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# The financing and managing of apartment rental income property in Boston

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BOSTON UNIVERSITY

College of Business Administration

THESIS

The Financing and Managing of Apartment Rental  
Income Property in Boston

By

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(B.S., Boston University - 1960)

Submitted in partial fulfillment of  
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This Thesis was prepared under my supervision,  
and approval is hereby indicated.

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Professor of accounting

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## CHAPTER I

### A RENEWED BOSTON

In the last few years Boston has been the scene of an enormous building campaign. Parcels of land once deemed slum or valueless are now considered prime building lots. While it is true that not all this building is apartment type, this rental income area is still of great significance and is the subject of this paper.

Throughout the Boston area there has been a continuous erection of new apartment buildings and, equally as important, renovation of existing buildings. While the trend of increased apartment house dwelling may be new in this area, it has existed in other parts of the country in different stages for many years.

Los Angeles and New York City have enjoyed this building boom for many years. Since 1947 New York has built 51 million square feet of rental space and in 1962 alone 26,000 apartments were completed. In spite of the boom in these cities, other cities such as Denver and Atlanta have begun to cut back on construction.

## A BLIGHTED CITY

For many years Boston had suffered from high property taxes, a poor transportation system and increased slum areas. Many businesses moved to industrial parks adjacent to Route 128 where they could build or rent more efficient plants and where community tax rates declined instead of increased. Many out-of-state firms were apprehensive of building in Massachusetts; and if a company did venture into the eastern part of the state, it came no further than Route 128, a 45 mile road arcing from the north to the south.

For each business that left Boston, a further tax burden was placed on the city. With more businesses located in the suburbs, more and more Boston residents moved toward the suburbs. But nearness to business was not the only reason drawing people away from Boston. For the many young married couples of Greater Boston, the suburbs offered what appeared to be low cost home ownership. Framingham and Natick became centers on new home construction. Communities with the appealing names of "Brentwood," "Ridgewood," and "Green Acres" drew the young people anxious to get away from the spiraling rents of the city. Many of these people were to return to Boston a few years later, their financial dreams somewhat disillusioned.

## THE PRUDENTIAL CENTER

In 1957 came the first ray of hope for Boston. On January 31 of that year, The Prudential Insurance Company of America announced plans for a \$60,000,000 Prudential Center to be built in the Back Bay section of Boston.<sup>1</sup> It took over two years to complete the plans and work out many legal aspects of the project. Occupying land that has been declared a "blighted open area," the Prudential Center is being built under the Massachusetts Urban Redevelopment Law, under the supervision of the Boston Redevelopment Authority.

The site of the development encompasses 31 1/3 acres in the Back Bay--an area more than twice the size of Rockefeller Center. The land comprises the entire area previously occupied by the Back Bay yards of the New York Central (Boston & Albany) Railroad, the property formerly occupied by the old Mechanics Building, plus a small parcel acquired from the Christian Science Church.

The plans call for seven buildings including the auditorium. These buildings will occupy about 25 per cent of the area, with the remaining surface devoted to parking, transportation facilities, and landscaping. Focal point of

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<sup>1</sup>Facts About Prudential Center, A Report Prepared by the Public Relations Department, The Prudential Insurance Company of America (Boston: September, 1962), p. 6.

the project, the fifty-two story Prudential Tower, will rise some 750 feet above the ground, and will be the tallest building in the United States outside Manhattan.

Nearby on Boylston Street at the westerly end of Park Square, John Druker & Son, real estate developer, has announced plans to build a 400 room, 20 story, \$10,000,000 hotel.<sup>2</sup>

Boston officials are also hope that the National Aeronautics and Space Agency will locate its \$50,000,000 research center in the city. While several cities across the country are being considered, government officials have hinted that Boston may be the final choice.

#### REDEVELOPMENT PROGRAM

Less than a year and a half after the Prudential Center ground breaking, Boston Mayor John F. Collins in September 1960 announced a proposed \$90,000,000 development program for the City of Boston calling for a large-scale urban renewal program with the accent on neighborhood rehabilitation rather than clearance. The illustration on

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<sup>2</sup>New Face of Boston, A Report by the Boston Chamber of Commerce (Boston: December, 1962), p. 4.

page 6 shows the areas to be affected by the Renewal Program.<sup>3</sup>

An important area in the Boston Redevelopment Program is the West End. The John Hancock Mutual Life Insurance Company has committed nearly \$11 million to finance the second group of apartment buildings at Charles River Park. The new project will include two tower structures, containing 460 residential units and a low-rise building for retail shops. The insurance company previously invested \$9,000,000 in the construction of the first two tower buildings of the Charles River Park development.

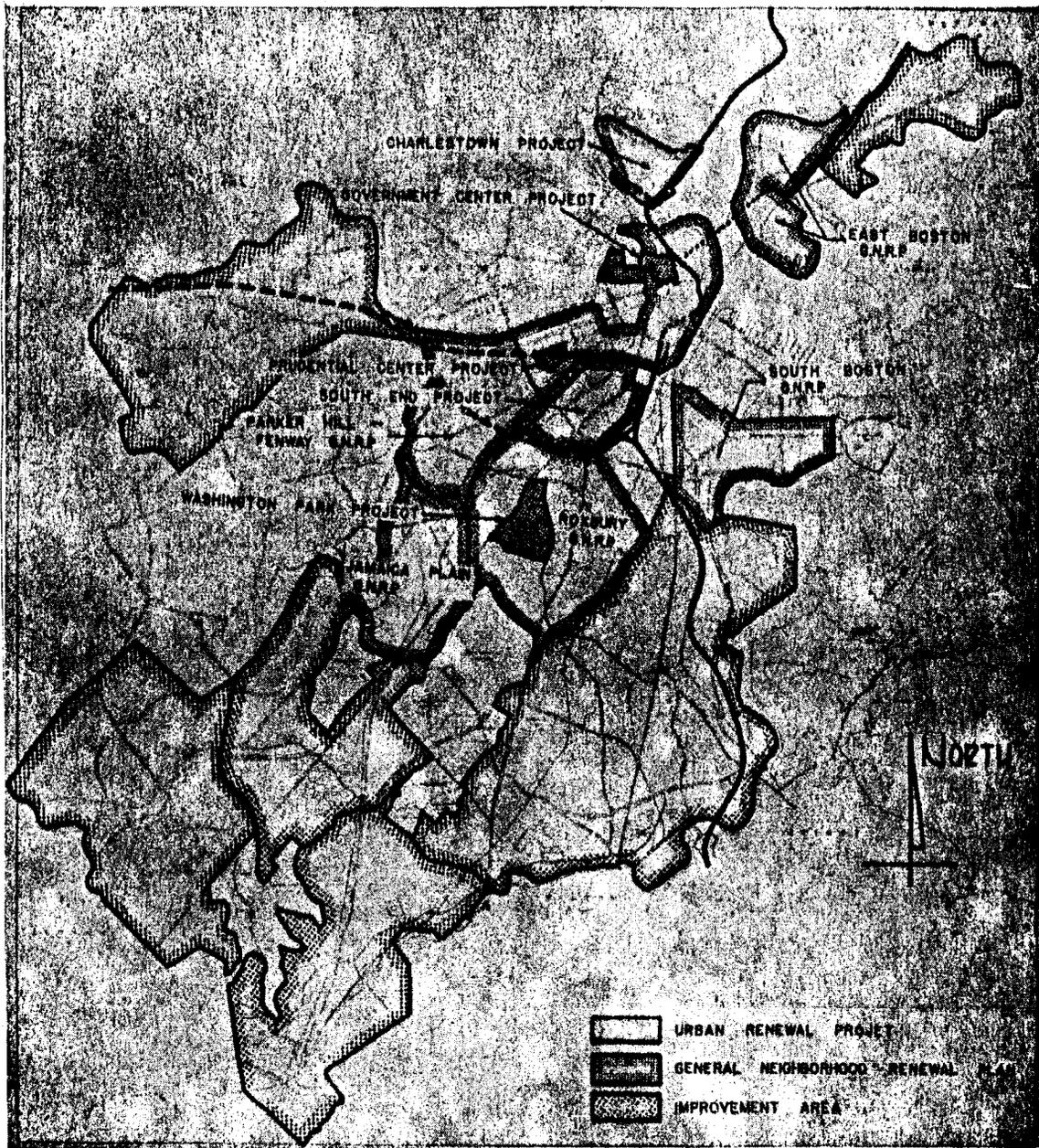
Boston's new growth is not limited solely to city and federal projects. Private development is playing a major role in reshaping the city. In the heart of Boston's financial district, in the Pearl and Franklin Streets area, The Boston British Properties, Inc. is proceeding with a \$20,000,000 office building. Around the corner on High Street, The Travelers Insurance Company has just announced plans to double the size of its recently completed office building.

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<sup>3</sup>The 90 Million Dollar Redevelopment Program For Boston, A Report by the Boston Redevelopment Authority (Boston: September 24, 1960), p. 2.

ILLUSTRATION I

# THE 90 MILLION DOLLAR DEVELOPMENT PROGRAM FOR BOSTON



One of the most extensive of all building development programs, representing more than \$300,000,000, is being sponsored by the Greater Boston educational institutions. Every college and university has under way or plans some kind of major expansion program.

It is this atmosphere of a renewed Boston that is perhaps the stimulus to the wave of apartment house construction now taking place in the city. But whatever the reason or reasons, these new apartment houses are going up one after the other; and it will be the purpose of the following chapters to analyze and to discuss the financial and managerial aspects of these new buildings as well as existing apartment houses.

## CHAPTER II

### FORMS OF OWNERSHIP

Ownership of property in Boston differs little from other parts of the country. Whether the property be an office building, a store, or an apartment house, its owner or owners may hold title in one of several different ways. It will be the purpose of this chapter to discuss the several methods of property ownership, some very old and others relatively new. I will also attempt to show the advantages and disadvantages of each method relative to the type of property under ownership. The discussion will begin with what is probably one of the oldest and least complicated forms of ownership--the Proprietorship.

#### THE PROPRIETORSHIP

The individual proprietorship is owned, managed and controlled by a single person. It is the simplest and most commonly used of all types of organizations. The proprietor possesses the entire responsibility for the operation and conduct of the business; he alone is liable for all the debts of

the business, and likewise, is entitled to all the profits.<sup>1</sup> There are several factors which have made the Proprietorship the most widely used form of ownership:

1. Ease of Formation. The proprietorship is the most easily formed of all the various forms of organizations. Any person capable of contracting can start in business with this type of organization, and it is not necessary to draw up a charter or secure permission from the state.

2. Cost of Formation. The proprietor pays no organization tax or annual fees, but only the property and income taxes paid by individuals (except in certain kinds of businesses where special licenses may be required).

3. Liability. The proprietor possesses unlimited liability. In the event of insolvency of the business, the creditors may attach his personal property for the satisfaction of their claims; this is only after the business assets have been exhausted by the creditors. If he is engaged in several businesses or owns several properties, he may lose them all through the failure of one.

4. Amount of Capital. The amount of capital which the individual proprietor may obtain is usually limited to his own

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<sup>1</sup>Elvin F. Donaldson, Business Organization and Procedure (New York: McGraw-Hill Book Company, 1938), pp. 18 ff.

assets; funds for expansion must usually come from the same internal source. Sometimes funds can be borrowed from relatives, friends or a bank, but the amount is usually small. If the profits from operations are not sufficient for expansion, money may be obtained by taking in partners, or from incorporating and selling securities; both Partnerships and Corporations are the subjects of other sections of this chapter.

5. Durability and Stability. The individual proprietorship is not the most durable form of organization. In addition to financial insolvency which terminates any type of organization, the proprietorship ceases to exist upon the death, insanity or personal bankruptcy of the proprietor. The uncertainty of duration of the proprietorship prevents it from being used in those businesses where long-time responsibility and commitments exist.

6. Directness of Control. The proprietor possesses directness of control; he is the sole person concerned with the operation of the business, and he can adopt whatever policies he chooses at any time. Along with this singleness and directness of control is the proven high rate of business failures in proprietorships due primarily to inexperienced management.

7. Legal Status. The sole proprietorship has no legal existence separate from that of the proprietor. Although we tend to look upon it as a type of organization, the law takes the

attitude that the proprietor is the proprietorship. Suits are brought by and against the proprietor, contracts made in his name, and all the assets of the business are held in his name.

In the proprietorship, all the profits are taxed directly to the proprietor. That is, he claims the profits on his personal income tax statements, and likewise makes deductions for losses on this same statement.

#### THE PARTNERSHIP

The next area of discussion will be the Partnership. A partnership is a relationship existing between two or more persons, which relationship is embodied in a contract, expressed or implied, existing between such persons as are carrying on a business enterprise which is owned by them in common.<sup>2</sup> A partnership is an unincorporated form of organization, the parties forming the partnership contributing as the capital stock of the business, cash or property or services. As in the proprietorship, the parties need only to be capable of contracting, and their business need only be lawful.

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<sup>2</sup> Avard Longley Bishop, The Financing of Business Enterprises (New York: Harper and Brothers, Publishers, 1929), pp. 25-26.

Usually the members of the partnership enter into a written partnership agreement when they decided to engage in business as partners. Among the more important points covered in the partnership agreement are: (1) The names of the partners and of the partnership; (2) the date when the contract shall become effective; (3) the nature and the place of the business; (4) the capital to be contributed by each partner; (5) the duties of the partners and the acts which one partner will not undertake on behalf of the partnership without the written consent of the other; (6) the date when the books are to be closed and the profits divided; (7) the portion of profits to be allocated to each partner; (8) drawings to be allowed each partner; (9) the length of time the partnership is to continue and the rights of the partners in the event of dissolution; (10) a provision for arbitration of disputes.<sup>3</sup>

The individual partners claim their share of the profits or losses on their respective personal income tax statements. Under normal circumstances, the partners share the profits and divide the losses equally. This may be

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<sup>3</sup>Charles W. Gerstenberg, Financial Organization and Management of Business (Englewood Cliffs: Prentice-Hall Inc., 1951), pp. 20-21.

altered by agreement among the partners. It may be agreed that one partner should get more (or less) than the others because he may have contributed more time or capital to the venture.

The partnership has some of the advantages of the proprietorship: The partnership is easy to form; relatively prompt action can be secured, especially if the partners get along well together; more capital can be secured than in the proprietorship; there is considerable flexibility in the organization in that an adjustment may be readily made when changing business conditions make it desirable. The partnership also shares some of the disadvantages: There is unlimited liability attendant upon each partner; there is the danger of an inexperienced partner committing the firm to contracts which are undesirable; decisions that should be made promptly may be delayed if the partners can not agree; the partnership is always in danger of being disrupted through death or insolvency.<sup>4</sup> The next area to be discussed is the corporation.

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<sup>4</sup>Bishop, op. cit., p. 33.

## THE CORPORATION

The corporation is hardly a new form of business organization. Blackstone in his "Commentaries on English Law"<sup>5</sup> published in 1765, defines the Corporation as "an artificial person created for preserving in perpetual succession certain rights, which being conferred on natural persons only, would fail in the process of time."<sup>6</sup>

Some years later in 1819,<sup>7</sup> Chief Justice Marshall, in the famous Dartmouth College case, defined the Corporation as "an artificial being, invisible, intangible, and existing only in contemplation of law. Being a creature of law, it possesses only these properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence."<sup>8</sup>

Legal studies have for many years been arguing with these definitions, but the definitions do point up some of

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<sup>5</sup>Archibald H. Stockder, Business Ownership Organization (New York: Henry Holt and Company, 1922), p. 110, citing Commentaries on English Law.

<sup>6</sup>Ibid.

<sup>7</sup>Chelcie C. Bosland, Corporate Finance and Regulation (New York: The Roland Press Company), pp. 10-11.

<sup>8</sup>Ibid.

the main characteristics of the corporation. First, it is a legal entity separate and distinct from the persons who at any particular moment compose it; Second, it is created by the act of a sovereign state; and Third, its powers are determined by the state and are specifically designated or implied in the corporate charter.

The fact that a corporation is an artificial person fixes its status as a legal entity, a being with all the rights, privileges and obligations of a person before the law. Herein, it differs from the partnership. The latter can sue and be sued only in the names of their several members, but the corporation may sue and be sued through its officers or agents, in the same way as any natural person. It may own real estate and any other property in its own name; note the change from the earlier laws prohibiting corporation ownership of real estate, which gave rise to the Massachusetts Trust. In fact, it may be granted the right to enjoy and to exercise, within reasonable limits, all rights and powers and privileges that a natural person might avail himself of when engaged in a similar business.<sup>9</sup>

Those persons whose names appear on the books of the corporation as owners of shares of its stock are the

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<sup>9</sup>Archibald H. Stockder, Business Ownership Organization (New York: Henry Holt and Company, 1922), pp. 111-12.

entrepreneurs of the business. As owners they have a claim on the unencumbered assets of the corporation, but no title to its property; this is held by the artificial person of the corporation itself.

The corporation itself assumes unlimited liability as all of its property may be taken to satisfy the claims of its creditors. Among these creditors are the corporation's stockholders, who on dissolution, are entitled to that balance of the assets remaining after all debts have been paid, each stockholder sharing according to the extent of his holdings.

One of the most characteristic features of the corporation is its stability, the result of its continuity of existence. The term of life of the corporation is determined by the charter granting powers, and is in no way dependent upon the life of its stockholders. Exclusive of expiration of the charter, the corporation may be dissolved and terminated through (1) voluntary action of the stockholders; (2) bankruptcy or insolvency; (3) by court decree in cases of violation of the law; and (4) by the state for default in complying with provisions of the charter.

The corporation possesses many advantages not found in either the proprietorship and partnership, as well as disadvantages not found in the other two.

1. The corporation has great flexibility in that it lends itself as readily to small as to large undertakings because the number of owners that may participate can be large or small. Unlike the proprietorship or the partnership, its being is not dependent upon the lives of the owners, but enjoys a definite term of life which, at its expiration, it easily extended.

2. The transferability of ownership of the corporation through its shares of stock makes it easy to withdraw from the business without in the least disturbing the organization.

Of course, large and sudden changes of ownership may result in changes of policies detrimental to other stockholders.

The owner or rather the stockholder can determine in advance and limit the risk of loss that he assumes; this he cannot do in either the proprietorship or partnership.

3. The corporation is a creation of the state and is subject therefore to constant regulation. The corporation must pay to the states in which it operates and to the Federal government many kinds of taxes and fees from which the proprietorship and partnership are exempt. Not least among these is the initial expense of the organization tax and the annual franchise tax which it must pay to continue its existence.

4. The corporation may do only those things that it is specifically authorized to do, while the owners in the personal

ownership organization may do anything that is not specifically prohibited. Of course, corporate charters can be amended to include different types of businesses by the same corporation.<sup>10</sup>

In the corporate form of ownership, the profits and losses are taxed quite differently from the proprietorship and partnership. Salaries paid to employees and executives of the corporation are taxed on their respective personal income tax statements. Employees, executives, and stockholders must also declare any dividends the corporation pays to them. An individual taxpayer may claim a \$50 dividend exclusion (\$100 on a joint return) and in addition may take the 4 per cent dividend credit.

The corporation pays taxes on its profits. Basically, this tax is calculated at 30 per cent with a surtax of 22 per cent of all income over \$25,000. (maximum 52 per cent).

#### THE MASSACHUSETTS TRUST

In the discussion on corporations above, I made brief reference to the Massachusetts Trust. Now I will discuss it

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<sup>10</sup>  
Ibid., pp. 121-22.

in further detail. The Massachusetts Trust--named for the state of its origin--was created to overcome the corporate laws of Massachusetts which, up until 1912, made no provision for the corporate ownership of real estate. In order to get around the legal impossibility of operating as a corporation, a plan was devised of forming real estate companies without a charter from the state but under the trust arrangements whereby a trust estate was created. The parties who executed the trust agreement came to be called beneficiaries under the trust, and shares were issued to them representing their proportionate participations in the ownership of the business.<sup>11</sup> In real estate, title in fee to the land and improvements is taken by a trustee in accordance with the terms of a trust agreement. The trustee issues certificates of beneficial interest to the participants, each of which covers rights to the occupancy of a specified apartment. The certificate of interest and the trust agreement also contain certain provisions for payments by the holder to meet the operating costs, taxes and debt service and to cover other contingencies. Ordinarily, provision is made for a board of advisors,

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<sup>11</sup>Avard Longley Bishop, The Financing of Business Enterprises (New York: Harper and Brothers Publishers, 1929), pp. 41-42.

selected from the certificate holders, to advise the trustee, although final authority usually rests in him.<sup>12</sup>

The whole capital of the enterprise, whether in the form of cash or real estate, is placed in the hands of the trustees who hold the same in trust for the financial advantage of the beneficiaries and who have wide powers in the management of the business. The trust agreement prescribes that the beneficiaries and their successors are to be liable only for their original investment, whereas the trustees are to have no financial liability whatsoever, provided they are carrying out the trust with due diligence and energy.

Practically all the advantages of the corporate form of organization accrue to the trust.<sup>13</sup> These are:

1. It may engage in any kind of business. In this respect it has an advantage over the corporation, as the latter is in some states prohibited from engaging in certain kinds of business.
2. No elaborate organization procedure is necessary for its formation.

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<sup>12</sup>Ernest M. Fisher, Urban Real Estate Markets-- Characteristics and Financing (New York: McGraw-Hill Book Company, 1951), p. 15.

<sup>13</sup>Elvin F. Donaldson, Business Organization and Procedure (New York: McGraw-Hill Book Company, 1938), pp. 66-67.

3. The beneficiaries have limited liability if the organization is operated in the proper manner. The trustees may by contract limit their liability.
4. Capital is relatively easy to obtain owing to the limited liability feature of the stock and the ease with which ownership can be transferred.
5. Management is concentrated in a small board of trustees who can act promptly in all matters pertaining to the business.
6. It possesses stability during the period for which the deed of trust runs.
7. It is free from regulation and interference in most states. Although it is taxed in some states, the taxes are usually smaller than those paid by the corporation.

The most important disadvantages of the Massachusetts Trust are as follows:

1. Its legal status is not well understood or definite in some states. The law which governs it is the law which is expressed in court decisions.
2. If the beneficiaries exercise any control over the trustees, the courts will rule that they have unlimited liability.
3. In some states the Massachusetts Trust is held to be a partnership, and accordingly its members have unlimited liability.

4. Its life is limited to the period of the time stated in the declaration of Trust.

5. Some states are now taxing it as they would a corporation, and there is some probability that additional states may do likewise in the future.

Similar in many respects to the Massachusetts Trust is the Real Estate Investment Trust.

#### REAL ESTATE INVESTMENT TRUST

A real estate investment trust is an unincorporated trust or association managed by one or more trustees, the beneficial ownership of which is evidenced by transferrable shares or certificates of beneficial interest.

To qualify under the 1960 tax law, a real estate investment trust must meet several requirements. A trust which distributes 90 per cent or more of its income and elects to be exempt from federal corporate income taxes is exempt to the extent income is distributed. It must be a trust as described above; its beneficial ownership must include 100 or more persons, and it cannot be a personal holding company.

There are several income and asset tests the trust must pass to qualify. It must derive at least 90 per cent of its gross income from dividends, interest, rentals from real property, gains from the sale of stock and abatements and refunds of taxes on real property. At least 75 per cent of its

gross income must be derived from rents from real property, mortgage interest, gains from the sale of real property, dividends and gains from the sale of shares in other qualified real estate investment trusts.

At the close of each quarter of the taxable year, 75 per cent of the value of the trust's total assets must be represented by real estate assets, cash and cash items, and government securities, and no more than 25 per cent of its assets can be represented by other types of securities.

It is imperative that the depreciation regulations be closely followed. Any other depreciation would temporarily and artificially lower the net income, 90 per cent of which must be distributed in dividends. In the event the depreciation was subsequently disallowed by an Internal Revenue examination, it could result in disqualification of the trust, since 90 per cent of the new net income might not have been distributed.<sup>14</sup>

The real estate investment trust is becoming more popular with investors, although some investors are reluctant to invest funds because of the financial troubles of the real estate syndicates.

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<sup>14</sup>George M. Lovejoy, "Management's Challenge in Real Estate Investment Trusts." Journal of Property Management, Vol. 28, II (Winter, 1962), pp. 109-12.

It is obvious at this point that taxation plays a major role in determining the best form of ownership to fit a particular type of business--in this case, real estate. Therefore, it is worthwhile to consider a method of taxation that is of great importance.

One major problem of the corporate form of ownership is double taxation; the corporation is taxed on its profits and then the individual stockholder pays a tax on his dividend income which came from these very profits. To avoid this double taxation the corporation can elect to be treated as an individual, its profits taxed directly to its owners (as in the proprietorship and partnership). To be treated in this respect the corporation must meet several requirements:

1. The corporation may not have more than 10 stockholders.
2. The corporation may issue only one type of stock.
3. The corporation may not receive more than 20 per cent of its gross income from rent receipts.

This third stipulation makes it difficult for most real estate firms to qualify. An exception could be a real estate developer who might make 80 per cent of his gross income from developing and selling real estate.

## THE SYNDICATE

A syndicate is a combination or group of several real estate owners pooling their capital to purchase a piece of property whose value is too great for any one firm to buy. The syndicate may be composed of several corporations or partnerships or both. The syndicators avoid double taxation found in other investments since, as a rule, they are organized as partnerships rather than corporations. The government claims a share of up to 52 per cent of all corporate profits; hence, one-half of what a corporation earns may be taken away before the stockholder gets his share. When he finally gets his dividend, it is taxed again, just as any other income received.<sup>15</sup> The individual taxpayer may claim the \$50 dividend exclusion and the 4 per cent dividend credit to lower his taxes on the dividends.

Syndicators generally avoid this double taxation by organizing as partnerships with a number of advantages of the corporation. Partnerships not being taxable entities, do not pay on the same tax scale as do corporations; only the individual partners pay a tax as income is earned. The property income is therefore taxed only once.

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<sup>15</sup>Bertram Lewis, Profits in Real Estate Syndication  
(New York: Harper and Brothers, 1962), p. 12.

The syndicate form of ownership offers many advantages which accrue mainly because of its size. It offers great stability and the economies of large size. Because syndicates often invest in several properties, it offers diversification, and we have already discussed the tax advantage.

When apartments are renting fast and when income is coming in steadily the real estate syndicators prosper, but when a high vacancy rate prevails and income drops, the syndicators are the first to feel the squeeze. In the normal arrangement, the promoter-syndicator sets up a limited partnership to get maximum leverage out of the tax laws. He becomes the general partner while the limited partners provide the equity capital to get the project started, with hopes of a steady, tax-sheltered income. (The return on syndicate real estate investment is about 9 per cent, down from 14 per cent of only a few years ago.)

Basically, the tax advantage of the syndicate works as follows: since the depreciation charges normally exceed rental income in the first few years after a building is purchased, the limited partner gets a tax free return on capital, and often a surplus depreciation charge can be written off on his personal tax return.

As stated above, when rental incomes are high, the syndicates prosper, but here is what happens when rental

incomes drop. Most syndicates that have gone public have been forced to cut their dividend; this is a drastic step as it was the promise of high returns that attracted many small investors. What badly hurts the syndicates is the pressure to get into more risky ventures. Prices were pushed up so they could no longer buy income properties with sufficient returns to pay dividends. The syndicates were forced to buy more speculative properties or else start building.<sup>16</sup>

The bad publicity adhering to the big real estate syndicate in New York is not indicative of all real estate syndicates. Many syndicates have moved slowly and with caution, and, as a result, continue to yield a realistic dividend to their investors.

#### COOPERATIVES AND CONDOMINIUMS

To complete this chapter, I will now discuss two relatively new concepts of real estate ownership, Cooperatives and Condominiums. A Cooperative is described as "A multi-unit building that is owned by the people who live in it, offering full apartment services upon a net cost of operation basis." If that is a true definition, there are many forms of cooperative apartments in existence today. Probably 98 per cent

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<sup>16</sup>"Building Boom Feels the Brake of Caution," Business Week (March 23, 1963), pp. 113-115.

of them are what we call the stock-and-lease plan where the tenants join together, usually in a cooperative, to own the building, each one with a proprietary lease. This lease sets forth the rights and privileges, right of occupancy, the basis for eviction, the method of collection, and the like.<sup>17</sup>

One variation of the plan which has been used for many years is the trust vehicle. The differences in the use of the trust as against a cooperative are minor, and the structure, practices and approaches are generally the same.

The Condominium is a comparatively new concept of cooperative ownership. Section 234 of the Housing Act of 1961 permits F.H.A. to insure condominium mortgages. It does not refer to the word "condominium," but, in general, its definition is "a multi-unit building in which all apartments are owned in fee simple, and in addition, each owner owns an individual interest in the public portion of the building." This includes the floor, the walls, the elevator, etc.<sup>18</sup>

All types of vehicles of cooperative ownership have in their plans some means of regulation: in the stock-and-lease plan, it is set forth in the proprietary lease and the

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<sup>17</sup>William S. Everett, "What is a Cooperative?" Journal of Property Management, Vol. 28, I, (Fall 1962), pp. 15-16.

<sup>18</sup>Ibid.

cooperative by-laws; in the "Own Your Own" type, the details are set forth in the exclusive occupancy agreement; in the condominium plan, it is called the "Declaration of Restrictions" which is made part of the deed.

One of the distinctions between cooperatives and condominiums is that in the former, the individual has a stock ownership and the corporate form of organization; in the latter, the occupant obtains a real estate title to his unit.<sup>19</sup>

There are restrictions on the sale of units in a cooperative, but in the condominium there is no restriction on the individual units. The member is free to sell his unit or lease it as best he can in the market. It may be that the condominium association will want to have some form of screening owners, and the F.H.A. will give consideration to such proposals so long as the selection is not on the basis of race, creed, or color.<sup>20</sup>

The few years experience with cooperatives have shown several advantages as well as disadvantages. It should be noted that unlike the regular landlord-tenant relationship where advantage to the former often means a disadvantage to

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<sup>19</sup>Harry E. Johnson, "Cooperatives and Condominiums-- Their Increasing Significance," Journal of Property Management, Vol. 28, I, (Fall 1962), p. 21.

<sup>20</sup>Ibid.

the latter, in the cooperative the owner and tenant are one in the same.

Listed briefly below are some of the advantages of cooperatives.

1. The right of permanent tenure.
2. Control of the standards of operation (the tenants are not at the mercy of outside owners, and they decide how well the building should be maintained).
3. Right of selection of neighbors.
4. Lowered maintenance costs (tenants operate the building and pay no profits to a landlord, getting their dividends in the form of lower rent, being assessed only enough to operate the property).
5. Certain tax deductible features (for the stock-and-lease plan, these features have been passed on to tenants even though ownership is in the form of a corporation, through the benefit of a special tax law that states if you pay taxes and interest into a qualified corporation, these expenses can be taken as individual deductions).
6. There is better upkeep in most cooperatives.
7. There is an increase in the value through amortization that is paid, as distinct from paying rental year after year.<sup>21</sup>

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<sup>21</sup>Everett, op. cit., p. 17.

Here are some of the disadvantages.

1. The standards in the cooperative are set by a majority vote and a tenant cannot always exercise an individual opinion.

2. Alterations to apartments must fit into the pattern of the entire building.

3. Under the stock-and-lease plan, and in most of the various cooperative plans, except the condominium, it is very difficult to re-finance. The mortgage is customarily placed on the entire building. It is paid off over a 20-year period and the tenant who wishes to sell at the end of five or ten years cannot re-finance his portion of it, except by a second mortgage. This is a difficulty that the seller finds has not been worked out well in the stock-and-lease plans.

4. In all types of cooperative buildings, including condominiums to some extent, the ownership is endangered by default of a single neighbor; if one apartment out of a dozen becomes delinquent, and there is a janitor wage or fuel bill to pay, the other eleven tenants must pay the bill.<sup>22</sup>

These are new concepts as compared to some of the other forms of ownership already discussed, and it is likely that as time passes, many of these disadvantages will be

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<sup>22</sup>Ibid.

removed perhaps even newer ownership concepts. Having discussed in this chapter the several forms of ownership available to the realtor, the next chapter will devote itself to the various methods of financing real estate undertakings.

## CHAPTER III

### METHODS OF FINANCING

There are two basic ways of financing the ownership of real estate: One, with your own capital or equity; two, with someone else's money. If the prospective real estate owner has sufficient capital of his own, he will be able to save the cost of interest payments he would have incurred had he borrowed the money to finance the project. This at first would appear to be the most expedient and most profitable method of financing. Yet for several reasons this method is not the most popular.

First, few persons have the available capital to buy real estate property. This, however, is not the major reason, for if it were, then a partnership could easily be formed to raise the funds. Second, few individuals or groups are willing to tie up their own money for very extended lengths of time. Assuming that most of us have a limited supply of capital, then such a large investment would leave us unable to take advantage of any profitable opportunity that might come along in future years. Third, few persons are willing

to take the risk, however slight, of a large financial loss, should the project fail. Should a bank financed project fail, the individual's loss is only a portion of the total loss. Fourth, many persons like real estate ownership as a means of long-term financial yields, but also want to be able to invest in present situations with a better and faster rate of return. In later chapters we will discuss how the rate of return on real estate is computed, and compare it to the rates of return of other investments.

This leads now to the second major method of financing--the use of someone else's money, or properly termed, mortgage financing. Perhaps the easiest way to explain the mortgage is to use an analogy. A mortgage is to a piece of real estate what a personal loan is to an automobile. Basically, it is a loan of money, the repayment of which is secured by the collateral of a piece of real estate. While, for the most part, a mortgage is taken to buy real estate property it also may be taken for numerous other reasons using unencumbered property as collateral.

I believe that as the various types of mortgages are discussed, their conditions, their advantages and disadvantages, a clearer picture will take shape. We can first start this discussion by dividing mortgages into two categories; senior mortgages and junior mortgages.

## SENIOR MORTGAGES

Senior mortgages are those whose owners have claims against the property superior to other mortgages and some other liens. A senior mortgage does not necessarily constitute a first claim against the property since there may be both legal and contractual claims ahead of it. Taxes and other government claims usually take precedence over senior mortgages.

A senior mortgage may contain a subordination clause permitting the mortgagor, under stipulated conditions, to place a lien on the property superior to the claims of the present mortgagee. For example, purchase-money mortgages are sometimes taken as part consideration for the price of vacant lots with the stipulation that their priority will be waived in favor of a construction loan, the proceeds of which will be used to construct a building on the premises. Construction mortgage loans are the subject of another part of this chapter.<sup>1</sup>

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<sup>1</sup>Henry E. Hoagland, Real Estate Principles (New York: McGraw-Hill Book Company, 1949), pp. 125-26.

## JUNIOR MORTGAGES

Junior mortgages are those whose claims are subject to prior mortgage claims. This type of mortgage usually contains two clauses not found in senior mortgages. The first, for the protection of the junior mortgagee, gives him the right to prevent defaults in prior liens by making the payments himself and adding them to his own claim against the property. The second, for the protection of the mortgagor, is known as the "subordination clause." This clause permits the mortgagor--so far as the junior mortgage is concerned--to renew the first mortgage at its expiration or to substitute a similar mortgage for it, leaving the junior mortgage in its existing relative position. Unless the clause is included in the junior mortgage, it may become a senior mortgage automatically if the present senior lien is paid off.

Junior mortgages sometimes are written for short periods of time--one, two, or three years--resulting in a situation which requires their renewal rather than their payment at maturity. It would appear that the owner of real estate who must resort to a second mortgage as a means of financing his property usually lacks the means of paying off such a claim at maturity. This is not necessarily true because if the mortgagor makes his payments on time and

occasionally refinances the mortgage, he is creating a strong credit reference with the banks which may be of importance in future transactions. Partly because of the risk involved, second mortgages frequently are made only with large discounts as well as high interest charges. For example, if the mortgage runs for one year the discount may be 10 per cent; two years, 15 per cent; and three years, 20 per cent. I can explain the term "discount" by a simple illustration. Assume a second mortgage is being taken for \$1000. for a two year period. The bank or mortgage lending institute deducts of discounts \$150. (15 per cent of \$1000.) giving the borrower a net loan of \$850.; the borrower pays interest charges on the full amount.

I will now discuss a major type of senior mortgage, the TERM mortgage. Whenever a mortgage debt agreements calls for the repayment of the principal sum, in full, at the end of a designated period of time, the unamortized debt remains outstanding, or unpaid, for a TERM of months or years. To differentiate the debt status of term mortgages, we can divide them into three groups: 1, straight; 2, closed; and 3, open-term mortgages.

Most mortgages prior to 1933 were non-amortized or STRAIGHT; such mortgages were generally placed for a term of three to five years with interest payable quarterly or

semiannually. These straight term mortgages were generally renewed for subsequent three to five year terms or refinanced if payment was demanded. Inability to budget the repayment of the total mortgage debt during the comparative short term caused financial grief to many home owners when mortgage re-financing was sought in a period of depression or during times when mortgage funds were difficult to obtain. During the financial crisis from 1933 to 1935, the government, through Homes Owners Loan Corporation, refinanced over a million term mortgages on an amortized basis under which principal and interest payments were due monthly over periods up to fifteen years. Since that time, the success and general acceptance of the amortizing payment practice has caused the issuance of term mortgages to be the exception rather than the rule in mortgage lending.<sup>2</sup>

Term mortgages which upon maturity, or due date, were not extended were said to be past due or OPEN mortgages. Such open mortgages were payable on demand at the request of the mortgagee and conversely the mortgagor could pay off an open mortgage any time such payments met his convenience. In practice, open mortgages proved financially hazardous because the mortgagee could and generally did call for payments--under threat of foreclosure--when mortgage funds were

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<sup>2</sup> Nelson L. North and Alfred A. Ring, Real Estate Principles (Englewood Cliffs: Prentice-Hall Company, 1960), pp. 147 ff.

scarce and mortgage interest high. The mortgagor, on the other hand, had the opportunity to refinance the debt when mortgage funds were plentiful and interest rates low. Under such circumstances the lender, of course, was at a disadvantage. Because of such risks, it is doubtful today that an astute borrower would take the chance to allow a term mortgage to remain open.<sup>3</sup>

Nearly all mortgage loans currently made include some provisions for periodic amortizing of the mortgage principal. This kind of mortgage and method of mortgage debt reduction, although introduced during the early history of Savings and Loan Institutions as a service to its members, was not popularized until the depression of 1929, when government participation in the mortgage lending field developed a trend towards this kind of mortgage. The amortizing mortgage offers advantages to both lender and borrower. The desirable features of this type of debt financing include:

1. Periodic reduction of the mortgage debt over long periods of time ranging from ten to thirty years depending on loan company, policy and government insured or loan guarantee provisions.

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<sup>3</sup>Ibid.

2. Low interest rates average five to six per cent, which are applicable only to remaining balances of mortgage debt.

3. Monthly payments of interest and principal which under the budget plan may include escrow amounts covering taxes, hazard insurance, water charges, and assessments, if any.<sup>4</sup>

Technically, the classification CLOSED mortgage applies to any unexpired mortgage which is not in default. In the mortgage market, the designation CLOSED mortgage is applied to term mortgages under which the mortgagee has advanced the maximum loan agreed upon. Thus where a \$10,000. mortgage loan is to be paid in fixed installments of \$2,000. each during various states of house construction, the mortgage is said to be closed when the last payment is made and the mortgage has reached the \$10,000. debt limit agreed upon.

Closely aligned to the closed mortgage is the construction loan mortgage. Since mortgage loans, as a rule, are made only on improved properties, builders and potential home owners in need of interim construction funds, arrange with lenders for "stop-gap" financing for a period of three

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<sup>4</sup>Ibid., pp. 148-49.

to six months or until the completion of the proposed structure in accordance with building plans and detailed specifications. The building or construction loan mortgage is distinct in that the amount of the loan is not fully paid to the borrower at the time of the mortgage closing. The purpose of this type of mortgage, as the name implies, is to aid an owner or his builder in financing the erection of a building. To provide for the distribution of mortgage funds at intervals of construction, an agreement known as a building loan contract is incorporated in the mortgage and recorded as a separate instrument in addition to the mortgage.<sup>5</sup> This agreement between the lender and the borrower provides that the borrower shall erect a certain building, as described by plans and specifications, on the land legally identified, and the lender shall loan, upon the security of such land and building, a specified amount to be repaid upon completion of the building. The agreement further provides that the amount of the loan shall be advanced to the borrower in installments as the building progresses, stating either that the amount and times of advances are to be at the lender's discretion, or in certain amounts at fixed periods in the course of construction.<sup>6</sup>

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<sup>5</sup>Ibid., pp. 150-51.

<sup>6</sup>Ibid.

The payment of interest specified in the building loan agreement, depending on custom and the amount of the loan, is payable either on the entire amount of the loan from the date of agreement or only on the amount of the installments from the date of the advance. The former method of interest payment is supported by the theory that the lender is setting aside the amount agreed upon as of the time the mortgage is signed, even though the money is actually paid as the work progresses. Loan advances, as a rule are made at predetermined building stages, after inspection by the lender and certification of satisfactory progress of construction. It is often provided that the loan shall continue until a definite period of completion. This enables the builder to sell his property more readily and provides needed time for the buyer to convert the construction loan into a permanent loan or refinance the mortgage when necessary.

In addition to these mortgages there is in use in many states a device called a TRUST DEED mortgage. It consists of an instrument which conveys to a third person--a trustee--a trust to hold the property as security or collateral for the payment of a debt to the lender. The purpose of this transaction is the same as a mortgage. The principal difference lies in the method of enforcement in case of default. The trustee, under law, is merely carrying out the

expressed will of the parties according to the terms of the trust deed mortgage. In practice, the creditor, by this means is freed from the requirement of ordinary foreclosure, frequently obtaining a speedier and more efficient method to bring about a sale. The borrower, too, in many states in which this type of mortgage is used, is not entitled to the usual right of redemption from foreclosure sales. There is a tendency for the courts to abolish the differences between the two mortgage forms where the trust deed method of financing is customary. Often where the amount of the loan is so large that no single person is willing to advance it, a trust mortgage is used. In a loan of millions of dollars upon a group of buildings, for example, the mortgage is made to a trustee. Instead of a single note, or bond, many are issued, depending upon the denomination of the bonds. The trustee acts on behalf of the bondholders. The mortgage contains, in addition to the usual clauses, various provisions concerning the rights and duties of the trustee and of the bondholders.<sup>7</sup>

In all these different types of mortgages there are certain numerous requirements set forth in the mortgage contract which the mortgagor is expected to meet. The most

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<sup>7</sup>Ibid., pp. 155-56.

important are: 1. To pay the indebtedness according to the terms of the mortgage. This clause merely repeats the personal obligation contained in the note which accompanies the mortgage; 2. To keep the property insured to an amount sufficient to protect the interest of the mortgagee. The latter should make sure that the insurance money paid as the result of damage to the property is payable to both mortgagor and mortgagee; 3. To alter, remove or demolish no buildings without the consent of the mortgagee. Whether this is stipulated in the mortgage or not, it is a legal protection commonly applied. Repairs and minor alterations are usually exempted from such a clause; 4. To pay all taxes, assessments, and water bills. In case of failure on the part of the mortgagor to meet such charges, the mortgagee is permitted, both by contract and by law, to pay them and add them to the debt. Failure of the mortgagor to pay these charges when due may be used by the mortgagee as valid grounds for foreclosure.<sup>8</sup>

Again, common to most types of mortgages is the refinancing agreement. A borrower's right to pay the principal amount of a mortgage before the due date must be negotiated with the lender. Institutional lenders generally have their

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<sup>8</sup> Henry E. Hoaglund, Real Estate Principles (New York: McGraw-Hill Book Company, 1949), pp. 128-29.

own policies on this matter, but a borrower should always try to include a prepayment option in the mortgage. There might be a change in the mortgage-money market at some time before maturity, and it might make refinancing profitable. (This prepayment privilege will, as a rule, be more limited in times of high interest rates, since the lender naturally wants to keep a high-yield investment as long as he can.)

Syndicators often use a mortgage refinancing to improve the net return from a property as well as to release amortization. For example, a syndicate might purchase a building with a mortgage calling for interest payments of  $4\frac{1}{2}$  per cent--amortization of  $2\frac{1}{2}$  per cent--a total of seven points (per cent). The mortgage lender might be eager to improve his income on this loan, particularly in times of high interest rate; and it might be possible to negotiate a change in terms of the mortgage to show five per cent interest and one per cent amortization--a total of six points--or savings of one point a year. The advantages and disadvantages to the borrower are: 1. His interest expense is higher, but his total cash payment is lower; 2. This increases the current return at the expense of a future possible recapture of amortization.<sup>9</sup>

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<sup>9</sup>Bertram Lewis, Profits In Real Estate Syndication (New York: Harper and Brothers, 1962), pp. 79-80.

Banks and the conventional lending institutes are not the only sources of mortgage funds. Two other important sources of mortgage lending are insurance companies and labor unions.

Life insurance companies constitute one of the largest sources of funds for real estate mortgages. The total available resources of these institutes have been growing at a very rapid rate. Total assets of life insurance companies have increased from less than \$8 billion in 1920 to \$50 billion in 1957. Meantime, in no single year of the intervening period did these companies fail to show a substantial gain.<sup>10</sup> The problem of finding investment outlets for these huge sums and of keeping them invested is not easily solved. In addition to the need for investing additions to resources each year, those already invested must be reinvested as bonds mature and as other refinancing becomes necessary. The investment policies of these companies have exhibited from time to time the perplexities which those responsible for them have felt.

Labor unions have in these past years invested heavily in relatively secure and medium yield investments. These funds come from the union dues and pension funds which, like

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<sup>10</sup>Hoaglund, op. cit., p. 425.

life insurance premiums, will eventually be paid out to union members. The Teamsters Union has invested large sums into new apartment buildings in the mid-West although we should realize that some of these apartments are solely for retired Teamsters Union members which provides a ready made rental market. Due to the recent investigation about misuse of the pension fund by Teamster officials, the union's participation in this area is likely to be curtailed.

## CHAPTER IV

### VALUATION OF REAL ESTATE

It would take but a brief ride through Boston to see the vast amount of new apartment construction taking place. Mayor Collins has recently stated that Boston in 1963 will enjoy almost \$1 billion of new construction and we can be sure that a sizable portion of it will be in new apartments. Every city has its stimulus to new construction; in Boston this impetus was the announcement of the \$60,000,000. Prudential Center and the proposed government center in Scollay Square. To skeptical real estate men these new developments were all the convincing they needed; as fast as old buildings could be torn down, or vacant lots cleared, new buildings began to rise.

The single most important reason for the wave of new construction was, of course, the immutable law of supply and demand. No other factor could realistically spur this growth. As stated in earlier chapters, many young couples who moved to the suburbs were later to return to the city. Some may have missed the convenience of downtown shopping or lack of

accessibility to the city; but many who did return did so for financial reasons. The prospective home owner is easily attracted by the low down payment, easy mortgage terms and low taxes. While mortgage payments have remained fairly constant over the years, taxes in many suburbs have risen considerably to finance new schools or sewerage systems. The following chart illustrates comparative home ownership costs per month with apartment living costs per month.<sup>1</sup>

THE HOUSE BUDGET		THE APARTMENT BUDGET	
Ownership Expense:		Rent	\$250.
Financing (principal and interest)	\$107.	Telephone	7.
Real estate taxes	25.	Total	<u>\$257.</u>
Insurance (hazard, personal property, liability)	8.		
Operating Expense:			
Maintenance and Repairs	75.		
Heating	20.		
Electricity	10.		
Water	8.		
Garbage, trash collection	3.		
Telephone	7.		
Total	<u>\$263.</u>		

The house budget figures are based on a single family home in the suburbs costing \$25,000. and carrying a \$15,000. mortgage. The apartment budget figures are based

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<sup>1</sup>"Apartments Make Sense, Too," Changing Times:  
The Kiplinger Magazine, May, 1962, 16-17.

on a 5½ room, three bedroom apartment, in a new elevator building with a swimming pool similar in size and price to apartments now being built in Boston and Brookline.

For many older persons the suburbs have lost their charm. The husband no longer has the desire (nor the energy) to mow the lawn or put out the trash barrels. Older couples with grown and married children no longer need the spaciousness of a home, and find themselves as comfortable in an apartment.

The Town of Brookline, adjacent to Boston, is an excellent example of resurgence of new apartment construction. Brookline is primarily a residential town and, except for the Brookline Village area now under redevelopment, it has always enjoyed a high valuation on its property and equally high rents. Some years ago, Brookline began its luxury apartment house construction with the Sovereign apartments on Beacon Street followed by the Park Street apartments and the Sewell Avenue apartments. A few years ago, these were considered the ultimate in luxury, convenience and rents. Now these are overshadowed by such buildings as Hammond House near South Brookline and the luxury apartments on Longwood Avenue, Monmouth Street, and Beacon Street. Among their attractions are swimming pools, closed-circuit television between the apartment and the lobby, and monthly rents well in the \$200. to \$400. range.

One trend can be seen from these past few years of apartment house construction. Construction of dwellings for rent increases rapidly as the evidence that rents will continue to rise becomes more convincing. The increase seems likely to appear first in the smaller types of structures--two, three-, and four-family buildings--the major portion of which are constructed by operators or speculative builders and sold to owner occupants. Sales appeal usually emphasizes the economy of ownership by showing that a large portion of the carrying charges can be met by rental income.<sup>2</sup>

The most common issue confronting the investor in real estate is one involving the soundness of the proposed price--will an investment at this figure pay? The answer may be a difficult one or a very obvious one, if the investor foresees impending price-level changes, population movements, style changes or other factors which will affect the property. However, the more usual situation calls for a review of the probable average incomes and expenses of the property and a comparison of its earning power with the proposed price. It is not unreasonable to assume that a property which can earn a fair rate of return on its cost, under assumed normal rental conditions, after providing for all reasonable expenses,

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<sup>2</sup>Ernest M. Fisher, Urban Real Estate--Characteristics And Financing (New York: McGraw-Hill Book Company, 1951), pp. 98-99.

taxes, and depreciation, is a sound investment. Estimates based on assumed normal conditions in the next five to ten years usually give an indication of these amounts.

In applying the above doctrine, it will first be necessary to estimate, by comparison or otherwise, what the normal annual rental value of the property for the next few years will be. Neither boom nor depression estimates should be used; a normal or average figure is needed. From this projected annual income must next be deducted: (1) expenses of operation, such as heat, water, and janitor service if furnished to tenants; (2) taxes; (3) depreciation; (4) maintenance; and (5) insurance. Each of these items should be a normal or average estimate based on experience with the given property or others like it. After these items are subtracted from the rental income, the remainder will represent the net earning power of the property. This net earning power expressed as a percentage of the price will provide a measure of the soundness of the investment. The average annual net earning power should be at least five per cent. The earnings of the property minus the interest payable on the mortgage debt will of course measure the owner's profit on his invested equity.<sup>3</sup>

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<sup>3</sup>John Clendenin, Introduction to Investments (New York: McGraw-Hill Book Company, 1960), pp. 600-01.

To continue the discussion on the advisability of real estate investment, it would be safe to state that a well-chosen real estate investment has many similarities to reasonably well-chosen stock commitments. Individual commitments intelligently chosen may make great gains, and others unwisely chosen may deteriorate rapidly in earning power and value. The great majority of properties fluctuate in value and in earning power as business conditions fluctuate and, perhaps, not much out of proportion to the changing values of good industrial stocks. Improved real estate property seems to be a fair price-level hedge, just as stocks are; no single property may be expected to epitomize the average, but the general tendency is for real estate prices to reflect the buying power of the dollar.

In a growing and inflationary economy, as we have experienced in post war years, real estate investments have two profit making advantages of great importance. First, both a growing population and increasing buying power impose demands on the supply of land and buildings. Increasing demand for land tends inevitably to increase its earning power, and increasing demand for the use of buildings assures profitable use of the existing supply. Second, price-level inflation tends to increase the amounts which people can afford to pay for either land or buildings and to increase the cost of completing new buildings: it therefore

tends to increase the earning power of both land and building, at least in terms of dollars. Investors in real estate thus may profit in both real buying power and in dollar terms in a period of growth and inflation.<sup>4</sup>

One important element which tends to add security to an investment in improved property must be recalled at this point. It should be noted that most real estate improvements are of the "wasting asset" type, which means that the investor-owner progressively recovers his capital through the property's gross earnings, in addition to obtaining whatever net income is earned. Since the operating expense on the average property is relatively low, the owner is certain to recover some of his capital (as a depreciation allowance) and perhaps some net gain out of the annual rents, even if the property is poorly designed or located. The value of the property should reflect the present value of all probable future cash recoveries and earnings, plus any speculative potential which exists. In contrast to this situation, an investment in the stock of a poorly managed industrial corporation would probably pay the investor nothing, for depreciation allowances and occasional small earnings would be needed to modernize the business, in order to prevent poor results from becoming total failure.

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<sup>4</sup>Ibid.

## APPRAISAL

The potential buyer of a piece of real estate needs a method to determine the value of the property; there are many methods of appraising real estate. Some are applicable to one type of property, some to another. Often different methods are used on the same appraisal, for the sake of verification.

### APPRAISAL METHODS

The appraisal methods most commonly used may be grouped into four general types: (1) those based on comparison of the given property with other properties on which values have recently been established by sale; (2) those based on capitalization of near-term gross or net income; (3) those based on the discounted present value of a series of estimated earnings and capital recoveries over a long term of years; and (4) those based on cost of replacement less depreciation. The first two approaches are used chiefly by individuals and dealers who do not wish to undertake elaborate calculations; they are easy ways to approximate results. The third approach is commonly used in appraising existing office buildings, apartment houses, and similar properties, when the appraiser has access to experience data and engineering estimates which will enable him to forecast probable income and expenses over a

long period of years. The fourth approach is one very widely employed by lenders on all kinds of improved property but notably, for present purposes, on dwellings.<sup>5</sup>

Appraisals based on cost replacement usually follow a process which is well worth a review by the investor. The appraiser usually begins by assigning a per-square-foot or per-cubic-foot basic value to the building, based upon the type and size of the structure. These basic values are very carefully estimated on the basis of building costs in the locality. The basic per unit valuation is then multiplied by the number of square feet or cubic feet, to arrive at a basic cost appraisal. Next, the basic cost appraisal is increased or decreased by specific sums, as the appraiser identifies good or deficient fireplaces, bathrooms, kitchen installations, hardwood floors, garage facilities, and the like. When the building replacement cost estimate is complete, it is then reduced by a percentage representing estimated depreciation; this is based on the age of the building, plus observed deterioration and maintenance factors. To this appraisal of the building is next added the estimated current value of the lot, to obtain a total value applicable to a normal dwelling in a normal neighborhood.<sup>6</sup>

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<sup>5</sup> John C. Clendenin, Introduction to Investments (New York: McGraw-Hill Book Company, 1960), pp. 605-06.

<sup>6</sup> Ibid.

However, there are several other factors which might justify arbitrary increases or decreases in the appraisal. Among them are (1) the suitability of the floor plan of the dwelling; (2) the suitability of the external appearance of the building; (3) the appropriateness of the building to the neighborhood, as respects size, quality, and style; (4) the apparent prosperity and durability of the immediate neighborhood; (5) the deed restrictions and zoning ordinances which affect the neighborhood; (6) the convenience of shopping district, employment opportunities, traffic arteries, and public transportation; and (7) the trends of community growth. The entire appraisal process is based on the cost of construction and is, therefore, most accurate on relatively new properties, in new areas, and in situations in which the building is clearly suited to its location and function.<sup>7</sup>

#### ZONING

Zoning means designating areas of the city which are to be used solely for certain designated purposes such as business, residence, schools industrial plants for light and heavy manufacturing. Zoning also affects the style of architecture in terms of height and design. Two examples will explain this. The City of Newton is one of the communities

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<sup>7</sup>Ibid., p. 607.

on the outskirts of Boston. For several decades, Norumbega Park has operated as an amusement center in Newton and the several acres which it occupies is zoned for recreation. A prospective buyer would like to remove most of the buildings and amusement stand and, in their place, erect several high-rise apartment houses. To this date, the city fathers have refused to change the zoning plans to accommodate this investor.

The Metropolitan Transit Authority is presently negotiating to sell some of its facilities in Cambridge. Each of the prospective buyers is eager to find out if Cambridge will modify the zoning ordinances so that he may erect high-rise apartments.

Thus zoning becomes of primary concern to the real estate investor planning to construct a new apartment building.

In this chapter we have discussed some of the "whys" of new apartment construction in Boston, noting that not only demand and supply, income and expenses, determine profits, but also the keen use of appraisals of property may make the difference between profits and losses. The next chapter shall be concerned with the concepts of depreciation.

## CHAPTER V

### DEPRECIATION--THE KEY TO REAL ESTATE INVESTMENT

Of the various expenses associated with real estate ownership, depreciation is one of the most important as it can be the key to profit or losses. Depreciation plays a crucial role in the taxability of income. In appraising a property, depreciation may be the single factor upon which a decision will hinge.

Depreciation is an accounting device by which a portion of an asset's value is assigned to each year of its so-called useful or economic life. Thus, if a particular asset can be expected to have a useful life of ten years, a portion of its original cost would be charged against the income of each year of its productive life; it would be unrealistic to charge the entire cost against the first year's operation. This allocation of capital cost over a period of years is the basic concept of depreciation. But its application to real estate is usually far more complex and

can offer very profitable results.<sup>1</sup>

While depreciation of a building is a write-off or recapture of invested dollars over a given period of time, the real value of a real estate investment may be increasing; this is the heart of real estate investment. If, for example, we were to buy a building with a life of fifty years, we would in theory write off two per cent of its original cost each year. At the end of ten years, the property would have a book value of 80 per cent of its original cost. But, in many cases, the building's market value may have increased to perhaps 150 per cent of its original cost. Despite the recapture of 20 per cent of cost during its first ten years of ownership, the building can be sold at a profit of 50 per cent above cost.

The first step in setting up a depreciation schedule is to estimate the useful life of the building. In doing so, consideration must be given to the type of property, its condition, age, and degree of use. A fireproof apartment building may have a life of forty years, while a semi-fireproof one may be depreciable over thirty years. Sometimes, a useful life estimate is broken down among such items as elevators, roofing, air conditioning, etc., all of which have varying lives; this would be applicable in a multi-unit apartment.<sup>2</sup>

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<sup>1</sup>Bertram Lewis, Profits in Real Estate Syndication (New York: Harper and Brothers, 1962), p. 92.

<sup>2</sup>Ibid., pp. 93 ff.

### CONCEPT OF USEFUL LIFE

The investor's best interest is served by using as short an "income tax life" as is permissible under Internal Revenue Service rules. The recapture of invested dollars as fast as possible is, of course, the main objective. Next, there must be an allocation of the purchase price between land and building. Clearly it is desirable to stress the value of the building, since land has an unlimited life and cannot be depreciated. (This is not completely correct as in oil wells and mines depletion is charged off as expense as their productive capacity decreases.) Allocation to the building may run as high as 92 or 93 per cent of the total purchase price.

Assume that a realtor has invested \$25,000. cash above a mortgage of \$75,000. in a twenty-five year old building with a depreciable life of 20 years. He would set up the depreciation schedule as follows: Appraise the land and building separately. Assume the land is valued at \$10,000. and the building, \$90,000.; thus, \$90,000. becomes the basis of depreciation.

The seller of the property may have owned it for a full twenty-five years and taken depreciation for each year that he held it, based on its original cost. Note carefully that when the realtor buys the property he starts a new

depreciation schedule based on the \$90,000. allocated cost, regardless of the present book value. (It is important to remember that the twenty-five year life expectancy and the building value must meet with the approval of the Internal Revenue Service.)

Let us take another example and see how depreciation interacts with the repayment of a mortgage to produce a tax shelter. Assume that an apartment building is purchased for \$3 million subject to a first mortgage of \$2 million. Assume, further, that the value of the land may reasonably be estimated at \$500,000. of the total cost, and that the building has a depreciable life of twenty-five years. Allowable depreciation is four per cent of the value of the building, or \$100,000. per year. Here is how the tax schedule would look.<sup>3</sup>

Rental Income		\$550,000.
Less: 6% interest on mortgage	\$120,000.	
Taxes	100,000.	
Payroll	80,000.	
Heat, Light	35,000.	
Insurance	15,000.	
Maint. repairs	60,000.	
Total Expenses		<u>410,000.</u>
Net Profit Before Depreciation		\$140,000.
Depreciation		<u>100,000.</u>
Taxable Income		40,000.

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<sup>3</sup>Ibid.

Recall that this statement is not complete from a real estate point. Starting with the net profit before depreciation of \$140,000, we now adjust the statement by deducting the amortization of the \$2 million mortgage, say \$40,000 per year, to arrive at a net cash flow of \$100,000. Thus, although the owner of the property has a net taxable profit of \$40,000, he has \$100,000 cash for distribution; his tax shelter is \$60,000 or 60 per cent of the distribution. An investor with a \$10,000 interest in the property would then be entitled to one per cent of the tax shelter against his \$1,000 annual distribution or \$600 tax free.<sup>4</sup>

#### ACCELERATED DEPRECIATION

In the above illustration, I used what is called the "straight-line" method of depreciation. Under I.R.S. rules there are several methods of "accelerated depreciation" that are equally acceptable. As their name implies, these methods speed up the depreciation, so that a greater allowance is made in the early years of ownership. Accelerated depreciation was designed to enable the recovery of invested dollars more rapidly to reflect the high depreciation of many assets during their early years.

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<sup>4</sup>Ibid.

The most popular method of computing accelerated depreciation is known as the "declining-balance" method.<sup>5</sup> Under this method, a fixed percentage (if not more than 200 per cent of the straight-line rate in new buildings and 150 per cent in older ones) is applied against a declining book value. This is how it works: First, establish the life of the property, and, from that, its straight-line depreciation rate. Assume that we can depreciate a \$500,000 building over 20 years, or at a rate of 5 per cent a year. If it is a new building, we may take 200 per cent of that straight-line rate, or 10 per cent, apply it each year against the declining balance.

In the first year, allowable depreciation equals \$50,000 (i.e. 10 per cent of \$500,000) compared with \$25,000 under the straight-line method--an obvious acceleration. In the second year, we again apply 10 per cent, but not to the original cost, as with straight-line depreciation, but to the new book value of \$450,000 (i.e., original cost of \$500,000 less the first year's depreciation of \$50,000). In the third year, the depreciation drops again, to \$40,500 reflecting the further reduction in the book value. Still, despite the decreasing amount of depreciation, after three years we have deducted a total of \$135,000 under the declining-balance method as opposed to \$75,000 available under the straight-line method.

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<sup>5</sup>Ibid.

For tax purposes, we are far ahead, particularly if the property is sold. As the years go on, of course, the allowable declining-balance depreciation will continue to decrease until it approaches zero in the last year. The average depreciation will equal \$25,000., the straight-line rate for each year, although the early years have had the benefits of a greater amount.

The second I.R.S. approved method of accelerating depreciation is known as the sum-of-the-years-digits method.<sup>6</sup> To arrive at the allowable depreciation in a particular year, a fraction is applied to the original cost of the asset. The numerator of the fraction represents the number of the year, counting forward from the last year of the asset's life, while the denominator is a constant, the sum of the years' digits. Here is a simple example:

Suppose the realtor wants to depreciate an apartment house with a useful life of 20 years and a cost of \$100,000. To arrive at the numerator of the fraction that is to be applied to the cost, take the number of the year, counting in reverse order. Thus, in the first year, the numerator is 20 since this is the 20th year from the last. The denominator of the fraction is computed by adding the sum of the

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<sup>6</sup>Ibid.

years' digits (20+19+18+17 etc. = 210). Thus, in the first year, the depreciation is 20/210 of the original cost of \$100,000. In the second year, it is 19/210 of \$100,000., the third year 18/210 and so on.

There are limitations to the use of the declining-balance method at twice the straight-line rate and to the sum-of-the-years digits method. The first limitation is that these methods apply only to tangible property acquired new, or constructed after December 31, 1953. The second limitation is that the property must have a useful life of three years or more.<sup>7</sup>

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<sup>7</sup>David E. Valente, "Methods of Depreciation," Journal of Property Management, Vol. 28, II (Winter 1962), 93-94.

## NEW DEPRECIATION RULES

In 1962, the Internal Revenue Service announced several changes in depreciation rules. The new depreciation guidelines apply useful lives to about 75 broad classes of assets and supersedes Bulletin F which had set out suggested useful lives for specific items by industry classification.<sup>8</sup>

Use of the new guidelines which generally shorten the periods of useful life as compared to Bulletin F is automatically allowed to all taxpayers at the outset and applies for a three year transition period. This new method of depreciation will continue to be acceptable in the fourth year unless there are clear indications that the taxpayer's replacement practices are not consistent with the depreciation claimed and are not even showing a trend in that direction.

The use of the new guideline lives may be questioned in the fourth year if the use of the Reserve Ratio Test indicates that the taxpayer is not moving toward a replacement practice consistent with the class life used for tax purposes.

It should be stated here that the new "useful life" guidelines do not, in general, change the basic principles applicable under the I.R.S. regulations in determining the

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<sup>8</sup>United States Internal Revenue Service, New Depreciation Rules, Commerce Clearing House, Inc., Chicago 1962 pp. 13 ff.

eligibility for, and the mathematical method of computing the amount of the depreciation deduction. The same basic rules used in the past to determine who is entitled to deduct depreciation, what property is depreciable, the basis for depreciation, the methods of depreciation are as effective under the new rulings as they were before.

It is in the determination of the useful life for depreciable assets that the new guidelines will affect the computation of the depreciation allowance. Under the new rules the "useful life" of an apartment building has been set at 40 years. This is not the minimum figure as the Internal Revenue Service will take into consideration pertinent facts which might shorten the useful life.

Before, I spoke of the Reserve Ratio Test as being important in determining the validity of a taxpayer's depreciation methods. It is therefore worthwhile to see how the reserve ratio test is computed, and just how it affects the taxpayer. The I.R.S. in its new rulings has designed an objective standard to measure the appropriateness of the taxpayer's depreciation methods. This standard is the reserve ratio which is computed by dividing the depreciation reserve for a particular class of assets by the original cost of these assets.<sup>9</sup>

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<sup>9</sup>Ibid., pp. 19 ff.

The Reserve Ratio Test measures the relationship between tax lives and replacement practices on a comprehensive basis with the objective of achieving a reasonable overall result.

The taxpayer may use the reserve ratio test as a means of justifying his right to follow the depreciation practices he is using. It will, however, be used only in conjunction with established standards as a basis for imposing longer lives than those the taxpayer considers appropriate. Where the reserve ratio test is not met, the taxpayer will be allowed to demonstrate the validity of his depreciation methods on the basis of facts.

An important feature of this test is the latitude it allows the taxpayer in the determination of his depreciable lives, provided they meet reasonable standards. The test will more quickly indicate a taxpayer's right to faster depreciation write-offs than the possibility that longer lives should be used.

## CHAPTER VI

### MANAGING AN APARTMENT BUILDING (REPAIRS AND RENOVATION)

To the person standing before a new apartment building it would appear that the building must be a natural profit maker. Here is a situation of high rental income with relatively little expense save taxes and insurance; this is a casual and incorrect observation. There are numerous expenses associated with managing an apartment, some more important than others, some due to locality and some due to the apartment manager's abilities. As an example of expenses varying according to locality, we can note<sup>1</sup> that in Boston taxes and fees represent 26 per cent of total rental income as compared to 11 per cent in Los Angeles; this is due to Boston's exceedingly high property taxes. A second example of costs relating to area would be fuel costs.<sup>2</sup> In Boston the fuel dollar

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<sup>1</sup>See Tables on Pages 71 and 72.

<sup>2</sup>See Table in Appendix: Comparison of Fuel Costs by Metropolitan Area.

TABLE I

WALK-UP BUILDINGS OVER 25 UNITS<sup>3</sup>

## Income and Operating Costs by Metropolitan Area

(a) Dollars Per Room Per Annum (b) Per Cent of Gross Possible Income

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	Boston		Chicago		Cincinnati		Denver	
	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)
RENTAL INCOME	\$325.74		\$326.46		\$211.64		\$427.67	
Extra Services Billed & Misc. Income	1.99		.98		.95		-	
GROSS POSSIBLE INCOME	326.48		327.06		211.86		428.08	
Deduct: for Vacancies and Delin. Rents	3.02		8.84		16.91		13.23	
ACTUAL COLLECTIONS	325.36		321.33		194.95		414.84	
EXPENSES								
Janitor & Cleaning Supplies	35.00	10.7%	36.73	11.2%	8.18	3.8%	27.69	6.4%
Electricity, Gas & Water	7.95	2.4	8.23	2.5	11.51	5.4	32.80	7.6
Fuel & Ash Removal	24.85	7.6	25.83	7.8	17.14	8.0	9.99	2.3
Air Conditioning Power	-	-	20.31	6.2	-	-	-	-
Management & Administrative	21.31	6.5	17.40	5.3	31.66	14.9	21.56	5.0
Elevator, Doormen & Tenant Service	-	-	-	-	-	-	.85	.1
SUBTOTAL--Operating Expenses	89.12	27.2	88.49	27.0	55.34	26.1	92.83	21.6
Ext. Maintenance, Repair & Painting	20.50	6.2	8.85	2.7	4.86	2.2	3.62	.8
Tenant Space Decorating	11.86	3.6	20.74	6.3	15.71	7.4	11.79	2.7
Tenant Space Maintenance & Repair	-	-	9.71	2.9	20.45	9.6	8.63	2.0
Public Space Decorating	2.40	.7	4.94	1.5	-	-	3.37	.7
Public Space Maintenance & Repair	16.09	4.9	3.92	1.1	.80	.3	2.58	.6
Elevator Maintenance & Repair	-	-	-	-	-	-	-	-
Other Mechanical Equipment Repair	14.77	4.5	8.98	2.7	4.64	2.1	8.01	1.8
Furnishings Maintenance & Repair	-	-	3.12	.9	.77	.3	12.03	2.8
Grounds Upkeep	-	-	.44	.1	2.38	1.1	.90	.2
SUBTOTAL--Maintenance & Repair	34.51	10.5	47.74	14.5	41.65	19.6	39.46	9.2
Cost of Extra Services	-	-	.33	.1	5.98	2.8	-	-
Insurance	7.94	2.4	8.56	2.6	1.92	.9	8.13	1.8
Taxes, Fees & Permits	77.20	23.6	56.43	17.2	22.46	10.6	59.00	13.7
GRAND TOTAL--ALL EXPENSES	208.78	63.9	194.32	59.4	121.78	57.4	195.66	45.7
NET OPERATING INCOME	116.56	35.7	129.91	39.7	86.82	40.9	219.18	51.2

<sup>3</sup>"Apartment Building Exchange," Journal of Property Management: Special Edition (1962), pp. 21, 22.

TABLE II

ELEVATOR BUILDINGS<sup>4</sup>

Income and Operating Costs by Metropolitan Area  
 (a) Dollars Per Room Per Annum (b) Per Cent of Gross Possible Income

	Baltimore		Boston		Chicago		Denver	
	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)
RENTAL INCOME	\$436.27		\$394.63		\$518.05		\$524.39	
Extra Services Billed & Misc. Income	14.07		.57		19.16		-	
GROSS POSSIBLE INCOME	452.05		394.95		531.08		524.39	
Deduct: for Vacancies and Delin. Rents	8.50		6.73		23.57		36.47	
ACTUAL COLLECTIONS	451.12		389.68		528.38		487.92	
EXPENSES								
Janitor & Cleaning Supplies	45.70	10.1%	31.48	7.9%	45.21	8.5%	33.01	6.2%
Electricity, Gas & Water	16.33	3.6	16.09	4.0	18.26	3.4	36.43	6.9
Fuel & Ash Removal	16.93	3.7	22.78	5.7	48.25	9.0	6.67	1.2
Air Conditioning Power	-	-	-	-	-	-	-	-
Management & Administrative	47.40	10.4	27.97	7.0	39.64	7.4	30.20	5.7
Elevator, Doormen & Tenant Service	20.87	4.6	-	-	63.72	11.9	-	-
SUBTOTAL--Operating Expenses	144.56	31.9	98.33	24.8	189.88	35.7	105.14	20.0
Ext. Maintenance, Repair & Painting	-	-	29.37	7.4	16.19	3.0	2.23	.4
Tenant Space Decorating	10.33	2.2	11.83	2.9	39.45	7.4	12.70	2.4
Tenant Space Maintenance & Repair	38.48	8.5	7.39	1.8	5.38	1.0	11.55	2.2
Public Space Decorating	-	-	.64	.1	8.89	1.6	1.09	.2
Public Space Maintenance & Repair	-	-	8.58	2.1	11.12	2.0	.86	.1
Elevator Maintenance & Repair	4.07	.9	5.35	1.3	7.41	1.3	3.67	.6
Other Mechanical Equipment Repair	.25	.0	5.61	1.4	16.75	3.1	.63	.1
Furnishings Maintenance & Repair	1.28	.2	.16	.0	2.60	.4	11.34	2.1
Grounds Upkeep	.21	.0	1.16	.2	.65	.1	1.10	.2
SUBTOTAL--Maintenance & Repair	41.94	9.2	45.86	11.6	65.88	12.4	43.43	8.2
Cost of Extra Services	7.57	1.6	-	-	12.20	2.2	-	-
Taxes, Fees & Permits	63.66	14.0	104.84	26.5	127.17	23.9	78.42	14.9
Insurance	6.00	1.3	11.96	3.0	10.66	2.0	4.87	.9
GRAND TOTAL--ALL EXPENSES	263.45	58.2	261.00	66.0	387.92	73.0	231.87	44.2
NET OPERATING INCOME	187.66	41.5	128.67	32.5	206.70	38.9	256.04	48.0

per room is almost twice that of Birmingham, Alabama and 25 per cent higher than New York City only a short distance away. In some cities the fuel costs are high for certain types of fuels, due to their scarcity or general lack of use; yet in Boston the fuel costs remain relatively high regardless of the type of fuel used. This is due not only to the cold winters in Boston, but also the New England climate where changing weather conditions use up more fuel than a long cold streak.

The charts on the following pages give a comprehensive breakdown of expenses for four major cities for different types of buildings. This discussion will center around Boston and will utilize three other cities for comparison of the major expenses. These charts are essentially Profit and Loss statements similar to those used by manufacturers or retail stores. We begin with the sources of income and deduct all the expenses incurred in securing this income; the balance represents a profit or loss.

#### JANITOR EXPENSES

Janitor and cleaning expenses represent 8 per cent of total income. This covers the low wages paid to the janitor, the cost of the small supplies he needs and sometimes the "rental value" of his room if he lives on the premises. Very often the janitor's apartment is in the basement of the building where there are no other apartments or in an area that the

landlord could not otherwise lease. Where a janitor services several different buildings the owner may apportion the janitor's services to the various buildings.

In looking at the janitor expense figure for the four cities, it is interesting to note the high per cent figure for Baltimore; this would seem somewhat incongruous with the large Negro population and relatively low cost of labor, although people from the mid-South say that in spite of this large colored population it is difficult to get good domestic help without paying good wages.

#### UTILITIES

Next on the expense sheet is electricity, gas and water or, as we refer to it, utilities. Boston's figure of 4 per cent is about the average but the figure is not truly representative as in most apartments the tenant is charged directly for gas and electricity by the utility companies. Very few owners, except perhaps in some of the new buildings, assume the cost of these utilities.

In Boston fuel costs are somewhat high due to the cold winters and New England climate. Chicago has the highest fuel expense of the four cities under consideration. The "Windy City" has lived up to its name by being one of the really cold spots in the country; in this winter season the Chicago temperature had dipped to  $-18^{\circ}$  F. In Boston coal and oil remain

the two prime sources of fuel with coal rapidly being replaced by oil. Coal is now used in only the old buildings and even here many owners are now converting to oil.

Almost all the new apartments in Boston are offering air conditioning, but, as in the case of utilities, the cost is almost always billed to the tenant directly through his electric bill. In older apartments, the landlords have often charged the tenant an installation fee especially where re-wiring is needed. This fee is usually charged to the tenant on the month of installation, but it is becoming common to increase the rental bill each month by one to three dollars for air conditioning service charges.

#### SPECIAL TENANT SERVICES

It is interesting to note that in Chicago, elevator, doormen and tenant services accounts for 12 per cent of total expenses while in Boston it is zero. In many of Chicago's luxury apartments, the owners provide doormen and elevator men and a tenant service comparable to the room service of a hotel. In Boston this concept has never gained popularity, although three of the new luxury apartments are offering doorman service.

## MAINTENANCE AND REPAIRS

The second phase of the expense sheet covers the nine components of maintenance and repairs. Note that figures for the different cities vary little; maintenance and repairs vary according to the type of building and, to some degree, locality. A new brick or concrete building will require much less maintenance than an older building. If the building has window sills or exterior doorways of wood, it will obviously require more maintenance than those of aluminum or stainless steel. Grounds upkeep will depend on the amount of land surrounding the building and whether the owner prefers grass and hedges to black asphalt.

## INSURANCE

Insurance premiums for the four cities range from a low of .9 per cent to a high of 4.8 per cent. These figures are based on several factors:

1. Insurance rates in the different cities.
2. Type of building being insured.
3. The owner's desire to stress one phase of insurance against another. (Example: In a fireproof building the owner may wish to carry a high liability insurance and a low fire policy.)
4. Terms of the mortgage contract.

## TAXES AND FEES

The last expense considered here is taxes, fees and permits. Boston with a tax rate of almost \$100 on the thousand has the highest per cent tax expense of any of the four cities, and one of the highest in the country; it is almost double that of Baltimore. Also, the tax expense in Boston is more than the total major operating expenses (janitor, utilities, fuel, air conditioning, management, elevator and door service) combined. The operating ratio in the Boston area is 66 per cent leaving a net operating income of 32.5 per cent (after adjustments). This is the lowest net operating income figure of the four cities and we must remember that we must now deduct the interest charges and amortization on the property; this will leave a much smaller final net figure before taxes.

A few years ago, a new owner could satisfy his existing tenants and attract new tenants by superficial renovation, that is, a coat of exterior and interior paint and perhaps a new entrance way. This condition existed for several reasons, but the main reason was that this type of renovation was all that was needed to compete with other landlords as very few new buildings were being erected.

As the new wave of construction began in Boston and its suburbs, owners of existing buildings found it necessary to

reevaluate their renovation plans. In the Brookline area and along Commonwealth Avenue and Beacon Street of Boston, owners of apartments began to divide their large eight and nine room units into two separate apartments, each with its own entrance and services. Along with the subdivision would go new kitchen and bathroom facilities, usually not of the best quality but sufficient to give the apartment a "new" look.

#### RENOVATION

Aside from the finance aspect of remodelling an existing apartment comes the problem of timing. In an apartment building where subdivision of units is contemplated or where extensive renovation is planned, it is almost always necessary to do the entire project at once rather than in stages. This often entails the eviction of tenants or waiting for leases to lapse. In either case it can be a drawn out process even before renovation is to begin, and means the loss of rental income for some length of time. It is up to the owner to weigh the loss of present income with future possible income.

If the renovations are minor or can be done in stages, the loss of rental income may be slight as one apartment can be renovated without disturbing any other apartment suites. It thus becomes necessary for the landlord to wait for a lease to expire and a tenant to leave, and then remodel the one vacant apartment after which he can advertise a vacancy in a

newly remodelled apartment. This is an optimum situation as the landlord need finance only one unit at a time, not have to worry about hurt feelings through evictions, and be in a position to rent one vacant apartment instead of several.

Renovations often include new kitchen cabinets, sinks with disposal units, built-in ovens, fresh paint or wallpaper, new bathroom facilities such as sinks, tubs and shower units, air conditioning and various other facilities. Of course, not every landlord will renovate with all these changes, but this partial list shows the wide range of changes available. The well-advised landlord will make a careful appraisal of the rate of return on any and all of these renovations. It is imperative to do this as the owner may later find he can not recoup his outlay unless he charges exorbitant rents which he may have difficulty getting.

In some buildings the landlord may have a choice whether to renovate or not, or the extent to which he need renovate; in some buildings it is a necessity to renovate to hold existing tenants. Also in cases where the owner contemplates changes involving electric utilities such as electric ovens, refrigerators and air conditioning, it may necessitate rewiring part or all of the building. The cost of rewiring varies from as little as \$160. per apartment to about \$245. in buildings of six or less floors of non-fire-proof construction. This includes all the cellar work, meter

equipment, apartment distribution panels, risers, overload protective devices, a cluster of outlets for new appliance circuits to the kitchen, cutting, patching, and any touch-up painting.<sup>5</sup>

In the following paragraphs are listings of various real estate transactions during the past few months. In each of the transactions<sup>6</sup> I will give the number of apartment units, the location of the property, the sales price, and the cost per unit. The apartments are in different areas of Boston and it is interesting to note the range of per unit sales prices.

A five-unit apartment house at 13 Hereford Street, Back Bay, sold at \$38,000; cost per unit was \$7600.

Twenty-one apartments on the Fenway were sold for \$90,000; cost per unit was \$4285.

Seventeen apartments at 109 Commonwealth Avenue, Back Bay, were sold at \$110,000; cost per unit was \$6470.

A twelve-apartment building at 231 Commonwealth Avenue, Back Bay, was sold for \$105,000; cost per unit was \$8750.

An 102-apartment house in Brighton was sold for \$900,000; cost per unit was \$8823.

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<sup>5</sup>Howard M. Sonn, "Improving Your Real Estate Investment Through Adequate Wiring," Journal of Property Management Vol. 27, III, 163-65.

<sup>6</sup>Real Estate Section, Boston Herald-Traveler, June, July, 1962.

Thus, in three different areas of the city, Back Bay, Brighton, and the Fenway, we have a per unit price range of from \$4300 to \$8800. Contributing to this price spread are the many appraisal factors discussed before, and the renovation needs being discussed in this chapter.

Much of the ground work for this chapter has been laid in previous chapters where discussions covered both old and new buildings together and new buildings separately. Both types of buildings have much in common such as the methods of finance. The one exception would be that in the case of a new building, a construction mortgage loan is utilized, while in an existing building a "conversion" or renovation mortgage loan may be used. The total costs will be different, and some of the appraisal methods may vary but essentially the over-all finance picture is the same. In fact the vacancy rate of an older building during renovation may be compared to the vacancy of a building under construction.

#### LEASING AND PRE-LEASING

Each type of building has its advantages and disadvantages. The new building has the glamour to attract prospective tenants, yet still has the disadvantage of having a 100 per cent initial vacancy rate. This is partially offset by advance advertising and pre-leasing; pre-leasing is becoming a problem as many tenants who signed leases far in advance

of occupancy find that rentals to later tenants have decreased where the owners have not been able to rent the apartments as easily as they first thought.

In an older building the owner may find an 80 per cent to 100 per cent occupancy to begin with, and unless he plans a full renovation entailing complete vacancy, he is in a better income situation than the owner of the new building. This may later be offset by the necessity of renovation or major repairs at a later date. Repairs and operating expenses being the subject of the next chapter will not be discussed further at this time.

A problem common to both the owners of old and new buildings is the element of time. Many times the owner of a new building may be trying to meet an occupancy date so that tenants are moving in while work continues in other sections of the building; it is the wise owner who does not sacrifice the quality of his building for a few days vacancy. This is also true in older apartments where rushed carpentry work often results in loose ceiling blocks or floor tile pieces.

## CHAPTER VII

### THE PROPERTY MANAGER

Property management, though not a new concept, has gained in importance only in the last five years. As apartment buildings grew in size their owners found they did not have sufficient time to devote to the leasing of units and the proper care of the building. The owners began to use property managers to operate their apartments; many times it was a promotion for the building janitor, but more often the job went to a professional manager. The professional manager often works for himself doing only this type of work, relying on fees as his income. Many times the property manager may be affiliated with a real estate broker's office. A good property manager, like the manager of an office or a plant, has the knowledge and know-how to do the job right. This knowledge will include the technical aspects of the job as to the proper paints and cleaners to use, an understanding of heating systems and wiring, and he will have sales ability to induce tenants to move into the building.

Many of the property managers in the country belong to an organization known as the National Association of Real

Estate Boards, with local divisions in every section of the country. Members of this organization refer to themselves as "Certified Property Managers" and use the C.P.M. designation after their names to designate their membership in the N.A.R.E.B.<sup>1</sup>

Depending on his capabilities, prestige, and the amount of freedom he is given, the property manager often begins his job even before a new apartment building is constructed. It is his job to advise on the best materials (dollar-wise and from a maintenance-free viewpoint) to be used in the building and also to help establish the rental charges. The rental charge must be attractive to the prospective tenant, competitive with similar properties, and must be sufficient to allow a fair return on capital. Setting up an income and expense schedule can be the most important task the property manager will do.

Once construction has begun on the building, the alert property manager should begin trying to lease the apartments. Though it may be six months to a year before the building is ready for occupancy, it may take several months for a prospective tenant to sell his home, sublease his old

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<sup>1</sup>The Journal of Property Management is the quarterly publication of the Institute of Real Estate Management of The National Association of Real Estate Boards.

apartment or just arrange for new furnishings, etc. It is also the property manager's job to select the right tenants, those not only who can afford to pay the rent, but those whose occupancy will attract others, i.e. persons who will keep the property in good condition.

The property manager in a new and old building will do his best to avoid a high turnover and will act swiftly to fill any vacancies. As shown on the attached Table (Table III) the national rental vacancy rate for 1961 averaged eight per cent. Based on a report by the Institute of Real Estate Management the national vacancy rental rate during this same period was only 2.8 per cent. If the manager finds that vacancies occur because of some problem in the building, he should act immediately to correct the situation; in fact this situation should never occur as a good property manager should encourage tenants to discuss their complaints with him first. Some tenants, of course, would probably demand so much of the service of the property that there would be little if anything left for the owner. Some owners who do not understand the problems of the property manager would be inclined to grant so little to their tenants that they would soon develop a high vacancy record. The manager is expected to stand between the owner and the tenant and to protect each. To the tenant he owes the best of service that can be rendered at the price paid. To the owner he owes the obligation to

TABLE III  
RENTAL VACANCY RATE<sup>2</sup>

YEAR	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1961.....	8.0	8.1	7.9	7.7
1960.....	7.2	7.3	7.6	7.6
1959.....	6.1	6.7	6.6	6.4
1958.....	5.7	6.0	5.8	6.0
1957.....	4.8	4.9	5.2	5.3
1956.....	5.6	5.4	5.8	5.3

<sup>2</sup>

Catherine E. Martini, "Vacancy Rates and the Outlook for the Rental Market," Journal of Property Management, Vol. 28, I (Fall 1962), p. 8.

return as much net income as possible, commensurate with reasonable service to the tenants.

#### PROPERTY MANAGEMENT GOALS

It will be worthwhile at this point to review the principles of real estate management. There are, or should be three basic goals in management: 1) Maximizing the productive level of the property; 2) extending the productive life period, and as a by-product of these two; 3) preserving and enhancing the capital value.

Working toward these three goals, management functions should be:

1. Merchandising space to secure a maximum gross income.
2. Reducing operating and maintenance costs to produce the maximum net return.
3. Reducing the financing burden.
4. Adapting the property to environmental and market changes through changes in management policy, through investing additional capital in remodeling, modernization, or additions for the purpose of either increasing gross income or reducing expenses.<sup>3</sup>

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<sup>3</sup>Richard U. Ratcliff, Real Estate Analysis (New York: McGraw-Hill Book Company, 1961), pp. 211 ff.

Operating expenses are defined as cash outlays which are necessary to maintain the productivity of the property; this is, of course, different from long term capital outlays. A high operating ratio is characteristic of many forms of real estate enterprise. When operating costs are high in proportion to revenues, and when the regular cash obligations of interest and principle payments on the mortgage are added, the total leaves a relatively narrow margin.

Actual figures from a three-year survey indicated that in a medium size, well-managed apartment building, operating expenses are approximately 60 per cent of gross income.

Fixed costs are typically high relative to variable costs in most real estate enterprises. In the survey mentioned above it was found that variable costs at full occupancy were about 40 per cent of total operating costs, and would have been higher in a less well managed building. The fixed costs which run on through high and low occupancies include: property taxes; general structural maintenance; insurance; cleaning and maintenance of sidewalks; management; and other costs depending on the type of property.

Since costs do not fall in direct proportion to revenue decreases, net income may be pinched off before vacancies and rent reductions have gone very far. If mortgage payments are added to the fixed costs, the break-even point will be reached with only a moderate reduction in gross

revenues.

It is therefore wise to minimize the burden of fixed obligations by shifting fixed costs to a variable basis whenever possible.

The advantages of sound business administration apply with equal force to all forms of business. In the management of real estate there are efficiencies and savings to be derived from the pursuit of well established business principles in the following respects:<sup>4</sup>

1. Selection of competent and experienced management, either an individual or a professional management firm.
2. Installation of an efficient operating organization.
3. Employment of effective accounting and budgeting controls.
4. Maintenance of favorable customer relations.
5. Use of effective collection methods.
6. Use of proper personnel policies in hiring and training, supervising and compensating employees.
7. Application of intelligent and careful purchasing methods.

While at first it would appear that these seven principles apply only to the large real investor, they are also very useful guides to the new or small realtor, and, as in any other business, it is never too early to try to put

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<sup>4</sup>Ibid., pp. 214-15.

these ideas to use.

### MAINTENANCE

There is a great deal of flexibility in maintenance expenses on those items which do not directly and immediately affect the productivity of real estate. Repainting can often be postponed; the replacement of a poor roof or of an old stove or refrigerator may not require immediate action. Whether or not the delay in some repair will affect revenues is very often dependent on competitive conditions in the market except for those repairs where delay may make rental space unusable.

From a long-run income viewpoint, prompt repair and replacement are the best policies. The renewal of deteriorated structural parts will prevent the spread of damage and minimize future repair expenses. In the short run there may be situations which justify postponement of repairs. When vacancies in competing apartment buildings are high, demand nonexistent, and revenues too low to meet essential expenses, it may be necessary to defer some of the less critical repairs due to lack of funds. When the market demand is so stagnant that modernization would have little influence on occupancy or rental levels, obsolete equipment can continue to be used.

Under certain conditions some maintenance operations

are most economically handled by staff employees; under other conditions costs can be minimized by letting out contracts for the work. For example, salaried full-time painters may be low cost when there is sufficient work to keep them steadily occupied. Where painting is intermittent, contracting is indicated.

### INVENTORIES AND SUPPLIES

Maintaining an apartment building, even a small one, involves more than replacing a burned out bulb or blown fuse. The janitor or maintenance man must have on hand at all times, an ample supply of bulbs, fuses, washers, locks and keys, and tools, and the wise real estate owner needs some form of inventory control. It is the owner's responsibility to find the most economic source of supply and not to have the janitor run to the retail hardware store at the last minute.

Most reputable supply houses will have the integrity to charge the owner only for what he ordered, and many supply houses offer sound suggestions on inventory control. It must be realized that no inventory control system is 100 per cent perfect, but just the fact that a system does exist may discourage pilferage. The following is an example of how a simple inventory control system might work.

First, a master inventory sheet is set up to cover each category of supplies in stock; it can be a simple

In-Out Balance showing purchases, new balances, items drawn from stock, new balances, etc. It would be the janitor's responsibility to keep the sheet up-to-date, and the owner would have copies of purchase invoices to verify the chart.

In conjunction with this master work sheet, the janitor or maintenance department should use a Work Card for each unit in the building. The cards can be kept on a monthly basis and would show all the work done during a particular period on each apartment unit. The cards not only provide a check against the master inventory sheet, but also may point up certain serious problems in a given unit. For example, constant replacement of light bulbs or fuses may indicate faulty wiring or that the tenant is using too much power through air-conditioning or other electric appliances.

#### FUEL EXPENSE

Aside from the general supplies, the owner must keep a constant watch on other important areas, one of which is fuel costs. As was indicated before, fuel costs in Boston exceed those of many other major cities. With this fact in mind, and with an attempt to cut expenses, the real estate owner should consider the following questions in his fuel purchases:

1. Can the owner purchase a medium or low grade fuel in lieu of a higher grade fuel without damage to the heating

system?

2. Can the owner rely on the fuel oil dealer not only to make his regular deliveries, but also to make emergency calls when necessary?

3. Is the heating system adequate for the building, or is it under strain to warm the building?

Assume that a building has a heating plant which would normally be expected to last for another five years. A new and more efficient plant will cost \$7,500. and will save \$1,000. per year. The new heating plant has an expected life of 15 years; thus an annual deposit of \$500. into a reserve for depreciation is indicated. Advancing the replacement by five years would add \$2,500. to expenses for a reserve for replacement, but would reduce costs by \$5,000. through savings in fuel and labor.

## INSURANCE

Insurance premiums represent a large expense to the real estate owner, and as such it is imperative that the owner put his insurance dollar to the best use. Normally fire insurance in an amount equal to approximately 80 per cent of the replacement cost is carried. Sometimes in the case of a large building this insurance is supplemented by use and occupancy insurance--that is, insurance against the loss of rent resulting from destruction of building.

It is also practical to carry some form of public liability insurance as well as steam boiler and plate glass insurance.

## CHAPTER VIII

### SUMMARY

There can be no question but that Boston is experiencing what I might term a "rejuvenation"--a massive building and rebuilding program already valued at \$200,000,000. and with several hundred million more yet to be spent in the next five years. Much of the funds come from government sources, such as the City of Boston Redevelopment Program and the Government Center sponsored by the Federal government. The balance of new construction is coming from private industry and it is this volume that attests to the interest of investors in Boston's future.

Up to now, construction of new apartment buildings has represented a large portion of this total construction program. This fact may be unique in Boston but has been part of the national scene for many years. Rental type housing, as a share of new construction, has been increasing during the past five years. In recent months, apartment construction has come to represent about one-third of housing starts. This is both the highest number of multi-family units in a

like period and the greatest portion of total residential building since the decade of the 20's. The influence on vacancy trends is obvious. The national vacancy rate stood at 2.6 per cent in 1950, gradually moved upward to 7.2 in the first quarter of 1960, and has held between that rate and 8.1 since. The first quarter of 1962 it registered 7.7 per cent. All of these rates include a high percentage of units that might be considered irrelevant for purpose of market analysis, and if these deficient apartments and houses are disregarded, the vacancy rate would be about 5.3 per cent. In Boston the vacancy rate during these past two years has averaged 2.0 per cent. This would be understandable when we consider that many of the families evicted from the West End and other areas under rehabilitation are moving into otherwise vacant apartments; also where there may have been a vacancy rate of from two to five per cent in areas as the West End, the vacancy rate is now zero as the property has been removed from the rental market.

Of the different types of ownership discussed, the two most in favor with realtors are the Massachusetts Trust and the Real Estate Investment Trust. As was stated before, the trust is a modified form of a corporation with many of its advantages.

As to how the construction of a new building or the purchase of an existing building will be financed will depend

on two basic factors: First, the total purchase price; and second, the amount that investors are able to willing to put up of their own equity. In all likelihood a senior mortgage will be issued to finance the unpaid amount of the purchase price, although this is often supported by a junior mortgage. In case of a new building, a construction mortgage loan will be used, later to be supplemented by a "regular" mortgage. Where the investors can pay the purchase price by means of one mortgage, it will be of advantage to them to do so as a second mortgage usually commands a higher interest rate than a first mortgage, and it means that the investor will have to negotiate with two sources rather than one for refinancing. Almost all mortgages are today self-amortizing by which the mortgagor includes a portion of the principal with his interest charge payments; this avoids balloon payments which caused so many defaults during the depression.

The construction of a new building or the purchase of an existing building each has its own advantages and disadvantages. The new building has the allure to attract prospective tenants, yet must fill a 100 per cent vacancy rate. An existing building, while it lacks the allure of a new building, has a low initial vacancy rate but renovation or remodelling may be necessary to retain the tenants.

The managerial problems confronting the owner of an apartment building are many. While the operating expenses

are readily apparent, there are many expenses such as insurances and taxes that, while not as obvious, take a larger per cent of the income dollar. In Boston, fuel expense runs high compared to many parts of the country, while expense of tenant services are lower. Total operating expenses in Boston vary little from the national average, yet, because of Boston's high tax rate, its total operating expenses are higher than the four other cities under comparison and bring Boston's net operating profit below that of the other cities.

As investment yield is the key to any investment, a prospective owner must be sure his investment return on a piece of real estate is higher than on another type of investment, for example, the interest paid by a bank, the interest on government securities, or the interest on a corporate or public bond issue.

Many real estate investors in Boston have found their investment return diminished due to the fact that the new luxury apartments can not be rented at the rental charge owners anticipated which entails either lowering rents or having a higher rental vacancy rate. As in other fields, when a profitable idea catches on, it is sure to be copied until such time as the Law of Diminishing Returns sets in, at which point it is too late.

## CHAPTER IX

### CONCLUSIONS

From the many areas discussed in this paper and considering the experiences in other parts of the country, certain definite conclusions can be reached concerning the future of apartment housing in Boston:

1. Both the Massachusetts Trust and the Real Estate Investment Trust will play larger roles in the ownership and financing of apartment buildings.

2. Due to unfavorable publicity and the decreasing of yield, syndicates will continue to play a secondary role in ownership and financing.

3. Depreciation, as is expected, will be a key factor in profitable real estate ownership.

4. The professional real estate manager will become more and more important as buildings increase in size and the need to cut expenses becomes more urgent.

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## APPENDIX

TABLE IV

## VACANT APARTMENTS--WALK-UP BUILDINGS 25 UNITS OR MORE

Metropolitan Area	Number of Apts. Reporting	January 1, 1961		December 31, 1961		Turnover	
		No. Vacant	Percentage Vacant	No. Vacant	Percentage Vacant	Number of New Tenants	Percentage Turnover
Ann Arbor	346	3	.9	14	4.0	186	53.8
Baltimore	350	0	.0	0	.0	63	18.0
Boston	544	0	.0	2	.4	89	16.4
Chicago	1354	21	1.6	19	1.4	234	17.3
Cincinnati	281	1	.4	5	1.8	45	16.0
Cleveland	73	3	4.1	4	5.5	14	19.2
Denver	371	11	3.0	14	3.8	200	53.9
Greensboro-High Point	60	0	.0	0	.0	9	15.0
Hartford	63	0	.0	0	.0	8	12.7
Indianapolis	64	1	1.6	2	3.1	11	17.2
Jersey City	105	0	.0	4	3.8	22	21.0
Los Angeles-Long Beach	372	15	4.0	19	5.1	186	50.0
Miami	87	0	.0	0	.0	24	27.6
Minneapolis	54	0	.0	3	5.6	12	22.2
Newark	89	0	.0	0	.0	8	9.0
Newport News-Hampton	516	9	1.7	1	.2	275	53.3
New York	160	0	.0	0	.0	12	7.5
Norfolk-Portsmouth	500	10	2.0	0	.0	365	73.0
Omaha	87	4	4.6	3	3.4	52	59.8
Paterson, N.J.	111	0	.0	1	.9	19	17.1
Portland	166	6	3.6	12	7.2	98	59.0
Richmond	216	0	.0	0	.0	52	24.1
St. Louis	193	1	.5	3	1.6	25	13.0
San Francisco-Oakland	75	3	4.0	1	1.3	31	41.3
Washington, D.C.	102	0	.0	2	2.0	14	13.7
Region							
North	3599	36	1.0	60	1.7	742	20.6
South	1909	20	1.0	3	.2	810	42.4
West	1037	38	3.7	47	4.5	532	51.3
Canada	20	0	0	0	0	0	0

TABLE V

## VACANT APARTMENTS--GARDEN TYPE BUILDINGS

Metropolitan Area	Number of Apts. Reporting	January 1, 1961		December 31, 1961		Turnover	
		No. Vacant	Percentage Vacant	No. Vacant	Percentage Vacant	Number of New Tenants	Percentage Turnover
Baltimore	468	39	8.3	20	4.3	228	48.7
Boston	125	0	.0	0	.0	40	32.0
Charleston	79	0	.0	2	2.5	28	35.4
Chicago	440	2	.5	2	.5	89	20.2
Cincinnati	68	2	2.9	0	.0	9	13.2
Columbus	86	1	1.2	2	2.3	32	37.2
Detroit	500	0	.0	0	.0	57	11.4
Hartford	101	2	2.0	4	4.0	20	19.8
Los Angeles-Long Beach	166	12	7.2	6	3.6	36	21.7
Newark	186	2	1.1	0	.0	34	18.3
Newport News-Hampton	1301	38	2.9	3	.2	861	66.2
Omaha	620	2	.3	39	6.3	313	50.5
Paterson, N.J.	276	5	1.8	3	1.1	84	30.4
Pittsburgh	203	93	45.8	17	8.4	76	37.4
Richmond	572	16	2.8	0	.0	346	60.5
San Francisco-Oakland	84	0	.0	0	.0	33	39.3
Shreveport	228	65	28.5	50	21.9	185	81.1
Washington, D. C.	2660	13	.5	20	.8	914	34.4
Region							
North	2649	109	4.1	70	2.6	761	28.7
South	5555	180	3.2	106	1.9	2660	47.9
West	356	13	3.7	15	4.2	108	30.3
Total	8560	302	3.5	191	2.2	3529	41.2

TABLE VI

## VACANT APARTMENTS--ELEVATOR BUILDINGS

Metropolitan Area	Number of Apts. Reporting	January 1, 1961		December 31, 1961		Turnover	
		No. Vacant	Percentage Vacant	No. Vacant	Percentage Vacant	Number of New Tenants	Percentage Turnover
Baltimore	365	2	.5	3	.8	19	5.2
Boston	295	1	.3	6	2.0	26	8.8
Chicago	427	0	.0	1	.2	47	11.0
Cleveland	130	8	6.2	7	5.4	20	15.4
Denver	277	10	3.6	19	6.9	120	43.3
Jersey City	113	2	1.8	1	.9	11	9.7
Kansas City	300	7	2.3	5	1.7	98	32.7
Los Angeles-Long Beach	1517	51	3.4	43	2.8	763	50.3
Milwaukee	341	15	4.4	14	4.1	33	9.7
Newark	75	0	.0	0	.0	8	10.7
Pittsburgh	259	4	1.5	1	.4	18	6.9
Portland	104	4	3.8	3	2.9	42	40.4
St. Louis	51	0	.0	0	.0	11	21.6
San Francisco-Oakland	271	4	1.5	2	.7	46	17.0
Shreveport	299	66	22.1	88	29.4	283	94.6
Washington, D. C.	4416	70	1.6	38	.9	1589	36.0
Montreal	79	1	1.3	0	.0	15	19.0
Vancouver	55	3	5.5	0	.0	13	23.6
Region							
North	2032	38	1.9	36	1.8	275	13.5
South	5113	138	2.7	129	2.5	1893	37.0
West	2169	69	3.2	67	3.1	971	44.8
Canada	174	10	5.7	6	3.4	29	16.7
Total	9488	255	2.7	238	2.5	3168	33.4

TABLE VII

## COMPARISON OF FUEL COSTS BY METROPOLITAN AREA

Metropolitan Area	Coal		Oil		Gas		All types	
	No. of rooms	Dollar cost per room	No. of rooms	Dollar cost per room	No. of rooms	Dollar cost per room	No. of rooms	Dollar cost per room
Baltimore	432	29.3	4617	17.1	-	-	5049	18.1
Birmingham	156	14.0	-	-	172	21.0	328	17.7
Boston	529	27.3	2559	21.5	-	-	3305	23.0
Chicago	7731	29.4	2717	17.4	72	25.8	10520	26.2
Cincinnati	513	17.2	-	-	609	21.3	1191	19.2
Denver	-	-	-	-	2540	9.6	2702	9.1
Jacksonville	-	-	387	21.1	-	-	387	21.1
Jersey City	-	-	934	24.8	-	-	934	24.8
Los Angeles- Long Beach	-	-	-	-	1920	7.7	3375	5.7
Milwaukee	871	17.1	324	26.3	-	-	1454	22.8
Minneapolis- St. Paul	246	18.1	-	-	-	-	246	18.1
Newark	157	28.0	1335	21.4	-	-	1492	22.1
New York	447	20.2	343	24.3	-	-	923	24.4
Omaha	238	14.7	-	-	764	16.5	1002	16.1
Paterson, N.J.	145	30.4	1580	24.4	-	-	1725	24.9
Portland	-	-	886	25.5	-	-	886	25.5
St. Louis	956	18.4	84	24.2	525	19.1	1565	19.0
San Francisco- Oakland	-	-	-	-	1591	15.1	1591	15.1
San Jose	-	-	-	-	146	3.9	146	3.9
Washington, D.C.	2460	18.4	11401	15.9	-	-	14272	17.6
Montreal	182	25.3	1129	24.3	172	37.8	1483	26.0
Toronto	296	26.3	700	35.2	-	-	996	32.5
Vancouver	82	21.0	374	16.3	180	32.1	737	20.7
Total	21915	22.3	31181	19.0	10515	14.8	67959	19.6