

# THE SPACE BETWEEN

Realities and Possibilities in Preserving  
Unsubsidized Affordable Rental Housing



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# Introduction

## Minnesota Preservation Plus Initiative (MPPI)

The Minnesota Preservation Plus Initiative is about proactive, sustainable housing policy and practice and reflects Minnesota’s longstanding commitment to systemic, long-term approaches to stabilization/preservation needs. This initiative is a community-wide approach to stewardship, focused not only on real estate but also on ownership and management. Every project that is capitalized properly, maintained, and operated capably—thereby avoiding costly preservation interventions—stretches existing resources further.

Preservation responses fall along a continuum, ranging from a passive system (limited ability to intervene) to a responsive system (response after opt-out notice is received or deterioration is at a critical point) to a preventive system (policies and resources support pre-emptive prevention).



## Unsubsidized Affordable Housing; Its Place in Preservation Efforts

Just as preservation activity falls along a continuum of differing responses, the *type* of affordable housing addressed also varies. Typically, jurisdictions start by developing policies/resources to target properties with federal subsidies. Later, properties with local investment are a focus, and finally unsubsidized yet affordable properties can be addressed.



In Minnesota, the current system addresses federally and locally subsidized properties, but a comparatively less systemic response exists to address unsubsidized properties that are affordable to lower-income households. These properties, however, provide more affordable housing than the aggregate of all privately owned subsidized rental properties, and constitute valuable resources that merit preservation consideration. Included in this group are properties that have affordable rents and are currently occupied by lower-income households, as well as those that have affordable rents but are occupied by higher-income households.

The following report details the findings of a study conducted through MPPI to explore the nature and challenges inherent in this stock, and make recommendations for specific policies and strategies to identify and preserve these units. It was developed over several months of intensive research conducted by a Project Team, with valuable input from the Strategic Partners. However, the opinions expressed here are that of the Project Team and should not be viewed as a formal opinion or endorsement from any particular Strategic Partner agency.



### Strategic Partners



### Project Team



**Definitions for This Discussion****SUBSIDIZED**

Units with project-based rent assistance or recipients of capital funding (with income and rent restrictions).

**UNSUBSIDIZED**

Units without project-based rent assistance or capital funding (may include tenant-based assistance).

**LIGHT-TOUCH**

New, highly-tailored interventions with customized affordability, compliance.

Minnesota policy makers have focused worthwhile and appropriate attention on preserving and increasing the state's supply of subsidized rental housing. However, most low-income renters do not live in subsidized housing, but instead, rely on the larger market of unsubsidized—yet affordable—rental for their housing. For this reason, optimizing this unsubsidized housing stock is also in the public interest and policy makers should seize select opportunities to maximize this important resource.

The majority of the unsubsidized rental market functions just fine without further governmental or nonprofit involvement. However, there are specific circumstances where a light-touch intervention can address a threat to this supply or an underutilized opportunity. This research focused on those limited, but important circumstances.

Ultimately, we believe that there is potential for limited, light-touch interventions in the unsubsidized rental housing market that could result in the preservation, creation, or better matching of existing affordable housing opportunities to those who need these resources most.

Interventions in the unsubsidized housing space, however, will look less like the highly-standardized programs often used in the subsidized housing industry; where resources, regulations, and structures are prescribed at federal and state levels with very little variation in their implementation. These standardized programs are operated largely outside of the influence of market dynamics and depend on consistently applied—if somewhat arbitrary—requirements. This strategy may be appropriate given the nature of subsidized affordable rental housing as a production backbone, where deep capital subsidies buy long-term affordability and where strict compliance and monitoring ensure the soundness of that investment.

By contrast, any light-touch interventions should be targeted toward only certain limited areas of the unsubsidized rental market, and need to be:

- responsive to a clearly identified reason to intervene;
- designed for the specific situations at hand; and
- re-engineered with changes in the local rental market over time.

**Intervention Outcomes**

**Preservation.** Prevent the loss of units to deterioration, demolition, or rent increases that would move the unit “up-market.” These may not necessarily decrease rent burden for existing residents or new residents.

**Creation.** Create new affordable rental housing opportunities by lowering otherwise out of reach rents. For instance, cost reduction programs might help drop rents to new/greater affordability levels.

**Matching.** Ensure that those who need affordable rental housing are getting access to it; matching rent and incomes to lessen or avoid rent burden. Examples include providing incentives for landlords to dedicate units upon turnover to lower-income households, or a voucher program that might help residents gain affordable access to units for which they could not otherwise compete.

### The Nature of Opportunity (continued)

To effectively engage in this work, philanthropic and public entities will need to leave behind the comfort of strict program guidelines and seize the opportunity and responsibility to act in real time and in the context of market fluctuations. Prudent public or philanthropic interventions in this segment of the market require a tailored approach, taking into account local market dynamics (even to a micro-market level) while simultaneously keeping the regional context in view. Any intervention will require a nuanced understanding of what is needed in the local market, a knowledge of changing market dynamics, and consideration of the cost and benefit of any action against others.

Rather than being the core or primary response to housing need, intervention in the unsubsidized rental market may play a complementary role to that of deep-subsidy programs and might allow our communities to respond more fluidly and nimbly than possible through these existing programs. Much of the investigation leading to this report focused on distinguishing the difference between the unsubsidized affordable rental housing space and that of subsidized affordable housing.

### Our Charge

This investigation was undertaken at the request of three Strategic Partners; the Family Housing Fund (FHF), the Greater Minnesota Housing Fund (GMHF) and the Minnesota Housing Finance Agency (Minnesota Housing) and is one component of a multi-year grant under the Minnesota Preservation Plus Initiative (MPPI) funded by the MacArthur Foundation. The vast majority of MPPI efforts focused on preserving existing subsidized affordable rental housing. This study is a complement to that work and does not indicate a wavering in the Strategic Partners' commitment to the preservation of subsidized units.

A Project Team was led by One Roof Global Consulting (One Roof) with instrumental participation of the Housing Preservation Project (HPP) and Urban Land Institute of Minnesota (ULI MN). This team combined significant technical expertise and a broad perspective on the importance of and issues surrounding affordable housing.

Our charge was to explore ways in which the Strategic Partners might support the continued affordability of rental housing that does not currently receive direct public subsidy.<sup>1</sup> This was envisioned to include the following light-touch intervention possibilities:

- Shallow, direct financial incentives
- Operating cost reduction efforts
- Technical assistance
- Regulatory options

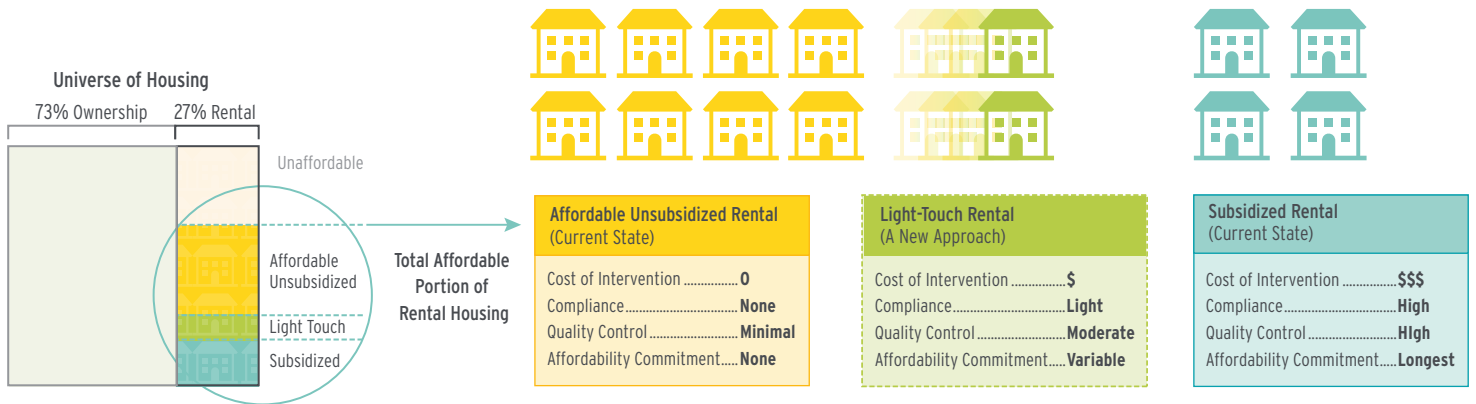
The intent was not to simply convert unsubsidized rental housing into subsidized rental housing, which would create greater competition for already oversubscribed subsidy funds. Rather, it was to think of new ways to influence select portions of the unsubsidized market to bring these properties closer to the characteristics that provide public benefit (depth and durability of affordability, quality assurance, etc.).

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1. This refers to deep capital subsidies like LIHTC, HOME, etc. Properties that accept Section 8 vouchers from individual tenants would not be considered subsidized for the purposes of this study.

## Creating Light-Touch Rental Housing

Light-touch rental housing is a new approach to ensure housing affordability in the unsubsidized affordable market. It should be highly-tailored to respond to specific market conditions and local community needs.



### Our Charge (continued)

We sought to define and understand the existing unsubsidized rental housing market and identify what could be done if the Strategic Partners were to decide to take action. This was an open and practically-oriented investigation of the current realities and possibilities in Minnesota, with a focus on the Twin Cities Metropolitan Area. The following is a summary of our findings regarding the dynamics of this housing market, the categorical interventions possible in this space, and our recommendations to the Strategic Partners to pursue specific steps to enact particular interventions.

## The Unsubsidized Affordable Rental Housing Market in Minnesota

### The Importance of Unsubsidized Rental

In the Twin Cities Metropolitan Area unsubsidized rental comprises at least 57% of all units with rents affordable to households at or below 50% of area median income (AMI); equating to as many as 120,000 units of housing.<sup>2</sup> The continued affordability of this unsubsidized housing—and its occupancy by those with corresponding need—cannot be taken for granted. There are neither controls to ensure the enduring affordability of these unsubsidized units, nor are there forces in the unsubsidized market to place low-income households, rather than high-income households, in the most affordable units.

2. Housing Preservation Project (HPP) calculation based on HUD's 2005-2009 CHAS data and HousingLink's Streams data. Depending on whether unsubsidized affordable units currently occupied by Section 8 voucher holders are counted in this supply or not, the share of the affordable rental market that is unsubsidized is either 57% or two-thirds. As noted elsewhere herein, a good argument can be made either way.



### The Importance of Unsubsidized Rental (continued)

Over the past decade, statewide rents have increased a seemingly modest 6%. However, incomes over the same period have dropped by 16%.<sup>3</sup> As a result, the percentage of very low-income households<sup>4</sup> who are cost burdened increased by over 30%.<sup>5</sup> Moreover, Minnesota Housing Partnership reports that from 2000-2010, Minnesota had the fastest increase in households paying more than half their income for housing of any state.<sup>6</sup> Most recent reports and our discussions with stakeholders indicate that Metro Area landlords are currently making up for an extended period of rent stagnation, with continued plans to raise rents. Furthermore, new units being constructed in the unsubsidized market necessitate charging the highest rents (particularly on a per square foot basis) in order to cover development costs. Dependence on unsubsidized market self-regulation or adjustment is unlikely to benefit low-income people. The trickling down of any benefit of new construction currently underway is likely a very long-term, if not dubious proposition.

### Unsubsidized Owners: Motivations and Challenges

Most, but not all, possible interventions in this space are simply different ways to influence the behavior of owners. In order to entertain the full spectrum of these possibilities we sought to understand the types of owners, their existing motivations, and the challenges they face in operating unsubsidized rental property by talking to them directly. Our observations are outlined here.

#### Types of Owners

While these owners are diverse, we have categorized them into three broad types:

- **Do-It-Yourself (DIY)/Part-time.** Owners with small portfolios consisting primarily of four-plexes, duplexes, and single-family homes that are self-managed and considered secondary sources of personal income or investment. These owners are most often employed in another industry with rental property as a side business.
- **Small-scale Professional.** Owners with portfolios that are less than 100 units that may or may not have professional management, but view property ownership and/or management as their full-time occupation.
- **Large-scale Professional.** Owners with portfolios of 100+ units that provide professional management as a related business line or through a fee-for-service arrangement. These are mostly formal business organizations that operate as an on-going concern, rather than individuals or partnerships.

In Greater Minnesota this typology exists, but is also greatly influenced by the size, economic growth, and demographics of the communities in which they work. It is worth noting that, across the board, nonprofit organizations are largely absent from ownership in the unsubsidized rental housing market.

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3. Minnesota Housing Partnership. *Slides for Housing Advocates*. January 2013.

4. Households earning 50% or less of AMI.

5. HPP calculation based on HUD's 2000 & 2009 CHAS data. This figure also includes housing deficits of overcrowding and lack of basic services, which are thought to be de minimis.

6. Minnesota Housing Partnership. *Slides for Housing Advocates*. January 2013.

### Owner Motivations

- **Cash flow.** The main motivator for each group is cash flow, with the DIY/part-time owners being more acutely affected by property cash flow disruptions.
- **Long-term investment.** Virtually all owners claimed to acquire properties with the intent to hold them for the “long-term,” defined variously, but always reported as longer than 10 years. Admittedly, our focus groups were more likely to attract conscientious and committed owners willing to discuss their business and its relationship to affordability; thus, we may not have been exposed to those involved in speculation.
- **Asset building.** Large-scale owners were the most concerned with and best equipped to maintain or build value in the real estate, meaning they are motivated to plan for and methodically address the capital improvement needs of their housing. DIY/part-time owners’ motivation in this regard is more varied, and the distance the owner must travel to the housing is a key factor in such improvements over time. Appreciation is a secondary factor to cash flow in buying decisions and return expectations.
- **Interaction with government.** Generally speaking, the DIY/part-time owners were more likely to want to avoid any involvement in government programs; thus, making intervention there much more challenging.

### Owner Challenges

- **Management.** Property management can be particularly challenging for DIY/part-time owners, but even large-scale professional owners detail the challenges presented by marketing, tenant screening, maintenance, and rules enforcement. Management challenges/shortcomings can become community concerns in the case of problem tenants and exterior maintenance.
- **Operating costs.** Operating costs are continuously rising, often independently from an owner’s ability to recoup them in rents. The two most frequently mentioned/troublesome operating costs were:
  - Property taxes—both pace and unpredictability of increases; and
  - Utilities—particularly the variability of publicly-provided ones.
- **Financing.** Access to and terms of financing for acquisition, rehabilitation/improvements, and refinance of existing debt varies greatly. Large-scale professional owners appear to be in a very liquid market for capital. Several lenders described a frenzy driven by low rates. Access to finance continues to be difficult for DIY/part-time owners, inexperienced owners, and any small-scale professional owners who lack strong banking relationships. The short-term nature of the financing currently available in the market is of concern when considering long-term affordability or even stability of properties.

## Identifying and Exploring Possible Interventions

Throughout interviews and focus groups with over 150 Minnesota stakeholders and national experts, we solicited ideas on possible interventions that might preserve, create, or match affordability in unsubsidized rental housing.

Through this process we identified nearly 50 intervention ideas, sought existing examples or parallels, and cataloged them. We then selected a few of these ideas, which appeared to have promise, but needed more investigation in order to understand their potential. The Strategic Partners, as the state's policy makers and affordable housing administrators, guided the selection of five promising ideas. These selections became the subject of deep-dive work groups with local technical experts. The Project Team then revisited all the suggested interventions (those that were the subject of deep-dives and others) to make recommendations to the Strategic Partners.

## Guiding Principles for Action

We suggest that any action that the Strategic Partners consider taking in the unsubsidized affordable rental space be guided by the following principles:

- Recognize that this is different than subsidized affordable rental.
- Capitalize on the lack of rules/dictates.
- Use local touch/knowledge.
- Pay attention to regional context.
- Choose partners/targets wisely.
- Monitor, evaluate, and actively manage.

### A Suggested Strategy to Test Key Interventions

The Project Team recommends that the Strategic Partners engage in a demonstration program(s) with select cities to more fully understand if the identified interventions, and in what combinations, would achieve the goals of preserving or creating affordable housing within the unsubsidized rental market. The demonstration(s) would test the political, financial, and administrative viability of such interventions. It would also allow for the Strategic Partners to tailor interventions based on local dynamics in a demonstration context where financial and reputational risk can be minimized. These should be phased and managed by the Strategic Partners, or their designee, as follows:

**Phase 1: Determine the scope of the demonstration program**

**Phase 2: Test intervention(s)**

**Phase 3: Evaluate and adjust**

## Recommendations

We have made four different types of recommendations.

1. **First Order Recommendations**—recommendations that we advise even if no other actions are taken.
2. **Direct Interventions**—project or program level interventions that are designed to impact a subset of properties, and/or provide a direct incentive to a property owner in exchange for an affordability pledge.
3. **System-wide Interventions**—interventions that provide benefit on many levels to all property owners and property types.
4. **Long-term Recommendations**—ideas to monitor as the market changes.

### 1. First Order Recommendations

We recommend that the Strategic Partners take these steps, even if no other interventions are contemplated.

- **Communication.** Promote understanding of the importance of the unsubsidized inventory as part of the affordable housing delivery system. Communicate the issues explored in this work with other important public, private, and philanthropic audiences that could be implementation partners.
- **Data.** Determine when and what kind of data is important enough to justify the resources to collect it. Establish a data protocol for the gathering and analysis of this useful and practical data. Start first with existing data. The protocol could provide for better tracking of unsubsidized properties, rent levels, etc. Highlight successful city inventories and encourage other cities to do similar work.
- **Metropolitan Council Regional Housing Policy Planning.** The Metropolitan Council has a unique function and influence that ranges beyond that of the subsidized housing realm. For that reason, we highly recommend involving this agency in any efforts. Their involvement would enhance the ability of the region to recognize the value that unsubsidized rental housing contributes to our communities. Recommendations relating to this organization include:
  - Increase the understanding of their process for determining regional affordable housing goals.
  - Encourage a new formula for calculating affordable housing goals including a more nuanced definition for what counts as credit towards the Livable Communities housing goals.<sup>7</sup>
  - Create incentives for local governments to test identified interventions.
  - Build this work into the Metropolitan Council Regional Housing Policy Plan.
- **Support mission-driven owners' entry into the unsubsidized space.** Continue to explore and understand the barriers and hesitations of mission-driven actors (both nonprofit and for-profit) and assist those who are interested in doing so to become involved.

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7. The Livable Communities Act is a grant program operated by Metropolitan Council in which Cities elect to participate by agreeing to work towards providing their share of affordable housing needed, as calculated by Metropolitan Council, for the metropolitan region. Participant cities also agree to invest annually towards building or preserving affordable housing within their communities.

## 2. Direct Interventions

Consistent with the spirit of this investigation, our suggested interventions focus on light-touch approaches; a much lower level of financial incentive than existing deep-subsidy sources, with fewer requirements and more flexibility.

- **Local government rent subsidy.** This is a potentially cost efficient method for creating or retaining affordable housing opportunities through a locally-funded and administered rent subsidy program(s). Cities that have limited opportunities to invest in the development of new affordable units could use local funds to create new affordable opportunities by writing down rents on existing units. This could also help to ensure that there is a match of lower-income households to the existing unsubsidized affordable housing supply. We recommend the Strategic Partners take the following steps:
  - Solicit interest from cities and property owners and include within a demonstration program administered by the Strategic Partners.
  - Encourage Metropolitan Council to recognize a rent subsidy program as contributing toward the local Livable Communities affordable housing goals.
- **Second mortgage/mezzanine debt/loan participation.** A second mortgage, mezzanine debt, or loan participation product might increase the availability of long-term, private sector debt for acquisition, rehabilitation, and/or refinance of properties that are currently offering some level of de-facto affordability. We recommend the Strategic Partners take the following next steps:
  - Solicit interest on the part of existing CDFI or funding intermediary to implement such a lending program and determine the parameters under which they would consider participation.
  - Provide resources (existing or through new program-related investment sources) to use alongside commercial debt.
- **Property tax incentives.** Through our research, it was revealed that Minnesota's Low Income Rental Classification Program (LIRC) or Section 4(d) program allows a local government to qualify properties for tax property breaks if some form of local financial assistance is provided and the owner agrees to income and rent restrictions. This underutilized provision creates the possibility for local governments to address housing goals by foregoing tax revenue in addition to offering cash incentives or regulation. We recommend that the Strategic Partners take these next steps:
  - Track any modifications to the Section 4(d) legislative authority through the upcoming legislative session and understand how a rewrite of the property tax laws would alter or eliminate Section 4(d).
  - Convene a broader conversation with a wide range of local governments (specifically targeting cities along emerging transit corridors), including counties, and perhaps the Metropolitan Council to discuss this tool and attempt to garner support for its prudent use.

### 3. System-wide Interventions

The Strategic Partners should consider enacting these interventions themselves or enlisting the right implementation partners to do so.

- **Encourage cities to:**
  - Use rental licensing programs to communicate with owners regarding interventions for maintaining quality and value in their investment.
  - Link educational and regulatory approaches. There are examples of cities that promote training by lowering licensing fees for participants.
  - Enact rental licensing regulations that include the stick and carrot approach, incentivizing and rewarding good behavior, and penalizing poor performance.
- **Reward cities that adopt rental licensing programs by:**
  - Providing added points within funding applications.
  - Favoring cities that require rental licensing in a newly weighted formula for determining contribution to regional affordable housing goals by Metropolitan Council.
- **Maximize the usefulness of the MN Housing Policy Toolbox to support unsubsidized rental housing efforts by:**
  - Promoting use of the Toolbox through Metropolitan Council, Minnesota Housing Partnership, Minnesota Multi Housing Association, ULI-MN/RCM, etc.
  - Incorporating strategies and recommendations from this report into the Toolbox where appropriate.
  - Developing a navigational tool within the Toolbox that can make accessing information on unsubsidized rental resources easier.
  - Identifying an ombudsman to help connect educational resources with technical and financial expertise depending upon the issue.
  - Creating a section specifically for rental property owners: “Help Rental Owners Succeed.”
- **Promote existing landlord/owner educational efforts.** Work through the Minnesota Multi Housing Association, Lutheran Social Services, local city property owners associations, the Crime Free Multi-Housing program, etc. Consider models for a single point of contact for information, technical assistance, and training similar to Chicago’s Preservation Compact.

### 4. Long-term Recommendations

The Project Team identified specific ideas that should be monitored in the future by the Strategic Partners as the market changes. The market conditions could impact the opportunity to intervene.

- **Short-term debt refinance.** Many properties taking advantage of the very low rates currently being offered in the market will need to find new financing in the next three to five years. This may provide an opportunity for intervention by public or philanthropic entities—exchanging debt for affordability commitments.
- **Use of Variable Rate Demand Notes (VRDN) or “low-floaters.”** While this financing option has been altered—possibly permanently—by changes in bank regulation and is currently not competitive with federally insured debt mechanisms, we recommend that the Strategic Partners monitor the changes in capital markets as this tool could lend itself well to acquisition of unsubsidized affordable rental housing.

## In This Section:

- 1 Context for This Investigation
- 2 Subsidized Rental Housing: Losing Ground
- 5 The Important Role of Unsubsidized Affordable Rental Housing

In 2009, the share of U.S. renters paying over 30% of their income for housing reached 49%—up from 38% in 2000.

In 2011, the portion of rent-burdened households in Minnesota was over 50%.

## Context for This Investigation

Over 18 million households in the United States are considered very low-income renters.<sup>1</sup> Yet available affordable rental housing units number only roughly 11.6 million, reflecting a significant supply gap and leaving no doubt that the U.S. continues to face an affordable rental housing crisis. The recent homeownership housing market bubble compounded by the Great Recession has led to declining median household incomes nationwide and an increased demand for affordable rental housing. This is evidenced by the unusually low rental vacancy rates found in major cities across the country and demonstrates that the supply gap is only continuing to widen. In turn, the share of rent-burdened households is skyrocketing.<sup>2</sup> In 2009, the share of all renters who paid over 30% of their income in rent reached 49% (up from 38% in 2000).<sup>3</sup> Unfortunately, the lowest-income populations suffer most in these market conditions and are more vulnerable than ever to absorbing substantial rent burdens as the dearth of affordable housing options grows and income stagnation persists. For instance, in 2009 78% of extremely low-income households and 77% of very low-income households<sup>4</sup> were facing moderate to severe rent-burdens.<sup>5</sup>

Minnesota follows these national trends, resulting in a tighter rental housing market and less affordability. In 2012 the rental vacancy rate in Minnesota was below 3%, the lowest in a decade<sup>6</sup> which, along with rent inflation and other factors, landed Minneapolis-St. Paul in second place on the 2012 Forbes list of worst cities for renters.<sup>7</sup> According to data produced by the National Low-Income Housing Coalition (NLIHC), there were only 78 affordable and available<sup>8</sup> units of rental housing for every 100 very low-income renter households in the Twin Cities 7-County Metro in 2010. The situation is similar in many Greater Minnesota counties. For example, St. Louis County had only 68 available affordable housing units for every 100 very low-income renter households in 2010. These realities are obscured in the statewide figure of 93 available and affordable units for every 100 renter households due to the averaging-in of those markets which have surplus.<sup>9</sup>

1 Households earning 50% or less of area median income (AMI).

2 Those households paying 30–50% of their household income in gross rent are counted as “moderately rent-burdened.” Those paying 50% or more of income are considered “severely rent-burdened.”

3 Joint Center for Housing Studies (JCHS). Harvard University. *America’s Rental Housing: Meeting Challenges, Building on Opportunities*. 2011.

4 Extremely low-income households are those earning 30% or less of AMI, and very-low income are those earning 50% or less of AMI.

5 JCHS. Harvard University. *America’s Rental Housing: Meeting Challenges, Building on Opportunities*. 2011.

6 Minnesota Housing Partnership (MHP). “2 x 4” *Housing Report-Quarter 3*. 2012.

7 Forbes. *The Best and Worst Cities For Renters*. 2012.

<http://www.forbes.com/sites/morganbrennan/2012/06/14/the-best-and-worst-cities-for-renters-2>.

8 A unit is both affordable and available if that unit is both affordable and vacant, or if it is currently occupied by a household at the defined income threshold or below.

9 Calculations from National Low-Income Housing Coalition’s (NLIHC) Gap Analysis Estimates for Minnesota Counties from CHAS 2005–2009 data.

Context for This Investigation  
(continued)

Figure 1

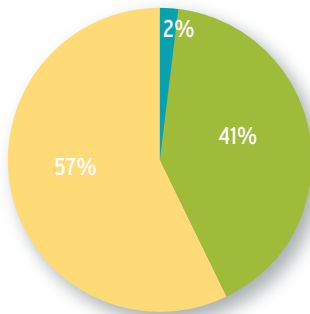
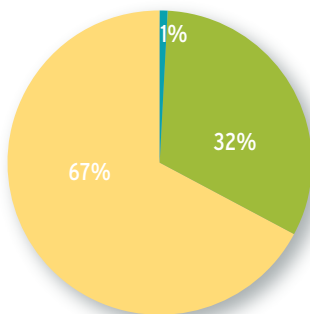
Renter-Occupied Units by  
Building Size in Minnesota

Figure 2

Renter-Occupied Units by  
Building Size in the Twin Cities  
Metro Area

## KEY

- 1-4 Units
- 5+ Units
- Other

Across the state of Minnesota, rents are on the rise. Minnesota Housing Partnership (MHP) reports that median rent in Minnesota has increased by 6% between 2000 to 2011.<sup>10</sup> In 2007, the average market rent for the Twin Cities Metro Area was approximately \$870/month.<sup>11</sup> By 2012 this number reached \$951/month. At first glance this may seem modest, but a majority of this rent inflation has occurred in just the past year, averaging a 3.8% increase from October 2011 to October 2012. Coupled with a loss in incomes (both real and adjusted for inflation), this rent inflation is resulting in more dramatic cost burdening in Minnesota. The NLIHC projected that affording a 2-bedroom unit at Fair Market Rent in 2011 required 1.3 full-time jobs for those earning the estimated mean renter hourly wage in Minnesota.<sup>12</sup> This affects occupations such as nursing aides, office clerks, and childcare workers who are earning less than the average annual income needed to afford a median priced apartment.

Moreover, MHP found that from 2000 to 2011 the median statewide renter income dropped by 16% while the median statewide rent cost went up by 6%. Reflecting this reality, in 2011 the statewide portion of rent-burdened households was over 50%.<sup>13</sup> In the Twin Cities Metro Area specifically, the number of households at or below 50% of AMI who are rent-burdened has increased by 31% over the past decade to include approximately 117,000 households.<sup>14</sup> This means that approximately 78% of Metro Area renters with incomes under 50% of AMI are now paying more than 30% of their income for housing.

## Subsidized Rental Housing: Losing Ground

### New Federal Funding Sources on the Wane

The most prevalent methods for addressing the affordable housing gap have centered on programs that produce or preserve subsidized units through capital subsidies. However, these programs are challenged in the current federal funding climate. For one, the U.S. Department of Housing and Urban Development (HUD) has faced significant budget cuts (\$3.7 billion in fiscal year 2012), which greatly affect the vitality of some of the most critical subsidized affordable housing programs. For instance, HUD's HOME program suffered a budget reduction of 38% between 2011 and 2012, which translates to an estimated production loss of 31,000 subsidized affordable units.<sup>15</sup> Allocations of HOME funds in Minnesota (Minnesota Housing and all other Participating Jurisdictions in Minnesota) were \$20.2 million in FFY 2011 compared to \$13.5 million in FFY 2012. Similarly, CDBG funding in Minnesota has decreased by 26% over the past 2 years from \$63.7 million in 2010 to \$46.8 million in 2012.<sup>16</sup>

10 MHP. *Slides for Housing Advocates*. January 2013.

11 GVA Marquette Advisors. *Twin Cities Apartment Market Update*. Third Quarter 2012

12 NLIHC. *Out of Reach Report*. 2012.

13 MHP. *Slides for Housing Advocates*. January 2013.

14 Housing Preservation Project (HPP) calculation based on HUD's 2000 & 2009 CHAS data. This figure also includes housing deficits of overcrowding and lack of basic services, which are thought to be de minimis.

15 JCHS. *America's Rental Housing: Meeting Challenges, Building on Opportunities*. 2011.

16 Minnesota Housing state appropriations. 2013.



Subsidized Rental Housing: Losing Ground  
(continued)

### LIHTC; Limitations of the Low-Income Housing Production Workhorse

The Low-Income Housing Tax Credit (LIHTC) is the primary driver behind new production, renovation, and preservation of subsidized affordable units in the country, typically generating equity to cover 60–70% of these development costs. The program has produced 1.7 million affordable units between its inception in 1986 and 2007. In Minnesota, the LIHTC has helped to finance 42,735 affordable units to date, an average of 1,644 per year. With the financial crisis in 2008, the market for the credits all but evaporated. In 2009, the federal government stepped in by creating the Tax Credit Assistance and Exchange Programs (TCAP and Exchange respectively). TCAP provided approximately \$2.25 billion in gap financing<sup>17</sup> and the Exchange facilitated the buyback of about \$5.7 billion in unmarketable credits.<sup>18</sup>

While the LIHTC market has now recovered and still serves as the single most valuable resource for affordable housing production and rehabilitation, the use of this program requires additional gap resources in most every case, amplifying the effect of the cuts in other federal programs (mentioned above) that are often used to fill these gaps. On their own, tax credits do not ensure the deepest levels of affordability, which can only be achieved by layering on other gap sources. Conversely, because of strict income limits that exclude households with higher incomes, this program cannot address the increasing rent burdens being experienced by many working class households earning just over 60% of AMI.<sup>19</sup>

In the US between 1995–2009, a total of 700,000 project-based, HUD-subsidized units were lost to physical deterioration and conversion to market rate.

### Project-Based Subsidy; Effects of Expiring Contracts, Prepaid Mortgages and Sun-setting

Project-based subsidies are a cornerstone of low-income housing in the U.S. Many project-based subsidy contracts and obligations are expiring in the midst of a hot rental market. Some owners see this as an opportunity to convert to market rate rent and occupancy, resulting in a loss of affordable housing nationally. Harvard's Joint Center for Housing Studies (JCHS) reports a total loss from physical deterioration and conversion to market-rate of 700,000 project-based HUD subsidized units from 1995–2009.<sup>20</sup> While some of this loss was offset by increases in tenant vouchers, which theoretically offer greater flexibility and locational choice, these housing units are no longer designated as permanent affordable housing stock.

### Tenant-Based Vouchers; Stretching to Adjust in the Market

Tenant-based rent subsidies are stretched as well. The Metropolitan Council<sup>21</sup> reports increasing rents and low vacancy rates in their service area. As a result, they are paying more per family for rental subsidies; limiting the number of families that they can serve through rental assistance programs. Moreover, the waiting list for vouchers administered by the Metro HRA has been closed since 2007.<sup>22</sup>

17 JCHS. *The Disruption of the Low-Income Housing Tax Credit Program*. 2009.

18 US Department of Treasury. Initiatives, Recovery Act, 1602 Program. <http://www.treasury.gov/initiatives/recovery/Pages/LIH-grants.aspx>. Accessed January 17, 2013.

19 JCHS. *America's Rental Housing: Meeting Challenges, Building on Opportunities*. 2011.

20 Ibid. This number combines the loss due to either property deterioration or expiration of subsidy contracts and consequent conversion to higher market-rate rents.

21 The regional planning agency and manager of the Metro HRA in the Twin Cities.

22 Personal communication. December 10, 2012.

### Subsidized Rental Housing: Losing Ground (continued)

Additionally, those who are able to secure vouchers will not necessarily find plentiful housing options available and/or affordable to them. According to a HOME Line survey in Anoka, Dakota, and Suburban Hennepin counties, only 33% of properties are actually available to Housing Choice Voucher-holders due to landlord restrictions. The Metropolitan Council also observes that in order to find available and appropriate housing, voucher recipients are often forced to pay rents above the voucher program limits. They estimate that, as a result, approximately 40% of tenants using vouchers are paying over 30% of their income for housing, the highest rate of rent-burdened voucher-holders they have seen in ten years.<sup>23</sup>

### Other Funding Sources and Their Prospects

The National Housing Trust Fund, which was designed to preserve and construct affordable housing for the lowest-income households, remains unfunded since its inception in 2008 and the national debate over deficit reduction and federal spending suggests that federal funding for housing will face continued pressure.<sup>24</sup>

### Minnesota Efforts to Keep Pace

In Minnesota, subsidized housing is faring better. In 2012, Minnesota Housing bucked the national trend of decreasing housing resources by securing \$30 million in a new Housing Infrastructure Bond program where the proceeds are used to preserve and create new affordable housing units and debt service is funded by appropriations.<sup>25</sup> This is a great victory in the current environment of shrinking resources and should signal the commitment to affordable housing in the state. However, it should not be overestimated in its ability to offset the drop in federal resources.

The commitment of the state housing financing agency and other funders to preservation is also evidenced by the active role of the Interagency Stabilization Group (ISG) and the various preferences given by most funders to preservation projects in their new funding allocation processes. As a result of these various efforts, from 2001-2009 in the Twin Cities Metro Area, there was a loss of only approximately 1,160 federally-subsidized units.<sup>26</sup> To give this number scale, as of 2012, there were approximately 60,000 rental units receiving some form of local, state, or federal project-based rental subsidy in the Metro which constitutes 18% of all rental housing and 33% of that which is affordable to households at 50% of AMI.<sup>27</sup>

From 2000 to 2009, the number of very low-income households in the Twin Cities Metro Area paying more than 30% of their income in rent grew by nearly 31% to include approximately 117,000 households.

<sup>23</sup> Personal communication. September 21, 2012.

<sup>24</sup> NLIHC. *Out of Reach Report*. 2012.

<sup>25</sup> Minnesota Housing. *Legislative Summary*. 2012.

<sup>26</sup> HPP calculations based on Minnesota Housing Partnership and HUD data. This number includes project-based Section 8 contract loss upon expiration, prepayment of subsidized mortgages and closure of public housing.

<sup>27</sup> HPP calculations based on data from HousingLink Streams.

Subsidized Rental Housing: Losing Ground  
(continued)

Figure 3

Rental Units by Affordability & Building Size in the Twin Cities Metro Area

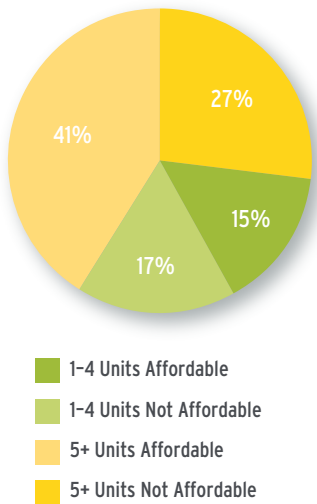
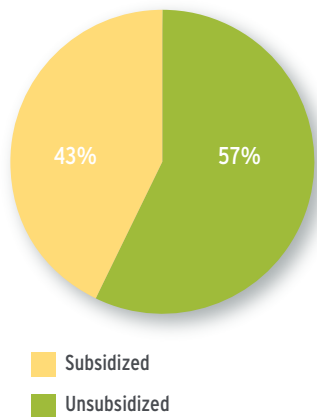


Figure 4

Subsidized vs. Unsubsidized Affordable Rental Units in the Twin Cities Metro Area



Measuring the Ground Lost

Even with the allocation of new housing production resources like tax credits, other capital subsidies and project-based assistance, and with the coordinated efforts to preserve existing affordable subsidized housing, the total stock of subsidized affordable housing in Minnesota increased by only about 8,500 units from 2000 to 2009.<sup>28</sup> Over that same period, the number of very low-income households (those earning 50% or less of AMI) grew by about 26,200. The number of very low-income households in the Metro paying more than 30% of their income in rent grew by nearly 31% to about 117,000 households.<sup>29</sup> This equates to 78% of that population.

The Important Role of Unsubsidized Affordable Rental Housing

The frequent focus on subsidized affordable rental housing can obscure the fact that most low-income renters actually rely on the unsubsidized rental market to meet their housing needs. Harder to locate and more difficult to track because they are outside the purview of government programs, unsubsidized rental properties comprise the majority of the affordable rental stock in the U.S. In fact, JCHS reported that in 2009, unsubsidized properties accounted for more than 75% of the affordable rental housing<sup>30</sup> stock in the country with at least one-third of this sector being comprised of privately-owned, small-scale multifamily buildings of 5-49 units.<sup>31</sup>

Limitations in data availability and consistency make precise knowledge of the unsubsidized affordable rental market difficult (See Attachment A). However, our analysis of the Twin Cities Metro Area indicates that no less than 57% of the total rental housing stock (or over 122,000 of 182,000 total rental units), is comprised of privately-owned unsubsidized housing with rents affordable at 50% of AMI.<sup>32</sup> The number of renter households earning incomes at or below 50% of AMI for the same 7-County Metro is approximately 150,000.

In addition, there are approximately 18,500 tenant-based rent vouchers available in this market area. However, a lack of information on the extent to which these vouchers are used in otherwise subsidized units (in LIHTC developments, for example) means that we cannot determine the extent to which these vouchers are expanding the universe of available affordable housing opportunities. If we were to assume that none of these vouchers were being applied to otherwise subsidized units, this would increase the percentage of the low-income people housed in the private market to 67%.

28 Federally-assisted units only, as no data is available on any units produced through only state and local resources. However, these are likely to be very small numbers.

29 HPP calculation based on HUD's 2000 & 2009 CHAS data. This figure also includes housing deficits of overcrowding and lack of basic services, which are thought to be de minimis.

30 Units with gross rents costing no more than 30% of 50% of HUD's-adjusted AMI.

31 U.S. Department of Housing and Urban Development. *Small Multifamily Risk Sharing Roundtable Presentation*. March 21, 2012.

32 HPP Calculations based on data from HUD's 2005-2009 CHAS and HousingLink.

The Important Role of Unsubsidized  
Affordable Rental Housing  
(continued)

Regardless, the long-term affordability and availability of the unsubsidized units is precarious. While the unsubsidized rental housing market has historically provided the vast majority of housing opportunities for low- and moderate-income families in America, the availability and quality of these units and their management is ever-changing, leaving renters vulnerable to shifting market conditions. Studies show that the rate of loss of unsubsidized affordable rental units is outpacing the loss of subsidized units on the national front. JCHS calculated that while the national loss of project-based subsidized units from 1995 to 2009 was approximately 18%, the U.S. housing market also experienced a 28% net loss of unsubsidized affordable rental units from 1999–2009.<sup>33</sup>

Furthermore, with no income or rent restrictions, many of these units are occupied by residents who can afford to pay more, but are enjoying the benefit of paying a relatively low percentage of their income for housing. In the Metro Area, over 42% of units with rents affordable at 50% of AMI (nearly 72,000 units) are occupied by households with higher incomes. This mismatch of incomes and rents explains why even though we do not appear to have a supply gap in the Metro Area, we still see an overwhelming majority of rent-burdened, low-income renters.

### Geographic Dimensions

Our team mapped some of the key indicators for these market dynamics, which illustrate the wide variations that may exist in these larger market areas. The statewide rent-burden map, in Attachment F shows where the counties with the highest concentrations of rent-burdened households are located. This map provides conclusive evidence that rent-burdened households tend to be located in higher density areas, such as the Twin Cities Metro and/or in high growth communities where housing resources are more scarce.

We went into greater depth in the Twin Cities Metro Area. The map in Attachment G illustrates where the low- to moderate-income households are located by Census Tract, showing that the density of renters is highest in the inner cities and first-ring suburbs and that the highest concentrations of low- to moderate-income households are located in these tracts as well. The map in Attachment H further elucidates which of these tracts contain the most dramatically cost-burdened households in terms of annual rent costs, which, not surprisingly, align closely with the concentrations of low- to moderate-income households.

By layering household income with rent costs, the map in Attachment I highlights potential “crisis” areas, meaning tracts where housing affordability is most dire as the lowest-income earners are most heavily-burdened by rent costs. However, this map also demonstrates that renter concentration is an important variable to consider when determining where and how intervention is advisable. For example, while tracts in the western suburbs of Minnetonka and Plymouth contain “crisis” tracts, the concentration of renters within these tracts is minimal.

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<sup>33</sup> JCHS. *America's Rental Housing: Meeting Challenges, Building on Opportunities*. 2011. This includes various capital and rent subsidy sources.

**The Important Role of Unsubsidized  
Affordable Rental Housing**  
(continued)

From 1999 to 2009, the  
U.S. housing market  
experienced a 28% net loss  
of unsubsidized affordable  
rental units.

Ultimately, the evolving conditions in the subsidized and unsubsidized rental markets that are described above indicate that a comprehensive and proactive housing policy stance should include, at minimum, a recognition of the unique and important role that unsubsidized affordable rental housing plays in fostering a healthy housing market. Beyond that, certain situations may justify carefully designed interventions by public or philanthropic actors who are interested in preserving and improving affordable housing opportunities.

### **Loss of Unsubsidized Affordable Rental Housing**

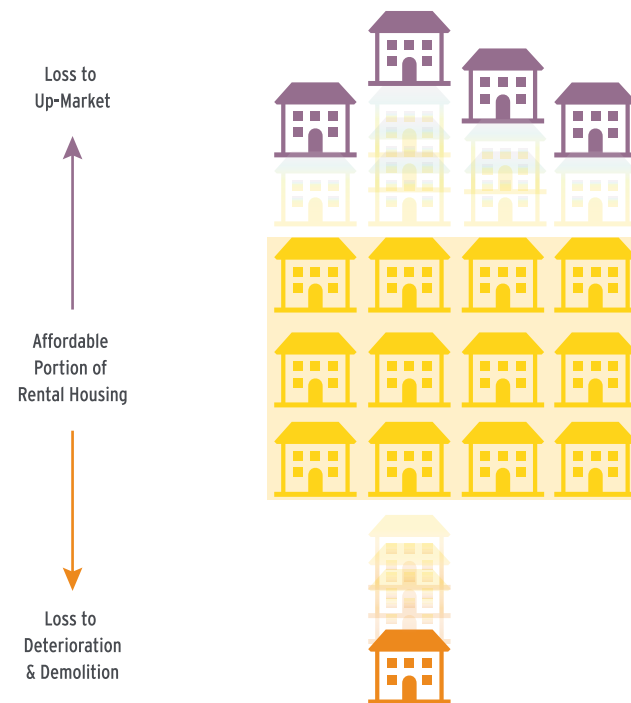
The unsubsidized housing market is fluid, with constant readjustments in sales prices, rents, and sometimes even in tenure. Hence the enduring affordability of rents in unsubsidized rental housing can be dubious as they operate without regulated commitment to affordability in this ever-shifting market.

We visualize the unsubsidized rental housing market as having a band of affordability, where rents are conceivably affordable to households with lower incomes—even if they are occupied by more affluent households. Units within this band of affordability can be lost by moving out the top, or falling out the bottom (see Figure 5 on page 8).

The Important Role of Unsubsidized  
Affordable Rental Housing  
(continued)

Figure 5

The Loss of Affordable Rental Housing



### Moving Out the Top; Up-Market Pricing and Conversions

Properties that move out the top of the affordability band move up-market either in their asking rents or sometimes (notably in the early 2000s condo boom) by converting to ownership tenure vs. rental. The result is that these units become unaffordable or inaccessible to current or new low-income renters. In the subsidized rental housing market this happens when a property owner opts not to renew an expiring subsidy contract, has come to the end of an LIHTC compliance period, or prepays a subsidized mortgage and is, therefore, no longer bound by income and rent restrictions. Unsubsidized affordable properties that move out the top have often undergone major rehab investments, which allow for higher rents, or have experienced a change in ownership, or both. Properties that move up-market are often located in gentrifying or rapid growth areas, such as those undergoing transit-oriented development or experiencing strong job growth opportunities. As an area experiences higher demand for housing, new or existing property owners are able to inflate rent prices to reflect stronger demand, moving properties out of the affordability band.

### Falling Out the Bottom; Demolition.

While less common, properties may leave the affordable rental housing market by falling out the bottom, meaning they permanently disappear from the housing market. Properties that drop out the bottom are those that have suffered significant disinvestment and deterioration and are unable to meet the health and safety code requirements to receive housing subsidy dollars or rental licensure in their respective community. Once properties deteriorate to this extent they are often slated for demolition, which permanently removes them from the housing supply. Only occasionally is this loss offset by direct replacement.

**In This Section:**

- 9 “Affordable Housing” as a Brand
- 10 Scarcity of Resources
- 10 Rising Rents: A Problem in Whose Opinion?
- 11 Nonprofit vs. For-profit Owners
- 12 Subsidized Housing Industry vs. Market Housing Industry
- 13 Realistic Opportunities for Nonprofits in Unsubsidized Rental
- 13 Defining “Affordable” in the Unsubsidized Market
- 14 Resolving or Lessening Tensions

There are some tensions inherent in the discussion around unsubsidized affordable rental housing. These became evident in our conversations with local stakeholders and were reinforced in our exploration of the national experience. It is important that we recognize and understand them before formulating any potential systemic or project-level initiatives.

**“Affordable Housing” as a Brand**

Affordable housing advocates and owners nationwide—and particularly here in Minnesota—have been successful in establishing and demanding high expectations for the physical quality and management practices within subsidized affordable rental housing. The creation of the Low-Income Housing Tax Credit (LIHTC or Section 42) program in 1986, has enhanced expectations for LIHTC properties through the rigorous underwriting standards required by the large private institutional investors and the professional for- and nonprofit developers who are involved in this program.<sup>34</sup>

Research and education by Minnesota entities like the Family Housing Fund, Greater Minnesota Housing Fund, Minnesota Housing, and Minnesota Housing Partnership, among others, have proven that Minnesota’s high quality subsidized affordable rental housing does not negatively impact adjacent property values and safety of neighborhoods. Their efforts have built a strong case that NIMBYism and fears surrounding new subsidized affordable housing development are unfounded.

As a result, the term “affordable housing” has become shorthand for quality, safe housing, and attractive neighbors—not just low rents. It is for good reason that housing advocates want to protect a brand that they have worked hard to establish.

Many of our interviewees expressed concern that acknowledging unsubsidized affordable rental housing—which might offer some affordability but is not subject to the various levels of scrutiny in development, compliance, and quality assurance in long-term management—might undermine or endanger the reputation of the subsidized affordable housing that is produced through LIHTC and other deep-subsidy programs. This comes into play both in terms of whether we call this kind of housing “affordable housing”, and whether subsidized housing owners would want their organizations associated with housing perceived as inferior in quality.

Out of sensitivity to this issue, our Project Team attempted to identify another term for unsubsidized affordable rental housing; soliciting feedback from local and national stakeholders alike. Attachment E is a list of the ideas for alternative names that were generated in the process. While we were unable to find a clear term that would be a preferable alternative to “unsubsidized affordable rental housing,” we have taken pains to distinguish the differences in the very nature of unsubsidized and subsidized affordable rental throughout our investigation.

<sup>34</sup> Which currently produces over 90% of all new subsidized affordable housing in the U.S.

## Scarcity of Resources

Even in the most prosperous times, it can be argued that there has been insufficient funding allocated to meet the growing housing needs of low-income populations through new production or preservation of existing subsidized affordable housing. Very high physical quality and management standards and the layering on of other community development agendas (social services, green building, economic development, public realm, etc.) exacerbate this shortfall by making new production costly (even if it is arguably “better” or more “holistic”). Recent and anticipated cuts to federal programs like HOME and CDBG amplify the perception and reality of resource scarcity.

In this funding environment, some stakeholders react negatively to even investigating unsubsidized affordable rental housing, for fear of a reallocation of the already limited resources that they have available to accomplish their work. Some of our interviewees expressed skepticism that completely new sources could be identified to intervene in unsubsidized affordable rental housing and a fear that any attempts to influence that market segment will mean a direct reduction in resources available to subsidized rental. In assessing potential interventions, our charge and intent was to avoid drawing upon resources normally devoted to subsidized rental housing, but this is admittedly murky.

## Rising Rents: A Problem in Whose Opinion?

Cities with the largest unsubsidized affordable rental housing stock are not necessarily the strongest advocates for its preservation. Policy makers in some cities where substantial amounts of unsubsidized affordable rental housing exist believe that fostering the full range of housing choice and affordability should be their focus instead of adding new subsidized units or intervening in the unsubsidized market. The unsubsidized affordable rental housing stock that is regarded by some as a rich resource, can also be seen by others as a nuisance, a sign of undesirability or obsolescence—or more neutrally—simply not the business of the public sector.

Upward movement in rents in a local market is often regarded as a sign of prosperity, improvement or advancement. A “strong” rental market (stable or increasing rents and low vacancies) is touted by locals as a sign of a healthy local economy and an advantage when attempting to attract development partners with market-driven opportunities. A “weak” rental market (stagnant or falling rents and high vacancies) can be a sign of transitioning demographics or economic decline, and typically requires some sort incentive to attract development partners.

The community at-large, and elected officials by extension, often have less concern over rent inflation than do the professional community development or planning staff in their employ. This means that even the most motivated staff of cities may be limited by political will in addition to financial and other capacity issues.



### Nonprofit vs. For-Profit Owners

A false dichotomy and rivalry is sometimes assumed between for-profit and nonprofit developers and owners. We expected to find a clear distinction and strong preference in the minds of funders and policy makers and perhaps even some territorialism between the for-profit and nonprofit entities themselves. Instead, we found that most stakeholders agreed that both for- and nonprofits can be good stewards of real estate assets and provide solid management of affordable housing. For-profits are not generally viewed as “bleeding properties to increase their profitability.” In point of fact, the majority of both subsidized and unsubsidized affordable housing units are developed and owned by for-profits.

More important than the tax classification of the owners were their:

- intent to own and build the value of the asset over the long term;
- commitment to respectful and consistent property management and tenant screening;
- concern over their reputation or corporate brand with renters, neighbors, investors and cities; and
- commitment to long-term affordability.

The distinctions between nonprofit and for-profit owners started to reveal themselves above the project level. For- and nonprofits may differ in their:

- sources of and access to capital (less so in subsidized affordable where federal programs dictate);
- related ability to take a portfolio approach to property improvement and cash flow management;
- ultimate use of profits that are up-streamed from the project level to the portfolio or entity level;
- willingness or drive to provide housing for lowest-income households or those with special needs—often requiring services that are supported by fundraising; and
- appetite for financial risk.

There is a practical reason for attempting to make these distinctions, as many potential interventions would be best accomplished with an owner who will act as a prudent steward of both the property and the affordability. The definition of desirable owners or stewards is not as simple as “nonprofit,” rather it is the motivation or “mission” of the company that dictates their support and capability to ensure quality affordable housing over the long term.

## Subsidized Housing Industry vs. Market Housing Industry

There may actually be a more important distinction between owners of subsidized affordable rental housing and those of unsubsidized rental housing (regardless of their for- or nonprofit status). While this can be related to the discussion of for- and nonprofit owners above, it is in fact a separate issue that can be conflated or confused.

Few organizations choose to operate in both the subsidized and unsubsidized housing markets.

Those entities (for- and nonprofit alike) who routinely participate in the development and ownership of subsidized housing have learned to operate effectively within that system, which is in some regards independent from market factors. LIHTC and other federal programs tend to drive the developments in which they are used. Where they are located, how they are structured, the depth of their subsidy, expectations of quality, future opportunities for recapitalization, depth and duration of affordability, compliance, etc. are all dictated by others. Participation with these programs can bring with it costs and processes that do not exist for owners in the market housing industry. Profits are realized primarily in development, while cash flow (or access to it) is limited during the hold. Sale after the compliance period is an opportunity for conversion to market-rate and additional profit to the owner, but more often means a recapitalization with similar deep capital subsidies. Owners that excel in this line of business are willing and able to conform to program requirements, tolerate the complexity, and build the required organizational infrastructure, all while still exercising creativity and autonomy.

By contrast, owners of market housing are free to make their own decisions based on their assessment of what is desirable in the market, financeable with private lenders, and profitable for them in the near and long term. The opportunity for profit may be more equally distributed during the hold of the asset with cash flow being a real driver for most. Because these owners do not have development subsidies, they often engage in perpetual capital improvements to a larger extent than is necessary/possible with subsidized housing. They also bear the risks associated with operating in this manner. Many successful owners manage their portfolios rather than their projects; meaning they may use resources flexibly across properties in a way that is expressly prohibited in the subsidized housing space. As an illustration, one of our interviewees reported that in any given month 20% of properties within their portfolio were receiving a temporary cash infusion from others that they owned.

Because of these two very different realities, few organizations choose to operate in both the subsidized and unsubsidized housing markets. For those that do operate in both, they tend to view these activities as two separate business lines. In addition to the practical aspects there are also significant philosophical considerations; some owners are generally averse to government participation and will avoid any more interaction than is absolutely necessary. As is the case with any established industry, the subsidized and market housing developers and owners have a set of interests to protect and may feel challenged by any discussion of change.

## Realistic Opportunities for Nonprofits in Unsubsidized Rental

There may be new opportunities for nonprofits in this market, particularly if public or philanthropic actors decide to engage/intervene in the unsubsidized affordable rental housing market at the point of property sale. This is where the discussion of for-and nonprofits dovetails with that of the subsidized and unsubsidized markets.

Where unsubsidized rental housing is at risk and a transfer of ownership is desired or imminent, or the investment of public resources is being considered, many people feel more comfortable with the idea of entrusting unsubsidized rental housing to nonprofits. They anticipate that in the absence of regulation and strict compliance requirements, nonprofits will be driven by their mission to maintain a balance between rent affordability and profitability/sustainability of the property. However, nonprofit ownership of unsubsidized affordable rental housing is not a perfect solution for many potential reasons, which include the following:

- **Not all nonprofits want to be in this game.** For mission, risk or reputation reasons, many are hesitant to enter this line of business. However, some are starting to experiment in order to diversify in the face of shrinking subsidy programs.
- **Some nonprofits are not well equipped.** After spending years in highly subsidized, highly regulated production programs, some organizations would need to retool to participate effectively. Examples:
  - Approach of making light initial capital investment coupled with long-term capital improvements from cash flow requires more intensive asset management/in-house construction expertise.
  - Much subsidized housing has migrated to serve lowest incomes and those with special needs. Serving mainstream tenants may require different property management approaches.
- **The required silo nature of subsidized housing** (firewalls between projects and little cash-flow up-streaming) means that most nonprofits have limited experience in managing significant amounts of flexible capital at the enterprise level.
- **Limited access to equity (their own and that of others) and debt at the enterprise level means that nonprofits are not as nimble.**

## Defining “Affordable” in the Unsubsidized Market

We did not enter into this study with the intent of simply bringing unsubsidized units into the deep capital subsidy funding system. In fact, quite the opposite; we were charged with thinking of fresh alternatives for the unique set of opportunities and challenges that unsubsidized rental offers to those who are interested in preserving and creating housing affordability.

As such, we do not need to adopt all of the methods and definitions that the subsidized housing programs employ (rent levels, compliance mechanisms, etc.). However, any attempt to either recognize the importance of, or identify strategic interventions in the unsubsidized rental market begs for some definition of “affordable.”

Defining “Affordable” in the  
Unsubsidized Market  
(continued)

Adopting a single definition is a challenge and perhaps even inadvisable in the context of unsubsidized rental because:

**The level of affordability that is meaningful or desirable depends a great deal on the local market, or even micro-market.** While subsidized housing, which is largely driven by federal programs, typically defines affordability on an MSA or county level, we may wish to define unsubsidized housing with a finer point. Some micro-markets might have a legitimate need for more units affordable over 50–60% of AMI, particularly those with strong job growth in advance of development opportunity (Eden Prairie and Thief River Falls are two such examples uncovered in our investigation). There are varying opinions about how deeply to target affordability.

**The level of financial incentive or other participation that can be offered in return for new affordability commitments will vary.** In any case, these are unlikely to match those of traditional subsidy programs. Affordability expectations need to be commensurate with the resources available. One tension familiar to anyone in the affordable housing industry is that incentives can be structured to create a small number of deeply affordable units, or a large number of moderately affordable units. Any potential intervention in the unsubsidized market will face the same dilemma.

**Affordability definitions might vary by purpose.** Recognizing existing affordability in the context of assessing need in the region may require a different definition than in the context of incentivizing new commitments for affordability. Because any interventions in this space would be largely locally designed and funded, this flexibility and nuance are possible.

To illustrate, we recommend recognizing unsubsidized units as affordable if they have rents at 30% of 60% of AMI (a typical subsidized housing definition). It is at this level that the units arguably contribute to a healthy housing market. For the most part, we support a similar affordability goal for interventions that require a financial or other incentive. We can foresee legitimate circumstances where local policy makers may target higher levels of affordability based on their micro-market circumstances and resource availability.

## Resolving or Lessening Tensions

We acknowledge these tensions and recognize that some may be stubborn or permanent. However, we suggest that the following may be helpful:

- Think of unsubsidized affordable rental housing as an entirely separate species from subsidized affordable rental housing; it is different in how it is /should be funded, how quality is monitored and assured, the longevity or durability of its affordability, and the contribution that it makes to a healthy housing market.
- Look for counterparties and implementation partners who understand the fundamental differences between the two and are comfortable acting in the unsubsidized space.
- Be clear when the conversation is about simply recognizing the existence and importance of unsubsidized rental housing in the market vs. potential financial or other resource allocation or intervention.
- Acknowledge that, in large part, the unsubsidized rental market functions well and is in no need of intervention. It is only in selected circumstances that intervention needs to be considered.

Resolving or Lessening Tensions  
(continued)

- Be clear when a proposed intervention is on:
  - A systemic level; where benefits of the proposed activity accrue to many and direct transfer of resources does not occur (i.e. training programs for tenants or owners, licensing and inspections programs in cities).
  - A project/program level; when direct incentives are given in exchange for a pledge from owners about affordability (i.e. mezzanine debt, rent subsidies). This results in a new third type of affordable rental housing; not subsidized (in the typical way, extent or requirements) and not unsubsidized (free of all requirements), but rather a “light-touch” (that is modestly subsidized or with fewer requirements and more flexibility).
- Create a new term for this previously unsubsidized affordable rental housing that is the subject of modest project/program level intervention. In this report we call it “light-touch housing.”

Figure 6

<b>Three Species of Affordable Rental Housing (Summary)*</b>			
	<b>Unsubsidized Affordable Rental Housing</b> Description of Current State	<b>Light-Touch Affordable Rental Housing</b> Proposed Future State	<b>Subsidized Rental Housing</b> Description of Current State
<b>Description</b>	Already existing and naturally-occurring affordability in market housing which contributes to a healthy, diverse housing market and promotes choice.	Previously unsubsidized affordable housing that, through light touch interventions, could create new opportunities or more public benefit.	The creation of new affordable housing units that are a product of deep subsidy programs usually federally defined but may be locally administered.
	Cost: 0 + Compliance: No compliance + Quality Control: Minimal + Affordability Duration: None	Cost: \$ + Compliance: Light Compliance + Quality Control: Moderate Quality Control + Affordability Duration: Variable	Cost: \$\$\$ + Compliance: High Compliance + Quality Control: High Quality Control + Affordability Duration: Longest

\* Please see page 101 for long-form table.

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- 23 Efforts on the Part of Cities

**Roots of Affordability**

Many factors influence the level of affordability found in unsubsidized housing; some are property specific, others vary by market. In this investigation we sought to better understand the roots of this affordability because they may determine the effectiveness or appropriateness of possible interventions. We found that there are four primary categories that affect natural affordability in the unsubsidized rental housing market.

**Location.** The location of a property is the single most influential factor on the rent levels set by property owners. Some locations simply demand lower rents than others. These locations might be isolated from amenities, experiencing higher crime rates, have a loss of population, etc. Even the finest units with the most amenities and highest quality of management will reach a practical ceiling on rents for their area. Alternatively, some desirable locations allow a landlord to ask for more rent than the quality, amenities, or management of the housing would otherwise warrant.

Because we often define affordability on macro-market basis (city-wide, metro-area wide, or statewide), the maximum rents that are feasible in any one market area may be considered affordable when taken in a larger context. They might not represent affordability for current residents. For instance, some parts of North Minneapolis have attractive housing stock available at low rents due to perceptions of that market area, whereas new employees in Thief River Falls are happy to pay top-dollar for any housing, regardless of condition, in the proximity of their jobs. This reality is generally acknowledged and has entered into debates on housing policy. For instance property tax breaks for unsubsidized affordable rental were discontinued, at least in part, over this dynamic.<sup>35</sup> Units whose rents were constrained by the limits of their market rather than owner choice were receiving public incentives; essentially wasting the public resource, without providing public benefit in return.

Our research reinforces that there can be great variation on even a micro-market level, defined at the level of a neighborhood or single-block geography. Similarly, in geographies where there is less demand for rental housing, such as rural areas and/or communities with weak employment, the rent levels will be depressed, translating to more existing affordability in the rental housing market.

**Physical Condition.** The physical condition of a property is another key determinant of rents. Physical conditions are often described by two terms: aging properties and distressed properties. As properties age they can become less attractive relative to other newer options in the market. While aging properties may provide a stock of clean and well-maintained rental units, their configuration, aesthetics, and lack of modern amenities limit the amount of rent a landlord is able to reasonably charge. However, age does not, in and of itself, ensure affordability. Some historic/older properties, can hold their own on rents due to their character or charm.

Some properties are of lower original quality and/or have been poorly maintained over time. These properties are likely to be described as distressed. They may show serious signs of wear and/or neglect, including deferred maintenance, infestation, and structural deficiencies.

<sup>35</sup> In this case, those that were not subject to deed restrictions, which were referred to as “pledged units.”

Roots of Affordability  
(continued)

These physical issues suppress the level of rents that can be charged for such properties, creating a supply of rental housing that is affordable for those still willing to live in the units.

**Management.** The quality of management can greatly affect rent levels as well. Properties that are poorly managed are more vulnerable to issues of nuisance, crime, low curb appeal, and physical quality. These often negatively affect marketability, which suppresses rent levels. These sorts of management issues are more common among smaller properties (< 20 units) that are self-managed by owners, many of whom hold other full-time jobs that preclude them from investing ample time or resources in property maintenance and tenant screening/relationships. We refer to these as DIY/part-time owners and distinguish them from small-scale and large-scale professional owners who are more likely to provide professional property management.

**Owner Decision and Optionality.** Some owners may choose not to charge the maximum rents that their properties could demand in their local market. Reasons for these decisions vary by owner and situation, but sometimes include a personal relationship or loyalty to tenants. More often, owners forego rent increases in order to avoid costly turnovers. An owner may not raise rents on existing tenants, in the attempt to retain them and reduce the cost and operational inconveniences associated with bringing on new, higher-paying tenants. The costs and payback time of turnovers are demonstrated in Text Box 1 and make a compelling case for this strategy.

Owner optionality to set rents below the maximum obtainable in the market is also determined by having manageable operating cost and debt repayment obligations. Those with lower costs have the luxury or flexibility of making such decisions more often. For this reason, it is particularly those who have held properties for long periods of time who can more easily offer some level of affordability while maintaining their properties and cash flow.

Figure 7

**TEXT BOX 1: Cost of Turnover: An Example of Earn-Back Time**

Turnovers can be expensive and a hassle. Owners will often go to great lengths to avoid them and will weigh potential rent increases carefully against the possibility of triggering turns. Consequently, there is a growing gap over time between asking rents on turnover, and the rents paid by long-term renters. Tenant retention can mutually benefit tenant and owner financially—as well as contribute to community stability.

**Turnover Costs:**

Repairs, repainting & cleaning	\$ 900
Vacancy (1 month, Metro avg. Q3 2012 Marquette Advisors)	\$ 950
Marketing & leasing:	
Typical leasing fee (75% of monthly rent)	\$ 713
Other expenses (15% of monthly rent)	\$ 143

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<b>Total</b>	<b>\$ 2,706</b>
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**Cost Recovery through Rent Increase:**

Monthly rent increase (10%)	\$ 95
Annual	\$ 1,141

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**Time to Recover Cost of Turnover = > 2 Years, 4 Months**

## The Shadow Market

Any thorough discussion of the current affordable rental market has to consider the impact of the foreclosure crisis and dramatic drop in home values on the rental of single-family homes, condos, and duplexes. Recently the *Wall Street Journal* reported that the shadow inventory was an estimated 3.4 million.<sup>36</sup> A significant portion of those units have been converted from owner- to renter-occupancy. In Minnesota, HousingLink reports that for the Twin Cities Metro Area, there were over 10,000 shadow market rental listings.<sup>37</sup> Of this number, 31% were single-family homes, 17% were townhomes, 11% were duplexes, and 7% were condos. Together these shadow market rentals comprised 67% of all rental market listings in the area.<sup>38</sup>

One important indicator of this phenomenon is the major investment being made by private equity players to buy foreclosed homes and rent them. Recently, the first publicly traded REIT to invest solely in single-family rental homes was created. A *New York Times* article quotes one industry analyst as opining that this will be a workable business model for at least three to five years.<sup>39</sup> At that point, investors will likely shift this stock back into owner-occupancy by selling off these homes.

The increasing interest by major investors in acquiring and operating large scattered site rental inventories (through bank or federal entity REO or note sales) has rung alarm bells in many communities. The fear is that large non-local investment entities, interested solely in profit, will manage this housing in ways not consistent with local community expectations and values and will dispose of these properties in a way that might destabilize markets. Scattered site rental management is challenging and can be difficult to do in a cost effective way. However, several entities have built a functioning business model and more are entering the space.

But it is not just large, for-profit investment groups engaged in REO rental. Nonprofit members of the Housing Partnership Network are investigating a collective business that would acquire and manage rental of REO stock to an acceptable standard and until such time as the units can be sold (hopefully to existing renters) without negatively affecting market health. This will bear watching, particularly in high foreclosure areas of the Twin Cities.

Individual owners and condominium associations also find themselves reluctant landlords in the shadow market. Faced with the prospect of having to sell at a loss, most owners will instead choose to rent their former primary residences and wait for the market to recover. Often, these new landlords have no experience or training and the responsible jurisdictions, mortgage lenders, and insurers may not be aware that the unit is now a rental unit. The condo boom in the mid 2000s resulted in the conversion of many modest apartment buildings into condominiums. Now some of these units are returning to the rental market but without the benefit of professional management in the same way that single-family homes are.

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36 Timiraos, Nick. *Wall Street Journal*. 'Shadow' overhyped as housing threat. December 25, 2012. Accessed online March 12, 2013. <http://online.wsj.com/article/SB10001424127887323291704578199523813607666.html>

37 Quarter 3, 2012.

38 HousingLink. *Trends in the Twin Cities Rental Market*. CURA Presentation. October 2012. Accessed online March 12, 2013. <http://www.cura.umn.edu/sites/cura.advantagelabs.com/files/content-docs/TwinCitiesRentTrends-Oct2012.pdf>

39 *New York Times*. *Big Money Bets on a Housing Rebound*. December 8, 2012.



**The Shadow Market**  
(continued)

Locally, there is some evidence of the dampening impact of the “shadow market.”<sup>40</sup> In October 2012, HousingLink observed that rents were actually declining in some suburbs, due to the shadow market creating more competition for traditional apartment rentals. In the fourth quarter of 2011, 65% of all rental listings with HousingLink came from the shadow market. In the fourth quarter of 2012, shadow market listings had dropped to 55%, perhaps foretelling the beginning of a shift of shadow market units from rental back to owner-occupancy.<sup>41</sup>

All this suggests that the level of rental housing stock available at the moment may be a temporary condition. Eventually many of these units will again leave the rental inventory with the timing of that shift determined by the market’s preference for ownership, availability of mortgage financing, etc.—factors other than rental housing need/demand.

### Owners of Unsubsidized Affordable Rental Housing

Much about the current state of unsubsidized affordable rental housing is a reflection of the entities that own the real estate. Likewise, the possibility of influencing the quality of the housing, its management, and the duration of the affordability depends on understanding the owners and their motivations. Through the course of our interviews and focus groups, there emerged three general categories of owners as well as some regional dynamics, which we discuss here.

#### Do-It-Yourself (DIY)/Part-Time Owners

These are owners with small portfolios that consist primarily of duplexes, fourplexes, and single-family homes that are self-managed and considered secondary personal sources of income or investment. They are most often employed in another industry. Often they purchase properties with the idea that they are a “passive” investment—a seemingly simple, straightforward business requiring little of them as owners on an ongoing basis. Eventually they find out that this is not the case, but this outlook and their other obligations continue to affect how they approach the management of their properties.

Some of these owners retain professional management for their properties after they discover the demands that the properties place on them. However, in most cases, the economics do not allow for professional management or these services are not viewed as an essential business expense. The challenge of owning rental properties is often further complicated when the property is not close to where the owner lives.

DIY/part-time owners typically purchase rental property as long-term investments, often with the idea that they will break-even during the hold and eventually pay off their mortgages. They assume that once the mortgage is paid the property will provide a steady source of cash flow. In many cases the property is viewed as a supplement to the owners’ other retirement investment. In hot market periods, like the early 2000s, DIY/part-time owners became very aggressive, depending on tax losses as well as break-even operations to justify high acquisition prices.

#### DIY/Part-Time Ownership

As characterized by a focus group contributor, these investments are “a job that you buy.”

<sup>40</sup> Defined by HousingLink as any rental listings that are properties with one or two units (single-family homes, duplexes, condos, townhomes).

<sup>41</sup> HousingLink. “Shadow Market Pressure Impacts Apartment Rents in Twin Cities Suburbs”. Twin Cities Rental Revue October 16, 2012.

Owners of Affordable Unsubsidized  
Rental Housing  
(continued)

However, current cash flow is also very important, and can, at times, undermine good decision-making. The personal finances of DIY/part-time owners often hinge closely on property occupancy and conditions. When even one month of vacancy occurs, it is a significant event for the owner and may put the rest of the owner's financial stability in peril. There is not only the immediate loss of rent, but also the time and cost of preparing the unit, marketing, showing, and leasing the unit. Vacancies are never convenient, and the time demand that turnover places on the owners can result in a strong temptation to cut corners in the process, particularly in renter selection where the negative effects of poor tenant screening may impact neighbors.

Given the problems created by the turnover of their rental units, these owners have a strong incentive to minimize rent increases. If they have satisfactory renters, these owners tend to avoid rent increases in the interest of avoiding turnover. If they have problematic tenants, they are not quick to act because of the personal time and financial burden it places on them.

With the time demands of rental unit ownership being a significant issue for these owners, there is a strong tendency to procrastinate in dealing with maintenance and management issues. Needed replacements or improvements to the properties are often postponed because the owners do not want to take the time to address the needs and/or the needed cash is not immediately available. In their financial planning for their rental units, these owners often include only ongoing operating and maintenance costs without an allowance for periodic reinvestments in the properties that are needed for major replacements such as roofs and boilers.

These owners can avail themselves of many resources to better learn the business that they are involved in, but the time commitment required to take advantage of the educational opportunities that exist may be a hindrance. There is also a strong tendency to try to minimize paperwork, again in the interest of limiting the time demands of their investments. The result is that some of these properties are managed in ways that are not in accordance with existing law and regulation.

While very low-interest financing is currently available, often these owners are unaware of availability of such financing, are unwilling/unable to prepare the necessary paperwork, or are already over-leveraged. These DIY/part-time owners also often do not qualify for the financing as lenders are looking beyond the properties for collateral or guarantees for loans as well as looking carefully at the experience and financial capacity of the owners.

Any program to work with these owners to preserve and enhance the affordability of their rental units would need to meet at least two requirements. First, the program would need to place minimal initial and ongoing demands on their time. Second, the program would need to be offered to them by or through an organization that is familiar and credible to them. The best scenario would be to select those owner who are already engaged with some sort of capacity building effort like those offered Minnesota Multi Housing Association (MHA), Lutheran Social Services (LSS) or cities.

Owners of Affordable Unsubsidized  
Rental Housing  
(continued)

### Small-Scale Professional Owners

We describe small-scale professional owners as those that typically own properties with 40-100 units. Often times, their businesses started as a part-time venture. However, over time their portfolios have grown and reached a point where these owners need to devote themselves full-time to the operation and management of their properties.

Some of these owners retain professional management for their properties. However, depending on the composition of their portfolios, this may not be a financially attractive option. In the Twin Cities Metro Area, there is not a lot of true fee management; meaning units that are managed by third-party professional managers with no connection to the ownership entity. For professionally managed properties, there is most often some identity of interest between the ownership entity and the management company.

Typically these small-scale owners also purchase their rental properties as long-term investments. However, immediate cash flow is of primary concern while turnover is an anticipated financial, administrative, and labor burden. With a larger portfolio, there are regular needs for replacement and improvements.

While these owners may be slightly less concerned about the immediate impact of turnovers, these are still a major concern for the owners with the most affordable rents. For these owners, their renters may be particularly price sensitive and may be more inclined to give notice and move when faced with a rent increase of any significance.

On the other hand, with reports of significant rent increases in the last 12 months and on the prospect of still greater rent increases, these owners are now more willing to push the rental markets in which they are located and impose significant rent increases on their current renters. GVA Marquette Advisors in their September 2012 Apartment Trends report found that over the 12 months ending in September, “year-over-year effective rent growth is calculated at 3.8%” for the Twin Cities. For a unit with a \$950 rent, a 3.8% rent increase is \$36.

While small-scale professional owners devote themselves to their properties on a full-time basis, time is still a significant issue for them. Given that their management operations are small, they must deal with various demands on their time and limited economies of scale. They tend to resist anything that represents a potentially significant additional workload.

The currently available, very low-interest financing is more accessible to these owners. It is usually much easier for them to meet the experience and financial capacity requirements of lenders. On the other hand, these owners may be very cautious about currently available financing because of the short-term nature of the mortgage loans, typically seven years or less. These owners may recognize that when a loan matures, interest rates may be significantly higher and threaten the viability of their operations in the future.

Any program to work with these owners to preserve and enhance the affordability of their rental units would need to meet at least two requirements. First, given other demands on their time, the program would need to place minimal initial and ongoing demands on their time. Second, the program would need to offer significant long-term benefits if these owners were to sign up for more than a few years. A major concern of these owners is that if they agree to limit their rents, they may lose out on a significant “once every ten years” opportunity to raise their rents to a significantly higher level.

These owners purchase their properties as long-term investments though immediate cash flow is of primary concern.

Owners of Affordable Unsubsidized  
Rental Housing  
(continued)

### Large-Scale Professional Owners

The large-scale professional owner typically has larger properties (100 units or more) and overall much larger portfolios. Their rental properties are managed by professional management companies, and, more often than not, these are affiliated with the owner.

These owners also reported buying rental properties as long-term investments, and while appreciation is often important to them, cash flow is most often the priority in the short term. However, there are occasional variations from this. For example, when the rental market turned down sharply in the early 2000s, some of these owners re-invested significantly in their properties. Their strategy was that as the rental market constricted they would position themselves to secure more than their proportionate share of the remaining market. These owners had the capital to make such investment decisions.

While turnover is always an issue, these owners undertake to balance turnover with income maximization. Analysis usually indicates that a building that experiences some turnover while the management works to increase rents has a higher gross income than a building where management simply attempts to minimize turnover. Some of these owners even use income maximization software programs that maximize income by varying asking rents, day by day or at least week by week, based on demand factors that are monitored on an ongoing basis.

While demands on staff time are an issue for all businesses, these owners are large enough that they achieve economies of scale by having staff who specialize in certain programs. A specialized program with paperwork demands is not reflexively rejected, but is rather evaluated for its potential to increase income overall. Some of these companies have a significant involvement in subsidized affordable rental housing.

Affordable financing with very competitive terms is generally not an issue for these owners. In fact, many large-scale professional owners have taken advantage of the low interest rate environment and have refinanced most of their portfolios.

Any program to work with these owners to preserve and enhance the affordability of their rental units would be carefully analyzed by these owners. There would need to be a clear net benefit to them in order to gain their involvement.

### Greater Minnesota

In Greater Minnesota this typology exists but is also greatly influenced by the size, economic growth, and demographics of the communities in which they work.

**Cities of More Than 25,000.** These cities include the MSAs of Rochester, Duluth, St. Cloud, Mankato, Moorhead (larger than Rochester when included with Fargo), East Grand Forks (a little smaller than St. Cloud when included with Grand Forks), and regional city centers such as Winona, Owatonna and Austin. In many ways, the rental housing market in these cities functions in a manner similar to the Twin Cities. There are some variations based on the economics of each city. For example, the rental market in Mankato is currently very strong with rents increasing rapidly.

Most or all of these cities have Class A, Class B and Class C rental housing. The Class C rental housing is much like that in the Twin Cities with no/few amenities, reasonable rents, and low- to moderate-income renters.

These owners achieve economies of scale and any specialized program involvement is evaluated in light of the potential to increase overall income.

Owners of Affordable Unsubsidized  
Rental Housing  
(continued)

**Cities of 10,000 to 25,000.** These cities include Faribault, Northfield, Willmar, Albert Lea, Red Wing, St. Michael, Hibbing, Hutchinson, Marshall, Brainerd (along with Baxter), New Ulm, Bemidji, Fergus Falls, Sauk Rapids, Worthington, Alexandria, Grand Rapids, and Fairmont. The circumstances of these communities vary considerably. Some are doing very well economically and have very strong rental markets such as Worthington. Others face challenges that impact rental markets such as Brainerd, which has the highest unemployment rate in the state.

Some of these communities have only Class C rental housing, which serves low- to moderate-income renters affordably. In the communities that are struggling economically, these rental properties tend to be in poor condition as the market will not support rents that provide for good property stewardship.

**Cities of Under 10,000.** In these communities, owners can struggle to preserve the unsubsidized rental housing that does exist, as there is little or no upward pressure on rents. This reality often contributes to poorer property conditions. Particularly in towns of less than 5,000 there is often little to no market for these rental properties if the owners want to sell them.

In these communities, there is sometimes a combination of resource-constrained owners and very low-income renters. Rental housing is often operated on an informal basis with no rental applications, no screening, and no leases. The cities often have limited capacity and/or ability to enforce rental housing standards in a systematized way or to assist rental property owners in improving their properties.

### Efforts on the Part of Cities

Through the course of focus groups, work sessions, and personal conversations, our Project Team learned about the efforts that are being made on the part of cities in the Twin Cities Metro Area and Greater Minnesota to both ensure the physical quality of unsubsidized affordable rental housing and equip property owners/managers to make good decisions regarding property maintenance and tenant relations. We discovered that many cities in Minnesota are proactively taking positive steps to maintain this housing stock as a viable option for residents within their communities. These key efforts are highlighted below.

**Rental Licensing.** Most cities in the Twin Cities Metro Area and many in Greater Minnesota require some form of rental licensing in their communities, though the renewal periods and compliance requirements vary. In Richfield, for example, owners of rental properties must renew their rental license on an annual basis, whereas Duluth requires license renewal every three years. For property owners in the City of Hopkins, the annual rental licensing is also tagged with a requirement to attend a minimum of one meeting of Hopkins Apartment Managers' Association each year. Similarly, the City of St. Cloud requires all owners of rental properties to participate in a Rental Property Training Program as part of obtaining a rental license.

Additionally, some cities utilize a reward system when determining the costs of rental license renewals and correlating number of required building inspections for a property. For example, if a property owner in Mounds View elects to attend a minimum number of property owner education meetings in a given year or earn a certificate in Crime Free training, he/she is charged a reduced fee for license renewal.

**Efforts on the Part of Cities**  
(continued)

**Inspections.** In concert with rental licensing, most cities actively perform housing quality inspections. From our conversations with various cities, these inspections range from minimal to robust, occurring once every one to four years, depending on the jurisdiction. There are a small number of cities that do not conduct regular inspections, but respond to community concerns on a complaint only basis. The local fire department, building inspectors housed within the local community development department, or inspection parties contracted by the city are among those responsible for conducting inspections. These inspectors confront code violations and issue citations when necessary to maintain at least a minimal physical quality standard to protect the health and safety of renters.

Again, some cities employ a reward system to encourage property owner/manager compliance with building standards. In Coon Rapids, for example, the number of required inspections on a semi-annual basis is dependent on the property owner's level of involvement in Crime Free training and landlord association meetings; the more involvement, the fewer inspections. Furthermore, this participation also dictates the amount of fines charged for building code violations with lesser fees charged to those who demonstrate active involvement in "good" landlord education. The City of Brooklyn Park has a robust rental inspection system in which building inspectors advise property owners on capital improvement plans to help them consistently pass building inspections.

**Owners/Managers Associations.** Many cities host and/or support rental property owners/managers associations, occurring on anywhere from a monthly to quarterly basis. The local Crime Free officer and/or building officials most often run the association meetings. Within the Metro Area, there are several cities that actively convene regular meetings geared towards educating property owners on issues such as planning for property improvements, budgeting, cultural sensitivity with tenants, tenant screening, executing rental agreements, etc. Moreover, our discussions with city staff revealed that these association meetings are viewed not only as a means to educate property owners and provide resources for confronting property-related problems, but also as an accessible sounding board for city staff to receive valuable feedback regarding local housing policy issues. The City of Mounds View, for example, has a loosely organized apartment manager's coalition, which serves as a forum through which the City can discuss potential housing policy decisions with those being affected.

**Crime Free Multi-Housing Training.** Most of the cities we talked to incentivize or require a property owner/manager to attend Crime Free training. The Crime Free Multi-Housing training program is a major initiative led by the Minnesota Crime Prevention Association, a nonprofit dedicated to developing crime prevention programs. It is a three-phase approach that educates landlords and tenants on maintaining a safe environment in multi-family dwellings. The first phase involves a one-day management-training workshop for property owners/managers that highlights issues such as applicant screening, rental agreements, being a proactive property manager, and warning signs of criminal activity. Phase two requires physical improvements to the property that promote safety, including installing dead bolts, strike plates, door viewers, etc. The third phase is a resident education workshop that teaches crime watch and prevention techniques.

**Efforts on the Part of Cities**  
(continued)

Cities recognize the Crime Free program as a valuable resource for maintaining better rental properties. This recognized value is evidenced by the reductions in rental licensing fees, number of required property inspections, and fines charged for code violations that are granted to property owners who participate in Crime Free training in numerous jurisdictions across the state of Minnesota.

**Loans.** While not as common as some of the other efforts made by cities, there are some cities that have established loan programs to aid in property maintenance and improvements for property owners. For example, the City of Brooklyn Park offers loan opportunities for rental property owners, including a Rental Rehab Loan (up to \$10,000) with low-interest financing (4%) for completing improvements that increase the livability of a property and a Rental Energy Loan that provides financing to owners for increasing the energy efficiency of their buildings. In Greater Minnesota, the City of Duluth offers Rental Property Rehab Loans that are administered through the local HRA. These are low interest loans (2%) for rental property owners to make improvements and/or housing updates with the intent of keeping properties safe, well maintained, and affordable. Generally these have been met with a cool response from owners for reasons that include privacy concerns, aversion to new debt, and administrative burden.

## Challenges of Intervening in the Unsubsidized Affordable Rental Housing Market

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- 26 Physical Quality/Condition
- 27 Management Quality
- 27 Duration of Affordability
- 27 Mechanisms to Ensure Affordability
- 28 Eligibility
- 28 Compelling Incentives
- 28 Income/Means Testing
- 29 Recognition or Counting of These Units
- 29 Diagnostic Framework

Meaningful definitions of affordability must consider the context of micro-markets –not just MSAs.

In the event that a philanthropic or public entity evaluates a given market and should decide that they wish to intervene in the unsubsidized affordable rental housing market, there are a myriad of challenges that collectively illustrate the inherent complexity of designing any programs or initiatives for this space.

### Defining Affordability

The first challenge to intervening in this space is defining what constitutes affordability that is worth recognizing, preserving, enhancing or extending. Subsidized affordable rental housing complies with income band targets (50% or 60% of AMI, typically). While it is tempting to create similar codified and universal definitions for interventions in unsubsidized rental housing, this rigidity and simplicity undermines creating meaningful affordability in the context of micro-markets. While we ourselves started with the desire to have a single definition, we have instead concluded that satisfactory affordability in any single intervention should be defined by weighing local conditions, depth of incentive, and length of commitment, among other factors. We anticipate that certain local market conditions in Minnesota could justify intervening to protect affordability of those up to 80% of AMI. As an illustration, market conditions in Florida are such that tax relief interventions are offered to nonprofit owners agreeing to rent units at affordable rates to elderly tenants of any income and to households earning up to 120% of AMI.

Additionally, the standard accepted in subsidized housing, that gross housing costs should not exceed 30% of income, may warrant re-examination in some contexts. The most obvious situation where higher than 30% of income allocated to rent might be acceptable is when the location of unsubsidized affordable housing allows for a reasonable combined burden for housing and transportation costs. This is an example of how those intervening in the unsubsidized affordable rental housing market could make prudent use of the flexibility afforded to them by virtue of the fact that they are outside of traditional subsidy programs.

### Physical Quality/Condition

Prior to any intervention, unsubsidized affordable rental housing is generally subject to only minimum life and safety standards as enforced by inspectors in their municipalities. As one interviewee said, “We can enforce full code compliance, but that doesn’t necessarily get us to what I consider minimum acceptable quality.” This housing represents a wide spectrum of physical condition/quality. In certain circumstances some measure of existing affordability may have been achieved by sacrificing the quality of the physical product when it was developed or its level of maintenance over time.



**Physical Quality/Condition**  
(continued)

However, much of the unsubsidized affordable rental housing stock is decent, well maintained, and fits well into the fabric of surrounding neighborhoods. Lower-level finishes, fewer amenities and age can limit asking rents without compromising basic standards. Interventions in this market could arguably provide an opportunity to incentivize improvements in sub-par housing, but due to resource limitations, lack of compliance regimes, and owner interest, resources may be better targeted toward those owners who already maintain properties at an acceptable level. Practically speaking, our expectations for unsubsidized affordable rental housing can be lower than those we have for subsidized housing, which attracts deep capital subsidies and accompanying high lender underwriting standards.

**Management Quality**

Many general concerns about rental housing are as much a function of the management as the population housed or the physical structures. The quality of tenant screening, rule enforcement, and grounds maintenance impacts the tenant experience as well as that of the surrounding neighbors. As such, interventions that involve incentives (carrots) are best targeted to properties that are already well managed; where program administrators' reputational risk for being involved is minimal. Interventions that involve enforcement (sticks) can be applied more broadly and to compel maintenance of minimum standards.

**Duration of Affordability**

One primary difference between subsidized and unsubsidized affordable rental housing is the durability or expected duration of the affordability. Interventions in unsubsidized rental housing can be used as a way to increase the period of time that affordability exists. In designing interventions it is important to understand current micro-market conditions and monitor their changes over time. The length of affordability required by any incentive-based intervention needs to be weighed against the amount of the incentive, owner tolerance, and these changing market conditions. This presents a thoughtful administrator with the opportunity to be more nimble than current deep capital subsidy programs ordinarily allow. Generally, we expect that the duration of affordability in this space will be shorter than that expected in subsidized affordable rental housing. The consensus among our interviewees is that incentive-based interventions should target a minimum of five-year affordability commitments.

**Mechanisms to Ensure Affordability**

Those who wish to influence the quality and affordability of unsubsidized affordable rental housing have many mechanisms to choose from to ensure that affordability and quality commitments are honored. In subsidized housing we have come to depend on long-term use agreements and deed restrictions with a high level of compliance reporting. These mechanisms are not practical in the unsubsidized affordable rental housing space given the limited financial resources that are likely to be applied, as well as owner and tenant resistance to intrusive compliance and administrative burden. However, there are options that may be palatable to owners, renters, and program administrators alike. These include simple contractual or loan agreements with self-certifications or elective annual participation that triggers benefit to owners. Simplicity,

**Mechanisms to Ensure Affordability**  
(continued)

use of layman’s language, and sensitivity to privacy concerns are of paramount importance in designing interventions. Looking at New York’s decade-old Rent Stabilization Program would be a good starting point for finding self-certification reports and a small owner support system that assists with compliance (see *Attachment C6 for more detail on Cost Saving Measures*).

**Eligibility**

Deciding who and what triggers eligibility will be an important step in designing any intervention. In addition to the affordability definitions discussed above, eligibility for incentive-based requirements should include owner willingness, commitment and previous track record in management, asset maintenance, and length of ownership. Most subsidized housing programs require that a minimum of 20% of units be affordable in order to trigger eligibility for resources. Incentive-based interventions in the unsubsidized affordable rental housing market will likely be less rich, and others may not involve any transfer of resources (like cost savings measures). In this context, adopting a minimum percentage of units requirement is less necessary/useful.

**Compelling Incentives**

Thoughtful consideration will be required in order to identify an appropriate level of investment of resources (financial or otherwise) that is commensurate with the benefit expected in return. Some interventions can be defined as systemic or general where actions on the part of a public or philanthropic entity result in a benefit to many. However, in the case of project-level interventions, where financial resources might be made available in exchange for specific commitments, this cost-benefit analysis is even more critical. No doubt that a comparison with other potential investments in housing and other community development outcomes is likely. We have explored these and other tensions in Section 3 of this study.

We do not advocate for the reduction of existing deep capital subsidy resources in order to address currently unsubsidized affordable rental housing. Instead, we are hopeful that the increased flexibility and lower cost and administrative burden in the unsubsidized market can result in more and greater opportunities.

**Income/Means Testing**

Data accessed during this study highlights the frequent mismatch between the affordability of rents and the income level of the occupants in unsubsidized affordable rental housing. Whereas subsidized housing gives significant control over the matching of rent and income levels to regulators and funders, the unsubsidized affordable rental space allows for choice on the part of residents and owners. Subsidized housing will limit/select occupancy by creating a ceiling on income levels of households considered eligible. By contrast, unsubsidized affordable rental housing is usually subjected to income minimums with landlords setting income standards that reduce their risk of non-payment of rent (usually corresponding to income at two to three times rent). This is an example of where the culture and practice in unsubsidized rental housing is completely divergent from that of subsidized housing, which can make the design of interventions challenging. We have concluded that while income goals and verification are desirable, the strictest rigor and controls cannot be applied to unsubsidized rental housing. Income

**Income/Means Testing**  
(continued)

verification at move-in (typically in most tenant screening processes) is likely to be palatable, with self-certification on an annual basis being more problematic for owners and tenants and also adding a significant public cost to administer and monitor. Income verification without the participation of the landlord after move-in would be ideal. Onerous administrative requirements are likely to dissuade participation altogether. Here again, income-testing requirements should be considered against the level of financial incentives and other factors in designing interventions.

**Recognition or Counting of These Units**

Recognizing potential municipal interventions in the unsubsidized affordable rental housing requires a more sophisticated and nuanced approach than the simple counting of units that is possible in subsidized housing. Cities in the Twin Cities Metropolitan Area take their Metropolitan Council regional housing goals seriously.<sup>43</sup> However, they also want to be assured that they are being given “credit” for the contribution that their existing housing stock is making to the health of the regional housing market.

Furthermore, they want to know that any additional efforts they make to preserve and extend affordability will be recognized in the context of new production goals. Many cities have limited new development opportunities/sites and meager financial resources to offer incentives when new development does occur. Any intervention that provides enhanced public benefit (longer duration of affordability, greater depth of affordability) should be recognized as creating enhanced housing opportunity, even when new units are not produced. The extent to which such efforts should be “counted” toward production goals requires a more complicated calculation than does the addition of subsidized affordable rental housing (like new LIHTC or HOME units).

**Diagnostic Framework**

It is not always necessary or advisable to intervene in the unsubsidized affordable housing market. However, in some cases it may be important to take action to ensure that the existing housing stock is preserved and remains affordable. Conceivable examples of where intervention might be important are along new transit lines or in small communities with high employment growth. Careful review of local conditions and market forces is essential to determine the need for, the prudent level, and form of intervention.

The following is a framework that includes specific considerations for local government to help determine if there is a need to intervene to assure that some unsubsidized affordable rental housing units remain or become affordable.

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<sup>43</sup> The regional housing goals are part of the Livable Communities Act grant program operated by Metropolitan Council in which cities elect to participate by agreeing to work towards providing their share of affordable housing needed, as calculated by Metropolitan Council, for the metropolitan region. Participant cities also agree to invest annually towards building or preserving affordable housing within their communities.

Diagnostic Framework  
(continued)

### Framework of Specific Considerations for Local Governments

Figure 8

Topic	Evaluation Questions	Rationale
<b>Evaluation of Community Goals for Affordable Housing</b>	<p>Are the city's existing goals and policies supportive of affordable housing?</p> <p>If so, to what level? If not, do existing goals and policies require modification to support intervention if needed?</p>	The existing political support for affordable rental housing will help in determining the level of funding sources available to intervene in preservation of unsubsidized affordable rental housing.
<b>New Rental Housing Market</b>	<p>Is there a strong or weak market interest in new rental housing?</p> <p>Are the proposals for market or high-end units?</p> <p>Is the level of subsidy needed to include affordable units within new rental housing cost prohibitive?</p>	In strong rental housing markets, it may be expensive to subsidize new units to ensure that there is affordability. Rather, a city may wish to financially support efforts to ensure that existing units remain affordable by attributing funding to unsubsidized units already built.
<b>Age and Condition of Existing Apartment Housing Stock</b>	<p>What is the city's inventory of existing unsubsidized affordable rental housing?</p> <p>Has renovation of the older housing stock occurred and at what level?</p> <p>Is there ample supply of existing affordable and/or unsubsidized affordable rental housing to serve current population?</p> <p>Is there a need to diversify the housing stock with market rate or high-end housing?</p>	Generally, older housing stock is where the unsubsidized affordable housing is most viable. However, if the market is strong and renovation is occurring on its own, the city may determine that there are different reasons to intervene, e.g. unsubsidized affordable units are no longer affordable rather than experiencing a decline in the quality of the housing stock.
<b>Rent Levels and Vacancy Rates</b>	<p>Are the rent levels in the micro-market area lower or higher than the average market rates in the MSA and why?</p> <p>Have the rents been increasing due to outside forces such as high demand, increases in employment options, and/or key infrastructure investments?</p> <p>Are rents declining?</p> <p>Is there a high or low vacancy rate and what is the expected trend?</p>	Different markets may require different interventions aimed variously at preservation, creation, or matching of housing opportunities.
<b>Risks of Displacement</b>	<p>What factors are there that may risk displacement of existing residents?</p> <p>Is there new transit investment or employment growth that may impact the marketability of existing housing supply?</p>	Some indicators of future market conditions can be observed and pre-emptive action taken. For instance, new transit services and major employer expansions are likely to tighten rent markets and result in displacement.
<b>Location of Existing Apartment Stock</b>	<p>Are the existing rental units located next to public transportation and/or jobs?</p>	When existing rental homes are well located near jobs and/or public transportation, their preservation can help improve the quality of life of residents and the surrounding community. Families living in such locations tend to incur lower transportation costs and automobile usage than those in more remote locations; reducing transportation costs, energy usage, and commute time and may help to ease congestion and traffic for others in the community. The household's rent payment capacity might be reasonably adjusted as a result.

Figure 8 continued on next page

Diagnostic Framework  
(continued)

### Framework of Specific Considerations for Local Governments

Figure 8 (continued)

Topic	Evaluation Questions	Rationale
<b>Housing Conditions and Safety</b>	<p>What is the level of housing code enforcement and police violations?</p> <p>Are the violations ongoing or limited?</p>	Rental complexes with frequent or severe violations may be targeted for a different level or type of intervention. More resources may be justified in these cases than in others, but might be focused on facilitating ownership/management change rather than in the form of incentives to current team.
<b>Ownership/Management Structure</b>	<p>What is the level of experience of the owners of existing apartment units and is there professional management available?</p>	The type and quality of management and the ownership members and structure may help to determine the appropriate form of and receptiveness to public intervention.
<b>Availability of Affordable Housing</b>	<p>Are there existing affordable housing options in the community? If so, are they subsidized, at risk of becoming unsubsidized due to expiration of funding sources or use obligations, or unsubsidized due to its location, quality, or both?</p> <p>How deep is the existing affordability and how does that compare with incomes in the area?</p>	If existing affordability levels and stock are a relatively good match for current or projected community needs, then monitoring might be sufficient. If a deficit exists, interventions should be tailored to the specific needs.
<b>Balance of Housing Value and Local Wage Rates</b>	<p>Are the incomes of households similar to the local wage rates? If not, are the wages for jobs in the city below what a household could afford to pay for rent in the area and is there a need to provide lower rent housing that matches the wages?</p>	Supporting a live-where-you-work policy allows residents more time to engage in the community and contribute to volunteering and public service.

**In This Section:**

32 Private Sector Lending

35 Public Sector Lending

37 Equity

Throughout our investigation, we sought to learn more about the current state of finance in the unsubsidized rental market. Property owners, cities, and financiers told us their experience anecdotally, which we then attempted to confirm by examining lending and application data collected under federal requirements. We inquired about acquisition, rehabilitation, and refinance sources.

### Private Sector Lending

Large-scale professional owners appear to be in a very fluid, almost frenzied, capital market. Several lenders we interviewed described having to compete for loans against other banks; offering the lowest rates that they have ever seen. For the owners who are able to access this financing, interest rates are very low (3–4%). However, the terms are short, usually between five to seven years. Some lenders have settled in a niche of making loans with three year terms which are anticipated to be taken out by long-term, federally-insured debt after stabilization, or simply as soon as a loan can be processed through this system. The Loan to Value (LTV) tolerance with most lenders has changed dramatically since before the financial crisis. LTV requirements as low as 50% were cited in our interviews, with most falling between 60–85%. Here again, federally-insured products are very attractive for those who can get them, offering around 85–90% LTV.

Access to debt continues to be more difficult for DIY/part-time owners and some small-scale professional owners. Financing for these owners is more dependent on relationships with lenders who place heavy emphasis on the personal credit history and guaranty capacity of the borrower; looking beyond the real estate for collateral and risk mitigation. Additionally, these borrowers may be harder-pressed to contribute the equity necessary to meet the current LTV expectations discussed above. Small transaction sizes also limit how many lenders are interested in working with even the most solid loans/borrowers at this scale.

*The following table summarizes our market research into debt available from various sources.*

Financing for DIY and small-scale owners is more dependent on relationships with lenders.

Financing Unsubsidized Rental: Scan of the Minnesota Market

Figure 9

	Financing/Lending Institution			
	Community Banks	CDFI/Intermediaries	Other Banks	Municipalities
<b>Eligible/Typical Uses</b>	Construction, acquisition, rehabilitation, refinance	No offerings found	Construction (but there is fear of bubble on these), acquisition, rehabilitation, refinance	Rehabilitation
<b>Minimum/Maximum Amount</b>	\$100k-\$7m with single lender, up to \$15m in participation		\$500k-\$40m, with \$5-\$10 million preferred	Min is \$20K, maximum is lesser of \$15,000 per unit or \$500,000
<b>Maximum LTV</b>	75-80%		50-80%	None, underwriter discretion. 50-80%
<b>Tenor</b>	Multifamily 5-10, single family rental conversion 5 to 7		3-15 years	7-15 years. 7 years for \$50-100K 10 years for \$100-300K 15 years for \$300-500K
<b>Amortization</b>	20-25 years		20-30 years	30 years
<b>Rates</b>	3.5-6.125%		Non GSE has had a floor of about 6.15% in the last year	3%
<b>Fees</b>	Origination fee 1%, sometimes smaller for larger deals		Origination .5-1%, with floor of \$10k	None, underwriter discretion. .5-1%.
<b>DSCR</b>	1.15-1.2		1.15-1.25	Don't set limits, leave it to the lenders to underwrite. 1.15-1.25.
	MHFA RRDL	MHFA RRL	FHA-Insured Products	RD 538
<b>Eligible/Typical Uses</b>	Rehabilitation	Rehabilitation	Construction, acquisition, rehabilitation, refinance	Construction (but not exclusively), acquisition, rehabilitation, refinance
<b>Minimum/Maximum Amount</b>	\$500k-\$40m, with \$5-\$10 million preferred	Maximum \$10k/unit	\$3m minimum or \$30,000 origination fee	None
<b>Maximum LTV</b>	None, lender discretion (no applications to date)	None, lender discretion. 50-80%.	80% cash out, 83% no cash out	90% for for-profit entities, 97% for non-profit entities
<b>Tenor</b>	Maximum 30 years. Under the program model, minimum of 10 years under \$100K, minimum of 15 years over \$100k, and can be extended to 30 years or the term of senior debt.	Maximum term 15 years	30-40 years	25-40 years
<b>Amortization</b>	30 years	15 years	Maximum = 75% of useful life 90% are 30 year, but some have 35-40 year max.	25-40 years
<b>Rates</b>	0% deferred loan, secured by mortgage	6%	2.70%-2.85% w/o MIP, 3.30%-3.4% w/MIP Rates very volatile recently.	Lenders and borrowers negotiate, so typical values are dictated by type of bank. Typical are 3.5-6.15%.
<b>Fees</b>	\$100 per unit, \$500 minimum \$3k maximum, +\$3k admin fee.	\$500 per loan processing	General service fee 1% plus transaction costs, unless lots of competition. Typical total fees are ~1.90%	\$2,500 application fee, one-time guarantee fee of 1% of loan amount due at loan closing, and annual servicing fee equal to 50 basis points on the outstanding loan balance at each year's end.
<b>DSCR</b>	None, lender discretion (no applications to date)	None, lender discretion. 1.15-1.25.	1.20 minimum	None, lender discretion. 1.15-1.25

Private Sector Lending  
(continued)

**Monitoring Terms/Interest Rates.** While interest rates available in the market at the moment are very attractive, our team quickly became concerned about the short terms that often accompany them. Many properties will need to find new financing in the next three to five years—in a potentially very different interest rate environment. If current LTV's have kept loan amounts modest, these properties may well be able to absorb potentially higher debt service upon refinance. However, this would likely put upward pressure on rents. If valuations do not at least hold constant, some owners might find themselves without refinancing options at all. If such a crisis emerges, it may provide an opportunity for intervention by public or philanthropic actors—exchanging debt for affordability commitments. Proactively, there is opportunity to work with lenders who serve (or wish to serve) small-scale owners/properties in order to address their lack of access and term challenges. This is discussed more fully in the deep dive on Second Mortgage/Mezzanine Debt mentioned in Section 7 and in Attachment B2.

**Recent Data on Lending in Minnesota.** While it is impossible to track the entire universe of rental housing lending, we sought to learn what we could about recent lending applications and activities in the state of Minnesota. To this end, Minnesota Housing assisted our team in accessing a 2011 dataset compiled and published by the Federal Financial Institutions Examination Council (FFIEC). It tracks all applications for loans for new purchase, improvement, or refinancing submitted to lenders who are required to report. This includes non-owner occupied units in all configurations: 1–4 units, and multifamily (5+ units). Some lending institutions are not required to report their activities, but we analyzed the information provided by those that do report.<sup>44</sup> No affordability data is collected in conjunction with this reporting. Despite these limitations, this data provided us with some insight into the current lending environment.

According to the 2011 FFIEC data, a total of 21,236 loan applications were made for financing of rental properties (all non-owner-occupied) in the state.<sup>45</sup> The vast majority of these loan applications (99% or 21,103) were for smaller properties; those with 1–4 units, which makes up approximately 236,677 rental properties or 41% of all renter-occupied housing in the state.<sup>46</sup> Of these smaller property loan applications, 61.4% were approved with an average loan size of about \$155,000. Multifamily properties<sup>47</sup> only constituted 1% of this activity or 133 applications, yet according to 2011 ACS data, there are approximately 323,025 multifamily rental properties in Minnesota, which accounts for 57% of the state's rental inventory. Of these multifamily applications, 88.7% were approved with an average loan size of \$1.015 million. The total volume of rental housing loans approved in 2011 was \$2.13 billion.

44 Under the Home Mortgage Disclosure Act (HMDA). It requires reporting from: **1) non-depository financial institutions** that have (a) home mortgage lending that accounted for either more than \$25 million or more than 10% of their total lending in 2011, (b) a home branch or office in a Metropolitan Statistical Area (MSA) or originated five or more home mortgages in an MSA in 2011, or (c) assets of more than \$10 million or have originated more than 100 home purchase loans (including refinances, and including parent company assets) in 2011; and **2) depository institutions** that are a bank, credit union, or savings association with (a) more than \$40 million of assets, (b) branch or office in a MSA or metropolitan division (MD) on the preceding December 31st, (c) origination of at least one home purchase or refinance of a home purchase on a 1–4 family dwelling in 2011, and (d) EITHER federally insured or regulated, had a mortgage loan insured, guaranteed, or supplemented by a federal agency, or had a loan intended for sale by the Federal National Mortgage Association (FNMA) or Federal Home Loan Mortgage Corporation (FHLMC).

45 The 2011 ACS reports that there are a total of approximately 571,028 renter-occupied properties in Minnesota.

46 American Community Survey (ACS). U.S. Census Bureau. 2011.

47 Multifamily is defined as ≥5 units for FFIEC purposes.



### Private Sector Lending (continued)

While making up a vastly smaller number of applications, approval rates for multifamily properties were higher than for 1–4 unit properties. This held true within the Metro Area, in Greater Minnesota, and across loans for all purposes (refinances, new purchases, and improvement loans). Interestingly, approval rates were 8–10% higher in Greater Minnesota than in the Metro Area for all loan purposes. This data reaffirms what we heard from interviewees about the difficulty that small-scale properties/owners have in obtaining financing, but indicates that Greater Minnesota borrowers are more likely to be successful applicants.

Purchases and refinances accounted for more than 95% of all loan applications and approvals, both in the Metro Area and Greater Minnesota. Improvement loans do not appear to be in high demand from applicants. This evidence echoes feedback from both owners and loan administrators about their experience with rental rehab loans. Taking on additional debt to make improvements is not a preferred approach for many owners and lenders may dissuade others from applying through their underwriting requirements.

The top two reasons loans were denied included the debt-to-income ratio and insufficient collateral. Here again, we see the loan application data confirming what we heard in interviews and focus groups, particularly with regard to the burden of operating costs and the difficulty in meeting LTV requirements.

### Public Sector Lending

There are some examples of public sector involvement in lending to the unsubsidized affordable housing market at all three levels of government.

**Federal.** FHA/GNMA<sup>48</sup> loans are more attractive now than ever before for borrowers and properties that qualify. While these loans are made by the private sector, it is the public sector insurance that produces the attractive terms. Currently such debt for acquisition and refinance can be obtained for less than 3% interest and with as long as a 40-year term and amortization. This financing can be obtained for both unsubsidized and subsidized affordable as well as market-rate housing. However, these loans are strictly underwritten, time-consuming and expensive to process. This means that only the largest and strongest deals/borrowers are real candidates for these loans.

**State.** Minnesota Housing has undertaken two recent initiatives that touch on our investigation. First, the Agency has applied to become a FHA lender. This is due, at least in part, to their recognition of the barriers that small-scale owners/projects face when trying to work with private, for-profit lenders. By entering this lending space, the Agency may be able to reach down-market in a way that other lenders cannot. While the initial intention of the Agency was to focus their lending on subsidized affordable housing projects, they could conceivably expand this focus to include small-scale, “market-rate” projects (per HUD’s definition) that are willing to make some affordability commitments. Secondly, Minnesota Housing has created a pilot program for Greater Minnesota called the Rental Rehab Deferred Loan program, the structure and initial experience of which is explained in Text Box 2 on page 36.

<sup>48</sup> These two insurance programs are often used in combination. FHA insures lenders against borrower default and GNMA insures investors against lender default. By mitigating risk of loss on default, the cost of debt is reduced.

Public Sector Lending  
(continued)

**Local.** Several municipalities have attempted to create local loan programs that offer preferential terms (low-no interest, deferred payment, etc.) to rental property owners who need to make improvements to their property. In some cases, these are tied to energy efficiency or affordability goals. Administrators report disappointing take up, and owners raise concerns over privacy issues, administrative burden, and reluctance to take on debt over their first mortgage.

Figure 10

**TEXT BOX 2: Rental Rehab Deferred Loan Pilot Program: A Local Experiment**

In February 2012, Minnesota Housing began offering the Rental Rehab Deferred Loan (RRDL) pilot program. The intent of the program was to help stabilize “naturally occurring” or otherwise unsubsidized affordable rental housing in Greater Minnesota; those serving residents earning 80% AMI or less and that would not compete in the super RFP funding allocation rounds. Agency research determined that about 60% of the rental housing located in Greater Minnesota contained fewer than 10 units. They created this product to target these smaller properties, but not at the exclusion of larger ones.

RRDL loans are for rehabilitation of existing properties and can be procured through an approved administrator (nonprofits or local governments), or by direct application to Minnesota Housing. The terms are:

- deferred payment
- not to exceed \$300,000
- 0% interest
- 10 and 30 year terms

The RRDL initial program uptake has been very slow, with only one loan application received to date. This practical experience demonstrates and reinforces some of the key points that we heard from our interviewees about the challenges of lending in this market, including:

- **Program design for products serving unsubsidized affordable rental need to be customized precisely for the needs of the properties, owners, and other financial participants.** Use of RRDL has been hindered by the fact that Rural Development program underwriting and requirements are not well aligned and that loan terms available on commercial debt are much shorter than what Minnesota Housing will allow. Since RRDL is not meant to be the primary funding source, this is very problematic.
- **Applications need to be simple and straight-forward, particularly when serving DIY/part-time, small-scale property owners.** The application and other standards for RRDL are fairly exhaustive and exceed the reporting capacity of the many owners (i.e. written leases, organizational financials, complex forms and guidelines designed for experienced developers and property management agents).
- **Many owners in this market segment are disinterested and skeptical.** Many owners are not interested in taking on debt, wary of the sharing of private information documentation, or are philosophically opposed to any sort of intervention by the public sector. Minnesota Housing’s attempts to pare down their typical processes and underwriting appear to have not gone quite far enough to enlist widespread interest.

Figure 10 continued on next page

**TEXT BOX 2: Rental Rehab Deferred Loan Pilot Program: A Local Experiment****What Can be Done?**

Pilots are intended to be experiments and allow for iterative refinement. Some changes to the program should be considered to increase take-up:

- Continue to work with administrators and borrowers to identify specific barriers and refine loan products accordingly.
- Develop specially-tailored underwriting standards and application materials for DIY/part-time owners of smaller rental properties. This may require more focus on desired outcomes and less on financial due diligence, which may admittedly test Minnesota Housing's tolerance for this approach.
- Reduce the number of submission requirements and identify areas of flexibility for rental properties with fewer than 10 units and with DIY/part-time owners.
- Reassess after changes are made to determine if stand-alone loans of this sort are viable vs. other methods (recoverable grants, participations, guarantees).

**Equity**

The ability of owners of unsubsidized rental housing property to use their equity in a project (whether existing equity through leverage or by contributing new equity) is a major factor in their ability to secure other financing. It is also a major factor in maintaining owner optionality during operations; meaning their ability to make improvements/repairs when necessary, wait out periods of rent stagnation or generally feel less pressure to increase rents. Recent downturns in valuations have eroded the existing equity that many owners had built up in their real estate, which now limits their ability to refinance and to move equity to other properties where it might be needed.

With regard to institutional equity, we were unable to find much evidence that entities such as REITs are investing equity in multifamily rental housing that offers any measure of affordability. For the most part, these entities are looking for investment opportunities in new construction and Class A real estate. One notable exception is the REIT established by the Housing Partnership Network (HPN) that is aimed at helping its members (primarily large housing nonprofits) acquire general occupancy rental. However, no local partners are involved in this REIT due to other priorities or their belief in the availability of other capital to engage in such acquisition. This effort is described in Attachment C4.

Finally, some see opportunity for profit or affordability in the acquisition of scattered site REO to be operated as rental (at least for a period of time). A Twin Cities group of investors is launching a new publicly traded REIT, Silver Bay Realty Trust, to do exactly that. However, their intended markets do not include the Twin Cities MSA. A handful of other investment groups are already active in this market and two or three more new public offerings are likely to follow this year. Here again, HPN is working to place their nonprofit network in a position to capture this opportunity believing that it will benefit their members, help to stabilize ownership housing markets, and perhaps preserve modest affordability. In the next several months, HPN members will reach a decision on whether or not to pursue this new business venture. At least one local HPN member is interested.

**In This Section:**

- 38 Types of Interventions
- 40 Potential Outcomes
- 40 Intervention Capture Document
- 41 Intervention Deep Dives Overview

During focus groups and one-on-one discussions with both local and national interviewees, we solicited the participants' ideas for potential interventions that might be considered by public, philanthropic or other entities interested in improving the quality, targeting or duration of existing affordability in currently unsubsidized affordable rental housing.

## Types of Interventions

The nature and depth of the possible interventions conceived of in our investigation vary greatly and we find it helpful to categorize them in several different ways. These categories are not mutually exclusive or exhaustive but simply provide a framework to help develop a clear understanding of and vocabulary to describe potential interventions while considering their potential and appropriateness.

**Systemic Interventions.** Some potential interventions can produce benefits that accrue to a large group of beneficiaries. Rental licensing and inspections regimes may benefit owners, tenants, and the community. Likewise, education programs can raise the collective capacity of owners, managers, and tenants.

**Direct Interventions.** These interventions are aimed at a specific counterparty that is the direct target or beneficiary of the intervention, though there may be additional benefits to those downstream from the point of intervention. In fact, many of the suggestions that we received involve splitting benefit between owners and tenants. For instance, a loan program may offer below-market terms to an owner in exchange for a commitment to share a portion of the savings with tenants in the form of fixed or lower rents. Perhaps the purest example of a direct intervention is a tenant-based rental subsidy.

**Incentive-Based Interventions.** These interventions attempt to change behavior or practice by creating an incentive (usually, but not always, financial) for the change. These are proverbially referred to as “carrots.” These interventions may be prospective, where the incentive is given in advance in exchange for a commitment. This is the case with most loan programs. Alternatively, incentives can be earned progressively over time, as is the case with the existing Section 4(d) property tax designation where the benefit is earned each year based on compliance in the previous year.

**Cost Containment Interventions.** These interventions do not involve a transfer of resources from the public or philanthropic entity in order to incentivize action, but rather aim to reduce the cost of operating housing in exchange for a commitment to pass a portion of that savings on to residents in the form of fixed or lower rents. One example of this type of intervention is the establishment of bulk purchasing of insurance for rent compliant properties. The relative impact of savings in different operating cost areas is illustrated in the example in Text Box 3 on page 39.

**Policy/Enforcement Interventions.** Some interventions do not involve the transfer of resources from one party to another, but rather involve the unilateral adoption and enforcement of standards and procedures under the authority of a government body.

Types of Interventions  
(continued)**TEXT BOX 3: Possible Operating Cost Savings and Their Impact on Rents**

Savings on operating costs could be captured—at least in part—to lower or take pressure off of rents. Illustrated here is the potential for savings in the three cost categories cited most frequently by owners. Combining savings in several categories might be necessary to achieve savings significant enough to motivate owners and to benefit renters.

<b>Example Operating Costs<sup>1</sup></b>	<b>Unit/Year</b>	<b>% Savings</b>	<b>\$ Savings</b>
Utilities (electricity, water/sewer, gas) <sup>2</sup>	\$ 934	25%	\$ 234
Insurance <sup>3</sup>	\$ 230	40%	\$ 92
Property taxes <sup>4</sup>	\$ 976	40%	\$ 390
Management, marketing & site staff	\$ 2,181		
Maintenance & repairs	\$ 1,359		
Miscellaneous	\$ 171		
	<b>\$ 5,851</b>		<b>\$ 716</b>
<b>Savings Unit/Month</b>			<b>\$ 60</b>

While savings could be generated by all units, the *benefit* could be concentrated on a few to amplify effect on rents.

- 1 2011 Operating Expense Data Survey conducted by the Minnesota Multi Housing Association, includes 33,755 apartments.
- 2 Natural gas has historically been a primary focus, but substantial savings can be achieved for water/sewer and electricity. Class C properties have not typically benefitted from systematic investments to reduce utility consumption for which utility companies often offer substantial rebates.
- 3 Substantial savings on premiums are available through pooling. Smaller, additional credits are available when programs like Crime Free Multi Housing and Smoke-Free Housing are utilized for all of the properties in the pool and backed by third-party compliance monitoring.
- 4 Approximately 40% reduction if a property that has been classified as a market-rate rental property 4(a) is reclassified as a low-income rental property 4(d).

## Potential Outcomes

We suggest that there are three major categories of outcomes that could result from an intervention in the unsubsidized affordable rental housing market. Here again, these are neither mutually exclusive, nor can it be assumed that by achieving one we achieve another.

**Preservation.** Some interventions could prevent the loss of units to deterioration, demolition, or rent increases that would move the unit “up-market.” These may not necessarily decrease rent burdens of existing residents or new residents.

**Creation.** Some interventions could create new affordable rental housing opportunities by lowering otherwise out-of-reach rents. For instance, cost reduction programs might help drop rents to new/greater affordability levels.

**Matching.** Some interventions could ensure that those who need affordable rental housing get access to it; matching units with affordable rents to those households with corresponding incomes can lessen rent burden. Examples include providing incentives for landlords to dedicate units to lower income households (likely upon turnover), or a voucher program that might help residents gain affordable access to units for which they would not otherwise compete.

## Intervention Capture Document

We have created a document (Attachment D) to capture nearly 50 suggested interventions, categorize them, and characterize the situations in which they may be most applicable. We did not edit this list according to perceived feasibility, replicability, or other important considerations. Rather, this capture document is intended to present the broad spectrum of ideas generated during our study. Our analysis and recommendations for action on specific ideas are presented in the narrative of this report.

Our rationale in making the entire list available is that a particular idea that is not feasible or advisable in one situation and at one point in time, may indeed be valuable in another. The electronic form of this catalog of potential interventions may act as an evolving resource as more thought and program experiments are made in the unsubsidized affordable rental market.

The capture document includes the following in summary form:

- **The idea by name.** Some ideas came up many times in conversations and we attempted to group similar ideas under a single name.
- **The impact potential.** These ideas were presented in response to a challenge or opportunity that our interviewees have experienced. We attempted to describe what challenges they were suggested to address.
- **A description/discussion.** Some interventions have alternatives, practical implications that are understood, likely targets, or counterparties, etc. We have tried to gather the most critical points here.
- **Known examples/resources from which to learn.** When we are aware of an existing model or related effort, we have listed them.

## Intervention Deep Dives Overview

After having cast a wide net for ideas about potential interventions, our Project Team and Strategic Partners selected five ideas to be the subject of deeper exploration by our team and community stakeholders. Topics selected for the work sessions are not necessarily the “best” ideas, but rather the ideas that were thought to have potential, yet required a more detailed build-out of a general concept before they could be assessed. Our task was to delve into the practical realities of these interesting ideas to determine if they were feasible, worth more investigation or potential action, and when possible, weigh their costs against their potential impact.

The following is a list of the interventions that were selected for work sessions, along with a brief summary of the findings of our work sessions and resulting analysis. *More in-depth information can be found in the Attachments B1-B5.*

### ★ Project Team Favorite Interventions

1. Local Government Rent Subsidy
2. Second Mortgage/Mezzanine Debt/Loan Participation
3. Local Section 4(d) Tax Program
4. Replacement Housing/Right of First Refusal Policies
5. Metropolitan Council Incentives for Innovative Practices
6. Regulatory/Training Measures
7. Insurance Cost Reduction Measures

★ Look for this symbol in Attachment D to find Project Team Favorites.

**Local Government Rent Subsidies.** Most local governments have very limited resources to devote to affordable housing, and many communities have scant development sites on which to use them. Interviewees suggested that the creation of a locally-funded rent subsidy program could be a cost-effective method and more frequent opportunity for local governments to create or retain affordable housing. A rent subsidy could be made available on a project basis to owners of existing unsubsidized affordable properties. In exchange, the owners would commit to maintain affordability for a term of at least five years, meet simple income verification compliance requirements, participate in Crime Free Multi-Housing training, and comply with property standards outlined in a local rental licensing program. Alternatively, rental subsidies could be offered directly to tenants; however, this option creates less leverage with property owners and may require additional administration on the part of cities.

Local governments in the Metro Area have been assigned affordable housing production goals by the Metropolitan Council, which are traditionally met by facilitating the production of new subsidized affordable units (through new construction or acquisition/rehab) by using local zoning and land use approval policies, incentive programs, and local funding sources to help close funding gaps. This may be very costly in stronger markets where this is in the context of new construction of market and/or high-end developments. As an alternative, the same amount of subsidy could be provided to rental owners to reserve units for lower-income households or to lower-income individuals directly to ensure that they can shop for units that would then be affordable to them.

This program concept might be particularly appealing to cities if the Metropolitan Council would acknowledge such a subsidy as part of the local government’s affordable housing production goals for the Livable Communities Act under the rationale that they are producing new affordable housing opportunities, even if they are not creating new physical units. This would require some recalibration of the formula used to set and monitor housing needs and goals. These subsidies could be especially beneficial in selected geographies to ensure that the benefit of rent stability accrues to residents who might otherwise see rising rents (job growth centers and transit proximate areas).

*A more complete discussion of our local government rent subsidy deep dive can be found in Attachment B1*

Intervention Deep Dives Overview  
(continued)

**Second Mortgage or Mezzanine Debt.** Interviewees suggested the potential creation of a second mortgage, mezzanine debt or loan participation product that might help to increase the availability of long-term, private sector debt for acquisition, rehab, and/or refinance. This could be made available to owners of properties in select markets that are currently offering some level of de-facto affordability. In exchange, the owners would be asked for a commitment to maintain affordability over the life of the loan and meet simple self-reporting rent-only compliance requirements.

In the absence of such a product, some owners find themselves unable to acquire, improve or refinance their properties, or are left paying very high rates of interest, which applies upward pressure on rents. They are excluded from taking advantage of historically low rates on debt primarily due to valuation issues or because they or their properties are not good candidates for federally-insured debt. Some are able to secure very low rates, but with extremely short terms, which leave them—and by extension their residents—vulnerable to extreme adjustments in three to five years. Banks are limited in how much lending they can do, even to their most loyal clients, due to dramatic drops in valuation or their own capital restrictions (particularly community banks that hold loans). An intervention could help address these challenges for owners and lenders while extracting affordability commitments in return.

Our working group outlined the parameters of a pilot lending program, modeled after the SBA 504 loan program, that would put an experienced private sector lender in the lead lender position; responsible for underwriting initial loan funding and servicing. As an example, for more than 20 years Chicago's major financial institutions have supported and used a non-profit entity, the Community Investment Corporation, to carry out such lending and assure them of an adequate supply of quality Community Reinvestment Act (CRA) eligible transactions. As CRA pressure on conventional lenders declines in communities, and mortgage defaults, foreclosures and bank failures continue, it is anticipated that consortia lending efforts such as these will also contract in number and scale. Therefore, care will have to be taken in designing a pilot program to determine the characteristics of lender motivation and to shape a product that offers attractive incentives.

In this model, a socially-motivated, subordinate lender would take between 25% and 35% of the deal, earning interest and fees, but assuming risk that would motivate the private sector lender to take longer tenor and higher total LTV. In designing a pilot, it may be useful to engage the Federal Home Loan Bank since it is their members, particularly community banks, that most often do portfolio lending and look to the FHLB for their liquidity. They may have practices and funding that could contribute to building an effective model.

This program might be appealing because it is not a subsidy, but rather a risk-sharing investment strategy. However, the ability to find the right CDFI or social lender that has or can raise capital for this purpose is a major assumption that would need to be tested. If such a subordinate lender can be found, prequalifying bank partners is another important step. Furthermore, using this product in selected geographies could help ensure that the benefit of rent stability accrues to residents who might otherwise see rising rents.

*A more complete discussion of our second mortgage deep dive can be found in Attachment B2.*



Intervention Deep Dives Overview  
(continued)

**Section 4(d) Property Tax Alternatives.** In our interviews with property owners and cities, property tax items were the most frequently identified interventions. Owners expressed concern about the amount and unpredictable nature of taxes, while cities recognized this as being a major point of leverage with their owners. We were asked to evaluate the existing property tax treatments for affordable rental housing to uncover if/how it could be used effectively in the unsubsidized affordable rental housing space. We concluded that there is flexibility in the existing Section 4(d) statute that might allow for a targeted application in currently unsubsidized rental, but also that select abatement might be an equally attractive alternative.

Minnesota’s Low Income Rental Classification Program (LIRC), also commonly known as the 4(d) program, provides a lower property tax rate for “low-income” rental properties that abide by rent and income restrictions. Typically, only properties subsidized by federal and state funds access this program. However, the 4(d) program also allows a local government to qualify properties if some minimal form of local “financial assistance” is provided and the owner agrees to income and rent restrictions. This underutilized provision creates the possibility for 4(d) to become a tool for local governments.

This may be applied in areas such as new transit corridors where market pressures may lead to escalating rents and the involuntary displacement of lower income renters. Expanded use of 4(d) could help to moderate rent increases and reduce or slow displacement. Pairing of 4(d) eligibility with other, even modest, local programs of financial assistance could make it more attractive for landlords to participate in both. In locations where many affordable rental units are occupied by persons who could afford to pay more, the 4(d) program’s income restrictions could be used to match such units (on turnover) with low-income occupants—in effect creating new housing opportunities for lower-income households without having to build new units.

While the potential for this underutilized tool is promising, there are challenges in implementation. First, a local government entity has to offer some modest form of “financial assistance,” though the statute creates no minimum level. Then, they would need to determine locally-targeted rent and income restrictions, taking care to avoid critiques of the previous program where a “one-size-fits-all” rent ceiling did not result in rents lower than those feasible in the micro-market. Additionally, the administrative burden on both landlords and local governments would need to be minimized in order to attract sufficient landlord participation and to be feasible for cities. The concerns of local taxing jurisdictions over lost tax revenue would also need to be addressed. Finally, this opportunity could be affected if the legislature undertakes property tax reform.

We recommend that locally-triggered Section 4(d) tax treatment be explored with cities that are thought to have markets vulnerable to displacement (like some of those on Southwest Light Rail Transit line). At the same time, the option of local property tax abatements in exchange for affordability commitments could be considered as another alternative.

*A more complete discussion of our Section 4(d) deep dive can be found in Attachment B3.*

Intervention Deep Dives Overview  
(continued)

**Variable Rate Demand Notes or “Low-floaters.”** We were asked to explore the use of Variable Rate Demand Notes (VRDN) or low-floater bond financing, particularly as a potential tool for the acquisition of existing unsubsidized affordable rental housing by a mission-oriented new owner. These types of bonds can significantly reduce the cost of financing by using the very short term, continuously remarketed bonds to obtain the lowest possible rates.

Debt service is often the largest single cost for a property owner and therefore plays a significant role in determining their flexibility with regard to rents. While we heard many owners talk excitedly about the record low interest rates available in the market at this time, the short terms on many of these loans are a cause for concern. Long-term HUD-insured loans are an option for some owners/properties, but not all. The flurry of FHA/HUD financing activity indicates that those who can are taking full advantage of this current state in the debt market.

The appeal of VRDN financing is the extremely low annual interest rate that it uniformly offers. Except for a matter of weeks in the early 1980s when the Federal Reserve took the prime rate to over 20%, low-floater base rates have been consistently very low (currently around 0.2%). It is important to note that in addition to the base interest rate, a low-floater borrower must pay for many additional financing costs that increase the effective cost of capital significantly. This results in an all-in rate that is still low in comparison with many other financing options, but slightly higher than current rates on FHA HUD-insured debt.

However, like FHA financing, this financing is likely feasible for only certain borrowers/properties. The property should have a strong rental history and be in (or brought up to) very good condition, and the owner must have excellent credit and a significant balance sheet. Additionally, a critical role must be played by a letter of credit (LOC) provider. The LOC provider’s credit is what investors underwrite (rather than the project itself) and their credit is the cause of the very low base interest rate. Bank consolidation and changes in regulation have limited the number of potential LOC providers, dampened their appetite for such participation, and changed the terms they are willing to offer.

With the help of technical experts in the field we have concluded that low-floater bond financing is not likely to be a useful tool at this moment in time and that future use of low floaters may not be quite as advantageous as it may have been for projects in the past due in large part to changes in federal requirements dictating that banks view the LOCs as loans. However, we recommend that the Strategic Partners monitor the changes in capital markets as we feel that there may be opportunities to use variable rate demand note financing in the future and that the tool could lend itself well to acquisition of unsubsidized affordable rental housing.

*A more complete discussion of our VRDN deep dive can be found in Attachment B4.*

**Intervention Deep Dives Overview**  
(continued)

**Clearinghouse for mission-driven owners.** For a variety of reasons, nonprofits and/or mission-driven buyers often have trouble competing with private for-profit buyers of unsubsidized affordable rental housing projects. In this deep dive we were asked to assess the need for and the feasibility of creating a clearinghouse or matchmaker function that would provide these buyers with the earliest and best possible access to acquisition opportunities, particularly where ongoing affordability or physical condition is at issue. Our conclusion is that there is not a need for a clearinghouse of this type.

In our deep dive and subsequent investigation we learned that brokers who actively market multifamily properties already include the major nonprofits on their short list of potential buyers when these properties come up for sale. The nonprofits we talked to agree, stressing that their challenge in acquiring unsubsidized rental projects is not in gaining access to the listing, but instead in other areas.

There are very real hurdles for nonprofit and mission-driven buyers to overcome in acquiring properties, although addressing them is not simply a matter of creating a marketing advantage. Nonprofit and mission-driven purchasers often focus on subsidized housing funding sources, so that when they negotiate price they must inevitably compensate for the lengthened transaction timelines that are required to obtain such funding. This will almost always exceed those required by a for-profit, market buyer. The lengthier closing time typically results in higher purchase prices, which might be attractive to patient sellers, but is counterproductive to the efficient use of subsidies. The Twin Cities Community Land Bank (TCCLB) can be utilized as a temporary purchaser to address this performance time disadvantage. However, while this can certainly help buyers be more nimble in acquisition while they wait for subsidies, holding costs and interest carry may erode any savings on purchase price. Nevertheless, if the goal is to help mission-driven entities acquire currently unsubsidized housing and maintain some level of affordability, they need permanent financing options (perhaps at the enterprise level) and a fresh approach to making capital improvements over time.

Some nonprofits said that the biggest problem with existing sources of unsubsidized rental financing was the uncertainty about being able to refinance the short-term debt currently available in the market (seven years, for example). Others noted that nonprofits could take on greater risk associated with acquiring these properties if they had the ability, like larger for-profits, to finance and manage their properties on a portfolio basis, where stronger projects could cross-subsidize weaker projects. This management scheme is hindered by both a lack of access to enterprise level capital and by the established systems and philosophy within their organizations. This relates to another barrier, which is found in the reluctance of some nonprofits to be associated with older, shopworn properties after having worked hard to equate affordable housing with high physical quality. Overcoming this reluctance would be part of a larger shift to a different business philosophy and recognition that this unsubsidized market operates differently than the subsidized housing industry. It also represents reputational risk in the minds of many.

Intervention Deep Dives Overview  
(continued)

Nonprofits are often viewed by cities as the most desirable purchasers of problem properties. Our participants thought that in some cases better strategic coordination between cities and nonprofits around code enforcement could make this less costly and more feasible by applying pressure to current owners, making them more amenable to sale.

An implicit assumption in much of this discussion is that, over time, a nonprofit or mission-driven owner can keep a property more affordable than the typical for-profit owner. While many people we talked to share that assumption, little concrete evidence seems to exist to establish this as reality. Research addressing this important question would be useful, and has been discussed by at least one national network organization. However, comparing apples-to-apples would be difficult, as the vast majority of nonprofit experience is in the operation of subsidized rental housing where compliance and reporting inflate costs and rents are capped.

In conclusion, it seems definitive that the disadvantages or challenges to nonprofit or mission-driven acquisition of unsubsidized affordable rental housing (with the goal of preserving or increasing affordability) are deeper and more complex than exposure to acquisition opportunities. As such, we do not recommend pursuing any next steps on the clearinghouse function.

*A more complete discussion of our clearinghouse deep dive can be found in Attachment B5.*

## Guiding Principles

We suggest that the following principles guide any action that the Strategic Partners consider taking in the unsubsidized affordable rental housing space.

- **Recognize that this is different than subsidized affordable rental.** Most action in the unsubsidized rental market will require a different set of tools and rules than that which we are accustomed to in the subsidized affordable housing industry. While light-touch public or philanthropic intervention may have the effect of moving a select portion of the unsubsidized rental housing stock closer to those characteristics that we associate with subsidized housing, these actions will not achieve the exact same results. Frankly put, we cannot expect the longest affordability terms, most onerous compliance, and finest physical product, amenities, and services in response to light interventions.
- **Capitalize on the lack of rules/dictates.** For many who are accustomed to the rigid regulation present in subsidized housing, the lack of well-defined federal, state, and local programs can be disconcerting. The ambiguity puts decision power and hence responsibility on the actor. However, this lends us the flexibility to address areas of need where our current subsidy toolbox is limiting. For instance, some communities struggle to provide affordable housing options to those households just above 60% of AMI. This arbitrary and bright-line cut off of LIHTC and other programs could become instead a gradation.
- **Use local touch/knowledge.** Because existing needs and changing market dynamics vary so widely, it is important to rely on local knowledge to decide when to intervene, what form that intervention should take, and to monitor the effectiveness of that intervention. This elevates the role of the local entity beyond that which it typically plays in subsidized housing programs.
- **Pay attention to regional context.** While local market dynamics can be very different, the ever-increasing interconnectedness of our region(s) is undeniable. Regional investment in public transportation amplifies the importance of looking at the market at this level as well.
- **Choose partners/targets wisely.** Interventions in the unsubsidized rental space will not be one-size-fits-all. Direct, incentive-based interventions are likely best targeted to those owners who have a track record of conscientious management and reinvestment. Problem property owners should be the targets of increased compliance efforts. Implementation partners should be those familiar with the space and willing to adopt a pro-affordability stance. This is particularly important when speaking of municipal partners.
- **Monitor, evaluate, and actively manage.** The flexibility that acting outside of existing programs might afford would also require a different level of ongoing and active management. In order to use any resources (financial or otherwise) to prudently innovate, the Strategic Partners would have to invest energy and expertise in oversight, evaluation, and mid-stream adjustments.

**In This Section:**

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48 First Order Recommendations

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Recommendations

54 Long-Term Recommendations

**Summary of Recommendations**

There are four types of recommendations identified by the Project Team. Some of these are recommendations for direct action by the Strategic Partners and others are recommendations that would require the action of other entities. The recommendations are meant to provide multiple levels of policy, educational, and financial interventions with the collective understanding that there is no single fix to successfully address the preservation or enhancement of unsubsidized affordable housing needs across the region.

- **First Order Recommendations.** These are recommendations that the Project Team advises pursuing, even if no other actions are taken.
- **Direct Intervention Recommendations.** Project or program level interventions that are designed to impact a subset of properties, and/or provide a direct incentive to a property owner in exchange for an affordability pledge.
- **System-Wide Intervention Recommendations.** Provides benefit on many levels to all property owners and property types.
- **Long-Term Recommendations.** Ideas to monitor as the market changes.

Actions beyond the first order recommendations could be implemented through the demonstration project strategy described in Text Box 4, on page 53.

**First Order Recommendations**

The Project Team identified general recommendations that should be considered by the Strategic Partners. Some of these are recommendations for direct action by the Strategic Partners and others are recommendations that would require the action of other entities. In the case of the latter, the Strategic Partners should advocate for these actions with the appropriate parties.

**1. Communication**

The Strategic Partners should communicate the findings of this report to potential implementation partners and communities of influence and actively solicit their feedback and participation in any future efforts. This might include, but not be limited to, the following housing and community organizations/dialogues:

- American Planning Association (APA) annual conference presentation
- Enterprise Community Partners
- Federal Home Loan Bank
- Greater Minnesota Housing Fund regional dialogues
- Housing Partnership Network
- Interagency Stabilization Group
- Joint Center for Housing Studies
- Living Cities
- Local Initiatives Support Corporation
- Metropolitan Council staff and committee
- Minnesota Housing regional community outreach sessions
- Minnesota Housing Partnership Board and membership meetings and publications
- Minnesota Multi Housing Association membership meetings and publications
- Minnesota NAHRO conference presentation
- Minnesota Preservation Plus Initiative website (when developed)
- Strength Matters
- ULI MN and Regional Council of Mayors presentation

First Order Recommendations  
(continued)**2. Data**

Tracking and inventorying unsubsidized affordable rental housing, in terms of location, ownership, and rent levels is a difficult and time-consuming task that is not formally done at most state or local levels. A lack of consistent and available data means that the increasing rent levels and ensuing decreases in affordability can easily go unrecognized. The opportunity for proactive preservation can be missed. The City of Richfield and the City of Eden Prairie have both undertaken rental housing inventories that help these cities keep their fingers on the pulse of their rental markets. Richfield's study was a one-time, more comprehensive and critical assessment, which helped them identify gaps in their local market. Eden Prairie's study is an annual information-gathering exercise that allows them to monitor affordability. Both are potential models for others. We see the value in information of this sort and recommend that the Strategic Partners do the following:

- Establish a data gathering and monitoring protocol for better tracking of unsubsidized properties, rent levels, etc. This could start by relying on existing data sources to the extent possible. HousingLink may be an excellent partner in this with Minnesota Housing as a lead strategic partner.
- Highlight successful city inventories and encourage other cities to do similar studies.

**3. Metropolitan Council Regional Housing Policy Planning**

The potential importance and unique role of the Metropolitan Council in the unsubsidized affordable rental housing space became clear during the course of our work. Unlike the Strategic Partners, who derive the majority of their current influence from their involvement in subsidized affordable rental housing, the Metropolitan Council has a broader base of funding and levers of influence. For this reason, we are making several recommendations that include actions on their part.

Within the 7-county region, the Metropolitan Council assigns affordable housing production goals to cities as part of the Livable Communities Act. These goals are currently required to be met by facilitating the production of new subsidized affordable units through new construction or acquisition/rehab. Cities can do this by using local zoning and land use approval policies, incentive programs, and local funding sources to help close funding gaps.

Through our focus groups and interviews with municipal community development and HRA staff, we learned that many cities have limited local dollars to apply to these goals. In some cases, they have limited city-controlled development sites available in their jurisdictions. Providing gap funds to new market rate developments to insert affordable units is very costly, particularly in stronger markets.

Thus, assigning the limited local funds that are available toward the creation or retention of affordable housing within existing unsubsidized affordable rental housing properties may be a more cost-effective approach. In addition, there was uncertainty among the cities involved in our study regarding how the housing affordability goals were calculated and how they included existing unsubsidized affordable housing. To that end, the Project Team recommends that the Strategic Partners do the following:

First Order Recommendations  
(continued)

- Ask the Metropolitan Council to hold information sessions and provide simple materials that explain the method and process for determining regional affordable housing goals. This will help cities understand how their existing unsubsidized affordable housing stock is being accounted for when setting new production goals. Metropolitan Council staff presence in some of our meetings has already been helpful in this regard.
- Encourage Metropolitan Council to consider a new formula for calculating affordable housing goals. This could include a more nuanced or weighted set of definitions for what counts as credit towards the goals, recognizing those units that are retained as well but not at the expense of newly created affordable units. This would mean moving from a simple binary approach (where units are counted or not) to a more complex, but objective assessment of the value of degrees and duration of affordability.
- Encourage the Metropolitan Council to create incentives for local governments to test identified interventions. These incentives could include a commitment to giving cities credit for these activities toward progress on meeting their affordable housing goals and in assessing their affordable housing performance scores, favorable scoring in funding decisions, and the provision of technical assistance where needed in operating these demonstration programs.
- Ask that the Metropolitan Council build this work into the Metropolitan Council Regional Housing Policy Plan, which is expected to be drafted in 2014 as part of the “Thrive MSP” regional planning process.

#### 4. Support mission-driven actors entry into the unsubsidized space

The Strategic Partners should continue to develop their understanding of the barriers and hesitations of mission-driven actors who might enter this market. Where possible they should assist those who are interested in doing so to become involved. Particularly where unsubsidized rental housing is at risk and/or a transfer of ownership is desired or imminent, there may be benefit to entrusting unsubsidized rental housing to properly-equipped nonprofits or mission-driven owners. We have outlined some of the reasons why nonprofit ownership of unsubsidized affordable rental housing is challenging in Section 3 of this report; we recommend that the Strategic Partners further evaluate the opportunities with nonprofits to diversify their portfolios by entering this market. This might begin by holding a session with mission-driven owners who are interested in acquisition in this market to identify their top issues and determine if any of the Strategic Partners are able to help overcome them (through interventions outlined in this work or other ways).



## Direct Intervention Recommendations

Direct interventions are project or program level interventions that are designed to impact a subset of properties, and/or provide a direct incentive to a property owner in exchange for an affordability pledge. Examples of the project or program interventions include rent subsidies, mezzanine financing/second mortgage debt, and property tax incentives. These types of interventions focus on providing a light-touch incentive to create or retain affordability at an agreed upon level. This light-touch affordability is seen as an in-between approach, providing a lower level of financial incentive than the existing deep subsidy sources, with fewer requirements and more flexibility.

### 1. Local Government Rent Subsidy

This is a potentially cost-efficient method for creating or retaining affordable housing units through locally-funded and administered rent subsidy program(s). Local governments could dedicate financial resources to reducing the rents on units already available in the market within unsubsidized affordable rental properties. This could be done either in the form of an ongoing “project-based” subsidy (attached to the unit) or as a Section 8-like voucher, which a tenant could take with them when they move as long as they stay within the community and are in good standing with the requirements of the financing resource. The intervention is appealing because it: a) could assure that unsubsidized units remain affordable as market conditions improve and vacancy rates are tightened; b) can be more cost-effective than providing larger subsidy to write down the cost of new market rate units; and c) helps match affordable units to those who need them most. The Project Team recommends that the Strategic Partners take the following next steps:

- Solicit interest from cities and property owners and include them in a demonstration program administered by the Strategic Partners.
- Provide matching funds to cities to encourage their local commitment.
- Encourage Metropolitan Council to consider accepting a rent subsidy program as an eligible use toward the local Livable Communities affordable housing goals (related to recommendation above).

### 2. Second Mortgage/Mezzanine Debt or Loan

A second mortgage, mezzanine debt or loan participation product was explored to potentially increase the availability of long-term, private sector debt for acquisition, rehabilitation, and/or refinance of priority projects, which are currently offering some level of de-facto affordability. The intervention is appealing because it leverages and extends use of private sector debt, is not a subsidy, but rather a return-producing investment, and requires property owner investment. The Project Team recommends that the Strategic Partners take the following next steps:

- Solicit interest on the part of existing CDFIs to implement such a lending program to determine the parameters under which they would consider participation.
- Provide resources (existing or through new program related investment sources) to use alongside commercial debt.

Direct Intervention Recommendations  
(continued)

### 3. Property Tax Incentives

Minnesota’s Low Income Rental Classification Program (LIRC), also commonly known as the Section 4(d) program, provides a lower property tax rate for “low-income” rental properties that abide by rent and income restrictions. Through our research, it was revealed that the Section 4(d) program allows a local government to qualify properties if some form of local “financial assistance” is provided and the owner agrees to income and rent restrictions. This underutilized provision creates the possibility for a new tool for local governments to address certain housing goals through incentives rather than regulation. The Project Team recommends that the Strategic Partners take the following next steps:

- Track any modifications to the Section 4(d) legislative authority through the upcoming legislative session and understand how a rewrite of the property tax laws would alter or eliminate Section 4(d).
- Convene broader conversations with a wide range of local governments (specifically targeting cities along emerging transit corridors), including counties, and perhaps the Metropolitan Council to discuss this tool and attempt to garner support for its prudent use.

### System-Wide Intervention Recommendations

System-wide interventions provide benefit on many levels to all property owners and property types. A systemic approach does not provide a direct transfer of resources to a particular property. For instance, there is inherent value in supporting organized education and technical resources to existing owners of rental housing. This includes training programs for tenants and owners and well as mentorship among industry representatives. Local regulatory measures, such as licensing and inspection of rental property, are applied systematically and provide a standard or expectation of quality and safety that may be at risk if the measure was not enforced.

We recommend that the Strategic Partners do the following:

- Encourage cities to:
  - Use rental licensing programs as a way to communicate with owners regarding interventions for maintaining quality and value in their investment and for the residents. Partner with the Minnesota Multi Housing Association to educate cities and property owners.
  - Link educational and regulatory approaches. Follow examples of cities that promote training by lower licensing fees. Enforcing regulations without training or educational options does not enhance property owners’ ability to conform.
  - Enact rental licensing regulations that include the stick and carrot approach. Incentivize and reward good behavior, enforce and penalize poor performance. In some cases, creating incentives for owners to transfer their properties to better owners would help.
- Reward cities that adopt rental licensing programs by:
  - Providing added points within funding applications.
  - Favoring cities that require licenses in new weighted formula for determining contribution to regional affordable housing goals by Metropolitan Council as described in more detail in Attachment B1.

System-Wide Intervention  
Recommendations  
(continued)

#### TEXT BOX 4: A Suggested Strategy to Test Key Interventions

The Project Team recommends that the Strategic Partners engage in a demonstration program(s) with select cities to more fully understand if the identified interventions, and in what combinations, would achieve the goals of preserving or creating affordable housing within the unsubsidized rental market. The demonstration(s) would test the political, financial, and administrative viability of such interventions. It would also allow for the Strategic Partners to tailor interventions based on local dynamics in a demonstration context where financial and reputational risk can be minimized. These should be phased and managed by the Strategic Partners, or their designee, as follows:

##### Phase 1

- Solicit city interest—through self-nomination
- Solicit property owner interest—target small to mid-sized owners
- Target a mix of markets—near transit (built or planned), urban/suburban/  
Greater Minnesota mix
- Identify funding sources to conduct the demonstration(s)
- Determine universal data collection needs
- Create an implementation plan
- Produce evaluation frameworks

##### Phase 2

- Design interventions to test—property tax incentive, rent subsidy, second mortgage,  
mezzanine debt, other
- Engage private financial institutions, property owners, and developers
- Assess circumstances where lowest income, highest burdened targeting is achievable
- Test the value of technical assistance and identify providers

##### Phase 3

- Evaluate demonstration(s) of the interventions
- Disseminate learnings
- Determine opportunity/desirability to move from demonstration to funded program

- Maximize the usefulness of the MN Housing Policy Toolbox to support unsubsidized rental housing efforts.
  - Promote use of the Toolbox through Metropolitan Council, Minnesota Housing Partnership, Minnesota Multi Housing Association, ULI MN/RCM, etc.
  - Incorporate strategies and recommendations from this report into the Toolbox where appropriate.
  - Develop a navigational tool within the Toolbox that can make accessing information on unsubsidized rental resources easier to find.
  - Identify an ombudsman to help connect educational resources with technical and financial expertise depending upon the issue. This strategy is similar to the core of Chicago’s successful Preservation Compact, which is the collaborative effort to stem the loss of affordable rental housing in Cook County.
  - Create a section specifically for rental property owners “Help Rental Owners Succeed.”
- Promote existing landlord/owner educational efforts through the Minnesota Multi Housing Association, Lutheran Social Services, local city property owners associations, and Crime Free Multi-Housing program. Identify a lead organization that works to connect the training on the quality, management, and regulatory front.

## Long-Term Recommendations

The Project Team identified specific ideas that should be monitored in the future by the Strategic Partners as the market changes. The market conditions could impact the opportunity to intervene.

### 1. Short-term Debt Refinance

Many properties taking advantage of the very low rates currently being offered in the market will need to find new financing in the next three to five years. They could potentially find themselves looking for new financing in a very different interest rate environment. If valuations do not at least hold constant, some owners might find themselves without refinancing options at all. If such a crisis emerges, it may provide an opportunity for intervention by public or philanthropic entities—exchanging debt for affordability commitments.

### 2. Use of Variable Rate Demand Notes (VRDN) or “Low-Floaters”

While this financing option has been permanently altered by changes in bank regulation and is currently not competitive with federally-insured debt mechanisms, we recommend that the Strategic Partners monitor the changes in capital markets. There may be opportunities to use VRDN (low-floater) financing in the future. This tool could lend itself well to acquisition of unsubsidized affordable rental housing.

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**Attachment A: Methodology****General**

The methodology for this research operated on two levels, a national front and a local front. Initially, the Project Team conducted a literature review of academic and trade journals to uncover any precedential initiatives, programs, and policies that have already been effective in this sphere. This review provided direction as to which organizations, agencies, and/or individuals were contacted for one-on-one discussion and deeper exploration of successful strategies and encountered challenges for the preservation of unsubsidized affordable rental housing.

Subsequently, we initiated numerous phone interviews with key experts in the affordable housing industry across the United States and within the state of Minnesota. Notes compiled from these conversations were used to inform this project by outlining the issues raised, including owner demographics, market trends and other factors affecting affordability and the definition of affordability, and intervention techniques and tools for preservation. To gain a comprehensive perspective on rental housing market(s) in Minnesota, one-on-one discussions also included brokers, lenders, property owners/managers, developers, tax accountants, and lawyers. Additionally, we held several focus groups with property owners/managers to better understand owner demographics and motivations. This time was also used to garner perspectives on the challenges to maintaining particular levels of affordability and what opportunities exist for incentivizing a commitment to either implementation or prolonged provision of affordability and/or improvement in the quality of stock or management of currently unsubsidized affordable rental housing. We had over 150 conversations in the course of this research

Throughout all the discussions, the Project Team asked interviewees and participants to share any ideas they had regarding potential interventions. We catalogued all of these ideas without edit (Attachment D). This working list of interventions provided the platform for the Strategic Partners along with the Project Team to select particular interventions for deep dive work sessions. Topics selected for the work sessions were not necessarily the "best" ideas, but rather the ideas that were thought to have potential, yet required more detailed build-out. Each chosen intervention was believed to have the capacity to strengthen the physical quality of unsubsidized affordable rental housing or its management, and/or prolong the duration of existing affordability. By means of several intensive half-day work sessions, the Project Team along with industry experts delved into the practical realities of the general ideas to determine if they merited further investigation and to weigh costs against potential impact. The information gleaned from these deep dive work sessions provides the programming basis and analysis and recommendations for the selected interventions highlighted in the body of this report.

## Data Specific

To support the rationale for this research and to explore the value of potential light-touch interventions, we gathered and analyzed quantitative data from the U.S. Census, the American Community Survey, and a variety of local data sources, including Minnesota Housing, HousingLink, Minnesota Housing Partnership, GVA Marquette Advisors, Stantec, and various City agencies. This was a complicated process and is further outlined below.

In 2011, Harvard's Joint Center for Housing Studies (JCHS) published "America's Rental Housing," a report that highlighted the importance of the unsubsidized rental housing supply in the U.S. and the threat to that resource. The report noted that as important as the subsidized housing stock is, the majority of the nation's low cost rental housing stock is unsubsidized. Moreover, the report concluded the very lowest cost unsubsidized stock was rapidly disappearing due both to removal of units and upward filtering to higher rent ranges.<sup>50</sup>

This report prompted the question of whether these same trends for this housing stock held true in Minnesota and the Metro Area. Unfortunately, we could not rely on the same data that was used by JCHS, because their findings were based on survey data, which provides too small of a sample for the Metro Area to be reliable. Instead, we started with HUD's Community Housing Affordability Strategies (CHAS) data.<sup>51</sup> CHAS data for the period 2005-2009 indicates that there are about 182,000 affordable rental units in the 7-County Metro (defined as affordable to a household at 50% of AMI).<sup>52</sup> We then used HousingLink Streams data to subtract the number of subsidized units from this total. Roughly 60,000, or one third, of the 182,000 affordable units have federal, state, and/or local project-based subsidies. The region's 18,500 Housing Choice Section 8 vouchers also have to be considered, though. Vouchers obscure the analysis somewhat, in that they can be used both in subsidized (e.g. tax credit) and unsubsidized properties, as well as in properties with rents we define both as affordable and unaffordable. Nevertheless, vouchers impose income limits, which is an important feature that distinguishes units with vouchers from the unsubsidized stock, so we subtracted vouchers as well. This leaves the unsubsidized affordable rental inventory at about 103,500 units, amounting to 57% of all affordable rental units.

We wanted to determine the change in this supply between 2000 and 2009, but could not do so by subtracting out the subsidized supply in 2000 because HousingLink Streams data did not exist at that time. However, it was still possible to get a rough sense of the magnitude of the change in the unsubsidized supply by calculating the change in total affordable units from 2000 to 2009, and then determining how much of that change could be attributed to changes in the subsidized housing supply. There are a number of complicating factors and incomplete data points that prevent the estimate of the change in the subsidized supply from becoming very precise. With those qualifications, we concluded that the number of affordable units without federal subsidies probably did not change much over the decade, but that there was likely a reduction in the affordable rental units with no subsidies, offset by increases in

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<sup>50</sup> Joint Center for Housing Studies (JCHS). Harvard University. *America's Rental Housing: Meeting Challenges, Building on Opportunities*. 2011.

<sup>51</sup> The CHAS data is based on sample data from the annual American Community Survey.

<sup>52</sup> AMI is the median family (not household) income for the 13 county Metropolitan Area, calculated annually by HUD.

units with non-federal subsidies. While this suggests the possibility of a diminishing supply of such units, it does not appear to be on the order of the national findings provided by JCHS.

Perhaps the most significant fact about the unsubsidized rental supply, affordable at 50% of AMI, is that about half of it is occupied by higher-income households. This suggests a possible strategy of making more of these units available to the lower-income households most in need of them, which, in turn, points out that income limits may be at least as important as rent levels in devising strategies to preserve and enhance affordability.

While the total supply of affordable units increased by about 8,500 units over the last decade (due almost entirely to an increase in subsidized units), at the same time the number of lower-income renter households inadequately housed increased by about 31%. This striking gap is due in part to the recession, in part by the inability of the current subsidy programs to serve the lowest-income households, and to the occupancy of half of the unsubsidized affordable supply by higher-income households.

## Attachment B1: Local Government Rent Subsidy Program

Our Strategic Partners selected several interventions to be the subject of deep-dive work sessions with local industry experts. These interventions were selected because they were suggested frequently in our interviews and focus groups, but required more thorough investigation before we could fully assess their potential. Absence of a work session on a suggested intervention does not indicate a lack of merit but rather an existing clarity around how it might work.

### Summary Description

Local governments could create affordable housing opportunities in their communities through rent (demand-side) subsidy rather than production (supply-side).

### Problem to Address

Local governments have limited resources, both financial and administrative, to dedicate to the production of affordable housing. Some cities have limited opportunities to support new affordable housing because few sites exist for new construction. Furthermore, new construction is more expensive than preserving existing affordable units. However, many of the existing unsubsidized affordable units do not always go to those with the most need. Likewise, the existing unsubsidized affordable units do not always get recognized as contributing to the local stock of affordable housing.

### Intervention Targets

Our participants agreed that a locally determined program would be targeted to existing owners/properties that are willing to accept rent subsidy funds with specific conditions.

- Existing rental properties that are currently unsubsidized and include units that are serving households with incomes at or below 80% of the median incomes for that particular market area.
- Work with property owners who are willing to accept rent subsidy with the condition that they will reserve a number of units to meet 30 to 60% of the median income households and apply the subsidy to reduce rents so that they are affordable to lower income household.
- Rental properties must be compliant with existing city codes and rental license requirements.
- Locally determine if the rent subsidy would be provided to individuals rather than property owners. Although administrative costs may be less, the ability to ensure housing quality would be greater with a project-based approach.
- Individuals must meet income guidelines and be an existing resident or be employed within the City.

### Local Government Rent Subsidy Intervention Targets

Owner Profile	Property Profile
<ul style="list-style-type: none"> <li>• Experienced and willing owners (not new entrants) as determined by local governments</li> <li>• Participant in and/or certified Crime Free Multifamily Housing</li> <li>• No citations or violations in their portfolio</li> <li>• Proven management capacity or professional contract manager</li> <li>• No federally-insured loan/project portfolio</li> </ul>	<ul style="list-style-type: none"> <li>• Licensed rental property with no outstanding violations</li> <li>• No limit on the size of property</li> <li>• Non-luxury market-rate rental</li> <li>• Gentrifying or strong market</li> </ul>



**Discussion** This potential intervention was suggested in work sessions by local government housing and community development staff as a method to provide more effective use of limited local dollars dedicated to the creation or retention of affordable housing within existing unsubsidized affordable rental housing properties. Local governments in the Metro Area have been assigned affordable housing production goals by the Metropolitan Council as part of the Livable Communities Act. These goals are currently required to be met by facilitating the production of new subsidized affordable units (through new construction or acquisition/rehab) by using local zoning and land use approval policies, incentive programs, and local funding sources to help close funding gaps. Providing gap funds to projects is very costly in stronger markets as part of new construction of market and/or above market rate developments. As an alternative, the same amount of subsidy could be provided to existing rental owners or to lower income individuals to ensure that existing units either remain affordable or are written down to create new or deeper affordability. Having another option to support affordable housing within existing unsubsidized and/or market units may be beneficial in meeting goals and achieving increase in availability of affordable housing.

**Operational Details** The local unit of government would create and administer the rent subsidy program internally or by contract with a nonprofit housing organization or existing rent subsidy administrator who has the expertise to income qualify and distribute eligible funds.

As an incentive for existing owners to participate, assist in submitting the rent subsidy program as eligible criteria to enable participation in the Section 4(d) program that provides a discount on property taxes.

**Terms.** Ultimate terms would be determined by the local government based upon available funding resources and political will. The following terms were discussed:

- **Maximum rent subsidy amount = \$200–\$400 per month** based upon local market rents and tenant incomes.
- **Minimum Term = 5 years.** If funding is available and the program is a success, expand to a maximum of 10 years.

**Compliance.** Annual compliance should include verification of income to assure that the rent subsidy is being applied to households with income at or below the determined area median income for that subsidy. Determine a process that is acceptable by the local unit of government but less prescriptive than existing Section 8 income certification requirements.

### Implementation Partners' Roles

**Public Sector.** Local units of government, Housing and Redevelopment Authority or Economic Development Authority as determined by city organizational structure should identify opportunities, select owners, properties, etc. Metropolitan Council should facilitate recognition as contributing to affordable housing goals.

**Nonprofit and/or Mission-Driven Private Sector.** Could administer the program on behalf of the local unit of government per an annual contract and/or private or nonprofit owner willing to contribute to a rent subsidy program.

**Affordability & Duration**

**Locally determined level of affordability.** Options include:

- Targeting the program to local employees, existing residents and/or seniors moving from existing single-family homes, or other target markets.
- Increasing the lowest-income households' access to already unsubsidized affordable units by reducing 60% affordable units to 30% affordability.
- Increasing the number of affordable units generally to buy down 80% units to 60%.

Consider allowing modest annual rent increases based upon market trends.

**Financial Considerations**

**Locally-sourced or allocated funds.** The program should be funded with sources that are at the discretion of local government. These include: Tax Increment Financing proceeds, percentage of Housing Revenue Bond Fees, HRA\EDA Levy, CDBG funds, and Housing Trust Funds.

The following examples show the comparative magnitude of expenditure that may be required to write down rents for a two bedroom unit for a family of four. The three examples outline the following:

**Example 1. New Market Apartment**

Rent subsidy for household with an income at 60% of AMI

**Example 2. Existing Market Apartment**

Rent subsidy for household with an income at 60% of AMI

**Example 3. Existing Unsubsidized Apartment**

Rent subsidy for household with an income at 30% of AMI

Apartment Type	Example 1: 60% AMI New Market Apartment	Example 2: 60% AMI Existing Market Apartment	Example 3: 30% AMI Existing Unsubsidized Affordable Apartment
Location	Hoigaard Village 5600 Camerata Way St. Louis Park	Avana on 7 7450 Highway 7 St. Louis Park	Royal Park Apartments 3100 Virginia Avenue S St. Louis Park
Four Person Household Annual Income	\$ 49,380	\$ 49,380	\$ 24,700
30% Income for Rent (monthly)	\$ 1,235	\$ 1,235	\$ 618
Rent 2 Bedroom (monthly)	\$ 1,775	\$ 1,400	\$ 815
Monthly Subsidy Needed	\$ 541	\$ 166	\$ 198
Annual Subsidy Needed	\$ 6,486	\$ 1,986	\$ 2,370
Five Years 2% inflation	\$ 33,753	\$ 10,335	\$ 12,334
Ten Years 2% inflation	\$ 71,020	\$ 21,746	\$ 35,363
Number of Units \$1 million in Investment	14	46	28

**Conclusions &  
Recommendations****This suggested intervention is appealing because it:**

- Assures that unsubsidized units remain affordable as market conditions improve and vacancy rates are tightened.
- Can be more cost effective than providing larger subsidy to write down the cost of new market rate units.
- Provides an additional incentive for new investments in affordable housing.

**We recommend the following next steps:**

- Solicit interest from cities and property owners and include them in a demonstration program administered by the Strategic Partners.
- Provide matching funds to cities to encourage their local commitment.
- Encourage Metropolitan Council to consider accepting the rent subsidy program as an eligible use toward the local Livable Communities affordable housing goals.

## Attachment B2: Second Mortgage/Mezzanine Debt

Our Strategic Partners selected several interventions to be the subject of deep-dive work sessions with local industry experts. These interventions were selected because they were suggested frequently in our interviews and focus groups, but required more thorough investigation before we could fully assess their potential. Absence of a work session on a suggested intervention does not indicate a lack of merit but rather an existing clarity around how it might work.

### Summary Description

A second mortgage, mezzanine debt, or loan participation product intended to increase the availability of long-term, private sector debt for acquisition, rehab, and/or refinance of priority projects that are currently offering some level of de-facto affordability.

### Problem to Address

This potential intervention was suggested as an unsubsidized way to make more private debt resources available to property owners who might otherwise not have access to capital at terms that can support affordability, property maintenance or profitability.

### Intervention Targets

Our participants agreed that a pilot program could be targeted to a select group of owners/properties and expanded later to include a broader base.

#### Second Mortgage/ Mezzanine Debt Product Intervention Targets

Owner Profile		Property Profile	
PILOT	<ul style="list-style-type: none"> <li>Experienced owners (not new entrants)</li> <li>No citations or violations in their portfolio</li> <li>Proven management capacity or professional contract manager</li> <li>No federally-insured loan/project portfolio</li> </ul>	PILOT	<ul style="list-style-type: none"> <li>Licensed rental property</li> <li>5-100 units</li> <li>Non-luxury market-rate rental</li> <li>Gentrifying or strong market</li> <li>All rents currently affordable at 60-115% of AMI, with at least 20% of units at affordable at 60% AMI</li> </ul>
EXPANDED	<ul style="list-style-type: none"> <li>Self-managed</li> </ul>	EXPANDED	<ul style="list-style-type: none"> <li>Middle to weak market areas (potentially with lower overall LTV)</li> <li>1-4 units or 100+ units</li> </ul>

### Discussion

Our interviews revealed that while large-scale professional owners seem to have many attractive financing options (particularly when financing larger developments with loan capacity over \$3 million where federally-insured debt is flooding the market), small-scale professional owners, some non-profits or DIY/part-time owners may have difficulty finding the resources they need due to these challenges:

- Short tenors.** Most commonly available in the unsubsidized market at the moment are five to seven year loans. Some property owners reported receiving loans with terms as short as two or three-years. In some cases, these short-term loans are attractive to property owners who intend to stabilize or reposition a property so that it can be refinanced through FHA or other insurance

### Discussion (continued)

programs. Many commercial lenders and community banks report that this is understood by lenders and matches their desire to place funds without committing to longer terms at the low rates that are competitive currently. However, many property owners are taking advantage of the very low interest rates on short-term debt without a clear strategy for refinance upon maturity. This leaves many owners/properties vulnerable to a dramatic increase in interest rates in the future. In turn, this will place upward pressure on rents (where market conditions allow), or will limit property maintenance and upkeep.

- **Loan-to-value (LTV) ceilings.** LTV maximums have dropped in the last five years to a typical 50–75%. This is particularly problematic for property owners who acquired at the peak of the market and have seen the value drop significantly. Being “underwater” or “upside-down” means that these owners cannot refinance to gain access to the low rates that are currently available. It also means that owners may not be able to sell without taking a loss, which has the result of keeping ill-prepared or reluctant owners in place. Brokers that we interviewed commented that the inability to trade-up is stifling the development of new actors in the unsubsidized space and making it difficult to motivate sellers who are no longer attentive to their assets. Even in strong micro-markets where rents are increasing rapidly, there is a lag in the recognition by appraisers of this increase, exacerbating this challenge.
- **Lack of cash equity.** Many owners do not have the option to contribute cash equity in order to meet LTV requirements and secure debt. Nonprofits have an even greater difficulty due to the fact that their resources are often locked into special purpose entities.

### Operational Details

Our discussion migrated to a model where a private lender could act in a lead lender role assuming primary responsibility for marketing, credit and real estate underwriting, closing, initial funding, and servicing of a loan. A public or philanthropic entity or mission-oriented lender would commit to making second position loan based largely on the lead lender underwriting which would be co-developed with the subordinate lenders. This takes advantage of private lender infrastructure, relationships and expertise, is easy for the borrower, and overcomes any hesitation to have private information made public. This is similar to how the SBA 504 program works.

#### Eligible Uses

- **Acquisition.** In geographies designated by public sector partners as priorities due to vulnerability to gentrification or lagging market values, and to owners that have a history of good management and reinvestment in their properties.
- **Rehabilitation.** Up to \$6,500 per unit and one major system (adopting HUD/FHA definition). Lead lender must have draw and construction administration capacity.
- **Refinance.** Targeted to owners that have a proven track record of good management and reinvestment in the property.

**Terms.** The following terms were discussed as being attractive to potential borrowers while limiting risk on the part of the subordinate lender.

- **Minimum and maximum subordinate loan amount = \$300 thousand to \$3 million.** This is a reflection of feedback that larger projects are likely to be candidates for federally-insured loans, but also of the fact that smaller transactions are cost ineffective.

### Operational Details (continued)

- **Minimum Tenor = 10 years.** The goal is to extend the lending horizon beyond what is currently prevalent in the market. Lenders have indicated that 10 years may be acceptable under the right circumstances.
- **Maximum overall LTV = 100% (110% for rehab).** This is to increase access to borrowers where properties have lost value, but are starting to come back and to allow for rehab scopes of work that benefit tenants and communities.
- **Lead lender LTV lead lender = 60–65%.** This is to increase private lender investment in properties and to borrowers that they might otherwise reject, while keeping their risk share high enough to avoid moral hazard.
- **Minimum borrower equity = 10%.** This would be new cash in the event of 110% LTV, and could be existing equity for other loans.
- **Rate = Fixed at “market rate” and adjusted for risk (with a cap).** Our intent is to open the flow of private debt to borrowers that are willing to provide some modest affordability to residents, not to subsidize the cost of debt, which is currently at all time lows.
- **Fees = Maximum 1.5%.** Fees to administer this loan product should be no higher than those used by the lender for other real estate lending and may be higher for construction loans.

**Prequalified lenders.** Lenders would be required to prequalify for the program by demonstrating that they have expertise in underwriting real estate and specifically multifamily rental housing.

**Compliance.** Compliance will be self-reported to the lender annually consisting of submission of the project rent roll and tax returns supporting the rents shown.

### Implementation Partners' Roles

**Banks.** Act as lead lender to market, underwrite, originate, and service loans on a prequalification basis. Responsible for funding all but borrower equity at closing.

**Borrowers.** Self-reporting regime envisions compliance on the part of borrowers.

**CDFIs/Intermediaries.** Act as lead lender to market, underwrite, originate, and service loans on a prequalification basis. Could also act as subordinate lender, particularly with support from/on behalf of public or philanthropic entities. Should not act as both.

**Philanthropic sector.** Could provide start up capital for the program, first loss capital to subordinate lenders or PRI for subordinate lenders to participate. Employers may wish to participate by donations, particularly in Greater Minnesota to support housing for workforce.

**Public sector.** Identify target geographies for the program and help market the program. Could also act as subordinate lender, particularly with support from/on behalf of public or philanthropic entities.

### Affordability & Duration

Rents affordable at 60–115% of AMI, with 20% of units affordable at 60% of AMI as long as the loan is outstanding (10 years minimum).

**Financial Considerations**

The following cost estimates are intended to show the magnitude of expenditure that we think might be necessary for this intervention, but could be highly variable. They are offered in order to help aid in the discussion of all interventions being considered.

For instance, if an existing CDFI with flexible source capital wished to engage in this lending activity, then the costs to launch would be quite low. If this activity were completely new for the subordinate lending organization, then it would be much more time consuming and costly.

Likewise, many different variables would affect the amount of capital that would be required to engage in this lending. We have attempted to model estimates on example transactions for illustration purposes only.

**2nd Mortgage Pilot Programs Example**

<b>PILOT</b>	<p><b>PILOT</b> A pilot pool of \$20 million could fund between 7-67 loans (depending on size and leverage), with somewhere between 533-1,600 units. Between 107-320 of these would be affordable at 60% of AML. Note: This would not be subsidy, but rather return-producing investment.</p> <p><b>Example transaction:</b> Jane owns a 109-unit property with one and two bedrooms that rent between \$650 and \$795/mo. She owes \$3.9 million on an existing first mortgage, which is coming to its maturity date soon. The current lender does not want to keep the loan and so they will charge her a 0.25% fee and 1.25% more in annual interest in order to extend her current loan for the next year. She cannot find a new lender easily because the current market value is only \$4.8 million, so her existing debt is about 81% of the value, which exceeds most lenders' LTV requirements. She is limited in her ability to come up with cash, plus she would rather use the money that she does have to make some improvements that make the property more desirable.</p> <p>A new financing scenario under the program that we have described above would allow Jane to take out the current lender, do improvements and keep rents affordable.</p>	
	<b>USES</b>	<b>SOURCES</b>
	Loan payoff .....\$ 3,900,000 Rehab .....\$ 490,500 Soft .....\$ 131,715 <b>Total .....\$ 4,522,215</b>	Jane .....\$ 480,000 (10% Uses) Lead Lender .....\$ 3,120,000 (65% LTV) Sub Lender .....\$ 922,215 (20% LTV) <b>Total .....\$ 4,522,215</b>
	Under the new scenario, Jane is paying only \$2,300 more each year in debt service, she has money to do some repairs and she has 10 years before she has to refinance again.	
<b>START UP COSTS</b>	Staff time to establish program and capital raise .....\$ 75,000-\$150,000 Legal fees loan document and inter-lender agreements .....\$ 50,000-\$75,000 Marketing .....\$ 15,000-\$25,000	
<b>ONGOING COSTS</b>	Loan origination and servicing costs .....\$ 0 (From transaction fees) Lending capital per loan .....\$ 300,000-\$3,000,000	

**Conclusions & Recommendations****This suggested intervention is appealing because it:**

- Leverages and extends use of private sector debt.
- Is not a subsidy, but rather a return-producing investment.
- Requires property owner investment.

It could be problematic because it:

- Requires subordinate lenders willing to take second-position risk.
- Requires significant capital.
- Includes self-reporting, rent-only compliance.

**We recommend the following next steps:**

- Solicit interest on the part of existing CDFIs to implement such a lending program to determine the parameters under which they would consider participation.
- Provide resources (existing or through new program related investment sources) to use alongside commercial debt.



## Attachment B3: Section 4(d) Property Tax Program

Our Strategic Partners selected several interventions to be the subject of deep-dive work sessions with local industry experts. These interventions were selected because they were suggested frequently in our interviews and focus groups, but required more thorough investigation before we could fully assess their potential. Absence of a work session on a suggested intervention does not indicate a lack of merit but rather an existing clarity around how it might work.

### Summary Description

This intervention could reduce the property tax burden on housing where some affordability commitment is made, even if not through deed restriction.

### Problem to Address

This intervention could address a widely-voiced complaint by landlords by easing the burden of property taxes—a significant and often unpredictable operating cost. Another challenge this could address is the reluctance of landlords to take advantage of local programs that encourage investment in their buildings. Pairing Section 4(d) eligibility with local programs of financial assistance could make them more attractive for landlords to participate. In buildings or locations where many affordable rental units are occupied by persons who could afford to pay more, Section 4(d) could also be used to target such units (on turnover) for lower-income occupancy through the income restrictions in a local Section 4(d) program—in effect creating new housing opportunities for lower-income households without having to build them. Finally, in areas such as transit corridors that face gentrification pressures, the concern is that escalating rents will result in the involuntary displacement of lower-income renters. Currently there are few tools to protect tenants facing these conditions, but an expanded use of Section 4(d) could moderate rent increases and reduce the level of displacement.

### Intervention Targets

A local Section 4(d) program could be targeted to the local issue to be addressed. A city facing gentrification threats along a new transit corridor, for example, could structure the program to attract owners with properties directly along the transit corridor. In another city, the issue may be getting owners of problem properties to participate in rehabilitation programs, so the local Section 4(d) program could be structured to appeal to them. Since bringing more properties into the Section 4(d) program results in a redistribution of levy within local taxing jurisdictions, carefully targeting the local program to reach a limited number of properties might be important.

### 4(d) Program Intervention Targets

Owner Profile	Property Profile
<ul style="list-style-type: none"> <li>Any owner of unit willing to meet minimal rent and income restrictions on an annual basis</li> </ul>	<ul style="list-style-type: none"> <li>Any rental property (even single-family unit) in which a unit of government has even small level of financial participation</li> </ul>

**Discussion** The Low Income Rental Classification Program (LIRC), also commonly referred to as the Section 4(d) program, provides a lower property tax rate for “low-income” rental properties (Minn. Stat. § 273.128). This law originally covered both “deemed” properties (publicly subsidized) and “pledged” properties (unsubsidized, but where landlords voluntarily agree to rent and income restrictions). The program was discontinued in 2003, and then partially restored by the legislature in 2005, to include only deemed (subsidized) properties. The program currently provides a tax break of 40% off the rate for residential rental properties, which for a Minneapolis rental property with rents at the level of HUD’s fair market rent would produce a savings of approximately \$25-35/unit/month. In return, owners commit to rent and income restrictions at 60% of AMI.

We originally envisioned going back to the legislature to try to restore some form of this program for pledged properties in order to address the challenges described below. Any such effort would have required addressing criticism of the former pledged program. In 2001, the Legislative Auditor found no evidence that the rent ceiling of 60% of AMI was having any significant and practical impact since most market rents were not approaching that ceiling. In effect, landlords were getting a tax break without offering anything in return. The rent cap really presented two problems—not only was it too high to be meaningful, but a one-size-fits-all standard did not account for greatly varying local rent markets.

We then realized that a more promising strategy to expand Section 4(d) actually already existed under the language of the current law. Properties can meet the definition of a qualifying “low-income rental property” if they are subject to rent and income restrictions under the terms of financial assistance provided not just by federal or state government, but by local units of government as well (Minn. Stat. § 273.128 Subd. 1 (4)). This means that if a local government provides some form of “financial assistance” to such properties, and the owner agrees to locally-determined rent and income restrictions, unsubsidized affordable properties can be treated as “low-income rental properties.” Note there is no definition of financial assistance, nor any minimum level, so local governments could either create minimal forms of financial assistance or tie Section 4(d) to existing programs of financial assistance. In addition, since the program would be local, rent and income restrictions could be locally-determined, rather than applied on a statewide one-size-fits-all standard.

**Operational Details** A threshold question is whether a local government currently offers any programs that can be considered “financial assistance” to residential rental properties, or if it can feasibly do so. Some cities have such programs, though many do not. There is no required minimum level of assistance, so the financial assistance could be quite modest. Some cities provide significant financial assistance to rental owners, such as tax credits or housing trust fund resources, which already carry rent and income restrictions, so Section 4(d) would not add to these restrictions. It may be more feasible to envision a local Section 4(d) program at the county level, or perhaps at the level of the Metropolitan Council, if funds provided by those entities could satisfy the financial assistance requirement. Another option might be to structure a local Section 4(d) program based upon a transit corridor.

**Operational Details**  
(continued)

A second issue includes addressing potential concerns of various taxing jurisdictions that face some shift in the tax burden as a result of an expanded Section 4(d) could be one strategy. Limiting the eligibility for local Section 4(d) by narrowly targeting eligible properties or by capping the number of properties. Persuading the taxing jurisdiction that the outcomes of this approach would be consistent with their own jurisdiction's housing goals would be another way to address this concern.

A third issue to address is minimizing the administrative burden, both for participating landlords and administering agencies. Owners would have to submit applications, along with certifying incomes of tenants, and then would likely have to file annual certifications of compliance. The local government could establish locally-tailored rules (income and rent limits) and provide owners with the certifications they would record and file with Minnesota Housing as is done currently. We recommend that rent limits be based upon current rents with an annual rent increase being permitted based upon a reasonable objective standard, such as the consumer price index or HUD annual adjustments. The local government would need to identify that annual increase and notify participating landlords. There would be costs to the local government for administering this program, which could hopefully be covered by landlord application fees. The program should be designed to piggyback on similar certifications from other programs, where possible, to keep administrative costs as low as possible.

**Implementation Partners' Roles**

A local government unit, either a city or county, Metropolitan Council, or a consortium of cities along a transit corridor, would have to choose to initiate this local Section 4(d) program. Minnesota Housing collects owner Section 4(d) certifications, and has been responsible for monitoring compliance. Conversations with Minnesota Housing staff suggest that locally-created Section 4(d) programs would not appreciably impact Minnesota Housing. Property owners could also be viewed as "implementing partners" in the sense that the program will not work unless they sign up. We did hear strong interest among landlords in the idea of qualifying for the Section 4(d) benefit. Local jurisdictions considering such programs would likely want to consult with the type of landlords they seek to target for their program to ensure the program design takes into account the views of the target group. Local taxing jurisdictions could also be viewed as partners by way of being consulted regarding the impact of potentially lost tax revenues.

**Affordability & Duration**

The state Section 4(d) law sets an affordability ceiling of 60% of AMI, but there is no reason local jurisdictions creating local programs could not target lower affordability levels based on local markets and local goals. In places where escalating rents are less of a concern but making more of the affordable units available to lower income households is the goal, income limits may be more important than rent limits. The duration of the affordability commitment would also need to be determined. When the Section 4(d) law covered pledged properties, owners committed to restrictions for a five-year period, which could be the logical place to start in considering the durational requirement.

**Financial Considerations**

The principal costs involved are the work to design a local program, ongoing administrative costs to run the program. The benefit is the ability to achieve a key goal of the local government, whether it is limiting displacement by capping rents, inducing landlords to fix up problem properties, or making already affordable units more available to the lowest income households. In each case, the local government will have to weigh the costs versus the likely benefits. It may be best to view these local programs as pilot programs, or time limited programs, in order to evaluate how well they achieve their intended goals.

**Alternatives**

There may be an alternative avenue to providing property tax reductions in exchange for use restrictions. Minnesota law currently allows for abatement of taxes on particular properties, under certain circumstances, at the initiation of the local taxing jurisdiction (Minn. Stat. § 469.1813). This law would appear to allow the city to set up the same kind of program as described above, without having to provide “financial assistance” as required by the Section 4(d) program. The abatement authority, however, has its own set of issues, including meeting a “public interest” test, and requiring the consent of all taxing jurisdictions as to their portion of taxes to be abated.

**Conclusions & Recommendations**

It should be noted that property tax reform appears to be on the agenda for the 2013 legislature. Some reform ideas include major simplification of the property tax, which could mean the altering or elimination altogether of specialized tax treatment such as Section 4(d). This obviously bears close watching. Assuming Section 4(d) remains largely intact, this proposal would benefit from conversations with a wider range of local governments, including counties, the Metropolitan Council, and even groups of cities along emerging transit corridors.

## Attachment B4: Variable Rate Demand Note (Low-Floater Bond) Financing

Our Strategic Partners selected several interventions to be the subject of deep-dive work sessions with local industry experts. These interventions were selected because they were suggested frequently in our interviews and focus groups, but required more thorough investigation before we could fully assess their potential. Absence of a work session on a suggested intervention does not indicate a lack of merit but rather an existing clarity around how it might work.

**Summary Description** Low-floater bonds can significantly reduce the cost of financing by using very short term, continuously remarketed bonds to obtain the lowest possible rates. Low-floater bonds can thus allow the property owner to have lower rents than might otherwise be possible with other forms of mortgage financing.

**Problem to Address** The cost of financing is always a challenge for rental properties. Higher cost capital puts significant upward pressure on rents. Low-floater bond financing provides low-cost financing for qualified owners and properties.

**Intervention Targets** Low-floater bond financing could potentially be used in a variety of situations where the owner and the property or properties qualify, subject to important capital market and regulatory constraints.

### Low-Floater Bonds Financing Intervention Targets

Owner Profile	Property Profile
<ul style="list-style-type: none"> <li>• A record of well managed properties</li> <li>• Good credit</li> <li>• Significant financial resources</li> </ul>	<ul style="list-style-type: none"> <li>• Large projects</li> <li>• Demonstrated history of low vacancies and steady or increasing rents</li> <li>• Located in strong rental market</li> <li>• Good condition</li> </ul>

**Discussion** This financing can be used to finance a single property or even conceivably a portfolio of properties where the ownership entities for all the properties have an identity of interest. The financing would be most competitive for a nonprofit owner in a municipality willing to issue tax-exempt bonds within the context of low-floater bond financing. However, critical to this financing is the issuance of a letter of credit (LOC) by an investment-grade bank. The LOC is for the full amount of the low-floater bond issue. The LOC allows the bond investors to purchase the bonds based on the credit of the bank, not on an underwriting of the property. Depending on the credit of the bank, rather than the real estate, allows for a very low interest rate.

**Operational Details** Low-floater bonds are re-marketed on a weekly basis. Investors often use them as a short-term investment. Evidence suggests that the interest rate on low-floater bonds is a reflection on how the equity markets are performing (which drives demand for “parking” money in short term instruments) and the credit of the LOC bank (which represents minimal risk to the investor), rather than just the general interest-rate environment. As a result, and somewhat counter-intuitively, when other interest rates are moving upwards, low-floater bond interest rates may stay low or stable.

### Operational Details (continued)

As noted above, low-floater bonds are effectively secured by an LOC issued by an investment-grade bank, not by the property. The bank that issues the LOC underwrites the property. The investors who purchase the low-floater bonds do not look to the property, but rather underwrite the bank and purchase the bonds based on the credit worthiness of the bank. The LOC is in the amount of the outstanding bonds. If ever the bonds cannot be re-sold at the end of a week, the current holder of the bonds can call on the LOC and demand their repayment. The rate on the LOC basically reflects the rate at which an investment-grade bank can borrow funds. As a result, the property owner is able to borrow funds at close to the rate at which an investment-grade bank can borrow funds (with some important additional costs described below).

In substance, the LOC is a loan by the issuing bank. In fact, regulators now require the banks to treat these LOCs in the same manner as they do loans on their balance sheet which has eroded bank interest in participating in this way.

### Implementation Partners' Roles

**Public Sector.** If tax-exempt bonds are to be used—local units of government, Housing and Redevelopment Authorities, or Economic Development Authorities. We explored the theoretical potential for Minnesota Housing to play some role as a secondary guarantor or act as the LOC issuer. However, this would be limited so as not to impact their credit rating, would require their full underwriting of each transaction, and affect their balance sheet similarly to how it would the bank's. Therefore we determined that this was not a viable role for them to play.

**Investment-grade Banks.** (Such as Wells Fargo or US Bank, who have participated in these deals in the Twin Cities market previously). However, the following limitations should be noted as they dampened the appetite of banks for such participation, and changed the terms they are willing to offer.

- Consolidation of large banks has reduced the number of potential LOC providers.
- Changes in bank regulations have caused LOC providers to regard these like loans, not just contingent liabilities.
- Calling of LOCs by investors during the credit crisis resulted in banks being forced to pay out large sums.

### Affordability & Duration

If tax-exempt bonds are used, local units of government are involved, and these requirements are built into the deal. For these tax-exempt bond issues, the minimum affordability requirements are 20% of the units with rents affordable by households at or below 50% of AMI, or 40% of the units affordable at or below 60% of AMI.

**Financial Considerations**

Low-floater bonds are issued only with the backing of LOCs of investment-grade banks. This LOC provision is a critical, and under the current capital market environment dubious, activity for banks. Since the financial crisis of 2008, the number of investment-grade banks that are able to issue these LOCs has shrunk considerably and their appetite and terms have changed. Fortunately, two of the remaining banks are located in the Twin Cities; Wells Fargo and US Bank. Assuming that these banks reenter this market, there are costs associated with their participation and with VRDN transaction that should be understood.

The all-in cost of one low-floater bond deal is summarized as follows as an example:

**Current Effective Annual Interest Rate (November 2012)**

Annual Interest Rate .....	0.200%
Annual Cost of LOC .....	0.250%
Annual Cost of Interest Rate Cap Insurance .....	0.250%
Annual Marketing Fee .....	0.125%
Annual Bond Trust Fee .....	0.200%
<b>TOTAL ANNUAL COST .....</b>	<b>2.825%</b>

**Conclusions & Recommendations**

This suggested intervention is appealing because of the historically low cost of low-floater bonds and the relative ease of gaining LOC participation by banks. While this financing strategy is not currently a palatable activity for banks and not competitive with FHA insured mortgage financing, low-floater bond financing may be an attractive alternative for project financing in the future. However, with the significantly changed financing environment since 2008, there are at least the following issues:

- Limited number of banks that still have the capacity to underwrite deals
- Significantly changed terms and conditions for deals
- Required treatment of LOC's as loans by the banks that issue them

We recommend the Strategic Partners monitor the changes in capital markets as there may be opportunities to use low-floater financing in the future.

## Attachment B5: Clearinghouse for Mission-Driven Owners

Our Strategic Partners selected several interventions to be the subject of deep-dive work sessions with local industry experts. These interventions were selected because they were suggested frequently in our interviews and focus groups, but required more thorough investigation before we could fully assess their potential. Absence of a work session on a suggested intervention does not indicate a lack of merit but rather an existing clarity around how it might work.

### Summary Description

Our intent was to consider the feasibility of a clearinghouse or matchmaker entity to position mission-driven buyers to have maximum and early access to high priority projects for potential acquisition. Through a work session with for-profit and nonprofit owners and brokers, we learned that there is not a need for such an entity. The brokers and nonprofits we talked to agreed that getting access to purchase opportunities is not the problem; thus, ensuing discussion focused on other hurdles to increasing mission-driven acquisition of these properties.

### Problem to Address

Nonprofit and other mission-driven buyers often have trouble competing with for-profit buyers for high priority affordable projects, due in large part to the fact that mission-driven buyers nearly always have to obtain funding from public entities. This means they have to negotiate lengthy terms that for-profit buyers do not, resulting in either lost opportunities or higher purchase prices. Other challenges with mission-driven entities acquiring these properties include uncertainty about the ability to do short term refinancing, the inability to manage risk by cross subsidization within portfolios of properties (stronger projects subsidizing weaker projects), and the challenges of being asked by local governments to acquire the most troubled properties. Finally, nonprofits are often concerned about the reputational risk of being associated with projects that do not have a “high quality” appearance.

### Intervention Targets

The kinds of properties to be targeted for acquisition are generally those that are currently affordable without subsidies but are important to the community, and are at risk either because of the likelihood of becoming unaffordable, or because they are threatened by physical deterioration. A subset of this group would be projects identified by local governments as problem properties where the local government would love to see a property transfer to a mission-driven owner.

#### Clearinghouse Intervention Targets

Owner Profile	Property Profile
<ul style="list-style-type: none"> <li>• Incoming: Mission-driven</li> <li>• Outgoing: Profit-driven</li> </ul>	<ul style="list-style-type: none"> <li>• Currently affordable without subsidies.</li> <li>• Light to modest rehab</li> </ul>



**Discussion**

For some potential purchasers who are accustomed to operating only in subsidized housing, moving into this market may require a shift in business philosophy. Part of the shift involves a willingness to be associated with older, more shopworn buildings. This may be contrary to the work that has been done to upgrade the public image of “affordable housing.” Perhaps one solution for nonprofits concerned with protecting their brand would be to spin off a separate entity for owning and managing such properties. There are other challenges as well. Owners would have to recognize that using public subsidies to upgrade these properties might not be an option. We know that many large and small for-profit entities have successfully acquired and operated many of these properties, focusing instead on longer-term capital improvement.

An ability to acquire and operate these projects without reliance on public subsidies, either for acquisition or rehabilitation, removes a barrier to competing for these properties, namely the need to negotiate lengthy terms before closing in order to access public funding processes. This, however, means obtaining market rate financing for acquisition and any rehabilitation is necessary, which may be a major challenge, due to a lack of enterprise-level equity. Twin Cities Community Land Bank (TCCLB) can make the purchase on a short time frame and temporarily hold the property until the nonprofit is ready to purchase. The feasibility of this strategy needs to be explored with TCCLB on a deal-by-deal basis. We know, through their preliminary experience, that holding costs and interest are barriers.

There are additional barriers that hamper nonprofit activity in this market. Many large for-profits can afford greater risk because their inventory is managed on a portfolio basis; allowing financially stronger projects to cross subsidize weaker performing properties. Nonprofits typically are unable to do this because their deals do not generate enough cash flow to the corporate parent cushion. Some of Minnesota’s larger nonprofits are beginning to amass such resources or borrow at the corporate level. Acquiring enterprise level capital would help, however, that is also a challenge for nonprofits. Moreover, nonprofits have voiced a reluctance to further acquire such projects without any comfort about their ability to refinance or upgrade projects in a seven to ten year time frame. It appears that in general, nonprofits are more risk averse than many for-profit operators, though this notion would benefit from more discussion with some of Minnesota’s larger nonprofit housing providers.

Finally, there should be some acknowledgment that cities often turn to nonprofits, urging them to acquire “problem properties” which can provide the toughest kinds of challenges. From what we heard, there are instances where better coordination between the city and a would-be mission-driven buyer would facilitate this goal. A mission-driven suitor will likely encounter a more receptive seller, for example, where the city has applied active code enforcement pressures, as opposed to passive tolerance of substandard conditions.

**Conclusions & Recommendations**

Implicit in this discussion is the notion that the community will be better off if these high priority projects are placed into the hands of a nonprofit or mission-driven housing provider. The assumption is that over time, a given project will remain more affordable or in better condition in the hands of an entity where maximizing profits is not the first priority. That said, there appears to be a lack of hard evidence to establish this supposition, despite its intuitive acceptance by many in the industry. Further research on the effect of the type of owner on affordability over the long term would be useful. Lastly, further discussion among nonprofit and mission-driven owners on how to compete more successfully in this market would be useful as well.

## Attachment C1: Rent Control

Rent control is the process by which a municipality or state regulates the residential rents that landlords may charge tenants. It is usually launched at points of broadly-perceived shortages or crises in the marketplace and is often put in place as a mechanism to protect longer-term tenants in a sharply appreciating market. The purpose of these rules is to retain lower-cost privately-owned units by establishing a mechanism that controls the amount of increased rent that may be charged annually, at turnover, or upon a major rehabilitation.

Modern rent controls were originally adopted in cities in the 1940s in response to housing shortages resulting from World War II, and then another surge appeared in 1971 as part of the Nixon-era wage and price controls. While some states, like New York and California have enabling legislation, and over 100 municipalities across the country have some type of rent control, the most comprehensive programs are seen in communities with large tenant populations, such as New York City, San Francisco and Washington, D.C.

During periods of strong growth and construction, opponents to the program have been able to successfully argue that there was no further need for the controls because supply was increasing and costs would, therefore, not escalate. Over the last 10 years in Cambridge, MA, the program has been fully eliminated while in New York City and San Francisco there was a relaxing of the rules that allow for decontrolling of units or resetting of rent levels at the time of tenant turnover.

The rules and practices vary widely among communities, with the larger city programs like New York being very complicated for both landlords and tenants to navigate. Since the rules are usually structured to protect residents who have lived in their apartments for long periods of time, it is the elderly population that must struggle to understand and carefully comply with these rules intended to protect them. The rules are usually applied to older properties built, for instance, in San Francisco before 1979. Often, as in Washington, D.C., the rules exempt smaller (four or fewer units) property owners. Programs are being started or tightened in some communities, like Hoboken, NJ, and Seattle, WA, where gentrification is occurring, and where transit oriented development (TOD) projects are putting new pressures on housing markets and rents are again rapidly climbing in places such as Washington, D.C. and the San Francisco area.

PolicyLink, a national research and action institute advancing economic and social equity by Lifting Up What Works®, has developed a comprehensive guide on the uses and establishment of local rent control programs. This online toolkit walks one through the steps that can be taken to assess the type of program appropriate for a locality, as well as how to organize and pay for the operations.

To balance the loss of potential income to the property owner when units are designated as rent controlled, some communities such as Washington, D.C. offer a concession of reduced real estate taxes. Owners resist imposition of rent controls because the cap on rental income is a cap on the value of the real property. By placing limits/controls on rent levels, cash flow is limited and, therefore, the capitalized value of the property is limited. Most communities adopt some method to recognize the capital improvements that owners make in properties, allowing them to increase the rents by a somewhat higher amount over a number years in order to recapture the expenditures. This practice of limiting the amount of return for capital improvements is a further irritant to landlords.

The mechanics and structure of the rent control programs vary widely by community; we found no dominant approach or best practice to single out. We also found that the public cost to administer the program varies and can be substantial, even if all efforts focus on the supply side tasks of registration, monitoring, and setting of rent levels. This is all work that must be done for the full year and requires several professional staff to execute, even if supplemented by occasional consultant assistance.

In our research and interviews we found no examples of eligibility tests for tenants to either access or remain in rent control units. The setting of rents is based on the age and size (number of units) of properties—not tenant means. The controls are intended to keep the inventory available and affordable to the current residents, whoever they are. Therefore, the population that benefits from the regulated rents may not be the most needy residents in the community, but simply the households that found the unit and satisfied the landlord’s standards to rent the unit.

#### How it informs our work:

- Exceptional economic and political conditions are required to secure passage of rent control ordinances. These conditions do not appear to be present in Minnesota at this time.
- In sharply rising cost neighborhoods, such as TOD areas, a modified rent control could be introduced as a means to protect longer-term and elderly residents from displacement.
- Good data is needed to determine the size, location, and characteristics of the target units to be covered by rent controls in a community. Annual analysis of market trends is needed to determine percentages for permissible annual rent increases.
- Administering even a modest program with minimum rules will require staff with skills in evaluating operating budgets for properties when requests are made for exceptions due to capital improvements or other circumstances. All of the tasks speak to the need for new and dedicated personnel to administer any program, local, regional or statewide. This would be a new cost item for a community and can be expected to be higher if the program includes unit inspections or code enforcement features.

## Attachment C2: Mezzanine Financing

At both the local and national levels, there are efforts to find vehicles that can be coupled with conventional debt financing to meet the actual cash needs of projects for acquisitions and/or capital improvements. This is the capital between a bank's 65% LTV limit and the owner/developer's need for cash (30% or more) to complete the purchase or secure the funding for needed repairs and improvements. Customarily, transactions are done with experienced owner/operators whose performance projections for the completed project demonstrate adequate cash flow to service either the additional debt or provide strong cash flow returns for equity investments. Each project must be rigorously analyzed since the lender/investor is looking equally at the real estate and the credibility of the borrower to measure the risk of the transaction. Several examples can point out the variety approaches that are being used and the types of situations where blending debt and equity products can create new opportunities for preserving the affordable housing inventory.

LTVs above 65% can be found in communities that have established funds with multiple lender participation, where the risks are shared among the major conventional lenders doing business there in order to offer what is widely recognized as critically needed financing for affordable housing in that particular community. Sometimes motivated by Community Reinvestment Act (CRA) requirements or community pressures, banks will make a commitment to do some volume of transactions in a particular neighborhood or type of property. Patient capital may be contributed to the fund from Community Development Financial Institution (CDFI) investments from the Department of Treasury, or from foundation grants or Program-Related Investment (PRI) loans.

In Chicago, the Community Investment Corporation (CIC) has been able to offer borrowers loans that can exceed 100% of current value plus improvement costs by starting with the After Rehab Value (ARV) for the property, based on the increased rental income from achievement of full occupancy or increased rents. The borrower may get a loan that looks like it has LTV of 130%. Once the repairs are completed, the debt will be able to be serviced with the project's higher rental income. CIC prides itself on being a "hands on" operation that works very closely with its borrowers through every stage of renovations and property operations. These efforts mitigate risk. By lending from a fund capitalized by the City's major banks, CIC then spreads the risk associated with any one loan among a pool of interested lending institutions.

In New York, the Community Preservation Corporation (CPC) has been a major force in creating affordable housing in New York City and across the state. Since its founding in 1974, it has financed the preservation and development of nearly 147,000 affordable housing units involving public and private investments of approximately \$8 billion. Their major strategy was to make first mortgage loans at low interest rates and at 80% or higher LTV by having the loans guaranteed by Fannie Mae, Freddie Mac, or similar city or state programs. The underwriting standards of these guarantors then guided the parameters of the lending done by CPC. Therefore, second mortgages have not been used on CPC-financed projects because the guarantors would not permit additional liens on the properties they had insured or on which they had bought notes. CPC's knowledge of the local markets and their relationships with lenders and local redevelopment officials allowed them to be nimble in setting targets and terms for loan products that could match with other available resources, such as neighborhood infrastructure projects, CDBG-funded commercial district revitalization projects, or code enforcement and receivership initiatives in distressed areas.

Also in New York, a group of foundations came together to offer capital in the New York City market. The Furman Center for Real Estate and Public Policy describes the initiative:

*The New York City Acquisition Loan Fund (AF) provides affordable housing developers, both nonprofit and for profit, with early financial resources to acquire property and to provide pre-development funds. The City of New York, major foundations, and members of the banking industry established the fund in 2006 using Battery Park City revenues and foundation loans and grants to create a guarantee fund to provide security for the banks that were providing the loan capital. Activities funded by AF include: conducting appraisals and environmental assessments, securing title and zoning approvals, and hiring consultants to assist in the acquisition and pre-development of low-income housing. Below-market rate loans are made for up to three-year terms. For profit developers can receive loans with a loan-to-value ratio of up to 95%, and nonprofit developers can receive loans with a loan-to-value ratio of up to 130%. Lending and subsequent production must meet affordability requirements established by originating lenders in the program, which vary based on each lender.*

This \$200 million fund targets creating or preserving up to 300,000 rental, homeownership and supportive housing units over a ten year period. Loans are originated by city agencies (NYC HDC), national intermediaries (LISC, Enterprise) or human service agencies (Corporation for Supportive Housing).

Currently, on the national front, a national loan fund is being launched by Enterprise Community Partners. The Enterprise Multifamily Opportunity Fund (the “Fund”) is a real estate private equity fund that invests in existing multifamily housing properties nationwide. Targeted properties (the “Properties”) include affordable or unrestricted, B and C Class multifamily properties with 50 or more units where there is opportunity for improvement and/or good value. The acquisition and rehabilitation of each Property is financed primarily by low interest permanent financing up to 85% LTV by permanent debt programs such as FHA, Fannie and Freddie Mac. The balance of the financing is provided as an equity investment by the Fund and a local nonprofit or for profit real estate owner/operator (the “Sponsor”) who must have a demonstrated track record of successfully owning and operating multifamily properties, asset management capabilities, and financial strength. Together, the Sponsor and the Fund will seek to earn an economic return by maximizing cash flow through professional property management, strategic physical improvements, and green retrofits. The Fund is not a solution for troubled projects or smaller properties. It will look for investments among LIHTC projects reaching the 15 year mark where affordability can be continued without having to go through a major renovation process as would be required to utilize a new 4% credit allocation. Enterprise sees that risk is mitigated in this program by investing in properties that have 80% or higher occupancy, and partnering with seasoned owner/managers. Enterprise anticipates that their fund will share in what is already demonstrated reliable cash flow from the project.

**How it informs our work:**

- Higher LTV lending is achieved most often by a shared risk mechanism such as pooled lender loan funds or through credit enhancements achieved with guarantees from foundations and other patient investors like CDFIs.
- Raising the capital for loan pools is becoming increasingly difficult as banks reduce their participation because of other financial pressures and/or reduced CRA pressures to lend in target markets. Foundations and high net worth individuals are among the potential investors being sought.
- Effective lending in this arena requires staff to have strong underwriting and coaching skills. The work is a combination of hard analysis and cultivation of borrower capacity to be alert to market conditions, and the ability to signal and adapt to changes efficiently.
- Second mortgage products appear to be rare, with first mortgage lenders generally not permitting additional debt on properties to which they lend or service loans. The challenge is to define the terms that first lenders will find acceptable to bring into transactions.

## Attachment C3: Rent Assistance Programs

As we looked across the country we found many examples of rental assistance initiatives where a subsidy payment is made on behalf of a low-income household to bridge the gap between the rent that they can afford (customarily at 30–40% of income) and the rent that the property owner is charging. These programs are administered by state and regional agencies, nonprofits and housing authorities. The administrative agencies are responsible for eligibility determination for participants, negotiation and payment of rent, and unit inspections. The programs are often funded through an annual appropriation of the state's budget.

Section 8 is the federally funded rental assistance program, with many states locally funding similar initiatives through annual appropriations of the state's legislature. The subsidy is provided as either assistance for a specific tenant and, therefore, is a subsidy that moves with the tenant, or as a subsidy that reduces the rent on a specific housing unit, making the unit affordable to any eligible low-income person who lives in the unit. In many states, these programs pre-date Section 8 with the tenant-based subsidies initially functioning as an income transfer program that allows low-income residents to either stay in their current apartments as rents increase, or to have greater mobility and choice when determining where they can afford to live. Connecticut and Massachusetts are examples where Section 8 tenant-based subsidy or voucher programs also operate on a statewide basis, allowing households to move where they find jobs, have a family support network or secure an otherwise attractive unit for their family. Unfortunately, efforts to expand or even sustain prior year commitments for tenant vouchers have in some cases met resistance from local communities when voucher holders are seen as people different from the rest of the community; a sign of the community's decline rather than of its success and increasing value. As an example, in Massachusetts efforts by state legislators to secure state funding for tenant-based vouchers as a tool to provide affordable rental housing in high demand markets have been unsuccessful.

As part of their housing appropriations, some states make rental assistance funds available to municipalities to use in their local affordability strategies. These project-based funds are then allocated to specific housing units and used to either retain affordability in raising markets or to stimulate development of new projects containing affordable units.

As the need for affordable housing has grown and the value of stable, decent housing to help address a wide range of social problems has become better understood, the rental assistance programs have been refined and embraced by a wide range of advocates. The matching of rental assistance initiatives with human service needs has flourished across the country in recent years. This has resulted in subsidies being made available to help bolster mental health, employment, homelessness and youth programs, to name a few. The funding may be state-appropriated housing dollars or social service agency funds dedicated to rental subsidy payments of program participants. Some programs are tenant-based while others have been used as an on-going subsidy in a property operated by the human service agency. The examples below are just a sample of the rich variety of housing needs that are addressed with rental subsidies today. By leading with a specific community issue, these programs are able to demonstrate multiple impacts for the dollars invested, and thereby secure a broader range of advocates and supporters for the programs. Particularly with the decline of affordable housing resources and the continuously growing demand, the targeted use of rental subsidies as part of service package for clients in human services programs can be expected to dominate the use of affordable housing tools.

**Transition Housing in New York City.** In an effort to help homeless New Yorkers living in the shelter system who are employed full-time but still unable to afford housing, the Coalition for the Homeless created its Rental Assistance Program. The program provides monthly rent subsidies as well as budgeting and counseling support for up to two years to help participants successfully transition into and maintain permanent affordable housing. This model program has saved New York City millions of dollars, since the cost of rental assistance (roughly \$7,700 per year) is considerably lower than the cost to shelter a family (\$38,000 per year). Last year, the Rental Assistance Program housed 34 single adults and 35 families. The program boasts an impressive success rate, with 97 percent of program participants maintaining permanent housing and financial independence after graduation.

**Foster Care Youth in Iowa.** This state offers rental assistance to youth aging out of the foster care system, as part of a multi-year transition plan to help build the independent living skills of the young person. The Iowa Department of Human Services coordinates state and federal funds from multiple agencies for youth moving into the private marketplace as renters, workers and students.

**Supportive Housing.** The Corporation for Supportive Housing on a national basis, and the Wilder Foundation's ROOF Project on a county basis, combine rental subsidy assistance along with comprehensive services to households in their efforts to knit together the supports the clients need to live independently long term. The rental subsidy addresses an immediate threat of homelessness while the bundle of other services are put in place to increase the likelihood of permanent success as on-going tenants.

#### How it informs our work:

- Rental subsidy that is tied to the tenant can be effective for improving the quality of lower rent properties, diversifying their location and preserving their availability in the marketplace. We see this in a couple of ways: knowledgeable tenants can seek and demand quality conditions; and tenants can shop broad geographic areas, decreasing the concentration of poverty in one area. The units remain affordable either to current tenants who are now able to remain in their units while landlords secure market rents, or individual selective units become part of the affordable housing inventory as the tenant leases a unit on the open market.
- Some communities discourage the use of rental vouchers because they fear these will bring undesirable people to their neighborhood or overload their community with more than what they see as their fair share of lower-income households.
- Successful expansion of rental subsidy vouchers may rely upon pairing them with a human service initiative, such as programming for the homeless, veterans or the mentally ill. This strategy may produce enough allies and supporters for new funding, but may also further stigmatize vouchers for the general population.
- It is usually impractical or cost prohibitive to have means tests in rent controlled, tax reduced or other incentives/waivers-granted properties where lower rent levels are trying to be maintained. However, the rental assistance initiative provides a mechanism to ensure that the beneficiaries are those most in need because the tenants would have to be determined as eligible participants at the inception and renewal of their lease.



## Attachment C4: Housing Partnership Equity Trust

The Housing Partnership Equity Trust (HPET) will provide a nimble and low-cost equity source for the purchase of unsubsidized rental properties by nonprofit organizations. The primary goal is to make nonprofit organizations more competitive in the open market acquisition of B and C Class properties that currently offer some level of affordability. The mission of these organizations—and the public interest—will be served by their conscientious property and asset management and modest long-term affordability for residents. A secondary goal is to provide an opportunity for income diversification among nonprofit members, whose sources for subsidized housing are drying up.

HPET is a joint effort of the Housing Partnership Network (HPN) and 13 of its members, and will be organized as a REIT. The first round of capitalization is almost complete at \$100 million. Properties acquired through the Trust will be owned in partnership between HPET (as Limited) and the HPN member organization (as General). HPN members may participate by making an equity contribution to HPET of at least \$250,000, and by financing at least 5% of the acquisition cost through their own resources. HPET plans to hold these properties for ten years, at which point the GP member may acquire the full interest, or the properties may be sold.

### How it informs our work:

- Provides a new model and funding source for nimble acquisition by nonprofits.
- The anticipated scale of projects is 150 units average, larger than many acquisition opportunities in our region.
- HPN members in the Twin Cities are not currently involved due to competing demands on their time and capital but,
  - Could partner with other participating HPN members immediately; and
  - Could invest in subsequent rounds of HPET.
- Provides guidance and precedent for affordability definition; 120% of AMI was the original affordability goal; current target of portfolio-side average of 80% was arrived at to satisfy charitable purpose requirements of funding sources.
- There is no means testing for tenants required by HPET, but may be applied by partners.
- An upcoming study of data on operating cost differentials between subsidized and unsubsidized rental housing may help expose where the cost centers are.

## Attachment C5: Property Tax Relief

States and municipalities commonly use property tax relief mechanisms in conjunction with other subsidy or rent restrictions as part of a comprehensive affordable housing strategy. Developers using LIHTC or Section 8 contracts will negotiate terms that provide lower base assessment and/or establish a predictable rate of increase for property taxes in exchange for the long-term (15 or more years) affordability commitment.

As a preservation tool in the unsubsidized stock, property tax relief is used most commonly to encourage repairs and improvements. To encourage owners to invest in renovations that sustain the quality of the existing inventory, communities offer several approaches including the following in which the owner is extended relief, but must also enter an agreement to rent to families with incomes below a specified level for the period of the abatement.

**Property Tax Increase Exemptions (Freeze).** These are exemptions from the increases that would have resulted from the value of the improvements. They are used in targeted areas in Seattle, WA (Multifamily Property Tax Exemption Program) for a maximum of 12 years, and in New York City, NY for up to 34 years, with the J51 program, in Portland, OR for a ten-year period.

**Nonprofit Tax Exemption.** In the example of Florida, properties owned by nonprofits and rented to eligible tenants (elderly, or up to 120% of AMI) constitute a “charitable use” and are exempt from property tax payments. The nonprofit must be the sole buyer/owner. Partial exemptions are possible if only some of the units are occupied by eligible tenants. See definitions at [www.housingissues.org/forms/advalor-occupied-rental-statute.html](http://www.housingissues.org/forms/advalor-occupied-rental-statute.html).

There is a thorough discussion of these techniques accompanied by suggestions on the most appropriate tool for the specific local conditions that can be found at [www.housingpolicy.org/toolbox/strategy/policies/tax\\_abatement.html](http://www.housingpolicy.org/toolbox/strategy/policies/tax_abatement.html). This site is part of the online guide for state and municipal governments, offering best practices as well as analysis techniques.

The Preservation Compact in Chicago ([www.preservationcompact.org](http://www.preservationcompact.org)) is probably the most comprehensive program in the country for existing property owners of unsubsidized affordable housing. It brings together information on the full range of resources for owners renting in low-to moderate-income neighborhoods in the city. Since the CIC is foundation-supported, there is no cost to owners to learn about loan programs, utility abatement initiatives or property tax assessment processes. The property tax reliefs available to owners in Chicago all require individual applications to the Cook County Assessor’s Affordable Housing Initiative program. Owners submit income and expense information for each property and an analysis of the costs. A comparison of comparables is then completed by the Assessor. This is done through an appeals process with the objective of setting the tax obligation for the property at a “fair” level. To assure maximum success to owners operating affordable housing, the Preservation Compact created a guide on the filing process and listings of consultants and attorneys who are able to walk owners through the process.

Another tool formerly used in the Chicago market was the Class 9 benefit. This program took advantage of the tax assessment structure's variables that had determined rates by category of property and often put properties into classifications and rate levels inappropriate for the actual use. This, however, created opportunities for adjustments that could bring properties into alignment with other community objectives. Therefore, the Class 9 incentive program offered a reduced assessment (as much as 50%) to owners who made improvements to their properties and agreed to offer affordable rents. Cook County's recently revised assessment structure eliminated the categories and has all residential properties assessed at 10% of the market value, and thereby eliminated the benefit of Class 9 treatment.

#### How it informs our work:

- Property tax reliefs require a careful balance between local concerns about the quality and availability of affordable housing, and the needed annual tax revenue. The program responses must be structured within and sensitive to market conditions. Tax relief mechanisms cut two ways: they cut property tax costs to owners, but the savings in operating costs are also a cut in local tax revenues. A careful cost-benefit analysis is needed in any community that is considering these initiatives and advocates will need to be prepared with documentation of the long-term community impact.
- Technical support to owners and skilled reviewing staff are necessary to successfully manage these programs.
- Property tax reform that evens categories or otherwise attempts to make the system simpler or consistent across the community may result in elimination of relief initiatives that operate on a case-by-case correction basis.
- If the nonprofit sector wants to expand its presence in affordable housing preservation, pursuing the strategy used in Florida that fully exempts property taxes for elderly and low-to moderate-income occupied units could give them added confidence that their operation of the property would help keep costs and rents at lower levels than would otherwise occur. A step-by-step application of Florida's strategy can be found at [www.housingissues.org/forms/advalor.php](http://www.housingissues.org/forms/advalor.php).

## Attachment C6: Cost Saving Measures

In 2007 housing advocates in Cook County, IL were increasingly concerned by the loss of affordable units to condo conversions and sales. Maintaining ownership and management of rental units was challenging and as property aged, the frustration and costs of keeping a property in good working order were getting increasingly expensive.

In turn, the region's public, private, and nonprofit leaders came together and formed the Preservation Compact ([www.preservationcompact.org](http://www.preservationcompact.org)) to preserve affordable multifamily rental housing in Cook County. Their strategy was to coordinate resources and share information in a way that allowed owners to realize greater efficiency in property operations. As they describe themselves, within the Preservation Compact, leaders from a variety of disciplines and expertise come together to identify their most pressing affordable rental housing problems, devise solutions, and then implement the on-the-ground strategies that can assist developers, owners, tenants, government officials and nonprofit organizations in ensuring safe, affordable housing far into the future.

The Preservation Compact is a partnership among utilities, local governments, technical assistance providers, lenders and an array of other organizations that are engaged in some aspect of rental housing. With a small staff that works at introducing and coordinating, rather than direct provision of services, the Compact facilitates a process of information sharing that they are confident is keeping property operating costs controlled and lowered for area landlords. Funding for the Compact comes primarily from the MacArthur Foundation. There are not membership dues or public agency contributions used to maintain the network or its work.

Among the efforts being pursued by the Compact, energy and property taxes were seen as two cost categories that could offer opportunity for real savings to rental property owners and/or tenants. Growing out of their relationship in the Compact, two members, CNT Energy and Community Investment Corporation (CIC), launched the Energy Savers Program, which offers free energy assessments for multifamily buildings and low cost financing for energy saving improvements. They report that to date, the Energy Savers Program has completed assessments on more than 20,000 units, retrofitted over 8,000 units, created over 400 jobs, and saved almost 2 million gas therms. The Preservation Compact further notes that a typical 24-unit building retrofitted by Energy Savers saves \$10,000 annually.

To address another cost area, taxation, the Preservation Compact is where owners can turn for technical information on rules, get help to prepare appeals, learn about new procedures and join others to advocate for changes in rules. Again, the belief is that the broad availability of this information has helped more owners to contain their tax liabilities and better control their costs.

Similarly, in New York City, smaller property owners can avail themselves of a wide-range of technical information and advisors by joining the Rent Stabilization Association (RSA). This membership organization describes itself as the largest real estate industry trade association in New York representing 25,000 property owners/agents responsible for approximately one million units of housing. RSA's members range from owners of one small building to large multi-family complexes, cooperatives and condominiums. Its broad representation has allowed it to develop a powerful base for its lobbying programs and to generate the funds necessary to provide a wide assortment of products and services to its members.

RSA provides services for members to do annual filings and compliance reporting, as well as offering a full array of group purchasing programs that can significantly save members cost in the operation of their properties. RSA operations are supported by annual dues (\$5 per unit or \$75 per building minimum) and fees for services that members select and use on an a la carte basis.

Also located in New York, the work of Urban Homestead Assistance Board (UHAB) targets cost saving efforts to a very specific type of property by helping existing building residents create limited equity cooperatives to take over ownership when properties are being sold or foreclosed. UHAB works with the cooperators to set up appropriate property management operations in addition to offering training and technical assistance to the residents, most of who are usually low-income. UHAB has several bulk buying programs and online bookkeeping services to help resident cooperatives control and minimize operating costs in their buildings.

UHAB is a nonprofit organization that provides services on a fee basis to the City of New York to facilitate transfer of properties to residents groups. It also looks to foundations, businesses and individuals for charitable contributions to support their organizing and technical assistance work with low-income residents groups.

#### How it informs our work:

- Long running and well-utilized cost saving initiatives offer a range of tools and services that include energy, property tax and bulk purchase assistance to property owners. Owners select or utilize these resources on an as-needed, voluntary basis.
- Funding for one-stop initiatives for rental property owners is most influenced by the scale of the potential user pool with the staff size and services offered directly reflecting the size and, therefore, capacity to pay for work that is done. In NYC fees to owners are so small that virtually any owner can afford to join and use individual services. The resulting large number of members makes possible a self-supporting service platform in that city. Foundation and government funding for these initiatives is a challenge to sustain since it is difficult to document consistent and/or significant impact for each contact made or service provided.

## Financing Unsubsidized Rental: Scan of the Minnesota Market

Deep Dive Team Favorites

1. Financial/Ownership Interventions				
Intervention	Impact Potential	Discussion	Program Examples, Source and/or Resources	
<b>DEEP DIVE: Pledged Units</b> For Deep Dive, see page 67.	Address burden of property taxes, the most-frequently mentioned operating cost, while capturing part of the relief delivered by lowering taxes to maintain affordable rents, or achieve other goals.	Requires legislation to restore this category of eligible properties. Open to criticism that concession was wasted; some unit rents were limited by local market, rather than by owner choice. Lower rates. Could be particularly effective for properties in gentrifying areas	Discontinued Minnesota 4d for pledged units.	
<b>DEEP DIVE: 4d Property Tax</b> For Deep Dive, see page 67.	Address burden of property taxes, the most-frequently mentioned operating cost, while capturing part of the relief delivered by lowering taxes to maintain affordable rents, or achieve other goals.	Cities or counties could trigger eligibility by providing minimal financial assistance while requiring locally-determined rent and income restrictions. No legislative change required. Potential to be more flexible and targeted. MHFA would have to certify properties, which is minimal burden.		
<b>DEEP DIVE: Alternative Qualification Method</b> For Deep Dive, see page 67.	The Project Team likes this intervention because currently very few tools exist for moderating rents in gentrifying areas. This can be used flexibly to achieve either preservation, additional affordability, or better matching.			
<b>Tax-Related Incentives</b>	"Dual Market" property tax	Alleviate costs of rising property taxes for long-time property owners in areas that are undergoing gentrification. Look for affordability in return.	Advocates for a two-tiered property tax assessment methodology that recognizes legacy property owners and preserves their ability to retain ownership while keeping rents low. Limits taxable value and assists these legacy owners in applying for the lower rates. Could be particularly effective for properties in gentrifying areas	WestTownUnited Coalition—Chicago
	Property tax increment holiday/abatement	Reduce upward pressure on rents through property tax reductions/caps. Look for affordability commitment in return.	Property tax break or freeze in priority areas in exchange for specific affordability commitments, or change of owners. Each taxing entity has to agree to abatement. Purpose must qualify under public interest test. Possible alternative to local 4d. Could be particularly effective for deteriorating properties or under problem ownership, or those adjacent to transit or in gentrifying areas	Minn. Stat. 469.1813; Granite Falls, NYJ51 Tax Abatement program, Seattle Multi Family Tax Exemptions Program
	Grant income tax offset	Maximize value of grants received by minimizing associated tax liability, so that the value goes to affordability or other stated purpose of grant	If real estate is owned by C corps grants can be structured as contributions and avoid tax. Not a very common scenario to try to address	
	Capital gains or transfer tax relief	Encourage transfer of ownership to nonprofit entities.	Relief, reimbursement or credit for taxes typically incurred upon sale. Could be focused on properties with aging owners and/or problem owners.	
	Renter's tax credit	Increase participation in Minnesota renter's credit, which effectively lowers rents paid on annual basis.	Collect data regarding participation rates in renters credit. If participation is low, determine whether creating a direct subsidy to renters by the property owner is worthwhile. If participation is moderate to high, do nothing. Potential exists to gather data on renters through rent credit filings, which could have broader applications.	

Attachment D continued on next page

Financing Unsubsidized Rental: Scan of the Minnesota Market

🔍 Deep Dive ★ Team Favorites

1. Financial/Ownership Interventions				
	Intervention	Impact Potential	Discussion	Program Examples, Source and/or Resources
Alternative Ownership/ Tenure	Property tax exemption (501c3 + private subsidy)	Facilitate transfer to entities that can reduce operating expenses (and rents) because of tax-exempt status.	501(c)3 non-profits that also qualify as institutions of public charities or HRAs could acquire properties and keep affordable because tax exempt status reduces operating costs.	Minn. Stat. 272.02 Subd. 7 and 39; Minn. Stat. 272.026; State of Florida
	TOD REIT	Acquire parcels along transit without requiring entirely new capital by using existing equity of current property owners. May aid in public acquisition without heating up market.	Overcome exit taxation issues and self-management fatigue by allowing property owners to exchange property into a REIT. Include measure of affordability.	
	Housing Partnership Equity Trust (HPET)	Assist nonprofit organizations in acquiring unsubsidized rental housing, or other properties that require equity by creating jointly managed equity pool.	This effort has been launched but no local members are participating due to competing priorities for financial and staff resources. Encourage a local HPN member to become HPET contributor/eligible for acquisition.	
	🔍 DEEP DIVE: Clearinghouse for Mission-Oriented Acquisition For Deep Dive, see page 74.	Ensure that mission-driven owners have best opportunity to acquire unsubsidized rental housing being disposed of by profit-motivated owners. Increase in mission-oriented owners is thought to be protection against rent increases, with or without formal restrictions.	Facilitate sale from willing profit-motivated owners to mission-oriented owners through a broker or a posting board for advanced notices. Encourage proactive monitoring of opportunities while potentially saving transaction costs by eliminating real estate agents. Big non-profits may already have this access. Determined unnecessary in Minnesota.	Community Investment Corporation (CIC) in Chicago maintains a posting board.
	Dedicate tax forfeiture properties to affordable purposes	Capture appropriate tax forfeited properties for uses as unsubsidized affordable for rental, rather than return to ownership.	As the county obtains tax forfeited properties, dedicate them for affordable housing. Last estimates are that 255 properties were forfeited in 2012, though many of these may be vacant, substandard or commercial.	Hennepin County transfers to the City of Minneapolis
	Aggregating small REOs	Provide a portfolio of scattered-site properties for non-profit or mission-minded entities to purchase for the maintenance of affordable housing units.	Concerns about scale, where portfolios exist, management of scattered site rental, but also reintroduction into ownership and market implications. Effective for small-scale properties (<20 units)	HPN RETURN effort, Silver Bay/ Two Harbors and other entities nationally.
	Land trust	Preserve affordability for a longer period by placing in trust.	Land trust could acquire and retain the land with restrictions and convey the building, in order to extend the restrictions that would normally be limited to 20-30 years in perpetuity. Resources to acquire likely to be prohibitive.	Twin Cities Community Land Bank, Albuquerque Sawmill Community Land Trust, others, but usually for owner-occupants
	Recapitalizing Manufactured Homes	Capture currently unoccupied homes and pads for manufactured homes which represent a very affordable housing opportunity.	According to Metropolitan Council there are 542 vacant homes and 1,423 vacant pads in MN. A mission-motivated owner could purchase manufactured homes (perhaps using special fund), and rent at very affordable rates.	NCF limited rental of FEMA homes in cooperatively-owned parks.

Attachment D continued on next page

Financing Unsubsidized Rental: Scan of the Minnesota Market

🔍 Deep Dive ★ Team Favorites

1. Financial/Ownership Interventions				
Intervention	Impact Potential	Discussion	Program Examples, Source and/or Resources	
Loan Funds/ Pools	Emergency response fund	Aid landlords in bearing the cost burdens for addressing emergency maintenance repairs required to keep properties in good living condition which would improve living conditions for tenants and neighbors.	Help owners address plumbing, HVAC and other basic emergency needs in exchange for income and/or rent restrictions. Could be made available to owners participating in owner education classes, city programs, etc. Best targeted towards small-scale properties (<20 units), deteriorating properties, or those in gentrifying areas.	CIC offers training and has loan funds, complemented by the Preservation Compact that connects owner in Cook County with programs, services and TA that can assist smaller owners.
	Non-emergency rental rehab loans	Alleviate cost burdens for landlords to perform necessary preventative rehabilitation and maintenance to keep properties in good condition and avoid emergency capital expenditures.	Make low cost loans available to owners who are willing to make some commitment to affordability.	City of Brooklyn Park; T.C. Interagency Stabilization Group (ISG)
	Weatherization/energy efficiency loans/grants	Enable property owners to save money on utility costs by retrofitting properties with energy efficient windows, appliances, etc.	Low-cost forgivable loans/recoverable grants to owners interested in making energy-efficiency upgrades that might also improve marketability. Use metering to help determining savings, split savings back between owners and renters. Primarily focused on deteriorating properties. Utility payee is key factor.	Deutsche Bank Foundation, City of Oakdale
	Façade and good neighbor loans	Encourage property investments that promote curb appeal and increase neighborhood stabilization and property values.	Provide a deferred loan for exterior improvements (façade or landscaping) to stabilize neighborhoods and increase curb appeal to reduce the negative impact of worn, out of date properties. Targeted towards small scale, self-managed properties that are deteriorating and/or aging.	
	Property Assessed Clean Energy (PACE) program	Increase financing availability/options. Create (Utilize) a new funding source for energy efficiency improvements.	Use tax assessment to repay public finance of energy improvements. City bonds for the program could be issued by development or area.	Similar to the single family PACE legislation. GMHF may consider lending in this space in the future.
	Small building pilot for FHA insurance	Increase financing availability/options. Make low-cost debt available to properties that are typically too small to qualify for FHA insurance.	Monitor HUD creation of small building pilot and encourage lender(s) to adopt this lending space. Targeted to small scale properties (<49 units).	National HUD / FHA pilot proposed, but not yet launched.
	Rent guaranty program	Alleviate property owners' concerns about their ability to collect rent from low income tenants by providing a guarantee of rental payments for owners willing to designate affordable units. This would help match low income people to existing affordable units.	Guaranty the owner timely payment in the event of non-payment by "certified tenant". This payment should flow directly to property owner in the event of non-payment. Long term repayment from the tenant when possible.	HUD's Section 8 program used with supportive housing services.
	🔍★ DEEP DIVE: 2nd Mortgage or Participation Loan Product For Deep Dive, see page 62.	<p>★ The Project Team likes this intervention because it leverages and extends use of private sector debt, is not a subsidy, but rather a return-producing investment, and requires property owners to participate financially.</p> <p>Increase the availability of private sector debt for acquisition, rehab, refinance of priority projects and in exchange for rent concessions.</p>	Create a program where approved lenders can originate and underwrite loans with public or philanthropic resources acting as first loss. This could help address credit access, LTV and tenor issues.	Former City of St. Paul commercial loan program and the SBA Certified Development Company/504 Loan Program.

Attachment D continued on next page



Financing Unsubsidized Rental: Scan of the Minnesota Market

🔍 Deep Dive ★ Team Favorites

1. Financial/Ownership Interventions

Intervention	Impact Potential	Discussion	Program Examples, Source and/or Resources
Note purchase mechanism	Increase the stock of affordable rental housing by capturing non-owner occupied units or non-re-performing notes for use as rental.	Particularly for single units in previous condo conversions where owners are underwater or otherwise unable to sell. Would require a scattered site management scheme to support the effort.	Mortgage Resolution Fund (MRF) in Illinois; Boston Community Capital-SUN Initiative; NJ Community Capital in HUD's Distressed Asset Stabilization Program—rental is new.
TIF fund	Create new source of flexible, light subsidy.	Create special TIF program provision to gather increment on new high-end rental units, proceeds used to fund affordability in other units. Would require legislative change.	Richfield, HPP recommendation to City of Minneapolis
🔍 DEEP DIVE: Low Floater Bonds For Deep Dive, see page 71.	Increase the use of this non-competitive financing resource that can be a low cost source of capital. Ensure that savings is accrued to the benefit of tenant (in lower rents) or property (in improvements). Regulatory changes have limited its effectiveness/attractiveness	Funding source for sophisticated existing owners and new non-profit owners, properties with long-term operating histories. Targeted towards large-scale properties with professional owners. Not viable in market currently, but could come back as market changes.	Numerous in Minneapolis and St. Paul
Light Rail Transit rent voucher	Soften the blow of displacement caused by transit development	Voucher for residents that get displaced by LRT development. Fund new voucher program that pays a portion of market rent on behalf of qualifying tenant that has been priced out of location by LRT. Would have to be carefully formulated to limit use or prove cause.	

Loan Funds/Pools (continued)

Attachment D continued on next page

Financing Unsubsidized Rental: Scan of the Minnesota Market

🔍 Deep Dive ★ Team Favorites

1. Financial/Ownership Interventions

Intervention	Impact Potential	Discussion	Program Examples, Source and/or Resources
Light Rail Transit rent voucher	Soften the blow of displacement caused by transit development	Voucher for residents that get displaced by LRT development. Fund new voucher program that pays a portion of market rent on behalf of qualifying tenant that has been priced out of location by LRT. Would have to be carefully formulated to limit use or prove cause.	
★ Voucher or Rent Subsidy Program	Increase the affordability of units in high-rent, high-demand micro-markets in order to ensure access by select income groups.	Voucher (traveling with tenants) or project-based (for selected properties) could augment tenant payments to create affordable options in markets where employment is strong, but housing options limited. Potential incentive for cities to provide subsidies in order to meet Met Council affordable housing goals, leading to new housing investments and additional affordability. Would help to ensure matching of rent to income.	Eden Prairie is considering creating a program in existing housing and St. Louis Park approved a limited program which has not been used.
	★ The Project Team likes this intervention because it is a potentially cost-efficient and flexible method to create or retain affordable housing opportunities, particularly for markets where there is limited new production. Particularly attractive if it can be included in their Metropolitan Council affordable housing goals.		
Special population vouchers	Ensure that difficult to house populations continue to have access in the market, If not served by permanent supportive housing.	Fund voucher program that pays a portion of market rent on behalf of a qualifying tenant that is otherwise difficult to house/remain in housing.	Wilder's ROOF program, Hennepin County Social Services pilot with SAMA and others; MHFA's Bridges and Housing Trust Fund Rental Assistance programs; Arlington County, VA; Corporation for Supportive Housing.
Workforce housing voucher pilot	Close the gap between workforce income and rents available in job rich locations.	Create new pilot to supplement household ability to pay in areas of high employment growth, transit, affluent communities. Target households between 60- 100% of area median income. Could be focused on identified niches small scale properties (<20 units), those adjacent to transit or in gentrifying areas.	
Subsidies to dedicate existing units to lower income households	Address affordability mismatch (affordable units occupied by higher income tenants) by incentivizing landlords to dedicate affordable units to lower-income tenants rather than higher income applicants.	Upon turnover, reserve units for lower income people to keep units from migrating up market and serving bargain shoppers. Landlords could be incented to do this through local 4d eligibility for example.	Florida non-profit property tax exemption program

Demand-Side Subsidies

Attachment D continued on next page

Financing Unsubsidized Rental: Scan of the Minnesota Market

🔍 Deep Dive ★ Team Favorites

1. Financial/Ownership Interventions				
	Intervention	Impact Potential	Discussion	Program Examples, Source and/or Resources
Credit Enhancement	Permanent loan guarantees	Increase access to financing for responsible property owners who provide affordable housing in the market.	Provide select property owners guarantees that allow access to financing at low cost in exchange for split of savings to rent.	312 loan program, FHA programs
Operating Cost Reduction	Property management a la carte program	Alleviate management and administrative costs and burden for property owners who self-manage small portfolios.	Create or identify (and subsidize?) access to property management services to complement self-performed tasks like tenant screening, marketing / leasing and capital needs.	Tenant Access, Task Management Services
	★ Insurance Cost Reduction	★ The Project Team likes this intervention because many cities already require crime free certifications along with rental licensing. Connecting these could decrease operating costs and increase property safety, livability.		
		Pursue cost-savings on property insurance (one of the largest operating costs) for landlords who participate in programs that ensure high quality maintenance and management and reduce risk.	Work with insurance companies to determine if they might provide a rebate on insurance premiums to complexes that complete a certain level of Crime Free MF Certification, smoke-free environments (might require monitoring).	UHAB in NYC, Condo associations in Colorado with American Family Insurance

Attachment D continued on next page

**Financing Unsubsidized Rental: Scan of the Minnesota Market**

**2. Education/Capacity Building Interventions**

	<b>Intervention</b>	<b>Impact Potential</b>	<b>Discussion</b>	<b>Program Examples, Source and/or Resources</b>
<b>Education, Training and Certification Programs</b>	Customer service/satisfaction orientation training for management.	Encourage better landlord/tenant relationships to prolong tenancy, encourage lease renewal and reduce turnovers; thereby, abating the amount of turnover costs for a landlord, costly moves for renters.	Aid landlords in renter retention by offering training in a customer service model/approach.	UK Housing Associations
	Renter certification	Increase low-income renters' access to affordable units that might otherwise be rented to a higher-income household by increasing landlord confidence.	Target renters, with intent of making them more conscientious, and provide owners/managers with an indication that they have been educated. Could be coupled with rent guaranty, licensing rebates, etc.	Lutheran Social Services
	Inspections services	Streamline, standardize and possibly the inspection process between cities and other inspecting agencies to reduce the costs incurred by landlords having to respond to multiple inspections in a given year. Save public resources by not duplicating inspections.	Coordinate the provision of consistent inspections (one-stop) for cities, HRAs and other agencies that might conduct inspections. Would have to agree on standards, which is problematic.	Met Council and cities share inspections information, cities contracting for inspection services from private providers
	Property management mentorships	Encourage knowledge sharing between experienced property owners and new property owners to ensure better business practices among new owners.	Match property managers and owners for one-on-one advice. Best targeted towards small scale, self-managed properties.	Occurs informally through MHA and LSS
	General management training	Ensure quality property management and upkeep by providing basic training on good business practices for property managers/owners. Reduce costly turn-over.	Give self-managed property owners a thorough base of knowledge in property management. Focus on items that effect stability of occupancy and capital needs projections and budgeting.	MHA, LSS, Richfield, HOME Line; Chicago Investment Corp. (CIC)
<b>Property Inventory</b>	Rental housing inventory	Allow public actors to know the affordable housing in their communities and better position them to preserve a sufficient number of affordable housing units.	Create inventory/database tracking rent levels by city/neighborhood in order to track change, identify acquisition opportunities, identify gaps, and assess strategies. Acting on preservation opportunities would require additional resources.	Central Corridor, Richfield, Downtown Minneapolis (pending)

Attachment D continued on next page

Financing Unsubsidized Rental: Scan of the Minnesota Market

🔍 Deep Dive ★ Team Favorites

3. Policy/Regulatory Interventions				
	Intervention	Impact Potential	Discussion	Program Examples, Source and/or Resources
Regulatory Measures	Rent Control	Secure affordable rents for low-income renters who live in gentrifying neighborhoods.	Limit rent levels (and perhaps income levels) charged by private property owners. This has proven highly problematic in practical experience.	NYC, LA and Washington D.C.
	★ Licensing/Registration	Enforce maintenance of rental properties and increase landlord accountability to their communities.	Make sure that all cities are requiring licensing or registration for rental property. Could include crime prevention elements. Fine tune city enforcement procedures to avoid innocent tenant displacement.	Most cities in Metro area include crime prevention elements.
	★ Inspections	Prevent loss of affordable housing due to poor maintenance and property deterioration.	Make sure that all cities are requiring inspection every 2 years.	Most Metro area cities
	★ Compliance Incentives	Reduce fees for property owners who follow property rental regulations, codes and licensing; thereby encouraging better property management.	Offer incentives for licensing, fee reductions and others to landlords who participate.	Mounds View
	★ The Project Team likes these interventions, particularly when bundled together, and believes that demonstrating the value of such programs could increase political will and staff capacity for them. Educational efforts and regulatory measures already exist and could be easily linked together to encourage more participation on the part of landlords in these capacity-building programs, which seek to raise the quality of properties and management.			
Policy Initiatives	Right of First Refusal Policy	Capture unsubsidized affordable housing units upon sale from existing owner, so that they can be transferred to residents .	City or residents would have first option to purchase units to be removed.	Washington D.C. Ordinance; Minn. Stat—right of purchase, ROC USA—mobile home parks; Montgomery County Condo Program.
	★ Affordable Apartment Replacement Policy	★ The Project Team likes this intervention because they address the loss of currently unsubsidized rental housing, which results in fewer options for low- and moderate-income people and increased rents. Could potentially be combined with a right of first refusal.		
		Require new subsidized, scattered site or mixed income developments to replace any resulting loss of currently unsubsidized affordable rental housing.	Could also include payment in lieu of replacement. Would require a procedure whereby the potential loss of affordable housing due to a city or county-assisted development project would be reviewed in relation to the overall supply of affordable housing, and, where appropriate, the development of a replacement plan.	Brooklyn Park replacement policy, City of Minneapolis, San Francisco
	★ Metropolitan Council housing goals to recognize innovative practices	★ The Project Team likes this intervention because currently cities are reticent to spend money/staff time on efforts that will not be counted toward Metropolitan Council affordable housing goals. Allowing more flexibility would free cities to pursue/tailor a number of interventions that specifically address preserving and/or creating affordable housing opportunities according to local context/needs.		
Incentivize cities to expand housing opportunities, not just new unit production, by giving credit towards affordable housing goals.		In the context of a more nuanced system of counting and assessing housing goals, the Metropolitan Council could recognize and give cities credit toward affordable housing goals when they create new affordability through practices like subsidizing existing units, creating local 4d programs, or providing incentives for landlords to dedicate existing units to lower-income households. Would necessitate revisions to the current housing goals system.	Cambridge, MA Affordable Housing Trust	

## Attachment E: Alternatives to the Term, “Unsubsidized Affordable Rental Housing”

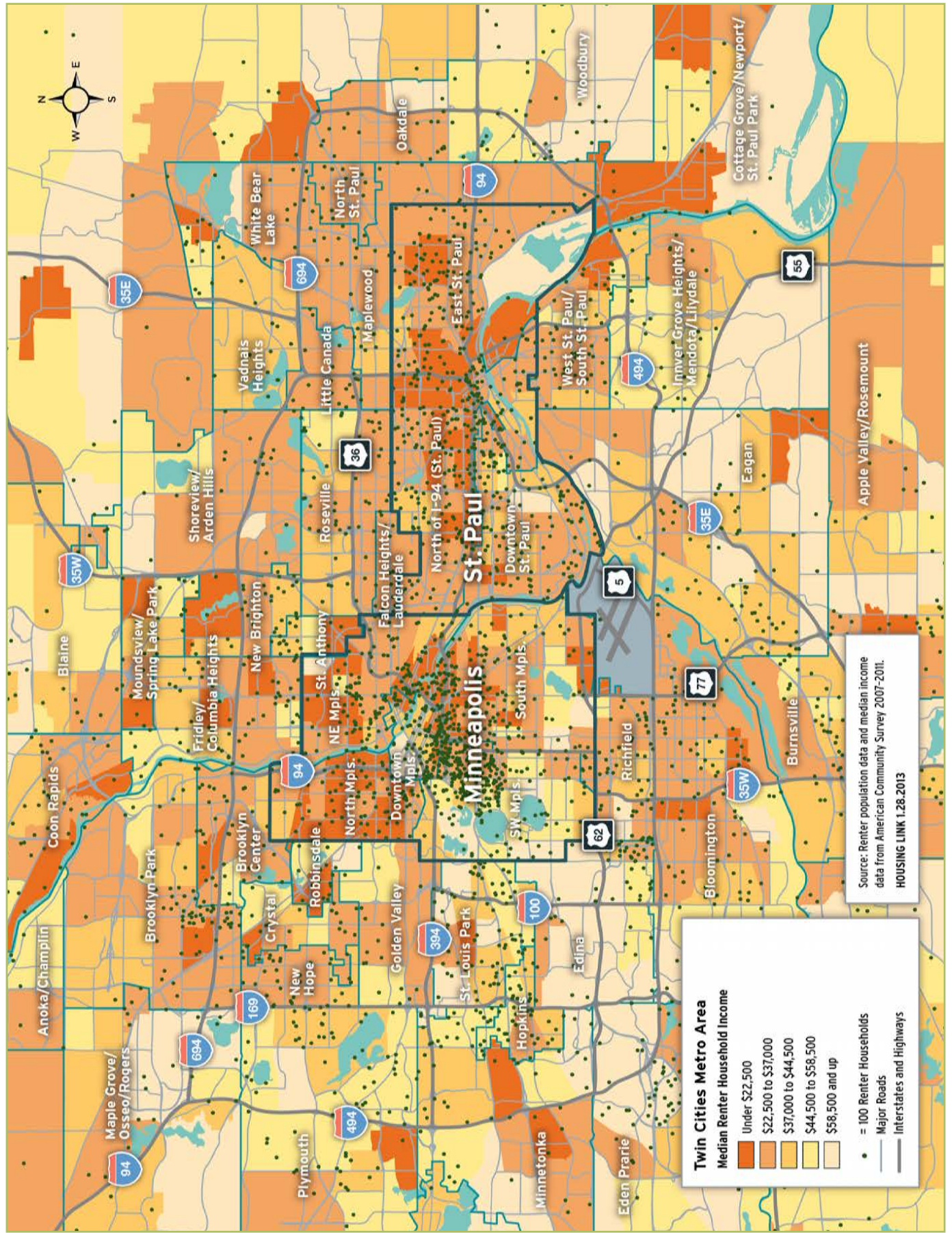
Our team searched for the best, clearest term for the subject of this work. The following is a summary of the terms suggested by interviewees, as well as some discussion of each.

### Alternative Names Matrix

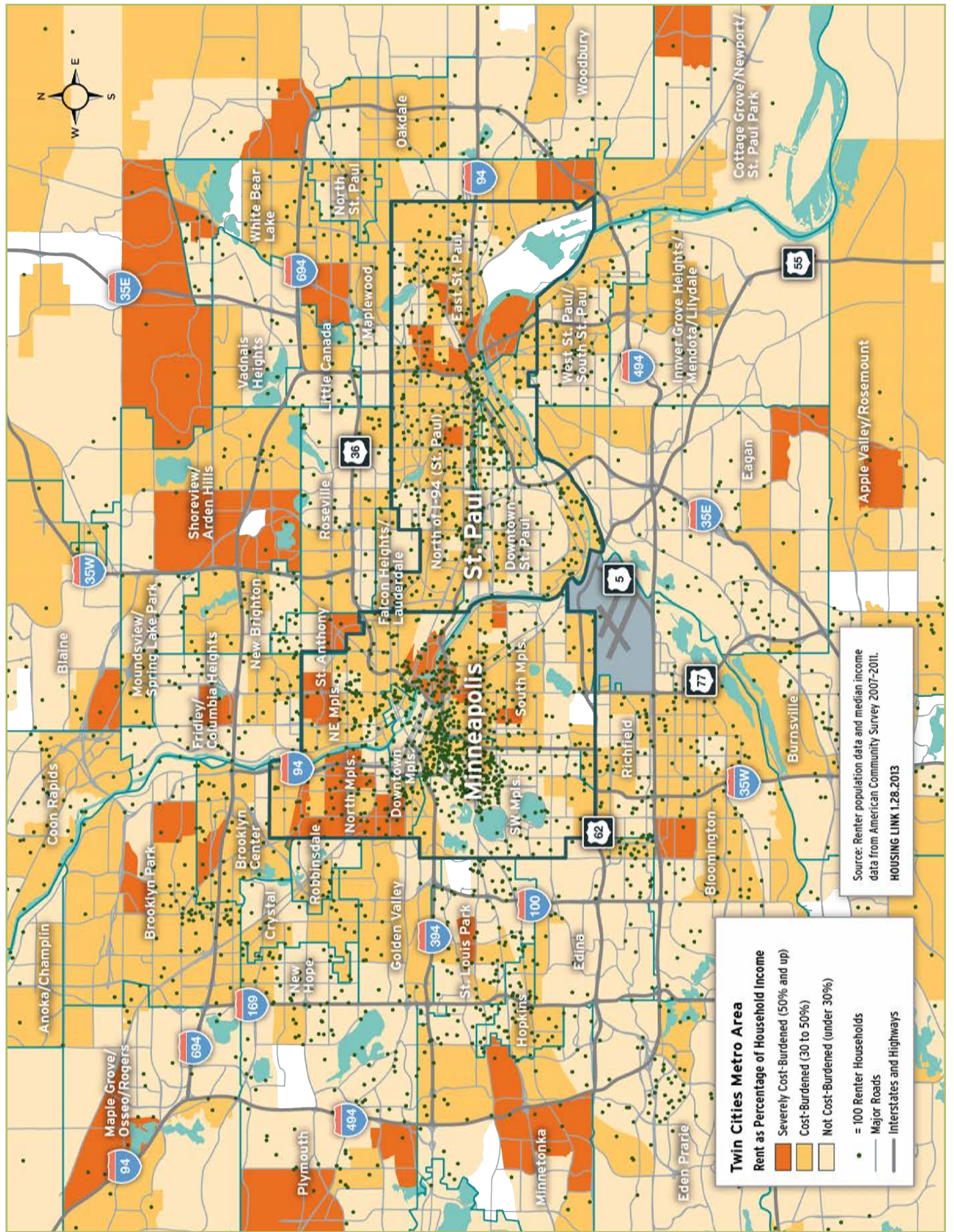
Potential Names	Comments from Team and Stakeholders
<b>Unassisted affordable rental housing</b>	Affordable threatens the “brand” that has been built over time that equates quality and consistency in management and physical product.
<b>Unregulated affordable housing</b>	Emphasizes government regulation and is politically charged. Affordable threatens the “brand” that has been built over time that equates quality and consistency in management and physical product.
<b>Unsubsidized moderate rent housing</b>	Moderate rent is a term that was used before deep capital subsidy programs became prevalent.
<b>Naturally-occurring rental housing (that is) affordable—NORHA</b>	Naturally implies that no effort is needed, that it takes care of itself. Affordable threatens the “brand” that has been built over time that equates quality and consistency in management and physical product.
<b>Naturally-occurring affordable rental</b>	Affordable threatens the “brand” that has been built over time that equates quality and consistency in management and physical product.
<b>De facto affordable rental</b>	Too many people do not know what the term “de facto” means. Affordable threatens the “brand” that has been built over time that equates quality and consistency in management and physical product.
<b>De facto low-cost rental housing</b>	Too many people do not know what the term “de facto” means.
<b>Low-cost rental housing</b>	This does not address quality at all, exclusive emphasis on price.
<b>Low cost/low rent housing</b>	This emphasizes price, not the appropriate distinction for the project; tends to imply low quality. “Low rent” is slang for lacking class.
<b>Market affordable rental housing</b>	Too contradictory by traditional housing / real estate definitions. Affordable threatens the “brand” that has been built over time that equates quality and consistency in management and physical product.
<b>Private low-cost stock</b>	Much of the subsidized affordable housing stock is also privately owned / managed; different from public housing.
<b>Sub-market rental housing</b>	This could be thought to mean sub-par.
<b>Down-market rental housing</b>	Term used in banking, financial services and particularly in developing world context for private sector foray into providing for low-income people, accessing those markets.

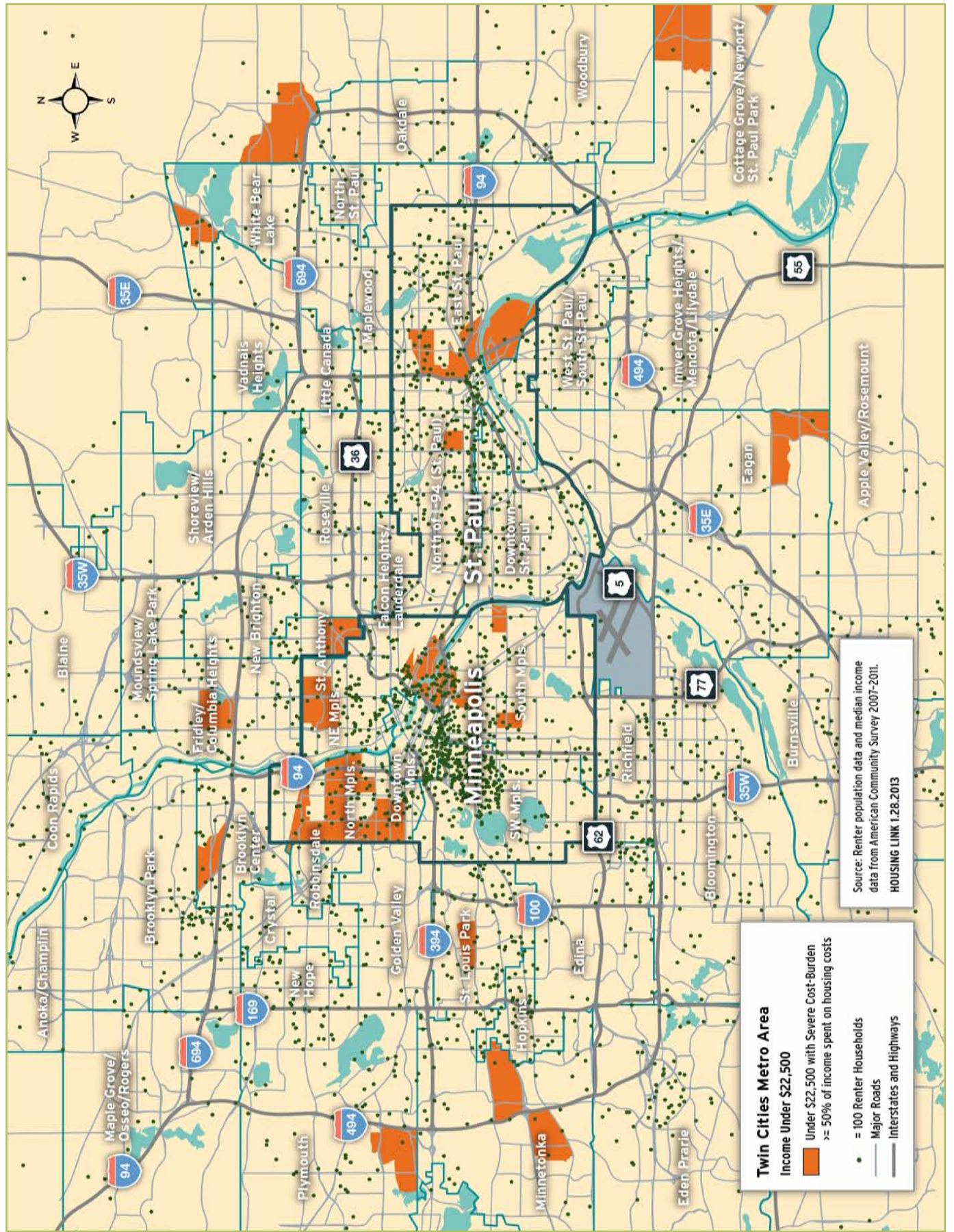


Attachment G: Twin Cities Metro Area Renter Income Map









Three Species of Affordable Rental Housing			
	Unsubsidized Affordable Rental Housing Description of Current State	Light-Touch Affordable Rental Housing Proposed Future State	Subsidized Rental Housing Description of Current State
<b>Description</b>	Already existing and naturally-occurring affordability in privately-owned housing which contributes to a healthy, diverse housing market and promotes choice.	Previously unsubsidized affordable housing that, through light touch interventions, could create new opportunities or more public benefit.	The creation of new affordable housing units that are a product of deep subsidy programs usually federally defined but may be locally administered.
Rent levels generally considered affordable	< 30% of HH income for purposes of counting stock, up to 50% by landlords	< 30% of HH income	< 30% of HH income
Possible alternative rent affordability standards	~ 45% of HH income when combined with transportation	~ 45% of HH income when combined with transportation	No flexibility in federal programs
Income levels	Not officially defined, but most often < 60% of AMI when counting stock.	< 80% of AMI (with strong recommendation to < 60% when possible)	Dictated by funding program, at most < 60% of AMI, often 50%
Minimum % of units in project to trigger funding	None	Could be at local authority discretion	20% of total units for HH income levels @ 50% of AMI; or 40% of total units for HH income levels @ 60% of AMI
Compliance regime	None	Simple, self-reporting or certification compliance; consider income compliance for initial induction and perhaps on an annual basis, but commensurate with incentive level	Initial and annual income and rent certification (next available unit rules)
Minimum compliance period	None	Recommend 5-7 years, commensurate with depth of incentive and compliance mechanism	30 year minimum
Physical Quality Control	Minimum quality control of life, health, and safety standards as enforced by local jurisdiction through code compliance regimes.		Deep capital subsidy with deed restriction
Subsidy/incentive approach	None	Flexible interventions with minimal subsidies could be selected according to the local needs/situation	Rigid and established programs that are universally applied
		Various options: cost savings, financial products, or demand side programs without deed restrictions	Deep capital subsidy with deed restriction
		Intervention aimed at achieving new opportunities for a defined public benefit of affordability	Intervention aimed at "new" unit production (construction or preservation)
Relationship to market	Rents primarily a function of local market dynamics.	Could be selected relative to micro-market needs/situation	Generally defined a metro-area basis, micro-market affordability rarely used
Entre	None	Units are already in place, so no additional community consents necessary.	New production requires local community consent, sometimes means projects add enhancements to win community approval, thereby inflating costs
Owner/decision making	Real estate investors (for-or nonprofit) make decisions based on real estate economics and work towards increasing property cash flow or appreciation.	Real estate investors who make decisions based on real estate economics could be influenced by the public/philanthropic sector incentives	For or non-profits with specialized business lines formed around subsidy programs, cash flow and appreciate share limited
Authority	None	Defined by funding organization willing to intervene	State, local credit and funding allocators

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