COMMUNITY INTEGRATION THROUGH CREATIVE FINANCING

A Summary of Robert Laux's Presentation at
the Iowa Association of Rehabilitation and
Residential Facilities Annual Meeting

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by

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A. INTRODUCTION

Bob Laux presented a **six-hour** session entitled "Community Integration Through Creative Financing" at the annual conference of the Iowa Association of Residential and Rehabilitation Facilities on May 7, 1986 in Des Moines. Laux is president of Creative Management Associates of Portsmouth, New Hampshire, a consulting firm which provides assistance to human service agencies in the development of residential services. He has 20 years experience in the field of MR/DD, with an academic background in psychology. His previous experience in administering human service agencies in Wisconsin and New Hampshire led to his interest in alternative funding strategies for residential development.

Laux claims there is more money available for the development of residential services now than ever before. However, he says that most agencies are not taking advantage of it because they are unaware of its availability. The purpose of his workshops is to inform human service agencies of the many options available so that they can make more rational, cost-effective decisions in the planning and development of residential services.

Laux's presentation was a six-hour condensation of what he usually presents in a series of five one-day presentations, so much of the material was not discussed in great depth.

Laux contends that one reason human services agencies are not aware of all of their options in residential financing is because they traditionally "think with their hearts, not with their heads." What is needed is more "business-like" thinking, to

explore all the alternatives and select the one which allows the **program to operate** in the **most** cost-effective way.

To do this, human service agency staff need to familiarize **themselves with general** real estate principles, including tax law. Such information **is** readily available through real estate licensing classes **and** IRS publications. Laux believes that **agencies** which **own,** or are developing residential facilities should have one of their staff members obtain a real estate license. Classes are frequently offere d through community colleges, and enrollment costs are approximately $100.

Laux believes that human service agencies can "think bus - iness" without compromising their commitment to serving their constituency. In fact, the principles he espouses are based on current thinking in the field of MR/DD, specifically normalization (people with disabilities should live in the same type of housing as non-disabled people) and least-restrictive environment.

B. EFFECTIVE STRATEGIES FOR COMMUNITY INTEGRATION

Community integration is best achieved through a well-planned, comprehensive effort. The strategy should follow a natural se - quence (see Exhibit 1.) , and a commitment from the state is **crucial. Some opposition** from the community is to be expected, and strategies to overcome it should be developed.

An **important first** step is to conduct a community analysis. Identify and contact key community leaders to provide them with information on **the** proposed project. Anticipate their questions and objection s and prepare responses. Concentrate not only on those leaders **who** are directly affected by the project, but also those who are indirectly affected (e.g., industrial leaders, farmers).

Analyze the neighbors of the proposed project by examining the city directory. This will show the occupations and family configurations of the neighbors. Hold a public meeting for the express purpose of obtaining public support, <u>not</u> to react to opposition. Set a positive tone from the start.

In meeting with the public, it should be realized that persuasion is an art. Attitude change involves credibility of source, penalty or rewards, and satisfaction of fears. Perception is fact; fear and concern are real. Denial will not eliminate fear; facts must be presented. The presenter must come across as credible; a business-like approach is most effective. Identification with the audience is critical; their objectives must be anticipated, e.g., child safety and property value concerns.

Human service agencies have done a poor job of making their case. Needed is the use of marketing principles, with state agencies and statewide organizations such as the developmental disabilities council, the Association for Retarded Citizens, and provider's associations taking the lead in educating the public. Laux suggests that the principles outlined in Exhibit 2 be used in an education campaign.

In preparing their campaign, planners should ask themselves: What does integration mean for us? What do we want to achieve, What do we want to see for the future? Good background reading in Burton Blatt's book, In and <u>Out</u> of <u>Mental Retardation.</u>

EXHIBIT 2.

MYTHS & **MYSTIQUES** ABOUT **DISABLED** & **NON-DISABLED** PEOPLE'S NEEDS

People don't need . . .

* special "systems", separate from others
* to **develop** relationships only with their "own kind"
* to be in large congregations with others "like them" e.g., special schools, special bus, sheltered workshop
* to be sent out of town to treatment facilities for retraining
* to be "placed" in long term care facilities
* to receive direct services from their "advocate" (con flict of interest)

People do need . . .

* an integrated place to be
* opportunities for community participation
* access to necessary services
* meaningful relationships
* community acceptance

Facilities cannot meet these needs? houses, apartments and condos can!

In developing residential services, agencies should strive toward individualized service, settings where non-disabled persons live, avoidance of congregations of disabled residents, minimum distances between sites, and utilization of existing housing options whenever possible. C. THE RULES OF PURCHASING PROPERTY

Human service agencies wishing to develop residential services need to have a basic understanding of the fundamentals of real estate- Knowledge of effective purchase and sales agreements, the basic document of real estate transactions, is important.

The function of the purchase and sales agreement is to create future enforcable duties in writing between two parties: one party to sell, and one to buy. All effective purchase and sales agreements contain the following provisions:

1) Standard provisions

- specified seller and buyer (the agency need not be named)
- specific property
- selling price and deposit
- deed: marketable title (quitclaim or warranty)
- transfer of title
- possession date
- realtor commissions
- insurance
- prorated taxes, utilities, special assessments
- property inclusions

2) Contingency **Provisions** (anything buyer/seller wants to protect **his/her interests)**

- **financing**
- **appraisal**
- **clarification of** easements, encumbrences of liens
- complete inspection by buyer or agent
- completed inventory list
- completed approval for occupancy by authorities
- transference of current status
- full compliance with applicable codes, land use, zoning, and other laws
- conveyance of leases or other agreements
- conveyance of deposits„ interest, etc.

D. FINANCING AND OWNERSHIP OPTIONS

Laux's thesis is that disabled people have a potentially much wider range of housing options available to them than is recognized by most human service agencies and others interested in residential services. These options an attainable through a vast array of ownership arrangements and financing alternatives. These options are the same ones available to the nondisabled population. Few of them are innovative in and of themselves--they are quite common to the non-disabled population. What is innovative is their use in deliberately providing a more "normalized" lifestyle in a less restrictive environment.

1) Financing Options

Options for financing housing for persons with disabilities are summarized below. Not all financing options apply to all ownership options. Further detail is given in the following section.

a) Conventional mortgages.

b) Second mortgages, taken on property already owned.

c) Secondary mortgage market, including?

- Federal National Mortgage Association, a.k.a. FNMA or "Fannie Mae" (conventional)
- Government National Mortgage Association, a.k.a. GNMA or "Ginnie Mae" (low income)
- Federal Home Loan Mortgage Corporation, a.k.a. FHLMC or "Freddie Mac" (conventional)

The secondary mortgage market is not available to non-profit corporations (i.e., most human service agencies), but private investors can use it to purchase housing units to lease to agencies on clients.

d) Junior mortgages, also know as second and third position mortgages.

e) Federal Housing Administration (FHAK There is currently a lot of money available from this source.

f) Veterans Administration (VA).

g) Balloon Mortgages.

h) Purchase Money Market

i) Construction Financing.

j) Foreclosure Sales, advertised frequently in Sunday newspapers k) Distress Sales, whereby the first party takes over the payments of the second party so the second party does not lose his/her credit rating.

Laux believes all of the above options are more attractive than the HUD 202 Program, which is the most commonly used means of financing housing for persons with disabilities- He believes the 202 program will soon be phased out. 2) Ownership Options

Laux discussed five categories of ownership of housing for persons with disabilities: human services agency owned; housing cooperatives; client owned; state owned; and private investor owned. The applicability, advantages and financing options of each category are detailed below.

a) Agency-owned. The biggest advantage of agency-owned residences is that the agency can have the greatest amount of control over the property's use. Furthermore, the agency can use its equity to get unsecured loans to provide addi tional services. An innovative example is an agency in New Hampshire which has bought a large apartment house, kept most of the existing non-disabled tenants, and filled the vacancies with their clients. The agency then sold shares to the tenants, creating an integrated housing cooperative.

The biggest drawback to agency ownership is tying up agency funds in capital expenses, which might otherwise have been used for program services. Laux's consulting firm recommends no more than 20% of an agency's budget be sunk into facility costs.

Financing alternatives for agencies to consider include:

(1) Conventional financing

(2) Federal/state assistance, used to leverage other funds

(3) Secondary mortgage market

(4) Trusts or bequests. With a "life trust," an individual

can donate property to a 501(c) 3 (tax exempt) organization **before he/she dies, and accrue considerable** tax advantages.

(5) Donations

(6) Creative financing

(7) Bargain sales. This is the sale of property to a qualified charitable organization for an amount which is less than the property's fair market value. The excess of the fair market value over the sales price represents a contribut ion to the charitable organization. The seller is then eligible to claim the contribution as deduction for income tax purposes. A net cash flow comparison will show an owner that a bargain sale can yield a cash flow very close to that resulting from a fa ir market sale Exhibit 3. There are many advantages to both buyer and seller in a bargain sale, outlined in Exhibit 4.

(8) Program Related Investments (PRI). PRI's are loans, equity investments or loan guarantees made by individuals, corporations, foundations or institutions to promote specific social causes or areas of interest. PRI's can be made to individuals, nonprofit or proprietary corporations, or other cause-related entities.

PRI's are similar to "social investing" as practiced by the insurance industry, and are often used to leverage other funds. The most common financing tools are debt, equity, loan guarantees and investments in intermediary organizations (for example, to a statewide organization who in turn gives down payments to local agencies for. housing projects). In 1984, there was an estimated $25 million available for PRI's. A study completed by New Ventures found PRI's to have several characteristics in common

Exhibit 3.

INFORMATION REQUIRED FOR BARGAIN SALES

CASH FLOW COMPARISONS:

"A net cash flow comparison will show an owner that a donation or a bargain sale can yield a cash flow very close to that resulting from a fair market sale."

FIVE STEPS IN DETERMINING NET CASH FLOW

1. CALCULATING SELLER'S ADJUSTED GROSS INCOME
2. CALCULATING THE SELLER'S TAX LIABILITY
3. CALCULATING THE IMPACT OF THE SALE ON THE SELLER'S INCOME (CASH INFLOW)
4. CALCULATING THE CLOSING COSTS, TAXES AND OTHER EXPENSES OF THE SALE (CASH OUTFLOW)
5. CALCULATING THE DIFFERENCE BETWEEN CASH INFLOW AND CASH OUTFLOW (NET CASH FLOW)

Source

The Trust For Public Land, 666 Broadway, New York, New York

Exhibit 4

WHY BARGAIN SALES?

* RECAPTURED PROFITS MADE FROM DEPRECIATED PROPERTY ARE ORDINARY INCOME, NOT CAPITAL GAINS

* A GIFT OR BARGAIN SALE CAN ELIMINATE CAPITAL GAINS TAX LIABILITY

* FOR APPRECIATED GIFTS, A DONOR MAY DEDUCT UP TO 30 PERCENT OF HIS ADJUSTED GROSS INCOME IN THE YEAR GIFT IS MADE. UNUSED PORTION MAY BE CARRIED FORWARD A MAXIMUM OF FIVE MORE YEARS

* CORPORATIONS CAN GAIN AN ANNUAL TAX DEDUCTION OF UP TO 10 PERCENT OF ALL INCOME USING A MUCH SIMPLER SLIDING SCALE AND A FIVE YEAR CARRY FORWARD PERIOD

* PARTNERSHIPS "PASS THROUGH" THE TAX CONSEQUENCES OF CHARITABLE CONTRIBUTIONS TO THE PARTICIPATING PARTNERS, WHETHER THEY ARE INDIVIDUALS OR CORPORATIONS, BASED ON THEIR PERCENTAGE OF INTEREST IN THE PARTNERSHIP

* ALL BENEFIT FROM ENJOYMENT OF FAVORABLE PUBLICITY FROM THE CHARITABLE TRANSACTION

(see Exhibit 5). The benefits of PRI's are outlined in Exhibit 6.

(b) Housing Cooperatives. A housing cooperative is a group of people organized for the purpose of owning, building or rehabilitating housing for its numbers. The group legally incorporates itself, and all property is owned by the corporation, as provided for in its articles of incorporation and bylaws. A member (shareholder) does not own his own dwelling unit; he owns a membership certificate which entitles him with the exclusive right to occupy a dwelling unit and to have a vote in the operation of the corporation.

Housing coops are frequently confused with condominiums. However, coops are developed under corporation laws (most states have specific statutes), not real estate laws, as condominiums are. With condominiums, the tenant owns his living unit; with coops, he does not. Further comparison is presented in Exhibit 7. In housing cooperatives, each member is entitled to one vote, regardless of the value of his unit in relationship to the other units. All operational decisions are made in a democratic manner. Furthermore, only those who live in the corporation's property can be a member: there are no absentee owners. Additional information on the operation of coops is presented in Exhibit 8.

A type of coop of special interest to low income persons (i.e., most persons with disabilities) is the "limited equity coop." Under this arrangement, when a member moves out, the cooperation re-purchases his share for the same price he paid for it. The members, therefore, do not benefit an increase in the property's market value, but in return, are guaranteed their

Exhibit 5. PROGRAM

RELATED INVESTMENTS

NEW VENTURES STUDY

FINDINGS

1. Three most frequently selected program support areas were local economic development, housing and manufacturing.

2. Most foundations making PRI's are small.

3. The number of foundations making PRI's is growing.

4. Most common PRI is between $100,000 - $250,000.

5. Demand for PRI's is growing but is still not large.

6. The loan is the most common form of PRI.

7. Most foundations do not provide technical assistance.

8. Most foundations are making PRI's alone.

9. Most foundations have experienced few problems in developing PRI policies or in executing PRI programs.

10. The GREAT MAJORITY of foundations (69.2) asserted that they are interested in making more PRI's.

Exhibit 6.

PROGRAM RELATED INVESTMENTS

FOUNDATION BENEFITS
FINDINGS

* FUTURE INTEREST FUNDS CAN BE RECYCLED

* FUNDS CAN LEVERAGE NON-FOUNDATION PARTICIPATION IN FUNDING

* FUNDS CAN BE USED WHERE GRANTS CANNOT (Non-Profits, Proprietary, Individuals)

* FUNDS CAN BE MADE FROM EITHER ENDOWMENT PRINCIPAL OR FROM ANNUAL INVESTMENT EARNINGS

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* FUNDS CAN BE CREDITED AGAINST 5% PAYOUT REQUIREMENT

* EXPANDS THE TOOLS AVAILABLE TO A FOUNDATION'S INTERESTS

PROMOTES A BUSINESS-LIKE RELATIONSHIP BETWEEN FOUNDATIONS AND RECIPIENTS

Exhibit 7.

COMPARISON OF SIMILAR TERMS

	COOPERATIVES	CONDOMINIUM
Mortgagor	The cooperative corporation	Each individual owner that borrowed money to purchase the unit
Mortgagee	The lending institution	Same
Monthly Charge	Proportionate share of all costs including mortgage	Percentage of common estate costs. Any mortgage payments on the individually owned unit are paid separately as are those assessed on the individual unit.
Real Estate Taxes	Assessed on the property of the cooperative corporation	Assessed on the individual unit
Voting	Each member has on« vote.	Each owner has the number of votes representing the percentage of value of his unit to the total of all units.
Mortgage Term	Cooperative corporation usually has 40 years—member is not a mortgagor.	Owner usually has 30 years—condominium is not a mortgagor.
Cosing or Settlement costs	Costs in addition to the price of the corporate property including mortgage service charge, title search, insurance and transfer of ownership charges paid when the cooperative first purchases the property. Only a small transfer fee is charged to transfer future membership in the cooperative.	Costs in addition to the price of a unit and its undivided interest in the common estate including mortgage service charge, title search, insurance and transfer of ownership charges paid each time the unit is resold or refinanced.
Equity	Increase in the value of a membership certificate over and above the initial or "downpayment" resulting from members monthly contribution toward payment of the corporate mortgage.	Increase in value of ownership interest in the unit as the owner pays off his mortgage and from market value appreciation.
Escrow Funds	Subscription or downpayments required to be held unused until the viable cooperative is assured. Transfer of membership funds are sometimes escrowed until the transfer is complete.	Subscription or downpayments required to be he'd unused until the condominium regime is recorded on the property and titles are conveyed to each buyer. Escrows are usually used in each resale situation. The deed is held in escrow until all conditions of the sale (including any prepayments) have been met.

housing will remain affordable, as there is no incentive for speculators to buy memberships and attempt to resell them for a profit. Further information on limited equity coops is presented in Exhibit 8.

The benefits of housing coops include;

* Natural interaction and integration opportunities. Coop memberships do not need to be limited to disabled persons; a certain percentage of memberships can be reserved for non-disabled persons.
* All members receive full voting rights.
* Persons with disabilities can share their housing on equal terms with others.
* Continuity of place and of relationships are maintained, as disabled tenants don't need to worry about being driven out by higher rents or by being "placed" in another facility by an agency.
* Networking opportunities: coops are easily organized by others in similar circumstances.
* Tax benefits to members are similar to those of other homeowners.

The basic organizational documents common among housing coops are:

(1) Articles of Incorporation: Describe the purpose of the organization, what constitutes a share and restriction on transfers.

(2) Bylaws: Describe tenant/shareholder requirements (e.g., low income), number and scheduling of meetings

Housing Cooperatives

A housing cooperative is a group of people organized for the purpose of owning, building or rehabilitating housing for its members and possibly for other people. The coop itself is a corporation which owns the housing in which the resident-members live. Each resident owns one share or membership in the corporation Like other types of coops, housing coops are democratically managed: one member, one vote. Members usually elect a board of directors who manage the cooperatively owned housing

A housing coop is actually a form of consumer coop. Depending on how you view it the coop is providing a service (housing) or a product (a home > to its members.

Housing coops are often eligible for 100?c financing. A coop can purchase housing without raising significant capita] from its members. The corporation holds one mortgage for the entire coop, collects the rents, makes the mortgage payments, pays the property taxes, pays the bills, does the bookkeeping and maintains the buildings. The corporation is responsible for major repairs, insurance, replacement of worn out equipment and upkeep of common grounds and facilities. Sometimes the corporation hires professional managers and sometimes the members manage the operation themselves. Members are not personally liable for the coop's mortgage.

Federal law and most state laws allow members of housing coops to deduct their share of the mortgage interest and property taxes on their personal tax returns

Some housing coop bylaws specify that when a member moves out. the member's share is repurchased by the corporation for the same amount the member originally paid or possibly for a slightly greater amount to compensate for inflation. This kind of set up is often referred to as a "limited equity coop" The members do not benefit from any increase in the market value of the real estate. In essence, the member is renting housing from the cooperative < except, of course, no landlord can jack up the rent or evict a tenant at will>. The member's original "down payment"—the membership fee—is much like a cleaning or security deposit, refunded when the member moves out. This limited equity system creates housing which is affordable by low-income families and keeps it that way There is no incentive for speculators to buy memberships, hoping to resell and make a large profit. To further discourage speculation and profit, the bylaws of many bousing coops require that all members be residents of the coop. This way. people are not allowed to buy an inexpensive membership and then sublease the housing to others at high rents

Some housing coops allow departing members to sell a membership for whatever it will fetch on the open market Such coops are called "market rate" or "full equity" coops. As the cost of housing escalates, so does the cost of a membership. Few coops survive under such an arrangement. The value of a membership increases until only wealthy people can afford shares. Speculators buy up memberships in hopes of reselling them at a handsome profit The drive to make a killing in the housing market destroys the principles and ideals which coops stand for.

Allowing memberships to sell at market value can have disastrous results for the entire coop if prices climb significantly. People, desperate for housing, buy in at prices they can't realistically afford: they are unable to make the steep monthly payments; the other members of the coop are unable to cover the payments, the entire coop faces foreclosure and loss of its housing. A limited equity coop will prevent this scenario.

Housing coops are most successful when a few specific procedures are followed:

1. The board of directors keeps members informed of all its actions. A system of regular com munications through meetings, newsletters, bulletim boards, etc. is set up and maintained.
2. The coop maintains adequate cash reserves for emergencies, for replacements and for repairs. Reserves reduce the possibility of members having to pay unexpected additional fees.
3. The board has the right to approve new member-residents. Boards often run credit checks on prospective members. Boards often meet with prospective members to explain the rights and responsibilities of coop membership
4. Sub-leasing is restricted to a short term or else not allowed at all. Where allowed, the bylaws specify the maximum time and how much rent may be charged.

and titles and duties of officers and directors.

(3) Offering memorandum: A prospectus offering shares publicly.

(4) Subscsription agreement: Defines roles of stockholders and purchasing power.

(5) Occupancy agreement.

Some financing options housing coops should consider are the sale of stock certificates; federal, state or local assistance; and/or monthly fees based on operational expenses. HUD mortgage insurance programs worth considering include Section 213 (Cooperative Housing); Section 207 (Multifamily Rental Housing); Section 212 (d) (3) and 212 (d) (4) (Multifamily Rental Housing for Low and Moderate Income Families); and rental rehabilitation programs through state housing finance authorities, which come with Section 8 (federal) rental subsidies.

(c) Client Ownership. In a few areas of the U.S. and Canada, human services agencies are assisting their clients with disabilities to buy their own housing. Through the use of creative financing and programming, these persons are able to achieve what is sought by the majority of the non-disabled population: home ownership. The options they choose are the same as those chosen by non-disabled persons: single family residences, condominiums, housing cooperatives, apartments and other multi-family dwellings.

The benefits of home ownership —build-up of equity, pride of ownership, and individual control of residence --take on added significance for persons with disabilities. With contracted program services available in the community, and delivered in the home, if necessary, the threat of being "placed" in another facility is mitigated. SSI eligibility is not affected by owning a home, and the homeowner's personal wealth will increase as their equity builds up.

Financing options include:

(1) Conventional mortgages. Lenders don't care if a person is profoundly mentally retarded; they are just interested in whether the loan can be repaid.

(2) Federal, state and local assistance. Most persons who have severe disabilities have low incomes, which qualify them for many of these programs.

(3) Shared equity. An investor helps with the financing, with the buyer eventually buying out the investor's share.

(4) Trusts and life trusts.

(5) Co-assignment of mortgage.

d) Private Investor -Financed. Tax laws provide private investors some substantial incentives to build or purchase housing which is leased to human services agencies serving persons with disabilities. However, before entering into this sort of arrangement, agencies should do an analysis to see if they will come out ahead. The cost analysis format presented in Exhibit 9. is one quick means of making this determination. An example of an analysis of a specific project is presented in Exhbiit 10. In situations where the -agency gains from the arrangement, a number of benefits accrue to the investor, the agency, and the state. These are:

Exhibit 9.

OWNERSHIP **VERSUS LEASING**

COST ANALYSIS

LEASING EXPENSE	OWNERSHIP EXPENSE
MONTHLY LEASE PAYMENTS (YES)	MONTHLY MORTGAGE PAYMENTS
PROPERTY TAXES (YES)	PROPERTY TAXES (MAYBE)
PROPERTY INSURANCE (NO)	PROPERTY INSURANCE (YES)
LIABILITY INSURANCE (YES)	LIABILITY INSURANCE (YES)
ADMINISTRATIVE FEES (NO)	ADMINISTATIVE FEES (STAFF)
LOST INTEREST EXPENSES (NO)	LOST INTEREST EXPENSE (YES)
CASH ACCESS REQUIRED (NO)	CASH ACCESS REQUIRED (YES)

Exhibit 10.

SAMPLE FUNDING ANALYSIS

Property: $120,000 home purchased for the provision of a community residence in New Hampshire.

OPTIONS:

I. Leasing commitment made by provider included a lease for three (3) years with one renewable option and a yearly escalator in the lease.

	Monthly	Yearly
Lease Payment	$1,516.67	$18,200.00
Taxes	156.00	1,872.00
Insurance	60.00	720.00
Admin. Fees	50.00	600.00
	$1,782.67	$21,392.00

II. Ownership by agency assumes 80% financing ($96,000) at 11.5% with three (3) year ARM for 15 years.

Mortgage Payment	$1,122.24	$13,466.88
Lost Interest (8%)	160.00	1,920.00
Taxes	156.00	1,872.00
	$1,438.24	$17,258.88

III. Leasing using the NH Guidelines with a five (5) year fixed lease payment, lessor to self insure. Lease can be renewed for two additional five (5) year periods.

Lease Payment (10%)	$1,000.00	$12,000.00
Taxes	156.00	1,872.00
	$1,156.00	$13,872.00
Lease Payment (12%)	$1,200.00	$14,400.00
Taxes	156.00	1,872.00
	$1,356.00	$16,272.00

CONSIDERATIONS

Option I is $4,133.12 more than ownership!
Option II is $3,386.88 more expensive than a good lease.
Option II is not bad if the lease costs are near 12%.

Benfits to Investors

1. Property appreciates in value
2. Good selection of property is available: these are regular houses, not facilities.
3. A long-term rental agreement may involve long-term subsidies, yielding a smooth, positive, expected cash flow.
4. Expenses offset income, but it is a paper loss: there are potentials for roll-over at FMV and for sale/donation.
5. The investor controls long-term securities.
6. The community perceives investor involvement positively.
7. Accelerated depreciation through Tax Reform Act of 1981.
8. Potential for investment credits in certain properties (e.g., historic preservation).
9. Investment is comparablbe to tax free bonds.

Benefits To Human Service Agencies

1. Funds are available today.
2. Investor-purchased existing property avoids construction time.
3. Control of who landlord will be (agencies can recruit).
4. Guaranteed rental rates during lease period.
5. Positive perception by community.
6. Opportunity to educate investors and their associates.
7. Investors may become interested in helping agency in other ways.

Benefits to State

1. Saves capital development costs: money can instead be used to leverage funds in local communities.

2. Avoids long-term capital commitments (e.g., institutions)
3. Can hedge inflationary costs: future costs are known over the length of the lease.
4. Absence of property liability: state doesn't need to maintain property.
5. Avoid depreciating assets.
6. Concept is attractive to affluent/politically astute persons: they will support it.

Laux emphasizes that for effective investor/agency partnerships, a strong commitment by the state is essential. The state could share the risks by, for example, underwriting an insurance programs, such as taking 2 million dollars and setting up a 10% pool to protect the investment. The state could also set up a savings trust to allow individuals to eventually purchase their own dwelling units from the investors. Another area of state support is the assurance of prompt reimbursements of ICF/MR monthly payments.

There are many sources of information available to agencies wishing to develop housing in this manner. They include CPAs, who can offer advice and put agencies in touch with investors; local investors in securities; IRS -sponsored tax courses; real estate agents who specialize in commercial property; lo cal bankers and attorneys; real estate consultants in programs for the handicapped (such as Bob Laux); publications of the American Management Association; and the state mental health/mental retardation office.

Laux believes state officials should become aware of creative financing, and should be "pushing" these ideas to the local communities as well as be available for technical assistance.

Those who purchase housing to lease for disabled individuals to live in have found their purchases to be good, solid investments, for the reasons outlined above. Potential investors in such property exist in every community. Agency officials who are seeking such investors should approach affluent, influential citizens, including physicians, dentists, accountants, contractors, attorneys, bankers, etc. (Those to avoid include known "slum lords" and persons who may have a conflict of interest) .

-Investors can be in a variety of forms, including:

individual (sole proprietor)

-partnership with land trust: this means property is secured beyond all partners: if one goes bankrupt, you don't lose the property -partnership without land trust

corporation

-limited partnership: affords flexibility.

When approaching potential investors, agency representatives don't need to "come on directly"; the approach can be simply asking for advice. For example, instead of asking "Will you do it?", they can ask "Do you know of anyone who might be interested?"

The "sales pitch" should include:

-Outlining the residential needs of the persons to be served. Tell of the state's commitment, and how the project will

benefit its clientele.

-Stating the community benefits of the project. **-Explaining the** need for investors who are interested in **positive community** benefits.

-Identifying **the** state's commitment to the concept. Stressing **the** advantage of a long-term agreement (e.g., a 5-year lease)

-Giving funding projections: where the agency's funds will come from to pay rent.

Before entering into a leasing agreement with an investor, agencies should assure that the terms are favorable to the agency. The major components to include a lease are outlined in Exhibit 11. To understand the financial costs and benefits accruing to agencies and investors, a hypothetical example is presented in.Exhibit 12.

Exhibit ll. MAJOR

COMPONENTS OF LEASES

* Description of premesis (legal, deed specific)
* Use of premesis (defined)
* Lease term and rate
* Taxes (property, assessment, special, etc.)
* Insurance (all risk, liability, subrogation waiver)
* Assignments (e.g., to another non-profit agency)
* Waste and alterations
* Repairs and maintenance (first year, capitalized, programic improvements, etc.)
* Utilities (hookups and operational)
* Cancellation clause ("funding out")
* Fire clause
* Rights of entry
* Bankruptcy (lessor's rights upon agency's demise)
* Subordination clause (lessee's foreclosure protection)
* Termination and default
* Option to renew (defines terms & costs in future terms)
* Right of first refusal (in the event of sale of premesis)

Property Specific:

* Signs
* Easement Appurtenances (access to property)
* Structural Appurtenances (use of all buildings)
* Permit acquisitions (building, zoning, occupancy)

Exhibit 12.

INVESTOR CASE FLOW ANALYSIS

ASSUMPTIONS

A private investor purchases a residential property for use by your agency as a small community residence. The property has the following values:

Land	$25,000.00
Building	90,000.00
Capital Improvements	10.000.00
Total Property Value	$125,000.00

Also assume that your agency will be expected to pay the investor at a rate equal to or greater than the fair market rental rate for comparable properties in the area. It is assumed that a rental rate of ten percent (10%) of the property cost will provide a measure of fair market rent.

RENTAL INCOME

$125,000 property value ® 10%/year = $1,041.67/month or $12,500 per year in rental income.

Lastly assume a preferred loan rate of 10.5% to the investor, amortized over a 30 year period, without a prepayment penalty and at a fixed rate throughout the loan. The following examples demonstrate the cash flow given a 10%, 15% or 20% down payment from an investort

RENTAL INCOME/CASH FLOW

Property	Investment	Debt	Cost	Income	Net
$125,000	10%/$12,50O	$112,500	$12,349	$12,500	$ 151
$125,000	15%/$18,750	$106,250	$11,663	$12,500	$ 837
$125,000	20%/$25,000	$100,000	$10,977	$12,500	$1,523

RETURN ON INVESTMENT

The remaining question is how long will it take the investor to recover his investment risk and provide a profit margin against present taxation?

CREATIVE MANAGEMENT ASSOCIATES INVESTMENT **CASH FLOW ANALYSIS** 10% INVESTMENT

(§12,500)

Assumptions: **Property** Value of $125,000, 10.5% loan rate amortized 30 years, **10% rental** income of Property value - Debt $112,500.

PERIODS	1986	1987	1988	1989	1990
INCOME	$12,500	$12,500	$12,500	$12,500	$12,500
DEBT	$12,349	$12,349	$12,349	$12,349	$12,349
CASH FLOW	151	151	151	151	151
TAX INC.	$12,500	$12,500	$12,500	$12,500	$12,500
LESS					
INTEREST	$11,786	$11,724	$11,655	$11,579	$11,494
DEP.	13,000	12,000	10,000	9,000	8,000
SUBTOTAL	24,786	23,724	21,655	20,579	19,494
TAX INC.	$12,286	$11,224	$ 9,155	$ 8,079	$ 6,994
TAX 50%	$ 6,143	$ 5,612	$ 4,578	$ 4,040	$ 3,497
CASH BEN.	6,294	5,763	4,729	4,191	3,648
RETURN %	50.35	46.10	37.83	33.53	29.18

($18,750)

Assumptions: Property Value of $125,000, 10.5% loan rate amortized 30 years, 10% rental income of Property Value - Debt $106,250.

PERIODS	1986	1987	1988	1989	1990
INCOME	$12,500	$12,500	$12,500	$12,500	$12,500
DEBT	11,663	11,663	11,663	11,663	11,663
CASH FLOW	837	837	837	837	837
TAX INC.	$12,500	$12,500	$12,500	$12,500	$12,500
LESS					
INTEREST	$11,131	$11,073	$11,007	$10,935	$10,855
DEPR.	13,000	12,000	10,000	9,000	8,000
SUBTOTAL	24,131	23,073	21,007	19,935	18,855
TAX INC.	$11,631	$10,573	$ 8,507	$ 7,435	$ 6,355
TAX 50%	$ 5,816	$ 5,287	$ 4,254	$ 3,718	$ 3,178
CASH BEN	6,653	6,124	5,091	4,555	4,015
RETURN %	35.48	32.66	27.15	24.29	21.41

CREATIVE MANAGEMENT ASSOCIATES — INVESTMENT CASH FLOW ANALYSIS — 20% INVESTMENT

($25,000)

Assumptions: Property Value of $125,000, 10.5% loan rate amortized 30 years, 10% rental income of property value - Debt $100,000.

PERIODS	1986	1987	1988	1989	1990
INCOME	$12,500	$12,500	$12,500	$12,500	$12,500
DEBT	10,977	10,977	10,977	10,977	10,977
CASH FLOW	1,523	1,523	1,523	1,523	1,523
TAX INC.	$12,500	$12,500	$12,500	$12,500	$12,500
LESS					
INTEREST	$10,476	$10,421	$10,360	$10,292	$10,217
DEPR.	13,000	12,000	10,000	9,000	8,000
SUBTOTAL	24,999	22,421	20,360	19,292	18,217
TAX INC.	$12,499	$ 9,921	$ 7,860	$ 6,792	$ 5,717
TAX 50%	$ 6,250	$ 4,961	$ 3,930	$ 3,396	$ 2,859
CASH BEN.	7,773	6,484	5,453	4,919	4,382
RETURN %	31.11	25.94	21.18	19.68	17.53

CREATIVE FINANCING STRATEGIES

RESOURCE LIST

Programs of HUD, U.S. Department of Housing and Urban Development, 451 Seventh **Street,** S.W., Washington, D.C

The Trust for Land, Northeast Regional Office, 666 Broadway, New York, New York 10012-2301. Att: Peter Stein, Vice President (212) 677-7171.

Social Investing Through Program Related Investments; A Report to The Ford Foundation, New Ventures, 666 Broadway, New York, New York 10010.

"Tax Advantaged Disposition of Unproductive Properties," Carol Clark, Real Estate Finance, Vol. 1, No. 4, Winter 1985, Federal Research Press,.65 Franklin Street, Boston, Mass. 02210.

The Federal Tax Course, 1986, Prentice-Hall, Inc., Englewood Cliffs, New Jersey.

Basic Cooperative Housing Insurance Handbook, Publication #4450.1, May 1973, 5/81 Reprint. A HUD Handbook, U.S. Department of Housing and Urban Development, Washington, D.C. 20410.

National Association of Housing Cooperatives, 2501 M. Street, N.W., Suite 451, Washington, D.C. 20037 (202) 887-0706.

How to Find a Bargain Home, Broughton-Hall, Inc., 1986 version, Home Information Center, 4129-H State Street, Santa Barbara, CA 93110, 805/687-4534.