THE USE OF PRIVATE INVESTMENT SOURCES TO CREATE RESIDENTIAL ALTERNATIVES

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PREFACE

APPROACHING A BUSINESS WORLD WITH A NONPROFIT MENTALITY

Most of us in human services truly believe in "normalization," "communitization" and a myriad of other catchy "lizations" that have become common lingo in our field. We are often amazed in social settings at the frequency of questions and repeated explanations needed to convince our not-so-adept-in-mental-retardation community counterparts. "Talking shop" In social settings for the human service worker is becoming a prerequisite for graduation from an accredited graduate program. But Isn't it nice how all those other "business" typos admire your perseverance and dedication to the field with comments like, "you must have enormous patience to work with 'those' people" or "you must be very dedicated." The prevailing attitude by those "others" who live next door and around the corner continues to be that the "human service worker" endures more trials and tribulations than the postal worker who forges through the ice and snow delivering his mail, however late. Suffice to say that our role as a "charity worker" is deeply entrenched In society's attitude about all human services. That attitude will lead to the demise of human services as we now Know it.

In this age of 13 percent Inflation, $1.25 per gallon gasoline, energy shortages and skyrocketing housing cost, society can not and will not continue to support social programs that carry no resemblance of cost effectiveness. We cannot continue to run $40,000 deficits because our projections were off! They will not tolerate program expansion expenditures because your staff request a trip to AAMD In Boston. The 80's will bring the age of accountability, leading to the eradication of inefficient programs. Ceiling funding for social service agencies may force a reversal of the deinstitutionalization movement with communitization written off as too costly an endeavor.

if any of the above hits home, it Is for you this paper was written. To avoid a disastrous 80's we must create a reversal in the field of human services. We must begin incorporating a "business attitude" In the way we manage our agencies. We must educate ourselves to the business world and produce cost effective, efficient, quality services. We must concentrate on delivering needed services that can be justified in the years to come. We must utilize the business field and its wealth of knowledge for board representation, administrative positions and fiscal management. We must become known as a valued member of the community and the business world. And for the nonprofit agency to survive, we must become. In all aspects of the word, a business.

Robert J. Laux

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INTRODUCTION

Over the last decade the country has experienced a growing reliance on government to support the cost of services to people who are mentally retarded or otherwise developmentally disabled. Providers and consumers alike seek funding assistance from a variety of tax-supported resources.

Government support is provided in many ways. A 1977 report of the Government Accounting Office Indicated that eleven major federal departments and agencies had been Identified which administered at least one hundred and thirty five programs which affect Americans who are mentally disabled. The majority of these programs Include some tax-supported funding. in addition to the direct financial assistance which comes from tax dollars, government provides Indirect support through a system of tax Incentives. Tax deductions In the internal revenue system encourage private Individuals to Invest their money in certain ways, a variety of these deductions benefit people with low incomes. Most people with developmental disabilities fall into this category and can benefit from Incentives within the tax structure -- from this indirect form of federal support.

To the best of our knowledge, tax benefits have been used primarily by proprietary agencies. Few nonprofit organizations recognize the potential of utilizing private Investment funds, supported by tax deductions, as an alternative funding source.

The author of this paper has carefully researched Incentives that are available to the private Investor who develops rental housing for low-Income Individuals and families. We are pleased to have this opportunity to share this Information with members and friends of the National Association of Private Residential Facilities for the Mentally Retarded.

Although the opinions of the author do not necessarily reflect opinions or positions of NAPRFMR, we can wholeheartedly endorse this approach to the development of residential alternatives

We believe that this manual will be a valuable resource to public and private, proprietary and nonprofit agencies alike.

Joni Fritz
Executive Director
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I. CURRENT TRENDS IN FUNDING HOUSING ALTERNATIVES

The creation of housing alternatives for developmentally disabled people remains today one of the cornerstones of effective deinstitutionalization. The realization that an array of continuum of residential alternatives must be available has Inspired proprietary and nonprofit service providers to develop living arrangements with a variety of titles ranging from: congregate living arrangements, group homes, hostels, boarding homes, developmental training units, intermediate care facilities for the mentally retarded, foster family homes, supervised apartments, behavioral training units and custodial facilities most of which support the movement from an Institutional environment to the community.

The human service industry has come to rely heavily on Federal and State government for financing new construction and renovation and for subsidizing the ongoing operational expenditures needed for residential programs. The most commonly utilized funding alternatives available through Federal and State sources include:

* Housing loans for new construction and substantial rehabilitation through Section 202 of the Department of Housing and Urban Development

* Community Facility Loans from the Farmers' Home Administration

* Community Development Block Grants

* Rental subsidies through Section 8 rental assistance and the Supplemental Security income program

* Medicaid (Title XIX) reimbursement for Intermediate care facilities for the mentally retarded (ICFs/MR)

Other Federal funding alternatives are available. Every human service agency involved with the development of residential alternatives should review a copy of HOUSING FOR DEVELOPMENTALLY DISABLED CITIZENS; AN ANALYSIS OF POLICY ISSUES (1978) published by the National Association of State Mental Retardation Program Directors.2 This excellent book outlines the most recent Federal programs available,' summarizes their objectives, provides valuable information in securing funds and recommends to the government needed changes In programs to eliminate currant problems.

There are some recognized benefits associated with the utilization of Federal housing funds that warrant summarization.

1. There are Federal dollars available, In one form or another. In every state.

2. Federal loans are available to nonprofit organizations at low interest rates.

3. Federal loan programs allow for the recapture of development costs incurred including: planning, architectural fees, etc.} and these are spread out over the loan period.

4. Rental subsidies are based on resident Income and/or fair market rents for your area and assure rental Income to your agency.

5. Rental subsidies are often easier to obtain If the project is funded through a Federal loan. (They are guaranteed to HUD Section 202 Borrowers.)

6. Recent changes by the government allow for congregate as well as individual housing units.

7. A long term commitment of money by the government supports long term trends of deinstitutionalization.

In many parts of the country the utilization of these alternatives is excellent and provides the primary vehicle for support of deinstitutionalization programs that have been developed. However, many of the agencies that have used Federal housing options will concur that there are drawbacks to this resource. Although many communities can relate both positive and negative experiences with Federal funding assistance, the most common complaints are outlined below.

1. The application process itself Is time consuming and costly and allows little assurance of recouping develop ment time costs through approval of your application.

2. The location of the facility may be limited to certain areas of your community gather than where you feel the residents would best be served.

3. Project cost overruns are common and increase the long-term program cost and the size of the loan.

4. You may be assigned the number of clients you may serve based on the value of the loan rather than the facility size which is most suited to your programming needs.

5. You may be In open competition with other agencies representing other disability groups for the same dollars, with little assurance that funding will be secured.

6. The long-term commitment to a building may defer continu um planning and resident movement to a less restrictive alternative or an independent living setting.

7. If you utilize housing developed by a State or local housing authority, contact for maintenance and complaints about the facility will be limited.

8. The community may have a negative perception of the Inter vention of the Federal government, which may add to the deviancy Image of your residents.

Although these complaints are not applicable in each situation, those who contemplate the use of Federal funds should be encouraged to seek out others who have had experience with the resource, both positive and negative, prior to application.

The funding of residential alternatives by private Investment sources has historically been limited to proprietary organizations which serve elderly and disabled persons. In most situations shareholders, in return for their investment of capital, receive dividends on profits generated by the service they offer, tax shelter through depreciation of capital assets and the long-term security of their Investment through the appreciation of property values. Many investors for saw the potential for return on their "residential" investment In the early stages of the deinstitutionalation on movement when state standards which now regulate the size of facilities were In their infancy. The result in some parts of the country was the creation of large, isolated custodial facilities, some of which hamper the current movement to smaller community-based programs. The development and funding of small residential facilities (less than eight) by a profit motivated, shareholder corporation Is in many respects not economically feasible where states limit the return on capital to less than 15 percent.

In the past three to four years a few private and public nonprofit agencies have recognized the opportunity and availability of private Investment funds for residential programs which serve people who are developmentally disabled. For some nonprofit agencies the attraction to the private investor has been the overwhelming problems associated with using Federal assistance. For others, the increase in accountability measures employed by state agencies has forced the operation of nonprofit agencies in a more effective, businesslike manner. Many agencies have thus obtained more business-oriented board members and staff. For whatever reason, the use of private Investors by nonprofit agencies is a viable alternative. The remainder of this manual will focus on how a nonprofit agency looks for, attracts and formulates a lease agreement with a private Investor.

II. **ORIENTING** THE NONPROFIT AGENCY TO THE BUSINESS WORLD

Any nonprofit agency, public or private, which intends to use the private Investor to fund residential programs, must be well versed in the philosophy of business. It must understand the principles of the business world, the benefits of real estate Investments and the motivation behind Industry - profit! You must educate yourself and your agency to the real estate market In your area and thoroughly understand current tax laws that relate to depreciation schedules and recapture rules. You should understand your state housing plans, Including projected expansion of state housing for developmentally disabled individuals, funding sources, and the state's commitment (If any) to the programs you seek to develop. Lastly, you must be prepared to present yourself as a viable business entity in your community and not as yet another charitable organization looking for a handout.

One of my biggest complaints with the current education of human service workers is the lack of Information provided in the area of business principles. Although there are sources of "business-type" Information available in most communities, the human service field seldom takes advantage of them. Most of the Information needed to effectively discuss this type of venture with the private investor may be obtained through the following resources:

* Your agency's consulting Certified Public Accountant to utilize his or her skills for something other than financial statements and audits

* Local Investors In securities (E.F. Hutton listens) who are often members of local service clubs (e.g. Rotary)

* Tax courses offered through your local community college or H & R Block

* Real estate agents in your community who deal in commercial property or land development

* Local bonkers and tax attorneys who may or may not be on your board of directors

* Real estate development consultants who -specialize in residential programs for disabled persons (exercise some caution with these)

* This manual, which will provide you with the basic Information needed to convince an investor that yours will be a wise and profitable venture

It is crucial that you realize the Importance of this education. The presentation of inaccurate or Insufficient Information about real estate investment benefits can be a deterrent for other investors In the future. If you do not have sufficient Information or do not understand the principles, It Is to your advantage to avoid such a discussion. Find someone who thoroughly understands these concepts to present your case for you.

III. THE PRIVATE INVESTOR '- WHO IS HE?

I can state unequivocally that there are potential investors in any community, anywhere in this country. The use of these Investors is directly related to your ability to seek them out, provide them with sufficient Information, and secure financial assistance, which will benefit both the Investor and your agency.

Basically, an investor is someone with a high Income who is interested In Investing In long-term securities to shelter that income from taxation until later years. Sources in your community will Include: accountants, attorneys, physicians, dentists, contractors, architects, realtors, bankers; In short, most business people who have relative high Income. Investors are motivated by profit-making opportunities, especially those with potential to shelter Income. They are always looking for good business opportunities and It Is up to you to educate them about the advantages of developing rental housing for people who are disabled.

The private Investor for use in this type of venture should be an affluent and Influential citizen in your community.[4] Avoid the town "slum lord" with a history of problem rental property and community eyesores, who has established a negative reputation. I don't need to tell you about the problems your organization may face in gaining community acceptance for your residents by using this type of investor.

You must also avoid situations that may be perceived by the community as a "conflict of Interest." No matter how good an arrangement sounds. If the Investor is your board president or the director of your agency you may have a difficult time convincing the community that this arrangement is in the resident's best interest and an appropriate use of funds.

One of the greatest benefit to having an "outside, Influential, citizen Investor" Is the potential for support from your community. (This and other benefits will be discussed in greater detail later.) Use this opportunity!

IV. THE ARRANGEMENT - KNOW YOUR STUFF!

The relationship between an agency which provides residential services and a private investor who provides funds for the construction or renovation of rental housing most often takes one of two forms. The "lease-back" (or lease purchase) or the "straight lease" arrangement. There are other types available but most are skewed versions of these.

A. LEASE PURCHASE AGREEMENTS

In the lease purchase agreement the basic question is, "Who really owns the property?" If the lease specifically states that over a period of time, say the length of the lease, the "lessor" (investor) relinquishes title to the "lessee" (your organization), you are In effect purchasing the building. Wherever payments are, In essence, a purchase of the building; the depreciation of the property rests with the lessee. If your lease contains any of the following statements you are, in the eyes of the Internal Revenue Service, purchasing the property over time:

If the lessee will acquire title upon the payment of a stated amount of rentals;

If the lessee Is required to pay a substantial part of the purchase price in the early years of the asset's life;

If the rental payments exceed a fair market value;

If the optional purchase price (where applicable) is nominal compared to the expected value of the asset when the option (to purchase) may be exercised;

If some part of the (rental) payment is designated as Interest;

If the lease may be renewed at nominal rentals over the useful life of the property.5

As you will see later in this paper, the depreciation of property may represent a large benefit to the private Investor; a benefit he may not care to relinquish!

B. STRAIGHT LEASE

Under a straight {ease agreement the lessor (Investor) provides the lessee (your organization) with a residential facility for your convenience and at his expense. In exchange for "X". amount of dollars per month the Investor agrees to construct (or purchase and renovate) a residential facility on "X" property for your stated purpose. The lease arrangement may contain an "optional" purchase price (calculated on the anticipated, appreciation value of the property) and a "right of first refusal" (stating that". If the lesser has a substantiated offer to purchase the property then your organization has the right to buy It at that price).Here are some additional "tips" that you may wish to Incorporate in your agreement.

1. Term of the lease - It will be to the advantage of both parties to have as a minimum a ten year lease, with the possibility of two five year options. (The benefits will he discussed later.)
2. Rent - A fixed amount for the period of the lease and adjusted in the optional years. As a rule of thumb, this amount usually ranges from one percent per month to ten percent per year of the actual cost of the facility.
3. Appurtenant rights - The right to cross over other property owned by the lessor, or someone else, to get to your residential property; stated for the term of the lease(an often overlooked technicality).
4. Property taxes - Since the property will be owned by the investor and not by your nonprofit organization, there will be property taxes. It is to your advantage to agree to pay these separate from the lease, directly to the local tax officer or, by agreement, to the lessor. This Is not only very "normalizing" but gives a positive Impression to the community that you are paying your own way

5. Utilities - The Investor should assume as a construction cost the "hookups" and origination fees for utilities (electricity, phone, heat, water, sewer, etc.) to the facility. Your agency can expect to pay all utility costs after taking possession of the property.
6. Maintenance - Most new construction is warranted for the first year by the contractor. This often provides you with one year to "get the bugs out" Including leaky pipes, faulty alarms, leaking skylights, etc. Thereafter the agency will be responsible for minor household repairs Including: appliances, interior painting, lawn mowing, cleaning, etc. Make sure that major repairs (i.e. roofing, exterior painting, furnace repairs, etc.) are covered for routine maintenance and/or repair by the lessor In defined Incremental periods.
7. Insurance - The lessor (Investor) should be responsible for providing extended coverage which Insures the property against loss by fire or other casualty. It Is Imperative that he provide this Insurance to protect his property from loss. You will be responsible for the provision of a liability Insurance policy, preferably $1,000,000 bodily Injury and property damage, and a "hold harmless clause." Basically, this means that If someone Is injured on the premises during your occupancy, you cannot bold the Investor responsible. A well designed building and an effectively run program should minimize this risk.
8. Fire and casualty clause - This Important provision states that In the event of a fire or other casualty your organization Is free from rent, and the responsibility for repair or reconstruction rests with the lessor. Further- more, the lessor must complete the repairs within "X" number of days, to your satisfaction, or you are free to terminate the lease and seek other property for your program. Usually the time needed to repair the property is cause for extending the lease a like amount of time.
9. Signs - If you do not want signs Indicating the nature or local on of your program, you should state that in the lease to prevent one from being erected by the lessor. Your state may require a barrier free access sign or a handicapped parking sign, to be In compliance with Section 504 regulations. This should be spelled out In the lease agreement.
10. Use of the property - Many investors will want you to specifically state the purpose of your use of the property in the lease. Statements such as "a residential treatment facility for the developmentally disabled, including but not limited to an Intermediate care facility, a group home or a boarding home, so long as the full-time residential population does not exceed 'X' persons, exclusive of lessee's employees who reside on the premises in connection with their employment"

allow for flexibility for your program funding sources throughout the term of the tease.

11. Permits - It should be stated that the lessor has obtained all appropriate local and state permits permitting him to construct and lease the property and use appurtenant areas. You will be responsible for permits needed to certify and operate a residential program.
12. Option to purchase - As previously mentioned, you may wish to Include a clause which allows you to purchase the building at the completion of the lease term. To avoid the tax problems associated with "lease-purchase" agreements, the defined purchase price should Include an economic indicator for appreciation of property values In your geographic area (e.g. six percent per year).
13. Right of first refusal - This Important clause allows your organization to purchase the building during the term of the lease, should the Investor obtain a "bonafided" and substantiated offer to sell the property. In the event there is an offer, your organization will have "X" number of days to purchase the property at the offered price. You may wish to exercise this right should the second Investor be the town "slum lord" or another such undesirable.
14. Use of adjoining property - If there Is other property which adjoins the residential facility and which Is owned or held by the investor, you may wish to restrict the use of that property. To avoid the future problems associated with living next to a warehouse, funeral home or train station, you should exercise this right from the onset of the lease.

Your lease may contain other provisions such as termination clauses, subleasing clauses, default and remedy clauses, other Indemnification clauses, etc. which your agency attorney can negotiate between you and the Investor. I would strongly encourage a thorough review of these "tips" and others you may Identify prior to seeking out an Investor.

C. OTHER COMPONENTS OF THE ARRANGEMENT

After you have decided on the type of lease arrangement you are seeking there are a number of Items with which you can now approach the investor. You are looking for an Investor who:

I. Will construct or renovate your choice of location and with your building design.(Architectural fees will most often be paid by the investor and included in your rental payments, or paid by "preoperational development costs" funded by state agencies which can afford this luxury 1)

2. Will work with you to jointly determine the site selection;

3. Will negotiate with you a rental price and guarantee that price throughout the lease period (e.g. ten years);

4. Will assume the responsibility for costs associated with the procurement of permits, utility hookups and architec tural fees;

5. Will allow you to select the colors of the building, car pets, Interior painting scheme and appliances (where applicable) ;

6. Will allow you, separate from the lease payment, to pay real estate taxes and utilities. (Most states recognize such costs under "purchase of service" arrangements.)

v. approaching the investor

Now that you have information about the type of lease arrangement that will best serve your agency and the type of facility you plan to build, you are ready to approach the Investor. As men-Honed before, the Investor is available in every community, providing that your salesmanship abilities are keen. It will be extremely helpful for you to review the tax benefits (contained in Section VI) which are available to the Investor. You may wish to have your agency's CPA attend negotiations to explain these benefits more thoroughly.

Let us assume that you have Identified a "potential" (and desirable) investor In your community and you have arranged a meeting at his convenience. The following represents a summary of the information you should present:

1. Outline the need for community residential programs for your population. Briefly describe <in laymen's terms) the deinstitutionalization movement and the need for people in your community to have alternatives to the institution. State the benefits of these alternatives to your community and the savings to the taxpayer.

2. Outline the type of facility you wish to locate and identify the population which will reside there In the most positive terms available, avoiding the confusing rhetoric of the field. Briefly describe the current trends toward normalization and those Federal and State laws which support this movement.

3. State that you are looking for Investors to construct or renovate property for your residential program. You are looking for a "landlord" who Is thought of positively in In the community, one Interested in a long-term rental agreement with your well-known and highly regarded agency,

4. Emphasize that you are a not-for-profit agency without the large sums of capital needed and without the desire to hold real estate capital. State that you do not want to construct programs that are void from taxation and

that you .recognize your community's need to increase its tax base.

5. Emphasize your State's commitment (If any) to this type of program, and the stability of your funding sources. For example, if the Intended facility Is to be funded through Medicaid (Title XIX) funds, you may wish to consult with your legislative representatives to gather Medicaid projections made by State and Federal government for the years to come.

6. If you have a "good" State Developmental Disabilities Plan available which includes housing projections for the population you wish to serve, use It to demonstrate the trend In your State and the State's commitment. Any letters you have from the head of the State agency for mental health and /or mental retardation, agency of human services, or other appropriate state agency or official, including the governor, will be helpful.

7. Explain the benefits to the Investor under this type of arrangement. (This Is where your agency's CPA may be helpful. Remember, if you do not thoroughly understand, don't talk about it Get someone else to do It for you!)

8. Lastly, It might be helpful to show the Investor a copy of this publication. (Just remember, I get 10 percent of your lease cost and rights to your first born son!

From that point on the Interest of the investor and negotiation of the agreement Is entirely up to you! If your agency is recognized in the community and highly regarded you should have no problems. Your training In human behavior should come In handy to help you Identify whether or not the Investor is interested. If he Is not personally Interested, he may know of others in your community who are, or he may be willing to form a partnership with others to produce the capital. Allow him time to think over the project without pressure from you.

VI. BENEFITS TO THE INVESTOR

The investment In any rental property "held for the production of income or for business purposes" carries with It many recognized benefits.[8] The Intention of this section is to make you aware of these benefits.

Although many of the listed benefits apply to all rental property, many are specifically allowed for rental property that is utilized by low-income residents who are eligible to receive local, State or Federal rental subsidies. Your specific set of circumstances should be carefully analyzed prior to further discussion of your particular arrangement.

The following benefits apply to Investors in rental property for people with low Incomes;

1. Any property has expected cash returns and appreciates In value over time. Supportive information Is available through your Chamber of Commerce, local housing agency or a knowledgeable real estate agency.
2. Real estate Investors always look for long-term rental agreements. Rental property which sits idle Is costly. A variety of costs are Incurred In the rental of property: commissions, advertisements, etc.
3. The rental of property to low-income Individuals is often guaranteed by rental subsidies which assure the payment of rent. To the population you are serving these may be Section 8 rent subsidies, SSI payments, local rental assistance payments, Medicaid, or a combination of these.
4. Rental income often protects a capital Investment by off setting expenses. In most situations this shelters current income until later years with a high return through the appreciated value of the property.
5. Rental property may often be "rolled over" by selling one property and buying others, thus expanding income potential and avoiding taxation.
6. Rental property to low-Income individuals carries with It a feeling by the Investor of involvement In the community. Although this may be hard to believe, many investors have stated a recognition of this fact and

have thus influenced other affluent individuals to consider this type of arrangement.

7. The investor can control his long-term securities. His Investments remain in the local economy and he benefits In knowing where they are at ail times, unlike investment In the stock market.

8. After depreciation (discussed In greater detail below) is completed, the property may be donated to your qualified nonprofit agency at the fair market value, thus allowing for a substantial tax benefit to the Investor in the year the property Is donated.

9. Depreciation potential Is one of the most important benefits to investors. The depreciation of property held for income purposes Is often misunderstood. The utilization of the information supplied below should be thoroughly evaluated with the Investor, based on the circumstances of your agreement.

Basically there are three types of depreciation schedules which are recognized by the Internal Revenue Service. • The type and/or combination of depreciation schedules will vary depending on the property held or whether It is new, used or renovated.

A. Straight line Depreciation represents the most common method of deducting depreciation. Under this method the amount which Is recoverable through depreciation Is pro rated evenly over the estimated "useful life" of the property. This method is calculated simply by dividing basis (cost less land value and salvage value) by the number of years in its expected useful life.

B. The Declining-Balance Method of depreciation gives the greatest allowance for depreciation in the first year in which the property is held and a gradually smaller allowance in each succeeding year. "Depreciation Is determined by applying a uniform rate each year to the unrecovered cost or other basis of the property (cost minus depreciation previously deducted). Advocates of this method contend that the value of the asset drops much faster in the early years of its life than In later years,...(others) reason that as depreciation charges go down, repair and maintenance expenses go up thus leveling out the total charges during the life of the property."10 The declining balance method is applicable to new rental property with a useful life of at least three years at a rate double the straight line rate (200%), and for used property at a rate not greater than 150% of the straight line rate. With new property the amount recoverable under this method is roughly equal to two-thirds of the cost In the first one-half of Its useful life.

C. The Sum of the Years Digits Method involves the application of changing fractions. "The denominator of each

COMPARISON OF EFFECTS ON RESIDENTIAL RENTAL PROPERTY BY DEPRECIATION SCHEDULES

Example: Assume an ICF/MR (six bed) is newly constructed using a cost, less land value which is non depreciable, of $150,000. You can also assume for tax purposes that the building has a life expectancy of 25 years and no salvage value for tax purposes.

Straight Line Depreciation

Year	Balance	Percent/yr.	Amount
1	$150,000	4%	$ 6,000
2	144,000	4%	$ 6,000
3	138,000	4%	$ 6,000
4	132,000	4%	$ 6,000
5	126,000	4%	$ 6,000
6	120,000	42	$ 6,000
7	114,000	4%	$ 6,000
8	108,000	4%	$ 6,000
9	102,000	4%	$ 6,000
10	96,000	4%	$ 6,000
	$ 90,000 (balance)	40%	$60,000

Declining Balance (200%)

Remaining Basis	Rate	Pep. Allow.
$150,000	8%	$12,000
$138,000	8%	$11,040
$126,960	8%	$10,157
$116,805	8%	$9,344
$107,460	8%	$8,597
$98,863	8%	$7,909
$90,954	8%	$7,275
$83,678	8%	$6,694
$76,984	8%	$6,159
$70,825	8%	$5,666
$ 65,159 (balance)	57%	$84,842

Sum of the Years Digits

Fraction	Percent/Yr.	Pep. Allow.
25/325	8%	$12,000
24/325	7%	10,500
23/325	7%	10,500
22/325	7%	10,500
21/325	7%	10,500
20/325	6%	9,000
19/325	6%	9,000
18/325	6%	9,000
17/325	5%	7,500
16/325	6%	7,500
$54,000 (balance)	64%	$96,000

* In straight line depredation the percentage rate and amount of depredation remains constant throughout.

** In double declining method the rate is 200% of straight line on the remaining balance.

*** In Sum of the Year Digits method the "2" rate has been rounded therefore represent; a minor numerical error.

fraction is the sum of the numbers which represent each year of the life of the asset. The numerator for each year is the number of years of remaining useful life.11 This method is also applicable to the basis (cost less. land value and salvage value) with a useful life of at least three years.

The table on page 1 presents an example of the difference in each of these depreciation schedules for a newly constructed ICF/MR with a cost of $150,000 (less land value and assuming no salvage value for tax purposes). The "useful life" of 25 years is calculated using the ESTIMATED USEFUL LIVES OF DEPRECIABLE HOSPITAL ASSETS, 1978 edition, published by the American Hospital Association, for masonry, wood frame buildings.

The use of the double declining method or the sum of the years digits method carry with them certain requirements when used with new residential rental property that should be more thoroughly explained by your agency's CPA and by those representing the Investor. There are also certain tax allowances which apply to property renovations and the renovation costs specifically Incurred for the removal of architectural barriers. Furthermore, the use of these "accelerated" methods allows the private investor to recapture most of his costs in a relatively short period of time. (See Item number 10.)

10. Recapture provisions provide another great benefit for private investors. When the accelerated methods are used In depreciation of rental property, the Investor may face . a large tax cost If the property Is sold or otherwise disposed of before Its useful life Is obtained. The difference between the straight-line method of depreciation and the accelerated method may be treated, for tax purposes, as "ordinary Income" versus "long term capital gains" If the property Is disposed of early. This Is a "recapture" of accelerated depreciation. As ordinary Income, the recaptured amount Is treated as though the Investor "earned" the income in that year and it must be added to his Income. This amount Is 100% taxable at his current warning rate and may force him Into a higher tax bracket.

If this Income Is treated as a long-term capital gain and is held for certain periods of time, 60% is excluded from Income as a return on investments held for more than 12 months and the remaining 40% Is treated as ordinary Income.

Section 1250 of the Internal Revenue Code - There are certain benefits to the investor who holds residential rental property for low-income Individuals and families. Most CPA's and Investors will not be aware of these benefits and it will be your responsibly to transmit this valuable information. These benefits specifically deal with the recapture of accelerated depreciation at the sale of property after December 31, 1975.

Basically this provision allows the Investor who holds property for 85% use by low-income Individuals to treat recapture as capital gains Income rather than ordinary Income, subject to the provisions stated. Section 1250(a)(I)(B)(II) states: "In the case of dwelling units which, on the average, were held for occupancy by families or Individuals eligible to receive subsidies under section 8 of the United States Housing Act of 1937, as amended, or under the provision of State or local law authorizing similar levels of subsidy for lower-Income families 100 percent minus I percentage point for each full month the property was held after the date the property was held 100 full months."12

The application of this special provision Is Indeed significant for the Investor. If he maintains ownership of the property for 100 months (8 years, 4 months) each additional month thereafter allows him to treat one percent of the recaptured amount as capital gain instead of ordinary Income. After 200 months (16 years, 6 months) the entire proceeds are treated as capital gain Income.

Most residential programs which serve developmentally disabled people will allow the investor to meet the 85 percent occupancy test. Furthermore, the "eligibility to receive section 8" rental subsidies or "similar levels of subsidy" by "State or local law" Includes SSI payments and Medicaid reimbursements If facility costs are allowable in your State. The client does not have to be In receipt of section 8 rent subsidies, just eligible to receive them.

Although the tax law Is quite clear in this area as It Is discussed above, you are strongly encouraged to discuss this provision with your agency CPA, State mental health and/or mental retardation officials and the regional IRS representative to assure Its applicability to your circumstances.

These benefits are significant to the private Investor and to your agency. As a businessperson in your community, the Investor should readily recognize these for his tax purposes. There are additional community and tax benefits not listed here. Include any that appear applicable as you talk to Investors.

VI. BENEFITS TO YOUR AGENCY

The benefits to your agency associated with the use of a private Investor are extremely important. Your agency should thoroughly review these and weigh them against the benefits of public funding sources In order to make an educated decision about which resources will be sought.

1. Availability of funds - The private Investor Is available In your community to fund residential programs for your population.
2. Control of the landlord - Your agency will have the luxury of controlling who the landlord is among the available Investors.
3. Construction time - Most Investors will want your occupancy In the shortest period of time possible following these negotiations. It is to his advantage to have you occupy early, allowing him to minimize capital outlay and to realize tax benefits early. As an example, one quality facility built In Vermont was constructed and operational In 53 days from ground-breaking to occupancy. The motivation for profit presents a different philosophy than Federal funding sources.
4. Facility design and location - These factors are controlled by your organization. You must decide on the design and location which will satisfy your residents' needs. If the Investor Is unwilling to accept your location, for whatever reasons, be assured that there are others available who will agree to your requirements.
5. Control of colors - This type of arrangement also offers you the opportunity to control exterior and interior color selections. We are all aware of the drab facilities already In existence. You can avoid this appearance and you will have the opportunity to utilize methods to design your residence to conform with and blend into the other residences In the neighborhood.
6. Facility size - The number of residents in the building is entirely up to you; however, you should conform to the needs of the Intended population and to State standards. The size Is not Important to the Investor as long as he can recoup his costs.
7. Rental rates - If the rental rates are guaranteed over the lease period and based on cost of construction, it will offer your agency a unique opportunity to have a "hedge against Inflation" benefiting both the local tax payers and your program's cost.

8. Educational opportunities - You will be educating an affluent (and often Influential) citizen as to your program objectives, the need for residential facilities and the current trends to move developmentally disabled persons from large Isolated Institutions to local communities. Most affluent citizens are perceived by the community as Informed decision makers and their participation will probably generate additional community support.

9. Participation In the community - By paying taxes your agency Is perceived by the community as another residential dwelling. Although you may maintain a nonprofit status your agency recognizes Its responsibility to participate In the community tax base.

10. Community perception of local financing - The investor will probably secure construction financing locally, use local attorneys and accountants and discuss his venture with others In the community. The community may perceive that local dollars are supporting a locally run and operated program. As previously mentioned, the Intervention of Federal or State dollars may be viewed negatively by the community.) The support from These local people will enhance your move to the community.

1l. Permits - By relying on the educated Investor to secure building permits and zoning applications, the burden of these activities may be taken off your agency. You should be available to assist your Investor with these activities (an educational opportunity hard to pass up) but allow him to disclose the Information. Although the above list highlights the primary benefits available to your agency by using a local Investor, you will quickly discover an awareness of others. The successful use of this viable resource will greatly depend on your ability to accomplish the stated activities and fake advantage of the out-lined opportunities. Good luck!

VIII. CONCLUSION

The use of private investment sources for the construction and/or renovation of residential facilities for people who are developmentally disabled has historically been limited to proprietary organizations and to their shareholders. The availability of this viable resource to the private or public nonprofit sector should not be overlooked.

To recognize the benefits associated with this type of agreement, the nonprofit organization must educate itself to the principles of business and real estate Investment In low-income rental housing. This manual is an effort to outline many of the benefits, thus creating an awareness of the resource and encouraging the deinstitutionalization movement.

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