AND EVALUATION. AS SUCH, THIS REPORT REPRESENTS THE VIEWS AND OPINIONS OF THE CONTRACTOR, BERKELEY PLANNING ASSOCIATES, WHO ARE NEITHER AGENTS NOR EMPLOYEES OF HUD AND WHO ARE SOLELY RESPONSIBLE FOR THE SELECTION AND CONTENT OF THE MATERIALS CONTAINED THEREIN AND THE ACCURACY OF THE REPORT. PUBLICATION OF THIS REPORT DOES NOT NECESSARILY REFLECT THE OPINIONS OF OR CONSTITUTE AN ENDORSEMENT OF THE REPORT BY THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT.

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Case studies are virtually impossible without the cooperation and support of the participants in the events to be described. We want to acknowledge the assistance of HUD staff in identifying projects, locating participants and, especially, in giving their own perspectives and insights on the complicated stories of specific projects. We are also indebted to all the numerous other people interviewed, both those who have been involved for better or worse in the effort to provide low-cost adequate housing, and to the tenants who now occupy it. Their open responses and insights were invaluable. The errors of omission or interpretation remain our own.

I. THE CASES: SUMMARY AND SYNTHESIS

INTRODUCTION

This is the second report resulting from the analysis of the financial failure of subsidized multifamily housing projects performed by Berkeley Planning Associates for the U. S. Department of Housing and Urban Development under Contract H-2148. Following the earlier statistical analysis of a large data file on some 618 projects, we have carried out detailed case studies on eleven projects. These case studies form the main body of this report.

The fact that extensive statistical analysis failed to reveal any simple pattern of causation for failure in multifamily subsidized projects makes the case studies particularly important. Clearly, failure does not just happen. Rather, it seems likely that failure is a stage in a very complex process and may result from many different causes operating in ways that are not the same in every instance. In order to develop hypotheses about these complex patterns of causality that can be tested and validated statistically, it is necessary to examine some instances of financial failure and non-failure in considerable detail. Within the limitations of time and information available, each case presented in this report attempts to provide a concise but rich picture of how a project came into being, how it has functioned in operation, and who and what was involved in its success or failure. These findings are presented generally in chronological order, so that the progressive development of a project may be followed despite the complexity of its often tangled history.

Some important characteristics of case studies should be understood at the outset. The case study is an effective and valid technique for understanding what happens in complicated situations subject to differing interpretations by people who have participated in them. Like any account of what happened at a particular time and place, the case study is a mixture of observation, selection, reporting and interpretation. Thus, it is a synthesis after the fact by one observer and may be subject to correction or alternative interpretation by other observers. On the other hand, the great strength of the case study lies in the fact that it is not bound by a single source or type of information. The observer will try to bring together written records, statistical information, and individual participants' recollections and interpretations in order to present the case in some of the richness of reality. It is this quality that makes the case study important, for it can provide a unique sense of the multiple influences at work in a given situation, at best allowing the participants to speak in their own words. A set of case studies can be extraordinarily suggestive of the forces at work while ensuring to some extent against oversimplification.

The lessons to be drawn from case studies, then, are suggestive and interpretive. The cost and time required for a single case prohibit studies of a large and statistically representative sample of all possible cases. Nevertheless, it is possible to choose cases that do reflect some range of differences in the population and, in the comparison of success and failure, do allow us to look at otherwise comparable projects. Such a representative sample has been sought in this instance, with cases drawn from a substantial range of settings and organizational arrangements.

The body of this report consists of two main parts. Section II presents our interpretation of the findings of the studies, together with a summary description of the cases and the rationale for their selection.

Section III comprises the cases themselves. We do not propose recommendations for future action on the part of HUD in relation to the development or management of subsidized multifamily housing. Such proposals require further integration of the present work with additional statistical analysis of a limited sample of projects and involvement of HUD staff. They will be the main objective of the final report of this project.

THE CASE SAMPLE

Eleven projects are a tiny sample of those in HUD Region IX, let alone the entire United States. It is therefore important to discuss how and why projects were selected and what they are like, as well as to present the findings about financial failure that they reveal. These are the objectives of this section.

The selection of a set of multifamily housing projects to examine in detail presents a problem of choice among important but conflicting criteria. Basic issues include the following:

(1) What types of cases should be selected?
(2) What types of projects should be represented?
(3) What geographical and locational distribution should be achieved?
(4) What proportion of financial successes and failures should be selected and how should they be related?

The final selection inevitably reflects a series of compromises among these considerations, within the constraints of available prior information and financial and human resources. To some degree the selection must be arbitrary. Nevertheless, it is not random or without careful evaluation of alternatives.

Given the scale of the project and the time and resources available, about ten to fifteen cases seemed to be an appropriate number to attempt. Experience has shown that fewer than ten cases is likely to be insufficient to provide an adequate range of experience and depth for purposes of comparison. On the other hand, to have attempted a larger number within the time and resources available for the effort would have resulted in studies that were too rapid and likely to be thin. Given, too, that a statistically representative sample is infeasible for this type of study, more cases would provide diminishing returns to effort. The eleven projects selected were chosen from a substantially larger group that was identified with the assistance of HUD Regional Office and Area Office staff. Only 9 are presented here.

The characteristics of projects to be studied were determined with three considerations in mind. First, we wanted projects that provided examples of cases with characteristics felt to be associated with financial failure by other observers. Among such possible factors, the type of sponsorship, location, degree of professional management, and age structure of the project's population have been suggested. A second consideration might be the selection of projects that are varied in other characteristics, for example, number of units, size of buildings, and design quality. The third consideration focuses upon the variable of interest, financial failure. As discussed in the Phase One Progress Report the definition of failure may take several forms. Even if we restrict its meaning to financial insolvency, alternative definitions exist, for example, default on mortgage payments, mortgage assignment, or foreclosure. Ideally, examples of more than one degree of failure should be sought. Further, we might wish to examine cases of failure or non-failure that match in other respects.

If cases were selected so as to cover the range of possible combinations of even a few variables, literally hundreds would be necessary. The possiblity of following a strict experimental design, then, does not exist. Our solution to this dilemma was pragmatic. Cases were selected with the objective of providing some representation for several major variables, but without attempting to cover all their combinations. Thus, we sought cases in built-up urban areas and in suburbs; with non-profit and limited dividend sponsors; from the Section 221(d)3 and 236 programs; and occupied by a range of ethnic groups. It was decided to look at rather more failures than non-failures, the criterion for financial failure being that the project had <u>at least</u> defaulted on its mortgage payments. Where possible, we sought non-failures that resembled failures in the group.

The sample finally selected turns out to be quite rich and varied in these respects. Table 1 provides a summary of the projects together with some descriptive information. Some comments on the distribution of projects with respect to particular variables are necessary.

Rather more cases are drawn from the 221(d)3 program than from 236. This is due primarily to the requirement for projects with some history of failure or success. Having been in existence much longer, the former program tends to provide more such examples.

Projects were selected from a broad range of metropolitan areas and medium sized cities in Region IX. Very small cities are not represented. Where projects clustered conveniently, while exhibiting variation in failure status, they were selected. Within the areas, most projects are in semi-developed suburban locations.

No cases of foreclosure could be identified, so the range of failure runs from default to assignment. However, the ambiguity of non-failure should also be noted. Three of the four projects that have not defaulted have nevertheless received mortgage modification to help them through financial crises at some point in their existence. Of the failed projects, one never had such a modification and two are pending. The cases were selected with the assistance of HUD staff who identified the nonfailing projects as successes. We do not know the extent to which projects with neither default nor mortgage modification exist in the Region.

Both non-profit and limited dividend sponsorship are well represented. The former, as among all subsidized projects, tend to have poorer populations and a higher incidence of rent supplement apartments. Failure and non-failure examples occur across both types of sponsor. However, we were unable to identify a non-failing inner-city, non-profit sponsored project.

Projects range from 100 to 400 units in size, a considerable spread. However, they are all characterized by the low-rise wood-frame and stucco type of construction prevalent in these programs in the late 1960's and early 1970's. Their populations tend to be mostly minorities, with a substantial proporation of families on public assistance.

An appropriate procedure for carrying out the studies was developed through two pilot efforts. These indicated that a substantial amount of information about the history of a project could be rapidly developed from a combination of analysis of records in HUD files, visual inspection of the project, and interviews with as many participants in the project's creation as could be found. To these were added interviews with tenants and people currently responsible for the management and operation of each project. Among the actors that the interviewer attempted to reach in each case were: HUD personnel, including those involved both in the production and management of the project; the owner or sponsor; the contractor or developer; housing consultants, in the case of non-profit sponsors; the architects, especially in cases where design appeared to be an important factor; the mortgagee; tenants currently living in the project (to locate past tenants would have been impracticable); and current and past project managers, both on and off-site. In addition, we were aware that in many cases other people have played important parts in a project's development. Such actors often were associated with other governmental agencies, for example redevelopment or public housing authorities.

In view of the fact that participants would be likely to recall events in very different ways and to interpret problems from quite different perspectives, it was important to contact as many as possible in each case. Despite our best efforts, the pressures of time and circumstance did not always allow this to be achieved. Some people simply could not be located and a very small number refused to be interviewed. Inevitably, gaps exist in the record. Nevertheless, the rate of response in most cases was very encouraging. Respondents were generally willing to speak frankly about their experiences and many talked at considerable length both about the project in question and their interpretation of the experience of subsidized multi-family housing in general.

The most difficult problem in such studies is dealing with diametrically conflicting recollections of events or interpretations of causation. Where these were irresolvable, we have attempted to present the alternative stories in the case.

Interviews were conducted informally. A tightly structured questionnaire was not used, both because we wanted people to talk about their experience in their own words and because of the wide range of roles that different actors might play in the evolution of a project. For each type of actor, a list of key issues was used to motivate the interview and to ensure that important topics were not missed.

THE ANATOMY OF FINANCIAL FAILURE

One cannot read the case studies or visit the projects in question without drawing conclusions about the nature and causes of financial, physical and social failure in multi-family housing. This section will present a synthesis of findings based on the cases studied. These conclusions make no claim to be statistical truth. Nevertheless, we believe that they have validity beyond the small sample of cases on which they are directly based. The widespread incidence of failure in multifamily projects and the similarity of the market circumstances, social conditions, participants in the process and governmental regulations under which such projects were built and occupied across the United States, give us reason to feel that these projects are not atypical. At the same time, they tell no simple story. What can be seen in the cases is entirely consistent with the absence of regular patterns of causation by simply defined variables that emerged from the initial analysis of the large statistical sample of projects. Failure springs from many sources and its incidence occurs in many ways. If there are broad conclusions to be drawn, they suggest themselves in the form of complex variables that are difficult to represent quantitatively but which may be no less valid for that fact.

Financial Failure: General Conclusions

Multifamily subsidized housing projects exist in an environment that allows them the slimmest of margins for success. They are vulnerable to so many ills, while protected by such thin defenses, that perhaps we should find remarkable not the high incidence of failure but rather the degree to which it does not occur. Even in this small sample, the circumstances and "causes" of failure were astonishingly diverse. Furthermore, none of the non-failing projects that we looked at was far from financial failure. Several had been forced to take emergency measures to head off insolvency. For failure and non-failure alike, the prospect of the future, especially of inflation, is grim. It is necessary, then, to ask what makes the existence of projects so precarious and why they are relatively unable to withstand the pressures upon them.

The fact that so many "causes" of failure can be identified suggests that the essential problems of subsidized housing are systemic and environmental. An analogy with medicine is suggestive here. To deal with a problem even so difficult as that of polio, it was possible to identify a class of viruses and develop ways to make most people, especially the highly vulnerable, immune to their attack. Heart disease cannot be dealt with in this way because if is a different kind of problem -- one that reflects the genetic inheritance and lifestyle of the individual and the nature of the society in which he exists. Thus, the "causes" of heart disease are identified as everything from fatty diets to smoking to excessively tension producing behavior. It turns out that these are also the "causes" of other, also systemic diseases, which makes us wonder about the nature of the causality involved. Nevertheless, it is possible to prescribe ways of behaving that will reduce the risk to the individual, and also to develop forms of crisis response that will help many to survive longer. The analogy with housing runs from description of the problem to the type of agenda for future action.

Looking at these cases, we see two broad characteristics that predispose them to financial failure. On the one hand, the pressures upon projects are many and powerful; on the other hand, their flexibility and resources for response are limited. The result is a permanent condition of instability, rather like a pyramid balanced on its point, in which any one or more of a myriad causes can result in failure. Putting it back again is much more difficult.

The task faced by the subsidized housing programs is a difficult one. The extremely high cost of deep subsidies for the large populations that would be eligible for housing on the basis of reasonable standards of quality, occupancy, and income, inevitably lead to tight constraints on costs and standards for construction and operation. But these constraints are imposed on a population and a social situation that makes them even more pressing than might be the case for the population at large. The eligible populations for subsidized housing are poor, which means not only that they have low or moderate incomes, but that they also have few resources to tide them over the hard times of unemployment or other crises that can interrupt their income. Their variability in income affects their ability to pay the rent regularly and on time. Many families are on public assistance, which smooths out the variation, but the amount is low and always needed for other basics of life. Rent does not always have the highest priority. The high incidence of large families means that subsidized projects, with the exception of those for the elderly, will have a higher than average density of children seeking outlets for their energy in constructive or destructive ways. Where these children are members of single-parent households, the task of adequate supervision may prove too much. In a general atmosphere of social breakdown, characterized by crime and drugs, people are disposed to act in short-range, selfish and socially destructive ways. For juveniles lacking the mobility that is characteristic of families of medium and high income, their world consists of the immediate area in which they live; it is that immediate environment, the project, that must absorb the impact of their presence and too often the high costs of wear-and-tear and vandalism that ensue.

Subsidized housing is caught between constraints on costs and pressures that would tend to increase them. Its successful construction and operation requires skills and organization of a high order together with flexibility and resources to take care of the crises that may not be individually predictable but are nevertheless sure to come in one form or another. To expect an extraordinary level of performance on the part of individuals in a mass program carried out under the most diverse conditions is simply unrealistic. Like other endeavors, subsidized housing attracts people who are dedicated and those who are venal, the smart and the dumb, the effective and the ineffectual. However, one way in which some of the worse effects of human variability may be diminished is through effective organization, especially a framework for action that allows people to be creative yet provides clear responsibilities and incentives for people to accept them. In this respect, the case studies reveal serious deficiencies in the way in which the programs function.

Like financial instability, the absence of a pattern of responsibility on the part of participants in the development of a housing project is difficult to characterize in a single variable. Yet it is clearly evident that in case after case of failure, not only were the problems difficult to deal with, but also there was nobody responsible for success or failure until it was too late. This is not to condemn people who work hard on difficult problems. In an interdependent situation, one person may have an enormous commitment but still be unable to affect the outcome. And it is unrealistic to expect people in general to accept responsibility far beyond the level prescribed by rules and indicated by the incentives that face the individual. Every housing program has many actors involved, some of them institutional, some individual. The necessity to partition activities in the complex process of development is evident. But, in cases of failure, it seemed that no one in the end was responsible for the whole enterprise. Indeed, incentives designed to attract participation removed many of the risks for participants who in ordinary circumstances might have been naturally concerned.

Originally, HUD was not intended to participate in the management of projects. Long deeply involved in programs for housing construction and financing, HUD's potential role as owner of last resort was masked by the expectation that mortgage insurance would function in a way similar to that in the conventional private market. As a result, monitoring of projects was often insufficient to let anyone see danger signals, even though conventional market mortgagees are careful about such things. Estimates of operating expenses have been cursory and inaccurate, the commendable desire to get projects built within program constraints sometimes leading to the acceptance of unrealistic estimates and generally to discounting the effects of inflation. The same pressures lead to exclusion of features such as recreational amenities that might be vital to project functioning. Project management and operations have been left to managers and sponsors.

For their part, owners and sponsors too often had only limited engagement with failing projects. Non-profit owners have essentially no equity interest in projects; though their commitment of seed money may have represented a financial sacrifice, it was seen as a contribution rather than an investment. Despite HUD's screening efforts, sponsors appear to have taken on projects with little real understanding either of housing or of the resources and human demands that were likely to occur. In some cases, the people in charge, though committed, were inexperienced, backed by no organization and unable to learn fast enough; in other cases, the organization was large, but thinly spread and constantly changing personnel. HUD staff literally never dealt with the same person more than once or twice.

Limited dividend sponsors have a larger equity, but in comparison with conventional housing it is frankly negligible. Despite individual concern for housing, the main consideration is the tax shelter provided by depreciation. Since tax savings are threatened with recapture if foreclosure occurs before ten years of ownership are over, the general partners may be pressured to take an active interest in project operations. This happened less often than not; other general partners milked projects for cash. Since HUD had been reluctant to follow through on foreclosure, limited partners continue to reap tax shelter benefits as projects deteriorate and attempts are made to save them. Even if a project is foreclosed, there is some question as to the vigilance with which IRS will seek to recapture excess tax savings. Finally, although the combination sponsorship, development and construction in a single entity increases the chances for responsibility at the early stages of a project's life, it allows owners to recapture very quickly their investment through profits on land (confirmed by HUD audit), design and architects' fees, and construction. When a project cannot meet its obligations, they bail out.

Mortgage institutions are likewise protected from risk, with a concomitant disincentive to active responsibility. Private mortgagees have their investments insured by HUD and risk only lost interest and inconvenience. Commercial banks usually cease to be involved after final endorsement, when the mortgage is typically sold to FNMA. The vigilance of FNMA is not necessarily unceasing. While its inspections and reports are accurate, they seem also to come too late. Since FNMA has purchased mortgages at a discount, it actually has no great incentive to hold onto mortgages when default occurs. Altogether, the absence of substantial financial risk, originally an incentive for participation, leads to a situation in which financial principals have little to protect. They behave accordingly.

Management entities are closest to projects and might be most concerned for their welfare. Large firms care for their own reputations and fear being blacklisted by HUD. But blacklisting is not universal, even within a HUD region; a firm blacklisted in San Francisco may manage projects in Sacramento. The practice of a fixed management fee and variable definitions of what is an allowable expense (for example, the on-site manager's salary) provide no positive incentive for effective management performance. Whether a project has high or low turnover, vandalism or crime makes no difference. Questions of an appropriate management strategy for low income, subsidized housing, will be discussed below.

If those who build and run projects have only limited responsibility, what of the tenants who live there and might be expected to care the most? By and large, in failing projects, they are apathetic or downright hostile. In either case, the results are costly to operation of the project. Almost nowhere had tenants organized, nor were they encouraged to do so. Without making excuses for antisocial behavior, we may note that some research has suggested that the more people are involved in community oriented activities, the more likely they are to feel in control of their own lives and take responsibility for the things that affect them. In the cases studied, it is striking that a sense of alienation on the part of tenants was so often associated with either chaos or rigid management and costly outlays for repairs and security. On the other hand, it has been cogently argued that people want from housing only shelter and reasonable security -- that anything more than this goes beyond what they might reasonably be expected to take on as part of the act of renting an apartment. The debate on community cannot be resolved here. Nevertheless, the absence of a sense of community in projects assures that one more group, the largest, accepts minimal responsibility for the welfare of the whole. And if the services received are poor and if some tenants act uncaringly or antisocially, can we be surprised that the sense of powerlessness in the remainder leads them to leave or otherwise withdraw?

Other participants play even slighter roles. Housing consultants package projects with the primary objective of seeing them built, after which their involvement typically ends. Governments and public authorities -- renewal agencies, planners, service agencies -- have their specific concerns but no more. Ultimately, one has the feeling in failing projects that no one is in charge.

A good deal of space has been devoted to the question of responsibility because it seems at once so difficult to pin down and so important to a project's viability, financial and otherwise.

Whether responsibility is defined as caring sufficiently to act or being firmly in charge, it comes through as critical to a project's ability to weather the permanent problems and intermittent crises that it will inevitably experience.

Financial Failure: Specific Conclusions

Beyond the pervasive characteristics of financially failing projects, many specific contributing factors can be identified. Alone or in combination, they may push projects into failure. Conversely, however, the presence of any one factor does not seem to be necessary or sufficient for a project to fail. Most of the factors discussed here have also been suggested by other observers. We make no claim for their "discovery". The lessons are simple enough.

Project Design: Poorly conceived project designs can exacerbate problems of operation, maintenance, vandalism and security in projects, but we cannot assign to design in the cases studied the dominant role in the social functioning of high and low-rise housing suggested by Oscar Newman and others. Most disturbing is the general lack of open space and facilities for children and juveniles' recreation. The reluctance of developers to see recreation as part of the task of housing is understandable -- it costs a great deal -- yet, the evidence in these cases suggests that lack of recreation will raise maintenance costs in a low or moderate income family project as surely as if the builder left the roofs off. The cost tradeoffs involved need to be investigated in more detail. Clearly, physical facilities alone are not necessarily enough. But they are necessary.

Location: Both failing and nonfailing projects are typically built in locations that are inherently undesirable in many respects. We recognize the constraints on the agency's ability to locate projects and doubt that location alone can be critical. Nevertheless, the innercity projects are located in areas of high crime and social disorder, often lacking an adequate market for their occupancy. The social and financial effects can be severe. Projects in the suburbs are a pale image of the surburban ideal. They are placed in marginal or residual locations, which their presence does little to change for the better. Services, especially shopping, access to employment and transportation are typically poor, an especially important consideration for low income tenants with limited mobility. Adding to the experience of difficulty in a number of instances was the effect of multiple projects built rapidly in close proximity. While it was recognized that a project might have problems in renting if others were too close nearby, the effect of successive projects on one that is a little older and experiencing financial and physical problems can be disastrous. The better tenants simply move to the newer housing, leaving the old to its fate.

HUD Processing: Not every project that was examined exhibited gross underestimates of operating and maintenance costs in its first year of operation, but the exceptions were rare. If budgets are set this tightly, then either they are unrealistic or the project's management must be routinely expected to be extraordinarily effective both in collecting rents and holding down costs. With some reservations, to be discussed below, it appears that operating cost estimates have been technically faulty or forced down to make projects feasible. Where the underestimation was done by developers, HUD has not challenged it. The resulting financial instability creates a situation where projects need rent increases as soon as they begin operation. No margin is left for mistakes or unexpected events, such as fires or earthquakes, that do happen. In order to fit rents within the program limits, amenities and service aspects of projects are slashed, while in some instances design elements that later proved to be the source of problems are left.

On the other hand, the total cost to the tenant includes not only operations and maintenance, but also taxes and mortgage payments that reflect the cost of land and construction. Local taxes have also been underestimated and perhaps unfairly assessed given the nature of subsidized housing. Neither HUD nor project management firms have been aggressive in seeking to have tax assessments reduced. In the case studies, there has been insufficient time to analyze carefully the cost of construction, but a number of cases tend to support the finding of the HUD Auditor's Office that land prices have been inflated, providing windfall gains that allow investors to recoup their investments rapidly. The use of "comparables" and advertised rather than actual sales prices for land value estimation would tend to produce over-estimation for land, thus raising project cost and putting pressure on operating cost estimates.

The lack of clear responsibility previously discussed appears to be important in HUD's responsiveness to projects in trouble. Requests for rent increases need careful screening to protect tenant interests, but they should not take months or years to process. Similarly, the reluctance of HUD to foreclose, or even send projects into receivership may be a valid effort to save them, but it also reduces the agency's credibility with owners and sponsors. To the extent that local HUD staff has limited means of response to financial difficulty and the processing of those responses is slow, the aura of uncertainty about a project that is in trouble will be increased and the more likely it will be that other participants will try to back away.

Construction: Although contractors can be held accountable for latent defects in the construction of projects revealed in the HUD 9-month and 12-month inspections, the needed repairs are not necessarily made. Some contractors prefer to go to court, a lengthy and expensive process for projects already financially in trouble. Others go bankrupt and cannot be collected from in any way. Expenses caused by construction problems, like those due to natural or human disasters can push a marginal project into financial failure.

Ownership: The role of owners has previously been discussed in connection with the problem of the absence of clear responsibility in failing projects. They are also the source of other problems. Nonprofit sponsors do indeed tend to be inexperienced in the operation of housing. Despite their good intentions they are not necessarily in tune with their tenants. The consultants who assist sponsors during the development have little or no counterparts during operation. In addition, consultants are not always effective or honest.

Limited dividend owners do not necessarily behave as though to protect their investments. Some have been ineffectual or negligent in the selection of project managers; others appear to have simply made off with project funds. While often pointed to as possessing superior and "hard-nosed" management capabilities, limited dividend sponsors coming from a background of the conventional apartment market by no means understand or sympathize with the populations that they are expected to house in subsidized projects. Their conception of what is properly included in the housing package may not be appropriate to the needs and dynamics of that population. The prospect that limited dividend owners will pull out wholesale once the 10 year minimum for tax shelters is reached is both real and potentially serious for the programs.

Management: There seem to be two "successful" strategies of management for projects like those in the sample. One approach is to maintain the project's financial and physical condition by rigorous and essentially external control. Tenants are screened carefully for risk; those who fail to pay their rent are promptly evicted; disruptive behavior or nonadherence to project rules are similarly treated; tenants are charged for damage attributable to them or their children; recreation and amenities are limited; and the project is aggresively patrolled by a security force that maintains close relationships with local police.

The result is a quiet, well-maintained, if expensive project, in which the tenants' personal responsibility and involvement are not great, but also one which they are not attempting to leave.

An alternative style for management involves the conscious effort to create a sense of community in which activities for the different population groups are fostered; some degree of tenant organization occurs; negotiations with tenants precede eviction, which is nevertheless enforced if necessary; partial responsibility for activities such as maintenance are carried out by tenants; and, in short, every effort is made to set up an internalized system of social control.

To avoid being carried away by one or the other of these polar scenarios, we should note that both have in common the objective of social control of individual behavior that can threaten the financial, social and physical viability of a project. Both are possible, but both are difficult to establish and maintain effectively. Both are costly, the former in maintenance and security costs, the latter in social services and facilities. It is unlikely that managers skilled in one style can easily adapt to the other, and it is unlikely that either style would be satisfying to all types of tenants. Finally, the probability that either one or the other can be achieved in a pure form on a mass scale is slim.

In practice, most projects seem to fall between these poles of management. Good management firms and individual managers are very difficult to find -- and subsidized projects need very good managers. Budgets are insufficient to attract or support sufficient numbers of skilled maintenance workers and supervisors able to handle large projects. On site managers may be appointed without skills or experience. Faced with constant crises, managers give up or retreat into ineffectuality. Absentee managment firms do little to improve the situation.

It has been common to blame the quality of management for the problems of projects such as these, and it is indeed true that management has been weak or negligent in many cases. Yet it is doubtful that good management alone can ensure the success of projects. Equally important is the provision of a setting in which reasonably good management can afford some mistake of judgement or performance without seeing projects fail, and in which consistently poor management is promptly identified and dealt with.

Social Problems: The social malaise of poverty and related problems plagues subsidized housing. Too many tenants have no hope of improving their opportunities. If the project is located in a semi-suburban slum area, these opportunities are literally miles away. High crime rates affect the liveability of the projects; the more enterprising tenants leave and mangement has to divert project funds for the employment of a security force. The despair and hostility of tenants is expressed in vandalism and rent delinquency. Management's reaction is to evict the trouble makers, which hardly turns out to be a solution if eviction is a costly unforeseen item in operating budgets, and the only tenants who can be attracted to the project are similar to those who have left.

These problems are exacerbated by the lack of social services and recreational opportunities, especially for projects in remote locations. No money was left in project budgets for social services -- day care, boy's clubs, adult education, employment services and so on. Most limited dividend sponsors and some non-profit sponsors simply do not want to be bothered with additional costly facilities and services. The programs do not require their inclusion and sponsors argue that services are the responsibility of other agencies, housing being enough of a headache in its own right.

Yet many subsidized projects, especially those with rent supplement leased housing (Section 23) apartments have concentrations of low income families with children who desperately need facilities and services. The reduced level of vandalism and general malaise noticeable in projects that provided services, especially for teenagers, was striking. Ironically, almost all projects for the elderly now include space and facilities for recreation and services.

Inflation: The ultimate enemy of financial solvency in subsidized housing is cost inflation as wages, prices of supplies, utilities and taxes continue to soar. The only way that most projects can absorb increased costs is through increased rents. High rents make it even more difficult to find families with incomes below the program limits who can also afford the rents without paying more than 25 percent of their incomes. The prospect of more inflation and higher costs of operation unmatched by comparable gains in tenant incomes or subsidies must daunt even the staunchest of managers.

Remedies: Faced with potential threats to project viability from so many quarters, what resources are there to counter them in a sufficient and timely way before failure ensues? Rent increases are a limited device, eventually pricing the apartments out of the reach of the program's target populations and commonly slow in being approved. When a project defaults on its mortgage, the only means now used to correct the default are rent increases and mortgage modifications, including the waiver of principal payments and payments to the reserve for replacements. In some circumstances, owners may make further equity contributions in the form of loans. They are reluctant to do so. The additional device of the operating loss loan from HUD is not widespread, though likely to be popular. If timely, such remedies can help but not solve the problem; in practice, they are often too late or too meager to do more than postpone the inevitable collapse. Meanwhile, projects continue to deteriorate and the quality of management and maintenance declines. Ultimately, projects can be placed in receivership or foreclosed and handed over to specialists, again with no guarantee of rejuvenation. In the limbo status that precedes this conclusive act, a project can drag on without concerted and vigorous intervention. The available remedies may not worsen the condition of failing projects, but they are hardly a match for the complexity of housing failure.

II. CASE STUDIES OF MULTIFAMILY PROJECTS

Nine case studies are presented in this section of the report. Although we have attempted comparability of style in presentation of the cases, each case exhibits its own peculiarities in organization and development. It is important that these specific characteristics not be lost in the effort to impose a uniform style of reporting. In particular, the cases vary substantially in length, reflecting in part the varying complexity of their histories.

The general structure of each case is as follows. The project's location, setting and physical and social characteristics are briefly described. The development and construction of the project are then taken up, with an emphasis on the conditions present at the time and the parts played by different actors. Following construction is an account of the operation and management of the project that describes the participants and the events important to the project's success or failure. Each case ends with a brief assessment of the present status of the project, the important factors contributing to that status, and the probable future.

Cases studied tend to be idiosyncratic, both because they deal with the unique reality of the events that they describe and because no two observers will put together an account of those events in quite the same way. We have tried in these accounts to show the inception and maturation of projects in as much of their individuality and complexity as is possible under the conditions of the study. Yet, looked at as a whole, the cases are more than a collection of separate stories. In a very small sample, they succeed in showing the richness and variety that any national program for providing housing will experience in the course of its implementation. They also demonstrate as well the limits placed on program effectiveness by our capacity to implement in the field.

Case Study 1: Non-Profit 221(d)3, 100% Rent Supplement, nearby Los Angeles

INTRODUCTION

A Renewal Project was undertaken in the north central part of the city, an area characterized as poor, black, and physically deteriorated. The City intended predominantly low to moderate income residential reuse, and today hundreds of units of subsidized housing exist along this two block stretch. The projects and single family Section 235 homes are new; the latter were well-designed and appear to be in excellent condition. But both this project and the one adjacent are subsidized multifamily projects in financial difficulty.

Disposition of commercial parcels in the renewal area has been a headache for the renewal agency. Plans for a supermarket to serve the redevelopment area fell through and the land in all likelihood will be used for a baseball diamond. The City intends to construct a major recreational facility nearby but ground has not yet been broken.

For several years, then, the residents of the area have lived beyond convenient walking distance of shopping or recreational facilities. Few own cars and parents are unwilling to allow their children to cross busy streets on the mile-long trek to the park. A mini-park lies at the northeast corner of the project where, according to the resident manager, car accidents frequently occur. For the most part, children play within the confines of the apartment projects. Parents without vehicles reach shopping facilities either by taking the bus or by walking a half-mile west to another supermarket. It was 97 degrees in town the day this interviewer visited the project -- a little warmer than usual, but the resident manager says he customarily starts work at 7:00 a.m., since by noon the heat is paralyzing.

Immobility also poses hardships for senior citizens. Because of the inadequacy of public transportation (there is no bus route along the projects front street) they must, for example, take a circuitous route to reach the Social Security Office. It takes at least a half hour to end up less than a mile from the projects.

Project I (153 units) actually consists of three sites -- one elderly (55 units) and two family complexes -- within the renewal area. The buildings are all two story wood frame and stucco walk-ups. None of the units is air-conditioned. There are no designated play areas except for a basketball court added after the project had been occupied for some time. Children play on the walkways and on small sideyards; they and the euclyptus trees work together to assure that the grass stays brown and scraggly. Finding other recreational outlets blocked, younger project residents exercise their ingenuity in ways that prove expensive to the management. The landscape was originally dotted with ground lights -- platter-shaped glass bulbs perched on three-foot metal stems. The platters can be made to twirl like flying saucers. They cost $150 apiece to replace. Each of the ground floor apartments has a wood fence at the back door to enhance privacy and pride of occupancy. The popularity of ABC's "Kung Fu," however, has induced demonstrations of teen-age prowess in dislodging individual slats with a single high-flying kick. Evidence of such skills can be seen throughout the family sites.

The managing agent will eventually place all exterior lights on the roofs of buildings and remove all fencing, replacing it with shrubbery. Treatment of symptoms, however, cannot be expected to combat the deeper problems of the project. An FHA inspector in November 1973, commented in his report that there was little hope for improving the general appearance of the project until recreational facilities and programs for teenagers and small children were provided.

The resident manager of the project, former "Program Coordinator" of social and recreational services, has been at the project for four years. A young, easy-going man, he appears to be quite popular with residents of all ages. In the course of an hour's interview in his office, a half dozen people stopped in to ask for basketballs, garden hoses, or help in combatting City Hall, to complain about strangers in the laundry room or ask if he wanted a milkshake from MacDonald's.

He has assumed, out of necessity, the responsibilities of recreation director (the position of "Program Coordinator" has been eliminated for lack of funds), and often does repairs himself to save project funds. He is assisted by one maintenance man and one part time person to sprinkle lawns. He also has a summer clerk-typist and a few Neighborhood Youth Corps workers.

Most of the heads of households in the family apartments are mothers receiving public assistance, and all residents receive Rent Supplement assistance. No child care is available, but he is certain that some mothers attempt to work a few hours each day without reporting it. He is not inclined to take steps to decrease their supplement, he says; sooner or later, due to transportation difficulties or other problems, the women are forced to relinquish their jobs anyway. He finds life difficult on his own salary ($8,700 per year), and though criticized by HUD for his "softness" on delinquencies, he does not wish to make life more difficult for tenants. He is liberal in accepting partial payment plans from hardpressed tenants, but he minimized the significance of delinquencies in terms of the project's overall budget. At present, they average $1500-2000 by his estimate, primarily due to late or stolen welfare checks, installments due on recently increased security deposits, or simply a bad month for the tenant. The gross potential monthly rent is $24,717.

However, he fears delinquencies will increase once tenants realize the significance of the project's default status and the possible increase in rents due to the termination of subsidies.[1] Many of the elderly tenants have already moved out, and vacancies are his biggest problem in terms of project income. At present, only 6% of the units are vacant, but he anticipates that this will increase to 10% or more very quickly. The 55-unit elderly complex also experienced a wave of vacancies last year as new senior citizen public housing opened up all over town. The new units have elevators, are one-bedroom rather than studio apartments, and offer more amenities. Although maintenance of the project's senior citizen complex excels over that of the family units, with lovely landscaping assisted by the tenants themselves, the senior citizens have been strongly attracted to competing projects, accounting for vacancies of 12 to 15 units in the fall and winter of 1973.

However, the prevailing problem at this project, from its earliest days, lay more with expenses than with project income. According to the resident manager, several roofs have leaked since initial occupancy, and new leaks are constantly discovered. Plumbing and electrical systems have always been defective: the sewage lines to one building become clogged every few months; flooding four apartments over and over again. The cause of the problem has never been determined; it may be the size of the pipes. Toilets were not installed properly. The weight of the fixtures rests not on the floor but on the pipe extending into the wall, and the pressure causes leaks. The plastic pipes themselves are easily damaged. The water cannot be shut off in individual buildings -- when major repairs are done, an entire block goes without service. Easily opened cheap locks were a security problem in the early days of the project. These were changed, but the manager's office still provides the only safe storage space.

Ground maintenance is an on-going defensive war. One family site was recently resodded. When the protective fencing is removed, of course, the grass will again be left to its own devices. Vandalism -- continuous, severe, and expensive -- plagues the project.

The present maintenance engineer is the third in two months. Turnover in maintenance staff generally results from the fact that three physically separate sites must be maintained. The staff member generally starts work at one site, intending to cover each systematically, but emergencies at other locations demand his time and build on his frustrations. Tenants have a mixed reaction to the project management's performance. It is slow to respond to complaints, some say, but they feel that the bigger problems relate to life in the neighborhood itself, trying to get somewhere without transportation, and trying to make ends meet.

The resident manager considers it absurd to attempt to keep up a project of 153 units with one maintenance man. Not only must he handle routine tasks and frequent emergencies, he must also restore vacant units to a marketable condition. Yet the project income does not permit a larger maintenance staff, let alon the provision of social and recreational services for an extremely proverty-stricken community. Various attempts have been made to start tenant organizations. "If ten or twelve people come to me with a problem," says the resident manger, "Well -- then I have to listen." But people do not believe that their actions can have an impact. At any time, he says, he can assemble some sort of advisory committee -- one was recently organized to petition the city for better bus service. But despair and apathy create an immovable mass in the path of sustained, effective organization.

A veteran of four years at the project, the resident manager has viewed its financial and social failure as inevitable almost from the start. There will never be enough money to pay bills; the next major plumbing disaster or increase in utility rates may signal the end of the project. More important, he says, "Each day I see people get a little more frustrated, just trying to live." They are tired of fighting. "They say, 'I'll try to pay later. If that's not all right, put me out.'" He does not put them out. Most of them, he says, find a way to pay sooner or later.

PROJECT DEVELOPMENT AND CONSTRUCTION

The Renewal Agency played an aggressive role in the early stages of the project's development. The Agency made the customary redevelopment decisions regarding the types of housing needed in the renewal area and the sites to be used for each type. On the basis of its market analysis it determined the rent levels which would accommodate the needs of residents to be displaced by renewal action, and informed developers that projects must be sustained by such rent levels plus corresponding federal subsidies. The firm which built the project felt that it would be difficult to build at the rent levels anticipated, but the Renewal Agency was adamant. It invited proposals from developers and simultaneously sought non-profit sponsors from within the city to assume eventual control. The Renewal Agency even selected the architect -- ordinarily the prerogative of the sponsor. Finally, the Renewal Agency particpated vigorously in all stages of processing by the Insuring Office.

The developer was selected in April 1967; in the following year two church groups incorporated and received federal and local approval for sponsorship. The developer claimed successful participation in at least 25 FHA insured projects from Colorado to California at the time their proposal was approved. None of their projects had defaulted, and an internal memo (10/4/67) from an FHA architect to the Assistant Chief Underwriter stated that "Our past experience with the developer, as general contractor on FHA projects has been very favorable." Prior to the designation of a non-profit sponsor, the Renewal Agency, the developer and the Insuring Office had an understanding that the developer was to act as the sponsor, to incur such costs in feasibility processing as may be necessary, and, at the time sponsorship was assumed by the non-profit group, to adopt the more limited role of general contractor. At the time the non-profit sponsor was designated (just prior to the issuance of a feasibility letter for the project), the size of the project, plans and specifications, and the mortgage amount had already been approved. The NPS, with no previous participation in housing development of any sort, appears by all counts to have stood in the wings as design, construction and financing were decided upon.

Two churches participated in the formation of the NPS. The more active was a nearly predominantly white congregation. Considerably less enthusiastic was the middle-income black congregation within the renewal area. While one busily planned for an attempt to expose its suburban white congregation to life in the ghetto, and prepared to galvanize volunteers for social and recreational services at the project, the other seems to have contributed relatively little.

The two churches which set up the Board of Directors viewed their role as primarily that of managers of a completed project, and understood that they need not concern themselves with construction or financial matters.

No clear understanding of how they arrived at that conclusion could be reached from written record or interviews -- indicative itself of a general confusion in the early stages of processing. According to the HUD Area Office files, a meeting was held with members of the Congregation in November 1967, at which time FHA representatives explained the responsibilities of non-profit sponsors, requirements for designation of their eligibility (e.g., necessity for incorporation, by-laws, etc.), and the fact that they would be held responsible for cash requirements needed at any stage to carry the project through the full term of the mortgage. Such meetings are standard HUD procedure in dealing with non-profit groups.

A representative of the development firm also states that he repeatedly reminded the non-profit group that they were embarking on a business venture, not simply a social program. However, the files also indicate that the developer volunteered to meet all cash requirements prior to initial endorsement, at which time it was to be reimbursed out of the proceeds of the loan. In a historical narrative of the project, the former President the NPS informed HUD in November 1972, that "the NPS role had been explained by the Builder-Developer as one carrying only a moral commitment. It was to see to matters such as social services and community relations and the finances would be handled by the 'experts,' i.e., Builder-Developer, HUD, the Redevelopment Agency and at a later time the Management Agent who would be retained. The NPS was comfortable in this role...." The last statement, by his later admission, is not entirely accurate; the non-profit group was never unified behind the Project and constantly questioned whether it ought to be involved at all. The HUD files contain internal memoranda noting the failures of the non-profit group to organize itself, and letters to the Redevelopment Agency requesting help on several occasions in pressuring the NPS to submit required documentation.

While the developer met fairly frequently with the leadership of the sponsoring group to report on progress, more significant discussions were held with the Redevelopment Agency and the Insuring Office alone. A bitter battle developed between the latter two agencies over amenities to be included in the project. At the pre-feasibility conference in May 1967, the developer was informed by HUD that the project must be of "modest design" and that apartments "shall not exceed minimum floor area" due to "allowable costs". A former executive of the development firm says that he continually argued with the Renewal Agency that the type of project they envisioned would be economically infeasible at the proposed rents. Nevertheless, the firm went on the written record as supporting the Redevelopment Agency, suggesting that the dispute was carried on outside the Insuring Office.

The Redevelopment Agency requested extra one-half baths for three and four bedroom units, and private patios for ground floor units in keeping with Southern Californian life-styles. The architect selected by the Redevelopment Agency also submitted plans for living areas at a higher square footage than what FHA considered advisable (610 sq. ft. was proposed for one bedroom, 770 sq. ft. for two and 960 sq. ft. for three bedroom units). The City required covered parking and stated its opposition to anything of an "institutional character, contending that such construction, by reducing pride of occupancy, encourages vandalism." (Conference record, 1/25/68) It opposed high densities out of a desire to keep the project more in character with the surrounding, predominantly single family neighborhood, and the application originally called for 133 units on a little less than eight acres.

The Insuring Office, on the other hand, continually stressed the need for keeping rents low, stated that the proposed size of the units rendered the project economically infeasible, and flatly refused to consider the amenities requested. The Office protested that it had no authority to waive program regulations on bathroom facilities "nor is it willing to recommend that any exception be made to the Rent Supplement Project Standards" for such purposes. (Letter dated 4/8/68 to the Redevelopment Agency from the Director of the Insuring Office) Covered parking and closed patios were unnecessary and would necessitate higher rents. No one could agree how much higher the rents would be, but according to Insuring Office calculations the maximum rent levels allowable in the Los Angeles area, including the 25% increase over the then prevailing rent schedules, would already be required to support the project without any of the amenities requested. The developer submitted projections of lower costs than those calculated by FHA.

It should be noted that the Insuring Office actually had greater discretion in the matter than it was willing to admit. When the Director sought advice from the FHA Regional Administrator and the latter forwarded the request to Central Office, the reply was that the design matters in question were entirely the prerogative of the Insuring Office.

Convinced that the absence of the additional amenities would result in a poor project, the Redevelopment Agency quibbled with the Insuring Office for six months, enlisting the support of local groups such as the American Friends Service Committee in their campaign. They received the extra one-half baths, some covered parking, and closed-in patios, but the patios had no external means of egress, a situation which was often corrected with crowbars or with feet. Furthermore, upon FHA's recommendation, the number of units was increased to 153 in order to increase the project income without necessitating higher rents. This resulted in a density of about 20 units per acre and an L.U.I. of 4.8. However, FHA did permit the larger floor area.

The fact that development of the project required coordination of both renewal and housing activities regulated at that time by two different federal offices also contributed to delays in execution of the proposal. Expiration of the City's Workable Program, temporarily cutting off further renewal funding, led to cessation of processing for a six-month period. The Renewal Agency did not complete acquisiton of parcels until several months later than anticipated, and apparently the land was not properly filled. Although renewal land is to be sold in a buildable condition, the developer spent over $42,000 in earth work, apart from landscaping, site improvements, and utilities.

Almost a year passed between the selection of the developer by the Redevelopment Agency (April 1967) and the issuance of the first feasibility letter (March 1968), due primarily to the problems with non-profit sponsorship, the Workable Program, and the unavailability of Rent Supplement funds. Following the arguments over amenities and, finally, execution of a Disposition Agreement between the Redevelopment Agency and the sponsor, a revised feasibility letter was issued in September 1968. Firm commitment was issued in February 1969, followed two weeks later by initial endorsement; and construction began in March, 1969.

Problems continued during construction. Severe antagonisms developed between the non-profit sponsors and the developer over a number of matters, particularly the cost-saving clause in initial closing documents, by which the developer would split any savings with the non-profit sponsor who felt that all savings should be handed over to be used for the benefit of the project. The conflict, which led to a total breakdown of communications and an enduring animosity, eventually proved meaningless, since the developer actually incurred cost overruns in construction.

Other problems emerged in the sub-contracting of plumbing and electrical work to local minority firms and in the implementation of the affirmative action plan. As the developer's representative relates the story, HUD made a "big deal" out of minority hiring but provided little assistance in locating minority contractors who were sufficiently capitalized to carry the jobs or in dealing with labor unions who were "touchy." Yet, it is not clear with whom the responsibility for such assistance lay, if indeed anyone was responsible. Nor did the Redevelopment Agency give much help, he recalls. The developer was then just "learning about getting involved in black communities". Dutifully, he recalls, they advertised and set up meetings in the neighborhood. However, minorities "couldn't understand why they couldn't just be hired off the street;" and the community meetings were explosive. He confided that the developer apparently lacked rapport with the minority subs eventually selected, and the situation deteriorated as their inability to perform led to construction delays. It is interesting to note, however, that this representative of the firm judged that on the whole the developer had a very poor record with HUD regarding minority participation.

Mother Nature joined the conspiracy against the project and a prolonged rainy period delayed construction further.

Construction was completed in April 1970, almost three months beyond the projected date. The developer claimed an overrun of $20,152.00, of which $7,536.00 was disallowed by FHA. The Insuring Office had by that time become rather disenchanted with the developer. Staff members in internal memoranda seriously questioned the nature of several of the change orders submitted during construction, intimating that a "sophisticated developer" was trying to outwit FHA for financial gain. At any rate with late fees, added interest expense, and overruns in materials and overhead, the developer appears to have made no profit on the venture. As trouble developed in other HUD-assisted projects the firm eventually went bankrupt (as did the parent conglomerate itself), preventing the hapless non-profit group from suing for correction of construction problems.

OPERATION AND MANAGEMENT

Preoccupied with its scrutiny of development costs, the Insuring Office seems to have almost totally ignored management considerations. At that time operating expenses were projected rather simplistically, on the basis of HUD's experience with other projects, as kept on file by the Property Management Section. Little or no field work was done in specific localities to permit the Office to anticipate increases in utility rates or taxes, for example.

It was unfortunate in the case of this project that the Insuring Office apparently saw no need for management plan until after initial endorsement, probably because the formal requirement for an early plan was not instituted by HUD until later on. Under prodding from FHA the developer located a management firm which hastily contracted with the NPS and prepared a makeshift plan. The latter, as presented in a three and one-half page letter to the Insuring Office (4/10/69), made no mention of social services, a tenant organization, or marketing methods to assure the intended racial and economic integration. The HUD internal review of the "plan" consisted of a three paragraph memo to the Chief Underwriter stating that basic requirements were met, that the management fee of 5% of gross collections required further explanation, and that "social services" of an unspecified nature should be "tied into budget". The reviewer apparently retained such a detachment from the situation that he was unaware that social services were to be provided on a voluntary basis by the sponsoring group; such services should nonetheless have been specified in the management plan. The reviewer concludes that FHA's experience with the firm had been satisfactory in the past. No other documentation -- plans, contracts or reviews, or even substantive correspondence -- appears in the file until such time as the non-profit group assumed management in November of 1972. There is no reference to the fact that the experience of the original managing agent was with elderly and not family projects.

The original firm never assumed management. A subsidiary of the present conglomerate apparently drifted into mangement of the project prior to initial occupancy. A year later (10/29/71), a team of auditors noted that the management agreement had never been approved by HUD. Responsibility was once again unclear.

Clearly the Insuring Office failed to grasp the significance of management practices to the viability of projects of this sort.

One might be tempted to describe the path of the fledgling project as downhill from initial occupancy were it not for the fact that the project floundered in an inescapable hole from the start. Tenants began moving in before landscaping was completed, and children looking for play areas destroyed the fragile new lawns. Construction problems immediately surfaced, draining a budget already crippled by slow rent-up which itself was a painful process. Following legal requirements, the Redevelopment Agency insisted, and the non-profit group agreed, that first priority be given to families displaced by renewal action, not all of whom would have otherwise cleared tenant screening processes. According to the former President of the non-profit sponsor, the sponsor assumed that few employed people qualified for Rent Supplement. Although the managing agent resisted, the sponsor felt morally, if not legally, obliged to accommodate as much of the Renewal project's workload as possible. The Redevelopment agency no doubt had an active conscience as well; the scrutiny of HUD's Relocation staff was probably also a factor. The socio-economic character of the project was established very early as one of destitute minorities. Tenant counseling, the NPS recalls, was "a weaker area."

Antagonism of the NPS towards the developer appears to have carried over to a milder extent in their relationship to the management firm selected by the developer. The former development company executive interviewed recalled that NPS considered the agent incompetent. The representative of the NPS stated more gently that "I think he was learning management at the time -- new at the business," "overextended," "made some mistakes," but "gave a lot to the project." The agent himself, a former Community Action Agency Director, states flatly, "I was green as hell." In any event, communications were poor between the management firm; and the Management Committee set up by the Church group. For example, there was never a clear understanding regarding whether the resident manager's salary was to be a separate line item in project expenses or drawn from the management fee.

The Management Committee set up its social services and recreation programs with energy and good will, but the predominantly white suburban volunteers were somewhat nervous in their dealings with tenants. "Timidity met apathy," the former President of the NPS informed the interviewer, and left the results to her imagination.

Meanwhile the managing agent wrestled with operating expenses which, in the first full year of occupancy, were roughly 30% higher than those projected by FHA on Form 2264. Electricity was originally estimated costing $6,400 per year, for example; in 1971 it was $24,011. For the same year other striking comparisons with original estimates can be selected:

Selected Examples of Operating Expenses - 1971

	HUD/FHA Estimates (2264)	Actual Expenses in 1971
Water	$ 4,750	$ 6,354
Gas	4,200	10,334
Garbage and Rubbish Removal	1,800	2,810
****	****	****
OPERATING TOTAL	29,900	44,380
Repairs	4,300	18,188
Grounds	500	14,095
****	****	****
MAINTENANCE TOTAL	15,400	40,692
TOTAL EXPENSES	$108,401	$158,764
EXPENSE RATIO	.46	.5943

To help keep the wolf from the door, the management let decorating slip. For example, the Form 2264 estimates call for $10,000 per year but in 1971 only $1,822 was spent on decorating. There were, however, precious few line items from which to siphon funds.

As described earlier, repairs and groundwork expenses were a direct result of faulty site design and construction. Even rent delinquencies due to poor tenant selection could not account for the serious financial difficulties encountered in these early stages. If one divides actual rent collected in 1971 by potential rent at 100% occupancy, an average occupancy of .966 is reached -- a thoroughly acceptable percentage. Bad debts amounted to $889.00. Although various actors have criticized the non-profit sponsor for its unbusiness like appoach and its "softness" on delinquencies, clearly the overriding problems were beyond its control.

The NPS was aware of the need for a rent increase early in 1971 and discussed the matter with the newly established HUD Area Office. They were told that the sponsor's experience with the project had not been of sufficient duration to document the need for a rent increase. In April of the same year, the sponsor felt compelled to repeat its request, and the Area Office seemed willing to recognize the need for the increase. However, the office was slow to act; and in August the rents were frozen in Phase I of the Economic Stabilization Program. The project was by this time in serious jeopardy. The sponsor terminated its contract with the managing agent and organized its own management corporation in the hope of cutting costs. Administrative expenses did decrease slightly in the following year through in-kind contributions, but a utilities tax was levied and utility rates increased. Real estate taxes increased, and much maintenance was deferred. Although the budget could not support it, a Program Coordinator was hired in 1971 to act as representative of tenant interests and direct programs of their behalf. The position took its toll on the budget and was terminated after a year. In January 1972, the project defaulted.

Several steps were taken -- expeditiously. A year's moratorium on mortgage principal payments (March 1972 to March 1973) and on payments to the Reserve for Replacement was granted by the Area Office. In 1971, these financial requirements amounted to $16,608. In addition, the rent freeze was lifted; and a rent increase of 7.5% was granted. This amounted to an additional $22,416 per year in gross potential rent. However, by the end of 1971, the project was more than $44,000 in the red. Consequently, the relief offered could not even bring all accounts current, and when the moratorium ended the project's troubles intensified.

At no time in 1972 did vacancies exceed 5%, usually hovering around 2%. Tenant accounts receivable sometimes swelled to $2600 out of a gross monthly potential of $24,417.00 but usually were closer to $1200. Accounts payable generally doubled or tripled that amount. At the time the moratorium ended and mortgage payments again became due, the project was still not operating in the black.

In 1973 the City housing inspectors required that $32,000 worth of repairs be done to bring units up to code or the Project would be shut down. Water rates increased an additional $3000 over the previous year. Repairs required by the City are still in progress. A 4.3% rent increase was granted in mid-1973, raising gross potential annual rent by roughly $13,000. However, in early 1974, the project again defaulted; and a six-month moratorium was again granted.

A six-page annual inspection report by the Area Office Housing Management Division noted the presence of erosion, ponding, trash and litter, vandalism and graffiti, security problems, broken windows and screens, cracked vinyl floor covering, dirty ranges and refrigerators, and the need for a tenant organization with "controlling the children in the project" as its prime goal. Another inspection four months later (4/74) noted that most of the above conditions persisted.

Both the FNMA representative for the area and the HUD Office Loan Management Branch Chief expressed sympathy and support for non-profit sponsors due to the presumed lack of self-interest in their motivations. The problems with such sponsorshipare two-fold, they say: (1) the non-profit sponsors seldom have the cash on hand to carry projects through difficult periods; and (2) they tend to be unbusiness like, too kind-hearted about delinquencies, and poor managers. Limited dividend sponsors on the other hand are usually willing to provide cash as the situation demands and consider the project as an economic venture more than a social program.

However, the Loan Management Chief conceded, such cash contributions cannot always be recovered. The Limited Dividend sponsor usually makes them where necessary to keep the project afloat in order to preserve the depreciation write-offs for himself and the limited partners. It is well worth his while. Cash contributions by the non-profit sponsor may be nothing more than a donation for which members of the group are never reimbursed. This raises questions about the structure of the program itself. One might conclude that far too many projects are not economically self-sustaining from the outset, that non-profit sponsors are not sufficiently aware of their personal risk, and that, caught short, such projects are almost inevitably doomed. At no time in the development of the Project was anyone sure where the sponsor would find any cash required. It is a question which should have been asked, and the project's sign-off should have hung in the balance.

In terms of management itself, the Loan Management Chief was highly critical of management's handling of maintenance. The management should require its maintenance staff to live on-site, he said. Furthermore, "when I see a guy walking around picking up trash by hand, without even a paper bag to put it in, I know there's a problem." HUD inspectors as has already been noted, feel that no improvements can be expected as long as recreational facilities are lacking.

CONCLUSION

This project, offspring of neighborhood renewal, was poorly located, under-designed, badly constructed, and financially undernourished. Responsibility for ensuring its effective operation rests nowhere. The environment encourages physical deterioration owning to the absence of adequate social support. The project's history exhibits so many contributing factors that to isolate any one as critical would be unproductive. To satisfy all the constraints and to put together all the actors proved to be just too difficult.

APPENDIX A: CHRONOLOGY OF THE PROJECT

1967	
4/5/67	Developer unanimously approved by City's Redevelopment Agency's "ad hoc" committee to select redeveloper.
6/67 - 3/68	Non-profit sponsor attempting to organize itself and to provide required documentation of its eligibility.
1968	
3/19/68	Feasibility letter issued to non-profit sponsor for 133 units of 221(d)(3) BMIR housing, 100% Rent Supplement.
5/28/68	Disposition Agreement
8/10/68	Revised feasibility letter permitting additional amenities and increasing the number of units to 153.
1969	
2/27/69	Initial Endorsement
3/19/69	Start of Construction
4/10/69	Submission of management plan (proposed management firm replaced prior to initial occupancy).
1970	
1/70	Initial Occupancy
4/24/70	Construction Completed
11/23/70	Final Endorsement
1971	
1/71	Request for rent increase (rejected)
4/71	Request for rent increase (approval withheld pending Phase I of Economic Stabilization Program).
10/71	Non-profit sponsor assumed management responsibilities.

1972

1/72	Default
3/72	Rent increase of 7.5% approved
3/72 - 3/73	Moratorium on payments (Mortgage and Reserve for Replacement)

1973

Fall/Winter	Vacancy losses due to expansion of low income housing opportunities in the City.

1974

January	Default. Six-month moratorium on mortgage payments granted.

APPENDIX B: ESTIMATED AND ACTUAL OPERATING EXPENSES

	2264 Estimates	1970	1971	1972	1973
Administrative	$ 18,860	$ 33,025	$22,193[1]	$20,790[2]	$27,557
Operating	29,900	29,529	44,380[3]	58,300	49,263
Maintenance	15,400	15,000	40,692[4]	17,242	29,686
Taxes and Insurance	44,241	27,625	51,499	58,530	

[1] Reflects reduced management fees following assumption of management by non-profit sponsor.

[2] No management fee.

[3] Reflects levy of utilities tax and utility rate increase.

[4] Primarily repairs and grounds expense.

Case Study 2: Limited Dividend, 221(d)(3), 40% Rent Supplement, Suburban Los Angeles.

This City lies in the San Fernando Valley, beyond the Santa Monica Mountains, linked to the rest of the Los Angeles Basin by a freeway. A run-down commercial strip stretches in a straight line from the freeway to the foothills of Angeles National Forest. Bad times have come to this City with its predominantly Black population in recent years with a decline in its supporting industries. It has become a pocket of unemployment, poverty, and crime.

In the mid-1960's several hundred units of subsidized housing were approved by the Los Angeles Insuring Office to serve the large numbers of low- and moderate-income families. Two projects were constructed next door to each other on the outskirts of the community. Other projects and Section 235 homes were built in the vicinity later.

According to the former builder of these projects, the location was originally considered excellent. There was a shopping center across the street, job opportunities nearby, and a ready market for the units among blue-collar families both Black and White.

However, today the shopping center no longer exists, the automobile plant, and other industrial plants have suffered economic reversals, and the blue-collar workers who were able have moved out of the projects. The project is now entirely Black, predominantly inhabited by welfare recipients, and 100% Rent Supplement. It's neighbor project deteriorated totally; it is allegedly a center for prostitution, drug dealing, and the storage of automatic weapons. Two buildings are totally burned out. At the time that project went into foreclosure one might have thought it was almost entirely vacant due to the number of units boarded up. In actuality, many such units were occupied by terrorized tenants in apartments barricaded to protect their remaining possessions.

This neighboring project continues to exert a negative impact upon the project under study and upon the entire neighborhood, now dotted with dozens of boarded-up ranch-type homes less than 15 years old. Half the monthly income of the project now goes to a twelve-man security patrol to check the vandalism and theft on the grounds, and the firing of automatic weapons at the windows of police vehicles. The security problem appears to be subsiding. Some tenants seem to resent the continual presence of these mysterious "police"; others are grateful for the safety afforded.

The project is comprised of 214 units of two-story, wood frame and stucco, row-type walk-up apartments on 10 acres. There is no community building; children play in small patches of open space, in the laundry rooms, or in the parking lot. The storage rooms have been broken into so frequently that they stand empty with doors hanging off a single hinge. The mail room provides a ready target for theft, particularly on the day welfare checks are due. Trash fills the yards and two small maintenance buildings, thoroughly vandalized, stand full of trash and glass. Graffiti decorates the laundry room, and all exterior walls are badly in need of paint.

Yet life here has improved substantially since March 1974 when the Los Angeles Area Office placed the project under receivership pending foreclosure proceedings. The tenants interviewed had confidence in the new Resident Manager, an energetic woman who responds quickly to complaints, understands the quality of life under welfare assistance and tries to find activities for the project's numerous children who come to her office where there are recreation programs, college-age tutors, and a sign-up list for camp. The management firm secured permission to use adjacent land for a program in which teen-agers plant vegetables for sale and use by the families in the project. The firm also hopes to construct a community building. It is not a revolution, but it is the sort of management the project has never had. Until the project went into receivership in March 1974, tenants remained completely victimized by a series of events beyond their control, which led to the social and economic disintegration of the project.

DEVELOPMENT AND CONSTRUCTION

By 1967 the developer's experience in HUD- assisted housing consisted of over twenty projects from Colorado to California with no defaults. The Los Angeles Insuring Office held the firm in high regard, and a former President of the firm states, in turn, that FHA in those years exhibited an "extreme amount of professionalism. They were basically doing what they were intended for -- they were an Insuring Office."

In regard to the site, he said we "really looked into that one" because it was a "minority pocket." The firm conducted a thorough analysis of the market, which appeared to be quite strong. If this were not the case, he affirmed, the firm would not have undertaken the project on a limited dividend basis requiring equity investment. He seemed to imply that non-profit sponsors, with whom the firm did roughly two-thirds of its business, were deemed more suitable sponsors of marginal projects. It is "very poor business," he said, to request limited partners to make additional cash contributions as a project encounters difficulty, and at no time was the limited partner, an independent investment firm, (whose financial participation and interests in the project limited to their initial equity and its recovery) asked to do so.

The Insuring Office received the request for pre-feasibility analysis in January 1966. The appraisers conducting the review rated the site average on most environmental factors, but below average on the adequacy of community facilities and the influence of surrounding improvements. Nevertheless, the review recommended approval in the light of the strong market in the surrounding low-income area. Application for feasibility analysis was submitted in June of the same year.

Land acquisition costs amounted to $450,000 -- an extraordinarily high price for 10 acres, but none of the reviews seems to consider it worth comment. The price tag perhaps explains at least partially the high L.U.I. of 5.0 and density of 21 units per acre, despite the low density surroundings. No need for special land treatment (e.g., for flooding) was anticipated either by the Insuring Office or the sponsor.

Processing appears to have been conducted in an orderly fashion. Initial endorsement occured in Fall 1967, and construction began a month later. No unusual construction problems were encountered, and construction was completed in 11 months. Permission to occupy came at the end of September 1968, and in six months rent-up was complete. Development costs actually amounted to $15,000 less then the anticipated $2,235,471.

OPERATION AND MANAGEMENT

The project, the builder recalls, was "well-conceived and well-executed." Nevertheless, it encountered cash flow problems very soon after rent-up. The first annual Statement of Profit and Loss submitted for the year 1969 cites an inexplicable $13,136.81 in bad debts and grounds expenses of $11,575 compared to the $1,500 projected annual expenses on FHA Form 2264.

The original management firm which handled the project for one year following initial occupancy was contacted for their recollection of the problems encountered. Unfortunately, there had been continual turnover within the firm, and the person primarily responsible for handling the project had died. However, representatives of the firm did recall that the developer had not properly banked the low tiers upon which the project was built, and erosion proved an unsightly problem, difficult to check. The tiers were replanted, but rain continued to wash away the mud and greenery. There is reference in the HUD files to drainage problems spotted just prior to construction, and these apparently created a considerable nuisance in the parking areas, but the management firm could not recall the nature of the problem.

Repairs the first year doubled the FHA-approved projection (among other problems keys were stolen and all locks in the project had to be replaced), garbage collection was also twice that estimated, and payroll costs were underestimated by almost 50%. The total discrepancies cited was over $20,394, but total operating expenses exceeded the original estimates by only $10,969 primarily because of deferred decorating expenses. The bad debts were counteracted by the fact that real estate taxes in the first year of the project were almost $15,000 less than projected.

The project, then, was a marginal operation in its first year. The developer terminated the contract with the original management firm at the end of 1969, and management was undertaken by another subsidary of the conglomerate to which the developer belonged. This was apparently not done out of dissatisfaction with current management, but simply as an arrangement more advantageous to the parent organization. The new management company functioned as an operationally distinct firm, but its representatives attended regular staff meetings of the other subsidiaries and submitted financial reports. The new president of the management firm was totally inexperienced in the management of subsidized projects. His top priority, as a representative of the developer recalls, was to reduce project expenditures and to seek a rent increase. However, he found the erosion and drainage problems so severe that it was necessary to make major expenditures just to clean up the area, level the top soil and put up wood retentions near the parking lots. The electrical and sprinkler systems also malfunctioned and vandalism increased.

Although he hired a resident manager, "I worked the project myself pretty close," he recalls. Bad debts were reduced in 1970 to $5,341 (still extraordinarily high) but garbage collection expenses increased over 50%, water costs went up 40%, and taxes increased by 80% over the previous year, about $12,000 more than the HUD-approved estimates. Almost every line item on the 1970 Statement of Profit and Loss shows a startling increase over the previous year. Not counting the tax increase, operating expenses rose by another $11,000.

Income also rose due to an 8.2% rent increase approved in June 1970. In that year an additional $10,440 in potential income was generated. The project continued its rather tenuous economic existence until the following year brought total disaster.

In February 1971, the Los Angeles earthquake struck. The project's plumbing system was disrupted, among other problems, and the Managing Agent estimates that $60,000 worth of repairs were required. The project had no earthquake insurance, and the 1971 Statement of Profit and Loss shows an expenditure of $26,384.85 on general repairs, plus $3,823 on air conditioning repair and maintenance. In addition, another $12,916 was spent on grounds supplies and replacements. Real estate taxes rose another $8,000 to a new high of $66,736, almost a 50% increase over the original projections. Operating costs by now so far exceeded the original estimates as to wreak total havoc on the budget.

The representative of the sponsor claims that they contributed a great deal of cash to keep the project solvent, but he does not recall the amount. No reference was found in the files, and the Managing Agent states that by the time of the earthquake neither the general nor limited partners were interested in contributing any cash to the project. In the meantime, however, they claimed substantial depreciation: $175,515 in 1969, $157,175 in 1970, and $140,521 in 1971. If applied to income in a conservative 30% tax bracket, the total was worth $142,000.

The final blow to the project actually came on the income side of the balance sheet. The City suffered a serious depression at this time, primarily due to reduced operations at the automobile plant. Other tenants had been employed at the nearby supermarket which shut down entirely. Representatives of the management firm recall that those tenants who were able to moved to more promising locations; those who could not stayed to go on welfare, or suffer eviction, or both. The developer's representative recalls that the managing agent brought him eviction notices "in batches -- 20 or 30 at a time." However, no market existed for the vacated units. Vacancies cost the project $20,317 in 1971, and $46,379 the following year --roughly 17% of the gross potential rent.

The interviewer spoke with the former Resident Manager who remembers clearly the difficulties encountered by tenants at the time. Whenever possible, she says, she attempted to work out financial arrangements with individual families, but she believes strongly that leniency towards chronically delinquent tenants can lead to the downfall of a project. Legal expenses rose from $1,277 in 1970 to almost $3,500 in 1972. The adjacent project simultaneously encountered the same financial reversals.) "The tenant base began to weaken," says the Managing Agent. The "good people" moved out; the "down-and-outers" moved in. Half of them, he says, lied about income when they filled out applications for apartment units.

One move recommended by the sponsor was that the Managing Agent seek a tax abatement; he felt that assessments (normally based on replacement value) were twice what they should have been if calculated on the basis of project income. The sponsor and managing agent tried to obtain hearings on the matter; "we should have hired a crack attorney," the former executive ruminates, but the managing agent declined to do so, and the project continued to be assessed at the same rate.

A "social problem" developed proportionate with the project's financial difficulties. The managing agent began to carry a pistol when walking the grounds and recalled his own terror at incidents of violence, such as a shoot-out within the complex between police and a robber fleeing the nearby project.

Besides the vandalism and theft, tenants simply stopped paying rent. For most of the fall of 1972 tenant Accounts Receivable averaged $16,000. In December they stood at $7,231. Bad debts amounted to $12,253 in 1972. The management might have carred out wholesale evictions of tenants, but it appears from the financial record that eventually, perceiving themselves in a hopeless situation, their tolerance for delinquencies increased. In 1972, the developer baled out. It, as well as its parent corporation, teetered at the brink of bankruptcy.

The new sponsor based in the Midwest, assuming ownership in January 1973, acted as general partner with a national investment firm as limited partners. The sponsor also assumed management responsibilities.

The written record deteriorates somewhat at this point. The new sponsor seemed somehow reluctant to communicate with the Area Office -- or with anyone else, for that matter -- concerning events at the project For example, he failed to file insurance claims after a fire damaged one of the buildings, and even after a tenant's friend drove his car into one of the buildings, damaging a set of gas mains serving four kitchens. The damage, amounting to roughly $25,000, was discovered several months later by a HUD inspection team. When questioned about it, the sponsor replied that he preferred to carry out the repairs himself since he could do it more cheaply. The insurance agency later cancelled its policy, refusing to reinstate it under the existing management. He also failed to pay real estate taxes promptly; the Area Office was finally contacted by the Assessor's Office concerning the matter.

The inspection team referred to above also noted that the plumbing system had never been repaired after the earthquake and that the units backed up after rain.

It took the sponsor six months to find and hire a Resident Manager. From that point, Resident Managers turned-over on an average of every six weeks. The project was renamed but this appears to be the extent of the sponsor's efforts to change its image. As far as Area Office inspection teams could determine, little or no maintenance was performed. It was no longer considered safe to walk through the projects at night or even to stay indoors. Vacancies climbed to 20% in the first half of the year, and kept climbing as the year wore on. Delinquencies increased in June of 1973, a total of 31 tenants owned $9,000 in back rents; but by early 1974, this had climbed to the $25-$30,000 range.

Vacant units were immediately vandalized. A HUD inspection team in June 1973 noted that none of the 25 vacant units inspected was habitable and that on-site personnel were "unable to account for 15 stoves, 17 refrigerators, and more than 17 air conditioners."

It was also in June that the project apparently defaulted for the first time. Notice of Default was sent to HUD in September 1973, citing a total delinquency of almost $100,000.00, $98,291 of which roughly $60,000 consisted of mortgage and interest and the remainder of tax and insurance deposits.

The FNMA representative servicing the mortgage listed as the main reasons for the deteriorating situation: (1) continual turnover in on-site management; (2) an increase in the number of non-paying tenants; and (3) the unwillingness of the mortgagor to invest even a limited amount of funds to improve the project. Without such funds, FNMA felt the situation was hopeless, a mortgage modification and moratorium on payments to the Reserve for Replacement would provide no relief. FNMA recommended assignment of the mortgage to HUD, and this occurred that September. The adjacent project, incidentally, had also defaulted and foreclosure proceedings were initiated.

A visit to the sponsor's office in August for the purpose of examination of the files had shown a proclivity towards undocumented check-writing. Such checks, made out to the sponsor or an employee of the management firm, totalled over $6,000.00. The FNMA representative, upon Notice of Default, reviewed the monthly income statements. "My analysis revealed," he wrote to the Branch Chief of Loan Management, "that as this loan came closer to being assigned, the number of discrepancies increased." Payables did not correlate from one month to the next. For example, the same amount of money was spent on payroll, temporary labor and security guards in the first half of September as was spent the entire month of August. (Yet at the end of September an employee of the project privately contacted the FNMA representative to ask the basis for the sponsor's claim that he could not meet the month's payroll.)

On items such as payroll, the sponsor/managing agent received reimbursement 15 to 30 days before expenses were incurred; no breakdown of personnel and services was provided. A security guard was paid $360 at the beginning of September for his services. They were not listed as an August payable, but he was reimbursed again the same month for work the first two weeks of September in the amount of $337.50. Items in the September cash flow included hotel accommodations, a nearly $400 car rental bill, and a $500 July phone bill. Disbursements for the months of May through September were dated the last day of the previous month; there was no reason to float expenditures in this fashion.

The HUD Regional Office, in the same month, communicated to the HUD Office of Loan Management, Associate General Counsel for Housing Management in Washington that "Our Area Office is of the opinion this loan cannot be reinstated. Their opinion is based on the owner's disregard to their financial obligations together with their uncooperative attitude."

Despite the sponsor's proposal for reinstatement of the mortgage (made, according to the HUD Loan Management Chief, under pressure from the limited partners who desired to retain depreciation advantages as long as possible), HUD decided in December to foreclose. The Area Office requested that the sponsor voluntarily hand over management to a receiver, but the sponsor continued to argue for reinstatement of the mortgage, promising an $18,000 cash contribution immediately and $100,000 a year later. The Area Office brushed the proposal aside due to the sponsor's poor record of keeping promises. In late January 1974, the Resident Manager, who had antagonized tenants by his disparaging remarks, was knifed as he walked through the project. Alarmed at the spectre of a project with no on-site management, the Area Office moved swiftly to take the issue of receivership to the courts, where it was speedily resolved in HUD's favor.

The sponsor meanwhile made one of his rare attempts to communicate his thoughts in writing to the Area Office.

"...I thought from our meeting with your representative...the first of the year you and your office would let us try to clean up the property per my previous letter and see if it won't fly.

I am at a loss why your office wants to foreclose this loan. Particularly in light of the fact that the sponsors have made an offer to put up cash and cover X amount of the loss in January of 1975. Further, it is a known fact that private enterprise can do better, and as you know FHA controls the adjacent apartment project, which terribly hurt the entire immediate area...I know you feel that the two should be operated as one project...."

We just hired a manager, who reminds me of Mr. Crawford, our Assistant Secretary of Housing when he was managing apartments as he is a real smart tough-type Black man. I know with him firmly implanted in the project and the assist of the Police Department, which we have been getting regularly that the project will turn around and will save the government a great deal of time and money.

I know when you meet our new manager you, too, will compare him to Mr. Crawford and we feel that we have the in-house talent and have invested a fantastic amount of time to turn this property around and will do so and no one else can do a better job at this point in attempting to achieve optimum occupancy in a project is sound once and for all..."

The Area Office, unimpressed, succeeded in getting the project into receivership in March 1974, to a firm which currently handles several other Los Angeles projects which have defaulted, and the adjacent apartment project which had been foreclosed.

Events at the project since receivership are worth noting. For the first time, it seems, the project is in the hands of truly capable managers. It is hardly a fair test of the receiver's skills to hand it a project close to disintegration in every sense of the word; but lessons can be learned from the firm's accomplishments thus far, and from its attitudes about those accomplishments.

At the time the receiver was appointed, they reported 117 of the 210 units were vacant and "damaged beyond habitation." Thirty-six apartments required extensive though minor repairs. The grounds and laundry rooms were in a deplorable condition, and the proliferation of illegal weapons and gang activity led parents to forbid children to walk alone through the project. Monthly collections had averaged about $8,500 out of a gross potential of $22,758. Some tenants owed up to $1,000 in back rent. The project was $200,000 behind in mortgage payments.

The interviewer spoke to one of the partners of the receiver who handles most subsidized housing management matters for the firm. Delinquencies, he feels, are one of the few forms of protest open to the poor. Whether or not sanctioned by law he considers them entirely legitimate in such cases as an uninhabitable project. Consequently all back rents due were forgiven, but teanants were informed that from the date of receivership delinquent tenants would be liable to eviction. In the next three months notices were served on 76 tenants. Two-thirds of those tenants, however, came to the Manager to discuss financial arrangements, and probably relatively few evictions will occur. The arrival of the Marshal with a Notice of Unlawful Detainer has a sobering effect on neighbors, says the Resident Manager, and restores the credibility of the management. On the other hand, the receiver claims to have excellent rapport with County Legal Aid.

Rental collections in April and May exceeded $14,000; in June, $17,200; and with repair and rentup of vacant units the management expects to collect $19,000 in August. By October, the anticipated foreclosure date, he expects the project to be fully marketable and self-sustaining.

Elimination of the vacancy problem was the management's top priority. The firm professes to have a rigorous screening process which discourages many applicants. A tenant is required to complete a questionnaire on employment, income, and rental history, and is obliged to provide several credit references. However, neither welfare recipients nor female heads of households are eliminated as eligible tenants. The primary purpose of the screening, according to the Resident Manager, is not only the selection of eligible tenants, but also impressing upon them the extent of their responsibilities.

Security was also tackled immediately. Half the monthly income currently goes to a 12-man security patrol team. However, inadequacy of recreational facilities was seen as the cause of most vandalism, and the management provided organized recreation, Girl Scouts, Boy Scouts, and hopes to construct a community building offering child care on land adjacent to the project. Where the funds for this purpose are to come from is not evident. These items are expensive, and the management would like a rent increase, but was told that because the project was in receivership it was inadvisable to "rock the boat."

The third management priority was the elimination of serious maintenance problems within individual units. Tenants reported that the Resident Manager responded quickly to complaints and consider the overall condition of the project much improved. A gardener, recently hired, has begun systematic improvement of the grounds.

No tenant organization exists; the Resident Manager individual is anxious to contact each family individually and establish rapport before attempting such organization. In the meantime the receiver donates portions of its management fee ($1470/month) for social gatherings.

The attitude of the partner contacted towards projects like this one, and the causes of their deterioration, is interesting. HUD, he feels, has demonstrated a low level of competence in identifying the needs of such projects far enough in advance. The receiver, he asserts, will make little or no money on this project by the time their services are terminated. However, under continued good management the enterprise can become profitable. On the whole, he suggests that they would prefer not to deal with HUD, but takes on such projects more-or-less as a public service, relying on private investments for its profits.

The representative was careful to distinguish between the Loan Management of the Los Angeles Area Office, which handles projects prior to foreclosure, and the Property Disposition Branch, whose primary concern is with Secretary-held properties such as the adjacent project. The Loan Management Branch was seen as both efficient and flexible, with a primary concern for the overall condition of the project, the quality of maintenance and the development of sound management plans for projects in distress. The Property Disposition staff was viewed much less positiviely, and were seen as excessively concerned with formal requirements.

> It may have been too late to save the adjacent project when the receiver assumed management, but the actions of the HUD office since then have probably sealed its doom. Help has been solicited from the Mayor's Office in dealing with HUD, and has apparently gotten substantive support.

On the other hand, representatives of the firm are optimistic about the capacity of the project to regenerate itself. The crucial task, and the most difficult, they say, is to create a sense of community which evaporated under the reign of terror. Seemingly, without pretense, they state that good management is simply a matter "of caring about people." The Resident Manager likes to deal with tenants on an individual basis --when tenant abuse of regulations occurs repeatedly, for example.

ASSESMENT

Insuring Office/Area Office. Opinions differ regarding the quality of processing carried on by the Insuring Office prior to construction of the project. The developer characterizes it as "professional," in keeping with the job that it had to do. The managing agents interviewed feel that HUD supervised the development of projects with little or no foresight into the nature of problems they would encounter. Projected budgets were based on generalized experience of operating expenses that did not account for local variations. Lack of attention to the need for social services and community facilities was clearly a serious mistake; management plans were not even required in the late 1960's.

After construction, one must wonder about the quality of on-site inspections (such as there were) which permitted plumbing problems to go unremedied two years after the earthquake. It also appears that the Area Office is inclined to take remedial action only at times of crisis. The developer's representative, who lavished high praise on HUD's performance prior to and during construction, stated that notification of expected operating deficits and requests for corresponding rental increases fell upon deaf ears until the project was actually in serious financial difficulty. HUD's rationale was apparently that rent increases would be harmful to tenants, although deferred maintenance is hardly less deleterious.

The FNMA representative, and not the Area Office itself, first noticed the poor financial management at the project. FNMA has financial interests to protect; HUD's interests are less immediate, and more diffuse. Once the Area Office became fully cognizant of the situation, however, it acted expeditiously to take remedial action.

The Sponsor. The original sponsor was as qualified and experienced as most in the Western region. He appears to have survived HUD paper requirements without difficulty and to have completed work within timetables set.

Quality of design and construction is another matter. There were inadequate public areas for recreation and community facilities, and the poor groundwork later drained the budget. The units themselves are basically satisfactory, though somewhat drab and carrying the stamp of a subsidized project.

The sponsor also failed to exercise adequate supervision over management -- for the purpose of protecting its investment, if nothing else. For all its experience with subsidized projects, it showed little understanding of the needs of lower-income tenants and failed to identify the social causes of the vandalism that plagued the project from the start. Major repairs were postponed until the general condition of the project was critical and began to impact its marketability.

Managing-Firms. Representatives of the first two firms handling the project place much of the blame for their difficulties with HUD's underestimation of operating expenses, and this certainly was a major factor. Increases in utility rates were beyond the control of these firms, and it is not certain that even with a more vigorous campaign the early management firm could have achieved some measure of tax relief.

The earthquake and sagging economic conditions in the City were also beyond the control of the management and default may have been inevitable if adequate maintenance was to be sustained without additional cash contributions from the sponsor. The Area Office felt that the second management firm used funds inefficiently, perhaps a result of its inexperience.

Turnover in Sponsorship/Management. Transfer of owernship and management to a firm obviously interested only in financial gain and exhibiting neither a minimum interest in, nor in the "in-house talent" for management would signal the demise of any subsidized project. No management plan beyond a skeletal set of promises appears to have ever been discussed. Within six months the project defaulted, yet it took another nine months to place the project in receivership.

APPENDIX A: CHRONOLOGY OF THE PROJECT

1/27/66	Receipt by FHA of request for pre-feasibility analysis
6/18/66	Application for Mortgage Insurance (2013)
9/16/66	Feasibility letter issued for 210 units of 221(d)(3) housing, 40% Rent Supplement
1967	
7/17/67	Firm commitment
10/31/67	Initial Endorsement
11/30/67	Start of Construction
1968	
9/26/68	Permission to occupy
10/31/68	Construction completed
1969	
3/26/69	Final Endorsement
1970	
4/23/70	Request for rent increase to counteract cash flow problems (malfunctioning electrical and sprinkler systems, drainage problems and vandalism)
6/8/70	8.2% rent increase granted

1971	
February	Los Angeles earthquake caused major damage to project
1971-1972	Depression in the City. Vacancies reached 17%.
1973	
January	Transfer of ownership and management to new partnership.
June	Default. First Resident Manager in six months hired by General Partner. Fire damage (unreported).
August	Fiscal irregularities discovered by HUD management review team visiting management office.
September	Notice of Default. Assignment to HUD. Intensive review by FNMA of financial statements uncovered further irregularities.
December	Decision to foreclose. Sponsor submitted proposal for reinstatement of mortgage. Rejected by HUD Loan Management Branch.
1974	
1/30/74	Resident Manager knifed.
3/11/74	Vacancies stand at 56%. Project placed under receivership. General Partner refuses to hand over financial records of project.
April	Contempt proceedings initiated. Financial records released.
June	Receiver reduces vacancies to 2%.

APPENDIX B: ESTIMATED AND ACTUAL OPERATING EXPENSES

	2264 Estimates	1969	1970	1971	1972
Administrative	$14,480	$34,157	$29,879	$42,743	$39,304
Operating[1]	22,200	11,737	17,027	13,820	16,810
Maintenance	24,550	26,073	36,278	47,370	42,722
Taxes	33,637	32,563	58,816	66,736	67,352

No statement for 1973 appears in the Area Office files.

[1]The line item "Payroll" under "Operating Expenses" on the 2264 amounts to $8,400. No such item appears on the annual Statements of Profit and Loss, which show only a greatly reduced figure for "Janitors' Payroll." There are, however, large contracts for repairs and grounds each year, inflating those line items far beyond the 2264 estimates under "Maintenance."

Case Study 3: Limited Dividend, 221(d)(3), Suburban Los Angeles

INTRODUCTION

The San Fernando Valley is home for over a million people who live in suburban tract homes on grid-pattern streets. Part of the community in which this Project is located is indistinguishable from the rest of the Valley with its modest tract homes. But as you drive toward the mountains, the community changes. A county employee spoke of 26% unemployment and heavy crime in the area. Wide highways lined with run-down commercial property bisect this neighborhood. Residential areas are characterized by small recently-built (about 15 years old), single family stucco houses on rather large lots. In some neighborhoods 10 to 20% of these single homes are abandoned and boarded up. The City is filled with vacant trash-filled lots of several acres, waiting for subdivisions that were never built.

In this part of town one finds hundreds of new subsidized apartment units. Two of the three subsidized projects are devastated, having suffered through years of neglect. The third, a startling contrast to the other two projects, is a modest 128-unit apartment complex built under the Section 221(d)(3) program. Like the City's other subsidized housing, this Project suffers from a poor location, bordered by vacant lots and cheap single family homes, some of them abandoned. The Project is miles away from the nearest supermarket. Elderly tenants wait for rides to the market rather than wait for infrequent busses on the many days when the thermometer passes 90 degrees. Significantly, the one advantage of the site is a pleasant city-maintained park with swimming pool and baseball diamond next door.

A visitor to the development has to look hard to find any physical inadequacies or problems. The freshly-painted dull beige two-story stucco buildings are surrounded by immaculately-kept landscaping. In the six years since its opening, the foliage on the grounds has thrived, quite a miracle in the dry San Fernando Valley. Trees and flowered shrubs are already a decent size and should provide plenty of shade in a few years. The project includes a small play area and a swimming pool damaged by the 1971 earthquake and soon to be filled in to make way for basketball courts. The interior of the buildings is equally pleasant with adequately spacious apartments. The keyword in describing the Project is "modest." The Project is anything but luxurious with its lack of balconies, elaborate landscaping, or fancy facades. Nevertheless, it is a pleasantly well-kept complex and provides a decent environment for its mostly Black, moderate income inhabitants. And it has succeeded in meeting its financial obligations.

PROJECT DEVELOPMENT AND CONSTRUCTION

This Project began as a 221(d)(4) project first suggested by the co-owner of the land who became one of the Project's three limited partners in 1964. The development's 6.3 acres of land were assigned a value of $357,000, or approximately $50,000 per acre. HUD discouraged the proposed 221(d)(4) since the area was developing slowly and a market for the apartments was not assured. The land-owner approached HUD again a year later and requested consideration of his project as a 221(d)(3). After two more years of waiting, initial endorsement was granted in December 1967. The real push in processing came from a visit to the Los Angeles HUD office made by Washington officials. The Central Office staff urged the Los Angeles office to speed up processing and to increase production. Meanwhile, an effort had been made to reduce construction costs by eliminating balconies, a child care center, and car ports, and by a change in layout from the original proposal. Construction began in February 1968, and ended in November 1968, with the first tenants moving in in September. Final endorsement came in June 1969.

One of the Project's limited partners also handled the contracting for this Project. His experience includes a large volume of military housing and office buildings. The Project had no particular construction problems or changes in design. The builder had some interesting comments in reference to the adequacy of FHA inspection. He explained that the possibilities for a contractor to cheat in FHA inspection are enormous, that the best way to prevent non-complying workmanship is to use only the most experienced contractors. Unfortunately, contractors with blemished reputations worked on 236's and 221(d)(3)'s, and sometimes projects were put together by developers with no construction experience who employed a group of subcontractors.

In April 1968, a meeting was held in the community to protest the tremendous volume of subsidized housing being constructed in this small area. Community leaders were most upset over the likelihood that schools would become hopelessly overcrowded. The community had never been consulted as to its wishes for three subsidized projects. Indeed, the developers of these projects appear to have been unaware that HUD had approved all three almost simultaneously. Accusations were made at the April meeting, but it was already too late. This City, economically depressed to begin with, was on the verge of becoming heavily impacted with a new load of low-income households.

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OPERATION AND MANAGEMENT

A rather small and reputable firm that manages about six apartment complexes has handled the Project's management since its initial phases. The Project's rent-up proceeded smoothly, as the project was completed long before the two other competing subsidized complexes nearby. By May 1969, this Project was 100% occupied, and since then has enjoyed a low vacancy rate, due mainly to the superior maintenance of the project.

Unanticipated expenses forced rents to be raised slightly in November 1969. On April 21, 1970, the sponsor requested an additional rent increase to cover increased salary expenses for staff and increased property taxes. The HUD-2264 estimates had missed the mark for several items. For example in 1970, total administrative expenses were three and one-half times the HUD estimate and real estate taxes were 21% higher than the estimate. (See Appendix B for a comparison between 2264 estimates and project experience.) Nevertheless, compensating adjustments of operating and maintenance expenses plus a high occupancy rate have given the Project a healthy margin within which to operate. HUD approved the request for increased rents on June 21, 1970.

The Project's successful operation was seriously threatened by the earthquake in February 1971, causing approximately $28,000 damage. A letter from the sponsor received by HUD on February 19 described the damage:

> Virtually every apartment has some cracks, interior at most doors and windows, and exterior in horizontal and vertical lines along the buildings. When one realizes that even the interior apartment cracks have to be pointed out, the plaster repaired and that the paint cannot be matched over two years later, an average of $125 per apartment for this damage is certainly reasonable. The exterior cracks also have to be opened up and repaired with epoxy and then waterproofed which will require some exterior painting of the stucco as well. Even the asphalt driveway which has numerous hairline cracks has to be opened along the length of these cracks and repaired and resealed to be waterproof. The additional damage that is visible include cracks in the first floors of the concrete in some apartments, foundation patching required at exterior buildings, toilets jumped off floors and broke, neighbors' block walls fell on our property, water heaters jumped out of cabinets within all of our two bedroom apartments, main line water breaks, heater and meter doors were broken, even the swimming pool requires patching on the expansion joints.

In the same letter, he requested a Section 241 loan that would increase the project's mortgage by $58,000, and a six-month waiver of principal and reserve for replacements on April 12, 1971. He later withdrew this request in favor of using money from the replacement reserve. HUD issued a commitment for the Section 241 loan on July 27, 1971, but before the loan could be executed, plans changed. The sponsor met with representatives of HUD and agreed that an addition to the mortgage at a higher interest rate would cause considerable administrative problems. They concluded that a simpler solution would be to modify the mortgage so that principal payments would be suspended for a period long enough to recover the cash expended on earthquake repairs. HUD Central Office finally approved the modification on November 17, 1971, retroactive to March 1, 1971, the date of the first mortgage payment following the earthquake. The modification continued for 28 months, until July 1, 1973. The Project then had sufficient funds to take care of the repairs that had been postponed. High maintenance expenses in 1972 reflect the cost of these repairs. Another rent increase was approved August 17, 1973 to absorb increased expenses from taxes and maintenance. The current rents ($100, $116 and $128 for one, two and three bedroom apartments, respectively) are approximately 18% higher than original rents. If it were not for the immediate attention given to the earthquake damage, and the steps that were taken to yield money to cover needed repairs, the Project would have surely gone into default.

Ironically, the earthquake provided a set of circumstances that actually benefitted the Project. The same earthquake caused considerably more damage at the other subsidized developments in town. At the same time, these two were woefully neglected by their managers and owners. As this Project bounced back after the quake, the other two drifted toward slum status and eventual default. Recently, a Los Angeles Times article compared the three projects and made this one appear so desirable that the management experienced a new wave of applications for apartments. Thus in spite of the severe impaction with subsidized housing, managers of this Project have never had trouble marketing their product.

HUD has preferred to not get involved since, as a staff member of HUD's Loan Management Branch put it, "that's the responsibility of the management and they're getting paid". Fortunately, the management has done a good job and HUD's non-intervention has been justified. The management firm admits the mistake of hiring a couple as resident managers who let the property run down in 1970. They were replaced three years ago by another couple who are assisted by their sons who also live in the complex. In the early days of the project management, the management firm erred in renting to families with incomes over the 221(d)(3) limits (17% of the original tenants). There was some confusion over the amount of security and cleaning deposits that could be charged and how those funds should be handled. These criticisms should not overshadow management's efficient, businesslike performance.

The effective job that the resident managers are doing is reflected in the spotless appearance of the development and the high regard that all involved, including the tenants, have for them. The lack of tenant complaints was striking. Even the recent increase was not raised as an issue by tenants. One resident expressed her satisfaction by saying, "I feel at home here." Satisfaction included the management, maintenance of the project, and the physical design of the apartments. The only complaint heard referred to the inconvenient location of the project accompanied by infrequent bus service.

The resident manager, who claims to know all the tenants, acts as counselor and rental agent. This included working with kids and helping to iron out marital disputes. The resident manager also does most of the maintenance, handles the teenagers, and deals with the more difficult problems (e.g., drunk tenants). Although they try to avoid evictions by working out arrangements with tenants, evictions begin when a tenant falls two months behind, and average one eviction per month. In order to avoid delinquencies, the units are rented only to employed people and not to welfare recipients. Credit and past rental records are also checked. They can afford to be choosy as they have a waiting list of applicants and have never had more than six vacancies among the 128 units. However, in spite of these strict screening policies, not much effort is made to explain subsidy programs to tenants.

Plumbing and electrical problems are given maintenance priority. A special maintenance burden has resulted from earthquake damage when all buildings and units had to be replastered and repainted. Maintenance is made easier by the fact that few children play on the grounds of the project since a nice park is just next door. Although not nearly as severe as elsewhere in town, crime haunts the project. Tenants spoke of fear, and there was mention of the theft of car batteries. The management firm's representative has proposed an unusual addition to the project that he feels will keep outside crime from coming in - he wants to build a 10-foot fence all around the project.

The type of management provided can be described as efficient and businesslike. In spite of their good rapport with the tenants, there are no set social programs for the complex. The manager's wife looked puzzled when asked about such programs.

ASSESSMENT

"In a nutshell it's good management." That was the first comment of one of the Project's limited partners, in his explanation of why the Project has been successful. Working along with the management's firm, whose offices are in the same building as the sponsor's, he has preferred to remain particularly involved in Project operations. He keeps a watchful eye on his investment, reacting quickly whenever a problem arises.

The sponsor is a partner in a firm of builders and developers who have put together many subsidized projects in California. In developing this one, he changed his usual practice of working with his partners in favor of forming a partnership with a relative and the Project's builder. He maintains that he "hasn't made a penny from the Project," a statement that cannot be proven but might be treated with some skepticism. He is reluctant to undertake further projects in minority areas because "there are just too many problems there." He was particularly bitter about having been criticized by the community as having contributed to the impaction of that area. This Project has required more of his attention than any of his other projects, yet his return has been meager because of expenses and a rent-delinquency problem (no more than 89% of rents are ever collected). He thinks delinquencies are inevitable in any subsidized project.

He asserts that, rather than protection of depreciation allowances, his main motivation to keep the Project current lies in his desire to maintain a good reputation with HUD, essential for a developer who is engaged mostly in FHA-insured work. His desire is strong enough to involve him in matters that most investors would avoid. For example, he keeps a close check on the accounting of the on-site managers and he was the principal force behind efforts to get financial assistance to help repair earthquake damage.

Although the sponsor personifies part of that "good management" that the Project has enjoyed, an evaluator must view his role with some perspective. Some people involved with the problem-plagued adjacent Project scoffed at this development, called it a "Disneyland," and suggested that he is out to serve only his own interests and not those of low-income tenants. Thus the sponsor seems more like a typical investor when he speaks about avoiding minority areas, not renting to tenants on welfare, and about not including recreation buildings in developments since they attract teenagers who cause trouble.

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Under his watchful eye, the Project will continue to be financially successful, just squeaking by on its meager budget. Yet, this success depends also upon the project's exclusionary tenant screening, thus evading the constraint that it serve low income people of all groups. Severe problems may suddenly plague the project as damage from the earthquake did in 1971, and throw it into default. However, as long as vigorous and strict yet not totally inflexible management persists, it will be free of many of the usual pathologies that destroy projects. Disneyland or not, this project provides decent, inexpensive housing for those tenants who can get in.

APPENDIX A: CHRONOLOGY OF THE PROJECT

1964

6/29/64	Pre-application contact

1966

4/21/66	2013 Submitted

1967

12/7/67	Initial Endorsement

1968

2/15/68	Construction begins
9/68	Initial occupancy
11/26/68	Construction ends

1969

6/17/69	Final Endorsement
11/12/69	Rent increase

1970

6/21/70	Second rent increase

1971

2/9/71	Earthquake
2/19/71	Sponsor files for Section 241 loan
4/21/71	Sponsor requests waiver of principal and reserve for replacements.
7/27/71	HUD approves Section 241 loan
9/71	Change in plans: Agreement is reached to seek a mortgage modification.
11/17/71	HUD approves mortgage modification, retroactive to 3/1/71.

1973

8/17/73	Third rent increase

APPENDIX B: ESTIMATED AND ACTUAL INCOME AND OPERATING EXPENSES

	FHA Form 2264	1969	1970	1971	1972
Total actual rent	151,296	152,986	162,945	161,567	159,082
Average occupancy		100%	100%	94.88%	94.3%
Administrative expenses	6,500	20,795	22,732	13,449	13,836
Operating expenses	14,600	10,166	12,591	20,741	19,094
Maintenance	14,550	12,503	12,884	16,026	30,866
Taxes and insurance	28,405	23,205	36,993	38,809	39,713
Total Expenses	73,775	66,672	85,200	89,025	103,509
Expense ratio	48.76%	43.58%	52.28%	55.1%	65.1%
Total financial require		84,581	58,434	56,413	53,085
Total cash required		151,263	143,634	145,438	156,594
Net cash flow		1,755	19,311	16,129	2,480

Case Study #4: Limited dividend, 236, 40% Rent Supplement, Suburb to a Medium Sized Northern California City

INTRODUCTION

A while ago representatives of the limited dividend partners came from the East Coast to inspect their investment and to see personally the myriad problems that their project has suffered through. Having heard it called "a slum," they were surprised to find a lack of the physical defects typical of East Coast slums. This project is not a group of crumbling, semi-abandoned, rat-infested tenements. Such an attitude is irrelevant, as this Project must be viewed in a West Coast context. Those more familiar with the West Coast rightly call it a slum.

This 287-unit apartment complex occupies part of a 17.6 acre plot; and is mostly occupied by moderate and low income Chicano and Black families. The Project consists of densely-packed two-story wood and stucco buildings that might euphimistically be called a garden-style apartment project. Some people have alternatively described it as a bunch of warehouses. Massive steel pylons carrying high tension power lines march through the complex, dividing it in half. The landscaping in well-traveled areas has been trampled into dust, while elsewhere plants appear to be sometimes neglected and struggling, and sometimes overgrown. In fact, part of the grounds looks like a construction site with dried, rut-filled mud. On rainy days the mud engulfs all -- sidewalks, parking lot, play areas. The white stucco walls have been splattered with this mud. Other eyesores include windows with missing screens and laundry rooms decorated with spray paint graffiti. The neighboring expressway and overgrown vacant lots also detract from the quality of the Project's environnment. While such physical deterioration is inexcusable in a complex as new as this one, it would be unfair to describe only its negative features. Residents interviewed seem to be pleased with the interiors of their apartments. Equipped play areas are situated on the site. Parts of the complex are really quite pleasant.

The Project's location is not much better than its maintenance. Although it has excellent access to an expressway, it suffers from the general lack of public transit in the County. Residents are dependent upon cars for shopping -- supermarkets are miles away. Since the project contains inadequate play areas for children, and the closest school yard is quite a few blocks away, kids have to make do with whatever space they can find for play. The sprawling suburb surrounds the Project with subdivisions of modest tract homes, some of which have been abandoned. The neighborhood has been impacted with low-income housing, with two large projects nearby. Driving through town one gets a feeling of wide-open spaces. These wide-open spaces are really the leftover vacant lots that no developer would dare touch. This suburb houses the City's minority population, Chicano and Black, and suffers from high unemployment and excessive crime. Knowing that they could not easily market new subdivisions on this side, developers avoid this part of town.

PROJECT DEVELOPMENT AND CONSTRUCTION

The HUD file on the Project contains very little information on the period before the final endorsement period. The usual memos from appraisers or even the letter of invitation to submit an application for firm commitment were missing. It seems that most of this material was thrown away after the project was completed. Housing managers seem to think that such early history is irrelevant to current management problems. While such an attitude is justifiable from a standpoint of current management, the loss of the Project's informal history has made evaluation of the adequacy of the project's processing nearly impossible. Compounding this problem of a lack of written material, the persons involved with developing the project have been difficult to find, making it necessary to rely on the memories of the few individuals who could be found.

The original efforts of the sponsor to develop the Project fell apart when an executive of the firm and original limited partner was unable to achieve an agreement with any contractor. A consultant acted for the firm and prepared the way for the partners who expected to benefit as limited partners. The consultant, who worked for the sponsor, later lost his job for not being able to achieve an arrangement satisfactory to the potential partners. The firm which had been approached as contractor by the original sponsor ended up packaging the development. A HUD staff member commented that the packager inherited a project that was poorly conceived and designed; but HUD disagreed, stating that the firm's problem was that it was working outside its typical area of operations, elsewhere in California. Nevertheless the firm operated as general contractor, formed the original skeleton limited and general partnerships, and a subsidiary originally managed the project. Construction began in December 1970, rent-up began in early September 1971, and construction was completed in mid-September 1971.

A staff member of the firm's management subsidiary asserted that the construction yielded no unusual problems or defects. However, he may have been less than candid during the interview. A HUD staff member called the firm "a good stick builder," explaining that the firm usually does good work, but no construction of subsidized housing is perfect. Representatives of other firms who have managed the Project blame the sponsor for construction defects such as drainage problems, leaking roofs, and poor sewer hook-ups. The drainage difficulties resulted in flooded sidewalks, standing pools of water, expanses of mud, and an eventual cave-in of the street, rupturing a main sewer. Roof drainage was connected to domestic sewers causing sewage to back up in apartments. The soil used in landscaping was so poor that few plants have survived. An employee of the firm that followed in managing the Project told of having to dig up the property to find the sprinkling system that wasn't placed according to plans and specifications. Play areas were asphalted

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with no protection for children falling from equipment. Concrete studs were left sticking up out of this asphalt. A representative of the sponsor felt that HUD and County inspections are adequately rigorous and should have caught any construction defects, but it does seem possible that certain defects could have been missed by inspectors. Although not legally obliged to do so, the sponsor has recently made some repairs to the development, repairs that have been found inadequate by current management and HUD.

The Project's architectural firm can be blamed for certain design inadequacies that have added to the Project's problems. The layout is so terribly dense that only inadequate play areas are provided. Children must play wherever there is room, often on the landscaping. Few trees have survived. Window sills in upper floors were placed at such a low level that children can fall out. Some of these design and construction problems can be traced to what a representative of the current management firm calls a tendency for 236 projects to be built as a "second-best" type of apartments, without the same amenities as unsubsidized new apartment developments.

This Project went through HUD's Accelerated Multi-Family Processing Program. The 2264 cost estimates were quite inaccurate, especially for property taxes, utilities, and maintenance. The tax estimate differed from the first year's bill by $25,000, a result of mis-communication between HUD and the County, which has a reputation for over-assessing 236's and changing projected assessments by the time of the first tax bill. As an appraiser in the San Francisco Area Office stated, the best HUD can do is accept the figure that the county assessor quotes. Utilities were estimated at $15 per unit, but actualy amounted to $25 per unit. Maintenance grossly exceeded estimates owing to the need for a large staff and many capital repairs. (See Appendix B for a comparison between 2264 estimates and project experience.)

Although tenants were occupying the project by late 1971, final endorsement was delayed until September 5, 1972. Before final endorsement another firm joined two representatives of the original developer as general partners of the development, representing ten limited partners. At final endorsement the current mortgagee purchased the mortgage from a savings and loan.

OPERATION AND MANAGEMENT

In its first three years, the Project has had three different management firms. A representative of the first claims that his firm had no problems and that its myriad troubles arose after they left. However, he may have been trying to cover up his firm's failure to provide adequate management. All other informants blamed this firm for allowing the landscaping and other maintenance to be severely neglected. A letter from the president of the management firm that replaced the original firm documented the neglect he found:

> "The exterior of the project needed immediate attention as the lawns had died out, from lack of care and water. The automatic sprinkler system was not in operation, due to breaks which had not been repaired. Trees and shrubs had died and much of the original landscaping had been destroyed by unsupervised children playing in planted areas. The entire project was filthy, with an accumulation of litter and garbage everywhere. The laundry rooms were a mess. In general, we found windows broken, many patio door screens and window screens off or destroyed, draperies hanging out of windows and patio doors stained and torn beyond repair and use. The entire project was well on its way to becoming a real ghetto.... The staff was not organized and had little or no equipment to work with. Most of the suppliers had cut off their credit since the bills had not been paid. As a result, apartment repairs were not being made. Residents were very unhappy. Good residents were in the process of moving out."

Initial rent-up policy resulted in a tenant mix with tenants clustered at the lower income limits of the 236 program with some paying more than 25% of their income on housing. The original management firm's representative spoke at length of the unanticipated expense of hiring security guards to protect the vandal and theft-prone property. Further, he blamed vandalism, especially that of laundry facilities, on unsupervised children who lived in the project. He complained about the insufficient funds allowed by HUD for the management of problem projects like this one. Interestingly, this firm has been quite successful in managing other subsidized projects in Southern California and in the Sacramento area.

Rents were raised slightly on July 25, 1972. The new management firm assumed the management August 15, 1972 at the request of the original manager. A HUD staff member commented that the new firm inherited the Project's physical problems and ignored its social problems. When the new firm stepped in it embarked upon a comprehensive plan to bring the project back into shape. However, lack of funds and a disorganized staff prevented the management's plan from ever being totally executed. In addition a misunderstanding between the two management firms developed over an investment in capital improvements that the second expected the sponsor's management firm to make. The new firm finally paid for many improvements without reimbursement, a situation that led to its financial demise.

New management was quite overwhelmed by the large amount of vandalism and abuse (broken windows, stolen screens, destroyed laundry rooms, mud-splattered walls, etc.) that troubled the project before and during its term of management. The firm had to make do with an inadequate maintenance budget. Substantial expenses were incurred in employing a staff large enough to take care of the deferred maintenance. Security guards had to be recruited and new door locks installed to protect property from crime. Most of the project's water heaters had to be replaced after they had been destroyed by the hard, lime-filled water. The cost of providing utilities soared, and an excessive tax bill was received. In addition, they attempted to expand the Project's social programs, another expense not in the budget. Rent from a commercial building on the site was anticipated in HUD processing, but never received. No management firm has been able to find a tenant for this poorly-located facility. Tenants for the apartments were also hard to find, as turnover of units continued to be rapid. Attempts at tenant screening were abandoned, and rentals were to families with very low incomes in order to fill units.

When management was assumed, the new firm continued to employ the on-site manager, in spite of warnings to look into the matter. Conflicts between the original manager and his maintenance staff and his lack of cooperation with the new firm (plus their insensitivity) added to the problems. The staff was lax in answering tenant complaints, and did not provide quality maintenance. Black residents accused the manager of favoring Chicanos and he was certainly negligent in collecting rents. In spite of all this he was not fired until the summer of 1973, and his firing became an issue in the first rent strike. Tenants who appreciated his loose rent collection policy, a source of delinquent rent problems, were especially bothered by his removal. Indeed, the manager remained on the premises to help organize the strike.

With these overwhelming problems, it's not surprising that the Project went into default in February 1973. On February 16, 1973, management recommended to HUD that the mortgage be modified by waiving the reserve for replacements and principal payments. This modification was approved by HUD tentatively on August 19, 1973, but has yet to be signed and put into effect. During August 1973 additional assistance was offered in the approval of up to 40% of the units for rent supplement and 20% of the units for Section 23 leasing. Current management, afraid of losing control of the tenants, has decided to not use Section 23. An interview with a staff member of the new management firm indicates that certain key personnel were insensitive to the Project's poverty-related problems. The Project employed on-site staff who insulted tenants and was unable to deal with their problems. Poor tenant-landlord relations were evidenced by the confusion and lack of communications over the attempted $15 per unit rent increase in the summer of 1973. In August 1973 the Project was hit by the ultimate problem of a rent strike. Tenants were outraged by the requested increase in rents when maintenance and services had gone neglected for years. They resented the insensitivity of management personnel. And the on-site manager remained on site to organize tenants after he had been fired for incompetence. The manager's rehiring became a tenant demand, but the main strike issues centered on neglected project maintenance.

Before the strike could be settled, the management firm bailed out and turned the Project over to a management firm known for rescuing defaulted projects. The corporation went out of business in January 1974, partially, it was alleged, because of the costs it had incurred without reimbursement from the Project's management.

A new management firm took over in September 1973 upon the invitation of HUD, the Project's owners, and an association of residents. They accepted management of a project in total chaos with its deteriorated physical plant and rent strike in which 50% of tenants were not paying rent. In addition, the vacancy rate had risen to 27%. A settlement in the strike was reached September 10, 1973, but, before the increased rents could be put into effect a second strike began, sparked by the organizing efforts of one disgruntled tenant. This second strike lasted from December until April 1974, and was organized around dissatisfaction with the management's plan for repairs. The rent increase was finally approved April 1, 1974.

The new on-site manager had an overwhelming job in trying to get the Project back on its feet. In May 1974 he was still struggling to rent 26 vacant units out of the total 287 in the project (9% vacancy rate). Although the rents are lower than most others in town, the still unfinished job of repairing the damage left by years of physical neglect is obviously discouraging many prospective tenants. By the time the rent increase had been approved many tenants had left without paying their back rent. The Project has always housed very low income families, families that need certain social services that the management has difficulty providing. The tenants are mostly Chicano, but there are also many Blacks and a few Whites residing in the complex. Over 20% of the current tenants obtain their income from some sort of public assistance. The low-income tenants not benefitting from rent supplements have a difficult time absorbing rent increases. Managers have complained that the tenant's social problems have added to their maintenance burden. Unsupervised children abuse project property. Vandalism, evidenced by broken windows, mud-spattered walls, and ravaged laundry facilities, has been traced to project residents and "their guests." Some of the vandalism can be a result of the frustration of tenants who have lived in a long-neglected project. Curiously enough, the tenants interviewed expressed pleasure with their apartments. Major complaints centered on neglect of the grounds and noisy neighbors.

HUD staff commented that the general partners have been uncooperative, hard to get hold of when approval has been needed for the efforts under way to save the Project. The fact that one of the partners has his office in the East does not make things any easier. It seems that one partner is reluctant to act without sure support from HUD. The Project's mortgagee echoed HUD's assessment of his uncooperativeness, saying: "That man's just impossible." This attitude adds significantly to problems when special cooperation is needed to save the Project.

CURRENT STATUS AND ASSESSMENT

The Project's default in February 1973 stimulated a major effort to correct the default. To achieve a turnaround there has been a rent increase, a change in real estate tax assessment, an application for a mortgage modification, an application for an operating loss loan, and some repairs by the construction contractor (two and a half years after the end of construction). HUD is withholding final approval of the mortgage modification, retroactive to February 1973, that would waive payments into the reserve for replacements, suspend principal payments, and require the payment of only a "true" one per cent on the outstanding principal. The modification and operating loss loan will be approved if the limited partners provide $100,000 in additional equity that has been requested. The mortgage company finally filed for foreclosure in March 1974 (over a year after default began), after the carrying costs became too burdensome on the defaulted mortgage. The HUD Housing Management Office has been heavily involved with the Project operations since default began. More time and attention are being devoted to the Project than to others in the San Francisco area. Several interviewees suggested that HUD Housing Management was simply unprepared for a problem-plagued project like this one.

It would be unfair to characterize this Project as a complete disaster. Some sections of the development are quite attractive, and one can see interesting features in the project's design. Attempts have been made to set up social programs for the tenants, including boxing lessons and adult education. It is encouraging to see some of the parties involved working so hard to save it from foreclosure. Unfortunately, one has little hope that these efforts will succeed. The current management continues to try to get something to grow in that poor soil and to try to decrease vacancies beyond the current 9% rate. Perhaps the most positive thing that can be stated about the Project is the comment of an elderly tenant, pleased with her apartment, who said that in spite of its problems, the Project is a lot better than her former home.

APPENDIX A: CHRONOLOGY OF THE PROJECT

1970	
6/30/70	2013 submitted.
12/9/70	Construction begins
12/9/70	Initial endorsement.
1971	
9/1/71	Rent-up begins.
9/15/71	Construction ends.
11/2/71	Rent revised downward slightly.
1972	
3/16/72	Discovery of tax and utility under-estimate.
7/25/72	HUD approves rent increase.
8/15/72	New firm assumes management.
9/72	Developers purchase limited partnerships; Eastern partner becomes a representative of the general and limited partners.
9/5/72	Final Endorsement.
1973	
2/73	Default begins.
2/16/73	Management suggests a mortgage modification.
8/1/73	First rent strike.
8/13/73	HUD approval of rent supplements for 114 units.
8/15/74	Management firm gives up.
8/19/74	HUD approves mortgage modification pending the execution of the proper forms; never finally approved.
8/20/73	HUD approves Section 23 leasing of 20% of the units. Never used.
9/73	New firm assumes management.
9/10/73	Rent strike settled.
12/1/73	Second rent strike.
12/21/73	Mortgagee notice of intention to begin foreclosure.
1974	
2/27/74	Original developer agrees to make some project repairs.
3/1/74	Foreclosure begins.
4/74	Rent strike settled.
4/1/74	Rents raised 15%.
4/17/74	Partner requests additional period for mortgage modifications.
4/17/74	Operating loss loan application submitted.
1974-1975	Taxes have been modified to $122,000/yr.

APPENDIX B. ESTIMATED AND ACTUAL INCOME AND OPERATING EXPENSES

	FHA Form 2264	1972	16 months ending 4/74
Total actual rent	$462,583	441,485	$609,909
Average occupancy	95%	90.5%	
Administrative expenses	33,600	71,861	123,000[1]
Operating expenses[2]	87,030	86,342	129,189
Maintenance	28,600	77,731	146,358
Taxes and insurance	115,740	90,917	204,856[3]
Total Expenses	264,970	326,851	603,403
Expense ratio	57.3%	74%	
Financial requirements (includes mortgage and replacement reserve)	175,477	175,477	170,610
Total cash required	440,447	502,328	774,013
Net cash flow	22,136	(61,243)	(164,104)

1 Including bad debts expense.

2 Includes utilities.

3 Current taxes are $122,000 per year after an abatement. Unfortunately, no expense statement has been done for the calendar year 1973, but one was completed for the 16 months ending April 1974. It is interesting to note that the unanticipated expenses most often mentioned, i.e., taxes and utilities, do not seem to be out of line in 1972. Maintenance appears to be the real culprit. However, enough information is available concerning the poor estimate of property taxes ($115,000 versus the $140,000 bill received) to believe that there is something wrong with the tax figure on the financial statement from which the above figures were taken. It is important to note that in spite of extraordinary maintenance expenses the project has still gone severely neglected.

Case Study #5: Non-Profit, 221(d)3, 100% Rent Supplement, nearby middle-sized Southern California city.

INTRODUCTION

Located just north of the Mexican border, this community is separated geographically from the rest of the city by the two other cities. But its isolation is more than physical. There's no reason to stop here -- nothing is there. No shopping, no employment, no agriculture, and if it were not for programs like Model Cities, no public services. In this town one does find scores of sub-standard wood-frame homes, inhabited mostly by Mexican-Americans, recent immigrants without the cash that could remove them from this depressed area. Recently there have been some changes in town. Several subdivisions of modest stucco homes have been built, also occupied by Chicanos who take marvelous pride in their gardening. Several freeways are under construction to assist tourists in their trips across the border.

And then there's subsidized housing. Rising above all this dust is the project. The monolithic appearance of this is enhanced by its density; 400 units in two and three story buildings on 15.4 acres. After all the buildings and parking lots had been built, there was literally room for nothing else. Thus one finds only one-half of a basketball court on the project grounds. Such a high density is expected in inner cities where housing is intermingled with shopping, factories, teeming city life. But such is not the case here. The city has expanses of unused land, albeit unusable for building in its barren, rocky, hilly state. The project is bordered by a steep canyon half-prepared by its owner for more subsidized housing. The local planning commission recently turned down the developer's plans for fear of impacting the city, but not before the same developer constructed a large 236 project next door. Thus the city is impacted. Needless to say, the children (1,200 of them) who live in the project are warned by the property owner to stay away from the undeveloped land bordering the project.

The Project is both financially and environmentally successful and has been very well maintained. The many lightly colored stucco buildings are quite attractive, especially since they are unmarred. Many of the left-over plots of land on the grounds have thriving patches of flowers and shrubbery. Several small buildings have been converted to decorated community centers -- an adult center, a girls' club, and a teen club. The adult center is the showpiece, rather plushly decorated and redesigned in order to give tenants a feeling that their center is set apart from their apartments, a unique place to spend some time. A small school for pre-schoolers occupies another corner of the project. Small sections of the grounds, 15 of them, have been converted to tiny play areas. However, kids tend to play wherever they want, often turning landscaped areas into dusty strips.

Internally, the project's design is barely adequate. Apartments in the project have the stamp of "subsidy" on them, having been constructed under the 221(d)(3) program before such amenities as carpeting and balconies were allowed. Rooms are tiny; kitchens are just barely adequate; the lack of air conditioning on stifling days can be devastating; and the drab tile floors are hazards for children who fall and hurt themselves. However, the most overwhelming aspect of the project is its sheer density. Adjoined buildings are separated by eight-foot wide corridors. That such a poorly-designed project has survived and flourished is remarkable.

PROJECT DEVELOPMENT AND CONSTRUCTION

The project was developed in a rather unique way. The developer handled all the pre-final endorsement work with intentions of selling the fully-developed project to a non-profit sponsor. The curious fact here is that the developer chose to develop the project with insurance upon completion rather than insurance of advances. Such an arrangement results in extra risks for the builder-seller, the main risk being the chance that the builder might not be able to find a non-profit sponsor to take over the project. One wonders how this businesslike company could have possibly managed a 100% Rent Supplement project like this one. Though seldom experienced, another risk is the right of HUD to refuse to insure cost overruns in construction. However, insurance upon completion is preferred by most limited dividend sponsors for its simplicity in that sponsors can avoid a lot of contact with HUD.

The builder currently owns and manages other subsidized developments in California, many in the same area. This identity-of-interest corporation has a good reputation for quality, professional construction and management. In addition to the projects in which the firm retains ownership, it has developed several subsidized projects for sale to non-profit sponsors. One such project was this one.

In November 1967 the builder submitted an FHA Form 2012, Request for Pre-Application Analysis for a 350-unit 221(d)(3) project. The proposal was changed to 400 units in March 1968, the time of submission of the Application for Project Mortgage Insurance. This change was an effort to improve "the overall economic potential of the project." HUD processed the application promptly. March 8 appraisers' memos comment on the need for a subsidized project in the city where 60% of the housing was substandard and 80% of the families earned less than $4,600 a year. There were reports of many families who had permission to immigrate, but were living across the border due to the severe housing shortage in the city. On top of this need was the anticipated need of relocation housing from planned freeway construction. However, the appraiser warned that the area lacked shopping and services and that Chicanos tend to prefer the privacy afforded by single family housing. He therefore recommended that the huge project be developed in phases, a recommendation that was largely ignored. A feasibility letter was issued in March 1968 followed by a conditional commitment of mortgage insurance in June 1968. Rent supplement funds of $478,368 for all project units were approved June 25, 1968. A Catholic Church group was approached by the developer in early 1969 and agreed to assume non-profit sponsorship of the project at final endorsement. Construction began June 4, 1969, the first apartments were ready for occupancy in February 1970, and all work was completed by June 1970.

Before cost certification could be completed the builder requested several changes in the maximum mortgage amount to cover cost overruns, assistance his company was offering to the sponsor, and an increase to 2% of the allowance for overhead. The series of meetings between HUD and the contractor concerning cost certification amounted to nothing more than bickering over costs incurred. The final change order came to only $27,250 of the final mortgage amount of $5,864,500. This prompted a 50¢ per unit rent increase to $158.50, $174.50, and $182.50 for two, three, and four bedroom apartments, respectively. Initial-final endorsement occurred on September 1, 1970.

Both the nine-month and the twelve-month inspection revealed a series of latent construction defects, most notably the crumbling of stucco at the corners of buildings and the separation of stairwells from the buildings due to settling. With a little coaxing from HUD and the non-profit sponsor, the builder made prompt repairs of all latent defects.

OPERATION AND MANAGEMENT

The Church group developed an interest in housing management as a result of the message of Vatican II, that Catholic groups extend their ministries into the community and into such fields as social welfare. The sponsor described its motivation as:

a) Assisting the poor in obtaining adequate housing;
b) Assisting the disadvantaged in improving themselves spiritually, culturally, economically and educationally so that they may assume their rightful place in society and make a more ample contribution to it.

An Executive Director of the non-profit corporation was appointed whose previous experience had been as a teacher in the East and in Southern California. He began working at the project about the time of the rent-up period in February 1970. Unfortunately, he and his colleagues were totally unprepared for the complicated work of processing tenant applications for a subsidized project and getting the place rented up. The developer became alarmed about the project that they still owned when February 1970 was almost over and no tenants had moved into the many units that had been completed for almost a month. Sensing disaster, a member of the developer's firm suggested that they assume management until the sponsor could get better organized. The Acting Director of the HUD Insuring Office concurred, writing:

> "Matters have now culminated in a conclusion by the builder-seller that the non-profit buyer is too inexperienced in the field to efficiently accomplish the initial rent-up and that, unless this function is taken over by the builder-seller, the success of the project may be jeopardized by a bad start."

The developer did assist in the rent-up, but the representative assigned to the apartment complex so harrassed employees that he proved to be a detriment rather than a help. Nevertheless, the concern proved largely unnecessary, as the project was fully rented, with a waiting list, by July 1970, attesting to the huge local market for low-rent housing.

The sponsor realized immediately that he had a difficult project to manage. A Police Department Captain predicted that the project would be plagued by crime, drugs and even riots. The management staff immediately began to work to prevent these predictions from coming to pass. The management's emphasis was placed on providing services needed by low income tenants. A census of the tenants taken in May 1971 revealed the following statistics: Of the 1,800 residents, 1,200 were under 20 years old. Eighty-two percent of the households were of Mexican-American heritage. Seventy-one percent of the households derived their major source of income from some sort of public assistance (61% from welfare exclusively). Much assistance in setting up services was provided by outside agencies with the encouragement of the non-profit sponsor. Model Cities funds were provided so that the School District could lease the project's classroom facility for pre-school instruction. The Welfare Department provides personnel on-site for counseling. Medical staff visit the project regularly. And the Mayor's Office in the larger city to the north has sponsored trips and activities for teenagers in the project.

Much of the social services are designed and provided by the non-profit sponsor's staff. Two apartment buildings have been renovated to accommodate community groups, the Adult Club, the Teen Club, and the Girls' Club. Work is under way currently to build a needed addition to the Adult Center's billiard room. Adult education classes are offered in English as a second language, citizenship, and home economics. Senior citizens attend social gatherings. Young people have a large number of activities to participate in, including a highly-successful girls' soccer team, plus a place of their own in which to get together. The staff has also encouraged a moderately successful Tenants' Council. In the words of the Social Services Director in the HUD Insuring Office, the project is a model for what social services should be offered in all projects. The non-profit sponsor has been successful in getting realistic tenant input into planning for social services. "He has touched base with various tenant needs --recreational, educational, medical, etc."

The array of social services has been evidently successful. All are well-utilized by the tenants who appreciate the efforts made on their behalf and by and large approve of the job the non-profit sponsor is doing. The resident managers agree on the amazing statistic that vandalism to the project's property amounts to only $10 a month, and most of that is perpetrated by outsiders. Such a claim might well be met with skepticism, but close examination revealed no evidence on the project's grounds of any obvious vandalism. Such a contrast to the experience of other subsidized developments certainly is contrary to what would be expected. Tenants reported a feeling of security in their strolls around the project after dark. Besides the function of social services as a means of crime prevention, the sponsor spoke of wanting to help tenants develop a pride in themselves, a self-sufficiency. He boasted of the adult education classes, the encouragement for tenants to become citizens, the emphasis on helping tenants prepare for employment. The 1974 census of tenants revealed an interesting phenomenon -- 36% of the tenants were employed and receiving no public assistance, an increase of 6% over 1971. This happened in spite of an almost total lack of employment sources in the area. It may also reflect increasing attractiveness of the project to stable, working families.

All is not peaches and cream at this project. Recently the Tenants' Council split over a drug-related issue. The use of drugs has always been widespread among teens who live at the project. Some kids who were interviewed said that the situation used to be a lot worse until a few heavy drug users were evicted. The dissident tenant group complains that the on-site managers are too lenient with drug users, that they should get tough and quickly evict the parents of teens who smoke pot. The non-profit sponsor's representative has a policy of trying to work things out with problem tenants, and is willing to give them the second chance that the disgruntled tenant group would deny them. He must now negotiate an agreement with the splinter group; however, most of those involved with the project have confidence in his ability to accomplish what most other sponsors find impossible.

The resident manager supervises a maintenance staff of 12. His main charge is maintaining the project's physical plant, as the sponsor's representative supervises the social services. Besides tenant complaints, which receive top priority, the on-site manager's staff specializes in preventive maintenance, checking for unnoticeable but needed repairs whenever a visit to an apartment is made. His men are quite handy at tasks beyond maintenance, such as building retaining walls and building tot lots out of unfertile gardens. He also supervises the rental staff, instructing them to screen out only those applicants who have records of evictions. Rather than evict tenants who having trouble making ends meet, he will work out an agreement for partial payment. Thus he ends up evicting only six or seven tenants a year. He thinks the job of managers of low income housing is to help the tenants, not to strictly enforce difficult rules. He attributes the low apartment turnover in the project (six apartments per month), insignificant rent delinquencies, and lack of vacancies to his management policies, but just as important is the lack of decent low-cost housing in the community.

Among other contrasts with typical subsidized housing projects, this project has an actively involved mortgagee. Several years ago, a large insurance company set aside approximately $140,000,000 to invest in insured mortgages of subsidized housing. The insurance company's local servicer recommended the project as an excellent investment and has never regretted his decision.

He has complete confidence in the sponsor's representative's judgment as to what is best for the project and has never argued about any alterations he proposes. He and his staff inspect the project twice a year and talk with the sponsor several times a year. On these inspections he has a set of priorities, things he looks for that are crucial to a development. If he finds anything wrong he immediately reports it to the sponsor, who has an excellent record of taking care of problems. He thinks HUD "nit picks" in its inspections, encouraging repairs to things like landscaping which aren't terribly important to the welfare of the project. Above all, he asserts that subsidized projects need conscientious and humane management. His experience with other subsidized projects suggests that management that is both strict and insensitive can cause more problems than it prevents. If this project should ever go into financial default he asserts that the servicer would try to ensure its survival with the sponsor, even if the default is the result of a catastrophe.

FINANCIAL SITUATION

On June 4, 1971, the sponsor requested a rental increase that would set project income at $988,416 a year. This increase was needed to cover the costs of providing the social services that had not been budgeted for. An application for an increase in rent supplement funds was filed July 8, 1971. HUD approved a portion of the request on August 11, 1971, with a note that a larger increase could be granted once Rent Supplement funds had been increased. But before the increase could be implemented, the Phase I wage-price controls were imposed. In spite of urgent letters from the sponsor to HUD, the Wage-Price Board, and President Nixon, it was not until January 1972 that an agreement was reached and rents were increased up to $913,608 a year including an increased reservation of Rent Supplement funds.

Before January the project went through a difficult time with a tight budget. A meeting was held by the sponsor with tenants to explain to them his problems and to ask for suggestions. Tenants decided to assist in maintenance so that part of the staff could be laid off, and even offered to march on the proper authorities to protest. The sponsor thinks the most productive aspect of the meeting was the fact that tenants saw the necessity of economizing on utilities and careful use of project property. Finances were also helped by the ability to tap a tax impound account that was unnecessarily large. During the freeze period the project narrowly missed going into default. When utility, maintenance and staff expenses had increased, rents were easily raised again in July 1973. Since sufficient rent supplement funds were available at the times of both rent increases, very few tenants experienced an increase in the amount of rent that they had to pay personally. The sponsor asserts that he has found HUD quite cooperative and has had no problems with requests for rent increases and increases of rent supplement funds. However, he confessed to feeling a little edgy about the next time he'll have to request more rent supplement funds. In asking for a rent increase, he cleverly requests enough to absorb a few months of inflation. However, HUD Office Staff Members explained that HUD never grants the full amount of increase requested, in an effort to be economical. If rents in low income housing are to be kept reasonably low, HUD must persistently emphasize restraint.

One of the sponsor's most difficult problems was straightening out a default of the Regulatory Agreement that ensued when alterations were undertaken prior to the approval of HUD and the mortgages. A HUD inspection in June 1971, revealed that sponsor's staff, in remodeling the community center, had removed a center wall, thereby weakening the building. HUD warned the sponsor of his mistake, and a period of confusion over regulations followed. It was not until October 1972 that architect's plans were approved and construction of the alterations was complete. The sponsor is surprisingly not bitter about all the bureaucratic hassles he encountered during this complicated process.

The builder-developers own much of the land around the project. Several years ago they completed construction of a large 236 project next door. One would expect that the adjacent project would offer competition to its neighbor, but this has not been the case. With only 40% of its units carrying rent supplement, it cannot compete with the low rents at the project under discussion herein. And also the adjacent project offers carpeting, balconies and other 236 amenities, it offers none of the extensive social services found at the 221(d)(3). Thus, while the first project has always enjoyed full occupancy, the newer one has had as many as 70 vacancies.

ASSESSMENT

This project could reasonably be described as a project that was destined for failure, sharing as it does so many of the characteristics of unsuccessful subsidized housing. The project was poorly designed with excessive density and complete lack of open space in view of the juvenile population. The spartan units offer only basic housing. One couldn't find a worse location -- miles away from employment and supermarkets, and in the middle of a dusty, barren, depressed area. Residents are desperately low income ; most receive some form of public assistance. The project houses many female-headed households. The project's non-profit sponsor began his term naively grappling with the bureaucracy of subsidized housing.

Yet somehow in spite of all its severe problems this project has managed not only to remain financially secure but has also been able to provide its tenants with exemplary housing services. Most people give the sponsor's representative the lion's share of the credit for running such an exceptional project. He has been unusually successful in discovering the needs of his tenants and then providing what they want. The tenants have responded to the situation. They have shown a special pride in themselves and their homes, a factor that is essential in the operation of successful subsidized housing. And, rare among projects, responsibility has been clearly assigned and accepted by virtually all participants in the complex development process.

The project inevitably raises many questions also. To what extent is its population, however poor, nevertheless upwardly mobile and intent on improving and caring for what they have? The sponsor has been a dynamic and effective manager of the project's fortunes. If such quality of leadership is necessary to make heavily subsidized housing successful, can we realistically expect it to be forthcoming? Is it not, in fact, a basic flaw in any program to demand such a level of excellence as a condition for projects to provide adequate and safe housing? And even with its advantages, can this project survive prolonged inflation? All in all, this project deserves our admiration as an example of what might and ought to be.

APPENDIX A: CHRONOLOGY OF THE PROJECT

1967	
11/2/67	Request for Pre-Application Analysis
11/9/67	Case assigned for processing
11/16/67	Processing canceled.
12/11/67	Rent Supplements reserved.
1968	
3/16/68	HUD receives 2013, Application for Project Mortgage Insurance.
3/12/68	Feasibility letter issued.
6/10/68	Conditional commitment issued, mortgage: $5,500,600.
6/14/68	Increase in rent supplements approved.
10/25/68	Firm commitment issued.
1969	
2/7/69	Non-profit corporation set up.
4/21/69	HUD receives amended 2013, mortgage: $5,842,900.
5/12/69	Approval of non-profit.
6/4/69	Start of construction.
6/20/69	HUD completes 2264, Commitment to Insure Upon Completion, mortgage: $5,837,300.
8/19/69	Agreement of sale at final endorsement.
1970	
2/70	Rent-up begins.
6/1/70	Construction complete.
7/22/70	2264 reprocessed to reflect change order of $27,250 Commitment to Insure Upon Completion, mortgage: $5,864,500.
9/1/70	Initial-final endorsement. Project sold to non-profit sponsor.
1971	
3/71	Developer repairs defects found in nine-month inspection.
6/2/71	Project in default of Regulatory Agreement; HUD caught unapproved attempted alterations.
6/4/71	Sponsor requests rent increase.
6/71	Builder repairs defects found in 12-month inspection.
7/8/71	Increase in rent supplements requested.
8/11/71	Rent increase granted, but held up by Phase I.
9/2/71	Increase in rent supplement funds approved.

13

1972	
1/5/72	Rent increase implemented.
10/10/72	Default corrected, work on alterations is complete.
1973	
7/25/73	HUD approved second rent increase.
1974	
4/9/74	Sponsor requests remodeling of adult center.

APPENDIX B: ESTIMATED AND ACTUAL INCOME AND OPERATING EXPENSES

	FHA Form 2264	Year ending 7/31/71	7/31/72	7/31/73
Total actual rent	$800,109	$856,740	$913,405	$956,454
Average occupancy	95%	99.6%	99.9%	99.6%
Administrative expenses	43,150	65,602	70,624	72,430
Operating expenses	112,384	169,622	178,590	202,523
Maintenance	41,365	17,181	17,184	28,943
Taxes and insurance	101,050	105,182	140,578	143,724
Total Expenses	297,949	357,587	406,976	447,620
Expense ratio	37.2%	41.75	44.6%	46.8%
Financial requirements	478,264	358,636[1]	478,071	477,909
Total cash requirement	776,213	716,226	885,047	925,529
Net cash flow	23,896	140,514	28,358	30,925

[1] nine months.

Case Study #6: Limited Dividend, 236, Suburb, Middle-sized Northern California City.

Many subsidized multi-family housing projects can be unambiguously described as either successful or failing financially, socially, or environmentally. For others, the issue is more cloudy. Ostensibly, the Project under study is successful. The Project is well-maintained, has never defaulted, and HUD has seldom been involved in the Project's operations. But, in the words of an officer of the firm that developed the complex:

> "This project is not a success. It has been a loser from the very beginning. It has never returned a dividend to the limited partners. If it were not for the largesse of the general partner, the Project would have been in foreclosure long ago."

This Project is a 400-unit Section 236 subsidized apartment complex built as the second phase of a huge subsidized development. The first phase consists of 300 units subsidized under the 221(d)(3) program. Although the two phases are geographically separated by a street, they blend so perfectly in design that one really can't tell them apart. Although this case study deals only with the 236 Project, it might be more logical to consider both projects as one, as they are managed and regarded by the owners as one project. Indeed, the Manager has experienced difficulty in explaining to prospective tenants why rents on one side of the road are a few dollars more than rents on the other side.

The Project's 28 buildings are situated on 20 well-landscaped acres. Most of these pleasantly-designed buildings are two-story walk-ups, but a few three-story buildings on the site contain townhouses. Of the 400 modest but modern units , 320 are two-bedroom and 80 are three-bedroom. The buildings are interspersed with twisting walkways, benches, shade trees, flowers, a lush lawn, and several play areas covered with rubber mats to protect kids. Although one might ask for more, these play areas seem to do an adequate job of providing open space for children. The brightly-painted carports are in contrast with typical drab parking lots. The grounds are spotlessly clean. Close examination does reveal some physical problems, often the result of heavy tenant use, or vandalism: bent window screens, torn fences surrounding the basketball court, flaws and splattered mud on the outside stucco walls, chalk graffiti, and several unfertile areas in the landscaping.

The Project may be compared to another large 236 project also in the same suburb. Both projects suffer the consequences of having been built in the poverty-stricken East side of the large city, an area plagued by high unemployment and crime. One can find scattered abandonment among the nearby subdivisions. The location of at least three huge subsidized apartment projects in the area has only exacerbated the situation, creating a reputation for the locality that is so bad that developers won't touch the many vacant tracts that dot the area. However, the project enjoys a more convenient location near shopping as opposed to the isolation of the other.

PROJECT DEVELOPMENT AND CONSTRUCTION

This Project was developed by what HUD calls "an identity of interest corporation," a firm that handles all the phases of project development itself. Thus one company has acted as developer, architect, contractor, general partner, and manager. The project was planned as the second phase of the original development. The builder filed an application for project mortgage insurance (FHA Form 2013) in March 1968 to sponsor the proposed project under the 221(d)(3) program. Another 2013 was filed in November 1968 to apply the 236 program to the project. FHA issued a letter of feasibility on December 2, 1969. The Project was processed to be insured upon completion, a common practice for limited dividend developments. FHA issued a commitment to insure on November 20, 1970.

The HUD processing file reveals little controversy surrounding the fledgling project, although one appraiser warned that the basic rents had been set at the upper limits of the 236 program, leaving only a narrow market of families who could live in the project without paying more than 25% of their income. Although the income limits for 236 were raised subsequent to this memo, rent increases brought the basic rents once again to the upper limit. The marketing problem of finding families who both qualify for 236 and who can afford the units has long been serious for the Project.

The feasibility letter was issued December 2, 1969 without any mention of the impact that the Project and two other large subsidized projects would have on this developing locality. Representatives of the builder-developer complain that HUD is responsible for the impaction with too many low-income residents, a concentration that has rendered the neighborhood unattractive to developers and tenants. The reputation has a basis in the high crime rate in the area. The Project's marketing has been hampered further by this reputation, and the Project's budget has been increased by the expenses of repairs of vandalism and of the needed security force.

Initial occupancy occurred in September 1970, prior to the completion of construction in March 1971. HUD certification of construction costs revealed a number of items that were disallowed amounting to $97,260 on a $6,548,200 mortgage. Such disallowances are quite common on subsidized projects and the final mortgage amount is usually a matter of compromise.

Final endorsement of the mortgage insurance was issued in April 1971, but even before final endorsement the newly constructed project was hit with a tax assessment twice what HUD had expected in calculating its

Form 2264 estimates. This surprise prompted the developer to request a rent increase which HUD approved on April 20, 1971, raising rents from $119 and $142 to $133 and $159. The problem of expenses exceeding income was further exacerbated by the long-term leases signed by tenants that prevented management from raising all rents simultaneously. Thus when the April 1971 rent increase was approved, 300 of the Project's 400 units had two-year leases locking them into lower rents that could not be raised until the tenants moved or the leases expired.

OPERATION AND MANAGEMENT

Although the project has never been in default, it just barely missed that status. The management and owners of the development have several times found it necessary to make further cash contributions despite diligent monitoring of costs. The Project has had serious problems that, if ignored, could have led to a default. Here is a perfect example of how initial underestimation of operating, maintenance, and management expenses, together with the impact of inflation can send a project into the red. This Project has experienced extreme unexpected costs of maintenance, property taxes, utilities, and legal fees for evictions. An officer of the developer wrote, in February 1973, concerning the unanticipated cost of security:

> ...the cost of security for the year 1972 was $12,892. At no time from the application for feasibility until the rent-up period had we contemplated or budgeted any amount for security. Therefore, this amount has become an unforeseen burden without any offsetting income.

(See Appendix B for a comparison between FHA Form 2264 estimates of project expenses and the expenses actually incurred.)

A member of the developer's firm commented that a development's reputation is established early in its history and stays with the project. Thus it was important for the Company to develop a good reputation for its project during the rent-up period. Rent-up went without any major problems, and occupancy has been high until recently when a 9% vacancy rate developed. Although this Project has a competitive edge in its excellent maintenance, the rents are much higher than the other subsidized projects, and close to market rents in the area.

In spite of marketing troubles, the strict management refuses to rent to ex-tenants of the nearly defaulted 236 Project. The management fears that refugees would abuse theirs to the extent that they abused their former home.

Crime and vandalism have been tremendous problems. Tenants spoke of their fear of going out at night. When asked about crime, the on-site manager, quickly brought out a newspaper article about a recent murder in the apartments. In another instance, a woman started a fire in her apartment late at night and walked away from it without warning her neighbors. One tenant threw a boisterous party that attracted well over a hundred teenagers, and after police broke up the party some continued their fun by breaking windows of cars in the project's parking lot. The 700-unit two-phase development copes with two or three robberies from cars a day. The manager and his staff must repair the damage of vandalism--broken windows, wall defacings, landscape destruction, and general abuse to apartment interiors. Such problems require large expenditures of funds for repairs, plus the employment of a night-time security guard.

In order to cope with these financial woes, aids are needed. Besides the April 1971 rent increase, two other increases were obtained in November 1972 and in May 1974. The requirement of deposits to the reserve for replacements has been suspended twice, May 1, 1971 to May 1, 1972 and March 1, 1973 to March 1, 1974. Mortgage principal payments were suspended for six months beginning March 1, 1973. These assistances plus contributions from the builder-developer have just barely kept the project from going into default.

The assistance described above was not obtained easily. The developer first requested a forebearance of mortgage principal payments and a suspension of deposits to the replacement reserve on February 14, 1973. In his letter of that date to HUD, he citied the undisputable situation of tax increases, tenants who were paying lower rents because of long-term leases, expense of hiring a security guard, and extraordinary vandalism. Even though the project had been granted a rent increase just prior to this letter, the project still needed help. FNMA, the mortgagee, approved this mortgage modification on June 4, 1973. However, HUD withheld its approval because of an ongoing argument over what the management fees should be. The company demanded 6% of all project income, including the mortgage reduction subsidy. In following a Regional guideline, HUD refused to grant more than 5½% of rent collections. The basis for the disagreement rested in a HUD memo of April 1970 that gave approval to the developer to collect a 6% fee. As the dispute ensued, the project's finances languished. A final agreement was not reached until April 1974, when negotiations were under way for another rent increase. HUD agreed to allow a 6% fee of rent collections, which would be increased as soon as the new rentals had been processed, a fee that comes to approximately $9 per unit. The mortgage modification was finally approved, retroactive to March 1, 1973.

The May 3, 1974 rent increase of 7.8% was demanded on the basis of increased legal and auditing fees, vacancy and collection losses, and an 18.5% increase in employees' wages following unionization. Since the management has had trouble finding families who can afford the three bedroom apartments within the 236 income limits, the two bedroom apartments bear a greater share of the rent increase. The 1974 rent increase prompted a protest from tenant groups. Petitions were circulated; a meeting was held among tenants, management, and HUD; and the tenants began to organize a nursery and social groups. However, this new tenant militancy soon dissipated for several reasons. One radical tenant began to take command and frightened away the rank and file with his revolutionary demands. The management seemed to respond to tenant demands by redesigning the security force and by not raising the rents of current tenants. But most important was a lack of any real cohesion among the tenants. The short term of occupancy of most tenants (64% turnover in 1972) results in a lack of commitment among residents. There is a certain amount of racial tension among tenants. And the tenants really did not have any crucial issue around which they could organize.

In these times of high inflation, project expenses continue to rise and will force future rent increases. As HUD bases its rental increase allowance on past expenses rather than future expectations, the rent increase process becomes a treadmill of sorts with income just catching up to expenses when rents are raised, but the project is bound to fall behind when expenses increase again. Thus subsidized projects just squeak by, dependent upon limited and general partners for cash when the project budget proves inadequate. The Project has benefitted from the assistance of developer (claimed to be $125,000). If this cash had not been available, something at the project would have surely suffered.

MANAGEMENT PRACTICES

Because the project offers such an example of a strict style of management, its practices will be described in some detail.

Over a year ago, maintenance was neglected. The physical project was deteriorating and the vacancy rate was climbing. Tenants spoke of extremely slow response to complaints. Representatives of the Developer conducted an assessment of the complex's management, and were so displeased with what they found that they fired the entire staff. This approach to the management of this developer's projects is cited by HUD staff and others as the secret to the "success" of projects like this one.

The on-site manager for the past year, assumes the no-nonsense attitude prescribed by the developer. He came to the Project from an upper-income development. Although he has some autonomy in his management practices, he basically follows the same policies that are applied to other properties owned by the developer. He works intimately with the developer, maintaining a "hot line" to the firm's offices. He and his staff of 20 manage the 700-unit two-phase development as one project.

The policies that the management enforces are extremely strict, leaving little freedom for tenants. Tenants are not allowed to own motorcycles, pets, barbeques, or to have plants inside their apartments, so stated one respondent. Tenants are charged for any damage they do to their apartments or that their children do to the project's landscaping. Even so, he complained that it's impossible to discover who is responsible for all tenant-caused abuse of property.

At one time, the management would not accept applications from female-headed households. Now the major restriction is that the prospective tenant show evidence of an income of at least $500 a month. Even so, a HUD staff member estimates that there are many tenants in the project paying close to 50% of their income on the rather high rents. In contrast to this, the manager claims that 50% of his tenants are probably lying about their incomes so they can enjoy the bargain rents (less than a dozen pay market rents). He spoke of one "low-income" tenant who owns three cars.

No excuses are taken from tenants who are late in paying rent. The night security officer posts a three-day notice of intent to evict if a tenant hasn't paid his or her rent by shortly after the first of the month. The management refuses to accept partial payment of rent, leaving open the option of going to court to collect what is owed to them. The project evicts six or seven tenants per month, usually for non-payment of rent, but management is quick to evict tenants for breaking the rules. One tenant was recently evicted for throwing a raucous party. This strict approach to apartment management seems to have paid off, as most rents are collected promptly after the first of each month. The loss for vacancies and uncollected rents in April 1974 was only 7% of the projected possible income. Rent collections are bolstered by the prompt payments local Housing Authority makes for the 63 units it leases under the Section 23 Program. Management has an excellent relation with the Housing Authority and views the program as a guarantee that rents will be paid.

In delivering services to the tenants, the first priority is security. This is partially in response to the major tenant complaint at the recent rental increase hearing, that the security staff on the project is inadequate. The project employs one armed security guard who patrols the grounds between 5:00 p.m. and 3:00 a.m.. The guard checks in at various stations on the grounds; each morning his route record is checked to make sure he has kept his appointed rounds. The guard uses a motorscooter in order to respond more quickly to urgent alarms. The manager also talked of the excellent rapport with the Police Department, which responds rapidly to requests from the project staff.

In spite of the efforts of the management, crime is a serious problem. One tenant felt that the security guard is unfair in applying varying rules among tenants who cause trouble. All tenants confessed to a fear of leaving their apartments at night. Security really has not improved since the threatened rent strike. As one tenant family explained, security is needed even after the guard goes off duty at 3:00 a.m., as evidenced by the recent fire that started long after the guard had departed. The on-site manager also fears for his safety at night. He is not sure what else can be done to make the project more safe. In the end, he blames the crime here on society, on the way we live.

No social services are provided in this Project for its 700 tenants. The two community rooms are hardly ever used. At the urging of HUD, the developer hired a sociologist as a consultant some years ago to see what could be done to provide services at one of the first subsidized projects the firm developed. The sociologist recommended against the employment of a full-time project social worker, who he was sure would become an advocate of the tenants. An officer of the firm thinks that it is the responsibility of the local community to provide social services, not the management's responsibility. He feels that to expect a developer to act with a social conscience is absurd. He made an emphatic point that there are just no funds available in project budgets for social programs.

The on-site manager scoffed at the idea of his providing social services for his tenants, explaining that HUD is unrealistic in demanding such, that they (HUD) just don't know about managing subsidized projects. He said that he "would love to set up programs for the tenants, but they are just so blasted apathetic." He explained how Boy Scout and Girl Scout troops have floundered for want of tenant support. He went through a lot of trouble to set up a meeting of tenants with the Police Department to instruct tenants on methods of crime prevention. Not a single tenant showed up. Although he would welcome some initiative on the part of tenants, he is now so discouraged that he is reluctant to embark on any other organizational attempts.

The tenants interviewed are pretty well-satisfied with the level of services provided by the management staff. They thought the rent increases have been justified by the higher costs of operating the project, although they complained of having to pay the price of the vandalism that other tenants cause. In spite of the high rents, most feel the project is a real bargain. Complaints centered on the inadequate security force, the slow response to complaints (sometimes the office loses phone messages left by tenants), and the inequitable enforcement of the strict project rules. Tenants expressed a desire for more spacious apartments, balconies and screen doors.

In his frustration, the manager admits that he will eventually quit his job here and move on to a complex that is easier to manage, perhaps a development for the elderly. Although well-paid, he feels the Project is just too many headaches. An afternoon spent with him convinced the interviewer that he is a sincere man and a conscientious manager. One quickly notices that he has had little experience working with low-income people and their particular problems. He lacks the resourcefulness that is all too rare in property managers, the ability to answer the often outrageous demands of tenants, yet to keep within the limited budget set by his firm. The developer explained how hard it is to find good managers for their projects, in spite of the high salaries offered.

THE DEVELOPER

Some HUD Area and Regional Office staff feel that the projects that look the best are owned by identity of interest sponsors. If a firm like this one knows more about how to handle the problems of housing management than HUD does, then HUD's job is easier. At this project, HUD prefers to remain in the background and let the developer run the show. The firm has developed numerous subsidized projects and currently owns and operates large developments containing over 2,500 units. The projects are financially successful and have excellent maintenance records.

However, at this project, controversies have arisen over management fees and construction costs that HUD auditors recommended to be disallowed. Sponsors have a habit of complaining that they never get their 6% dividend and that partners are forced to make contributions to project operations. However, the real profit lies in tax shelters from accelerated depreciation and are not revealed. The contributions of the partners are actually loans that are withdrawn later. One would expect that such a large operation would be able to achieve some economies of scale. However, this does not happen in this firm's management, as all management functions, including bookkeeping and clerical work are done on site. Thus all supportive staff expense is charged directly to the project, rather than absorbed by the management fee. On the other hand, these costs might be considered as inevitable in exchange for the expertise of companies such as this one. A full accounting of the rate of return would nevertheless be desirable for such publicly subsidized operations.

In an hour and a half conversation with him, an Officer of the Developer was given ample time to vent his criticisms of HUD. He feels that HUD has been scandalously negligent in contributing to impaction with subsidized projects. The lack of coordination at HUD produced a situation where none of the developers of other projects in the area was aware of other projects that were in the works. He maintains that HUD gave in to political pressures in approving one project, something he feels should have never occurred. He did not say whether his firm ever applies such pressure. He sees FHA processing as generating irrational prudence in not allowing small amenities that can make or break a project and is most outraged by the long involved process connected with rent increases. He claims that he has had rent increase requests returned for re-submission because a period was left out of a sentence. Essentially, he perceives HUD as believing that all sponsors withhold information in requesting rent increases, while the statements of all tenants go without question. He complains that most HUD personnel have no experience, really don't know what they're doing. He comments, if they have an accountant's statement before them, why should there be any question regarding a rent increase? Yet time and again he has had to go through the time-consuming hassles of working out an agreement with HUD. Precious time is lost and projects slip further into debt while the bickering goes on.

He also criticized general aspects of the 236 program. The inclusion of utilities in project rents is destroying many a project's budget. Managers' requests for rent increases cannot keep up with soaring utility rents. The Project's high rents are afforded by only a small number of families whose incomes are below the 236 limits. He says the program's income limits must be raised to reflect inflation, and to provide his project with a larger market. If he could start over again, he would never build in this locality, although he recognizes that the political obstacles to building subsidized housing west of the City are immense. But after all his criticisms of HUD and 236, he admitted that if the program is ever reinstated his firm would probably be quick to participate.

ASSESSMENT

This Project survives financially from year to year. Diligent management has produced a well-maintained, well-run project. But the same diligence results in inflexibility, and insensitivity to the problems of low-income tenants, an inability to deliver anything but the basic services. One can imagine the difficulty that the no-nonsense developer might have in dealing with a complex problem like a rent strike. Thus, the Project could hardly be classified as a "success." Financially, it is doubtful whether HUD will ever allow a rent increase of sufficient amount to provide a healthy margin for operations. Socially, it is doubtful if the tenants will ever receive the services they need. This Project is in many ways a pleasant place to live, but it is also in many ways a loser.

APPENDIX A: CHRONOLOGY OF THE PROJECT

1968	
3/68	First 2013 filed
1969	
9/11/69	Feasibility letter issued
1970	
3/3/70	Construction begins
9/1/70	Initial occupancy
10/23/70	Developer receives very high tax assessment
11/20/70	FHA Commitment to insure upon completion
12/10/70	Rent increase request
1971	
3/16/71	Completion of construction
4/19/71	Final endorsement
4/20/71	HUD approves rent increase to cover taxes
4/28/71	HUD approves suspension of deposits to replacement reserve, May 1971 through April 1972
5/13/71	Mortgage sold to FNMA.
1972	
6/26/72	Thirty units of Section 23 leasing approved
11/17/72	Rent increase approved, $144 and $172
1973	
2/73	Developer requests forebearance on mortgage principal payments and reserve for replacements
1974	
1/3/74	Postings of notice of rent increase request, petitions follow.
4/2/74	Management fee controversy settled; six month forebearance of principal payments and 12 month suspension of replacement reserve deposits approved, retroactive to March 1, 1973
5/3/74	HUD approves 7.8% rent increase, $157 and $185

APPENDIX B: ESTIMATED AND ACTUAL INCOME AND OPERATING EXPENSES

	FHA Form 2264	Ten Months in 1971	1972
Total actual rent	$641,673	$529,589	$645,954
Average occupancy	95%		96.4%
Other income		22,379	30,479
Total income	641,763	551,968	676,433
Administrative and renting expense		77,528	114,849
Operating expenses		89,965	114,177
Maintenance		53,801	86,198
Taxes and insurance	184,000	124,013	216,642
Total Expenses	383,462	345,307	615,188
Expense ratio	59.75%	62.55%	90.94%
Income before financing	258,301	206,661	61,245

This table needs some explanation. It was difficult to put together mainly because of the developer's accounting practices. On their accounting statements, the mortgage interest reduction subsidy is included as income, and the total interest rate included as a project expense (not a normal practice), thus making it impossible to calculate the project's financial requirement from the information given by the sponsor. The above statement is lacking also since the only 12-month period for which an expense statement has been filed is the year 1972.

FHA's 2264 estimates were amended in April 1971 to reflect the higher tax bill received and the early rent increases granted. Unfortunately, the 2264 does not break down the total expenses anymore than those shown.

Case Study #7: (Limited Dividend, 236), Large Northern Central California City

INTRODUCTION

This Project is a 108-unit complex containing 16 one-bedroom, 48 two-bedroom, and 44 three-bedroom apartments in seven two-story walkup buildings clustered around two inner courtyards. The site manager's office and a laundry room are situated in the center of the apartments. A slatted chainlink fence encircles the Project on three sides, as do parking spaces. It looks very much like a rather typical, undistinguished suburban apartment development.

The Project stands in splendid isolation surrounded by empty farmland. Within view there are two small apartment complexes, a suburban housing tract, and an adjoining farmhouse. It lies just north of a freeway bypass north of a large city. Shopping and schools are a short drive away to the east and south. An Air Force base and a depressed neighborhood both lie in these directions. Two troubled housing projects (Section 236 and 221(d)(4)) are across the freeway but well camouflaged by surrounding farmhouses. This semi-rural setting is a mere ten-minute drive from downtown via two freeways. Bus service is available.

More than half of the tenants are Black and Chicano. There is a heavy concentration of military dependents and the Project is heavily populated with small children.

PROJECT DEVELOPMENT AND CONSTRUCTION

The development and building of the Project was smooth and rapid. In February 1969, the sponsors first contacted FHA with a view to building a subsidized project. Form 2013, proposing a 221(d)(3) BMIR project was received in early June of that year. After FHA review and questioning, in October that request was converted to Section 236. The FHA Commitment to Insure (Form 2264) was issued in early June of that year. After FHA review and questioning, in October that request was converted to Section 236. The FHA Commitment to Insure (Form 2264) was issued in the same month, and initial endorsement followed in December. Construction was uneventful, beginning in April 1970. In November, the project opened after FHA final inspection; and in March 1971 final endorsement was received. No significant construction problems were encountered.

OPERATION AND MANAGEMENT

The Project, then, got off to a good start. Since then, it has survived financially, but not without difficulty. The following sections discuss the characteristics of the project from physical, management, social and financial perspectives.

Location and Physical Design: While located in a relatively isolated site, no one interviewed attributed its problems primarily to this factor. The sponsors had expected that a small shopping center would be built nearby, but that never happened. This makes residents dependent upon cars to do their shopping. This also holds true for recreation and entertainment, although the bus system services the project.

Everyone agrees that lack of adequate recreational facilities is a primary factor in the vandalism and maintenance problems experienced here. Despite its capacity for nearly 300 children, no recreation facilities were designed into the project. In the fall of 1971, following rent-up, the Project was populated by 178 children and had no formal play facilities whatsoever. There are no adjacent play facilities. Resident children do not use the park opposite another Project a half-mile south across the freeway largely because of the distance involved. Apparently, the empty fields surrounding the Project are not used regularly by most project children. Instead, they prefer to use the Project's lawns and parking lots as their playground.

When the interviewer visited the Project, a spirited football game was in progress on the front lawn in view of the site manager's office. A good deal of the vandalism and exterior maintenance problems can be traced to this abysmal lack of recreational facilities. A related problem is the lack of supervision of the children of working parents absent during the day. There is no day care center. According to the present site manager, the vast majority of resident children are ten years old or younger. Bark from the shrub beds was scattered and had to be replaced by grass. Wood strips in the chainlink fence and sprinkler head risers disappear regularly. According to the sponsors, the Project in 1973-1974 was:

> "experiencing a great deal of mischievous damage. Trees were being uprooted, windows broken, and many of the children were congregating with nothing to do, in and around the manager's area."

At the suggestion of tenants, management converted a vacant, ground floor three-bedroom apartment in the center of the project into a recreation room with adult supervision. Three tenants organized resident parents to volunteer to supervise this unit; two of the three have since moved and the third is the new manager. No new tenant leaders have yet emerged. This recreation room is very popular with the children, although all of the original equipment donated (e.g., ping-pong, pool, and record player) have been stolen. At the same time, the middle of the rear parking lot was blocked off and a basketball backboard was installed by the management firm. HUD's Loan Management staff first learned of these conversions of facilities for recreational use when a management staffer inspected the Project in February 1974. The sponsors were asked on April 2 to justify these unauthorized conversions. They responded to this request on April 15, and HUD has approved these arrangements.

All parties agree that even these limited recreation facilities have materially reduced the vandalism attributable to the previous void of recreational opportunities. The management firm's representative would also like to have tot lots for the younger children. However, he asserted that, in the absence of an armed guard, installation of a portable swimming pool would be a "disaster."

Vandalism has occurred both to the exterior of the project and the interiors of the apartments. Much of the former damage attributable to unsupervised, bored and restless children was described above. Tenants interviewed also reported vandalism of cars in the parking lot, e.g., broken windows and antennas and stolen tires. It is believed that a significant amount of the damage which has led to excessive maintenance costs has been caused by "outsiders."

Both the management representatives and tenants interviewed indicated that many vacating tenants had done considerable damage to their apartments. A January 31, 1974 FHA inspection report noted:

> "Tenant care of dwelling units as determined by the condition of the vacant units inspected is not satisfactory. Units were dirty, equipment dirty, and some damage done to units prior to last occupant vacating or having been evicted."

The FHA inspector recommended continuing inspection of occupied units until management is satisfied that every occupant is properly caring for his/her apartment.

The latest FHA inspection report dated May 13, 1974 concluded:

> "It is apparent that the maintenance program and its efficiency is not totally satisfactory, althought it is improving. The problem appears to be too much of a backlog of essential maintenance for the number of project employees."

In response, the management firm is in the process of hiring an additional part-time maintenance worker.

Management: The management firm was created by the project's general partners to manage subsidized project. It currently manages four other Section 236 projects in Northern California for a packager and shares offices in a nearby city. Due to the high turnover of on-site managers at the Project during 1973-1974, the management firm's representative has spent considerable time there. He is well thought of by the new interim on-site manager and the sponsors. The HUD Loan Management Officer best acquainted with the Project's history thought that this firm is an "average" housing management firm.

The Form 2264 allowance for administrative management expenses was $8,600 (Managerial Staff - $7,000, Advertising - $600, and Other -

$1,000). On October 15, 1970 the developer forwarded the proposed management contract to FHA. He argued that:

> "The provision in the budget for administrative cost appears to be unrealistic. In order to obtain experienced and competent management for a 236 project, you must pay at least $850 per month for a manager plus his apartment and utilities. In addition, a combination of clerk-assistant manager must be employed to allow the manager time to show the apartments, supervise the operation, and have a weekend free."

Management projected its annual administrative costs to be $15,000. In addition, its management fee would be another $7,200 (5% of the monthly total gross). In its 1971 Financial Statement, management's administrative and advertising costs, exclusive of this management fee, were $20,102.53. Salaries alone for a full-time manager and maintenance worker, part-time clerical help, and a security patrol, totaled $15,541.50, almost double FHA's original estimate. Advertising costs more than trebled FHA's estimate.

Presently, the management firm says that its administrative costs for a manager ($500 monthly), assistant manager, accounting (done by a controller in the home office) and office expenses are $13,200 annually. It's management fee is $9,200. This total of $22,400 compares with its 1970 projection of $22,200, as opposed to the FHA estimate of only $8,600. The management representative says that FHA neglected to calculate accurately the cost of payroll taxes and legal expenses for evictions in estimating management costs. Clearly, the 2264 estimates were hopelessly inadequate.

The original on-site manager was chosen because of his prior (1969-1970) experience in managing other non-profit projects elsewhere in California. Nevertheless, in the summer of 1972 he was replaced because management felt that he had done a poor job screening tenants and supervising maintenance. His successors both left routinely because of health problems.

A project maintenance worker was appointed resident manager in September 1973. Tenants cited his wife's abusive and hostile attitude, and her lackadaisical performance as office manager was mentioned as offensive to many tenants. Tenants interviewed charged that they ransacked the apartments of absent tenants. In the spring of 1974 they left suddenly after embezzling $2,300.

The present interim manager had no prior experience and is being trained and supervised by management who is much in evidence in the Project office. A fourth person is being hired to assist in both clerical work and maintenance. The Project has two maintenance workers. The interim manager has lived at the project since Spring, 1972.

The rapid turnover of site managers in 1973-1974 has caused serious management problems, especially in attracting and screening tenants, preventing rent delinquency, supervising maintenance, and preventing vandalism. Management's presence has helped to alleviate these problems.

The original manager performed well during rent-up but was replaced because he failed to screen well and prevent rent delinquency afterwards. During 1971, approximately half the Project tenants were military dependents. Today there are still many military dependents at the Project, and management claims to have good relations with the Base's housing referral office.

According to management, military dependents have been the Project's best tenants. They and their children are well-behaved and they pay their rent regularly. On the other hand, single women, either divorced or separated, with three to five children who are unemployed and dependent upon AFDC, are said to pose the bulk of management's problems. Management now rejects 80% applicants on the basis of low-income (i.e., welfare dependency) or appearance (e.g., unruly children). Over one-half (13 out of 24) of the current vacancies are three bedroom apartments, which probably reflects this stricter screening process and more selective standard. Management does not accept applicants from the neighboring defaulted and foreclosed Section 236 projects on the theory that, if they lived there before, they are likely to cause trouble (i.e., nonpayment of rent or irresponsible behavior).

Management has consistently used eviction notices to rid itself of problem tenants. The developer informed FHA that 28 tenants were lost after rents were increased in the summer of 1972. However, he believes that most of these were problem tenants who used this as an excuse to leave (i.e., delinquent tenants). The Project has always been racially mixed, with Blacks now in the majority, and has had a steady influx of military dependents. No tenants receive rent supplements or are beneficiaries of public housing leasing. However, the military dependents do draw military housing allowances.

Despite the recent turnover in resident managers, management seems to have kept relatively good records. No doubt this reflects their presence and the use of their bookkeeper to maintain financial accounts. However, HUD's 1974 management review noted irregularities. HUD required submission of Form 93479 from January-October 1973, but has since discontinued this requirement on the ground that it imposed too heavy a burden on the sponsor and overworked HUD Loan Management servicing staff.

<u>Social Problems and Organization</u>: In addition to the vandalism described above, the following additional behavioral problems were cited. Burglaries and petty theft are common with thieves entering apartments by simply smashing windows. This was corroborated by a tenant who said that she was afraid to leave her apartment for more than a few days for fear of being burglarized. In September 1971 the manager reported:

"I feel that our small amount of incidents are far below the city or state average --out a half dozen burglaries approximately half were caused by irate boyfriends or girlfriends breaking in to steal personal effects or clothes, the other half are guests or friends."

A White tenant interviewed complained that Black tenants refuse to report thefts or testify as witnesses. On the other hand, the current manager, who is Black, knows of few incidents of burglary or violence.

Other types of criminal behavior were also cited. Management claims that considerable drug dealing occurs at the Project and that the police have staked out the Project at times. He also claims that teenage Black and Chicano gangs "face off" in the rear parking lot. Presumably, these are mostly outsiders. Last year a tenant was murdered at the Project by a relative in a domestic feud, and in December 1973 the site office was robbed at gunpoint.

White tenants interviewed complained of vandalism, burglaries, poor maintenance, the presence of drug addicts and drunks, fighting and knifings, noisy partying, and roving packs of stray dogs. They predicted that the Project would not "last long" because tenants did not care and management was letting maintenance deteriorate. They had lived there for two years, were satisfied with their individual apartment, and liked the reasonable rents and the policy of renting to couples with children (three) and pets (two dogs).

In 1971 a security guard was hired to patrol the project between midnight and sunrise. This was discontinued because the cost was prohibitive and the guard did not provide adequate security. The current manager, a longtime resident, claims that most tenants are "sociable" and that incidents of theft, vandalism and violence are minimal. These sharply contrasting views of the quality of life at the Project may reflect underlying racial or social conflicts not readily evident to the short-term observer.

Tenant turnover was described by management as normal for this locality. Excepting those evicted for nonpayment of rent, the primary reasons given for turnover were military reassignment and home purchase.

There is no tenant organization at the Project. When tenants suggested creation of recreation facilities, management cooperated in the conversion of existing space to recreation use. A few tenants recruited other tenant volunteers to supervise the new recreation room, but no formal tenants' association emerged from this effort. A tenant couple interviewed knew only a few neighbors and professed no interest in establishing closer ties with fellow tenants.

Individual tenant complaints have been directed to on-site managers. The FHA files contain only two formal tenant complaints received over the past three years; both were referred to management.

Financial: The Project has operated at a deficit virtually since it opened, although in 1971 it generated $1,590 more in gross income than anticipated in the 2264 estimate. In their attempt to at least break even in cash flow, the sponsors have been granted FHA approval for suspension of payments into the Replacement Reserve, a rent increase and the switch of utility charges to individual tenants. Nevertheless, the Project would be in default today except for a series of working capital loans advanced by the general partners to keep the Project afloat financially.

The cash flow deficit rose steadily during the first ten months of 1973 -- from $2,618.48 to $17,328.72. The disbursements to gross rents received ratio rose from 111% to 174%. Form 2264 estimated an expense ratio of 67%. This disparity reflects inaccurate FHA estimates of costs, a high vacancy rate, and excessive maintenance costs.

Presently, 24 of the 108 apartments are vacant, a vacancy rate of 22%. Since the initial rent-up in 1970-1971, the Project has never reached the projected normal vacancy rate of 5%. During January-October 1973, the vacancy rate ranged from a high of 20% to a low of 10%. Management thinks that 10% (rather than 5%) should be considered the normal vacancy rate.

On June 20, 1969, FHA's multi-family appraiser, analyzing the Project's feasibility as a proposed Section 221(d)(3) BMIR project, had concluded:

> "The location is not strong enough to attract tenants from outside areas who would be eligible under the program.... Rental rates are not sufficiently low enough to benefit potential tenants and (that) success of the proposed project cannot be reasonably anticipated."

One month later the Chief Underwriter concluded that the Project was feasible predicated on the two following conditions:

> "1. The rent schedule is within the ability to pay of most residents of the area.
>
> 2. It can be anticipated with certainty that the rental accommodations offered in this project will be clearly superior to existing rentals in the area."

Presumably, the latter reference was to the substandard housing prevalent in the area, largely populated by poor and minority persons. While the first condition seems to have been met, it is unclear whether the Project can be considered superior to nearby conventional and subsidized housing, especially that constructed since 1970. The FHA files contain no separate feasibility analysis of the Project as a converted Section 236 proposal and it is assumed that none was undertaken.

On the cost side, problems have occurred with utilities, maintenance, management, and taxes.

The Project's apartments are individually metered, but until March 1974, the cost of utilities was included in the rent. There is no dispute that FHA under-estimated utility costs. In 1971 the actual cost of gas and electricity was $24,948.03 compared to the 2264 estimate of $15,764. The sponsor attributes this overrun to low utility district estimates on which they and FHA originally relied and constant tenant overuse (by approximately 25%).

On September 21, 1970, shortly before the Project was opened, the sponsors requested FHA to allow them to charge individual tenants for overuse of utilities. The Chief Underwriter replied:

> "We are informed (by HUD's Regional Office) that the regulations will not permit the imposition of any added charge on the tenants for utilities even where abuses have occurred. In cases where tenants have clearly produced excess utility costs, the project management has no recourse except to begin eviction proceedings. In further clarification, it should be clearly understood that FHA takes no exception to the monitoring of electric and gas consumption by the individual tenants and, moreover, we would regard this as part of prudent management. Eviction of unsatisfactory tenants in cases where abuses occur is, however, the only means of correction which we can offer."

A year later the sponsors began to request that FHA allow them to redraw the leases and have the tenants individually assume the costs of their own utilities. In March 1972 FHA Mortgage Servicing Officer denied their request:

> "Present Federal Housing Administration (FHA) procedures do not permit our approval of the owners redrawing of the leases or the amending of the Regulatory Agreement to provide for the tenants to pay their own utilities even if each living unit is individually metered. The increased operating costs to the project because of this personal benefit feature of Section 236 transactions is an allowable expense when FHA examines an application for a rent increase. On the other hand, the resident manager should counsel tenants that their excessive use of utilities could result in a rent increase and the manager should extend every effort to teach tenants to use their utility services properly."

After a rent increase was granted in June 1972, the sponsors renewed their request to switch utility costs to tenants:

"We have had some difficulty in renting the units under the new rent increase because of the failure of the tenants to understand the relationship of the rent to the cost of utilities. As a result, when we advise a tenant who is making an inquiry about rents, he immediately assumes that the rent is too high, without taking into consideration that such rents include utilities.

"In going through this matter very carefully, the owners feel that if the units can be rented without including utilities, we can reduce our rents by the amount of utilities which have been incurred during the last year and thus have a project which will have a sustained occupancy. This is an excellent project both from the standpoint of design and location, but to properly maintain and keep the project operating in the black it is necessary that we have a greater occupancy than what has been experienced during the last eight months. Our experience has shown by including utilities there is an abuse in the use of utilities by the tenant. This in turn increases operating expenses and rents which must be passed on to those innocent tenants."

It was almost two and a half years before HUD finally acceded to this request and allowed the sponsors to reduce the rents and have tenants pay their own utility charges.

While not as serious an issue, in 1971 the cost of water was $8,484.30 compared to the 2264 estimate of only $3,600. However, by 1973 water costs had been reduced to $3,600.

At the beginning, maintenance provided some financial leeway for the project. In 1971 the maintenance costs were $3,000 below the Form 2264 estimate of $16,850, because of the newness of the project. By 1973, maintenance costs had more than doubled to $33,422. This included $6,230 in salaries, $10,430 in repairs (including supplies), and $6,959 for landscape gardening. Presumably, much of this overrun is attributable to unanticipated exterior and interior vandalism. However, the estimates for maintenance salaries did not allow for an on-site maintenance crew of three persons (full or part-time), which is what it now requires to maintain the project adequately.

Management costs were analyzed previously. Administrative costs, including the management fee, were $22,400 in 1973, compared with $17,996 in 1971, both far above the 2264 estimate of only $8,600. According to the general partners, management did not receive its fee in 1971-1972. Losses resulting from the armed robbery and embezzlement of funds from the site office were recovered through insurance.

The initial estimate of real estate taxes was $36,105. In 1971-1972, the tax bill was only $22,625. However, this resulted from prepayment of taxes at Final Closing. The Project was subsequently re-assessed and the tax bill increased to $44,344, substantially above the 2264 estimate. Of course, this tax increase was considered by FHA when it approved a rent increase. The sponsors did not appeal this tax reassessment, which they considered to be routine.

The operating deficit has been countered by three means -- working capital loans, rent increases and mortgage payment modifications. According to one of the General Partners, they have made working capital loans totaling $26,000 in 1973 and $7,500 to date in 1974. Previously, much smaller advances were made during 1971-1972. These loans have been by "squawking but not balking" General Partners. The cash contributions, voluntarily made, explain why the Project is not in default.

According to this partner, these loans have offset any profits realized from the General Partners' tax shelter. This is unlikely, but it cannot be demonstrated without audit. Of course, there is also the income and profit generated by the management firm which is wholly owned by the General Partners. Additionally, architects and General Partners received architect's design and supervising fees of $57,572 and another partner received legal and consultant's fees of $10,000 when the Project was built. The equity investment of these three general partners was $87,602.

The sponsor's original rent increase request was denied because it was made during the Phase I rent freeze in 1971. A Phase II rent increase request was approved in June 1972 and put immediately into effect. The gross annual income authorized by FHA rose from $141,317 to $175,467. Citing Phase II rent increase ceilings, FHA's approved rent increases were less than those requested by the sponsors. Rents were reduced in March 1974 to reflect the deduction of utility charges switched to tenants.

FHA has authorized a series of six-month suspensions of Replacement Reserve payments beginning in October 1971. The 2264 estimated an annual build-up of replacement reserves of $5,145.

ASSESSMENT

One of the General Partners is an experienced real estate lawyer, housing consultant, and housing packager (including Sections 221(d)(3), 231 and eight 236 projects). His two General Partners --local architects -- are also experienced in designing FHA projects. Their performance has been favorably reviewed by both production and management staff in the local HUD office.

He has sold off four of his Section 236 projects and retained four, all managed by his management firm. He claims success in two but has experienced difficulties with a Section 236 elderly project, which is only 55% occupied.

The willingness of the General Partners to prevent the Project from going into default by making cash contributions in the form of working capital loans to offset operating deficits and allow for adequate maintenance speaks well of their commitment to date to prevent it from going into default. This has stood them in good stead with HUD. However, it seems inevitable that a time will come when they are either no longer able or willing to continue doing so. Each time that they have thought that problems at the Project were resolved, new crises have arisen (e.g., the embezzlement and flight after the utility switch-over was finally effected). So, it remains to be seen what their ultimate decision will be if the continuing operating deficit is not soon eliminated. He is reluctant to consider another rent increase in the immediate future.

The management firm is a creation of the General Partners. He and the management representatives seem to work closely together. They share offices and are a nearby drive from the project and the representative has spent considerable time on-site.

Overall, management's performance has been mixed. The choices of the site managers have proven to be mistakes and have contributed to the vacancy problem. Poor tenant screening, failure to provide recreational facilities earlier, and maintenance problems have all plagued the Project and are management's responsibility. On the other hand, with the cooperation of the General Partners who own the management firm, it has continued adequate on-site staffing and overcome the difficulties caused by resident manager turnover thus far, has relandscaped as necessary, did install limited recreational facilities, has seemingly resolved rent delinquency, and has kept reasonably good records.

Production staff in the Insuring Office under-estimated operating costs in the 1969 Form 2264 and failed to require the sponsors to include adequate recreational facilities on-site in the Project's design. This seems to have been a typical pattern for Section 236 multi-family projects processed during this period. HUD management staff took more than two years to approve the utility switch-over. However, this delay seems to have been due to policy decisions of the Director and Regional Office and based upon existing regulations. Otherwise, Loan Management staff have conducted regular on-site physical inspections and two 1974 management reviews on-site.

Overall, the Project must be considered a "success" only if that term is interpreted to mean that it is not in default and assigned. More realistically, its future should be considered precarious and the project must be watched closely.

In nearly four years of operation, it has consistently failed to break even, much less earn a return on equity investment. It has accumulated nearly $40,000 in debts owed to the General Partners. Almost three years of Replacement Reserve payments in excess of $15,000 have been suspended. In order to develop a financially successful project in the short run, the sponsor and management need to achieve and maintain a maximum vacancy rate of 10%, to improve tenant screening and to minimize rent delinquency. They need to stabilize on-site management, to improve maintenance, security and recreational facilities and to eliminate vandalism. Further, they need to establish a climate where conflicts among the tenants and between tenants and themselves are minimized. This would appear to be a difficult but not an insurmountable task.

In the longer run, the Project must somehow build up an adequate Replacement Reserve for capital improvements. Whether the General Partners try to recover their cash advances through increased cash flow or through appreciation at eventual sale or simply write it off as a business loss remains to be seen. The decision as to whether to increase rents to increase cash flow so as to eliminate continued operating deficits before or after an adequate occupancy level is achieved may prove critical. To raise rents and lose good tenants or fail to attract new tenants would be self-defeating. Continuing high quality maintenance and significant improvement in the very limited recreational facilities available to the many children living at the Project may well determine whether it recovers financially and becomes a socially viable housing complex and an attractive environment serving tenants of moderate income and many races or whether it slowly but steadily heads for default and assignment forcing HUD and FNMA to make hard decisions.

APPENDIX A: CHRONOLOGY OF THE PROJECT

1969

6/2/69	Sponsors contacted FHA.
6/7/69	FHA received 2013 for Section 221(d)(3) BMIR proposal.
10/1/69	FHA received 2013 for Section 236 proposal (Conditional Feasibility as 221(d)(3) BMIR was converted to 236).
10/15/69	FHA Commitment to Insure (2264) issued.
12/17/69	FHA Initial Endorsement.

1970

April/May	Start of construction.
11/2/70	FHA Final Inspection; Project opened.

1971

3/19/71	FHA Final Endorsement.
9/13/71	Sponsors inform FHA that Project is losing $1,000-$1,500 monthly (despite no apparent vacancy or rent delinquency problems according to FHA/FNMA.) Sponsors request that tenants assume costs of utilities and rents be increased.

1972

1/24/72	Sponsors repeat request for utility switch and also request suspension of Replacement Reserve Payments, citing increased property taxes.
3/1/72	FHA (1) denies utility switch; (2) denies rent increase because it originated during Phase I rent freeze, but indicated a renewed rent increase request will be approved when supporting data is submitted; (3) approves a six month temporary suspension of payments to Replacement Reserve, noting sponsors have made a "substantial working capital loan during past few months to prevent project from defaulting with FNMA." (This suspension arrangement has been extended ever since.)
6/6/72	FHA approves rent increase: One-Bedroom $80 - $106.50 Two-Bedroom $100 - $128.00 Three-Bedroom $125 - $153.50
June	Second on-site manager hired to replace fired original manager.
12/6/72	Sponsors renew request to switch utilities.

1973

3/28/73	HUD requests monthly operating statements. (Requirement discontinued after October 1973.)
September	Fourth On-site Manager replaces third On-site Manager.
9/6/73	Sponsors renew request again to switch utilities.
December	Armed robbery at site office.

1974

1/9/74 FHA approves utility switch and rent decreases:

One-Bedroom	$106.50 - $ 97.17
Two-Bedroom	$128.00 - $118.00
Three-Bedroom	$153.50 - $142.67

May Fourth On-site Manager skips and embezzels cash. Temporary fifth On-site Manager hired.

APPENDIX B: ESTIMATED AND ACTUAL OPERATING COSTS

	FHA Form 2264	1971	1972 (est.)
Administrative	$ 8,600	$20,103	$ 22,800
Operating	22,014	36,649	36,633
Maintenance	16,850	13,861	19,080
Taxes (Prop.)	36,105	22,862	44,344
Total Cost	83,569	95,475	122,857

Case Study 8: Non Profit, 221(d)(3) BMIR, 100% Rent Supplement
Small City, near San Francisco

INTRODUCTION

This is a small industrial city near San Francisco. During World War II its expanding shipyards drew large numbers of migrants, including a Black population from the South. After the war, the shipyards left, but the people are still there and others have joined them.

The project lies in the heart of a Model Cities neighborhood. It is located at the very end of the decaying downtown section of the city's main thoroughfare, and apartments were built on a vacant parcel of land land previously owned by a railroad land company, and this site faces the huge depot. The area consists of mixed industrial, commercial and residential uses. A modest tract housing complex lies across the street.

In July 1974, the project presented a reasonably good appearance to the visitor. It consists of 158 units in 33 buildings, including 18 studios, 30 one-bedroom, 38 two-bedroom, and 72 three-bedroom apartments. All 158 apartments are subsidized through rent supplements. Most of the tenants qualify for subsidized occupancy by reasons of being handicapped, elderly, or relocated from substandard housing. The 110 two- and three-bedroom apartments are primarily rented by divorced or separated women dependent upon AFDC. Only five units are currently vacant. According to the on-site Manager and Social Worker, approximately 375 children live in the project. All of the tenants and staff are Black. The project has defaulted on its mortgage.

PROJECT DEVELOPMENT AND CONSTRUCTION

The sponsor is a Baptist Church, a small Black church founded in 1946 in a suburb north of the City. The driving force behind this housing project is the Church's pastor. He first conceived of his Church sponsoring low-income housing in the ghetto riot atmosphere of 1967. He and his congregation were inspired by then-HUD Secretary Robert Weaver's plea during a Bay Area speech for church involvement in solving urban social problems, and in particular, housing. He was provided with HUD literature on the Section 221(d)(3) BMIR and Rent Supplement Programs by the Western Regional Director of a non-profit housing center. The Reverend turned to his church's realtor, a Black realtor, in a neighboring town without previous multi-family housing experience. They approached FHA in early 1967 and the gestation of the project began. The dream of the Reverend and his Trustees was to build and manage non-profit low-rent housing for poor families trapped in substandard housing. Their dream was to founder on the shoals of poor construction, poor management, and the social problems engendered by racism and poverty. Their many problems are typically those faced by well-intentioned, but inexperienced and undercapitalized non-profit sponsors. Despite considerable assistance from FHA and various local agencies, it was reported that they were victimized by the unwise choice of an unscrupulous general contractor and an incompetent management agency.

Initially, a previous FHA reservation for a church-sponsored 80-unit rent supplement project was transferred to the church in August 1967. The Church proposed to build more than 25% four-bedroom apartments, but this finally proved to be economically unfeasible. Even worse, the Church and its realtor could not locate an acceptable building site in town. Processing was halted on February 13, 1968 when their fourth proposal site was denied the necessary rezoning. Then the realtor located a fifth site which finally proved acceptable. It was rezoned for the proposed mix of 150 two, three-, and four-bedroom units. Perhaps due to the difficulty in finding suitable sites and securing rezoning, FHA demanded in April 1968 that the church find a qualified housing consultant.

The consultant was an attorney and a realtor, with considerable experience with redevelopment agencies. He was instrumental in the selection of the general contractor, and the management agent. Presumably, the consultant was acquainted with both firms through his work with nonprofit sponsors and minority contractors. The consultant could not be located for interviewing. As their attorney, the Church hired a member of the local Planning Commission and an architect who had designed a Baptist church. Their initial choice as contractors were local: one had done work for a nearby redevelopment agency, and the other had built Baptist churches elsewhere in California. However, they could not obtain bonding. Upon the advice of the consultant, and under pressure from FHA to hire a minority contractor, a subsidiary of a Los Angeles-based construction firm headed by an energetic Black developer, was chosen.

In June 1968 new problems arose in processing. Rezoning had not been approved yet for the site. The City had not authorized rent supplement housing as part of its Workable Program, and the replacement cost exceeded the Form 2264 maximum amount. By September 1968 most of the processing problems were resolved. The size of the project was increased to 158 units, the land value was increased to $290,000, the allocation of rent supplement funds was increased, and the equity requirements of the sponsor was reduced to $6,000. In October 1968, a new Form 2013 was issued, and in November 1968 FHA issued a Conditional Commitment. In March 1969, another Form 2013 was submitted in which the replacement cost had risen to $2,167,000. On July 14, 1969 FHA initially endorsed the project, and construction commenced eight days later - more than two years after the Church had begun negotiations with FHA to sponsor low-income housing. There was little doubt about the market for this housing which was the first Section 221(d)(3) BMIR rent supplement project in town. More than 2,000 families were to be relocated between 1966 and 1975, and half of them earned less than $6,000 annually. The Housing Authority had a waiting list of 471 families in November 1967 for its 500 non-elderly units. The 1960 census indicated that 11% of the City's rental housing was substandard and another 10% was deteriorating.

Having hurdled the many unfamiliar obstacles of FHA processing with the aid of the Consultant, the Church faced its next major problem. The Church members wanted to manage "their" housing. Like their realtor, the church members on the Board of the non-profit housing corporation were told flatly by FHA that they were not qualified to manage the project. They fought to no avail to reverse this decision. The Consultant and the FHA then located a management agent whose choice was to doom the project to failure.

Beginning in 1967, a two-county Council of Churches had sponsored federally-subsidized low-income housing projects. In January 1969, the Council had itself assumed management of one of the projects. A year later the Council established a subsidiary corporation to manage these and several other housing projects, including the project under study. This management firm has a staff of seven, including a budget director, accountant, social services director, maintenance superintendent and lawyer, all based in Southern California.

In August 1969 a management plan was submitted. It proposed to train the members of the Church as housing managers, gardeners, and maintenance workers. The group would handle all bookkeeping and financial responsibilities. Several of the staff would visit the project regularly to supervise management operations. Within six months, or upon FHA approval, management responsibility would be relinquished to the local housing corporation. On August 29, 1969, FHA approved this plan contigent upon the transfer of a "well-experienced" member of the staff to the project to act as Resident Manager. However, this promise was never fulfilled. Instead, an associate, managing another FHA project was assigned to provide on-site supervision. A staff of five was hired. Three of them were Church members: the manager, a maintenance worker, and a social worker. Only the social worker had relevant prior experience. The other employees were a secretary and a second maintenance worker.

A rent-up budget of $27,000 for 1970 was proposed. This arrangement was reluctantly accepted with the understanding that the Church members acting as staff would assume full management responsibility sometime in 1971. Those Church members who served as staff at the project or who served on the Board of the non-profit corporation were the most actively involved with the housing that they had sponsored.

The next crisis faced by the Reverend was the contractor's failure to perform competently, or in good faith. According to the Reverend the contractor lied about construction progress and stole materials. According to the realtor, he failed to pay his subcontractors on time. By May 1970 FHA refused to advance mortgage proceeds because of the contractor's repeated reporting violations. The project was not completed as scheduled on July 17, 1970. The contractor claimed to have lost 43 days on account of rain, but the architect and the mortgagee both contradicted him. Final endorsement did not occur until July 9, 1971. While tenants began to occupy the unfinished project in August 1970, it was not finally completed until August 1971 when the sprinkler system and landscaping were installed. The architect and realtor pressured the bonding company to complete this exterior work, and litigation is now pending between subcontractors and the bonding company. The contractor is bankrupt and his whereabouts is unknown. He is currently under criminal investigation by the FBI and HUD's Inspector General for possible fraud, embezzlement, and kick-backs in connection with this project and other federally-subsidized housing projects in Southern California.

OPERATION AND MANAGEMENT

The project began its first full year of operation on an acrimonious note. The two Reverends were feuding constantly. On February 24, 1971 a meeting with HUD Loan Management was held to demand that HUD fire the Council of Church's Director and allow the local to manage the project. HUD replied that we would not look favorably on a cancellation of the existing management contract and would not necessarily recommend that the Reverend and his staff act as the new management staff. Two days earlier the Council of Churches had written to HUD:

> "We are, as you know, managing the project. This has been, and still is, a very difficult project to manage. It is in such a state financially that as of the moment, I'm not quite sure what will happen to it. I suppose this all depends upon how HUD can help to re-adjust the financing so that the delinquencies in the monies owed can be taken care of. However, in the meantime, we are doing our best.
>
> We are confronted with some serious problems in relation to it. One is the insistence on the part of the present fire and liability company that an armed guard be on duty 24 hours a day, seven days a week. There just is not money enough in the income from this project to cover that kind of expense. I've been searching other fire and liability companies to see if I can get a company that will take it without that kind of stipulation. So far, I have not been completely successful, but it seems now that I do have one that might take it -- based largely upon the fact that we are allowing them to cover all the other projects that we own or manage. Therefore, we are able to get a more favorable rate without this requirement.
>
> However, at the same time, the local Reverend continues to badger me about him taking over the complete management of the project. My own personal feeling in the matter is that I would be happy to get rid of the whole thing. However, I do not honestly believe that he or his people are, at this point, capable of management -- taking care of the books and all the other details necessary for competent operation of the project. For one thing, he accepts the decisions and opinions of his realtor completely, without reservation. When he makes up his mind on the way something should be done, he proceeds, and forces other people to concur and support his position. He is a constant source of irritation to me.

However, if we can have the assurance in writing (and a copy sent to him, that we will continue to be the managers for the rest of the year, I believe that we can assist in making some adjustments in the charges that the City has, and maybe in the taxes, in addition to the insurance adjustment. All of this would bring the costs more in line.

However, I cannot continue to have interference from the Reverend. He goes to the same people I have contacted and makes statements which are contradictory to the things I have said and am preparing to do. Consequently, I don't get any results. Therefore, I think this matter should be clarified immediately, and without any doubt in anyone's mind, so that this bickering will stop. It keeps my staff (not only those on the site, but also the supervisorial staff) in a constant state of turmoil and uncertainty regarding the project. I'm very hesitant to put forth any great effort which will be of additional cost to my firm to keep this thing and get it into shape when I have this degree of uncertainty. Any assistance you could give me would certainly be appreciated."

He was referring to $11,000 that the management firm had claimed for expenses during rent-up.

HUD's inability to resolve this raging dispute between non-profit sponsor and absentee management agent (also supposedly non-profit) contributed to the rapid decline in the project's circumstances. Resident management staff had to obtain approval for all major decisions from the Council of Churches management staff in Southern California where the rent supplement checks were sent. On April 9, 1971, the local Reverend complained to management:

"...the training program, as you have pursued it, is not adequate or satisfactory at all. (The) Community worker had no guidance. The Maintenance Program is far from satisfactory. Janitorial service is not sufficient. We respectfully call your attention to the fact that none of these people have received any guidance or training from your firm. "

Management responded that it had obtained a new insurance contract and objected to the sponsor hiring security guards in order to obtain insurance without his prior knowledge or approval. He accused the sponsor of disrupting management by making "dishonest accusations" to HUD. He defended managements performance:

"...had this project been completed anywhere near the time that we were told it would be, we would not be experiencing the difficulties that we are now. It was not our fault that this happened, nor was it our responsibility to correct it.

In light of the very limited funds and the pressure put on us to make up the deficit, we are very reluctant to add to the staff or incur the additional expense of more training for the present personnel. We have supervised what has gone on in the past, and we will continue to do so. It appears that we are now able to get this project straightened out and when that is a fact, we will continue our training program for the staff."

Conditions at the project were deteriorating rapidly.

On July 27, 1971, the sponsor requested a 10% increase, citing a projected annual operating deficit of $27,457. By this time he had enlisted the aid of a closing attorney for the mortgagee, (which sold the mortgage to FNMA on August 3, 1971), to persuade HUD to fire the management firm. HUD put the sponsor in touch with several local management firms, one of which prepared the data to support the proposed rent increase. Citing actual annual property taxes of $57,200, sewer tax of $2,844, exterminating expenses of $948, insurance costs of $5,250, and garbage disposal costs of $6,541. The original Form 2264 estimates respectively were:

Property taxes	$39,816
Sewer Tax	---
Exterminator	350
Insurance	$ 3,580
Garbage Disposal	$ 1,580

The Form 2264 was obviously inadequate.

However, this proposed rent increase ran into the Phase I rent freeze and the confusion surrounding Phase II rent stabilization regulations and the replacement of the management agent. New management soon renewed this rent increase request and it was promptly approved by HUD on April 25, 1972 and became effective June 1, 1972. It had little adverse economic effect on the tenants because of the commensurate increase in rent supplements. The new market rent schedule was:

Studio	$123
One-Bedroom	$157
Two-Bedroom	$157
Three Bedroom	$215

On August 2, 1971 the Council of Churches management firm proposed to relinquish control of management to the sponsor when their contract expired at the end of December 1971. The Director offered to remain as a management consultant for a nominal fee but he warned:

"...you people are going to have to demonstrate a better and more satisfactory degree of cooperation with us. One of the reasons HUD has given me for not accepting you as an adequate experienced manager is that you have complained so consistently and constantly of our relationship -- and for the life of me, I can't understand it.

This project has cost us a great deal more money than we have gotten out of it; and we will never retrieve our initial investment. We've advanced thousands of dollars to you and never complained. No other agency would do this, nor be expected to do it. Yet you have never expressed any appreciation for it and you have caused us a great deal of trouble. I don't think it is fair, and I don't think it is Christian. I went into this with the idea that since both of us were Christian and churchmen, we would be fair with each other. But if this kind of relationship cannot be attained, certainly I would not want to prolong our relationship beyond January 1, under any circumstances. "

It is possible that the animosity between the Reverends was partially due to the fact that the one was White and all of the members of the local Church and their tenants were Black. The sponsor expressed bitterness at the attitudes of certain White HUD staffers toward their ability to develop and manage the project themselves. The sponsor does agree that his church needed guidance and training, but he would have preferred that HUD do this rather than a private firm. HUD staff regard the sponsor's realtor as generally incompetent, if not dishonest. His wife (and partner) was fired by HUD as manager of a 32-unit Section 221(d)(3) project because of her alleged incompetence. His own real estate business is currently deep in debt.

As for the Council of Churches management firm, an FHA inspector reported on August 6, 1971 that: "The condition of this project indicates that it is gravely in need of satisfactory management and maintenance." There was poor supervision, no training program, poor maintenance, poor tenant screening, inability to prevent rent delinquency, poor bookkeeping, and overpayment of management personnel. Nevertheless, apparently in 1969, the Council of Churches Director enjoyed the fullest confidence of the Chief Underwriter.

On August 9, 1971, the sponsor's attorney informed HUD that the sponsor had agreed to hire new management beginning September 1, 1971, "provided that HUD exercise its right to terminate the management arrangement under which the former firm is operating. He added, "personal feelings have become so intense that a reconciliation is impossible."

HUD did not intervene and on September 1 the attorney renewed his appeal. "The relationship between the owner and the manager have not improved and the project is headed for economic disaster." HUD responded by ordering an immediate audit of the management of the project. However, HUD did not respond directly to the sponsor's demand and on November 17, 1971 notified the Council of Churches their firms management contract would not be renewed and asked that all the books be turned over on December 31.

The project was not this management firm's only headache. On August 10, 1971 another project had been assigned to HUD. By January 1972 the Council of Churches had forced the Director to resign and the management firm was declared bankrupt. The HUD Office arranged modification agreements on the Southern California projects all in default. A Regional HUD audit report on the management firm was issued on August 29, 1972. On October 3, 1972, the Director of the Loan Management Branch of the HUD office demanded that the Council of Churches repay $126,022 in excessive and improper charges by the management firm for wages, salaries, management fees, maintenance materials, and advances. The Council refused and no subsequent HUD legal action has been taken. The audit claimed that management owed the project $8,945, offset partially by $4,483 owed them.

In retrospect, the project was badly served by its housing consultant and victimized by its general contractor and management agent.

In January 1972 new management was begun at the project retaining the original staff. While it had only six vacancies, it had an estimated $10,000 outstanding in Tenants Accounts Receivable. The sponsor felt that previous management had allowed "scum" to live in the project. Poor Blacks who previously had lived in slum housing were suddenly transported from "chicken coops" to a "palace." Several of those interviewed stated that they had no familiarity with the proper use and maintenance of appliances, carpeting, or drapes. Some respondents stated that single mothers could, or would not control their children, whom the sponsor believed were often "unwanted" and "mean" (breaking windows, vandalizing the sprinklers, lawn and shrubbery, writing graffiti, and destroying the property at neighboring residents enroute to the playground to its south). The Reverend's attitude appeared to be distinctly paternalistic. He felt that management was too slow to evict problem tenants.

On January 27, 1972, FNMA representatives inspected the project. They reported a monthly operating deficiency of approximately $2,000 due to low FHA estimates, mismanagment, failure of the contractor to complete construction, and excessive maintenance costs due to lack of tenant care and vandalism by project children. Two of six vacant units had been burned. He concluded:

> "In my opinion, the Resident Manager is doing an adequate job in maintaining adequate rent receipt controls and with the new management firm, the condition of the project should improve in the foreseeable future. However, in view of the project's cash flow position, we should not be surprised if a modification of amortization is requested in the near future."

The predicted crisis was not long delayed. Despite HUD approval of the first rent increase and the replacement of the Resident Manager by a local real estate broker, the project was in deep financial trouble in the spring of 1972. The sponsor turned to his realtor and the Model Cities housing staff. It was decided to approach a national housing firm if they might buy the project. The new management firm prepared an estimate of required capital improvements. A meeting was held on May 9, 1972 with the firm's regional director. However, subsequent negotiations eventually resulted in them declining to purchase the project. Their decision was based upon what they regarded as excessive repair estimates submitted ($54,100), HUD's refusal to allow them to convert the project from a non-profit to a limited dividend project without having to invest 10% equity in cash, and their ability to claim only straight-line (instead of accelerated) depreciation.

By June 1972, the vacancy rate had leapt to an alarming 15%. The project went into default. Management submitted a proposed mortgage repayment schedule on August 1. In September 1972 the Assistant City Manager reported on the project's status. He noted that management estimated that $115,000 would be needed to rehabilitate and landscape the project and to eliminate the mortgage delinquency. The firm had declined to rescue the project and the Model Cities program could not make any cash contribution. His detailed analysis is worth recounting at length:

> "Analysis of the project revealed that the project is inherently unsound due to its financial structure. The project consists of 158 units financed under an FHA-insured 221(d)(3) market interest rate loan. The resulting market rate rents in the project are well in excess of prevailing rents in the project area. To make the project marketable and therefore feasible, FHA approved the use of rent supplements for all of the 158 units.
>
> When the project was initially occupied, the majority of tenants qualfied by moving from substandard conditions caused by overcrowding. Undoubtedly, some tenants originally qualified themselves by moving in with other families and thus becoming overcrowded.
>
> Subsequently, HUD changed the occupancy rules to effectively allow only families moving from physically substandard conditions, as certified by the City, to occupy rent supplement units.

Families moving from overcrowded conditions which are not physically substandard would have to be formally displaced by an enforcement action based upon occupancy standards in order to qualify for rent supplemented units. Since the project was previously qualifying most of its tenants on the basis of overcrowding, the project is now experiencing some difficulties in getting good tenants.

In addition it has had problems with a number of tenants and has had to evict some. As incomes increase, families find themselves paying more rent. In many cases the rent increases are greatly resented and misunderstood, resulting in rent delinquencies and other problems.

The occupancy rules for rent-supplemented projects make it impossible to achieve economic integration in the project, since the project is attracting only low-income families. The gap between the rent-supplemented rents and the market-rate rents is sufficient to eliminate the possibility of attracting tenants with incomes in excess of the public housing income limits. Also the bad image of the project has discouraged prospective tenants able to afford housing elsewhere. Management has consistently found that tenants move on to other housing situations when their incomes increase. In particular, a number of tenants have moved to Section 236 projects, according to the management. The impending occupancy of the Section 236 project presents the possibility of a further exodus of tenants from their project.

We cannot afford more vacancies than it currently has. (Currently running between 10 and 15 units.) The project's management budget is inadequate and the sponsor is already two months behind on the mortgage payments. HUD recently approved an increase in the rents and in the rent-supplements allotment for the project, which will help the situation somewhat. Also, the management has asked for a moratorium on principal payments and payments to the project's operating reserves to help in bringing the mortgage payments current. The management firm indicates that it will take about 1-1/2 years to get the project solvent, assuming a reasonable vacancy rate.

The management of the project was originally contracted to a church group in Southern California. The project declined rapidly under that group's management. More recently, the management was contracted to another firm on a one-year's contract with the provision that it retain staff connected with the sponsor and train them to assume management of the project.

Another firm has done a great deal to improve the management of the project. The project is somewhat better maintained than it was, and the major errors of the previous management group appear to have been rectified.

However, the new management firm's contract expires on December 31, at which time the sponsor intends to manage the project itself. Management has been handicapped in managing the project by the sponsor's staff and does not feel that the sponsor is competent to manage the project. Even if management is retained, it is unlikely that the project will have sufficient revenue to ensure an adequate management and maintenance program.

The project needs a number of physical improvements, including landscaping, drainage, lighting, painting, paving, garbage bins, recreational equipment, etc. It would be imprudent to invest money in the needed improvements however when there is no guarantee that the management budget and staffing will be adequate to maintain the project. Although the site planning of the project is poor, good landscaping could do much to improve its appearance. However, landscaping must be protected and maintained to be a worthwhile investment.

A long term solution to the situation might be achieved through two actions: 1. Refinancing of the project under Section 236, and 2. Repossession by FHA and subsequent refinancing.

The refinancing of the project under FHA Section 236 loan would allow needed improvements to be made and change the occupancy guidelines so that most of the rent supplements could be phased-out as families in the lower-moderate income range occupied the project. The Section 236 rents could be below the market rents and competitive with other rents in the area. At the same time the project would have more money for management. However, our communications with HUD indicate that it is unlikely that HUD would approve refinancing the project under Section 236. To do so HUD would probably have to classify the project as a rehabilitation project. Since the project is only a few years old and in standard condition, it would not qualify as a rehabilitation project.

If the project runs into further trouble and gets further behind on its mortgage payments, HUD will be forced to repossess it. At that point HUD would presumably refinance the project on a sounder basis."

By Fall 1972, the sponsor had replaced the on-site manager and reduced vacancies to a normal turnover rate of five. He began refurbishing vandalized apartments and he and the Social Worker began new social services for the younger children. An FNMA inspection in October 1972 found that refencing, repainting, and relandscaping was needed.

In April 1973 a maintenance worker was promoted to on-site manager, with the management agent continued. During the nine-month period from June 1972 through February 1973, income had averaged $27,787. Its operating expenses were $12,000 and its debt service was $20,594, leaving a monthly cash flow deficit of $4,807. In April 1973, FNMA rejected management request for a one-year moratorium on principal payments and waiver of Reserve for Replacement payments and instead recommended assignment. FNMA's analysis of default was:

> Analysis by this office staff attributes the present unsurmountable financial and physical difficulties as a combination of mistakes.
>
> The initial underwriting projected real estate taxes at $39,800. The 1971-72 taxes were $62,800 and 1972-73 taxes were $61,900. This increase is in excess of 35% of the initial projections. Direct operating expenses contemplated a monthly expenditure of approximately $6200 actual expenses show a monthly cost almost doubling this amount.
>
> The property management firm originally handling this project did not sense the obvious difficulties and deferred the maintenance and repair requirements. This led to the historical degeneration of the quality of tenant. Turnover, vandalism, and rent receivable drastically increased. The second project management firm in its effort to reverse this situation allowed the loan to default.
>
> Without a cash injection the request for relief is obviously not workable. This office and HUD's Area Office explored the possibility of generating this amount of cash through an operating loss loan. This program was abandoned considering the already existing heavy debt and the physical quality and on-going deterioration of the project.
>
> HUD's Area Office agreed that an assignment of the loan was the most logical way to go considering the condition of the project, the money required to bring it into a good repair condition, the on-going monthly operating loss, and the extent of the outstanding delinquency.

On April 24, 1973, a HUD inspection report said that the project was in "fair" physical condition but needed better tenant screening to prevent vandalism or:

> "This project will be lost and at a high cost to the government to recondition it. I (the Inspector) believe the present management agent is not doing their job with the government's interest in mind."

Management later hotly disputed the Inspector's charge of mismanagement. On June 14, 1973, a staff member of HUD's Loan Management Branch inspected the project to determine whether to foreclose or prepare a workout agreement. He reported that the project's appearance was "good", that tenants interviewed were satisfied with management's performance, and that management had "brought the project a long way, removing the undesirable tenants, and making necessary repairs as the funds became available." He recommended another rent increase and HUD's Chief Underwriter decided against foreclosure.

On October 25, 1973, management submitted a provisional workout agreement. It called for a rent increase and an increase in rent supplements effective January 1, 1974, and 18-month moratorium on principal and replacement reserve payments beginning on that date, and continuation of capital improvements. It projected total 1974 administrative, operating, maintenance, tax and insurance expenses to be $202,872. This compares with the 2264 estimate prepared in 1969 of $115,168.

HUD approved a one-year workout arrangement under which management pays from the rents the current service charge, taxes, interest and $4,000 monthly to reduce the outstanding delinquent interest. Due to processing delays occasioned in part by failure to recertify tenants' income correctly, the second rent increase (of 14%) was delayed four months and did not take effect until May 1, 1974. The current rent schedule is:

Studio	$140
One-Bedroom	$179
Two-Bedroom	$206
Three-Bedroom	$246

Rent supplements were increased accordingly. Due to this delay, management paid less than half of the agreed-upon amount monthly to reduce delinquent interest from December 1973 through April 1974. As of May 1974, the project owed $128,691 in interest, $15,842 in principal, and $11,753 in replacement reserves. A HUD staff member proposes to revise the workout arrangement by reamortizing the principal and interest after delinquent taxes and service charges are repaid. If Central Office approves, he predicts that the project would be returned to full debt service within 90 days.

ASSESSMENT

Today, the project still suffers from significant defects dating back to its inception. It suffers from too many children being concentrated without adequate adult supervision and recreational facilities. Three play areas have proven inadequate. Because of neighborhood hostility toward its troublesome teenagers, they cannot fully utilize the large playground across the avenue. The Social Worker has instituted sewing and cooking classes for the younger children in a vacant apartment that has been converted into a recreation room and her office. The Health Department has conducted a monthly "well-baby" clinic in the community center building. The City has hired five project resident teenagers this summer under the auspices of the Neighborhood Youth Corps program. What is still badly needed is a child-care program but the sponsor has been unsuccessful in attempting to establish one on-site. Given the rate of welfare dependency, this would have to be a publicly-subsidized program. Neither management nor HUD have made any apparent attempts to remedy this critical problem. The problems caused by restless, unsupervised poor Black teenagers is not being resolved by anyone. The latest HUD inspection report (dated June 25, 1974) notes: "The basic fault appears to be keeping the young boys busy with activities other than vandalism... the boys need a sports program desperately."

Generally, the management and maintenance programs of the Church-controlled on-site staff seems to be going well under management's supervision. The superintendent since late in 1973, has instituted a preventive maintenance program. He called a couple of tenant meetings and asked for tenant cooperation. The sponsor does not appear to favor any formal tenant organization as one answer to the project's problems. Tenant complaints have been sporadic and individual. For example, in July 1974 two formal tenant complaints were received by HUD. One woman complained that her drapes have not yet been installed. Another woman complained that her carpet had not been cleaned and a broken window had not been repaired. According to the sponsor, all too many of the tenants are unable, or unwilling, to do routine maintenance in their apartments. The sponsor believes that tenant demoralization and disorganization reflect welfare dependency and unemployment. Paternalism (enlightened, perhaps) is the prevailing management attitude. Rent delinquency has been significantly reduced by a firm eviction policy.

In retrospect, the project was doomed from its origin. An inexperienced church sponsor representing the well-meaning aspirations of a middle-class Black congregation was saddled with a larger than anticipated project in an isolated, deteriorating slum neighborhood. Instead of an economic mix, it was filled entirely with poor lower-class Black tenants. Poor housing consultants, an unscrupulous general contractor, and an incompetent management agent all transformed the noble dream into a disaster. Low FHA 2264 estimates and delayed rent increases, the mistaken choice of management firm and hesitancy in later ousting it contributed to the default. What FHA did contribute positively was rent supplements and a new management firm. But, these solutions were primarily addressed to financial problems rather than its social problem. The Church attempted to fill this gap but has not succeeded. Various public agencies like Model Cities, the Welfare Department, and the Police have also failed to turn this project around. Racial segregation, poverty, alienation and violence continue to characterize the inner-city ghetto where the project was built. Isolated, FHA-subsidized housing projects have contributed little to the solution of these overwhelming social evils. Better housing has not necessarily produced a better life or prospects for poor, minority tenants.

APPENDIX A: CHRONOLOGY OF THE PROJECT

1967

8/67	FHA reserves 221 (d)(3) BMIR Rent Supplements.

1968

1/68	Church sponsor submits 2012.
2/68	Processing discontinued due to unacceptable sites.
4/68	FHA requires new housing consultant.
7/68	Church submits 2013.
9/68	FHA issues Feasibility Letter.
10/68	Church submits revised 2013.
11/68	FHA issues Conditional Commitment.

1969

3/69	Church submits another 2013.
7/69	Initial FHA endorsement. Start of construction.
8/69	FHA approves RSB Management Plan.

1970

8/70	Initial occupancy.

1971

7/71	Project requests rent increase. FHA Final Endorsement.
8/71	FNMA buys mortgage.

1972

1/72	New firm assumes management.
4/72	FHA approves rent increase.
7/72	FNMA Notice of Default.
Fall, 1972	National Corporation decides not to purchase.

1973

4/73	FNMA Assignment.
10/73	HUD approves provisionsal workout agreement.

1974

5/74	Second FHA-approved rent increase takes effect.

APPENDIX B: ESTIMATED AND ACTUAL OPERATING COSTS

	2264 (1969)	1970-1971 (est.)	1972-1973	1974 (est.)
Administrative	$13,460	$13,460	$37,995	$51,780
Operating	34,917		42,943	36,768
(Garbage)	(1,580)		(7,175)	(7,200)
(Utilities)	(18,837)		(23,141)	(20,400)
Maintenance	17,850	64,580	35,702	38,112
(Decorating)	(10,500)		(6,906)	(------)
(Repairs)	(3,120)		(17,606)	(------)
(Exterminating)	(350)		(1,078)	(960)
(Insurance)	(3,580)		(------)	(5,424)
Taxes (Property)	39,816	62,809	60,244	59,364
TOTAL	$115,168	$134,790	$235,293	$202,872
Expense/Net Income	34%	--	59%	48%

Case Study 9: (Non-Profit, 221(d)3, 40% Rent Supplement)
Large Northern California City

INTRODUCTION

Just West and slightly South of downtown lies a neighborhood which over the years has housed migrant groups trying to make it in America. The latest of these are Black Americans who migrated from the South during the 1940's in search of jobs in war industries. By the 1960's the old turn-of-the-century buildings had become seedy, housing a large segment of this city's low-income population. The area was ripe for urban renewal.

First to be redeveloped was the section on top of a hill, the current site of subsidized housing, luxury housing, and other uses. The area was cleared later and is still being redeveloped. The post-renewal land uses in the area are almost entirely subsidized housing -- block after block of low-rise new apartment buildings housing families displaced by the demolition of their homes years ago. Besides a large central park, the only open space left is the many vacant lots waiting to be developed. Out of this sea of subsidized housing rises a 108-unit 221(d)3 apartment project.

Its style blends well with the traditional housing, but not very well with the neighboring new projects. The project's narrow three-story townhouses line the streets that border the grounds, leaving a large courtyard in the center for recreation and garbage collection. About one-third of the units are over the garage, the rest occupy a gradually-rising slope. The buildings are garishly painted stucco. The garish colors and height of the project (three stories on top of a parking garage) set it apart from the other, simpler complexes in the neighborhood. Balconies, slanted roofs, and landscaping enhance its appearance.

The architects of this unusual project, won a HUD award for their design. Considering some of the unusual ideas employed, one can understand the reasons for the award. However, some of the same design elements proved to be problems later. The Project occupies the former site of a brewery and retains part of the brewery superstructure. The retention of the brewery garage was an attempt to cut costs in providing the HUD-required parking places while retaining a feeling for the past. No one anticipated the crime problems that would plague the garage. Two large metal vats, several concrete girders, and a high tower were kept on the grounds of the project from the brewery with the same idea of relating to the past. No one anticipated that these decorations would turn out to be horrible eyesores, and that the vats would have to be removed after they had become unhealthy receptacles for rain water and garbage.

The architect explained that the real emphasis was on the provision of interior space, that the apartments in the project are sumptuously large. HUD cost limits kept the architect from including some desired amenities. For instance, the architect wanted to use brown shingles on the exterior, but had to settle for stucco, which was later painted with rather startling colors. The architect worked closely with the contractor, but received little help (or hindrance) from HUD or the sponsor. When asked what he would do if he could re-design the project he suggested that he would leave out the tot lots that were destroyed. Instead, he would pressure the city and the Redevelopment Authority to heed their responsibility of providing open space.

Unfortunately, the project's interesting design is masked by its physical neglect. Landscaping has long since given way to mounds of bare earth. Spray-paint graffiti decorate the stucco walls. The garage, which had to be closed after it had become the center of criminal activity, is a boarded-up, vandalized eyesore contaminating the rest of the complex. Wooden latticework on the balconies is falling apart. Exterior doors to apartments do not shut and lock properly. The Neighborhood provides an excellent location close to jobs, shopping, and cultural institutions. The city has an excellent public transit system that services all neighborhoods. However, the neighborhood retains its inner city image in spite of redevelopment. The population is almost 100% Black and many have very low incomes. Crime haunts this neighborhood.

PROJECT DEVELOPMENT AND CONSTRUCTION

The project's consultant submitted a request for pre-application analysis on October 15, 1966. This was followed in March, 1967 by the filing of a 2013 form, the Application for Project Mortgage Insurance replaced by several subsequent 2013's. The non-profit corporation, was set up November 27, 1967, under the sponsorship of a Baptist Church. HUD's initial endorsement occurred in December 1968, the project was dedicated September 21, 1969, and construction was completed December 12, 1969. Final endorsement came in February 1970, the same month the mortgage was sold by a Bank to FNMA.

The processing of the fledgling development seems to have proceeded without any major complications. Negotiations were made with the neophyte sponsor in an effort to explain responsibilities. One appraiser warned that the inclusion of so many amenities in project design would result in rents that would be much too high. Rents were eventually set as follows, with 40% of the units rent supplemented:

one bedroom	$122.50	three bedroom	$165.50
two bedroom	$144.00	four bedroom	$182.50

The project's non-profit sponsor, (Baptist Church) got involved without any previous experience in housing. Board members are now bitter about being taken advantage of by their consultant, whom they trusted. They also expressed frustration about FHA's ignoring their complaints about the performance of the contractor, one of the largest general contractors in the area, having the good reputation that accompanies a large scale operation. However, Church Board members complained that during their monitoring of construction progress, they discovered mistakes that were ignored when brought to the attention of FHA and City inspectors. These discoveries amounted to the use of galvanized instead of copper pipes of much too small dimensions, the use of a boiler of inadequate size, and wooden instead of steel fences. Board members claim that FHA warned them to be quiet with their complaints or the project would never get completed. These construction and material mistakes haunted the project in its early years of operation.

OPERATION AND MANAGEMENT

HUD seriously under-estimated project income and expenses. A prophetic memo from a HUD staff member in 1967 warned that rents were set at the highest level possible, occupancy was projected at 95%, tax abatement was needed, and little room was left to absorb expenses generated by problems that might arise. (A comparison of HUD projections to actual experience is shown in Appendix B.) Rent collections were projected at 100% occupancy, which of course was never achieved, although rent collections in 1973 surpassed the original estimate. Taxes were under-estimated until abatement was achieved. The most serious under-estimation was for operating expenses, including utilities. One of the project's boilers was inoperative for over a year, forcing tenants to use their ovens for heat, pushing utility bills sky high. Little was left over in this tight budget for maintenance expenses, thus it is easy to see why maintenance went neglected.

A consulting firm experienced in the subsidized housing field, handled the project's processing and the consultant's management firm was the project's first manager.

The project has gone through an unfortunate series of poor management firms, the first of which was the consultants, who was to handle management for the interim period until another manager, hopefully someone from the community, could be found. However, it was not until June 1, 1972 that a new manager took over. After 20 phone calls and one and a half months of waiting, the interviewer was still not able to arrange a meeting with the consultant who maintains that he is just too busy. It is perhaps not surprising that he was unwilling to be interviewed, as he has been described by most of those involved with the project as the real villain in the story. Perhaps that was his problem, that he was a consultant trying to do a manager's job. He operated under the philosophy that the project did not need a full-time on-site manager, a dangerous policy considering the dynamics of the project.

A staff member of the Redevelopment Authority felt that under the original manager and his staff the project experienced the worst rent-up that she had ever witnessed. The entire concept of a subsidy was lost when leases were thrown at tenants. The project's current on-site manager, speculated that the project was rented quickly with the objective of getting the management fee. Families displaced by redevelopment were not given the required preferential treatment. Now the project is reaping the harvest of terrible tenant-management relations from this negligence. And to date no tenant seems to understand how rent supplement and leased housing programs work.

Tenants and others complained that maintenance was painfully neglected. Proper guidance to the staff was not given. The consultant's efforts to collect rents were unsuccessful, and he left the project with a large uncollectables problem. Probably the most frustrating fact is that he just did not pay his bills, that he employed an attorney to write letters for postponing payment. Subsequent managers, were surprised to get old bills incurred by him months after he had left. The bookkeeping was left in such a hopeless state that CPA firms had a terrible time documenting income and expense statements. Several people blamed negligent bookkeeping for the inability of subsequent firms to file the proper forms for a rent increase and a mortgage modification. The firms just did not have enough information to do the work needed. On top of all of this, a memo in HUD's file mentioned that the consultant/manager was collecting 11% of rents as his management fee instead of the 5.6% that had been approved.

One must be uneasy evaluating his involvement with the project without having been able to speak with him in person. No doubt, he would dispute much of what has been related above. Since a HUD ruling regarding conflict of interest, consultants are no longer allowed to manage projects. But it is not clear whether a conflict of interest kept him from doing a decent job or whether he was just a bad manager. It is most tragic that neither HUD nor the sponsor were aware of the negligence until after he had left.

The consultant/manager left the project June 1, 1972, when a new management consultant took over. A spokesman for the Redevelopment Authority explained that "the new consultant had too little knowledge to know what he did know." This was his first experience with a low to moderate income project. Thus in January 1973, he misunderstood a statement made by HUD and presumed that a mortgage modification had been arranged, although none of the necessary forms had been filed, nor had FNMA approved. FNMA and HUD were puzzled when monthly payments of interest but no principal continued to come in. Thus the project's original default was the result of a misunderstanding. He continued to run the project, including the unsuccessful use of a strong arm to collect rents, until February 9, 1973.

HUD and the project's current manager, spoke highly of the second manager. It does appear that he left many utility bills unpaid, a practice that led to the Church Board's action of taking over the project's checkbook. He failed to employ a resident manager after October, 1972. And he can be severely criticized for his misunderstanding of the mortgage modification process and his failure to request the needed rent increase.

The effort to find a minority-based management firm for the project was finally successful when a new firm assumed control on February 9, 1973. It consisted mainly of two men and was a subsidiary of a firm active in managing subsidized projects. The brevity of its term at the project (February 1973 to June 1973) was a result of internal conflicts between the management firm and its subsidiary. During this time, the project suffered through a chaotic period of neglect of rent collections, bill paying, and HUD form filing. The management firm was particularly impatient with the Church Board's control of fiscal matters. The new manager is also guilty of not pushing for a mortgage modification or a rent increase. After the manager departed, the project was left under the direction of the Church Board and the on-site manager.

FNMA wanted a management firm for the project so a private corporation was invited as an observer to a meeting between FNMA and HUD. They later assumed management in a support role on July 15, 1973. The on-site manager was continued and the Church Board continued to manage the project's fiscal matters. One HUD staff member saw this firm as the final blow to the project. It was called in basically to handle the background work for the mortgage modification and the needed rent increase. Actually, the Redevelopment Authority did the preparatory work needed for the modification and the management firm merely sent a letter to FNMA. It finally got around to posting the notices for a rent increase in November, but didn't comply with HUD regulations, so the whole process had to be repeated after it went out of business in January. A former Corporation staff member blamed the delay on the hopeless shape of the projects books, giving the CPA an impossible time preparing the necessary forms. One Redevelopment Authority blames the management firm's lack of agressiveness in pushing the parties involved to assist in setting the records in order. The on-site manager thinks that the management corporation took advantage of the project since the firm collected its management fee, yet never visited the project. Anyway, the Corporation was falling apart as an organization while managing the project.

The on-site manager, formerly a member of the non-profit Church Board, assumed the resident manager's function. He is given a lot of credit for his work by HUD, the Redevelopment Authority spokesman, and even the tenants. When he took over, the project was in sad shape. Maintenance had been neglected, many tenants were delinquent in paying their rents, and the rent increase had still not been processed. Working with his limited budget, he had done as many repairs as possible. He and his staff do much of the work themselves including replacing the property's galvanized plumbing with copper, and removing two metal vats left over as sculpture from the brewery days. He bargains with tenants who owe rent by offering to do requested repairs if they pay what they owe. He has taken a few delinquent tenants to small claims court, and claims that others took notice and now rent collections have improved. He has a policy of charging tenants who damage their apartments or the grounds of the project. This policy has sparked a number of tenant complaints of unfairness. The project's vacancy rate and turnover rate have been low mainly because of the housing shortage in the neighborhood.

In spite of the hard work of the on-site manager and his staff, much work still needs to be done. He is only one man working with a limited budget. Thus it is not surprising that a number of tenants involved in the project's tenants' association have strongly objected to the recent rent increase that was not accompanied by any great project improvement. The manager claims that these same tenants were originally co-operative in helping along the rent increase until one dissatisfied tenant stirred them up. Probably the saddest thing here is a lack of communication between the manager and the tenants. The tenants do not understand the project's problems and operations and the subsidy programs and are somewhat shy in complaining to the manager. He stubbornly will not admit mistakes or compromise with tenants. A man more articulate is needed to explain the project's complicated problems to the tenants.

A conversation with tenants and a visit to a Tenants Association meeting (about 15 families participate) left the interviewer even more aware of the lack of tenant-manager communications. The tenants, who have experienced years of poor service, have a legitimate reason to be angry. Crime has always been a problem, especially when the garage was open and was being used by car thieves, drug dealers, and pimps. The grounds have always been in hopeless condition, and many apartments have had severe problems. For a year, part of the project had no heat! The tenants express frustration at not having their complaints adequately answered by managers, by the Board, or by HUD. Lack of impact has led to diminishing participation by tenants in project affairs. As one woman put it, tenants tend to just go into their private apartments where they can't be bothered. The Tenants' Association is especially upset about tenants who fail to pay their rent and abuse the project. They think the manager and the Board should be more aggresive in evicting these trouble-makers.

Unfortunately, HUD was not actively involved with the project during its early problems, probably because no one realized that anything was wrong. HUD expects management to competently perform its functions. Since the firms involved had good reputations, one should not be too critical of HUD's good faith. However, even when the project entered into obvious financial difficulty, HUD reacted slowly, especially to the ultimate default status. And although HUD encouraged managers to work on a mortgage modification and a rent increase, the slow pursuit of these two needed saviors is partially a result of HUD's unaggressive policies. Even now HUD prefers to remain uninvolved while Redevelopment Authority assists the project both in its own interests and HUD's.

HUD did get involved in the selection of management firms, and was subsequently disappointed in the performance of trusted firms. The consultant, has been heavily criticized by everyone involved, but was easily approved by FHA. He managed the project for over two years, a conflict of interest that HUD no longer allows. HUD encouraged the use of the minority-based firm. When things started to appear desperate, HUD and FNMA invited another management firm to look into managing the project, and they later took over. All of these firms have contributed to the dismal mess. When the second management firm went bankrupt in January 1974, HUD, rather than force the project to accept another management firm, allowed the Redevelopment Authority to manage the project with an on-site manager. HUD personnel yield to the Redevelopment Authority when asked details about the project. Although HUD is certainly guilty of poor judgment in recommending the above management firms, HUD employees were reacting to the firms' reputations, which had been fine before they got involved with managing this project.

The Redevelopment Authority, is heavily involved in what's going on in the renewal area. Their representative has kept a watchful eye on the project since the rent-up began. However, it was not until it began to experience serious problems that the Redevelopment Authority could influence the Church Board and the management. A Redevelopment Authority staff member assumed the responsibility of preparing the information needed for the mortgage modification after so many management firms had failed to produce, and did the work for the 1974 rent increase after the second management firm went out of business. She participates in all working meetings arranged to assist the project and maintains close contact with the on-site manager. Currently, they are trying to work out what can be done to the garage to make it useful. Unfortunately, she seems to be somewhat out of touch with tenant complaints, but hopes that satisfaction increases as the maintenance and repair schedule is executed. A member of the Tenants's Association complained that the Redevelopment Authority's representative is "too authoritarian".

The Redevelopment Authority spokesman expressed hope that problems would be solved. Already too many projects have failed in the project's neighborhood. She did express sympathy for the tenants whose needs have long been neglected. As she explained, most subsidized projects have a "honeymoon period" of excellent cooperation between management and tenants. During the honeymoon new tenants are quite satisfied with their new, inexpensive apartments, and relatively high level of services. But according to her there was no honeymoon for this project.

ASSESSMENT

The default began in January 1973 when the then manager misunderstood instructions from HUD and thought that a mortgage modification had been approved and was in effect. However this modification, a 12-month waiver of principal payments and payments into the reserve for replacements, was not approved until August 10, 1973, retroactive to April 1, 1973, and was later extended for six more months. The project had experienced financial difficulty long before that, however, having run a $24,315 deficit ($200,000 income) for the fiscal year ending August 1971. Probably the most amazing bit of financial history in this project's operations is that the project's first rent increase was approved March 29, 1974, over a year after default began. The parties involved hope that a combination of the rent increase and mortgage modification will bring this project out of trouble.

The most serious problem is that it has not had competent management. Compounding these management problems are defects in the project's design and construction, crime and vandalism, HUD's under-estimation of project expenses, and the effects of inflation. The incompetent management firms were slow in requesting the needed rent increase. One HUD staff member, commenting on the effects of inflation on the project, expressed the view that it is just a matter of time before all 221(d)3s and 236s default, since they are caught in a pinch between rising expenses (utilities, insurance, taxes) and the limits to which rents can be raised. The only things that can be done to rescue a defaulted project, until deeper subsidies are provided, are modification of the mortgage and rent increases.

This project provides inexpensive housing for its tenants that is probably better than their former homes. The development can also be commended for providing a child care facility on site. However, this does not make up for the severe mismanagement and neglect that has been part of the history of the project. And it remains to be seen whether the mortgage modification and rent increase will provide the funds needed to do the extensive job of getting the place back into order.

APPENDIX A: CHRONOLOGY OF THE PROJECT

1966	
10/5/66	Form 2012 received, Request for Pre-Application Analysis.
1967	
3/20/67	First 2013 filed.
11/27/67	Non-profit corporation formed.
1968	
7/28/68	FHA conditional commitment.
12/9/68	Initial endorsement.
1969	
9/21/69	Dedication of project.
12/12/69	Construction completed.
1970	
1/19/70	Final endorsement.
1971	
6/1/71	Twelve-month waiver of reserve replacements.
6/29/71	$4,500 from residual receipts account to pay for security service and expenses from vandalism.
12/16/71	Management firm expresses desire to leave.
1972	
6/1/72	Management firm terminates contract; new management firm hired.
6/1/72	Management requests extension of waiver of reserve for replacements; HUD denies waiver and suggests a rent increase instead.

1973

1/1/73	Default begins.
1/73	Non-profit in control of checking account.
2/9/73	New management firm hired.
4/24/73	HUD tells GNMA to elect, to assign, or foreclose by May 13, 1973.
5/30/73	New management firm notifies HUD that it intends to leave by June 30, 1973.
6/13/73	Section 23 Leasing approved for 26 units.
7/15/73	New management firm hired.
8/8/73	Mortgage modification requested.
8/10/73	HUD approves mortgage modification, retroactive to April 1, 1973.

1974

2/1/74	Application for rent increase.
3/29/74	Rent increase approved.

APPENDIX B: ESTIMATED AND ACTUAL INCOME AND OPERATING EXPENSES

	FHA 2264	8/31/71	8/31/72	8/31/73
Total actual rent	$206,760	$199,838	$209,526	$198,445
Average occupancy	100%	95%	91.7%	95.3%
Administrative expenses	11,500	14,630	12,957	17,047
Operating expenses	30,000	52,840	55,894	56,460
Includes:				
Electric		18,477	22,465	23,009
Payroll		18,568	17,675	20,594
Maintenance	12,000	8,802	11,685	9,096
Taxes and insurance	32,419	44,730	26,484	28,342
Total Expenses	85,919	121,002	107,020	110,945
Expense ratio	41.5%	60.6%	51%	55.9%
Interest & amortization	96,303	96,303	96,303	82,961 (modified)
Replacement reserve	9,130	6,848	2,280	5,321
Total cash requirement	161,352	224,153	205,603	199,227
Net cash flow	45,408	(24,315)	(3,923)	(782)

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