use the consultant McNeil had used, Recap Advisers. In October the City and Grove Property (through their consultant) were in substantial agreement as to the terms.

Councillor Born asked if there was going to be a sale of units to the City. Ms. Achtenberg stated that the effect on affordability was going to be the same as if the City had purchased the units.

Councillor Born asked what Grove was going to do with the loan. Mr. Herzog said that essentially it was to be Grove's money; it was calculated to produce a return that would compensate Grove for the requirement that the units be affordable in perpetuity.

Ms. Achtenberg stated that conceptually they were investing the money and paying the loan off. The idea was that this was not going to cost the owners anything. In July, Grove's consultant indicated that they were prepared for a quick agreement if the City could increase its offer by $1,000,000, so City staff were expecting a quick agreement.

Ms. Achtenberg said that some of what is going on now is that the market is super-heated. The limitation of whether we can buy the building ought to be financial. In some cases nonprofits could be competitive. Time is always an issue, because anything done with public money takes more time. The question is how to get back to a situation in which there will be some consequences to actions such as those that Grove took. Ms. Achtenberg said that the City Council hearing was actually tremendously effective.

Elaine DeRosa, Executive Director, CEOC, stated that the public focus brings it to the attention of the state elected officials. There are more people in places with power to do something. It can affect next year's budget at the State House.

Ms. Achtenberg stated that Grove recognizes that they got into a bad public relations position that will continue to follow them.

Councillor Born asked whether Cambridge could have prevented the prepayment. Ms. Achtenberg stated that the City of Boston is seeking a temporary restraining order to enjoin rent increases following prepayment of the HUD mortgage in an expiring use building.

Councillor Born asked whether anyone in the country has been successful in stopping or slowing down prepayment.

Ms. DeRosa said that there are another couple of communities where there is an issue of cities which should have been offered a right of first refusal by McNeil and were not.

Ms. Achtenberg stated that the hearing emphasized that the City Council is on top of things and is very concerned. She noted that Keith Munsell is on the board of Grove Properties and he was involved with McNeil.

Councillor Born said that Grove has been described to her as thinly financed without a lot of equity. She stated that in situations such as 929 House it would be helpful to have some communication with the administrative staff before the hearing. Councillor Born then asked what leverage the City has with the owners at this point.

Mr. Herzog stated that Grove is extremely concerned about the eminent domain issue. They have retained a lawyer. The morning after the City Council hearing, Damon Navarro called to say that the building was worth $19,000,000, and now CDD staff has heard that they are claiming it is worth $25,000,000. Elaine DeRosa said that the deed states that the consideration was 5.1 million dollars.

Councillor Triantafillou stated that it is fraud not to have deed stamps for the full value of the consideration. The lawyers have also committed fraud if they recorded a deed without stamps for the full consideration.

Councillor Born asked about other points of leverage.

Ms. Achtenberg stated that the rent levels in the 24 units are an issue. She said that there is also the issue of whether there is a breach of contract because there was an understanding that there was a deal.

Councillor Russell asked if there had been any contacts with other McNeil/Grove tenants and city officials in other cities which the McNeil/Grove properties are located.

Ms. DeRosa stated that Representative Capuano is in contact with the Congressman who represents Hartford and they intend to do some joint work. It was suggested that perhaps members of the City Council could meet with the Grove board.

Councillor Triantafillou asked whether the City has a consultant who is familiar with REITS. The question was answered in the affirmative.

Ms. Achtenberg said that Hal Gorman, a Connecticut corporation lawyer on the Grove board, was the one who first raised the objection about the deal. He first called it a legal objection. He subsequently admitted that it was a business problem, not a legal problem.

Ms. DeRosa said that they have a tax attorney who is trying to talk to Damon Navarro about what the issues are from Grove's point of view.

Councillor Born submitted a letter from Peter Cohen (attached). Councillor Born asked whether eminent domain would solve some of the tax problems that Grove has. Mr. Herzog said that he could request that the answer to this question be part of the City Manager's response to the City Council.

Councillor Born moved that the letter from Peter Cohen be referred to the City Manager and that the response that the City Manager is preparing on the 929 House comment on the letter. The motion passed without objection.

Mr. Herzog noted the existence of another tax tool, like-kind exchanges.

Councillor Triantafillou said that there should be an exemption for capital gains tax for affordable housing.

Ms. Achtenberg cautioned about the City Council creating for Grove a question about who Grove is negotiating with, the City Council or CDD.

In response to a question about Grove's offer to keep affordable six units in addition to the 24 required by the zoning variance, Mr. Herzog stated that Grove's proposal for all the units (24 plus 6) was not acceptable to the City. Grove proposed that units be only for elderly persons and that they be affordable to people with 80% of the median income, rather than 50%.

It was noted that another option is publicity directed at investors and potential investors.

Ms. Achtenberg stated that Grove does not appear to understand that the proposed Expiring Use bill would affect them, and that this kind of publicity increases the likelihood of passage of the bill.

It was agreed that Councillor Born, as Chair of the Housing and Community Development Committee, will write to Grove Properties on behalf of the committee. It was further agreed that Mr. Herzog will provide additional information about Lowell House in Boston where some legal action has been taken to prevent rent increases.

Councillor Born stated that she would still like to understand what the business reason was for not making the deal. If the City were to sue for breach of contract, that could certainly affect the attractiveness of Grove as an investment.

Councillor Triantafillou noted that availability of stockholders derivative suits brought by someone who has bought a share. These suits have been used for social purposes.

Ms. Achtenberg said that in other similar situations, there have been e-mail campaigns. Mr. Herzog stated that 808 tenants did a fax list.

Councillor Born thanked all those present for their participation.

The meeting was adjourned at 1:15 p.m.

For the Committee,

Kathy Born DMD

Councillor Kathleen Leahy Born
Chair

F:030299Hous&ComDevReport

Subj: 929 House
Date: 99-02-26 00:03:46 EST
From: PLCCamb
To: KathyBorn

11 Donnell St.
02138
2/25/1999

Kathy Leahy Born
Cambridge City Council

Re: 929 House and the Doctrine of Involuntary Conversions

Dear Kathy:

General Salutations. Thank you for your kind e-mail. I have actually been planning to e-mail you since the night of the City Council's meeting on the subject of backyard zoning and 929 House. As you know, I attended that long session (from 5:30 to midnight?) because of my interest in backyard zoning. Nonetheless, I was fascinated with the 929 House discussion because of the housing policy questions in involves for Cambridge, the political theater it generated that night, and because, like you, early in my career (as an associate in a large real estate firm) I happened to be involved with some of these building that now are "expiring use" buildings.

Thus, although I did not testify on the 929 House subject, I listened carefully and gave some of the key issues a lot of thought. I felt that your questions to Grove were particularly trenchant. Likewise I felt your demeanor towards Grove was about right. They did not have to be there at all, and I felt that at least one Councilor went way overboard in expressions of hostility towards Grove.

Grove certainly has not handled its negotiations cleverly and like most others I favor a solution which will not cause the city to lose affordable housing units. Nonetheless, Grove's representatives must be treated with respect or they may choose not to cooperate at all.

The Real Topic of this Letter. The real reason that I am writing you now is to share with you an important piece of legal information that neither Grove, nor any councilor, nor any staff mentioned but which is important for all those representing the city to know. It also deals head on with Grove's purported reason for not wanting to sell the property to the city even if the parties could agree on its fair market value.

Grove's Purported Reason for Not Wanting to Sell 929 House. You may recall that Grove's representatives said that if Grove were to sell the building then Grove would face huge capital gains liability. They even claimed that the building had a "negative basis." (My best recollection of tax law is that property can never have a tax basis less than zero.) Assume for the moment that Grove's tax basis in the building is zero and that they could sell the building for $12,000,000. In such a circumstance, Grove would pay capital gains tax on the full value of $12,000,000 (something anybody legitimately could want to avoid). Ergo, Grove does not want to sell. When Councilor Toomey made some comment to the effect that the could take the building by eminent domain, a little light bulb went on in my head (at about the same time that I saw a number of eyeballs rolling).

A Possible Answer - The Doctrine of Involuntary Conversions. I understand the reason why municipal officials, as a general rule, shy away from using eminent domain when they so often can achieve their goals through straight negotiation. This, however, may be one of the rare cases where the exception proves the rule and both sides might be better off if the city were to use its eminent domain power. The reason is to be found in a tax law doctrine relating to what are known as "involuntary conversions." This subject is dealt with in section 1033 of the Internal Revenue Code. Without getting in to all the details suffice it to say that if a property owner suffers an involuntary conversion and receives compensation for it, it is not treated as a taxable event, so long as the money is used to replace that which has been involuntarily converted.

An Example of How an Involuntary Conversion. Suppose in 1977 I bought an apartment building for $150,000 (50,000 for the land and $100,000 for the building). I then depreciated the building over 22 years so that my tax basis in the property is only $50,000 (just the original value of the land – the building now has a tax basis of zero). Meanwhile the building is fully insured for its replacement value of $200,000 (due to inflation in construction costs). Now due to bad luck a gas main ruptures causing a fire and the building is completely burnt to the ground (luckily nobody gets hurt). My insurance pays me the $200,000. What happens next? If I use the $200,000 to rebuild the building within the specified time periods I will not be taxed. Or if I sold the land for $50,000 and used along with my $200,000 of insurance money to buy new similar property I would not pay any tax and would have a carry over tax basis of $50,000 in the new property.

On the other hand, if I had sold the building for $250,000 I would have had to pay tax on the capital gain (the sale price $250,000 minus the tax basis – still $50,000 – i.e., $200,000).

Application of the Theory to Grove. As it happens, a taking with resultant financial compensation is an involuntary conversion and affords its subject the same tax relief that someone who lost his property in a fire has with his insurance proceeds. Thus if the city were to use its power of eminent domain to take the property and Grove were to be awarded a large sum of cash as compensation it could roll this money into another similar property, have a carry over tax basis, and not have to pay any tax on the transaction. Under these circumstances I believe that the city should not be as shy as it usually is about exercising the power of eminent domain if it is necessary to achieve the important housing goals we have.

The same analysis would apply if the city were to effect a partial taking (if it took a portion of the property, of a portion of the ownership interest in the property, or if it passed zoning that was deemed to effect a taking) instead of the whole thing.

During the course of the meeting I mentioned this analysis briefly to a couple of city councilors and members of the Community Development Department, but I had the feeling that they might have been too preoccupied to focus on what I was telling them. I am hoping by expressing my thoughts on 929 House in writing, far from the madcap action of a public meeting, and to one with such a keen mind, that this will get a better hearing. If you agree that this could be an important piece of the negotiation puzzle with Grove, then you might want to suggest to the legal department that they verify my analysis.

I hope that this is of some interest and/or help to you in grappling with the complex issues presented by the case of the 929 House. As the hour is late, I will communicate with you on the subject of backyard zoning at a later date.

Very truly yours,

Peter L. Cohen

Tel. 497-7180
Fax. 497-7190

City of Cambridge

In City Council March 29, 1999

The Housing and Community Development Committee held a public meeting on March 2, 1999, beginning at 11:15 a.m. in the Ackermann Room for the purpose of discussing possible City responses to housing crises such as 929 House.

Present at the hearing were Councillor Kathleen Leahy Born, Chair of the Committee, Councillor Henrietta Davis, Councillor Sheila T. Russell, Councillor Katherine Triantafillou, and City Clerk D. Margaret Drury. Also present were Roger Herzog for the Community Development Department (CDD), Emily Achtenberg, Housing Consultant to CDD, and Elaine DeRosa, Executive Director of Cambridge Economic Opportunity Committee (CEOC).

Councillor Born convened the hearing and explained the purpose. She noted that at a Task Force meeting on improving City Council effectiveness, it was suggested that quick preliminary subcommittee meetings where a number of options could be developed might be useful for crisis situations such as that presented by 929 House. Councillor Born stated that she believes a menu of options is needed.

Councillor Triantafillou agreed that the City Council needs to hear from staff about what options are available.

Roger Herzog, Director of Housing for Community Development, stated that 929 House is an interesting example because up to the date of the new owner reneging on the deal, the strategy had seemed like a good solution to the problem. The previous owner, McNeil, informed the city that they were going to prepay their HUD mortgage and that they were willing to negotiate with the city to try to preserve the affordable units. Mr. Herzog said that the building was initially permitted in 1971 with 127 residential units, 56 were assisted under HUD's 236 program and the remaining 71 were market rate.

Councillor Born asked if the whole building was subject to the 236 mortgage. Emily Achtenberg said that only 56 units were assisted by the 236; it was a typical MHFA deal. Mr. Herzog stated that the City got HUD technical assistance funds through CEDAC to fund the pre-development costs last year. The City's goal was to preserve 57 units.

Councillor Triantafillou asked who was doing the negotiating, and was told that the negotiators were Roger Herzog, Elizabeth Sternberg and Emily Achtenberg. The negotiations began in May 1998. McNeil had told the City that they were not interested in selling. McNeil had hired Recap Advisers as a consultant. In June McNeil said that they were going to sell their whole portfolio to Grove Properties. Grove continued to

Committee Report #1 2215

A report from Councillor Born, Chair of the Housing and Community Development Committee, for a meeting held on March 2, 1999 for the purpose of discussing possible city respnoses to housing crises such as 929 House.

In City Council March 29, 1999

Report Accepted

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