

**"Developing Affordable Housing  
In Central Vermont"**

**CED Project - Final Report  
Community Economic Development Program  
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Montpelier, Vt.**

In the course of my job, I occasionally have to drive to the nearby town of Northfield where one of our small projects is located. Early last fall I noticed that what had once been an old nightclub was up for sale. It was a large two-and-a-half story building set on a large empty lot on a stretch of highway which featured single-family homes every couple of hundred yards, and I thought it would probably make a good rehab project to turn the building into a three-or four-family apartment house.

I would have pursued the idea further, but we were already up to our necks in projects, trying to secure \$3 million in financing for a 46-unit project and another half-million in rehab funds for two other projects. There just wasn't time to take it on. As the fall progressed, I noticed the realtor's sign came down and presumed that someone had purchased the building. A little while later, there were signs that work was being done.

Then for a couple of months, my trips to Northfield were by another route and I lost track of what was happening to the old nightclub. Two weeks I went to Northfield again by the old route, and saw two families moving their furniture into the finished building. Exactly as I had foreseen, it had been converted into a four-family house, with plenty of parking and play area for children. What brought me up short was that the conversion had been accomplished in three months from the time the realtors sign went up to move-in by the new tenants. By contrast, our projects had either taken two steps backward or had moved forward only a half step.

A year ago yesterday, I did the first pro forma calculations for our Elm Street project, the acquisition and rehabilitation of 46 dilapidated apartments in six buildings in downtown Montpelier, and last week I added another version to the file, which is now almost two inches thick. And we are still at least six months away from the closing.

The second part of my CED project was the acquisition and rehab of 16 units in two buildings in Randolph, Vt. which we eventually want to convert to a limited equity housing cooperative. This project initially went smoothly enough, and, in fact, from conception to acquisition, including commitments for the rehab work took only two months. Glitches developed, however, in implementing the rehab, so that only now is the most important part of that work getting underway.

Last week I was at a housing development workshop whose leader gave us the Six Stages of Non-Profit Housing Development:

1) Enthusiasm; 2) Disillusionment; 3) Panic; 4) Anger at the funding sources; 5) Punishment of the victims, and 6) Praise of the non-participants. We are now at stage 5 with Elm Street, whose tenants are now being forced to pay another season of heating bills of up to \$1,000 for a two-bedroom apartment in drafty, uninsulated buildings. Whether we will ever get to stage 6 is still not certain.

It has been a very sobering experience. When CVCLT began this project, the Executive Director and I had just completed the purchase of and rehab work had been underway for a month on a single-family house in Northfield that we were converting to a shared living house for three adults. From conception to that point, the project had taken four months, which to us at the time seemed unduly long. We took on the Elm Street project, with more than 10 times the number of tenants and five times the amount of money involved believing that large projects could not be that much more time consuming than small ones and so it would be a more efficient use of our time to do so. Clearly, we were wrong,

very wrong.

What I would like to do is to summarize the main events in the development of each project and then draw some conclusions.

**ELM STREET, a.k.a NORTH BRANCH APARTMENTS, Montpelier, Vt.**

The six buildings have been seriously disinvested by the current and former owners. There are numerous safety hazards and building and health code violations, and the apartments are some of the most dreary and depressing living spaces in the city.

A total of 85% of the families in the project have incomes of less than 50% of median (\$15,500 for a family of four), and their heating bills are extraordinarily high, even the units without electric heat.

The property consists of five woodframed buildings and one large, sprawling cinderblock building which was originally built for commercial uses, so it's layout is not really suited for apartment living. The units in this building have mostly large, fixed plate glass windows and the second floor kitchens have a ceiling height of about 5'8". The building is virtually uninsulated and in very bad physical shape.

The 31 units in the five other buildings need a great deal of work, both to spruce up the apartments and make them safe and energy efficient and to make structural improvements in the buildings. Our original estimate for the rehab work was \$600,000, which seemed to be the maximum the project could afford with conventional financing, but after we had an architect look at the buildings, this estimate was raised to \$900,000 without any frills.

Faced with the necessity of this expenditure, we knew we must apply for federally subsidized funds to pay the costs so the tenants' rents would not have to be raised. We had been trying to avoid this because our limited experience with HUD had not been favorable. However, as soon as the HUD loan officer saw the cinderblock building, he said he would refuse to put any money

into it, that it had to be torn down and replaced with a new one.

This raised the ante considerably. Even with a HUD 312 loan of \$1 million at 3.25% for the rehab work, we did not have enough low-cost money in the project to replace the cinderblock building, so once again we were forced to consider a source of funding we had avoided, the Low Income Housing Tax Credits. Under this IRS law, tax credits are sold to wealthy individuals and corporations and the proceeds used as equity in projects such as ours. We had avoided this funding source for political reasons, since we dislike the idea of such individuals and corporations being able to avoid their full tax liability. However, it was clear the project could be done no other way, so we put our principles aside and plunged ahead.

At this point, we were up against the HUD 312 application deadline and to meet it, our application had to have full construction specifications and a completed bid process, that is, in effect, a construction contract. We dithered around a bit not wanting to rush the architect and the development of the project but were finally forced to go ahead by the HUD loan officer who now saw the project as one of the "best in the nation" but who also warned us that if we did not meet the deadline for the current fiscal year that there might not be funding available in the next fiscal year.

The architect's staff worked a lot of overtime; we rushed the contractors through the bid process, and the HUD loan officer actually was able to stretch the deadline a week for us unbeknownst to his superiors. The upshot was that we received a low bid that was nearly \$100,000 below our budget and \$300,000 below the architect's estimate. I was ecstatic for about a week.

Then we began to get messages from the HUD regional office that the staff in Washington felt there were serious "defects" in the application. We answered the objections in a series of letters which the regional HUD loan officer later characterized as "impressive" -- but they were not impressive enough. Nor

could they have been, as things turned out.

One of the most serious "defects" in the eyes of the Washington HUD officials was that we were phasing the construction, that is, doing the rehab first and then the new construction, and that we had not supplied a completed bid package and construction contract for the new building. A second objection was to the structure of the tax credit deal; HUD insisted that the co-general partners of the ownership entity have a 51% stake of the ownership to ensure that "the project would be managed correctly," that is, that enough rents would be collected to make the HUD loan payments.

We had not supplied a construction contract for the new building because nowhere on the application did it say we had to; the HUD loan, after all, was for the rehab only. Moreover, we planned to do the new construction after the rehab so that the tenants of the cinderblock building could live in vacant units of the rehab buildings while theirs was torn down and rebuilt. No contractor would bid on a new construction project so far in the future.

The tax credit partnership requirements of HUD made even less sense in our eyes. The partnership was to be composed of two co-general partners, a for-profit subsidiary of CVCLT and a for-profit subsidiary of Housing Vermont, a non-profit tax credit syndicator, and of the limited partners who would buy the tax credits whose proceeds were to be the project's equity. All of these deals are structured so that the limited partners owe 99% of the project and the co-general partners 1% so that the limited partners get the maximum tax benefits. In any event, since CVCLT and Housing Vermont are non-profit corporations, they pay no taxes and so have no use for tax credits.

The upshot of the situation was that I went to Washington with the head of Montpelier's Community Development Agency, through which office the HUD loan would ultimately come, and explained all of this to a Deputy Assistant Secretary of HUD. At

the time he seemed persuaded and cooperative. He even admitted that HUD had approved phased construction projects like ours in the past but because of all the bad loans and mismanagement in the past few years, they had changed the rules without telling us. A few weeks later, however, we received word that HUD would remain firm on both points. Subsequently, HUD agreed to our reasoning on the ownership structure but they remain firm on the insistence of a bid contract for the new construction.

We then put the architectural work out to bid, selected the architect but then two days after that work started our surveyor discovered that the current owners of the building did not in fact own the 10-car parking lot (the only major off-street parking available for the tenants) adjacent to one of the buildings as they thought they did, and which was, in fact, described as part of the property in the purchase and sales agreement. This meant that there was a defect in the title, which in turn meant we did not have site control and without that we could not be sure we would have the money to pay the architect for the work he was doing designing the new building. So that work had to come to a halt while we negotiated with both the current owners and the owner of the parking lot.

At this point, and Act of God complicated things even further. The west side of the property, which includes the parking lot and two of the project's buildings, also includes a 200-foot long, 75-foot high cliff of ledge. Early in December a large piece of the ledge fell from the top of the cliff and crushed a van parked below. The city immediately order the owners to correct the condition and stabilize the ledge. Our architect advised us there was no way the ledge could be stabilized for any reasonable amount of money.

A few inquiries also revealed to us that only Lloyd's of London would provide liability insurance of such a condition and at about the same rates it would charge to insure an oil tanker in the Persian Gulf during war. Our best hope of saving the

project, it was soon clear, was to cut out the property on the west side of the street all together, leaving two buildings and eight of the apartments to their fate with the current owner, and negotiating separately with the former owner for the parking lot.

This we have done. The owner of the parking lot wanted \$45,000 to sell it to the current owners, but has agreed to make a "bargain sale" to us for \$20,000, meaning he can take the difference between the sale price and the appraised value as a tax deduction. And after protracted and very complicated negotiations, the owners of the buildings today (January 25) verbally accepted our offer of \$503,000 for the remaining four buildings.

Meanwhile, the construction bid on the rehab work technically expired at the beginning of December but has been verbally extended. Whether the construction company will honor it four or five months hence will probably depend on whether we are able to offer them a financial incentive to do so and what other work they may have lined up.

As for our financing, the situation is this: By September, we had secured grant and loan commitments for just over \$1 million from the state's Community Development Block Grant program and the Housing and Conservation Trust Fund. We had also been allocated about \$600,000 in Low Income Housing Tax Credits and were eligible for another \$400,000 in Historic Preservation tax credits, leaving the \$1 million HUD loan application.

With the reduction in the scale of the project, we assume that the CDBG and HCTF loans will be scaled back proportionately, and that the equity from tax credits will also be reduced. Of course, our rehab costs will be reduced also, but preliminary calculations indicate there will be a small gap.

Moreover, our experience with HUD so far fills us with trepidation about re-submission of our 312 application, so we are contemplating foregoing HUD altogether and instead applying for a \$1,000,000 loan from the Affordable Housing Program of the Federal Home Loan Bank. The worst case scenario is that the gap



will be large enough so that we have to apply for both the HUD and AHP loans. We must make this decision within the next month.

**HIDDEN VALLEY APARTMENTS, HEDDING DRIVE, Randolph, Vt.**

As I mentioned earlier, the acquisition and funding of the rehab of these 16 units went smoothly, but problems with the rehab funding developed shortly afterwards. That funding was from two HUD programs, the Community Development Block Grant program, which was to be channelled through the Randolph Neighborhood Housing Services (RNHS), and the Rural Rental Rehabilitation program which is administered by another Vermont non-profit, the Lake Champlain Housing Development Corp.

In April, RNHS went through a staffing crisis. The rehab specialist was fired by the director, and then the director was fired by the board, leaving no staff. RNHS had made an \$82,500 loan commitment to us for the Hidden Valley rehab, but there was no one at the agency who could process it or supervise the rehab work.

It took until July before new staff was hired, and then it took another two months to sort out the confusion left by the crisis and begin to write the rehab specifications for our project. While that was being done, the new director discovered that the agency had, in fact, only about \$35,000 which they could lend us for the work.

CVCLT was then informed by Lake Champlain that the project would not be eligible after all for a Rural Rental Rehabilitation loan (it's really a 0%, deferred loan, which amounts to a grant) because we had also planned to use six Section 8 project-based certificates (rent subsidies), and HUD regulations prevent Rental Rehab money from being used with any other federal subsidies. So, where we had originally been counting on receiving \$82,500 from RNHS and \$73,000 from RRR, we now found ourselves with only \$35,000 available.

This was intolerable, and we called everyone we knew at HUD. After extended negotiations, the regional HUD loan officer "found" us 12 Sec. 8 vouchers, which are rent subsidies granted to individual tenants, whereas the certificates attach to particular apartments. Since the tenants can "take" their vouchers with them if they move, there is no conflict with the RRR regulations over "double-dipping."

However, because the RRR funds must be matched, our renewed eligibility gave us only another \$35,000 not the \$73,000 we had originally budgeted. So toward the middle of August, we made a reluctant decision to apply for a subsidized loan from the Affordable Housing Program of the Federal Home Loan Bank of Boston through the Vermont Federal Bank, one of the savings and loan institutions supervised by the FHLB-B. The application deadline, however, was only two-and-a-half weeks away, and we were not at all optimistic about our chances. I called the bank, asked if we could apply at this late date, and to my mild surprise, they said yes. I completed the application a day and delivered it in person the following day.

Vermont Federal had never handled one of these FHLB subsidized loans before, but they went out of their way to help us. After we made a few changes (mainly changing the request from a 0% loan to a grant because net present value calculations made a grant less expensive than a loan) in the application, they agreed to submit it to the FHLB-B.

It turned out that the reason the Vermont Federal officers were so accommodating by underwriting a \$120,000 request in 10 days was that they were trying to move their headquarters into a new community and had to have the move approved by the FHLB-B under provisions of the Community Reinvestment Act.

The CRA requires that when banks seek to expand their operations into new communities they must show that they have taken positive steps to address the needs of all of the residents of the areas they have been serving. Up to this point, Vermont

Federal did not have a distinguished record in this respect, at least in terms of serving low income Vermonters, so this application was a timely blessing for them.

Towards the end of October, we found out that the application had been approved, and, in fact, was the only Vermont project to win approval. Now we actually had more money than we needed for the rehab work, since the RRR money will match any other money we raise up to certain limits. Not only do we get the match against the \$35,000 from RNHS, but also against the \$120,000 from Vermont Federal-FHLB. We then found out that we were actually first runner up in the competition, which meant that if the winning projects qualified for all they had applied for, there would be no money for us.

We then decided we could improve our chances by assuming we would qualify for the full amount we were eligible for under the RRR program and to reduce our FHLB application from \$120,000 to actual amount we needed to do all the rehab work we wanted, \$54,000. We notified Vermont Federal of this change and a few weeks later were informed that the money was ours. Last week we received the first payment of \$15,000 which went directly to our heating contractor who is converting the system from electric to gas, and as I write he is drilling holes in the walls for the new baseboard radiation.

I can't leave this project without mentioning the fact that working with RNHS has been much more of a headache than anticipated. Our agreement with them was that they were to write the rehab specifications, put the work out to bid and supervise it. The rehab work is somewhat complicated in that it involves a number of unrelated items, most of which are to correct safety code violations, and we have discovered that the agency, even though it is comprised of only two people, is highly bureaucratic and does a very poor job of planning.

A half a dozen times we have gotten calls telling us we have to sign some document or other immediately; or alternatively to

inform us that we have to make the half hour trip down there to take care of some detail that is not their responsibility under our agreement but must be done NOW! and that they can't be bothered to drive five minutes to the project to do themselves.

We have decided, therefore, that once they have spent their \$35,000 on the first phase of the rehab work, we will assume full responsibility for managing the rehab. Even though it means a lot more work for us (we are also managing \$120,000 worth of rehab on three buildings we own in Montpelier and have three single family homes under development), it will be worth it to us not to have to deal with RNHS.

### CONCLUSIONS

1) The Department of Housing and Urban Development, whose primary mission is to provide affordable housing to low and moderate income Americans, is the single greatest obstacle to affordable housing in the nation.

I sincerely believe this is not an exaggeration. Part of the reason for this fact is, obviously, political. Former President Reagan's henchmen decimated the agency ten years ago and then turned it into a pot of gold for their favorite developers and financial supporters. Bush's appointees, in turn, have used the excuse of the mismanagement in the Reagan years as a reason to do nothing, especially nothing for non-profit developers. As a result, a "worthy" (the word of the HUD Deputy Assistant Secretary) project such as Elm Street is stymied by pettifoggery.

2) The squeaky wheel gets the grease. An old adage whose truth has been proved by our not only getting the decision about the Randolph project's eligibility reversed but by it's being also awarded 12 project-based certificates after the state's allotment had been used up. We were also able to get HUD to reverse itself on its decision regarding the tax credit/ownership question concerning Elm Street. It is necessary to fight City

Hall to get what is just.

3) Anticipate the needs of the underwriters. Looking back, it is reasonable for HUD to have wanted to know the actual cost of the new building for the Elm Street project, not just the estimate we gave them. So, even though the application made no reference to the new construction, we should have foreseen that any prudent underwriter would want to know this cost as precisely as possible before he would commit money to another part of the project.

This is especially true in this case because we knew early on that the rents from the rehabbed buildings were not sufficient to make the HUD loan payments, that is, that we needed the rents from the new building to make the HUD payments. HUD was right, if the bids for the new building came in significantly above our budget, we could not have built it, and the HUD loan would be in danger.

With regard to our Randolph project, we were very lucky to have applied for the FHLB loan when we did which happened to coincide with Vermont Federal's application to move into a new community and so came under CRA review. If we had been aware of their need to show they were doing something for low income Vermonters, we could have submitted an AHP application for the full rehab cost in the first round of competition months earlier and saved ourselves a lot of work and trouble and gotten the rehab done quicker.

4) Never believe your local HUD loan officer knows what he's talking about. We were told by our local HUD loan officer that our application had an "excellent chance," that the project would receive national attention and so forth. The truth is he was under pressure to use up the HUD 312 funds and also wanted a feather for his cap by funding one of the biggest 312 loans in the country. Why he didn't know of the requirement for a new construction contract is still a mystery. Did Washington not inform the local offices of the rules change, or did he not read

that memo, or did he read it and ignore it? We are likely never to know.

5) Things are always more expensive and complicated than they seem. Our first Elm Street development pro forma had 12 line items and totalled \$1.6 million and the operating budget had 16 line items and expenses totalled \$109,000. The current development budget has 20 line items and totals \$2.6 million (and was up to \$3.1 million when we were still thinking of doing all 46 units. The operating budget has 24 line items and, with 46 units totalled \$148,000. The complications of the Randolph project have already been described.

6) Big projects take lots of time, and

7) Be prepared to deal with Acts of God.

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