

The Year 40 Problem in Massachusetts– Analysis of the First Wave of Housing Projects

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Introduction

Roughly 40 years ago, the United States was in the midst of a huge push to create affordable multifamily rental housing. Starting in the mid-1960s and continuing through the late 1970s, almost a million affordable rental housing units were produced nationwide through federally-assisted mortgage programs that tied affordability restrictions to below-market-rate 40-year mortgages. Along with several other states, Massachusetts supplemented the federal programs by financing similar housing with state funding.

While a 40-year mortgage term may have seemed like forever in 1970, policymakers have long predicted a “Year 40 Problem” as thousands of mortgages nationwide reach maturity and affordable units are eligible to be converted to market-rate. Already in Massachusetts, over 3,800 affordable apartments have reached the end of their 40-year mortgages with no other affordability restrictions. Another 13,200 apartments in 110 projects will reach Year 40 by the end of the decade.

This paper offers insight into the expiring mortgage or “Year 40 Problem” examining the first 19 Massachusetts projects that reached their mortgage term without other restrictions. 89% of these projects lost some or all of their affordability at Year 40, a loss of 2,095 units². A list of the projects with a breakdown of affordable units and outcomes is attached as Appendix A. To help understand and address upcoming preservation challenges, the paper sheds light on the range of Year 40 outcomes and analyzes the project attributes that might indicate whether a Year 40 project will lose affordable units.

History

In the mid-1960s federal programs first became available that allowed private capital and private ownership in the development of affordable rental housing. A series of financing initiatives offered 40-year fixed-rate mortgages with effective interest rates of 1%-3% to owners, enabling the projects to charge reduced rents to lower income tenants. As further inducement to private sector participation in

¹ CEDAC is a public-private, community development finance institution that provides technical assistance, pre-development lending, and consulting services to non-profit organizations involved in housing development, workforce development, neighborhood economic development, and capital improvements to child care facilities. CEDAC works with its partner agencies at the state level - the Department of Housing and Community Development, MassHousing, the Massachusetts Housing Partnership, and MassDevelopment - to focus resources in support of the non-profit development agenda as an important element of Massachusetts' system for production of affordable housing. CEDAC is also active in national housing preservation policy research and development and is recognized as a leader in the non-profit community development industry.

² While the loss of affordable housing units is an important policy concern, it should not be inferred that 2,100 families were forced out of their housing at mortgage maturity. In many cases, individual tenants were protected, even though their housing units were lost from the affordable stock.

the HUD programs, most of the HUD mortgages permitted prepayment after the first 20 years of the 40-year term.³

The first of these mortgage programs was the HUD Section 221(d)(3) Below Market Interest Rate (BMIR) program, supplanted a few years later by the HUD Section 236 program. In the early 1970s, MassHousing created a state-financed version of the Section 236 program called Section 13A.⁴ Although varying in the specifics, these programs had the same basic philosophy: below-market-rate mortgage payments would allow owners to charge reduced rents to lower income tenants.⁵ HUD or MassHousing set and regulated rents modestly below what could be charged in the market; the programs are often referred to as “shallow subsidy” programs.⁶

Although these projects generally did not have any Section 8 or other rental assistance when they began operations, many projects applied for and received project-based Section 8 assistance for their properties in the 1970s. Project-based Section 8 had three advantages for project financial stability: 1) lower vacancy rates, 2) a stable income stream from the government and 3) a wider income band of tenants who can afford to live at the property. Residents paid 25% - 30% of their income for rent, with HUD providing the balance. Thus with Section 8 assistance, residents with very low incomes could generally afford to live at these assisted properties. Consequently Section 8 and similar forms of project-based operating assistance are referred to as “deep subsidy” programs.

The 19 projects reviewed were produced between 1965 and 1970, and virtually all were financed through the HUD 221(d)(3) BMIR program, the first of the three major mortgage finance programs. Over the next few years, more HUD Section 236 and MassHousing projects will also reach Year 40. The peak crisis years in Massachusetts are expected to be 2017 and 2018 as the chart below illustrates. By the early 1980s, completely different financing models supplanted these affordable housing programs such that the Year 40 problem in Massachusetts ends fairly abruptly in 2019 with just a few projects at risk in 2020 and 2021.

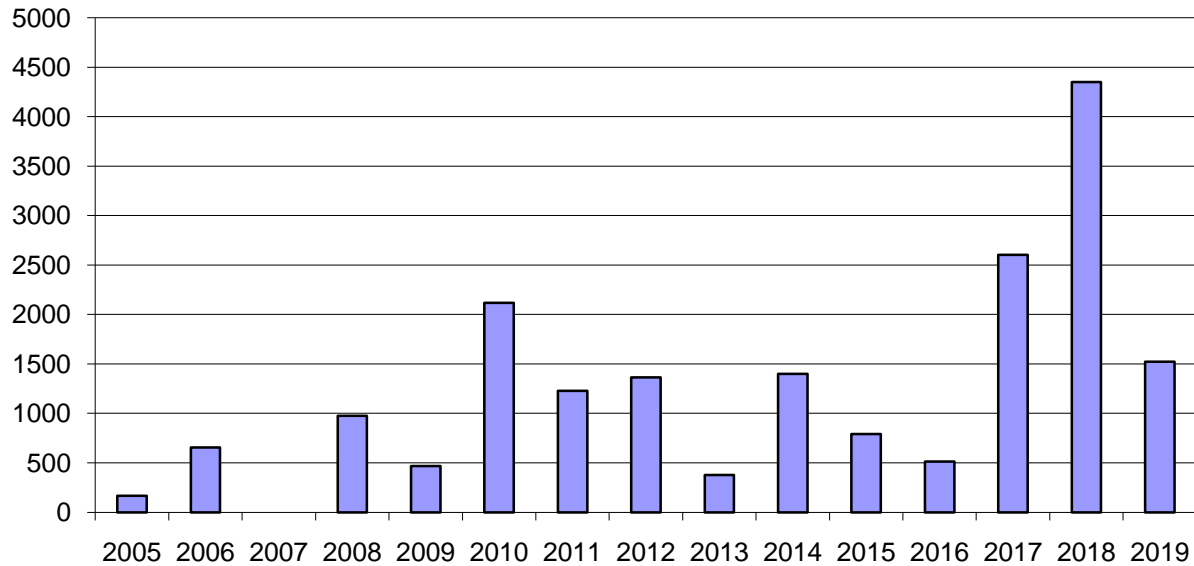
³ MassHousing, on the other hand, did not permit prepayment on most of the projects it financed, and they remain “locked” until mortgage maturity.

⁴ The two HUD programs produced about one million units of affordable housing nationwide. In Massachusetts, over 29,000 affordable rental apartments were built using the HUD and MassHousing programs between 1965 and 1979. A huge spike in production between 1972 and 1976 accounted for almost 21,000 of these apartments. These levels of affordable housing production dwarf the affordable housing production rates today.

⁵ Programs varied in their degree of income targeting; the term “lower income” is used throughout this paper to indicate tenants who had incomes less than 95% of the area median income. Generally tenant incomes in these projects were significantly lower than this.

⁶ These are by no means the only affordable housing programs that were active during the 1960’s and 1970’s. However, only Section 221(d)(3) BMIR, Section 236, and Section 13A properties have the Year 40 issue.

Units in Year 40 Projects In MA With No Other Restrictions 2005 - 2019



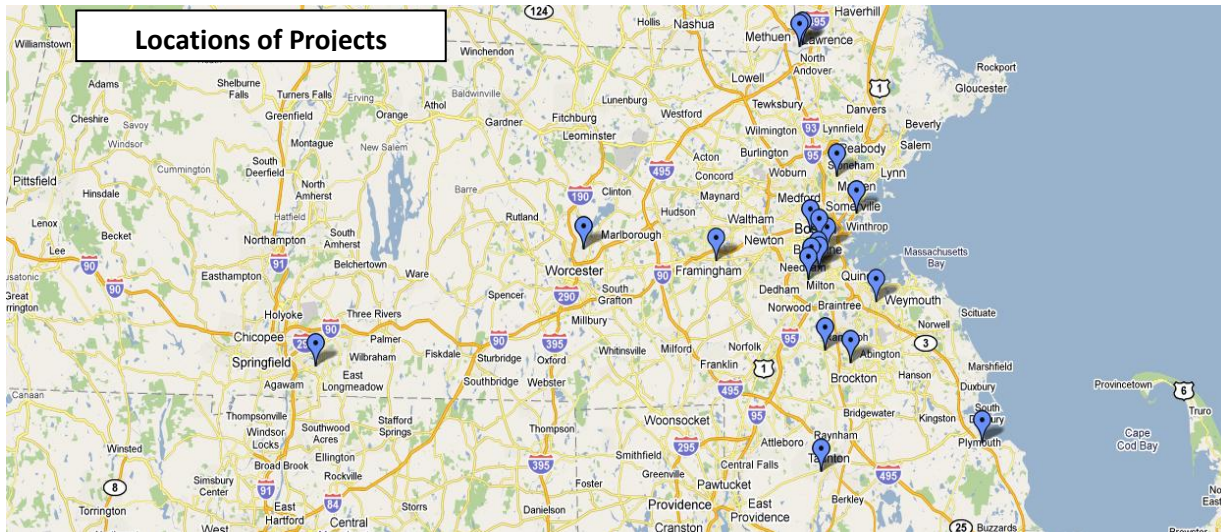
Characteristics of Projects Reviewed

The 19 projects that have now reached Year 40⁷ total 3,823 units of housing and feature several characteristics worth noting.

Geographic Range/Location: The projects are concentrated in densely populated Eastern Massachusetts. Boston and the Metro West areas account for over 70% of the projects with the remainder located in urban areas throughout the state. None of the developments is located in a small town or a rural area, likely a result of the large size of the projects built during this period.

The local housing markets where the projects are located are quite varied. While the Boston area has one of the most expensive and tight rental markets in the country (even during the recent economic downturn), several of the developments are in communities, such as Springfield, Worcester and Lawrence, which have much lower median rents and higher vacancy rates.

⁷ These 19 projects represent less than a third of those originally financed. Among those not included in the 19, some were foreclosed years ago or otherwise lost as affordable housing, while others prepaid their mortgages at year 20. A third set agreed to affordability restrictions that guaranteed the project would remain affordable even after mortgage maturity and are therefore are not at risk for loss of affordability at Year 40.



<u>Region</u>	<u>No. of Projects</u>	<u>No. of Units</u>
City of Boston	7	2,119
Metro Boston ⁸	5	497
Lawrence	2	314
Worcester	1	200
Southeast	3	536
Springfield	<u>1</u>	<u>157</u>
Totals	19	3,823

Project Size and Composition. Compared to affordable housing being developed today, these complexes are quite large, averaging 200 units each. They are also primarily family developments with a preponderance of 2 and 3-bedroom units. Only one development was elderly-only.

Operating Subsidy. The amount of Section 8 project-based operating assistance in the 19 properties varied greatly. Six of the properties had no Section 8, 7 properties had 25-70% of the units assisted with Section 8, and the remaining 6 projects had more than 70% Section 8 assistance.

Ownership. With the exception of 2 projects with cooperative ownership structures, all owners were professional for-profit real estate companies. Many were New England-based and own multiple developments of this type. One real estate company owned 7 of the projects.

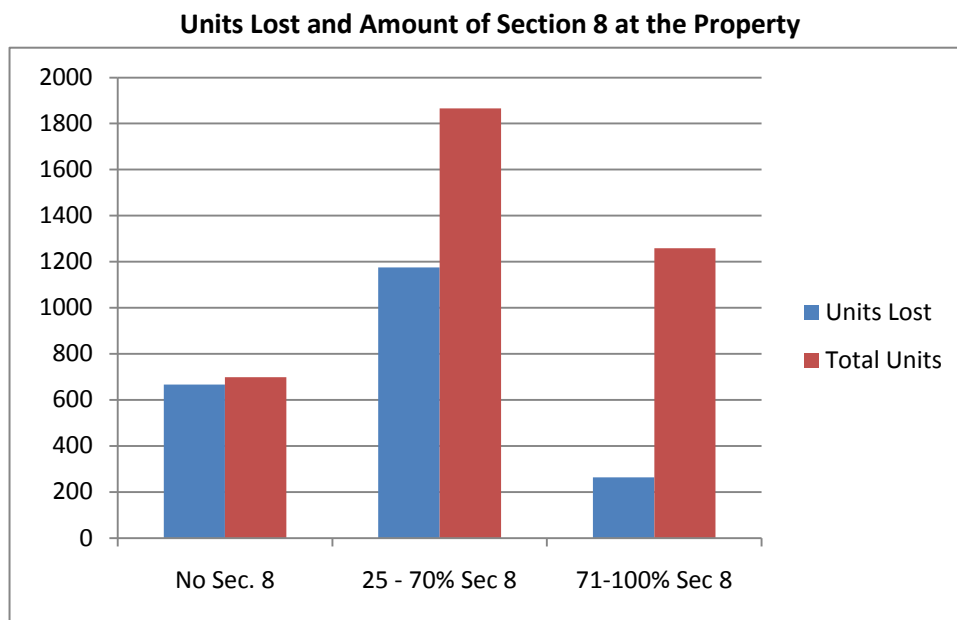
Outcomes. Taken as a whole, 2,095 units (55%), were lost as long-term affordable housing resources. Several projects also changed owner or ownership structure within a few years of mortgage maturity. Three projects were sold to for-profit preservation purchasers. One of the cooperatively-owned developments was converted to condominiums with some units retained as affordable for low-income buyers.

⁸ The Metro Boston region is comprised of the Metro Area Planning Council region excluding the city of Boston. 100 municipalities are included that all have transportation and economic ties to Boston.

Finally it is noteworthy that, unlike many older assisted projects nationwide, none of the 19 projects was “troubled” at the time of mortgage maturity. None was in foreclosure and only one project had a failing REAC inspection score⁹. Loss of these projects to the affordable inventory has therefore been by “opt-out” rather than “fail-out.”¹⁰

Analyzing Factors Attributing for Lost Units

Of the project attributes that could be analyzed, only the percentage of Section 8 in the property appears to correlate strongly with the percentage of units preserved at mortgage maturity. The relationship is quite clear; the greater the Section 8, the higher the likelihood that that units will be preserved as affordable. For the 6 projects that had no Section 8 at mortgage maturity, 95% of the units (667 units) were lost. Among the 7 projects with 25-70% Section 8, 63% of the total units (1,175 units) were lost at mortgage maturity. Most of the units lost in this group were the non-Section 8 units, while the majority of the Section 8 units in this group were preserved. Finally, of the 6 projects with 70-100% Section 8, 20% of the total units (253 units) were lost at mortgage maturity.



Throughout the whole cohort of projects reviewed, 2,095 units were lost at Year 40 - 55% of the total units. However, virtually all of the units lost were shallow subsidy units without Section 8 assistance. Only 551 Section 8 units were lost, which while a large absolute number of affordable units, nevertheless represents just 26% of the total units lost. To look at this statistic from another angle, of the 1,728 units that *were* preserved, just 245 apartments were shallow subsidy units with no Section 8. The other 1,483 preserved units had the benefit of Section 8 assistance.

⁹ The Real Estate Assessment Center (REAC) at HUD tracks property conditions at HUD financed projects. Wentworth Manor in Stoughton had REAC scores that declined below the acceptable grade of 60 by the time of mortgage maturity.

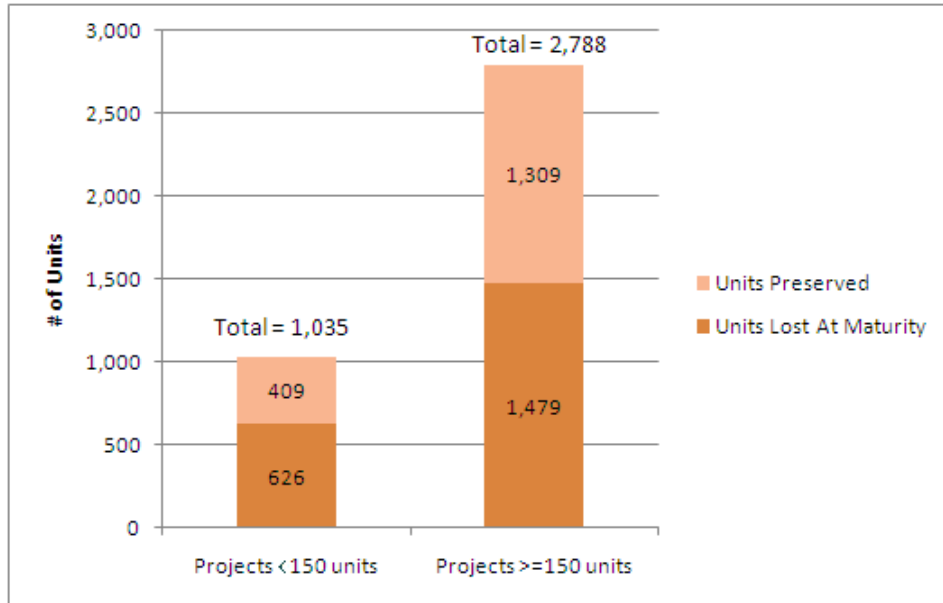
¹⁰ In other words, owners took voluntary action to remove projects from the affordable inventory rather than having project economic failure force the projects from the inventory.

Other attributes analyzed did not correlate strongly with loss of units.

Project size

The average project size in the 19 projects was 201 units, and the median size was 152 units. The 10 projects with less than 150 units lost 60% of the total units while the 9 projects with more than 150 units lost 53% of the units. Project size therefore is not a strong indicator for which projects will be lost.

Units Lost for Projects Less than 150 units and Greater than 150 Units

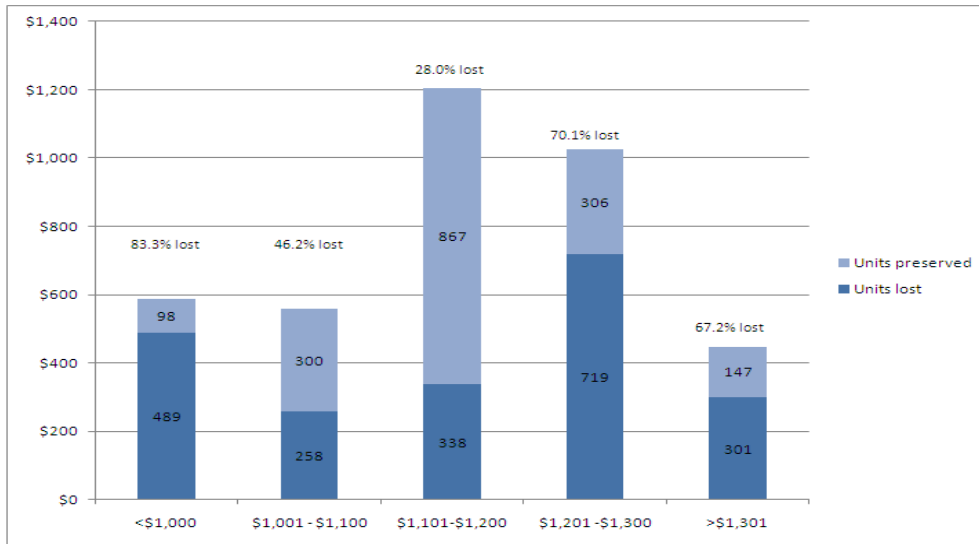


Market rents in the project locations

It would certainly appear logical that owners whose projects were located in higher rent neighborhoods would be more likely to convert to market-rate housing than those projects in poorer neighborhoods. However, after comparing the percentage of lost units based on zip code level average rents, no clear pattern emerges.¹¹ In fact, as the chart on the next page makes clear, the highest percentage of lost units was in the lowest rent neighborhoods, while the lowest percentage of loss was the middle rent neighborhoods. This counterintuitive outcome indicates that market rents are not the most important criterion that owners use when making a determination whether to maintain a project as affordable housing.

¹¹ HUD has published zip code level “fair market rents” for most of the country as a demonstration. The data can be found here: http://www.huduser.org/portal/datasets/fmr/fmrs/index_sa.html. For reference the 2 bedroom “micro FMR” was used as that is the most common unit type in the 19 projects reviewed. The 19 projects were divided into 5 categories based on the 2 bedroom “micro FMR” for the main property address.

Units Lost and Preserved Based on 2 Bedroom Neighborhood Rent Levels



ELIHPA Use Restrictions

In the late 1980s, the first housing preservation crisis emerged as HUD-financed mortgages had the option to pre-pay the mortgage after the initial 20 year term and end affordability. The Emergency Low Income Housing Preservation Act (ELIHPA), among other provisions, offered significant financial incentives for owners who agreed to keep their projects affordable through Year 40. Of the 19 projects reviewed, 11 took part in ELIHPA. These developments represent 58% of the projects, but since several of the ELIHPA projects are very large, they comprise 73% of the units reviewed. It should also be noted that over 2,000 of these apartments were controlled by a single owner; and, therefore, that owner’s decision-making strongly affects outcomes for this entire subset of projects.

ELIHPA did have the benefit of keeping units affordable for an additional 18-20 years when owners could have pre-paid at Year 20; however, participation in that program is not a good predictor that units would be kept affordable longer-term. Overall 43% of the ELIHPA units were lost at Year 40, slightly less than the average for all projects. The ELIHPA program only lasted a few years, funding about 35 projects in Massachusetts. Almost all of the ELIHPA projects in Massachusetts will reach Year 40 by mid-2012¹².

Geography

The 19 projects reviewed were predominately located in and around Boston, though some were scattered throughout the state. Of the 7 projects in the city of Boston 42% of the units in Boston were lost, although this masks a wide variation, as 2 projects lost no units, while another lost 540 units. Five projects were located in the MAPC communities surrounding Boston; of these 497 total units, 350 units

¹² A successor program to ELIHPA was “The Low-Income Housing Preservation and Resident Homeownership Act of 1991” or LIHPRHA. LIHPRHA required 50 year affordability restrictions (rather than the 18-20 remaining years left until year 40 for ELIHPA). CEDAC was extremely active in the 1990s assisting nonprofits and resident organizations acquire housing through the LIHPRHA program.

were lost (70%).¹³ The Southeast region had 3 projects, one each in Brockton, Taunton and Plymouth. 334 units were lost in these projects, representing 62% of the total units. The remaining cities of Lawrence, Worcester and Springfield only included one or two projects each. At least some units were lost in each community. Although the sample size is too small to provide definitive data, geography does not appear to be an indicator of which projects preserved affordability.

Several other project characteristics could not be explored due to the small sample size. For example, only one project was restricted as elderly only. Likewise 2 projects were originally organized as cooperatives and 2 out of the 19 projects were funded through the Section 236 program. None of the first 19 projects had MassHousing financing, as the first MassHousing project will not reach Year 40 until 2012.

Why Section 8 is Important in Housing Preservation Decisions

The amount of Section 8 assistance at a property best correlates to the number of units preserved as affordable. To grasp the importance of project-based Section 8, it is useful to understand the different decisions an owner can make when a project reaches Year 40. One option would be to decide not to renew the Section 8 contract (if any) upon the maturity of the 40-year mortgage, and reposition the project as market-rate housing. A second option would be to keep a portion of the units affordable for lower income renters, typically the Section 8 units as will be described below. Finally, owners could decide to keep all the units in the property affordable¹⁴. The percentage of Section 8 is critical in understanding the benefit to the owner of each option.

Renewing the existing Section 8 contract at a property reaching Year 40 is a relatively straightforward procedure. The owner submits an application to the HUD local office following a well established process, and HUD will generally renew the Section 8 contract. A contract renewal at mortgage maturity, while limited to the same number of Section 8 units as before, is normally eligible to be at rent levels that are equivalent to the market rent in the neighborhood.¹⁵ For many properties this can be a significant increase in rental income, entirely paid for by HUD, since the tenants will continue to pay 30% of their income for rent. Thus the owner of a project that has the majority of units assisted by Section 8 can receive a substantial increase in income for continuing to operate the project as before.

However, there is no similarly linear path for preserving shallow subsidy units without Section 8 assistance. For these shallow subsidy units, the restriction guaranteeing affordability is tied to the mortgage and related documents, all of which terminate at mortgage maturity. Once the project reaches Year 40, the owner must to seek out new funding to keep these units affordable. Shallow

¹³ It is interesting that Metro Boston lost a much higher percentage of units than the city of Boston. A possible explanation may be the proactive policies by the City of Boston to prioritize affordable housing preservation.

¹⁴ An owner could also sell the property but at that point the purchaser would have essentially the same choices as the original owner.

¹⁵ There are several flavors of Section 8 each with its own rules. This brief description only covers the situation for the Year 40 projects in the study. MassHousing financed Year 40 projects have additional hurdles to renewing operating assistance for those projects.

subsidy programs do still exist, but they involve significant processing and have affordability restrictions that are somewhat different from the older HUD and MassHousing programs. An owner who wanted to preserve shallow subsidy units would today likely apply for 4% Low Income Housing Tax Credits and tax exempt debt, a process that normally takes at least several months and considerable expense¹⁶. Owners would need to adjust to new income limits for residents, new compliance procedures, and changes in asset management¹⁷. In addition owners would need to agree to a new affordability term of at least 30 years.

In addition to the greater processing, shallow subsidy programs (unlike Section 8) do not offer operating assistance and are not targeted at the very low income households supported by the deep subsidy Section 8 assistance. Tenant paid rents must cover the operating costs of the apartment complex. In order to increase income at the property, the owner must raise the rent paid by the existing lower income tenants at the property. In general, newer programs allow for only a slight increase in rents to existing tenants, and, therefore, a very limited increase of the rental income to the property. So an owner with a Year 40 project with no Section 8 assistance must go through significant effort and expense to obtain new shallow subsidy financing. However, after finally receiving new this new financing, without Section 8 assistance there is much less chance for a significant increase in project operating revenue.¹⁸

Looking to the Future

If this first wave of Year 40 projects is any indication, the future for preservation of the assisted stock in Massachusetts looks dark. So far, 70% of the Year 40 units with Section 8 have maintained their affordability, but just 13% of the shallow subsidy units have been preserved. If we apply the results of this analysis to the 110 projects that will reach Year 40 by the end of the decade, we can expect to lose about 1,200 of the 3,950 Section 8 units and about 8,300 of the 9,300 shallow subsidy units if action is not taken.¹⁹ Without significant public funding, the Commonwealth could lose 9,500 affordable housing units by the end of 2019. This is particularly alarming given that the state currently produces only about 1,500 new units of affordable rental housing each year.²⁰ Thus for every 3 affordable units the state produces over the next 9 years, it could lose 2 units as Year 40 projects are converted to market rate housing.

¹⁶ Projects that need a higher level of public capital subsidy would need to apply for additional resources that in Massachusetts are offered in competitive funding rounds twice a year.

¹⁷ In some cases there is an opportunity to apply for new project-based Section 8 vouchers. However, in Massachusetts the usual limit for project-based vouchers is 8 per project, too few to have much impact in these large projects.

¹⁸ There are other reasons to apply for new shallow subsidy financing. A refinancing using housing tax credits and tax exempt debt would provide some capital for repairs at the site, and generally a one-time developer fee to the owner of the property.

¹⁹ In addition, there are over 1,000 units with deep subsidy from programs other than Section 8, such as RAP or Rent Supplement. Currently there is no clear path towards renewing these rental assistance contracts at year 40, so without national policy changes, it is unclear whether this non-Section 8 rental assistance will assist in the preservation of these projects.

²⁰ Data from CHAPA based on the change in the statewide rental housing inventory from Sept 1997 through May 2010.

Conclusion

Examination of the first 19 projects to reach Year 40 in Massachusetts indicates that many owners decided not to continue to operate the developments as affordable housing. Overall, 55% of the units were lost as affordable at mortgage maturity. However, this number masks a large difference between those units receiving Section 8 assistance, and shallow subsidy units that did not have Section 8. Of the 2,095 units lost, 551 had Section 8 assistance, while 1,544 were shallow subsidy units. Projecting these ratios forward to the 110 projects that will reach Year 40 by 2019, the state could lose 9,500 affordable housing units. Discussion of the state and federal policy reforms necessary to preserve this important stock of affordable rental housing is beyond the scope of this paper. It is clear, however, that absent a significant public sector commitment to housing preservation, thousands of existing affordable units will be lost in the coming decade.

APPENDIX A: Projects in Massachusetts Reaching Year 40 Through September 2010

Project Name	City/ Neighbor- hood	Region	Maturity Date	Units	S8 Units	Non S8 Units	Type	Units Lost At Maturity
Allen Street Apts	Springfield	Springfield	8/1/2008	157	0	157	BMIR	157
Battles Farm Village	Brockton	Southeast	2/1/2010	320	202	118	236	118
Bradford Apartments	Lawrence	Lawrence	12/1/2005	168	100	68	BMIR	168*
Brandywyne	E. Boston	Boston	8/1/2008	402	266	136	BMIR	136
Brookline Coop	Brookline	Metro Boston	4/1/2006	116	0	116	BMIR	84
Bryant Terrace	Malden	Metro Boston	6/1/2009	108	0	108	BMIR	108
Camelot Court	Brighton	Boston	1/1/2008	161	132	29	BMIR	161
Cummins Towers	Roslindale	Boston	7/1/2010	239	180	59	236	59
Florence Apts	Roslindale	Boston	4/1/2008	138	126	12	BMIR	12
Georgetowne I	Hyde Park	Boston	3/1/2010	601	429	172	BMIR	0
High Point Village	Roslindale	Boston	9/1/2006	540	319	221	BMIR	540
Highland Hills	Taunton	Southeast	9/1/2010	116	0	116	BMIR	116
Mayflower Village	Plymouth	Southeast	11/1/2009	100	0	100	BMIR	100
Mountain Village	Worcester	Worcester	1/1/2010	200	60	140	BMIR	140
Park Gardens	Roxbury	Boston	12/1/2008	38	38	0	BMIR	0
Parkside Apts West	Lawrence	Lawrence	3/1/2010	146	98	48	BMIR	48
Sherwood Park Apts	Framingham	Metro Boston	12/1/2008	81	60	21	BMIR	21
Tammy Brook Apts	Weymouth	Metro Boston	6/1/2009	90	24	66	BMIR	25
Wentworth Manor	Stoughton	Metro Boston	5/1/2010	102	0	102	BMIR	102
		Totals		3,823	2,034	1,789		2,095

* Subsequent to its mortgage maturity, Bradford apartments was purchased and preserved (but without project-based Section 8 as these had already been converted to vouchers). The property now known as Sycamore Village has 161 affordable units.