

# Explanation of FRM's Windfall Profits at High Point Village

1) **Initial Cash Investment (1966): \$120,000.** In 1963, the Kargman family formed a General Partnership to develop High Point Village, investing \$120,000 in shares of stock (valued at \$90,000 from Max Kargman, and \$30,000 from his son, Bill, the current principal of FRM.) It is not known if these funds were actually advanced by the Kargmans, or if this is merely a paper value. Nonetheless, it represents the maximum actual cash investment by the Kargmans in High Point Village. The bulk (90%) of development costs were covered by a 100% insured, 40 year mortgage from HUD, with a HUD "Interest Reduction Payment" subsidy to lower the effective rate of interest to 1%, in exchange for a rent control agreement keeping rents below market for 40 years, and a "project-based" subsidy contract to lower rents further for very low income families. HUD required a 10% "equity" investment by developers to match the HUD loan; this was raised by a combination of actual cash by the General Partners, and the sale of tax shelters to Limited Partner investors for the balance.

2) **1<sup>st</sup> Windfall Profit (1966): \$1.1 million.** To attract capital for low income housing in the 1960's, Congress allowed wealthy investors to shelter a portion of their incomes from the then-high tax rates by claiming hypothetical "losses" on Limited Partnership investments in low income housing. (Of course, properties did not "lose" value, they gained value over time; these "losses" were mostly fictitious). Of the total development cost of \$7.6 million at High Point, HUD provided a 100% guaranteed loan of \$6.945 million (90%), and the Partnership raised the balance, about \$650,000 (\$770,000 minus the \$120,000 GP investment), by selling tax shelters to Limited Partner investors. Typically, Partnerships raised about 23% of Total Development Costs as net proceeds from the sale of tax shelters, paid into the Partnership over the first few years. At High Point, we estimate the total net "yield" to be about \$1.8 million. Since only about \$700,000 of this amount was actually needed for HUD's 10% "match" requirement, we estimate about \$1.15 million in net windfall profits to the General Partners in the opening few years, on a cash investment of \$120,000.

3) **2<sup>nd</sup> Windfall Profit (1993): \$16.9 million.** Due to a glitch in HUD programs, FRM and other owners had an opportunity to "prepay" the balance of the 40 year HUD loan after 20 years and convert to unrestricted market rate housing. To avert a national crisis, Congress adopted the Title II Preservation Program, which restricted prepayment rights. The program allowed owners to borrow an "equity take out" loan against the property, much like a homeowner who takes out a second mortgage against their building if the market value has increased, but on a much larger scale. In exchange, the owner agreed to keep rents affordable for the balance of the original 40 year HUD loan.

At High Point, the Kargmans borrowed \$19.3 million against the new appraised value of \$27 million with a tax free equity take out loan, and were required to invest back only \$2.4 million in repairs. HUD insured the new loan, and allowed FRM to deduct the interest payments on the loan. To pay for the new loan, HUD allowed FRM to substantially raise rents for moderate income tenants, displacing many. HUD also tripled the Section 8 contract for High Point, from \$1 to \$3 million annually, to pay for the new loan. This amounted to a huge, second windfall of \$16.9 million to FRM.

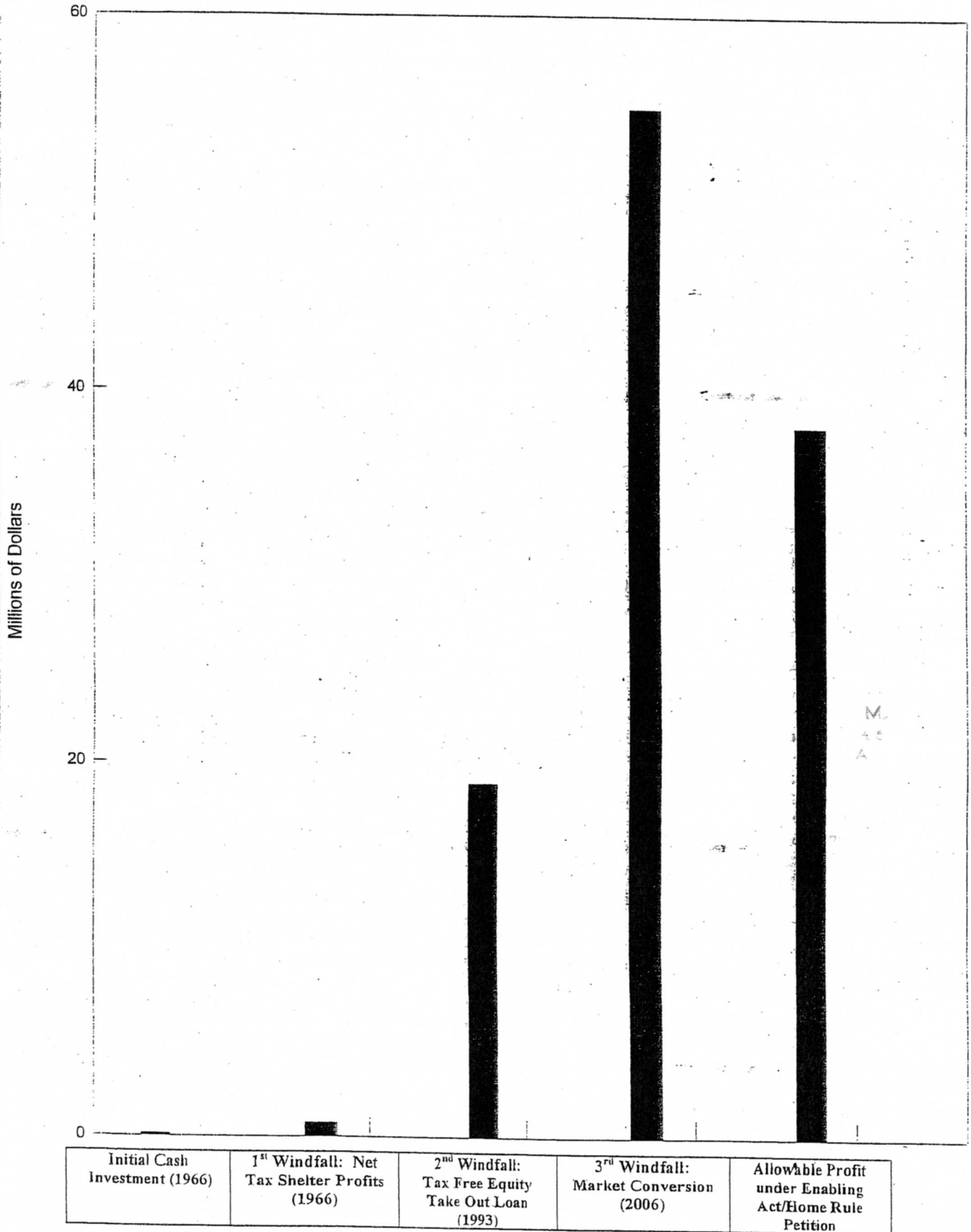
4) **3<sup>rd</sup> Windfall Profit (2006): \$55 million.** After 1993, High Point continued to gain in value in Boston's overheated real estate market. By August 2006, High Point reached the end of its 40 year HUD mortgage. A year earlier, FRM notified residents and HUD of its intention to convert High Point to market rents when the mortgage and Title II Use Agreement (which restricted rents below market for lower income people) expired. FRM ended the subsidy contracts in August 2006. By law, HUD offered qualifying residents Enhanced Section 8 Vouchers to pay the difference between previous, regulated rents and the new market rents, which were substantially higher. Although Enhanced Vouchers protect most tenants from displacement, as apartments become vacant, owners can rent to new residents at unrestricted market rents.

Rental income at High Point has increased about \$1.5 million annually since August 2006. Along with the end of debt service payments on the original 40 year loan, this has left High Point with much higher rental income and a dramatically increased value of approximately \$80 million. This has rewarded FRM with a third windfall profit estimated at \$55 million, in addition to the 1993 windfall of \$16.9 million. With the increased rental income (now over \$9 million annually, up from \$7.6 million in 2004), FRM has taken out a \$23 million repair loan to rebuild High Point as a "gated community." Even after paying debt service on this loan, FRM is making an annual profit in excess of \$3 million. Coincidentally, HUD is still paying FRM more than this, about \$3.3 million each year, to subsidize the rents of the remaining low income families with Enhanced Vouchers.

5) **Allowable Profit Under Enabling Act/Home Rule Petition: \$38 million.** Both the Enabling Act and Home Rule Petitions would give cities the option to require owners to renew expiring Section 8 contracts, and to regulate non-Section 8 rents. Cities could allow owners to renew Section 8 under HUD's Mark Up to Market (MU2M) Program, which allows owners to receive full market rent levels, paid by HUD as higher Section 8 subsidies. Unlike Enhanced Vouchers (which pay owners the same market rent), MU2M would require owners to rent apartments that become vacant to very low income people (less than 50% of the median income.)

Had these tools been available at High Point, the city could have required renewal of the 320 unit Section 8 contract under MU2M, and frozen the 220 non-Section 8 rents at their previous, below market level during the Title II Plan. FRM would still have reaped a \$38 million windfall above the pre-conversion rents, paid for by increased HUD subsidies. But future tenants would be low and moderate income people, maintaining the mixed income, multiracial character of High Point. The City would also have preserved 540 units of affordable housing, *at no cost to the City or State*, since the increased subsidies are paid by HUD. While \$38 million is less than the \$55 million obtained by FRM's market conversion in 2006, it is a more than generous "rate of return" on FRM's original investment of only \$120,000.

# FRM Windfall Profits at High Point Village



Analysis of equity gains only. Does not include allowable 6% annual return on equity (\$286,000 in 2004), 5.5% management fee (\$385,000 in 2004), hidden fees (identify of interest companies), tax deductible interest payments on equity take out loan (1993-2004), or Reserve for Replacement funds released at end of 40 year mortgage (estimated at several million dollars). For more information, contact: Mass Alliance of HUD Tenants ([maht@saveourhomes.org](mailto:maht@saveourhomes.org)).