

JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

IX. MISCELLANEOUS PROJECTS AND CORRESPONDENCE WITH INDUSTRY

E. Expert Witness and Statements to Government Agencies

3. Request to HUD (Donna Shalala) for Research Funding to Study Section 8 Real Estate Investments Sponsored by University of Wisconsin Department of Real Estate and Urban Economics



DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D. C. 20410

OFFICE OF THE ASSISTANT SECRETARY
FOR POLICY DEVELOPMENT AND RESEARCH

November 1, 1978

IN REPLY REFER TO:

Mr. James A. Graaskamp
Chairman
Real Estate and Urban Land
Economics
University of Wisconsin
School of Business
1155 Observatory Drive
Madison, Wisconsin 53706

Dear Mr. Graaskamp:

Assistant Secretary Shalala has asked me to thank you for your letter of October 5, 1978 concerning the research interests and expertise of your Department. I have enclosed two forms for you to complete to make sure you are included on the bidders lists for research projects of special interest to you.

We have chosen the problems of the elderly and handicapped as two of our priority research areas, and are currently developing long-term research agendas for these areas. We would very much like to see the results of any research you have undertaken on either the elderly or handicapped so we may consider it in our planning and add it to our library. I have enclosed some of our publications for you, and hope you find them useful.

Sincerely,

Raymond J. Struyk
Deputy Assistant Secretary
for Research

Enclosure

University of Wisconsin Madison

School of Business
1155 Observatory Drive
Madison, Wisconsin 53706

Graduate School of Business

March 27, 1979

Department of Housing & Urban Development
Office of Policy Development & Research
451 7th Street S.W.
Washington, D.C. 20410

Att: PD & R Correspondence Unit

Re: Summary Proposal Letter for Unsolicited Research Proposal

Gentlemen:

In accordance with your requirement for unsolicited research proposals dated 1/6/78. We are providing a letter outline as follows:

A. Sponsoring organization would be the Department of Real Estate & Urban Land Economics, School of Business, University of Wisconsin, 1155 Observatory Drive, Madison, Wisconsin 53706
The sponsor is a non-profit academic institution.

B. Specific Objective of the Research

Private owner Section 8 new construction developments are a new type of real estate investment hybrid where the real estate is encumbered by a management contract in return for an operational subsidy as opposed to older forms of subsidy which involve outright public ownership following private construction or outright leasing of private facilities. The strength and duration of the encumbrance, and therefore the risk to private capital as well as to long term public objectives for a pool of housing units at less than market rents, is a function of the Annual Contributions Contract (ACC). The hypothesis of this research is that the fourth and fifth year ACC balance surplus (deficit) is a prime indicator of the following:

1. Project solvency defined as providing sufficient cash flow to continue investor interest in the Section 8 program, thus committing the housing units over the longer term.
2. Management competence in using HUD resources well
3. The adequacy of tenant contributions and HUD adjustments to FMR's relative to inflationary trends in operation.
4. Likelihood of investors switching from subsidized to non-subsidized status.

All of these issues, and particularly the final point, provide a response to a recent GAO report projecting a high volume of Section 8 switchovers, a trend we doubt based on our preliminary research.

The draw-down on the ACC balance is sensitive to a variety of variables and assumptions. Sets of these assumptions portray different scenarios about the impact of inflation on operating expenses and tenant income, public policies relative to real estate taxes, initial equity contributions and project reserves, time lags between contract signing and final rent-up, the ratio of FMR to actual market rents in various markets, allowable ACC modifications, and so on. It would also be desirable to solve for parameters in the factors above that would produce specified rates of return, both prospective and retrospective, both risk measures and cash measures of exposure. It would further be useful to have a model which would suggest when certain trends in combination would deplete the ACC too rapidly or avoid premature exhaustion of the funds by adjustment of tenant contributions, real estate taxes, etc. for those at HUD overseeing the management of the existing Section 8 stock. We believe that certain financial models of real estate investment developed here at the University and unique to our department, as well as the background of several of our staff in Section 8 housing, make possible research development of the critical parameters and scenarios appropriate to continued management of the Section 8 portfolio with minimum switchovers if desired.

C. Issues and Problems

There is no historical base for projecting the likely default rate for Section 8 developments using either insured loans from FHA or special assistance loans from state housing agencies. Various agencies such as GAO or special interest groups have projected future scenarios based on a predisposed single set of assumptions with little sensitivity analysis. Simultaneously HUD has researched the comparative rents between Section 8 and non-Section developments; HUD conclusions about the viability and switchover rates of Section 8 development have been based primarily on the initial feasibility characteristics of the development. Both HUD and GAO inference are vulnerable to long term cash dynamics of Section 8 projects.

Section 8 developments are characterized by stages of profit sources in the land, construction, management, tax shelter, cash distributions possible appreciation and ultimate reversion values. There are many misconceptions about the timing, conditions and magnitude of each profit source under a variety of external influences and circumstances. For example, a high rise elderly that might have been feasible with FMR rents 22% over market, may still net 6% if a six year switchover occurs with a corresponding decrease in net income and reduction in value. However, to provide the debt cover required on a conventional mortgage the investor would need to provide significant amounts of additional equity although the cash return and the value base might not be adequate to stimulate further commitment.

D. Relevance to HUD Priorities

The Section 8 program is the main vehicle for housing assistance to low and moderate income families and the new construction program is the major component of this program. There is a major concern

about the long run costs of ACC contracts over 20-40 years as well as the stability of the supply of units committed to or encumbered by Section 8. This research structures the equations and parameters of alternative forces affecting the ACC balance as a proxy for project failure, switchover, or maintenance in the supply of lower cost housing.

E. Methodology

The methodology will make intensive use of a University of Wisconsin investment model called MR CAP by developing the appropriate financial parameters for alternative scenarios involving different categories of project types including high rise elderly, scattered elderly, scattered site family housing, and so on. Data sources for these parameters are readily available here in Madison including FMR's, state FHA bond prospecti, HUD 2013, and several local computer accounting services. The MR CAP computer program is currently operational on University of Wisconsin computer system; thus there would be little time wasted in system development and data searches at the expense of scenario development and actual testing of hypothesis.

F. Products of Research

Products include basic sensitivity tables for alternative project types which produce fifth year surplus or deficits for the ACC balance, in short, the tolerance for variance from initial 2013 assumptions about the project.

A second product thus derived would be selected graphs, nomographs or financial tables by project type which would indicate the investment attractiveness of the project and the rent levels, conventional interest levels and other factors which might cause a switchover to non-subsidized tenants. The Mr CAP model is capable of producing sensitivity tables, as well as histogram and comparative curve graphs for selected sets of assumptions.

A 5-10 page executive summary of research findings and a statement as to the implications relative to future federal policy on Section 8 matters.

A 50-75 page report which details the methodology, instruction of various analytical equations, and related supporting selected material. The executive summary and the report should have application both for those making policy at HUD and those staff members responsible for management and performance of existing projects. The report may also provide risk parameters of interest to the investment and development community, particularly as SEC disclosure provisions may relate to project prospecti and reporting requirements.

*See next page
for another version
of page 4*

G. Duration of Research

If the research proposal were approved by July 1, 1979, it could be completed in four calendar months; should approval come later there would be additional conflicts with fall semester teaching schedules and seven months would be required for completion following date of approval.

H. Professional Efforts and Project Costs

<u>Item</u>	<u>HUD Contribution</u>	<u>UW Contribution</u>
Computer research port		\$2200
Supervision -		
Prof. J. A. Graaskamp		2500
Overhead at 60%		
Federal contract		1200
Report production		
(25 copies)		1000
		<u>7200 (41%)</u>
Researcher (4 months)	\$6000	
Overhead (60%)	3600	
Travel - Chicago & D.C.		
HUD offices	<u>450</u>	
	<u>\$10050</u>	
Total research project cost		<u>10050 (59%)</u> <u>\$17250 (100%)</u>

Project manager and senior researcher:

Prof. James A. Graaskamp, Ph.D., SREA, CRE
Chairman, Real Estate & Urban Land Economics
608-262-6378
1/18 person year

Leon G. Shilton
Senior researcher
1/3 person year

Respectfully submitted,



James A. Graaskamp
Chairman, Real Estate & Urban Land Economics

JAG/dmb

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H. Professional Efforts and Project Costs

<u>Item</u>	<u>HUD Contribution</u>	<u>UW Contribution</u>
Computer research port- 6 months (Includes computer research time & computer utility services)	\$1100	
Project management supervision (Prof. J. A. Graaskamp)		\$1500
Fringe Benefits 20%		300
Senior researcher (L.G. Shilton)	6000	
Fringe Benefits : 10.25%	615	
Travel - Chicago & D.C. offices	450	
Report production & typing (25 copies)	500	
University/federal overhead indirect costs (60%)	8665 3600	900
	<u>\$12265 (82%)</u>	<u>\$2700 (18%)</u>


I. Project manager and senior researcher:

Prof. James A. Graaskamp, Ph.D., SREA, CRE
Chairman, Real Estate & Urban Land Economics
608-262-6378
1/18 person year

Leon G. Shilton
Senior researcher
1/3 person year

This proposal for risk analysis of the ACC fund balances from the standpoint of the developer/owner and in terms of HUD budgets and objectives therefore carries a total cost to HUD of TWELVE THOUSAND TWO HUNDRED SIXTY-FIVE DOLLARS.

Respectfully submitted,


James A. Graaskamp
Chairman, Real Estate & Urban Land Economics



JAMES A. GRAASKAMP
Professor of Real Estate
University of Wisconsin, School of Business
Madison, Wisconsin

EDUCATION:

University of Wisconsin, Madison, Wisconsin
Ph.D. (1964) Urban Land Economics and Risk Management

Marquette University, Milwaukee, Wisconsin
M.B.A. (1957) Finance major

Rollins College, Winter Park, Florida
A.B. (1955) English major

ACADEMIC HONORS:

Chairman, Department of Real Estate & Urban Land Economics
University of Wisconsin Fellow, Omicron Delta Kappa
Lambda Alpha - Ely Chapter
Beta Gamma Sigma, William Henry Kiekhofler Teaching Award (1966)
Urban Land Institute Research Fellow

UNIVERSITY TEACHING SPECIALTIES:

Urban Land Economics, Undergraduate and Graduate appraisal theory and method courses, Real Estate Investment and Finance, Real Estate Marketing Research, Residential and Commercial Property Development, Principles of Risk Management.

RESEARCH INTERESTS:

Development of a variety of after-tax cash flow investment simulation models for real estate; research of innovative tax assessment techniques; recreational real estate development, techniques of feasibility analysis.

EXPERIENCE IN PRIVATE INDUSTRY:

Co-founder of general contracting firm in Madison, a land development firm in Madison, and a farm investment corporation. Member - Board of Directors - Wisconsin Housing Finance Agency. Work includes investment counseling in insurance companies and banks in Wisconsin, court testimony as expert witness, and projects for various Wisconsin municipalities as well as private investors. Co-designer and instructor of EDUCARE teaching program for computer terminal applications in real estate.

PROFESSIONAL DESIGNATIONS:

Senior Real Estate Analyst - SREA; American Society of Real Estate Counselors - CRE; College of Property Underwriters - CPCU

Leon Shilton

CAREER HISTORY

- April 1976 - Current Director of Housing, Wisconson Housing Finance Authority; responsible for the creation and implementation of a multi-family underwriting system through with 6,200 units of housing have been financed; oversees all phases from site selection to management; coordinates housing scheduling with bond financing activities; primary person responsible to Members of Authority for housing activities; prepares and monitors housing research activities and public information; prepares budgets and policy alternatives; administers programs with staff of eighteen professionals and paraprofessionals; salary \$28,200.
- 1973-1976 Director of Production (1975-1976)
Housing Supervisor (1973-1975)
Lansing Office, Michigan State Housing Development Authority; supervised staff of Housing Development professionals and paraprofessionals in the processing of multi-family and elderly housing rental development packages, (annual production - 3,000 units in out-state Michigan); guided, controlled, and monitored staff through fourteen-step housing process and maintained on-going liaison with private sector; determined mortgage underwriting policies and packaging policies; prepared and implemented research results in energy conservation and environmental protection; salary \$21,200.
- 1971-1973 Research Associate
Michigan State Housing Development Authority; as a Housing Development Officer, prepared six housing developments (typically 125 units, at a \$2,000,000 cost) for both Section 236 and moderate income; supervision included determination of economic, architectural, political, legal and management feasibility. As a Researcher, assisted in the conceptualization and preparation of request for research proposals in the evaluation of responses, coordination with H.U.D. research activities, and in the monitoring of research in conjunction with research director.
- 1972-1974 Consultant to Greater Lansing Legal Aid Bureau; (non-remunerative) summarized Housing Program procedures for plaintiffs contesting rent increases, (plaintiffs won); advised use of census data, environmental resources and environmental processing for plaintiffs contesting arterial highway, (plaintiffs won).

Leon Shilton

Major Reports, Manuals

- I. Michigan Housing Process The Michigan Housing Process is a procedures manual developed jointly by the McKenzie Company and a core staff of the Michigan State Housing Development Authority. I was a working member of the core staff and my major function was to provide a history of development processing. As a housing officer and a member of the core staff I was able to bridge the gap between those who were implementing the financing and underwriting program and those who were conducting the management study. I was instrumental in conceptualizing the major steps.
- II. The Primary Economic Impact at the State and Local Levels of MSHDA-Financed Housing The impact analysis was an economic study of the economic benefits of the MSHA Housing Finance Program. I supervised the members of the research organization which performed the study.
- III. Community Impact Model This is a computer model which on a case-by-case basis illustrates the economic consequences to a community of a proposed multi-family development. The impact is detailed in terms of property tax flaws, service requirements, and the initial result of the construction activity. Three descriptive manuals and summaries detail the model. I supervised the members of the research organization which developed the model and implemented it.
- IV. Various Policy Memoranda At the Wisconsin Housing Finance Authority I have prepared major policy memoranda including the following:
 - A. Range of Risk This policy memorandum dealt with the inherent risk of the multi-family program. It detailed the risk during construction and subsequent management. It was used as a decision tool to determine acceptable fee and completion assurance requirements.
 - B. Rehabilitation This memorandum described the complexities and cost of a large volume multi-family rehabilitation program.

In the course of my work I am required to prepare grant applications, monthly reports to the Members of the Authority and compose necessary public information material.



DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410

ASSISTANT SECRETARY FOR
POLICY DEVELOPMENT AND RESEARCH

30 MAR 1979

IN REPLY REFER TO:

Professor James A. Graaskamp
Chairman, Real Estate
and Urban Land Economics
University of Wisconsin
1155 Observatory Drive
Madison, Wisconsin 53706

Dear Professor Graaskamp:

This is in response to your letter of February 26 to Under Secretary Jay Janis regarding Professor Leon Shilton's work on developing a cash flow model of Section 8 New Construction projects.

Although cash flow models have been of some use in our office, the work proposed overlaps other models that we have already supported. In my office, the Division of Housing and Demographic Analysis already has access to a cash flow model developed by Dr. William B. Brueggeman of the Southern Methodist University, which has been applied to Section 8 New Construction. Thus, it is doubtful that the proposed project would meet the Department's research needs and I cannot offer you encouragement for support at this time.

Thank you for your interest.

Sincerely yours,

Donna E. Shalala



UNIVERSITY OF WISCONSIN-MADISON

Research Administration-Financial

Telephone 608-262-3822

750 University Avenue
Madison, Wisconsin 53706

April 25, 1979

Reply to Attn. of
Proposal #16807

Department of Housing & Urban Development
Office of Policy Development & Research
451 7th Street SW
Washington, DC 20410

ATTN: PD & R Correspondence Unit

Gentlemen:

Submitted herewith, in behalf of the Board of Regents of the University of Wisconsin System, is an application requesting \$12,265 for the period July 1, 1979 through October 31, 1979 in support of research entitled "Financial Risk Parameters of Section 8 Housing Contracts" under the direction of Dr. James A. Graaskamp of the School of Business.

This proposal has been administratively approved and is submitted for your consideration. Will you please keep this office advised as developments occur with regard to this application.

Please use the above-referenced proposal number in any future correspondence.

Sincerely,

Robert W. Erickson
Director

RWE:JEB:pn
Enclosure

cc: Dean G. P. Huber
Dr. J. A. Graaskamp ✓