

THE MCKNIGHT FOUNDATION

FOOD FOR THOUGHT



The Tension in Affordable Housing: Are Current “Best Practices” Enough?

*A report by Stacy Becker on affordable housing, commissioned by
The McKnight Foundation.*

DECEMBER 2013

Foreword

The McKnight Foundation originally commissioned Stacy Becker's *The Tension in Affordable Housing* as a thought-provoking and challenging piece for use in a focus group with some of our longtime affordable housing partners. Recognizing the brief report's potential value for a broader audience, we share it now as part of our "Food for Thought" series, a collection of independent reports to help inform our awareness of the fields in which we operate.

In September 2013, McKnight's Region & Communities program convened a small focus group in preparation for a program presentation to the Foundation's board of directors. Across programs, strategic discussions with our board are frequent and meaningful to ongoing refinements. As a matter of practice within McKnight's evaluation framework, we also schedule "deep dives" every few years or so with the board to test working assumptions on goals and strategies, explore the always changing environment of our work, and examine our approach in a broader context.

During this fall's conversations with the board, Becker's piece helped to provide clarity and prompt new thinking in light of the most significant disruption of the housing world since the Great Depression. *The Tension in Affordable Housing* pulls together the biggest demographic, economic, social, and environmental forces that will shape Minnesota's affordable housing field for at least the next five years. Echoing the report's findings, McKnight's board has acknowledged that Minnesota is blessed with one of the most sophisticated affordable housing systems in the country, and has also affirmed the Foundation's continuing commitment to our state's affordable housing field.

Becker's report casts a spotlight on several challenges facing Minnesota's affordable housing sector, including questions about the sector's capacity, operating environment, and the various means through which it delivers affordable housing. Like our many colleagues in the field, we don't have answers to all the questions raised — but we recognize that these critical questions belong to everyone working to provide homes for all across our state.

The issues raised are issues we face together as we strengthen programs and platforms for greater family self-sufficiency and communities that are economically efficient, environmentally sound, and socially equitable. We hope the report offers useful points of consideration in your own work.

**Neal Cuthbert, Vice President of Program
The McKnight Foundation**

The Tension in Affordable Housing: Are Current “Best Practices” Enough?

Minnesota has a reputation for excellence in public systems — an excellence that some believe is overshadowed as other states also advance more innovations. Not so in affordable housing.

Minnesota has developed an affordable housing sector considered by many to be second to none, starting with sound stewardship by the state housing agency and extending to intermediaries who push and prod to engage and address challenges as they arise, local and regional government leaders committed to creating affordable housing, and a host of community-based organizations that both produce and advocate for affordable housing — all underpinned by generous philanthropy that very early on recognized the importance of stable and affordable housing to the success of families.

Moreover, the state’s sector has a clear vision of affordable housing: it is not just a structure in which to live, but a platform to increase family stability and link families to opportunities through access to transportation, education, employment and healthy lifestyles. In Minnesota, affordable housing also strives to be energy efficient and green.

Yet at this moment when our state’s affordable housing sector is as fully realized as ever, various economic, demographic, and political forces have converged to make “homes for all” even more elusive. If we had unlimited resources, our solution might be clear: simply ramp up production. But we live in a resource-constrained world, driven by questions about whether every dollar is used for the maximum benefit of people served.

Our presenting question then is this: With Minnesota’s strong affordable housing sector in an unprecedented position to advance its work, can our current “best practices” meet the needs of the future — or is some fundamental restructuring in order?

RECENT KEY AFFORDABLE HOUSING OUTCOMES

A review of key outcomes, emergent from the confluence of many factors in addition to affordable housing sector efforts, helps illustrate the nature of the challenge.

- The percentage of Minnesota working renter families with severe housing burdens (50% or more of income) has increased from 15.9% in 2008 to 16.9% in 2011. Although at a lower level and a lesser increase than nationwide averages that shifted from 21.8% in 2008 to 23.7% in 2011, Minnesota’s lower cost burdens are consistent with other Midwestern states. (Center for Housing Policy)
- From 2000 to 2009, the number of very low-income metro households paying more than 30% of their income in rent grew by nearly 31%, to about 117,000 households. By 2011, 51% of metro renters had cost burdens of 30% or more of their income. (MPPI)

- Overall, the production of new affordable rental housing in the metro area has fallen well short of [Livable Communities Act](#) (LCA) goals in most communities. From 1995-2010, 63% of rental units were produced in only six communities. Remaining communities achieved only 36% of their LCA rental production goals. (HPP)
- Racially/ethnically concentrated areas of poverty are persistent in the metro, if not entrenched. Up to 40% of low-income people of color in the metro live in such areas. (Met Council)
- A concerted effort to improve the availability of affordable housing along transit corridors has yet to materialize as hoped. In 2012, metro area households had an average housing-plus-transportation cost burden of 46% of income, reaching average highs of 55% in Scott County. (Housing Link)
- Despite some notable recent successes, overall homelessness has been increasing — from 7,751 in 2006 to 10,214 in 2012. (Wilder Research)
- In the metro area, there are an estimated 182,000 units of privately owned, unsubsidized housing with rents affordable at or below 50% of area median income. That's more than the number of households *requiring* such housing, which has been estimated at 150,000 households. Many of these units are occupied by higher-income households. (MPHI)

In short, as fast as our affordable housing sector is moving the ball, the goalpost seems to be moving away even faster.

A REVIEW OF AFFORDABLE HOUSING PROGRESS AND CHALLENGES

The availability of subsidized affordable housing is just *one* of several factors leading to outcomes like those above. Funders such as The McKnight Foundation want to understand how efforts in the affordable housing sector add up to better outcomes for families, linking families to economic opportunity and greater self-sufficiency. We review the sector's capacity, operating environment, and the means through which it delivers affordable housing.

Capacity. Despite the recent crisis in the housing market, or perhaps because of it, Minnesota's affordable housing sector is maturing in composition, skill, and effectiveness:

- Developers have become comfortable with the sophisticated and complex financial transactions inherent in affordable housing production, including the ability to assemble and effectively collaborate with multiple partners, increasingly including partners from other sectors such as health.
- For years, the affordable housing sector consisted of a crowded field that included many small developers, some of whom lacked the highly technical skills needed for affordable housing production. More recently, producers are tending toward larger more regional affordable housing developers, with fewer small CDCs.

- Organizations within the sector are also beginning to more highly differentiate themselves as they set deliberate priorities about which housing market segment to work in, which types of projects to engage in, and which outcomes to aim for.
- Nonprofit developers as well as intermediaries are moving beyond a sole focus on individual projects, toward portfolio creation.
- Developers and intermediaries are taking a more holistic approach to housing, as they actively see and act on links to other goals and service areas, from jobs to emerging markets, healthy communities, health care, and transportation.
- While consensus has emerged about the desirability of transit-oriented development with a mix of uses and mixed-income housing, the practice remains limited, beset by uneven policy and financial challenges.
- Perhaps as a result of having to survive housing market and financial crises, and not being able to rely on relatively stable revenue streams such as annual appropriations, the housing sector is pushing itself to innovate around financing, project design, and partnerships.
- The sector has had considerable success in recent years in reaching out to acquire additional new monetary resources, e.g., Minnesota Housing with the bonding bill, Greater Minnesota Housing Fund garnering employer support, the City of Minneapolis' housing trust fund, various capital campaigns, and more.

Operating environment. Although the housing market is recovering, many families continue to struggle. Wages have stagnated, income gaps have widened, and poverty rates have climbed. When it comes to housing, low-income families — some of whom lost homes to foreclosure or are unable to get mortgages — must compete in an exceedingly tight rental market, just as middle-income young adults and empty nesters are *also* indicating greater preferences for rental housing.

At the same time, federal funding for low-income families wanes. In the housing sector, the steady decline of [HOME](#) and [CDBG funding](#) has now met with federal sequestration, and cutbacks in public housing and [Housing Choice Vouchers](#) are the result. In 2013 survey of Minnesota housing authorities, 64% of respondents said they stopped issuing vouchers as a result of federal cuts; another 9% said they expect to do so in the next six months. Thirty-three percent said they either increased minimum rents or expect to do so. As for public housing, one-half of respondents deferred capital improvement projects; 24% have reduced security, and 20% have imposed higher utility fees on tenants. (MPH and NAHRO) And it is likely that future funding will decline even more, as funding formulas are based on prior year allotments.

Finally, 9% low-income housing tax credits (LIHTC) are slated to float once again in 2014 which, given the current rates of 7.5%, would constitute a considerable *decrease* in purchasing power. LIHTC is the primary financing vehicle for the production of affordable housing in the

United States.¹ The intensity of competition for 9% credits has led some developers to pursue projects with 4% credits only — credits that typically don't provide the depth of subsidy needed to produce housing for the lowest income households. (HPP)

At state and local levels, the sector is achieving some hard won success improving the public's acceptance of housing choice as a fundamental characteristic of a strong community. Affordable housing seems to be claiming legitimacy that public assistance programs continue to struggle with, although they often serve the same families. One notable example, a recent bonding bill for affordable housing passed the Minnesota legislature with bipartisan support.

Delivery and production. Affordable housing is delivered in many ways, with homebuyer assistance, rental assistance, and rental production being the three primary means. Of the \$638 million spent by Minnesota Housing in 2012 on various forms of housing assistance, 17% was for rental production. The \$638 million provided financial assistance to nearly 63,000 units, of which 1,954 units were rental production. (Minnesota Housing, 2012)

While production may be a relatively small portion of units delivered in any given year, it is the production and preservation of units that creates the region's stock of affordable rental housing. The current total number of affordable rental units in the 7-county metro (not counting affordable unsubsidized) has been estimated at 61,000. Of these, 46% are affordable at 30% area median income (AMI); 50% are affordable at 60% of AMI; and the remaining 4% are priced at 80% of AMI. Also, there are an estimated 5,900 units of supportive housing. (Housing Link)

What's being produced

Despite the housing crisis and loss of federal funds, Minnesota's production of affordable housing is as strong as ever. With some clearly established priorities, the production pipeline is strong and busy with no signs of abating despite the tightened fiscal situation. There is a strong focus on rental housing given tight credit markets and the increased demand for rental housing. Housing is being developed as a linchpin for community building, as developers pursue links among access to healthy lifestyles, jobs, and transit. Developers are increasingly focused on mixed-income, mixed-use development, revealing many challenges such as the need for patient capital, greater gap financing, and a lack of understanding of how such development functions relative to the market in which it is developed. There are also renewed focuses on preservation, the homeless, and those requiring supportive housing, with \$35 million of bonding authority obtained by Minnesota Housing for the latter.

Statewide production or preservation of rental units has varied over the past three years, amounting to 2,553 units in 2010, 4,130 in 2011, and 1,954 in 2012. In the 7-county metro, production/preservation has averaged about 1,900 units since 2004. Of those, 32% were affordable at 30% of AMI, 66% at 60% AMI, and 2% at 80% AMI. (Housing Link)

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- LIHTC are allocated by the federal government to states for the production of housing that will remain affordable for at least 30 years. States award the credits to developers in a competitive process. Investors then purchase the tax credits from the developer in exchange for an equity stake in the housing development. Because the 9% tax credits are more valuable than the 4% credits, they infuse more investor capital in a housing project.

Preservation is considered the most cost-effective way to provide affordable housing. A recent report issued by Minnesota Housing shows that preservation costs average \$113,000 per unit, compared to \$212,000 for new construction. (Deppe) Since 1998, Minnesota Housing has invested in the preservation or stabilization of more than 16,700 federally subsidized rental units; in 2012 alone, 1,190 rental units were preserved. Over the next five years, Minnesota Housing aims to invest in the preservation of roughly 1,000 units per year. (Minnesota Housing 2013)

Production challenges

Nonetheless, the overall production of affordable housing (both rental and ownership) has fallen well short of LCA goals set by the Metropolitan Council. From 1995 through 2010, 63% of rental production occurred in just six cities, namely Minneapolis, St. Paul, Brooklyn Park, Bloomington, Burnsville, and Woodbury, although their combined goals represented only 12% of the metro's total. (HPP) And with the exception of Burnsville and Woodbury, these cities also contain most of the metro's 80 census tracts of "racially concentrated areas of poverty." The Met Council's draft Fair Housing and Equity Assessment report to HUD concluded that, "The overall geography of poverty, and especially the specific locations of deepening poverty, suggests poverty entrenched." (Met Council)

The push to produce more transit-oriented affordable housing may also be struggling. [The Big Picture project](#), sponsored by the Central Corridor Funders Collaborative, proposed a goal of 4,500 new and preserved affordable units along the central corridor within a decade. While there has been a surge in rental production, only a small percentage is affordable: 75% of the units projected in the decade are already under way with a limited number of affordable units. (HPP)

Another emerging issue is senior housing. Minnesota, like all states, stands at the cusp of massive retirements of the Baby Boomer generation. Among Minnesota seniors, 88,000 live below the poverty line, and from 2008 to 2010 the number of seniors requesting food support grew 22%. Half of those requesting food support are disabled, and 90% live alone. (PRWeb) A national 2000 AARP survey showed that among homeowners 65 and older, 32% had not modified their homes because they could not afford to do so. (Bipartisan Policy Center) In the meantime, the health care system also continues to evolve.

While most seniors have a desire to age in their homes, it raises tough issues such as the suitability of their housing, transportation, and the provision of long-term care. The number of Minnesota seniors estimated to need long-term care by 2020 is more than 150,000 — doubling to 300,000 by 2050. (DHS) Long-term care can be expensive; the average current cost of long-term care for seniors is estimated at roughly \$50,000 (Kemper et al). While a few agencies have begun to recognize the emerging needs of seniors, society's question of "what to do about senior housing" remains largely an unanswered question.

Finally, Minnesota has nearly 40,000 housing units tagged for federal project-based rental assistance. Minnesota Housing staff estimates that roughly 30% of the 31,000 Section 8 units are at risk of opting out in the next five years. In addition, many properties need capital improvements but lack reserve funds to pay for them; 9,200 units have not had significant capital improvements for at least the past 15 years. Based on current preservation resources and average funding levels, Minnesota Housing projects that it could meet the needs of 20% of the units needing capital improvements over the next five years. In the past 3 years, although

supplemented by Housing Infrastructure Bonds, the agency was oversubscribed at 3 to 1 with applications for funding to preserve federally assisted units. (Minnesota Housing 2013)

Financing and costs

The number and the mix of units produced or preserved is highly dependent on available financing, including tax credits (e.g., some developers are switching to 4% tax credits because of the intense competition for the 9% credits), gap financing, and pre-development. In particular, developers cite the lack of funds in two areas somewhat unique to affordable housing because of its complexity: *predevelopment activities*, which intensify as projects grow more complex; and *bridge loans or capital* that provide financing over the three to five year period it takes for more complex projects to be constructed and stabilize economically.

New construction is expensive. Total development costs are high, averaging \$211,880 per unit for new construction, prompting Minnesota Housing to begin allocating points based on costs for developers seeking project financing. However, from analyses conducted by Minnesota Housing and Washington State, it is not clear that costs are *inappropriately* high. (Deppe) A survey of other states' total development costs revealed that Minnesota's 2012 average costs per unit for tax credit properties was \$178,134, compared to a high of \$297,418 in Massachusetts and a low of \$119,000 in Tennessee. Within the survey, Minnesota's costs were most comparable to Florida and Delaware. (State of Washington)

The State of Washington study points out that affordable housing is burdened with costs that market rate housing doesn't face, such as extra reserves and financing fees related to low-income housing tax credits, a prolonged development period due to the need for multiple financing sources, and requirements to meet other public goals, such as prevailing wage, energy efficiency, and quality standards. In Minnesota, for example, the average per unit total development cost for a new construction project involving acquisition was \$34,500 more for a tax credit project than a non-tax credit project in the metro area, and \$2,800 more in Greater Minnesota. (Deppe)

Private sector "mismatches" are also potential affordable housing sources

A new report presents a surprising fact: in the Minneapolis-St. Paul metro area, there are an estimated 182,000 privately owned unsubsidized housing units with rents affordable at or below 50% of AMI, while the number of households requiring such housing has been estimated to be considerably less, at 150,000 households. (MPHI)

The report points to a "mismatch," in which households of greater means are occupying the affordable housing, leaving it unavailable to low-income people. Given the costliness of producing new affordable housing, and declining federal resources, the report has sparked interest in whether employing new approaches to harness this private sector housing wouldn't provide a quicker and more cost-effective approach to meeting needs for affordable housing.

QUESTIONS

In this environment of increasing need and reduced federal funding, difficult questions arise. Many are all the more difficult because there are no empirical answers to seek and gain. Rather, they are questions of policy and values that we must wrestle with. We present a few here for consideration:

1. As a result of the economic hardship and federal cutbacks, the need for affordable housing — especially quality housing that links people to transit, jobs, and education — seems to be outpacing the speed with which we are able to produce it. So to what extent is it important to innovate *new* approaches to work better and faster?
2. Given increasing needs and federal cutbacks, does reining in the costs of affordable production carry a heightened urgency? What principles should we apply when considering matters of cost:
 - a. What related objectives are important to support as well, such as access to health clinics; transit; mixed-income, mixed-use development; healthy lifestyles; public spaces and art; green building and energy efficiency?
 - b. What's the right balance between containing costs to serve more families, versus creating fewer projects that more fully meet families' needs?
3. Should the de-concentration of poverty be a central goal for affordable housing? If yes, what do we need to do to be more successful? What might be sacrificed?
4. If sequestration continues, amounting in limited resources compared to overall need, must there be a tightening of priorities (e.g., emphasizing support for people of lowest incomes, or for more preservation)? If so, what should our priorities be?
5. Should there be a concerted focus on housing and related needs of seniors? If so, who needs to lead this and how can we make sure it happens?
6. How can the private sector, especially private sector housing development, be leveraged in affordable housing solutions?
7. One might argue that Minnesota's affordable housing sector has developed many of the critical skills needed to solve the difficult public problems of today — sophisticated financial skills, problem-solving skills, the capacity to attract partners and work in a highly collaborative manner, and foresight to transcend its own field and create links with other critical fields such as health, transit, and education. So is there a broader leadership role our affordable housing sector should be filling with respect to the difficult problems of our day? What would this role look like, and how might it manifest in the work of delivering affordable housing?
8. Questions like these create fertile opportunities for discussion and problem-solving. Where will such discussions continue going forward?

*Notes

- (1) *The views expressed in this paper are those of the author's, based on a series of interviews and the sources listed at the end of the paper. The purpose of this paper is not to proffer a definitive view of the state of the affordable housing, but to put forth questions based on issues raised in the interviews to enable a frank discussion about future courses of action.*
- (2) *This paper used data from a variety of sources to shape a general picture; in some cases the data do not always agree.*
- (3) *Both statewide and metro area data are provided; there is greater reliance on metro data only because it is more readily available.*

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ABOUT FOOD FOR THOUGHT

This publication was commissioned by The McKnight Foundation as part of the “Food for Thought” series — a collection of third-party reports that inform our program strategies and are shared with the fields we support.

This publication is available for download at www.mcknight.org.

ABOUT THE McKNIGHT FOUNDATION

The McKnight Foundation, a Minnesota-based family foundation, seeks to improve the quality of life for present and future generations. Through grantmaking, collaboration, and encouragement of strategic policy reform, we use our resources to attend, unite, and empower those we serve. Program interests include regional economic and community development, Minnesota’s arts and artists, early literacy, youth development, Midwest climate and energy, Mississippi River water quality, neuroscience, international crop research, and community-building in Southeast Asia. Our primary geographic focus is the state of Minnesota, with significant support also directed to strategies throughout the U.S. and in Africa, Southeast Asia, and Latin America.

Founded in 1953 and endowed by William and Maude McKnight, the Minnesota-based Foundation had assets of approximately \$2 billion and granted about \$85 million in 2012.

ABOUT THE AUTHOR

Stacy Becker’s independent consulting practice, Becker Consulting, advises government agencies, foundations, policy groups and nonprofits on strategic and financial matters. She formerly served as budget director for the City and County of San Francisco, budget director for the City of Saint Paul, and public works director for the City of Saint Paul. She holds an M.P.P. from the John F. Kennedy School of Government and a M.Sc. in City Design and Social Science from the London School of Economics, which she attended as a Bush Leadership Fellow.

COVER PHOTO — Renaissance Box, an inspired renovation of a historic shoe factory in downtown St. Paul into 70 units of LEED-Gold affordable housing, was awarded the 2013 AIA Minnesota/McKnight Affordable Housing Design Award.

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