



Reforming Subsidized Housing Policy in the Twin Cities to Cut Costs and Reduce Segregation

Institute on Metropolitan Opportunity

January 2014

I. Introduction and Summary

The Twin Cities metropolitan area is one of the least diverse and most affluent regions in the nation. It once operated the nation's most effective program to ensure education and housing integration and fairness. In the early 1990s, there were very few segregated schools in the Twin Cities. Today there are more than 130. The region is much more segregated than Portland and Seattle—the areas most often cited as its primary competitors. Recently the deeply segregated neighborhoods of the Twin Cities experienced an unusually harsh period of decline and disinvestment. Nothing comparable happened in Portland and Seattle.

At one time, the Twin Cities implemented one of the most integrative affordable housing programs in the nation, but its housing integration program was abandoned in 1986. School integration efforts have also been in decline since the late 1990s. In recent years, subsidized housing programs have largely been centered on building and rebuilding housing in the poorest parts of the region.

In recent decades, the central cities have captured a disproportionate share of subsidized housing funding. A large part of the short-term rationale for this is economic development, but in the longer run, the strategy hurts these areas and the region by further concentrating poverty in just a few neighborhoods. The evidence to date suggest these policies have intensified racial segregation and the concentration of poverty. Moreover, because many policymakers and analysts have explicitly rejected the goals of racial integration, it appears that they are unlikely to change course.

The available data also imply that central city development programs are inefficient, spending much more per unit of new affordable housing in the central cities than comparable housing costs in more affluent, opportunity-rich suburbs. Many of the leading developers working in the poorest parts of the region also pay their managers very high salaries. As a result, the funding system incentivizes higher cost projects in segregated neighborhoods over lower cost projects in integrated neighborhoods.

Proponents of this strategy argue that subsidizing housing in low-income neighborhoods strengthens areas deprived of private credit. Most research, however, contradicts this view. The most significant regional attempt to revitalize a neighborhood through housing construction—the Franklin-Portland Gateway—is one of the most expensive affordable housing projects in recent history and appears to have done little or nothing to change its neighborhood's downward trajectory.

On the other hand, potential projects in higher-opportunity suburban areas have gone unfunded. Affordable housing projects in these areas are not only much more cost effective, but can also reduce the concentration of poverty and provide the region's low income citizens greater access to better schools, safer neighborhoods, and more economic opportunity.

The federal Fair Housing Act requires recipients of housing dollars to affirmatively further fair housing. Simply put, federal funding must be used on projects that encourage integration. The region's current subsidized housing strategies are clearly not meeting this requirement.

II. Placement of Subsidized and LIHTC Housing Units in the Twin Cities

This section examines how subsidized housing is distributed across the Twin Cities metropolitan area.¹ The analysis uses data from HousingLink’s Streams data set, which includes information for housing units receiving subsidies from all public sources except HUD’s Section 8 voucher program. The locations of all subsidized units and units supported by the Low Income Tax Housing Credit (LIHTC) are broken out in three ways—by central cities and suburbs; by the racial composition of the surrounding neighborhoods; and by the racial composition of the elementary schools assigned to the units by school district attendance boundaries.

The central city-suburb comparison matters for a variety of reasons. First, the complicated administrative structure that controls the regional distribution of large amounts of subsidized housing divides the region this way. LIHTC funding in the metropolitan area is distributed through five “sub-allocators”—public entities designated by the State of Minnesota to determine LIHTC allocations within their borders. Each of the central cities is a sub-allocator in this system, along with Dakota County, Washington County and the Minnesota Housing Finance Agency (MHFA), which allocates funds across the entire state, including to projects within the boundaries of the other sub-allocators. The central city-suburb comparison thus provides a window into how the administrative structure affects the regional distribution of subsidized housing. In addition, other funding streams often contribute to LIHTC projects and other programs (like Section 8 vouchers) are affected by how LIHTC sites are spread across the region, so the sub-allocator system has effects beyond LIHTC.

The region’s central cities are also crucial to the economic and social well-being of the region. Minneapolis and St. Paul are already home to greatly disproportionate shares of the region’s low-income population and people of color.² Job growth also lags behind the suburbs in most years.³ Research shows that cities and suburbs sink or swim together.⁴ A subsidized housing system that concentrates poverty in the central cities and increases regional segregation levels creates significant long-run costs for the region.

The composition of the neighborhoods where subsidized housing is located matters because public agencies distributing housing subsidies are required by law to affirmatively further fair housing. This means that public actors should not pursue policies that further concentrate

¹ For the purposes of this work, the Twin Cities metropolitan area is defined as the region’s seven central counties—Anoka, Carver, Dakota, Hennepin, Ramsey, Scott and Washington counties. The HousingLink data set is limited to these counties and they contain the overwhelming majority of subsidized housing in the official 13-county metropolitan area.

² Orfield, Myron and Thomas Luce, *Region: Planning the Future of the Twin Cities*, University of Minnesota Press, 2010, Chapters 1 and 3.

³ Luce, Thomas, Myron Orfield and Jill Mazullo “Access to Growing Job Centers in the Twin Cities Metropolitan Area,” *CURA Reporter*, Vol. 36, No. 1, Spring 2006.

⁴ Andrew Haughwout and Robert Inman, “How Should Suburbs Help Their Central Cities?” Federal Reserve Bank of New York Staff Report No. 186 (May 2004), available at www.newyorkfed.org/research/staff_reports/sr186.pdf (accessed February 2008); Robin Leichenko, “Growth and Change in U.S. Cities and Suburbs,” *Growth and Change*, 32 (2001): 326-354; Richard Voith, “Do Suburbs Need Cities?” *Journal of Regional Science*, 38:3 (1998): 445-464, and Albert Solé-Ollé and Elisabet Viladecans-Marsal, “Central Cities as Engines of Metropolitan Area Growth,” *Journal of Regional Science*, 44: 2 (2004).

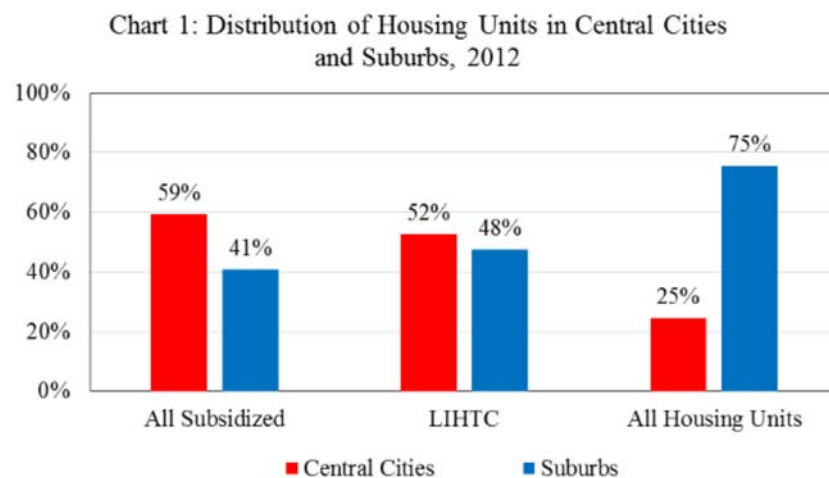
subsidized housing in neighborhoods that already contain disproportionate shares of the region’s affordable housing stock and poor populations. Similarly, they should not concentrate subsidized housing in ways that increase racial segregation in the region’s neighborhoods.

The make-up of schools near subsidized housing matters because a large body of research shows that a school’s poverty rate is the most powerful predictor of student performance and that integrated schools are associated with better student performance for kids of all races.⁵ The Twin Cities consistently ranks at or near the bottom of large U.S. metropolitan areas in the magnitude of racial achievement gaps, regardless of the measures used to evaluate student performance. A distribution of subsidized housing that provides the region’s low-income kids access to low-poverty and racially integrated schools should therefore be a high priority.

A. Central Cities and Suburbs

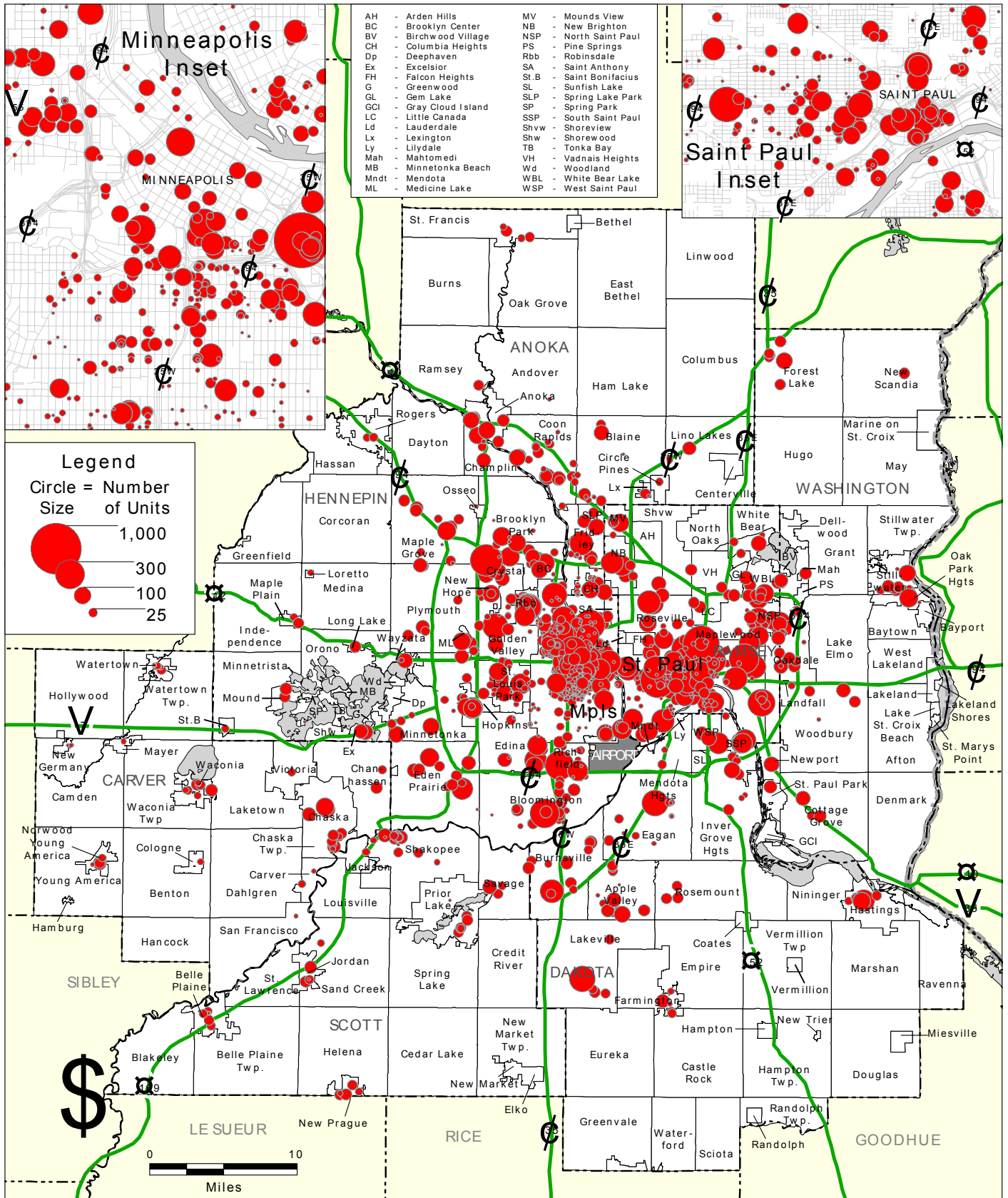
Subsidized housing in the Twin Cities is highly concentrated in the region’s two central cities. In 2012, about 25 percent of the region’s population and housing units were located in Minneapolis and St. Paul. However, more than twice this share of the region’s subsidized housing was located there—59 percent of all subsidized units and 53 percent of LIHTC units. (Chart 1.)

The distribution of subsidized housing within the central cities and across suburbs also shows a distinct pattern. (Map 1.) In the central cities, subsidized units are highly concentrated in neighborhoods along the I-94 corridor—areas with high concentrations of low income people and people of color. Although subsidized units are more scattered in the suburbs, the bulk of the units are in inner suburbs, near to the central cities—areas which generally exhibit more poverty than other suburban areas and which are more likely to be in racial transition.



⁵ See Failed Promises: Assessing Charter Schools in the Twin Cities, IMO, 2008, pp. 6-7 available at <http://www.law.umn.edu/metro/index/inst.-metro.-opp/school-studies/8-failed-promises-assessing-charter-schools-in-the-twin-cities.pdf> for a summary of this literature.

Map 1: MINNEAPOLIS - ST PAUL 7-COUNTY REGION All Subsidized Housing by Project Site in 2012



Data Source: HousingLink STREAMS, NCompass, Minnesota Housing

B. Neighborhood Types

The distribution of subsidized housing across neighborhoods with different racial mixes provides a window on how well the regional system has met its responsibility to affirmatively further fair housing. By this criterion, an effective housing system should not increase economic and racial segregation by concentrating subsidized housing in non-white segregated neighborhoods—areas which are often already characterized by high poverty and poor economic opportunities. Similarly, predominantly white neighborhoods—areas which typically show the lowest crime rates, the strongest environmental and health conditions, and the fastest growing job markets—should not be under-represented in subsidized housing markets. Finally, integrated, racially diverse areas are of interest because these areas are often unstable—in the midst of rapid economic and/or racial transition. Targeting these areas for subsidized housing development may further destabilize them.

The data show very clearly that publicly subsidized housing is heavily concentrated in areas that are already majority non-white. Further, racially diverse, integrated neighborhoods—areas that are often very unstable and susceptible to economic decline—are also home to disproportionate shares of subsidized housing. Despite the fact that most of the region’s housing units are in predominantly white areas, subsidized units are much more likely to be found in majority non-white or racially diverse areas. This can be seen in two ways.

Map 2 shows the percentage of the population that was non-white in census tracts across the region. It is easy to see that the distribution of racially diverse (20-50 percent non-white) and majority-non-white areas are distributed in much the same pattern as subsidized housing. (Map 1.) Majority non-white neighborhoods follow the I-94 corridor through St. Paul and Minneapolis, just as the subsidized units do. Racially diverse and majority non-white areas in the suburbs are also concentrated in inner suburban areas, oftentimes mirroring the subsidized housing patterns in Map 1.

Table 1 shows the relationship more explicitly. In 2012, the share of all subsidized housing units in majority non-white census tracts (33.3 percent) was more than three times greater than the percentage of all housing units in those areas (10.7 percent). Racially diverse areas were also home to disproportionate shares of subsidized housing—44.5 percent of the region’s subsidized units compared to just 33.6 percent of all housing units. In contrast, predominantly white areas contained less than a fourth of subsidized units, despite containing more than half of all housing.

Map 2

Percentage Minority Population by Census Tract, 2010

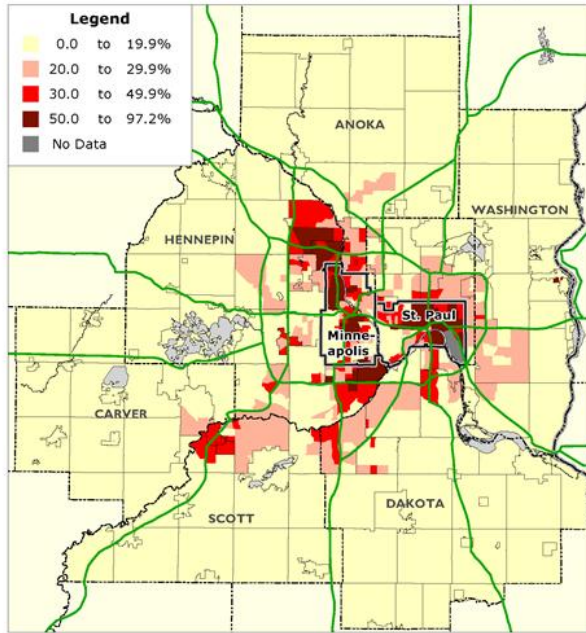


Table 1

**Twin Cities Seven County Area
Number of Total Subsidized, LIHTC and Housing Units
by Percentage Minority in Census Tracts**

% Share of Minority in Tract:	Subsidized Units	LIHTC Units	Total Units
0 to 19%	13,296	2,704	620,429
20 to 29%	13,571	3,157	238,646
30 to 49%	13,131	2,465	134,306
50 to 100%	19,950	3,501	118,685
Total	59,948	11,827	1,112,066

**Twin Cities Seven County Area
Share of Total Subsidized, LIHTC and Housing Units
by Percentage Minority in Census Tracts, 2005-2011**

% Share of Minority in Tract:	Subsidized Units	LIHTC Units	Total Units
0 to 19%	22.2	22.9	55.8
20 to 29%	22.6	26.7	21.5
30 to 49%	21.9	20.8	12.1
50 to 100%	33.3	29.6	10.7
Total	100.0	100.0	100.0

Source: 2012 HousingLink, 2010 U.S Census Bureau.

C. School Types

The make-up of the schools serving subsidized housing is an important indicator of the opportunity structure available to housing residents. Highly segregated schools are also nearly always high-poverty schools, and school poverty is powerful predictor of student performance. Racially integrated schools are of value in and of themselves as well—integration is associated with better student performance for kids of all races. The Twin Cities’ consistently poor rank on racial disparities of all kinds, especially student achievement, makes it doubly important to use all means available to reduce disparities. Employing pro-integrative strategies in the placement of subsidized housing is one such tool.

Not surprisingly, comparing the distribution of subsidized housing to the composition of elementary schools shows patterns much like the population data. Despite the fact that the majority of all students in the region are located in areas with predominantly white student populations in elementary schools, only about one-sixth of subsidized units are in those areas. (Table 2.) This part of the region, of course, is where educational opportunities are strongest for the most part, where crime is lowest, where environmental and health conditions are strongest, and where jobs are growing most quickly. The lack of housing in these areas affordable for lower-income households shuts off long-run opportunities to low-income children of color, contributing to the region’s enormous racial gaps in educational performance.

Reflecting this pattern, nearly 60 percent of subsidized units are in attendance boundaries for majority non-white schools, even though those areas have less than a fourth of all students in the region. These areas are home to the greatest concentrations of lower-performing schools. Attendance boundaries for integrated schools—those with 30 to 50 percent non-white students—contain a proportionate share of subsidized housing. Roughly a fourth of the region’s subsidized housing is in these areas, reflecting their share of the elementary student population. This positive result is tempered by the fact that, like neighborhoods with similar compositions, many of these schools are actually in racial and economic transition. Although integrated in 2012, these schools can be very unstable, meaning that it is inadvisable to add more subsidized housing in these areas.

Map 3 (below) shows the attendance boundaries of elementary schools in the region, divided into three categories – predominantly white (schools with non-white shares between 0 and 30 percent), integrated (non-white shares between 30 and 50 percent), and majority non-white (non-white shares greater than 50 percent). A comparison with Map 1 shows how closely subsidized housing patterns mirror the distribution of predominantly non-white and integrated schools.

Map 3

Racial Composition of Public Elementary Schools by School Attendance Areas, 2012-2013

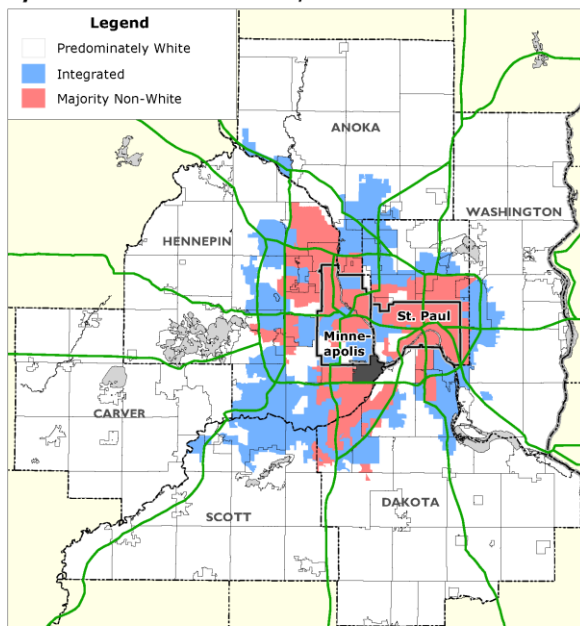


Table 2

**Twin Cities Seven County Area
Number of Total Subsidized, LIHTC Units and Students by
Percentage Minority in Elementary School Attendance Areas**

% Share of Minority in Area:	Subsidized Units	LIHTC Units	Student Population
0 to 29%	9,356	2,211	100,980
30 to 49%	15,806	3,104	43,407
50 to 100%	34,786	6,512	43,666
Total	59,948	11,827	188,053

**Twin Cities Seven County Area
Share of Total Subsidized, LIHTC Units and Students by
Percentage Minority in Elementary School Attendance Areas**

% Share of Minority in Area:	Subsidized Units	LIHTC Units	Student Population
0 to 29%	15.6	18.7	53.7
30 to 49%	26.4	26.2	23.1
50 to 100%	58.0	55.1	23.2
Total	100.0	100.0	100.0

Source: 2012 HousingLink, 2013 Minnesota Department of Education

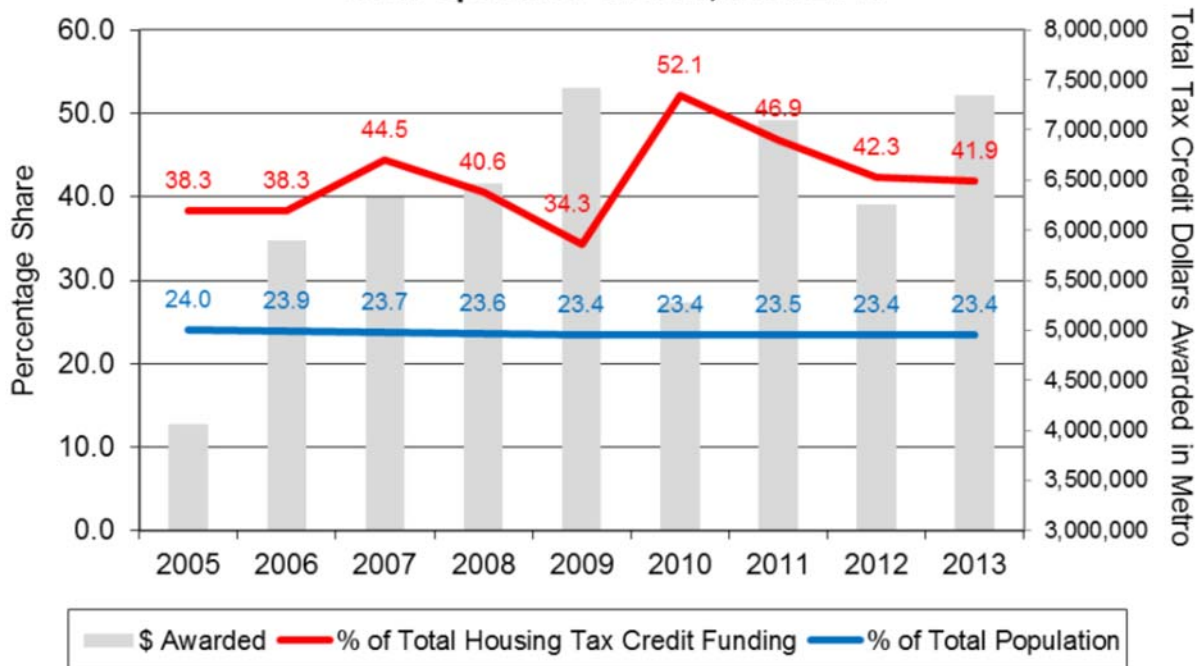
D. Recent Patterns of MHFA LIHTC Allocations

A great deal of the imbalance in the distribution of subsidized housing is due to the disproportionate share of subsidized housing in the two central cities. Data shortcomings make it impossible to see if recent funding patterns have improved or worsened the imbalance. Data

showing recent LIHTC awards are limited largely to projects with MHFA participation.⁶ Data are not available for some projects awarded solely by the Cities of Minneapolis and St. Paul. The two central cities distribute roughly a third of the region’s LIHTC funding in their roles as sub-allocators. Projects with some degree of MHFA participation are counted in the figures below. However, some projects receiving LIHTC funding from suballocators may not be included in the MHFA reports . Nonetheless, the available data show a greatly disproportionate share of LIHTC funding going to sites in Minneapolis and St. Paul; because the central cities are the largest suballocators, more accurate data would almost certainly increase their total share of LIHTC funding.

The LIHTC allocation data show that the percentage of LIHTC awards going to the central cities, measured in dollars, hovered near 40 percent from 2005 to 2009, rose to 50 percent in 2010, and dropped slightly to the mid to low 40 percent range from 2011 to 2013. (Chart 2.) Although these shares (which understate the actual distribution of all LIHTC funds to the central cities) are lower than the share of LIHTC units shown in Chart 1, they still indicate that a disproportionate amount of LIHTC funding is going to central city locations. The two central cities were home to less than 24 percent of the region’s population during this period but received 42 percent of the tax credit funding during the period. Between 2005 and 2013, \$23 million of funding went to the central cities, resulting in over 1,200 new LIHTC units, often in segregated neighborhoods. At the same time, the state rejected about \$33 million worth of requests from suburban areas—places more likely to have higher achieving and more integrated schools.⁷

Chart 2: Central City LIHTC and Population Shares, 2005-2013



⁶ The data are from MHFA’s annual publication of “Housing Tax Credit Awards and Applicants.”

⁷ Figures from IMO analysis of 2005 to 2013 MHFA housing tax credit allocations. Population in chart is from population estimates provide by the Metropolitan Council. http://stats.metroc.state.mn.us/data_download/DD_start.aspx

III. The Costs of Subsidized Housing in the Central Cities and Suburbs

The two central cities are home to disproportionate shares of the regional pool of subsidized housing. Together, Minneapolis and St. Paul contain 59 percent of the region’s subsidized housing, compared to only 25 percent of all housing units (and an even smaller share of population).

Although this unbalanced distribution concentrates poverty and increases racial segregation, one possible defense is that it also provides more “bang for the buck” by focusing funding in lower-cost areas, thereby maximizing the regional total of affordable housing units generated by limited funds. Similarly, if it is cheaper to build affordable housing in the cities and the award process rewards lower costs, then the application process might create an advantage for projects in city locations. This section evaluates and rejects that argument, determining that per-unit total development costs are significantly higher in the central cities. It also explores some possible explanations for these higher costs.

A. Costs of Subsidized Housing Construction

Data for 166 MHFA-funded projects involving new construction of subsidized housing between 1999 and 2013 shows that it is more expensive to construct subsidized housing in Minneapolis or St. Paul than elsewhere in the metropolitan area.⁸ This conclusion is drawn from a statistical model built from data from MHFA data, HousingLink’s Streams dataset and various other sources. The analysis controls for building characteristics and a number of other project attributes that could affect costs. The results imply that, all else equal, it costs significantly more to construct new subsidized housing units in the central cities than in the rest of the region—\$30,000 more per housing unit in Minneapolis and \$37,900 more in St. Paul. These amounts represent 14 and 18 percent, respectively, of the regional average cost per unit of constructing new subsidized housing during this period.

Table 3 shows the characteristics of new construction projects in the Twin Cities region between 1999 and 2013 for the region as a whole, the two central cities and the suburbs. The dataset includes cost and other information for the 166 new construction projects reported by MHFA for that period. The simple cost data show that the region-wide average cost per housing unit (in 2012 dollars) was \$209,334. Projects located in Minneapolis and St. Paul show substantially higher costs per unit—\$227,660 in Minneapolis and \$224,157 in St. Paul—while those in the suburbs were less expensive—\$194,174. However, the simple averages do not reflect other characteristics of the projects and the sites that could affect costs, perhaps enough to reverse the conclusion that projects in the central cities are more expensive.

⁸ The analysis is for new construction only. An effective model of costs for rehabilitation projects would be impossible with available data given how varied these projects are. The cost data are based on budgeted costs and the dataset was edited to exclude duplicated records resulting from revised budgets. In the case of duplicates, the most recent entry was used. The resulting sample of 166 projects is meant to capture all new construction projects that received MHFA funding. Cost data include total development costs—funding from all sources, including non-MHFA public funding and private money. The sample includes projects that received LIHTC funding only from MHFA as well as projects that received LIHTC funds from both MHFA and another regional sub-allocator. See Section II for a description of the sub-allocator system.

Table 3: Summary Statistics for Variables Included in the Statistical Analysis

Variable	Full Sample		Minneapolis		St. Paul		Suburbs	
	Mean	Std. Dev.	Mean	Std. Dev.	Mean	Std. Dev.	Mean	Std. Dev.
Total Development Cost per Unit (2012 \$)	209,334	53,816	227,660	62,381	224,157	64,263	194,174	39,330
Percentage of Units:								
0 Bedrooms	15	33	21	36	15	33	10	30
1 Bedroom	16	26	22	26	25	30	10	23
2 Bedrooms	32	24	26	22	29	25	36	25
3 Bedrooms	24	23	18	21	15	23	30	24
4 Bedrooms	2	7	3	7	2	5	2	7
Percentage of Units Affordable at:								
30% of Regional Median Income	23	35	29	36	37	41	16	32
50% of Regional Median Income	42	42	34	38	33	38	48	45
60% of Regional Median Income	24	39	25	37	15	31	26	42
80% of Regional Median Income	1	5	2	9	0	0	0	1
Percentage of Units Market Rate								
Land Acquisition Included (0/1)	11	21	10	17	11	23	11	23
Demolition Required (0/1)	0.32	0.47	0.51	0.51	0.55	0.51	0.15	0.36
Historic Building(s) Involved (0/1)	0.24	0.43	0.38	0.49	0.41	0.50	0.10	0.31
Rehabilitation of Existing Unit (0/1)	0.02	0.13	0.04	0.19	0.05	0.21	0.00	0.00
Conversion (0/1)	0.09	0.29	0.13	0.34	0.18	0.40	0.05	0.21
Non-residential Dev. (sq. ft. per res. unit)	0.03	0.17	0.05	0.23	0.09	0.29	0.00	0.00
Non-residential Dev. (0/1 - sq. ft. n.a.)	23	77	47	115	23	57	7	40
Units per Building	0.06	0.24	0.13	0.34	0.14	0.35	0.00	0.00
Number of Buildings	33	35	41	32	54	52	23	27
LHHC included (0/1)	3.3	3.8	2.5	4.1	2.1	2.7	4.1	3.7
Minneapolis Location (0/1)	0.75	0.43	0.80	0.40	0.59	0.50	0.76	0.43
St. Paul Location (0/1)	0.33	0.47						
St. Paul Location (0/1)	0.13	0.34						

Sources: HousingLink, MHFA, various news articles, real estate listings and LHHC proposal documents.

First and most obviously, cost is heavily impacted by the characteristics of units in question. If the central cities were building larger units—or perhaps targeting slightly higher-income residents—then one might expect different construction costs. As it turns out, the opposite was occurring: central city units are disproportionately efficiencies or one-bedroom, while suburban units are more likely to contain two or three bedrooms. Higher shares of central city units also tended to be affordable at lower incomes.

Another possible explanation for higher costs in the cities is commercial space. City developments were in fact more likely to be mixed-use, with commercial space intended for retail or offices. This space is theoretically eligible for fewer public dollars than housing, but even mixed-use developments tend to be very heavily publicly-subsidized. Similarly, city projects were more likely to include land acquisition costs, demolition costs or historic buildings; all factors that could increase costs.

Other factors may impact costs, but have less predictable effects on the city-suburb cost comparison. These include the percentage of units to be rented at market rents, whether the project includes some rehabilitation of existing units, the number of buildings, the number of units per building and whether the project includes LIHTC funding.

The statistical model (reported in Table A.1, Appendix A) includes all of the above factors, and demonstrates that many do in fact affect per-unit costs. However, controlling for these characteristics actually results in a wider cost gap between central cities and suburbs than in the simple averages. After accounting for all of these factors, the gap nearly doubles to \$30,000 for Minneapolis and more than doubles to \$37,900 for St. Paul.⁹ Indeed, a location in Minneapolis or St. Paul remains among the most important of all the factors affecting costs per unit.

The large cost effect of a central city location is rivaled in the results only by whether the project included LIHTC funding, the number of units per building, the percentage of units that are market rate, whether land acquisition was required and whether the project includes high percentages of large units (three or four bedroom units).¹⁰ That site and unit characteristics are important is not surprising. The large effect for LIHTC funding—all else equal, projects with LIHTC funding had costs \$40,660 higher per unit—is less easy to explain. It is not simply an effect of public funding because all projects in the dataset received some amount of public money. It could represent higher costs due to red tape (if LIHTC is more heavily regulated than other funding sources) or those due to less strict rules about how to spend the money (if LIHTC is less heavily regulated than other funding sources). In either case, it is a finding worthy of further research.

The actual cost discrepancy may be even greater than indicated by the statistical analysis because it could be argued that the model controls for characteristics that should be omitted as policy variables. Building size and composition is as much a function of a development's geographic location as it is a discretionary choice of the developer. Likewise, if historic preservation and

⁹ IMO is now collecting data on another factor that may matter—whether the units were built to accommodate special populations like elderly or disabled tenants.

¹⁰ This comparison is based on standardized coefficients, shown in Table A.1. Only the LIHTC and units per building coefficients exceed the Minneapolis and St. Paul coefficients (in absolute value).

other project characteristics drive up costs, this may form part of the case against city building. Nonetheless, the model errs on the side of caution by including these factors; despite this, the cost disparity remains.

The econometric model only incorporates characteristics of the developments in question. If the full cost difference between city and suburb can't be predicted by looking at *what* is being built, the gap must be the result of *how* projects are being built or funded, or *who* is building them.

It is possible that construction costs in the cities are higher because of the relative difficulty of building large developments in a densely populated area. These costs can arise from a number of sources. Land suitable for development is scarcer in the cities and therefore likely costs more as well. (Note, however, that the land for affordable developments is not always acquired at market price and is often in low-cost, high poverty neighborhoods.) Additionally, other costs associated with construction might be higher in central city locations—sites might be more difficult to access or might require additional safety measures. If building is on or near a former industrial site, pollution cleanup could be required before development can begin. Last but hardly least, the cities might more strictly regulate construction and development. Traffic studies, pollution studies and environmental certifications, historic preservation rules—all increase the expense of building.

The other notable feature of affordable housing development in the central cities is the number of private firms and interest groups with a hand in its creation. While housing construction in the suburbs is frequently managed by county development agencies, the cities are home to a large network of heterogeneous organizations, all with a role in the process. This could work to raise costs in several ways. First, some groups may directly benefit from increased spending in the housing sector—particularly public spending, some of which is little more than free money for developers. Another, more subtle mechanism by which interest groups increase costs is by promoting projects without regard to cost-efficiency. For instance, while developing in a particular neighborhood may be expensive, a community development corporation based in that neighborhood creates a political constituency for development activity focused in that neighborhood. These development constituencies are not necessarily geographic—for instance, some of the largest development organizations in the Twin Cities focus on housing for recovering addicts. Nor are they necessarily private. Minneapolis's Department of Community Planning and Economic Development is far larger, better funded, and better organized than its suburban equivalents; it has the clout to substantially increase development within the city.

Because of their number and complexity, determining which of these factors is primarily responsible for the cost difference between cities and suburbs is impossible without better data. Moreover, it is unlikely that one single explanation exists; instead, some combination of the above factors probably contributes to the higher cost of affordable housing construction in the cities.

Nonetheless, the available data is sufficient to determine that affordable housing supply is not especially responsive to cost. The emphasis on expensive city building over cheaper suburban building suggests that the amount of construction is not strongly impacted by small marginal increases or decreases in unit cost. Of course, some of this is by design. Cost-effectiveness is

not the primary goal of affordable housing construction; rather, affordable housing fills a range of needs which the private housing market has failed to provide. But all else equal, increased cost-effectiveness would allow more bang for the public's buck. What's more, unresponsiveness to cost helps demonstrate defects in the affordable housing market—defects which have deepened as the affordable housing funding has become more tangled and the development community has fragmented.

B. The Twin Cities Development Community

Prominent among the potential explanations above for higher costs in the central cities is the number of private firms and interest groups with a hand in its creation. Affordable housing development in the Twin Cities (and especially in the central cities) is dominated by a web of sundry developers, community development corporations, investors and government entities. The large number of participants helps to draw public funds into the housing development apparatus while complicating any attempt to align funding with discernible policy goals. Analyzing community developers poses a difficulty: there is no truly “typical” organization. At present, the Metropolitan Consortium of Community Developers (MCCD), which includes almost all the major players in the Twin Cities housing nonprofit scene, has forty-nine members, which range from tiny community groups to large non-profits with yearly revenues in the dozens of millions of dollars. Some organizations—for instance, Twin Cities Habitat for Humanity—are affiliated with larger national groups, while others are affiliated with for-profit companies. Activities run the gamut as well: large developers are able to independently conduct most development, while neighborhood groups are forced to partner with builders, architects, financiers, and each other.

1. Housing Nonprofit Financial Overview

In terms of raw spending and revenue, the activities of the larger members far outstrip those of the smaller members. In 2011, the last year for which data are available, MCCD members had combined expenses of \$178,111,075. But the activities of just eight of the 49 member organizations accounted for \$110,193,034, or nearly 62 percent, of this total. These organizations were Aeon, Artspace, Twin Cities Habitat for Humanity, RS Eden (a nonprofit building supportive housing for substance abuse victims), Commonbond, the Greater Metropolitan Housing Corporation, Project for Pride in Living, and the Community Housing Development Corporation, each with more than \$10 million in expenses.¹¹

By comparison, the expenditures of small Neighborhood Development Corporations are much lower. For example, 17 organizations spent under a million dollars in 2011, accounting for less than 5 percent of total spending.

The MCCD organizations have three primary sources of revenue: program service fees, private contributions, and government grants. Of the three, program services contributed the largest share, totaling \$90,318,705 in 2011. Coming next, private contributions provided \$52,288,626. Finally, government grants accounted for \$46,719,761 to MCCD members.

¹¹ Nonprofit financial data is drawn from the Form 990s of the respective organizations for the year 2011, available on www.guidestar.com.

Nearly 90 percent of reported MCCD expenses go to program services, with the remainder spent on administration and fundraising. Approximately 30 percent of total expenses are in the form of employee compensation. However, both these figures, and particularly compensation, vary widely between organizations.

There appears to be little relationship between an organization's reported financial characteristics and the amount of government grant money it receives. The percentage of total revenue accounted for by grants varies widely between organizations, both large and small, ranging from nothing or a few percent to nearly the entirety of an organization's yearly income. Nor does an organization's size (in assets or in members) seem to correlate well with the percentage revenue received through grants. Among the eight highest-spending organizations for instance, the Greater Metropolitan Housing Corporation received \$5,233,407, while CommonBond received a comparatively meager \$690,000 in grants. And smaller nonprofits frequently received large sums: for instance, Dayton's Bluff Neighborhood Housing Services (\$2,834,567), Emerge Community Development (\$2,942,801), and the Hmong American Partnership (\$3,440,103).

Unsurprisingly, executive compensation appears to be associated with an organization's size. Of the "Big Eight" organizations that account for most expenses, seven also have the highest-paid chief officers of MCCD member organizations, with yearly salaries ranging from \$207,200 to \$144,056. (Aeon comes in tenth, paying its president \$123,861.) In general, heading up a housing nonprofit appears to be fairly lucrative, with only eight organizations paying their chief executives less than \$50,000 a year. (At least one of these is overseen by the CEO of Minneapolis for-profit developer The Ackerberg Group; it is possible that the leadership of other MCCD members also includes for-profit business owners.)

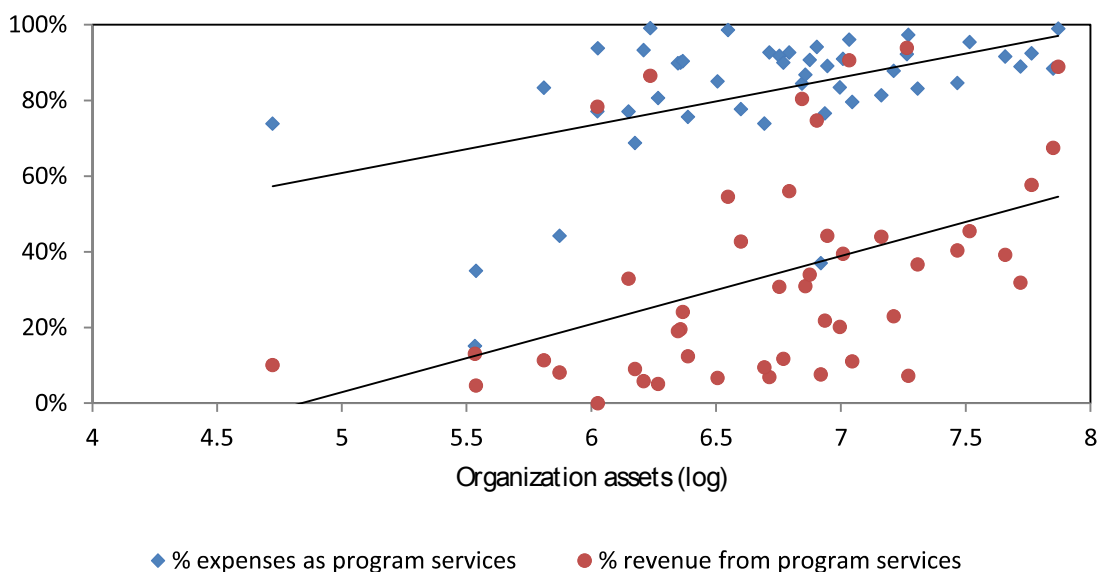
Among the rank-and-file employees, average salaries vary dramatically across organizations. Some are apparently quite high—the Community Housing Development Corporation reports only five employees and \$786,289 in compensation, averaging out to \$157,257 each, and Portico reports 17 employees, averaging out to \$91,802 apiece—but the majority range between \$25,000 and \$55,000 per year.

There is one area in which clear distinctions between organizations do emerge, however: program services expenditures and revenues. While most MCCD members' expenses are largely dedicated to program services, that proportion tends to increase in organizations with more assets. What's more, larger organizations derive a significantly higher percentage of their revenue from program services. This correlation is statistically significant at a 1% confidence level.

While care should be taken to not draw too many conclusions from these figures, the rather strong association between an organization's size and its programs' finances suggest that MCCD's large nonprofits operate more efficiently and in a manner more akin to for-profit enterprises. They draw large amounts of their funding from service fees and cover the gap between revenues with grants and contributions, while smaller organizations tend to fund more of their activities directly out of grants and contributions. (Chart 3.) This distinction may also represent the large organizations' tendency to participate in stable, ongoing arrangements which

they are successfully able to monetize—for instance, participating in continuous housing development for fees—instead of a selection of relatively heterogeneous activities, primarily linked by their geographic focus.

Chart 3: Percent Revenue and Expenses from Program Services, MCOO Members (2011)



2. Case Studies

Given the diversity of housing organizations and projects in the Twin Cities, a closer examination of a few individual nonprofits has the potential to reveal details that be overlooked in a broad, sector-wide analysis. Two of the largest local nonprofits were selected for this purpose: Community Housing Development Corporation and AEON. Besides being particularly influential members of the local affordable housing community, these two organizations appear to have adopted very different development approaches. In addition, another type of actor is briefly examined: financial intermediaries. These entities help provide and direct the complex funding streams at the core of subsidized housing development.

a. Community Housing Development Corporation

Among the variety of housing nonprofits and CDCs in the Twin Cities, Community Housing Development Corporation (CHDC) stands at one pole: it is small and keeps a comparatively low profile, but has unusually large financial resources at its disposal. Its 2011 revenues were nearly \$15 million, the fourth highest among MCOO members. It also received a relatively low fraction of those revenues directly from public and private contributions—only two percent and nine percent, respectively. By comparison, 27 percent of combined MCOO revenues came from private contributions, and 24 percent came from government grants. CHDC instead gets the vast

majority of its revenue from program services, primarily tenant rent; in this way it closely resembles a for-profit firm.

This resemblance is not a coincidence. CHDC is closely associated with Brighton Development Company (BDC), a major Twin Cities developer for three decades. CHDC was created in 1982 (one year after Brighton itself was created) by one of Brighton's three founders, who still remains CHDC's vice president and highest-paid employee, earning \$207,200 in 2011. In late 2012, Brighton's owners decided to wind down the for-profit development firm and shortly afterwards, another of its founders joined CHDC (after having served in the past as a CHDC vice president, receiving \$102,440 in 2007).¹²

CHDC's association with Brighton extends beyond shared employees. Prior to 2007, CHDC reported no employees on its Form 990 tax filings. It did, however, employ both Brighton Development Company and its property management subsidiary as subcontractors. Between 1999 and 2012, CHDC paid over \$11.5 million to BDC and BDC Management.

Between the shared employees, business interactions, and the unusual lack of independent publicity or identity—CHDC itself doesn't have so much as a website—the organization in many ways appears to be little more than the nonprofit branch of Brighton, although it does appear to have established itself as a more independent entity in recent years. In the mid-2000s, CHDC began to bring a number of its subcontracted business activities in-house. Former BDC employees began receiving compensation as CHDC employees and the nonprofit hired another BDC employee to serve as property manager. Between 2003 and 2008, CHDC paid \$1.1 million to its housing financial consultants JLPope; these payments stopped in 2009 when it hired a JLPope employee as asset manager. Meanwhile, it stopped reporting any payments to BDC or any other external developer.

Over the same period, CHDC experienced rapid growth. In 1999, the nonprofit owned seven properties comprising 645 units of housing, and participated in ten limited liability partnerships (LLPs), presumably for the purpose of syndicating low income housing tax credits on additional properties.¹³ In 2012, CHDC owned 19 properties with 1,542 housing units. Its participation in LLPs peaked at 24 in 2007, before falling back to 19 in 2012. Both expenses and revenues more than doubled over this period, while contractor expenses fell by 40 percent.

Most of CHDC's projects are located in the central cities. Outside of its syndication partnerships, only 472 units (or 31 percent) of its housing are located elsewhere—and 198 of those are located outside the metro area altogether. The Twin Cities suburban developments are all in Hennepin County: Prairie Meadows, a 168 unit project dating back to 1976 located in Eden Prairie; Raspberry Ridge, a 101 unit development from 1979 in Hopkins, and Unity Place in Brooklyn Center, which contains 112 units and last received funding in 1978. (Note, however, that the composition may have changed in recent years. Syndication partnerships typically last fifteen years or more; thus, any newer developments constructed or rehabilitated with tax credits would still be owned by the partnership. Nonetheless, the evidence, if incomplete, suggests a significant focus on central city development.)

¹² Burl Gilyard, *Condo Pioneer Brighton Winding Down*, Finance & Commerce, Oct. 18, 2012.

¹³ See Section IV. for a description of how LLPs are used in syndications.

Chart 4: CHDC Revenues, 1999-2012

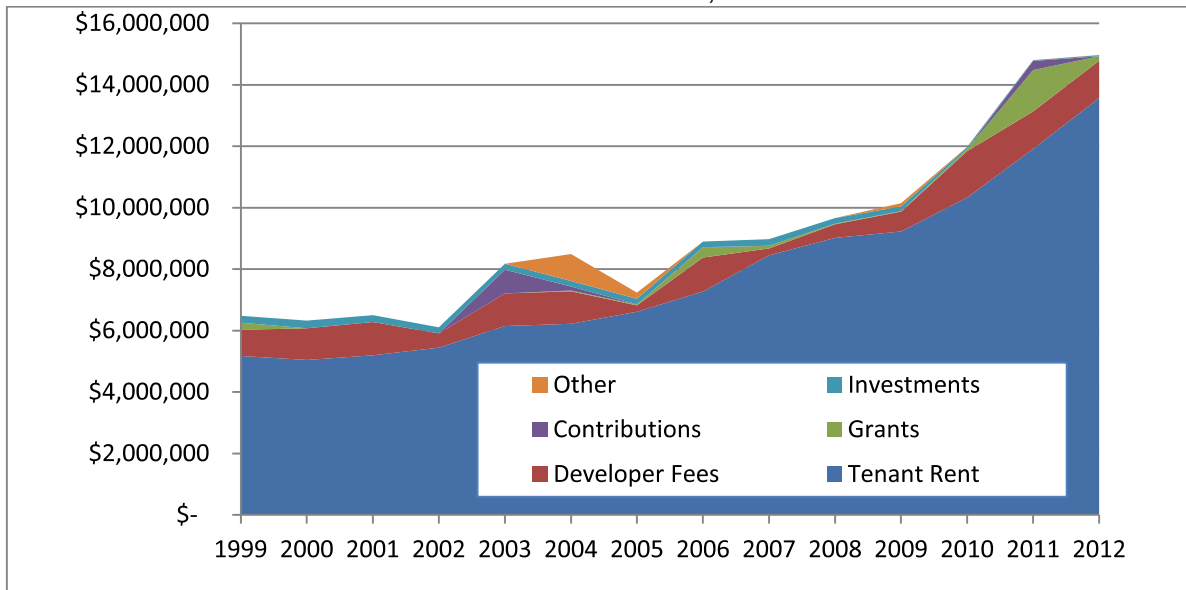
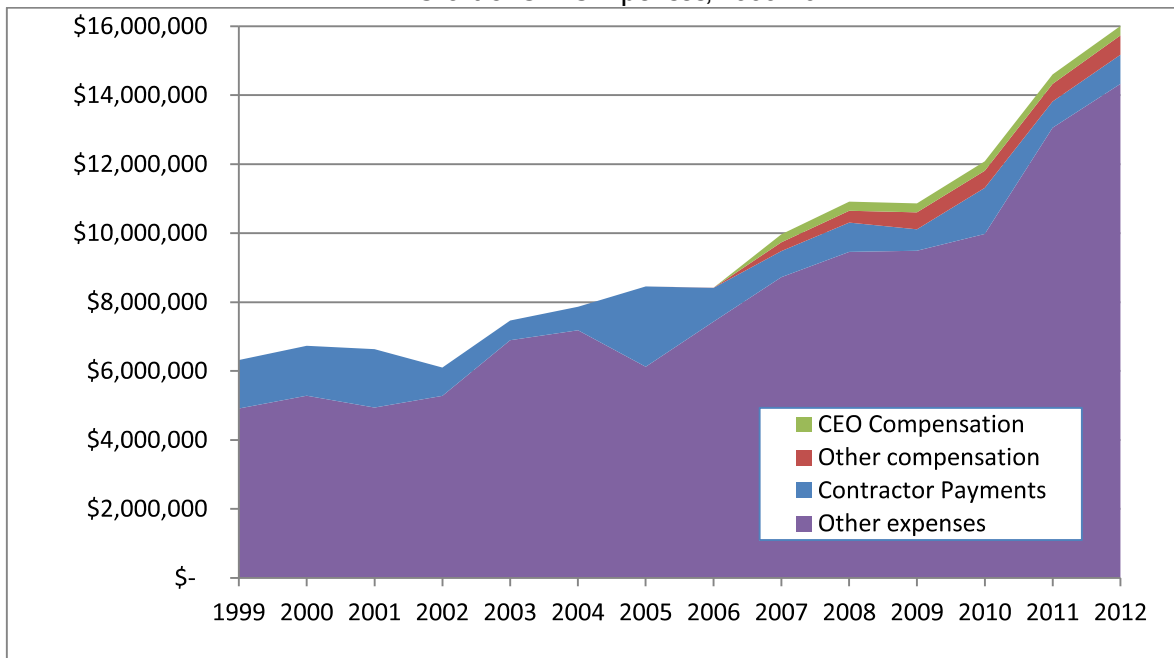


Chart 5: CHDC Expenses, 1999-2012



b. AEON

Twin Cities nonprofit developer Aeon appears to operate under a very different model, relying heavily on public funding to conduct a broad range of activities related to housing. Aeon's programs are wide-ranging, including both development of new properties, often in conjunction with local nonprofits and organizations, and purchases of existing properties, which it then manages. Aeon conducts rental operations in-house, accounting for a sizeable portion of its yearly revenue.

Where CHDC generates most of its yearly revenue from its own programs, Aeon derives a very substantial fraction of its revenue from private contributions and government grants—16 percent and 25 percent in 2011, respectively. It is also a much larger organization, with 149 employees (compared to CHDC's five). Much of the size difference is a consequence of Aeon's property management and rental services—the addition of these divisions in 2008 resulted in the addition of more than 75 employees.¹⁴ However, like CHDC, Aeon also appears to have experienced rapid growth over the past decade even if its rental business is ignored. Aeon reported owning and operating 920 units in 1999, and 1,952 units by 2011. The actual figure, however, is probably much larger, when units owned as part of a syndication partnership are included.

Aeon's primary development focus is the central cities, and the vast majority of its units are located in the urban cores of Minneapolis and Saint Paul. In recent years, it has made a limited push into a handful of suburbs; these developments, while not insignificant, still seem to be more the exception than the norm. Its suburban developments include Clover Field Marketplace, a \$24 million complex in Chaska with 117 units and 7,500 square feet of commercial space¹⁵; Har Mar Apartments in Roseville, comprised of 120 units purchased for \$5 million in 2006 and 50 additional units built for \$12.7 million in 2012;¹⁶ and Shingle Creek Towers, a foreclosed 122-unit Brooklyn Center development purchased in 2012.¹⁷

¹⁴ *Aeon Adds Property Management June 1*, Finance & Commerce, April 10, 2008.

¹⁵ *Nonprofit Aeon Opens Clover Field Marketplace*, Finance & Commerce, October 30, 2008.

¹⁶ *Aeon Adds Affordable Rentals in Roseville*, Finance & Commerce, February 1, 2012.

¹⁷ The Shingle Creek purchase had a complicated history, and one that demonstrates the sort of multilateral transactions that frequently arise in the affordable housing sector. The property was originally purchased from HUD in 2011 by a New York landlord "with a history of code violations," who residents feared would raise rents. The Twin Cities nonprofit Housing Preservation Project filed a lawsuit against HUD, ultimately resulting in a second HUD auction restricted to nonprofits. Aeon won the auction with a "bid" of \$1, and residents settled the lawsuit after being given assurances from Aeon that present occupants would see no rent increase and at least 36 units would remain rent restricted. See Katy Zillmer, *Tenants' Fight for Their Rights Pays Off in Brooklyn Center*, Sun Post, June 26, 2012.

Chart 6: Aeon Expenditures, 1999-2011

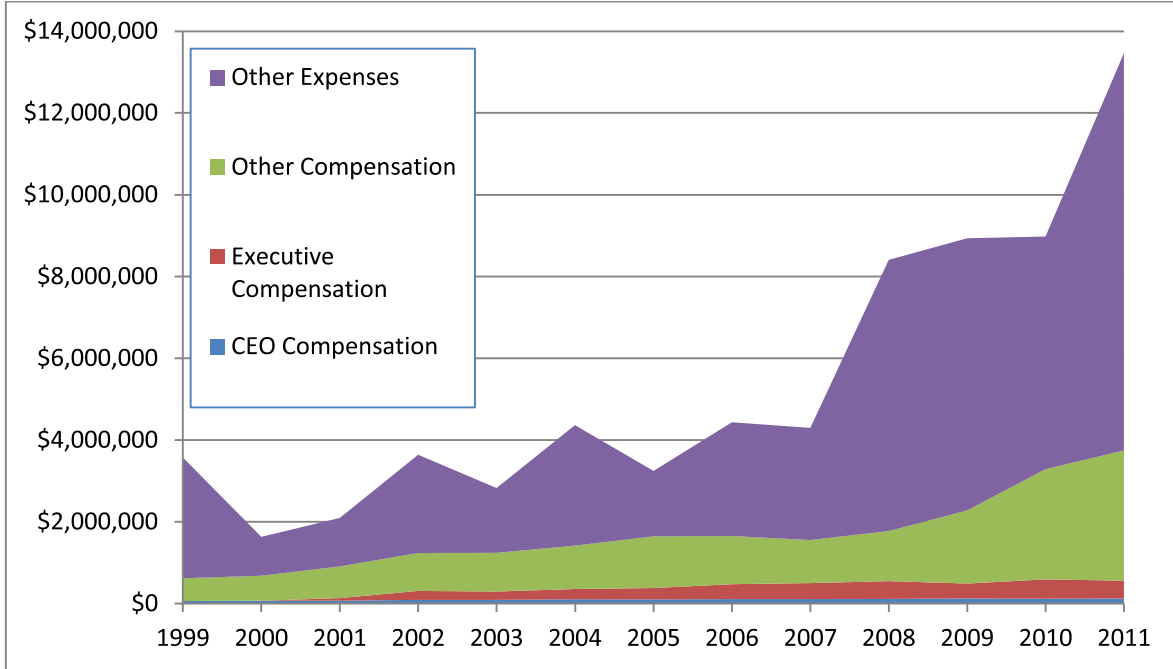
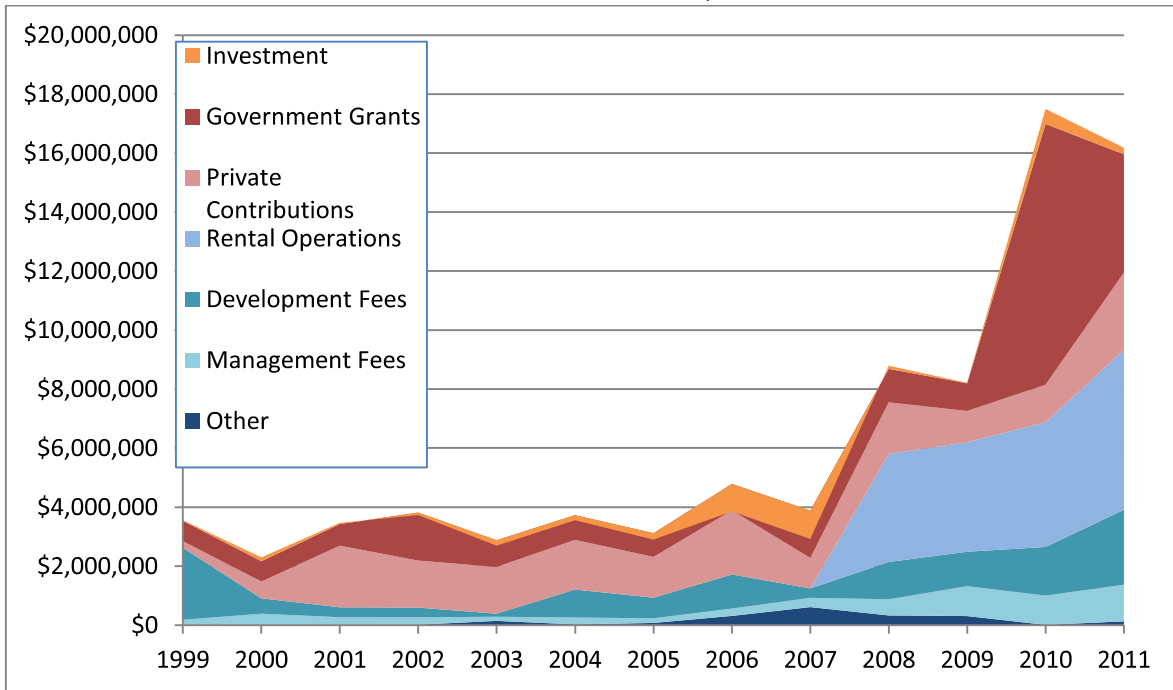


Chart 7: Aeon Revenues, 1999-2011



c. Affordable Housing Financial Intermediaries: LISC and Family Housing Fund

Developers are the most high-profile members of the affordable housing community, but some financial intermediaries are similar in size. These organizations—frequently nonprofits as well—provide loans and grants to housing projects, helping developers cover funding gaps and navigate the complexities of the financing process. In essence, they fill a market niche created by the complexity of the affordable housing system, bringing together the vast number of government and private entities that participate financially in the construction of a single housing project.

Family Housing Fund is one example of a local housing intermediary, comparable in size to the larger local developers (like Aeon and CHDC). In 2011 it maintained assets of \$72,156,907 and liabilities of \$34,384,044. Its expenses, \$10,554,586, significantly exceeded its income of \$6,414,242. As with for-profit financial firms, its executives are well-compensated, with its president receiving \$173,159 and vice president getting \$139,495.

But the largest Minnesota organizations are dwarfed by national nonprofit housing intermediaries. One of the largest national players in affordable housing financing is Local Initiatives Support Corporation (LISC), which is headquartered in New York. It is comparable in size to a significant national financial firm, with assets totaling \$440,406,573 in 2011, and income of \$149,668,788. Its size is reflected on its payroll: the same year, LISC paid out \$5,299,110 in salary, with its president receiving \$408,432.

IV. Other Factors Leading to Greater Spending in Central Cities

This section explores two other features of the subsidized housing sector that contribute to the central city focus of regional spending: the criteria used to select projects for public funding, particularly low-income housing tax credits, and the use of subsidized housing as a means of boosting neighborhood economic development.

A. Project Selection

Funding for affordable housing is provided by a complex web of public and private agencies, and through a variety of financial vehicles. The best-known and most influential of these is LIHTC, allocated to the states by the federal government, and to developers by a series of sub-allocators. In the Twin Cities, the largest sub-allocators are MHFA, Minneapolis and St. Paul. In addition, a variety of other local entities receive a portion tax credits, including for instance Dakota County and some municipalities.

State law currently guarantees that Minneapolis and St. Paul each receive a share of tax credits significantly greater than their share of the region's population. The formula in the law includes a component that allocates tax credits to each central city (and only to them) at 1.25 times

population and awards additional allocations based on the number of welfare recipients in the sub-allocators' service areas, which also disproportionately favors the central cities.¹⁸

Public agencies also provide funding to developers through a range of different direct loans and grants. Public money is sometimes augmented with private grants, which usually works its way through a network of nonprofits. Frequently, private grants originate from organizations which themselves received significant contributions of public money; at least some part of these private grants represents indirect public contributions. Finally, of course, some purely private investment capital is spent developing low-cost units, although the layering of funding mechanisms tends to obscure the exact size of the private contribution.

One explanation for why affordable housing construction focuses on the central cities despite higher costs is because funding allocators deemphasize project cost. Tax credit allocations do take cost into consideration, but LIHTC projects are evaluated by point-based allocative systems that give more emphasis to a welter of other factors. Other sources of funding seem to function in a similar fashion. In addition, money is frequently allocated to geographic areas, which prevents lower-cost projects from outcompeting high-cost projects, to the extent that lower-cost projects are outside prioritized funding areas.

1. How the Low Income Housing Tax Credit Works

LIHTC allocation is complex. The determination of which projects receive LIHTC allocations is independent of the determination of the number of credits that will be allocated. As a result, a particularly expensive project, requiring a large number of credits, is not necessarily at a disadvantage when compared to a cheaper project.

a. Proposal Grading System

Federal law requires that developments meet one of two criteria to qualify for tax credits: either 1) 20 percent or more of a development's units must be rent restricted and occupied by families below 50 percent of the region's average median income, or 2) 40 percent or more of a development's units must be rent restricted and occupied to families below 60 percent of the region's average median income. Confusingly, this multidimensional standard incorporates local average incomes, the relative number of units provided, the actual rents on those units, the actual occupancy of those units, and the actual incomes of the occupants.¹⁹

Projects which meet these criteria are chosen for tax credit allocations in a competitive process, the particulars of which are governed by the suballocating agency. In Minnesota, projects are assigned points based on their characteristics; proposals with more points are given priority over proposals with fewer points. The point system is the suballocator's most direct means of

¹⁸ Minn. Stat. § 462A.222, subd. 1 creates Minneapolis and St. Paul as sub-allocators of the tax credit and subd. 2 allocates the credit to both central cities at 1.25 times population with additional allocation points based on the number of welfare recipients.

¹⁹ Tim Iglesias and Rochelle E. Lento, *The Legal Guide to Affordable Housing Development* 252-61 (2011).

incentivizing certain types of affordable housing construction, and prioritizing particular policy goals.²⁰

To qualify for tax credits, projects must score at least 30 points. However, each year, developments seek far more credits than are available. Because most developments depend on credits for a substantial portion—and often the majority—of their funding, developers have a strong incentive to maximize the number of points scored, and therefore their chances of receiving adequate funding.²¹

The number of tax credits a project receives is determined by the project’s characteristics, not the competitive point process. A handful of points are available for more cost-efficient projects; outside of those, a project cannot increase its chances of receiving tax credits by cutting costs. The formula for the amount of credits allocated takes into account a range of different factors and incorporates multiple, shifting standards. The number of tax credits provided also varies with the number of affordable units included in the project, of course.

Determining eligibility is only the first step. In order to calculate the actual number of credits allocated, allocators must also determine the project’s “eligible basis,” which includes most costs of construction, but omits certain expenses, such as land costs. Tax credits are then assigned to cover a certain percentage of the eligible basis. The percentage varies based on whether the project is rehabilitating an existing unit or constructing a new unit; the former qualifies for tax credits covering 30 percent of the project’s cost, while the latter qualifies for credits covering 70 percent. Additionally, a certain number of credits are set aside to be allocated to nonprofit organizations. Finally, projects to be constructed in “Qualified Census Tracts” or “Difficult Development Areas,” determined by HUD on a yearly basis, are allowed to increase their eligible basis by up to 30 percent.²²

Further confusing the matter is the process of actually generating capital from tax credits. A given dollar value of credits does not translate directly into the same amount of cash for a developer. Instead, a tax credit entitles the holder to deduct that amount from its taxes for ten years. Thus, ten dollars in credits can potentially reduce the holder’s tax bill by one hundred dollars over a decade. But the *present* value to a holder might be markedly less than one hundred dollars. This is both because simply multiplying the allocation by ten ignores the reduced future value of money, and because uncertainty about future events introduces an element of risk into the credit grantee’s expected returns. Two major risks include the project owner’s ability to ensure the project remains qualified for credits for the following decade, and the risk that the tax credits available in a given year could exceed the applicable tax burden, meaning that some go to waste.²³

This complicated structure has produced an equally complicated financial backend. Because a project’s backers will rarely generate enough taxable income to make full use of the credits,

²⁰ Minnesota Housing Finance Agency, Housing Tax Credit 2013 Qualified Allocation Plan, available at http://www.mnhousing.gov/idc/groups/public/documents/webcontent/mhfa_012460.pdf.

²¹ *Id.*

²² Iglesias and Lento, *supra* note 2.

²³ *Id.*

credits are usually distributed by forming a partnership or limited liability corporation with for-profit investors. (This unusual arrangement is necessary to comply with the requirements of federal tax law.) The developer or tax credit recipient becomes the general partner, and the investors join as limited partners. The limited partners invest capital into the partnership—effectively the “price” being paid for the tax credits—and receive a 99.99 percent share of profits generated, thus transferring the benefit of the tax credits from the recipient to investors. This process is collectively known as “syndication.”²⁴

b. Effects of Point Systems on Project Placement and Characteristics

The point system for allocating tax credits among different projects has clear potential to affect the characteristics of project proposals. As the primary suballocator in the state of Minnesota, MHFA’s point system represents a particularly influential set of policy priorities.

MHFA assigns a relatively large number of points to projects targeting certain populations. Ten points are given to projects in which 75 percent of the units contain two or more bedrooms and are prioritized for families with children; alternatively, a project is assigned 10 points if 50 percent or more of its units are single-bedroom and affordable at 30 percent of AMI. Obviously, these two conditions are mutually exclusive. Another 10 points are available to projects for which 50 percent of the units are set aside for “special populations,” oftentimes meaning residents with disabilities or drug dependencies. The prevalence of larger units in the suburbs and smaller units in the central cities suggests that suburban developers have availed themselves of the first criteria while urban developers have relied upon the second. One potential explanation for this trend is the higher cost of developing in the cities: since the points awarded are the same in either case, developers facing higher costs might be more likely to rely on the route which allows them to build smaller units.²⁵

Ten points are also awarded for units which rehabilitate existing structures, and an additional two if the rehabilitation is part of a community stabilization plan. If a project involves new construction, 10 points are only available if it will not require a substantial extension of existing utility lines. This criteria also significantly favors urban developers, who have a larger number of existing structures to choose from and, presumably, a more thorough network of utilities to draw upon.²⁶

Five points are given to projects in or near “Top Growth Communities,” where MHFA has determined that rapid job growth has created extra housing demand. In 2013, Minneapolis was included in these communities. Once again, this seems to advantage Minneapolis developers, particularly in conjunction with the point allotment for new construction relying on existing utilities. In smaller, thriving cities, land with existing utility connections might be subject to higher competing demands; in comparison, Minneapolis’s larger geographic area gives developers more opportunity to obtain the Top Growth Community points while building on relatively cheap, previously developed land.²⁷

²⁴ *Id.*

²⁵ Minnesota Housing Finance Agency, 2013 Housing Tax Credit Self-Scoring Worksheet

²⁶ *Id.*

²⁷ *Id.*

A heavy emphasis is placed on providing housing to combat long-term homelessness. Project proposals that meet certain conditions related to providing permanent housing for the homeless receive 100 “bonus” points, until \$1,795,000 in tax credits are exhausted. Afterwards, projects can earn up to 10 points for setting aside 50 percent or more of their units for long-term homelessness; even projects which only set aside 5 to 10 percent of their units can earn five extra points. Many affordable housing developments include a smattering of units targeted for the long-term homeless; this provision probably explains why. It also likely advantages developments in areas which suffer from higher rates of homelessness and disadvantages developments appropriate primarily for lower-income families.²⁸

Three points are available for projects with access to mass transit; once again, this advantages proposals in regions with dense mass transit near land available for development.²⁹

Comparatively few points are awarded to projects on the basis of cost-effectiveness. Up to six are available, on a sliding scale, for projects that keep “soft costs” down. Up to 20 can be earned by projects which are fully funded or have a large percentage of their funding secured; this does not directly address the issue of cost, but might provide an advantage to cheaper developments, which are presumably easier to fund. And up to 10 points are given to proposals which receive some percentage of their funding from other government contributions—a factor which may or may not favor lower-cost projects.³⁰

Finally, it is worth noting that economic integration of affordable housing projects appears to be an extremely low priority, at least as reflected by the point system. Developments with between 25 and 50 percent affordable units—in other words, developments which mix lower-income and middle- or higher-income populations—are eligible for a meager two points. Projects located in higher-income communities are also eligible for just two points. Notably, the point system allows applicants to count only one of these two sources, even if both apply. For comparison, a developer can also earn two points by providing high-speed internet access and declaring its building smoke-free. Developers looking to maximize their chance of being awarded tax credits face no real incentive to consider economic integration.³¹

Other aspects of the LIHTC system can also influence the placement and composition of developments. In particular, the public-private financing system and syndication have the potential to add new dimensions to the construction of affordable housing, by adding a set of investment conditions and constraints to housing projects which are often difficult to predict. One such constraint is the developer’s “bureaucratic intelligence,” as an organization with expertise and experience in setting up the financial infrastructure for housing might have a substantial advantage over a developer who is merely a competent builder. Syndication also subjects developers and credit allocators to new pressures. For instance, investors regularly demand financial commitments from the housing project owner (which may endanger its nonprofit status, if it exists). A project which is depreciating and running at a loss may allow

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

further tax write-offs, to the delight of investors, although probably not to occupants seeking long-term housing.³²

Perhaps even more importantly, syndication drags a number of third parties into the affordable housing market—parties who often have a very limited interest in actually providing housing. These include not only the private investors, but specialized coordinators, or syndicators. These additional participants may have incentives that are at odds with the housing objectives of the tax credit grant. For example, if tax credits, for whatever reason, are a particularly profitable investment in some circumstances, then investors and syndicators might especially support projects which maximize the allocation of tax credits. Placing projects in lower-income Qualified Census Tracts and Difficult Development Areas helps accomplish this end, as does building projects in which 100 percent of the units are affordable.

Other components of the LIHTC system suggest additional reasons for the emphasis on development in the central cities. Even absent investor pressure, the tax credit “bonus” provided to Qualified Census Tracts or Difficult Development Areas provides a higher incentive for urban developers to focus on acquiring tax credits. Studies have shown that housing construction is disproportionately encouraged by the bonus, and high-density QCTs or DDAs are primarily found in the cities.³³

B. Subsidized Housing as Economic Development Policy

Deficiencies in the private credit market underlie one common argument in favor of subsidized development in low-income neighborhoods. According to some advocates of central city development, low-income areas that fail to attract private lending can be revitalized by public lending for the purposes of building low-income housing.

Unfortunately, while ameliorating the effects of unfair lending is an attractive policy goal, research shows that affordable housing generally fails to revitalize stricken neighborhoods. Indeed, development often has a negative effect, as these neighborhoods are frequently at high risk of racial or economic transition³⁴ and are among the most likely to be adversely affected by the addition of subsidized housing. For instance, a literature review by George Galster concluded that neighborhood characteristics influence how subsidized housing affects surrounding areas and that there is growing evidence that neighborhoods with moderate home values and poverty rates are at greater risk of experiencing negative effects, even at lower concentrations of affordable or multi-family housing. Galster also concluded that “affordable housing seems least likely to generate negative impacts when inserted into high-value, low

³² Ross Clarke, *The Low Income Housing Tax Credit: Challenges Presented by the Onset of Year 15 in the St. Louis Region*, available at http://www.stlouisfed.org/community_development/assets/pdf/lihtc_report.pdf.

³³ Nathaniel Baum-Snow and Justin Marion, *The Effects of Low Income Housing Tax Credit Developments on Neighborhoods*, available at <http://www.ncbi.nlm.nih.gov/pmc/articles/PMC3824966/>.

³⁴ See Orfield, Myron and Thomas Luce, “America’s Racially Diverse Suburbs: Opportunities and Challenges,” *Housing Policy Debate*, Vol. 23, No. 2, 395–430, <http://dx.doi.org/10.1080/10511482.2012.756822>, 2013 and See Institute on Race and Poverty, *A Comprehensive Strategy to Integrate Twin Cities Schools and Neighborhoods* 20–22 (July 2009), http://www.irpumn.org/uls/resources/projects/Regional_Integration_Draft_3_-_Long_Version.pdf.

poverty, stable neighborhoods.”³⁵ Similarly, a literature review by Abt Associates concluded that the effect of subsidized housing on nearby properties “appears to depend on the scale of the project and the stability of the neighborhood. A small project in a stable neighborhood has either no effect or a small positive effect. On the other hand, a project added to an unstable neighborhood, especially a large project, can either cause a decline in property values or prevent revitalization that would otherwise occur as a result of market forces.”³⁶

These trends are in evidence in the Twin Cities. The new consolidated plan for the City of Minneapolis, for instance, expands the neighborhoods eligible for subsidized housing to include census tracts with minority shares between 29 and 50 percent, potentially intensifying the city’s pattern of racial segregation. As the following case study will demonstrate, huge amounts of public funding are poured into large housing developments in these low-income, segregated areas. But there is little evidence of the predicted economic boost that would make such projects worthwhile.

1. East Phillips, Minneapolis: Franklin-Portland Gateway Development

The Franklin-Portland Gateway, also known as the South Quarter, demonstrates how considerable resources, including LIHTC, are used to build subsidized housing in racially segregated, inner city. (Map 4 shows the location of the project and highlights the nearby neighborhoods covered by Tables 4 and 5.) Located in the Northwest portion of Minneapolis’ Phillips neighborhood on four blocks surrounding the intersection of Franklin and Portland Avenues, the Gateway is one of the most expensive affordable housing developments in the region. According to MHFA data on funding streams, total development costs for the four buildings included in the project exceed \$66 million: \$9,816,165 for the Children’s Village Center, completed in 2004; \$9,549,952 for the Jourdain building, completed in 2006; \$13,216,898 for the Wellstone building, completed in 2008; and finally, \$33,899,340 for Phase IV, which is still under development.³⁷

The \$32.5 million spent so far has produced 126 units of new housing, 97 of which are affordable. Unusually for a central city project, many of these units are geared towards families, with 74 containing two or more bedrooms. Plans for Phase IV include an additional 120 units, almost all of which are to be affordable. However, history gives some cause for caution: in the earlier phases, the number of units and percentage of affordable units was adjusted downwards as construction progressed.

The project is not dedicated solely to housing. The existing buildings contain approximately 8,500 square feet of rentable commercial space and about 2,700 square feet dedicated to tenant

³⁵ George Galster, *The Effects of Affordable and Multi-Family Housing on Market Values of Nearby Homes*, in *GROWTH MANAGEMENT AND AFFORDABLE HOUSING* 176–211 (Anthony Downs, ed., 2004).

³⁶ JILL KHADDURI, KIMBERLY BURNETT & DAVID RODDA, *TARGETING HOUSING PRODUCTION SUBSIDIES: LITERATURE REVIEW*, Abt Associates, Cambridge MA (2003), 41, 63.

³⁷ All information on project costs and funding in the Franklin-Portland development is collected from a spreadsheet of proposed funding sources provided by MHFA.

community space.³⁸ They also contain an office complex for Hope Community, the CDC responsible for orchestrating the development. This may help to explain the relatively high costs associated with the project, which ranged from \$259,857 to \$340,849 per housing unit (in 2012 dollars) for the four phases. However, the multivariate statistical analysis described above and shown in Table A.1 implies that the addition of commercial space does not add very much to average per-unit development costs.

Like virtually every modern affordable housing development, the Franklin-Portland project relies on a complex mix of funding. The project has drawn from, or plans to draw from, over two dozen different funding sources, including federal, state, county, and city programs that provide grants and interest-free loans, private grant-writing foundations (which in turn receive public money), charitable contributions, and a small portion of private developer capital. A brief overview of these funding sources provides a window into the byzantine world of affordable housing financing, where a dizzying collection of programs—almost invariably assigned an opaque acronymic title—are mined for construction capital. The end result is a confusing alphabet soup which effectively obscures many of the incentives faced by housing developers.

The most significant single source of funding for the project, by far, is the low-income housing tax credit. Syndication of tax credits are is responsible for \$14.6 million of funding for the existing buildings, and is planned to provide another \$12.2 for Phase IV.

The remaining costs are covered by a diverse array of programs. For Phase II, the developers received a \$3.2 million federally-insured Section 221(d)4 mortgage from HUD; Phase IV will incorporate another \$9.1 million federally-insured mortgage. Phase I was awarded a \$1.9 million loan from MHFA's Minnesota Families Affordable Rental Investment Fund (MARIF) program. Approximately \$3.2 million in loans were also received from the city of Minneapolis, with at least some of these travelling through the Affordable Housing Trust Fund program. Through its Livable Community Demonstration Account, the Minneapolis Community Development Agency (MCDA) provided \$1.2 million to the first three phases and is slated to give \$790,000 to Phase IV. MCDA also awarded Phase I a \$400,000 Community Development Block Grant, and a \$305,000 HOME loan. Another \$2 million is expected to come through MHFA's Economic Development and Housing Challenge (EDHC) program, and Phase III was selected for a \$185,000 loan from the agency's Housing Trust Fund for Ending Long-Term Homelessness. Hennepin County has contributed approximately \$2 million through a smattering of loan programs. The nonprofit affordable housing financier Family Housing Fund (FHF) loaned the project \$890,000, some portion of which was presumably granted to FHF by government entities. Phases I and II received \$225,000 from the HUD Empowerment Zone initiative, which helped fund projects in designated geographic zones. (Conveniently, three corners of the Franklin-Portland intersection fall into these zones. The corner that does not is the location of Phase IV, which was delayed until after the Empowerment Zone program expired in 2011.)³⁹ Finally, a variety of other private and nonprofit entities provided the remaining cash.

³⁸ Information about the Franklin-Portland Gateway from the City of Minneapolis Community Planning and Economic Development. http://www.ci.minneapolis.mn.us/cped/projects/cped_franklin_portland_gateway Last accessed 12/5/2013.

³⁹ See the HUD Empowerment Zone locator, available at <http://egis.hud.gov/ezrlocator/>.

As is the norm with affordable housing development, public agencies ultimately pick up most of the tab. Of the \$32.5 million spent on the first three phases, only somewhere between \$2.7 and \$6.1 million—8 to 19 percent—is from purely private sources. Similar figures are expected for Phase IV, which expects to raise from private sources only \$6.2 million of its \$33.9 million price tag.

Proponents of the Gateway argue that the development will bring viability to an economically struggling and undercapitalized area, and that it will be a catalyst for further development in the area.⁴⁰ However, although the development has replaced many dilapidated structures that surrounded the intersection, there is no evidence that the Gateway has revitalized the surrounding area in a significant way. In fact, the area has fared much worse over the last 10 years than the city and region as a whole.

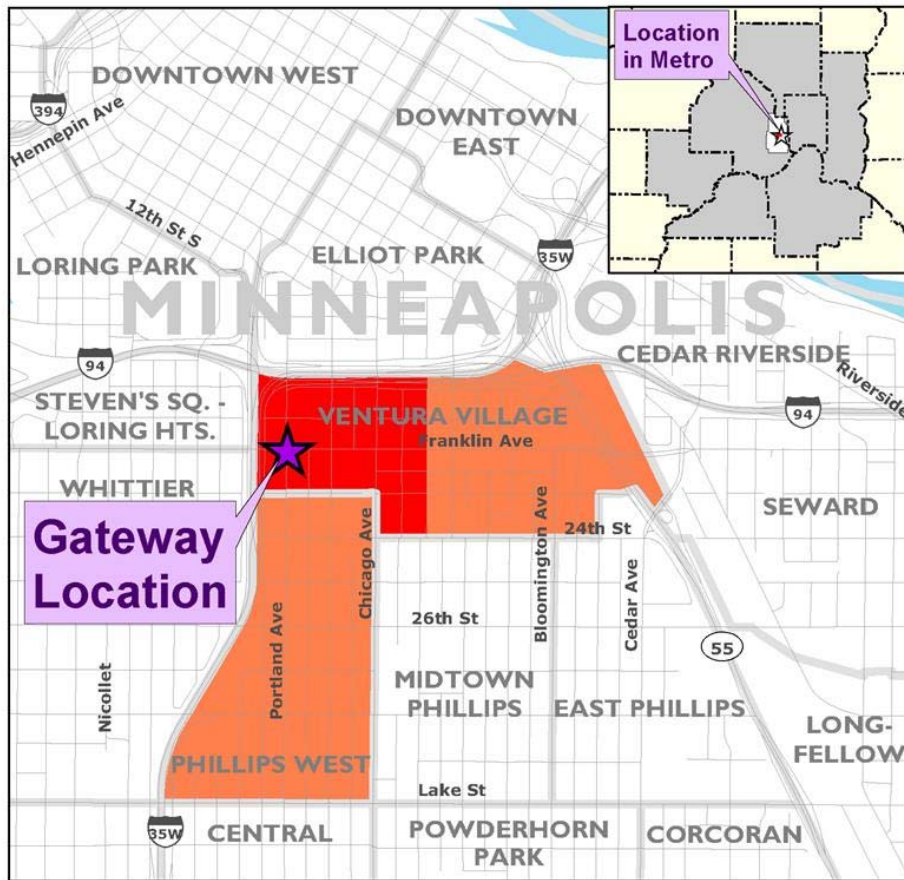
Tables 4 and 5 show racial and economic trends over the last 10 years in the area surrounding the Gateway development. As of 2010 the census tract containing the Gateway (red area in Map 4) has a population that is 73 percent people of color, a decline of 7 percentage points since 2000. While population was essentially stable in the City of Minneapolis between 2000 and 2010 (and growing 10% in the metro area overall), the Gateway's population declined by 3.3 percent.

This area compares poorly economically as well. The median household income is \$21,757, less than half that of the city of Minneapolis, which is \$47,478 and only one-third the income level of the metropolitan area as a whole, which is \$66,157. During the 2000s household incomes rose 25 percent in the city of Minneapolis and 22 percent in the metro area, but rose only 5 percent in the census tract containing the Gateway.⁴¹

⁴⁰ See AEON fact sheet, The Wellstone: Franklin-Portland Gateway Phase III. <http://www.aeonmn.org/files/aeon/files/fact%20sheets/Wellstone%2005-09.pdf> last accessed 12/5/2013; Burl Gilyard, "Developers trying to finish final corner at Franklin and Portland", Finance and Commerce, May 5th 2011. <http://finance-commerce.com/2011/05/developers-trying-to-finish-final-corner-at-franklin-and-portland/> Last accessed 12/5/2013; Dan Olson, "South Minneapolis 'wasteland' sprouts new development," Minnesota Public Radio, November 17th, 2014. http://news.minnesota.publicradio.org/features/2004/11/17_olsond_development/ Last accessed 12/5/2013.

⁴¹ Income growth rates were not adjusted for inflation.

Map 4: Franklin-Portland Gateway



The Gateway tract also has a very high poverty rate of 44.6 percent, double that of Minneapolis and more than four times that of the metro area—and the area’s poverty rate increased by 2.5 percentage points in the 2000s. Labor force participation is just 68 percent in the neighborhood, lower than either Minneapolis or the metro area (both at 73 percent) and participation rates have also dropped more sharply in the Gateway tract, down 9 percentage points in the 2000s, than either Minneapolis or the metro area overall, at down 5 points and up 0.6 points respectively.

Table 4**Race and Economics of Gateway Neighborhood,
Minneapolis and Twin Cities Metropolitan Area**

	Percentage Race and Ethnicity in 2010		
	<u>Gateway*</u>	<u>Minneapolis</u>	<u>Metro</u>
White	26.9	60.3	78.6
Black	40.1	18.3	7.3
American Indian	3.4	1.7	0.6
Asian	1.7	5.6	5.7
Hispanic or Latino	23.1	10.5	5.4
All Others	4.9	3.7	2.4
	<u>Gateway</u>	<u>Minneapolis</u>	<u>Metro</u>
Population	3,198	382,578	3,279,833
Median HH Income in dollars	21,757	47,478	66,157
% Below Poverty Line	44.6	22.3	9.9
Labor Force Participation %	68.2	73.0	73.2
	Median Sales 2010 through Oct.2013 (in \$)		
	<u>Gateway</u>	<u>Minneapolis</u>	<u>Metro</u>
Single Family	125,000	195,000	n/a
Duplexes-Triplexes	144,000	172,528	n/a
Condos/Co-ops	123,000	213,000	n/a
Apartments (per foot)	37.8	59.2	n/a
Commercial (per foot)	69.8	63.9	n/a

*Gateway includes all of Ventura Village and West Phillips neighborhood for sales data and Census Tract 59.02 in Minneapolis for U.S. Census data.
Sources: U.S. Census Bureau, City of Minneapolis.

Table 5**Change in Race and Economics of Gateway Neighborhood,
Minneapolis and Twin Cities Metropolitan Area**

	2000 to 2010 Point Change		
	<u>Gateway*</u>	<u>Minneapolis</u>	<u>Metro</u>
White	7.4	-2.2	-6.1
Black	4.1	0.5	2.0
American Indian	-2.8	-0.3	-0.1
Asian	-1.5	-0.5	1.6
Hispanic or Latino	-2.4	2.8	2.0
All Others	-4.8	-0.3	0.5
	<u>Gateway</u>	<u>Minneapolis</u>	<u>Metro</u>
	2000 to 2010 Percentage Change		
Population	-3.3	0.0	10.5
Median HH Income in dollars	4.9	25.4	21.8
	2000 to 2010 Point Change		
% Below Poverty Line	2.5	5.4	3.2
Labor Force Participation %	-9.1	-5.0	0.6
	2002-05 to 2010-13 Sales % Change		
	<u>Gateway</u>	<u>Minneapolis</u>	<u>Metro</u>
Single Family	-31.3	1.0	n/a
Duplexes-Triplexes	-38.7	-30.2	n/a
Condos/Co-ops	-35.8	2.1	n/a
Apartments (per foot)	-37.8	-16.2	n/a
Commercial (per foot)	-9.0	-1.9	n/a

*Gateway includes all of Ventura Village and West Phillips neighborhood for sales data and Census Tract 59.02 in Minneapolis for U.S. Census data.
Sources: U.S. Census Bureau, City of Minneapolis.

Property sales prices too are lower and have dropped more dramatically in neighborhoods that surround the Gateway than in the city as a whole. Data from the Minneapolis City Assessor's Office show that, since 2010, all property sales values (except commercial) are significantly lower in the Gateway neighborhoods than in the city overall. (Table 4.)

There are enormous differences between the Gateway area and Minneapolis when it comes to sales prices changes between the pre-recession (2002-2005) and the post-recession (2010-2013) periods. (Table 5.) Single family properties prices dropped 31 percent in the Gateway area, while they increased 1 percent in Minneapolis; sales prices for condos/co-ops dropped 36 percent, while climbing 2 percent in Minneapolis; apartment (per square foot) prices declined twice as much, and commercial (per square foot) prices four times as much in the Gateway as prices in Minneapolis; and finally, duplex-triplex property sales declined in the Gateway by 39 percent and in Minneapolis by 30 percent.

V. Conclusions

The public policies determining the distribution of subsidized housing in the Twin Cities are clearly not meeting the region's responsibility to affirmatively further fair housing. The metropolitan area abandoned its role as a national leader in this area decades ago. The result is an affordable housing system that concentrates subsidized housing in the region's poorest and most segregated neighborhoods. This increases the concentration of poverty in the two central

cities, in the region's most racially diverse neighborhoods, and in the attendance areas of predominantly non-white schools. In the long run, this hurts the regional economy and exacerbates the racial gaps in income, employment and student performance that plague the Twin Cities.

There are a variety of possible responses that could put the region back on track:

- The sub-allocator system that arbitrarily distributes a disproportionate share of the region's tax credits to the two central cities should be abandoned so that all potential projects compete on equal footing for tax credits.
- The point system used to evaluate tax credit proposals should be redesigned to greatly increase the values given to cost effectiveness, strategies promoting economic and racial integration, and access to educational opportunities.
- Every possible means should be pursued to guarantee that all parts of the region contribute their fair share of affordable housing (subsidized or not) to the regional housing market. This means, in particular, that the Metropolitan Council should use all of its powers to ensure that affordable housing is located to enhance access to all types of opportunities for households at all income levels. It also means that areas that are currently economically and racially diverse should not be overburdened, putting them at risk of rapid transition.
- The metro area should pursue a regionalized system to distribute Section 8 vouchers. If the current system (which allocates vouchers to several agencies) remains, then the portability of all vouchers from one agency to another should be required.
- All possible actions should be taken to ensure that Section 8 vouchers are redeemable in all parts of the region, particularly in high-opportunity areas where this is currently not the case.
- Finally, and perhaps most importantly, federal, state and regional resources for policies designed to improve economic and social conditions in the region's poorest neighborhoods *over the long term* should be increased dramatically. These include, for instance, programs to create living wage jobs, better access to high-performing schools and safer streets. The current lack of such funding in these areas creates the cut-throat competition by central cities for the only significant funding sources left—those for subsidized housing—despite the fact that any economic development benefits of such spending (if they even exist) are short-lived and come with clear long-term costs in the form of greater concentrations of poverty.

Appendix A. Multiple Regression Results

**Table A.1: Regression Results: Determinants of
Per Unit Cost of LIHTCAffordable Housing Projects (2012 \$)**

<u>Variable</u>	<u>Coefficient</u>	<u>t statistic</u>		<u>Standardized Coefficient</u>
Minneapolis Location	30,025	3.56	**	0.28
St. Paul Location	37,903	3.36	**	0.27
Percentage of Units:				
1 Bedroom	142	0.89		0.07
2 Bedrooms	304	1.74	**	0.14
3 Bedrooms	467	2.37	**	0.20
4 Bedrooms	1,979	3.34	**	0.22
Percentage of Units Affordable at:				
50% of Regional Median Income	-5	-0.04		0.00
60% of Regional Median Income	-149	-1.27		-0.11
80% of Regional Median Income	-330	-0.63		-0.04
Percentage of Units Market Rate	556	3.20	**	0.26
Land Acquisition Included	27,366	3.44	**	0.25
Demolition Required	4,758	0.57		0.04
Historic Building(s) Involved	65,223	1.92	*	0.18
Rehabilitation of Existing Unit	-9,009	-0.73		-0.05
Conversion	-23,378	-0.85		-0.09
Non-residential Development (sq. ft. per re	27	0.68		0.05
Non-residential Development Included (sq.	1,070	0.08		0.01
Units per Building	-363	-3.32	**	-0.30
Number of Buildings	-1,409	-1.52		-0.12
LIHTC included	40,661	4.33	**	0.33
Constant	140,095	11.20	**	0.00
Adj. R ²	0.46			
N	163			

** : coefficient significant at 95% confidence level.

* : coefficient significant at 90% confidence level.

Weighted Least Squares: Weight = Total Units^{.5}