# Neighborhood Reinvestment Corporation
# Mixed Income Symposium, April 4, 2002
# Issue Paper: Mixed Income Housing
# To Serve Households Below 30% of AMI

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1. **Overview.** The purpose of this paper is to frame the range of issues to be considered in the symposium.

1.1. **Definition.** The properties to be considered in the symposium include a significant number of units for families with children, with household incomes below 30% of area median (sometimes also referred to as "extremely low-income" or ELI households). These properties also include a significant number of families with incomes well above 30% of area median, and paying rent at or modestly below market levels[1]. "Family" properties are the primary area of interest for the symposium, including properties serving some seniors[2] and/or some households that include individuals with disabilities[3].

1.2. **General Caveats.** Symposium participants should keep in mind the following background conditions, limitations, and cautions, when discussing mixed-income approaches for serving ELI households:

1.2.1. **Mixed-Income Is One Approach.** The symposium seeks to explore ways to use mixed-income approaches to create housing opportunities for ELI households. However, it is not suggested that mixed-income approaches are the only way to pursue ELI housing opportunities.

1.2.2. **Sustainability.** Last year's symposium topic was sustainability – how to develop, finance and structure affordable rental housing so that it can meet its ongoing financial and physical needs without needing periodic injections of government subsidy. The mixed income approaches to be discussed in this year's symposium should be consistent with sustainability principles. See the concept paper on Sustainability, and the discussion of Sustainable Underwriting Principles[4] (attached).

1.2.3. **Neighborhoods.** Mixed income strategies need to be founded in a deep understanding of neighborhood dynamics, in both the short and long term. An approach that is ideal for one property may be counterproductive in an otherwise similar property that is located in a different neighborhood. We also need to

[1] To the extent the units are rent restricted (e.g., LIHTC), the rents will also be within the maximum rents permitted under the rent restriction.

[2] However, there are some potentially very interesting opportunities to create mixed-income all-elderly communities as well. These opportunities include §202 refinancing, and possibly refinancing of RHS §515 elderly properties.

[3] Arguably, an otherwise sound development approach will allow a property to succeed whether or not some residents are persons with disabilities.

[4] These papers, and other papers listed as references, were prepared by The Compass Group in its capacity as advisor to The Millennial Housing Commission. Readers should not, however, assume that the Commission's forthcoming recommendations will agree with these papers.

consider the "echo effects" of policy – policy drives funding, sponsors propose developments that meet the funding criteria, and the development are in place for a long period of time. If the policy is flawed (either in theory or in implementation), there can be adverse long-term effects on neighborhoods. Conversely, if the policy and implementation are thoughtful and flexible, the long-term neighborhood effects can be very positive.

1.2.4. **Housing Opportunities.** The symposium is intended to explore mixed-income strategies to increase housing opportunities for ELI households. To the extent that existing properties, serving predominantly ELI households, are converted to mixed-income resident profiles, additional housing would need to be created so that there is no net loss of ELI housing opportunities.

1.2.5. **Complexity.** Although it is tempting to believe that we know "the formula" for successful mixed-income affordable rental housing, experience thus far suggests that:

1.2.5.1. A number of factors influence success.

1.2.5.2. The relative importance of each factor varies from property to property.

1.2.5.3. Success results from several good choices pursued diligently and in combination, rather than from a single "magic bullet."

1.3. **Reference.** See the concept paper on Mixed Income Rental Housing (attached). Some of the conclusions of this paper are summarized here, but it is recommended that symposium participants read the concept paper itself.

1.4. **Outline.** This paper covers the following major topics:

1.4.1. **Background.** Why are mixed-income approaches so widely supported? What works, what doesn't work, and why? See section 2.

1.4.2. **Economics and Demographics.** How much subsidy does it take, to make newly constructed garden apartments affordable, consistent with sustainability principles? What do Census and American Housing Survey data tell us about low-income renter households? See section 3.

1.4.3. **Range of Incomes.** What are the rules of thumb for designing a successful mix of incomes? Do those rules of thumb vary depending on how broad a mix is attempted? See section 4.

1.4.4. **Approaches.** Which approaches and strategies hold promise for creating and sustaining mixed-income communities? See section 5.

1.4.5. **Issues.** Which issues, in particular, should the symposium attempt to define and discuss? See section 6.

2. **Background.** For "family" properties, most affordable housing professionals support the increased use of mixed-income approaches. The following is a brief discussion of why mixed-income approaches have widespread support.

2.1. **Benefits of mixed income communities.** These include:

2.1.1. **Market Discipline.** In order to attract households paying rents close to (or at) market, the property must meet market standards. This, in turn, makes the property more likely to fit into the neighborhood, and more likely to be successful over the long term.

2.1.2. **Financial Viability.** Having some rents close to (or at) market implies a lower operating cost ratio, hence lower exposure to operating cost increases that outstrip increases in income.

2.1.3. **Avoid Concentrations of Poverty.** Mixed-income properties avoid the various well-documented problems that plague many concentrated-poverty properties.

2.1.4. **Social/Cultural Access (or Role-Modeling) Benefits.** There is a general expectation that, in mixed-income communities, interaction between higher- and lower-income residents, particularly for children, can lead to work-positive and marriage-positive outcomes for lower-income residents. However, the limited evidence so far suggests that interaction with higher-income residents typically does not occur, even with vigorous management. However, a significantly enhanced property management approach can achieve high levels of interaction between management staff and lower-income residents, and there is some evidence of social / cultural access benefits in these situations.

2.1.5. **Political Benefits.** There is general agreement that mixed-income communities are less likely to attract local political opposition and more likely to command favorable political attention when residents and/or the owner need assistance from local government.

2.2. **Rules of Thumb.** The following is a brief summary of the working principles that leading practitioners believe are appropriate for mixed-income affordable rental housing.

2.2.1. **Location Matters.** Most successful mixed-income properties are located in low-poverty areas[5].

2.2.2. **Gateway Cities Matter.** The Khadduri and Martin study cited in the Mixed Income Concept Paper found that being located in one of the eight 'immigrant gateway' cities[6] made a property more likely to be mixed income. That is, recent immigrants appear to be relatively more likely than non-immigrants to accept mixed-income communities.

2.2.3. **Management Matters.** There is widespread agreement that high quality, intensive property management is an essential feature of successful mixed-income properties.

2.2.3.1. **Service Strategies.** One important component of the management approach is the extent to which non-housing services are incorporated into the property's day-to-day operations. There is some evidence that additional service support enhances property viability.

[5] A variety of measurements have been used. Perhaps the most widely used is percentage of households with incomes below the poverty line.
[6] Los Angeles, Anaheim, San Francisco, New York, Washington, Miami, Chicago, and Houston.

2.2.4. **Market vs. Below-Market Matters.** If the higher-income units are priced at full market rents (or nearly full market rents), success is more difficult to attain and sustain than if the higher-income units are priced well below full market rents. The 'bargain element' (whether created by use agreements, management practice, or 'ceiling rents') helps to attract and retain the higher-income residents.

2.2.5. **Amount of Income Difference Matters.** The Brophy and Smith study cited in the Mixed Income Concept Paper found that properties with wider income mixes were more likely to suffer social tensions.

2.2.6. **Percentage Mix Matters.** There is some evidence that, as the percentage of ELI households grows, properties are less likely to remain stable. This corresponds to a "healthy village" concept – a community with a modest number of needy members is likely to be healthy, as opposed to a community with a disproportionately large number of needy members.

2.2.7. **Role Modeling Benefits are Elusive.** There is relatively little evidence that lower-income children actually receive role-modeling benefits, except from management staff and only then when management is unusually active.

2.2.8. **Active vs. Passive Marketing.** Markets, and properties, demand differing approaches. In some situations, the property's mixed-income status is a feature worth advertising; in other situations, aggressive promotion of the property's mixed-income status can be counterproductive.

2.2.9. **Same Quality Levels.** There is general agreement that the lower income and higher income units should have the same general quality level, but not necessarily exactly the same design or features.

2.2.10. **Schools Matter.** A property's ability to retain higher-income families with children appears to depend heavily on the quality of the local public schools. This also has implications for management and service strategies – in all likelihood, properties that sponsor activities designed to improve educational outcomes for children are more likely to succeed in retaining higher-income families with children.

2.2.11. **Work Matters.** As the demographics section shows, roughly half of non-elderly ELI households derive most of their income from employment. As discussed in more detail in the range of incomes section, experienced managers believe that it is easier to sustain a mixed-income profile if the lower-income residents are working families. Further, a working ELI household is much more likely than a non-working household to be able to increase its income and thereby broaden the property's income mix. Similarly, a mixed income property that is located near entry-level jobs is more likely to succeed than an otherwise similar property located farther from employment opportunities.

3. **Economics and Demographics.** Concerning economics, in general, in order to be affordable to ELI households, rental units need either §8 (or other rental assistance), virtually 100% capital subsidy (so that there is no debt service expense for the ELI units), or a combination (for example, capital subsidy sufficient to bring rents down to a level

eligible for §8). Concerning demographics, in general, ELI renter households account for 22% of all renters, are extremely likely to have high housing cost burdens, are more likely to be elderly than other renters, are less likely to have significant employment income than other renters, and are more likely to have children than other renters.

3.1. **Economics.** In order to produce affordability for lower-income households, significant amounts of subsidy are required. In general, approaches that subsidize the cost of acquisition / rehab / development can reduce rents only so far; also in general, that minimum feasible rent level – while much lower than most ELI households actually pay for housing[7] – represents a relatively high proportion of the incomes of ELI households.

3.2. **Cost of Mixed-Income Approaches.** It is certainly true that, all else equal, it costs more to produce a unit that is affordable to an ELI household as opposed to an otherwise similar household but with higher income. A more interesting question is whether, all else equal, it costs more to house an ELI household in a mixed-income community as opposed to a concentrated-poverty community. Symposium participants should come prepared to discuss this (see the Issues section below). However, arguably a mixed-income approach should not involve materially higher costs:

3.2.1. **Reasons Why Mixed-Income Approaches May Not Be More Costly.** It is true that a concentrated-poverty property could survive, at least in the short term, with a slightly lower-cost site, slightly lower-cost design, and slightly lower-cost maintenance than would be required for success in a mixed-income property. However, experience with concentrated-poverty properties suggests strongly that these short-term savings are very likely to lead to longer-term additional costs. Accordingly, it may well be that a mixed-income approach does not imply materially higher costs, particularly when costs are measured on a life-cycle basis, and when one takes into account the costs needed to make a concentrated-poverty property successful and viable over the long term.

3.2.2. **New Construction / Substantial Rehabilitation.** See the attached Financial Analysis Summary, illustrating the levels of capital subsidy (such as LIHTC and HOME) needed to make newly constructed garden apartments affordable to households at varying income levels. Similar results should be expected for substantial rehabilitation. This analysis suggests, in general, the following conclusions:

3.2.2.1. **Rent Floor for Feasibility.** Below a given rent level (roughly $350 to $500 for most of the areas analyzed), there is a high risk that increases in rents will fail to keep pace with increases in operating costs[8]. Accordingly, properties are not long-term sustainable at rents below this level, even with no debt service costs.

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[7] The median housing cost burden for renter households below 30% AMI is in excess of 70%, according to a tabulation of American Housing Survey data by Cushing Dolbeare.

[8] Expert underwriters agree that rents should be projected to grow at a lower "trending rate" than expenses. If the expense ratio (expenses: rental income) is too high, the property is likely to suffer decreases in Net Operating Income because expenses are growing faster than income. Thus, to be sustainable, properties need a healthy margin between rental income and expenses.

3.2.2.2. **Limits of Capital Subsidy.** Accordingly, capital subsidies can bring rents down only to this rent floor, and no further. To reduce rents further requires rental assistance, internal cross subsidy, or both.

3.2.2.3. **Affordability at 30% AMI.** For most of the areas analyzed, the rent floor for feasibility implies a housing cost (rent plus utilities) burden of 36% to 44% of the income of a household at 30% AMI. The cost burden for a household at, say, 25% AMI would be correspondingly higher. That said, the availability of a large stock of such housing, reserved for ELI households under appropriate long-term use agreements, would represent an immense improvement in housing opportunities for ELI families who must now compete with higher-income households for a very limited stock of lower cost housing.

3.2.3. **Acquisition / Light Rehab.** If the property can be acquired well below replacement cost, a given amount of capital subsidy can produce much lower rents than in a new construction / substantial rehabilitation property. There will still be a rent floor for feasibility, however, roughly at the same level indicated for the new construction analysis.

3.2.4. **Rental Assistance.** Regardless of the level of rent needed to produce a sustainable development, affordability for ELI households can be produced by simply paying the difference between what they can afford, and the rent for the unit. This can be accomplished through Section 8 (project based or tenant based), the Rural Housing Service's Rental Assistance Program[9], or through HOME tenant based rental assistance. The cost of the rental assistance will depend on the income level for the target resident profile, the sustainable rents for the property, and the level of affordability (housing cost burden, minimum rents, ceiling rents, …).

3.2.5. **Internal Cross Subsidy.** The portion of rent paid by higher-income households that is not needed to cover the cost of operations can be used to provide subsidy for lower-income households. Unless the market-rate units are themselves subsidized, this "internal cross subsidy" approach is of limited usefulness[10].

3.3. **Demographics.** The following highlights important dimensions of the data on ELI renter households[11], as further illustrated in seven attached charts and tables:

3.3.1. Number of households. There ware 7.4 million ELI renter households in 1999 (see the attached chart "Number of Renters By % AMI (millions)"). ELI renters form 22% of all renter households (see "Distribution of Renters By % AMI").

[9] However, in recent years there has been little or no incremental Rental Assistance available.

[10] As a matter of real estate economics, market rents generally never exceed the level at which unsubsidized new construction is marginally feasible. As a result, it is almost always true that every penny of market rent is needed to cover the various costs of operation – vacancy and bad debt loss, operating expenses, reserves, debt service, and return on equity capital. Therefore, unless the market-rate units receive capital subsidy, there is no potential for internal cross subsidy until and unless the property's cash flow expands beyond the level required for the property's sustainability.

[11] All data are from special tabulations of the 1999 American Housing Survey. Tabulations were prepared by Cushing Dolbeare and are available by email from the author at cwilkins@compassgroup.net

3.3.2. Housing cost burden. Most ELI households have severe housing cost burdens. Most renters who have severe housing cost burdens are ELI renters.

3.3.2.1. See "Renter Housing Cost Burden, By % AMI." ELI renters form the great bulk of renters with housing cost burdens above 50% of income. Even in the highest-income decile of ELI renters (those with incomes between 20% and 30% of AMI), nearly 50% of households have housing cost burdens above 50%.

3.3.2.2. The attached table "Renter Households, Housing Cost Burden by % AMI" shows the fraction of renter households having various combinations of income and housing cost burden. Nearly 70% of ELI renters had housing cost burdens above 50%. Only 15.5% of ELI renters had housing cost burdens below 30%. By contrast, renters with incomes in the 50%-80% AMI range were much more likely (61.5%) to have cost burdens below 30% and much less likely (5.3%) to have cost burdens above 50%.

3.3.3. Elderly. See "Renter Households, % Elderly[12], By % AMI." Elderly renters in general have lower incomes than non-elderly renters. Thus, many ELI renters are elderly. Some 23% of ELI renters are elderly; by comparison, only 5% of renters with incomes between 80% and 120% of AMI are elderly.

3.3.4. Working / not working. See "Non-Elderly Renters With Significant Employment Income[13], By % AMI." Virtually all renters with incomes above the ELI range have significant employment income. However, many ELI households also have significant employment income (67% of those in the 20%-30% AMI range, and 28% of those in the 10%-20% AMI range).

3.3.5. With children and without. See "Non-Elderly Renter Households By Number of Children and % AMI." Non-elderly ELI renter households are more likely to include children (just over 50% of such households include children, vs. roughly one-third of renter households in the 80%-120% AMI range). Moreover, renter households with three or more children are clustered at the low end of the household income range.

## 4. Range of Incomes.

### 4.1. Percentage of ELI Households.

4.1.1. **Conventional wisdom.** Many affordable housing experts believe that a mix including up to 20% ELI elderly households is almost always feasible. There is general consensus that a mix including non-working ELI family households is more risky. Many experts believe that up to 20% non-working family ELI households is feasible with good management, and that higher percentages may or may not be feasible.

4.1.2. **Non-working vs. working ELI households.** Most experts believe that if families already have a "culture of work", a more deeply targeted mix of

[12] For purposes of this analysis, "elderly" means that the householder was age 65 or older.
[13] For purposes of this analysis, "significant employment income" means that the household's employment income equals at least 50% of a full time, minimum wage income.

incomes is potentially feasible. In this regard, see the Demographics section above, which shows that there are significant numbers of "working" vs. "non-working" ELI family households.

4.2. **Different Mixes.** According to conventional wisdom, sponsors should consider the following factors when planning a development with these mixes:

4.2.1. **"30 to 60" mix.** Some households below 30% AMI, with the remaining households meeting LIHTC requirements. In this mix, the conventional wisdom rule of thumb is the most frequently cited advice.

4.2.2. **"30 to 80" mix.** Some households below 30% AMI, with at least a significant number of the remaining households being typical market renters. There is some evidence that the presence of a middle band, say from 40% to 60% AMI, is very helpful and perhaps essential in achieving community stability and viability.

4.2.3. **"30 to 120" mix.** Some households below 30% AMI, with at least a significant number of the remaining households having incomes at or near the highest levels typical for renter households in the local market. Here, the evidence is stronger that a middle band is needed.

5. **Approaches.** A number of approaches hold out the potential for reaching households below 30% AMI. Some approaches minimize the rents required to make the property feasible. Others directly subsidize the lower-income households.

5.1. **Acquisition of Low Value (Regulated or Unregulated) Affordable Apartments.** Ability to serve a mixed income clientele is supported by the low acquisition cost, which in turn requires low amounts of debt, making the property feasible at relatively low rents. An example is the Peters Colony property (Suburban / Healthy Urban Situation Room).

5.2. **Subsidized Acquisition and Light Rehab.** Mixed income is supported by moderate acquisition cost plus capital grants (LIHTC, LIHTC plus HOME, …). This approach also involves low debt service costs, making the property feasible at relatively low rents.

5.3. **Subsidized New Construction / Substantial Rehab.** Mixed income is supported by capital grants. This approach requires a larger amount of capital grant per unit, to achieve the same level of affordability as the previous approach.

5.4. **§8 Vouchers (Project Based, "First Use", or Tenant Based).** Mixed income is supported by vouchers, plus (perhaps) capital grants to get rents down to the level reachable by vouchers. All units will rent at or modestly below market rents, and the units with vouchers will be occupied by extremely-low-income households who pay an affordable amount for rent and utilities (with the voucher paying the rest). Using a partial – Section – 8 "split subsidy" approach[14] seems particularly promising for achieving and sustaining a mixed income profile, as it avoids the potential for over-

[14] The term "split subsidy" indicates that some units may have capital subsidies (e.g., LIHTC) while those same units (or others) may have rental assistance (e.g. §8).

concentration of extremely low-income households while maintaining excellent affordability to ELI households.

5.4.1. **Project Based Vouchers.** One approach is to tie the vouchers to the ELI units.

5.4.2. **"First Use" Vouchers.** Another approach is to allocate a voucher to each unit, on the condition that the household move into the unit after completion of construction / rehab. Afterwards, households may relocate and keep the voucher.

5.4.3. **Tenant Based Vouchers.** Under this approach, the owner would work with the PHA, with an objective of housing some number of voucher holders who choose to live there.

5.5. **Internal Cross Subsidy.** A portion of the rents from high-income households can be used to reduce rents on low-income units. The Metropolitan (High Cost Situation Room) is an example. Rent increases since original development have allowed the property to serve a larger proportion of lower-income households than originally planned.

5.6. **Mixed-Income Retrofit of Market Properties.** A strategy rather than an approach (various mixed income approaches could be applied to such a property), this starts with a market-rate property and introduces a mixed-income component. The Peters Colony property (Suburban / Healthy Urban Situation Room) is an example.

5.7. **Mixed-Income Retrofit of Concentrated-Poverty Properties.** The counterpart to the previous strategy is to introduce a higher-income / close-to-market-rent component into a formerly concentrated-poverty property. Many HOPE VI redevelopments follow this paradigm[15].

5.8. **Scattered Sites.** By scattering small properties, reserved for and occupied by ELI households, in otherwise non-poverty neighborhoods, a mixed income profile can be achieved at the neighborhood level even though the properties themselves may be 100% ELI. There is a strong track record of success in rural areas in particular, with scattered duplexes and single-family rentals. This could include a mix of rental and homeownership units.

5.9. **Mixed Buildings.** ELI buildings could be alternated with market-rent buildings within the same property. There is some evidence, however, that this approach is likely to lead to the ELI buildings being stigmatized. This approach also more or less commits the property to a particular mix that may or may not be appropriate in the future. Property management professionals express concern that LIHTC rules drive many partial-LIHTC properties into this approach.

6. **Issues.** The symposium is intended to explore at least the following key issues:

[15] HOPE VI has been less successful in preserving the total number of ELI housing opportunities. Often, a HOPE VI development produces fewer total units than were demolished, with only a portion of the replacement units being targeted for ELI households. Supporters of HOPE VI argue that the value of removing a failed property and creating a successful one outweighs the loss of ELI housing opportunities. Also, typically many of the pre-HOPE-VI units typically were vacant, so that the actual loss of ELI opportunities is not as large as it may appear.

6.1. **Defining Success.** Should we expect the eventual mix of incomes to vary from the originally intended mix; if so, how much variation would be consistent with "success", and is the answer different depending on the direction of the variation? For how many years does a property need to demonstrate financial and physical viability to be considered "successful"? If residents are satisfied, is that good enough, or does there need to be a more robust sense of community than is usually present in a rental housing development?

6.2. **Choice of Approach.** Under what circumstances is each approach (see section 5 above) particularly appropriate? Under what circumstances should various approaches be avoided? What combinations of approaches may work particularly well? Are there combinations of approaches that should be avoided?

6.3. **Affordability.** The §8 and public housing programs use a formula based on adjusted household income, with a low (or zero) minimum rent and a high (or absent) ceiling rent.

6.3.1. **Alternative Affordability Formulas.** The §8 and public housing approach provides good affordability[16] but has been criticized for disincentivizing work[17] and marriage[18]. Symposium participants could consider whether other affordability formulas (e.g., flat rents, imposition of higher minimum rents, and/or imposition of meaningful ceiling rents at least modestly below market rents) would be more effective in achieving mixed-income objectives.

6.3.2. **Housing Cost Burdens Above 30%.** Under what circumstances might a sponsor consider serving households under 30% AMI with housing cost ratios above the 30% ratio used in the §8 and public housing programs?

6.3.2.1. **Consider Past Rental Performance.** One consideration is the household's past performance. Many ELI households have a consistent record of paying rent and utilities well above 30% of adjusted income. It would be reasonable to assume that such households could sustain similar housing costs in the future.

6.4. **Range of Income Mix.** What factors should sponsors consider when pursuing mixes of ELI households with lower-income households (at 40%-60% AMI), moderate income (low end market rate) households, and upper income (high end market rate) households?

6.5. **Upward Mobility.** What factors are most likely to lead to increased incomes for ELI residents? What factors are most likely to lead to the retention of former ELI households whose incomes have increased? Of higher income households whose

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[16] However, a flat percentage is a flawed approach, because other necessary expenses such as food require an increasing share of income as household income declines. Thus, a formula that decreased the percentage as income decreased would provide better affordability than the current §8 and public housing formulas.

[17] The 30% of income formula is equivalent to a 30% "work tax" on incremental income. When this "housing work tax" is added to payroll taxes and income taxes (not to mention phase-out of other means-tested benefits), the result can be a perverse situation in which the household may be better off not seeking additional employment income.

[18] If a single parent, living in §8 or public housing, is considering marriage, the rent formula creates a 30% "tax" against the income of the potential spouse. In practice, the phase-out of other means-tested benefits makes the effective "tax" rate even higher. This creates a powerful incentive for the couple to conceal their relationship from the government and from the landlord.

incomes increase further? After a property has achieved its mixed-income objective, to what extent should households with the highest incomes be encouraged or required to relocate, to make room for additional lower-income households?

6.6. **Sustainability.** Do mixed income properties raise particular sustainability issues? If so, what are they? Do sustainability principles apply differently to "30 to 60", "30 to 80" and "30 to 120" mixed income properties?

6.7. **Service Strategies.** Under what circumstances are non-housing services needed in mixed-income properties? To what extent are outcome-based service strategies appropriate, and how can they be developed and implemented?

6.8. **Community-Building Strategies.** To what extent should management promote social interaction between income groups, and what approaches are likely to be effective? To what extent will other community-building approaches be appropriate or necessary?

6.9. **Working vs. Non-Working Households.** Many families below 30% AMI receive some income from work. For some such families, work is the primary source of income. If the property serves a "working" vs. "non-working" profile in its below-30% residents, what implications would this have for management? For service strategies? For feasibility? For the percentage of ELI households that the property should seek to serve?

6.10. **Percentage of ELI Households.** Does the conventional wisdom need to be modified / sharpened / enhanced? If so, how?

6.10.1. **Example.** There is a rule of thumb that suggests that a mix of 20% non-working families represents a borderline of feasibility. Is this a reasonable rule of thumb? If not, how could that be demonstrated so as to change affordable housing development practice? If so, how should the rule of thumb be enhanced, to indicate situations where a different borderline would be indicated?

6.10.2. **Interaction Between Issues.** To what extent could rules of thumb be modified if the property utilized intensive service strategies, or community-building strategies? If the property utilized a broader than normal, or narrower than normal, income mix?

6.11. **Facilitating Mixed-Income Approaches.** What changes to existing programs (e.g., LIHTC, §8) would improve sponsors' ability to develop and finance sustainable mixed-income communities?

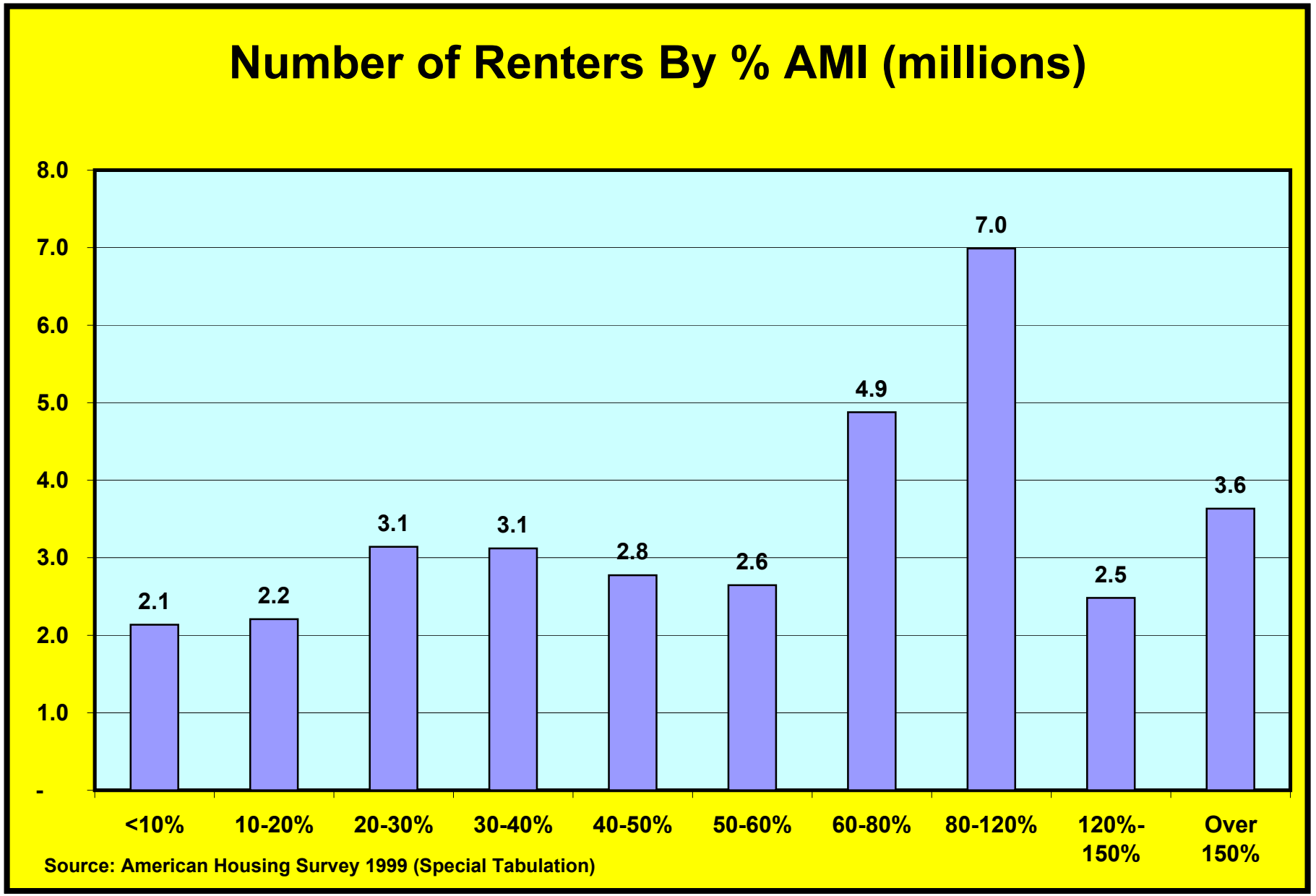
6.11.1. **Reduce or Eliminate Conflicts Between Programs.** In what ways might existing programs conflict with each other in potential mixed-income approaches? How could those conflicts be mitigated or eliminated? Conflicts could arise with respect to such program features as resident selection criteria (e.g., a program targeted to a particular population might conflict with another program requiring availability to the general public), income limits, income certification and recertification, treatment of over-income residents, and financial requirements (e.g., a program that prohibits junior financing or is not compatible with a long-term use agreement).

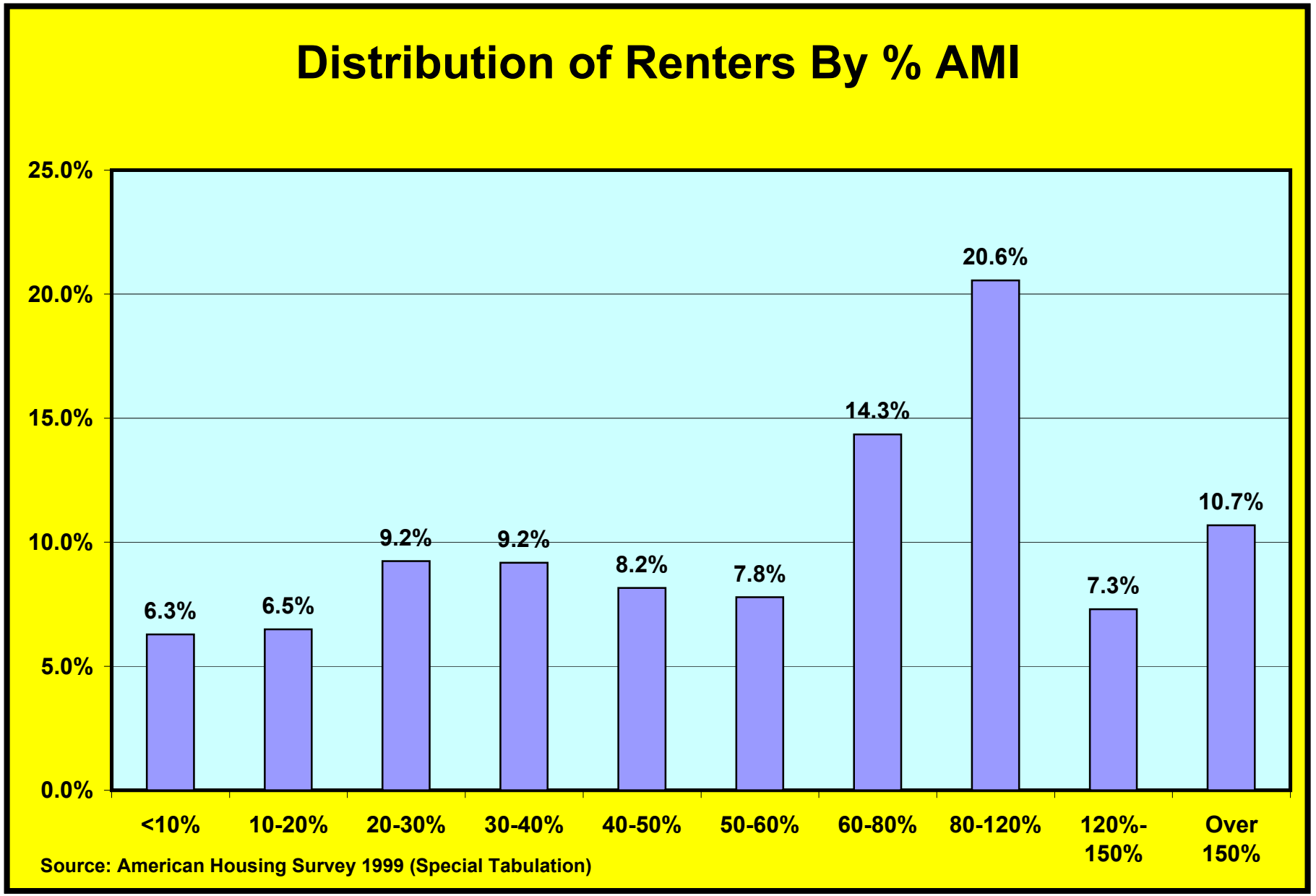
6.12. **Legislative.** Do we need additional programs? Changes to existing programs? New funding approaches? Improved interaction between existing programs and funding? If so, what specific changes are needed?

6.13. **Research.** What additional information do we need, in order to develop successful and sustainable mixed-income communities? How could that additional information be developed?

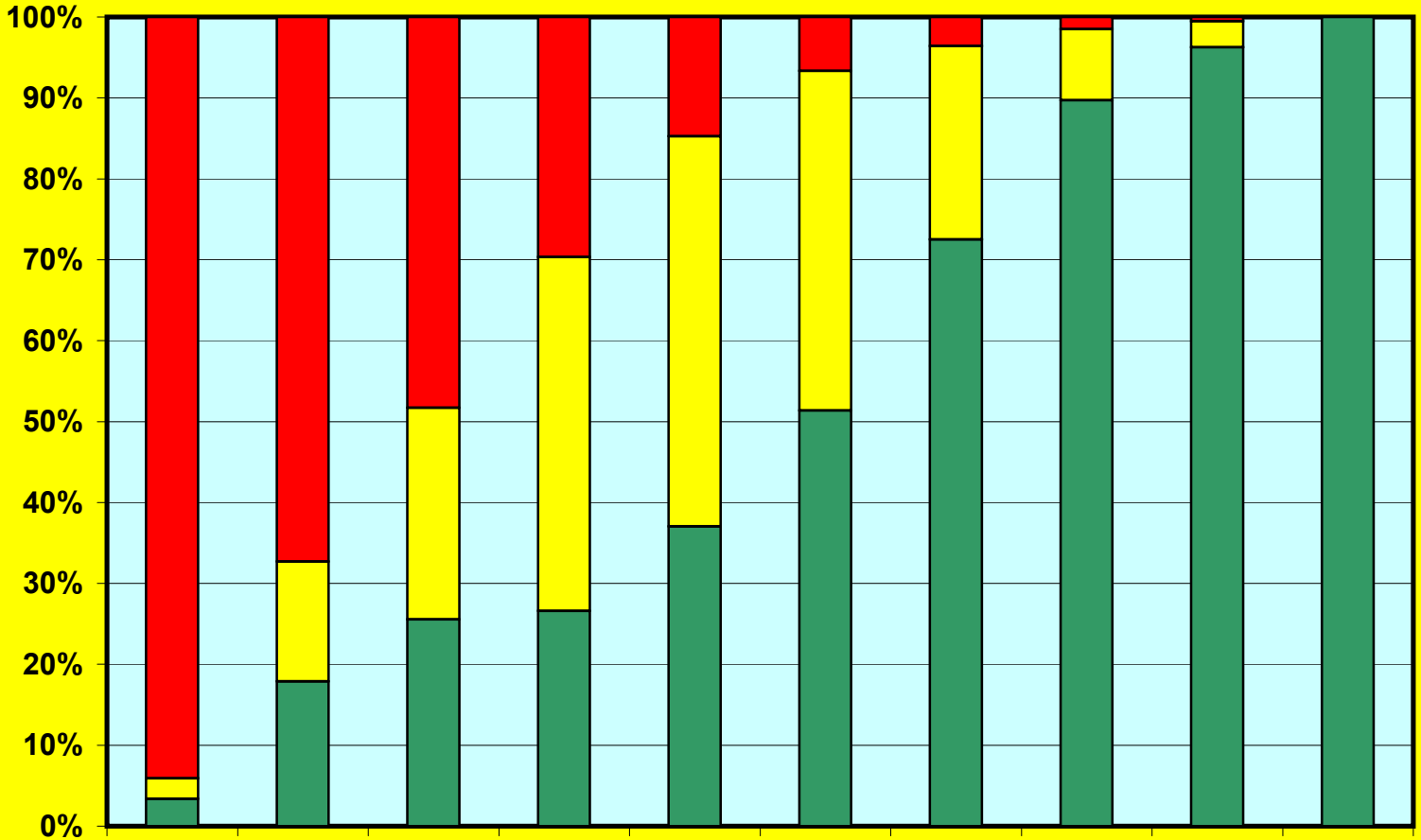
Attachments:

1. Sustainability Concept Paper.
2. Sustainable Underwriting Principles.
3. Mixed Income Concept Paper.
4. Financial Analysis Summary (new construction feasibility for seven varied geographic areas in the U.S.).
5. Demographic Data Summary. Six charts and one table, illustrating key demographic data elements.





# Renter Housing Cost Burden, By % AMI

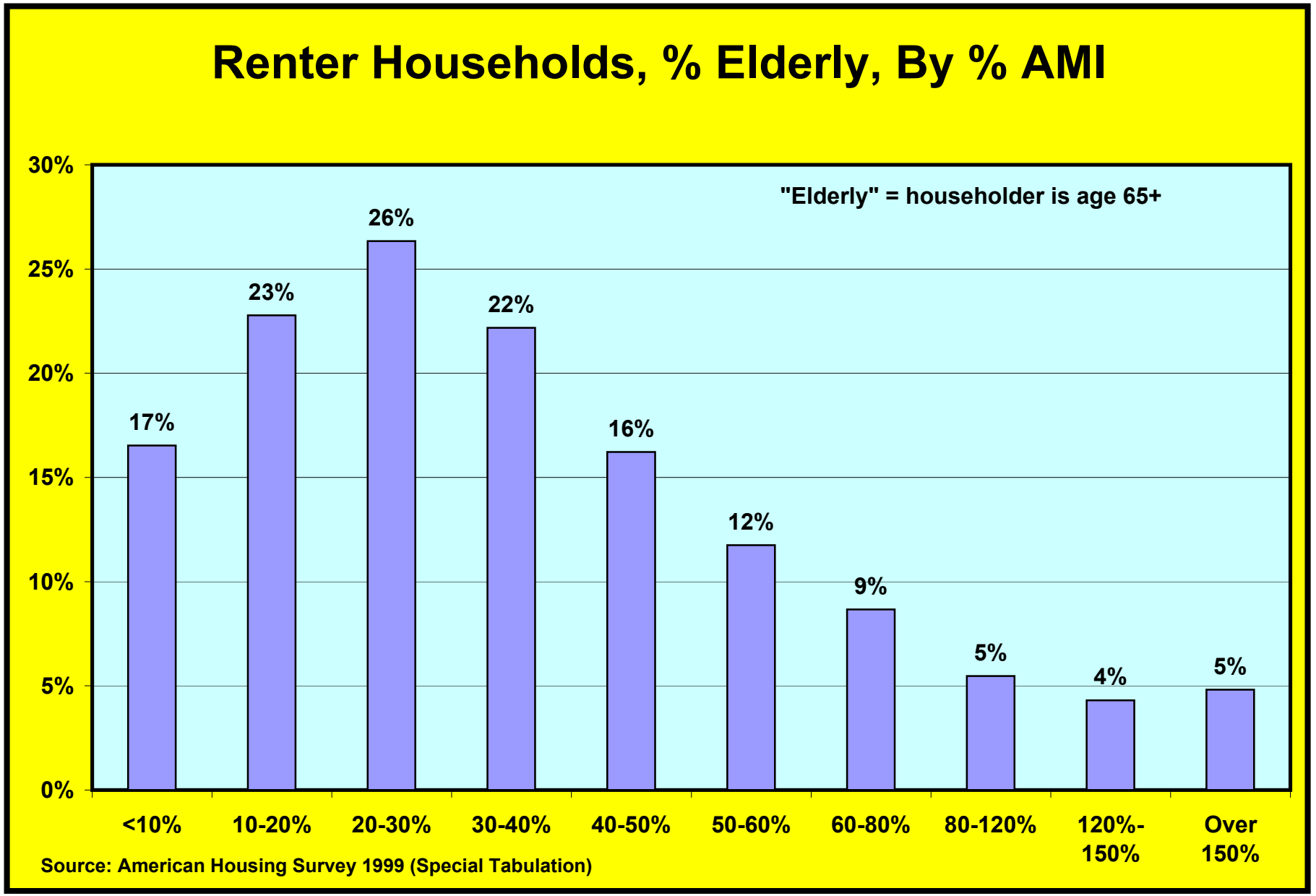



Source: American Housing Survey 1999 (Special Tabulation)

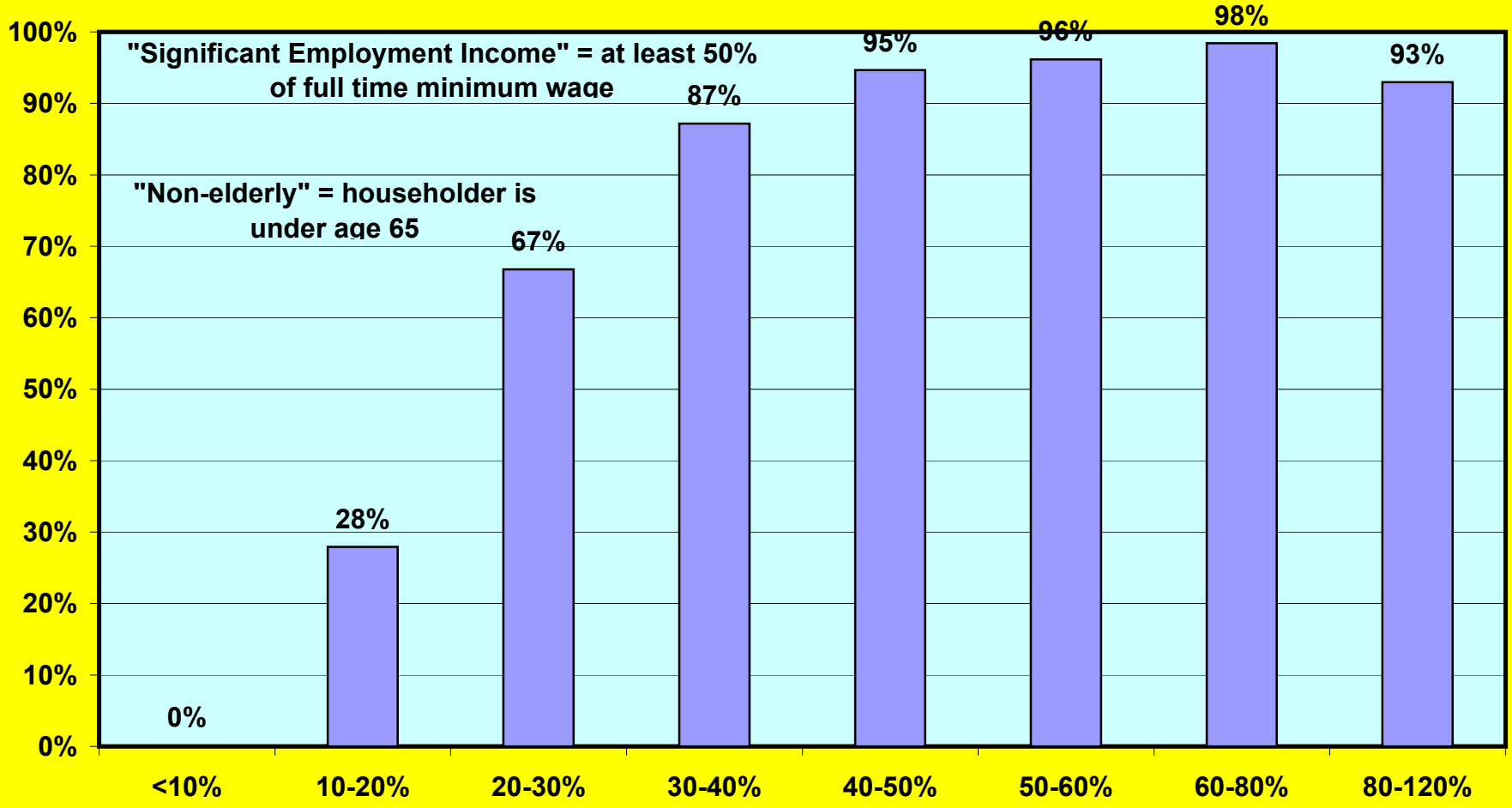
# Renter Households, Housing Cost Burden By % AMI

| Housing Cost Burden | Percent of Area Median Income | | | | | Total |
|---|---|---|---|---|---|---|
| | <30% | 30-50% | 50-80% | 80-120% | >120% | |
| **0%** | 0.8% | 0.7% | 1.1% | 0.7% | 0.4% | 0.8% |
| **1-10%** | 2.0% | 4.2% | 5.3% | 7.7% | 26.1% | 8.8% |
| **11-20%** | 4.1% | 8.1% | 16.0% | 39.4% | 58.9% | 24.8% |
| **21-30%** | 8.6% | 16.5% | 39.1% | 39.2% | 11.9% | 23.1% |
| **31-40%** | 8.5% | 25.6% | 24.8% | 9.5% | 1.7% | 13.8% |
| **41-50%** | 6.3% | 20.3% | 8.4% | 1.9% | 0.6% | 7.2% |
| **51-60%** | 6.9% | 11.4% | 2.6% | 0.8% | 0.2% | 4.2% |
| **61-70%** | 6.3% | 6.0% | 1.2% | 0.4% | 0.1% | 2.8% |
| **71-80%** | 6.7% | 2.8% | 0.4% | 0.1% | 0.1% | 2.1% |
| **81-90%** | 4.2% | 1.3% | 0.4% | 0.1% | 0.0% | 1.3% |
| **91-100%** | 3.5% | 0.8% | 0.3% | 0.1% | 0.0% | 1.0% |
| **>100%** | 42.2% | 2.3% | 0.4% | 0.1% | 0.0% | 10.1% |
| **Total** | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

Source: American Housing Survey 1999, Special Tabulation

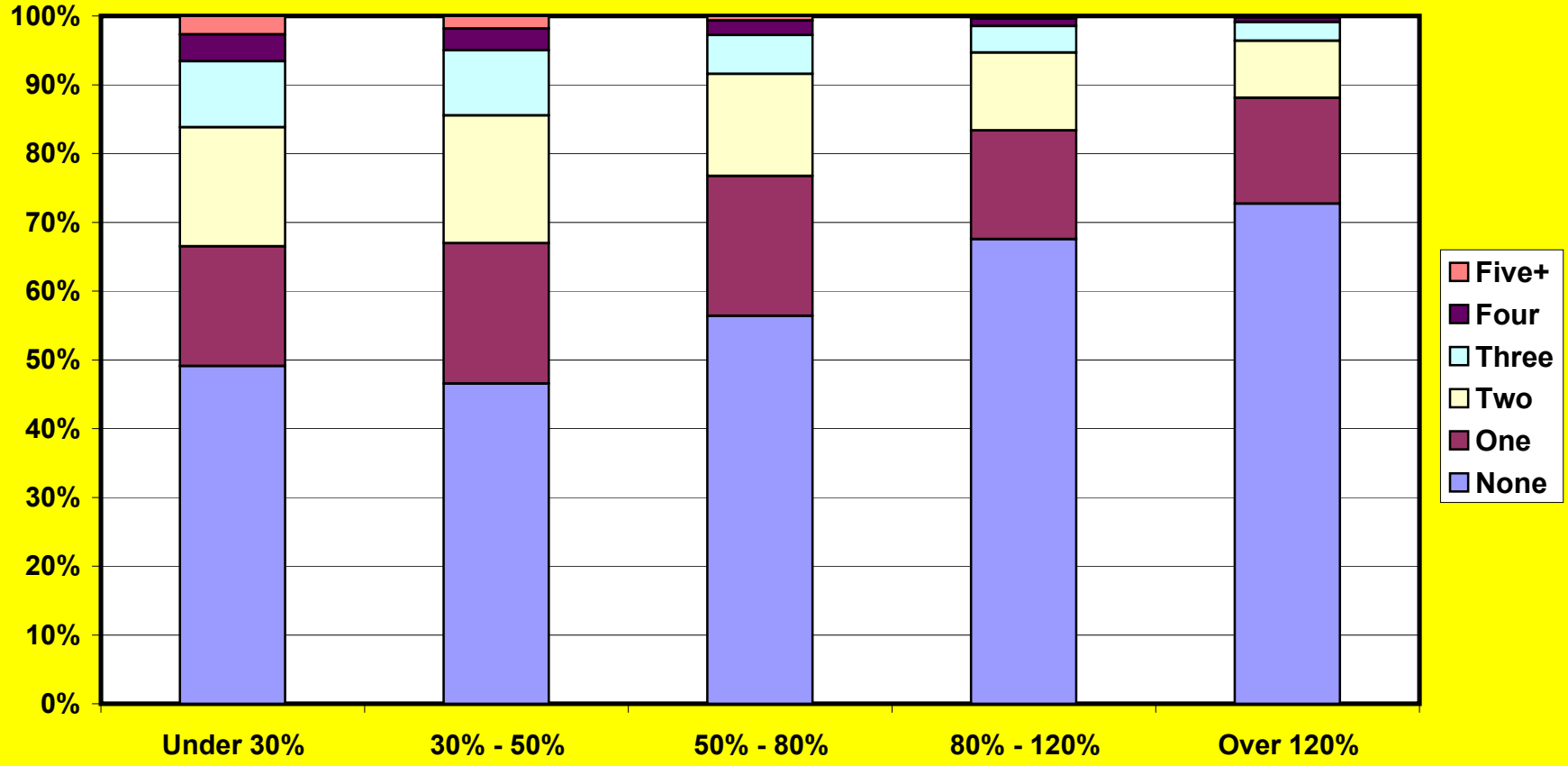


# Non-Elderly Renters With Significant Employment Income, By % AMI




Source: American Housing Survey 1999 (Special Tabulation)

# Non-Elderly Renter Households By Number of Children and % AMI




Source: American Housing Survey 1999 (Special Tabulation)

"Non-elderly" = householder is under age 65

# Raw Data

| Renters By % AMI | Percent | Frequency |
|---|---|---|
| <10% | 6.3% | 2,136 |
| 10-20% | 6.5% | 2,207 |
| 20-30% | 9.2% | 3,140 |
| 30-40% | 9.2% | 3,120 |
| 40-50% | 8.2% | 2,774 |
| 50-60% | 7.8% | 2,646 |
| 60-70% | 7.3% | 2,467 |
| 70-80% | 7.1% | 2,411 |
| 80-90% | 6.0% | 2,026 |
| 90-100% | 5.0% | 1,711 |
| 100-110% | 5.7% | 1,947 |
| 110-120% | 3.8% | 1,306 |
| 120%-130% | 2.9% | 985 |
| 130%-140% | 2.4% | 820 |
| 140%-150% | 2.0% | 678 |
| Over 150% | 10.7% | 3,632 |
| Total | | 34,007 |

| Renters By % AMI | Percent | Frequency (000) | Frequency (millions) |
|---|---|---|---|
| <10% | 6.3% | 2,136 | 2.1 |
| 10-20% | 6.5% | 2,207 | 2.2 |
| 20-30% | 9.2% | 3,140 | 3.1 |
| 30-40% | 9.2% | 3,120 | 3.1 |
| 40-50% | 8.2% | 2,774 | 2.8 |
| 50-60% | 7.8% | 2,646 | 2.6 |
| 60-80% | 14.3% | 4,878 | 4.9 |
| 80-120% | 20.6% | 6,990 | 7.0 |
| 120%-150% | 7.3% | 2,483 | 2.5 |
| Over 150% | 10.7% | 3,632 | 3.6 |
| Total | | 34,006 | 34.0 |

| Renters With Children | Without | With Kids | Total | % With Kids |
|---|---|---|---|---|
| <10% | 1293 | 843 | 2136 | 39% |
| 10-20% | 1263 | 944 | 2207 | 43% |
| 20-30% | 1902 | 1238 | 3140 | 39% |
| 30-40% | 1754 | 1366 | 3120 | 44% |
| 40-50% | 1572 | 1202 | 2774 | 43% |
| 50-60% | 1503 | 1142 | 2645 | 43% |
| 60-70% | 1556 | 912 | 2468 | 37% |
| 70-80% | 1486 | 924 | 2410 | 38% |
| 80-90% | 1368 | 658 | 2026 | 32% |
| 90-100% | 1182 | 529 | 1711 | 31% |
| 100-110% | 1362 | 585 | 1947 | 30% |
| 110-120% | 928 | 378 | 1306 | 29% |
| 120%-130% | 741 | 243 | 984 | 25% |
| 130%-140% | 542 | 279 | 821 | 34% |

| % of Renter Households With Children, by % AMI | Percent | With Kids | Total |
|---|---|---|---|
| <10% | 39.5% | 843 | 2136 |
| 10-20% | 42.8% | 944 | 2207 |
| 20-30% | 39.4% | 1238 | 3140 |
| 30-40% | 43.8% | 1366 | 3120 |
| 40-50% | 43.3% | 1202 | 2774 |
| 50-60% | 43.2% | 1142 | 2645 |
| 60-80% | 37.6% | 1836 | 4878 |
| 80-120% | 30.8% | 2150 | 6990 |
| 120%-150% | 29.8% | 739 | 2484 |
| Over 150% | 23.8% | 866 | 3632 |
| Total | 36.2% | 12326 | 34006 |

| | | | | |
|---|---|---|---|---|
| 140%-150% | 462 | 217 | 679 | 32% |
| Over 150% | 2766 | 866 | 3632 | 24% |
| | 21680 | 12326 | 34006 | 36% |
| | 21680 | | | |

| **Non Elderly Renters With Children** | With Kids | Without | Total | % With Kids |
|---|---|---|---|---|
| Under 30% | 2977 | 2870 | 5847 | 51% |
| 30% - 50% | 2540 | 2211 | 4751 | 53% |
| 50% - 80% | 2962 | 3829 | 6791 | 44% |
| 80% - 120% | 2129 | 4431 | 6560 | 32% |
| Over 120% | 1593 | 4240 | 5833 | 27% |
| Total | 12201 | 17581 | 29782 | 41% |

| **Elderly Renters** | Head of Hhold not elderly | Elderly | Total | % Elderly |
|---|---|---|---|---|
| <10% | 1783 | 353 | 2136 | 17% |
| 10-20% | 1705 | 503 | 2208 | 23% |
| 20-30% | 2313 | 827 | 3140 | 26% |
| 30-40% | 2428 | 692 | 3120 | 22% |
| 40-50% | 2324 | 450 | 2774 | 16% |
| 50-60% | 2335 | 311 | 2646 | 12% |
| 60-70% | 2235 | 233 | 2468 | 9% |
| 70-80% | 2221 | 190 | 2411 | 8% |
| 80-90% | 1911 | 115 | 2026 | 6% |
| 90-100% | 1630 | 81 | 1711 | 5% |
| 100-110% | 1805 | 142 | 1947 | 7% |
| 110-120% | 1262 | 44 | 1306 | 3% |
| 120%-130% | 941 | 43 | 984 | 4% |
| 130%-140% | 783 | 38 | 821 | 5% |
| 140%-150% | 652 | 26 | 678 | 4% |
| Over 150% | 3457 | 175 | 3632 | 5% |
| | 29785 | 4223 | 34008 | |

| **Householder Age 65+, By % AMI** | Percent | Total | |
|---|---|---|---|
| <10% | 16.5% | 353 | 2136 |
| 10-20% | 22.8% | 503 | 2208 |
| 20-30% | 26.3% | 827 | 3140 |
| 30-40% | 22.2% | 692 | 3120 |
| 40-50% | 16.2% | 450 | 2774 |
| 50-60% | 11.8% | 311 | 2646 |
| 60-80% | 8.7% | 423 | 4879 |
| 80-120% | 5.5% | 382 | 6990 |
| 120%-150% | 4.3% | 107 | 2483 |
| Over 150% | 4.8% | 175 | 3632 |
| Total | 12.4% | 4223 | 34008 |

| **Housing Cost Burden** | <30% | 31-50% | 50%+ | Total | <30% | 31-50% | 50%+ |
|---|---|---|---|---|---|---|---|

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| <10% | 72 | 54 | 2,008 | 2,134 | 3.4% | 2.5% | 94.1% |
| 10-20% | 395 | 327 | 1,485 | 2,207 | 17.9% | 14.8% | 67.3% |
| 20-30% | 802 | 822 | 1,517 | 3,141 | 25.5% | 26.2% | 48.3% |
| 30-40% | 831 | 1,365 | 926 | 3,122 | 26.6% | 43.7% | 29.7% |
| 40-50% | 1,028 | 1,338 | 409 | 2,775 | 37.0% | 48.2% | 14.7% |
| 50-60% | 1,359 | 1,111 | 176 | 2,646 | 51.4% | 42.0% | 6.7% |
| 60-70% | 1,668 | 694 | 107 | 2,469 | 67.6% | 28.1% | 4.3% |
| 70-80% | 1,869 | 471 | 69 | 2,409 | 77.6% | 19.6% | 2.9% |
| 80-90% | 1,697 | 291 | 37 | 2,025 | 83.8% | 14.4% | 1.8% |
| 90-100% | 1,514 | 160 | 37 | 1,711 | 88.5% | 9.4% | 2.2% |
| 100-110% | 1,822 | 110 | 15 | 1,947 | 93.6% | 5.6% | 0.8% |
| 110-120% | 1,236 | 55 | 15 | 1,306 | 94.6% | 4.2% | 1.1% |
| 120%-130% | 931 | 47 | 7 | 985 | 94.5% | 4.8% | 0.7% |
| 130%-140% | 789 | 23 | 6 | 818 | 96.5% | 2.8% | 0.7% |
| 140%-150% | 668 | 10 | | 678 | 98.5% | 1.5% | 0.0% |
| Over 150% | 3,583 | 50 | | 3,633 | 98.6% | 1.4% | 0.0% |
| Total | 20,264 | 6,928 | 6,814 | 34,006 | 59.6% | 20.4% | 20.0% |

| **Housing Cost Burden** | <30% | 31-50% | 50%+ | Total | <30% | 31-50% | 50%+ |
|---|---|---|---|---|---|---|---|
| <10% | 72 | 54 | 2,008 | 2,134 | 3.4% | 2.5% | 94.1% |
| 10-20% | 395 | 327 | 1,485 | 2,207 | 17.9% | 14.8% | 67.3% |
| 20-30% | 802 | 822 | 1,517 | 3,141 | 25.5% | 26.2% | 48.3% |
| 30-40% | 831 | 1,365 | 926 | 3,122 | 26.6% | 43.7% | 29.7% |
| 40-50% | 1,028 | 1,338 | 409 | 2,775 | 37.0% | 48.2% | 14.7% |
| 50-60% | 1,359 | 1,111 | 176 | 2,646 | 51.4% | 42.0% | 6.7% |
| 60-80% | 3,537 | 1,165 | 176 | 4,878 | 72.5% | 23.9% | 3.6% |
| 80-120% | 6,269 | 616 | 104 | 6,989 | 89.7% | 8.8% | 1.5% |
| 120-150% | 2,388 | 80 | 13 | 2,481 | 96.3% | 3.2% | 0.5% |
| Over 150% | 3,583 | | | 3,583 | 100.0% | 0.0% | 0.0% |
| | 20,264 | 6,878 | 6,814 | 33,956 | 59.7% | 20.3% | 20.1% |

| **Non Elderly Renters, Number of Children** | None | One | Two | Three | Four | Five+ | Total |
|---|---|---|---|---|---|---|---|
| Under 30% | 2870 | 1018 | 1013 | 560 | 229 | 157 | 5847 |
| 30% - 50% | 2211 | 970 | 883 | 450 | 150 | 87 | 4751 |
| 50% - 80% | 3829 | 1382 | 1009 | 384 | 141 | 46 | 6791 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| 80% - 120% | 4431 | 1038 | 742 | 264 | 75 | 24 | 6560 |
| Over 120% | 4240 | 898 | 484 | 159 | 39 | 13 | 5833 |
| Total | 17581 | 5306 | 4131 | 1807 | 630 | 327 | 29782 |
| | | | | | | | 29782 |

**Non Elderly Renters, Number of Children**

| | None | One | Two | Three | Four | Five+ | Total |
|---|---|---|---|---|---|---|---|
| Under 30% | 49.1% | 17.4% | 17.3% | 9.6% | 3.9% | 2.7% | 100.0% |
| 30% - 50% | 46.5% | 20.4% | 18.6% | 9.5% | 3.2% | 1.8% | 100.0% |
| 50% - 80% | 56.4% | 20.4% | 14.9% | 5.7% | 2.1% | 0.7% | 100.0% |
| 80% - 120% | 67.5% | 15.8% | 11.3% | 3.9% | 1.1% | 0.4% | 100.0% |
| Over 120% | 72.7% | 15.4% | 8.3% | 2.7% | 0.7% | 0.2% | 100.0% |
| Total | 59.0% | 17.8% | 13.9% | 6.1% | 2.1% | 1.1% | 100.0% |

**Elderly Renters, Number of Children**

| | None | One | Two | Three | Four+ | Total |
|---|---|---|---|---|---|---|
| Under 30% | 1622 | 25 | 24 | 4 | 10 | 1685 |
| 30% - 50% | 1114 | 16 | 7 | 4 | 2 | 1143 |
| 50% - 80% | 719 | 14 | 3 | | | 736 |
| 80% - 120% | 372 | 4 | 1 | | | 377 |
| Over 120% | 271 | 11 | | | | 282 |
| Total | 4098 | 70 | 35 | 8 | 12 | 4223 |
| | | | | | | 4223 |

**Elderly Renters, Number of Children**

| | None | One | Two | Three | Four | Total |
|---|---|---|---|---|---|---|
| Under 30% | 96.3% | 1.5% | 1.4% | 0.2% | 0.6% | 100.0% |
| 30% - 50% | 97.5% | 1.4% | 0.6% | 0.3% | 0.2% | 100.0% |
| 50% - 80% | 97.7% | 1.9% | 0.4% | 0.0% | 0.0% | 100.0% |
| 80% - 120% | 98.7% | 1.1% | 0.3% | 0.0% | 0.0% | 100.0% |
| Over 120% | 96.1% | 3.9% | 0.0% | 0.0% | 0.0% | 100.0% |
| Total | 97.0% | 1.7% | 0.8% | 0.2% | 0.3% | 100.0% |

| Non-Elderly Working Renters | < 50% FT Minimum Wage | 50%+ | Total | % Working |
|---|---|---|---|---|
| <10% | 1781 | 2 | 1783 | 0% |
| 10-20% | 1228 | 476 | 1704 | 28% |
| 20-30% | 769 | 1544 | 2313 | 67% |
| 30-40% | 312 | 2116 | 2428 | 87% |
| 40-50% | 124 | 2200 | 2324 | 95% |
| 50-60% | 90 | 2245 | 2335 | 96% |
| 60-70% | 42 | 2193 | 2235 | 98% |
| 70-80% | 28 | 2193 | 2221 | 99% |
| 80-90% | 31 | 1880 | 1911 | 98% |
| 90-100% | 12 | 1618 | 1630 | 99% |
| 100-110% | 400 | 1405 | 1805 | 78% |
| 110-120% | 22 | 1240 | 1262 | 98% |
| 120%-130% | 9 | 932 | 941 | 99% |
| 130%-140% | 5 | 778 | 783 | 99% |
| 140%-150% | 5 | 647 | 652 | 99% |
| Over 150% | 52 | 3405 | 3457 | 98% |
| | 4910 | 24874 | 29784 | |

| Non-Elderly Working Renters | Percent | 50%+ of FT Minimum Wage | Total |
|---|---|---|---|
| <10% | 0.1% | 2 | 1783 |
| 10-20% | 27.9% | 476 | 1704 |
| 20-30% | 66.8% | 1544 | 2313 |
| 30-40% | 87.1% | 2116 | 2428 |
| 40-50% | 94.7% | 2200 | 2324 |
| 50-60% | 96.1% | 2245 | 2335 |
| 60-80% | 98.4% | 4386 | 4456 |
| 80-120% | 93.0% | 6143 | 6608 |
| 120%-150% | 99.2% | 2357 | 2376 |
| Over 150% | 98.5% | 3405 | 3457 |
| Total | 83.5% | 24874 | 29784 |

# Millennial Housing Commission Financial Modeling Summary

| Highlights of Analysis | Baltimore | Atlanta | New York City | Orange County CA | Omaha | Philadelphia | Rural Colorado |
|---|---|---|---|---|---|---|---|
| The lowest income targeting consistent with sustainability is (% of AMI): | 39% | 40% | 83% | 36% | 36% | 44% | 42% |
| At this level of income targeting: | | | | | | | |
| Capital subsidy (% of TDC): | 87% | 83% | 84% | 86% | 88% | 84% | 86% |
| Sustainable reserve deposit ($ PUPA): | $775 | $575 | $975 | $775 | $575 | $775 | $575 |
| DSCR (using lending-style reserve deposit): | 2.50:1 | 1.60:1 | 2.75:1 | 3.10:1 | 2.20:1 | 1.75:1 | 1.65:1 |
| Non-subsidized apartment development is feasible at incomes of this % of AMI and above: | 72% | 70% | 154% | 73% | 69% | 81% | 85% |
| Sustainable reserve deposit ($ PUPA): | $425 | $350 | $525 | $425 | $350 | $425 | $350 |
| DSCR (using lending-style reserve deposit): | 1.20:1 | 1.20:1 | 1.20:1 | 1.20:1 | 1.20:1 | 1.20:1 | 1.20:1 |

Implications for housing policy:

1. Percentage of AMI is a useful benchmark for many areas of the country, but it is not a universally consistent benchmark. Policies that are expressed in percentage of AMI should contain exceptions for areas in which the standard policy would produce inappropriate results.

2. In general, programs that attempt to serve households with incomes below 45% of AMI through new construction will require care in design:
   - Careful underwriting will be needed, to ensure that the property's rental income can be expected to grow fast enough to cover increases in expenses.
   - Mixed-income strategies are more likely to result in sustainable properties than strategies that target 100% occupancy by the lowest income households (whose affordable rents are only marginally above the projected costs of operation without debt service).
   - Consideration should be given to structuring the property to attract a higher-income clientele, and using operating subsidy (such as Section 8) in order to provide affordability to the lowest-income households.
   - Properties that rely on capital subsidies alone may not be able to provide affordability to the lowest-income families at the 30% housing cost ratio used as the standard in the public housing and Section 8 programs, but will still be able to deliver housing costs well below the amounts a substantial majority of these households currently pay.

3. Some in the affordable housing community assume that households above 60% of AMI can afford to rent or purchase newly constructed market-rate housing. This analysis suggests that, in general, households below 70% of AMI are likely to require assistance in order to rent newly constructed apartments. In some markets, households with somewhat higher incomes will need assistance.

4. The New York City example illustrates that there are some areas of the country for which the normal rules of thumb are simply not applicable. It would be be reasonable to target additional subsidy resources to these markets, and to develop market-specific eligibility and funding criteria.

# Millennial Housing Commission Financial Modeling Summary

| | Baltimore | Atlanta | New York City | Orange County CA | Omaha | Philadelphia | Rural Colorado | |
|---|---|---|---|---|---|---|---|---|
| Total Development Cost | $77,000 | $74,000 | $154,000 | $99,000 | $72,000 | $82,000 | $74,000 | per unit |
| Area Median Income | $63,100 | $66,500 | $59,100 | $73,700 | $62,400 | $60,100 | $48,400 | 4 persons |
| Lowest Feasible Income Targeting is for Households at | 39% | 40% | 83% | 36% | 36% | 44% | 42% | of AMI |
| Lowest Feasible 2BR Rent is | $444 | $489 | $954 | $497 | $380 | $485 | $348 | |
| Housing Cost Burden at 30% AMI | 39% | 40% | 83% | 36% | 36% | 44% | 42% | of income |
| Capital Subsidy Required is | 87% | 83% | 84% | 86% | 88% | 84% | 86% | of TDC |
| Debt Service Coverage Ratio is | 2.50:1 | 1.60:1 | 2.75:1 | 3.10:1 | 2.20:1 | 1.75:1 | 1.65:1 | |
| Sustainable Reserve Deposit is | $775 | $575 | $975 | $775 | $575 | $775 | $575 | PUPA |
| Income Targeting at | 45% | 45% | 95% | 40% | 45% | 50% | 48% | of AMI |
| Requires Capital Subsidy of | 69% | 68% | 66% | 75% | 64% | 70% | 75% | of TDC |
| Debt Service Coverage Ratio is | 1.40:1 | 1.30:1 | 1.25:1 | 1.45:1 | 1.40:1 | 1.50:1 | 1.45:1 | |
| Sustainable Reserve Deposit is | $600 | $450 | $550 | $675 | $575 | $775 | $575 | PUPA |
| Income Targeting at | 55% | 55% | 110% | 50% | 55% | 55% | 55% | of AMI |
| Requires Capital Subsidy of | 43% | 39% | 49% | 51% | 35% | 54% | 58% | of TDC |
| Debt Service Coverage Ratio is | 1.25:1 | 1.20:1 | 1.25:1 | 1.25:1 | 1.25:1 | 1.25:1 | 1.25:1 | |
| Sustainable Reserve Deposit is | $425 | $350 | $525 | $425 | $350 | $425 | $375 | PUPA |
| Income Targeting at | 65% | 60% | 125% | 60% | 60% | 65% | 65% | of AMI |
| Requires Capital Subsidy of | 19% | 26% | 32% | 28% | 22% | 33% | 38% | of TDC |
| Debt Service Coverage Ratio is | 1.25:1 | 1.20:1 | 1.25:1 | 1.20:1 | 1.20:1 | 1.25:1 | 1.20:1 | |
| Sustainable Reserve Deposit is | $425 | $350 | $525 | $425 | $350 | $425 | $350 | PUPA |
| Non-Subsidized Development is Feasible At Incomes of | 72.4% | 70.0% | 153.5% | 72.9% | 68.7% | 80.7% | 85.0% | of AMI |
| Debt Service Coverage Ratio is | 1.20:1 | 1.20:1 | 1.20:1 | 1.20:1 | 1.20:1 | 1.20:1 | 1.20:1 | |
| Sustainable Reserve Deposit is | $425 | $350 | $525 | $425 | $350 | $425 | $350 | PUPA |

1. Development cost was derived using HUD's high cost area factors.
2. Lowest feasible income is the lowest targeting feasible that produces rising NOI (3.0% trending of rents and 3.5% trending of expenses and reserves)
3, DSCR is measured using a lending-style reserve deposit and is sized to produce at least a 1.20 DSCR using the sustainable reserve deposit.
4. The reserve deposit is sized to cover 100% of capital needs for at least the first 20 years. In the lowest feasible targeting scenario, the reserve is sized to cover 100% of capital needs for the first 50-60 years. In the other scenarios, the reserve deposit is sized so that, in combination with prudently foreseeable refinancing (9%, 25 years, 1.50:1 DSCR on trailing actual NOI), capital needs for the first 50-60 years can be covered.

# Millennial Housing Commission Financial Modeling Summary

**Baltimore MD $77 K TDC $63.1 K AMI**

**Non Subsidized Development is Feasible at 72.4% AMI and above**

| | 39% AMI | 45% AMI | 55% AMI | 65% AMI | 70% AMI | 72% AMI | 100% AMI |
|---|---|---|---|---|---|---|---|
| 2BR Target Rent | $444 | $529 | $671 | $813 | $884 | $918 | |
| 2BR Tenant Paid Utilities | $110 | $110 | $110 | $110 | $110 | $110 | |
| 2BR Housing Cost | $554 | $639 | $781 | $923 | $994 | $1,028 | |
| Three Person Household AMI | $22,200 | $25,600 | $31,200 | $36,900 | $39,800 | $41,100 | $56,800 |
| Housing Cost Ratio | 30% | 30% | 30% | 30% | 30% | 30% | |
| Supportable 1st Mortgage / unit | $6,800 | $20,300 | $38,000 | $53,300 | $60,900 | $67,300 | |
| Suportable Equity Capital / unit | $3,300 | $3,300 | $6,200 | $9,400 | $11,000 | $9,500 | |
| Capital Subsidy Needed / unit | | | | | | | |
| 9% LIHTC | $37,100 | $37,100 | $0 | $0 | $0 | $0 | |
| HOME or other | $29,800 | $16,300 | $32,800 | $14,300 | $5,100 | $200 | |
| Total Capitalization | $77,000 | $77,000 | $77,000 | $77,000 | $77,000 | $77,000 | |
| % Capital Subsidy Needed | 87% | 69% | 43% | 19% | 7% | 0% | |
| DSCR on 1st Mortgage | 2.50 | 1.40 | 1.25 | 1.25 | 1.25 | 1.20 | |
| Sustainable Reserve for Replacements | | | | | | | |
| Initial Deposit ($ / unit) | $775 | $600 | $425 | $425 | $425 | $425 | |
| First Year Deposit ($ / unit) | $775 | $600 | $425 | $425 | $425 | $425 | |

Note -- below 39% AMI, the operating expense ratio is too large for NOI stability (income does not rise rapidly enough to offset increases in expenses, using reasonable assumptions)

# Millennial Housing Commission Financial Modeling Summary

**Atlanta, Georgia $74 K TDC $66.5 K AMI**

**Non Subsidized Development is Feasible at 70.0% AMI and above**

| | 40% AMI | 45% AMI | 55% AMI | 60% AMI | 65% AMI | 70.0% AMI | 100% AMI |
|---|---|---|---|---|---|---|---|
| 2BR Target Rent | $489 | $563 | $713 | $788 | $863 | $937 | |
| 2BR Tenant Paid Utilities | $110 | $110 | $110 | $110 | $110 | $110 | |
| 2BR Housing Cost | $599 | $673 | $823 | $898 | $973 | $1,047 | |
| Three Person Household AMI | $23,900 | $26,900 | $32,900 | $35,900 | $38,900 | $41,900 | $59,850 |
| Housing Cost Ratio | 30% | 30% | 30% | 30% | 30% | 30% | |
| Supportable 1st Mortgage / unit | $10,700 | $20,800 | $39,400 | $47,700 | $56,100 | $64,500 | |
| Suportable Equity Capital / unit | $2,100 | $3,200 | $5,600 | $7,000 | $8,400 | $9,800 | |
| Capital Subsidy Needed / unit | | | | | | | |
| 9% LIHTC | $37,000 | $37,000 | $0 | $0 | $0 | $0 | |
| HOME or other | $24,200 | $13,000 | $29,000 | $19,300 | $9,500 | ($300) | |
| Total Capitalization | $74,000 | $74,000 | $74,000 | $74,000 | $74,000 | $74,000 | |
| % Capital Subsidy Needed | 83% | 68% | 39% | 26% | 13% | 0% | |
| DSCR on 1st Mortgage | 1.60 | 1.30 | 1.20 | 1.20 | 1.20 | 1.20 | |
| Sustainable Reserve for Replacements | | | | | | | |
| Initial Deposit ($ / unit) | $575 | $450 | $350 | $350 | $350 | $350 | |
| First Year Deposit ($ / unit) | $575 | $450 | $350 | $350 | $350 | $350 | |

Note -- below 40% AMI, the operating expense ratio is too large for NOI stability (income does not rise rapidly enough to offset increases in expenses, using reasonable assumptions)

# Millennial Housing Commission Financial Modeling Summary

**New York City Area $154 K TDC $59.1 K AMI**

**Non Subsidized Development is Feasible at 153.5% AMI and above**

| | 83% AMI | 95% AMI | 110% AMI | 125% AMI | 140% AMI | 153.5% AMI | 100% AMI |
|---|---|---|---|---|---|---|---|
| 2BR Target Rent | $954 | $1,114 | $1,313 | $1,513 | $1,712 | $1,892 | |
| 2BR Tenant Paid Utilities | $0 | $110 | $110 | $110 | $110 | $110 | |
| 2BR Housing Cost | $954 | $1,224 | $1,423 | $1,623 | $1,822 | $2,002 | |
| Three Person Household AMI | $44,200 | $50,500 | $58,500 | $66,500 | $74,500 | $81,700 | $53,200 |
| Housing Cost Ratio | 26% | 29% | 29% | 29% | 29% | 29% | |
| Supportable 1st Mortgage / unit | $12,700 | $45,000 | $66,400 | $87,900 | $113,900 | $134,000 | |
| Suportable Equity Capital / unit | $11,800 | $6,900 | $11,700 | $16,200 | $16,900 | $20,200 | |
| Capital Subsidy Needed / unit | | | | | | | |
| 9% LIHTC | $70,300 | $70,300 | $0 | $0 | $0 | $0 | |
| HOME or other | $59,200 | $31,800 | $75,900 | $49,900 | $23,200 | ($200) | |
| Total Capitalization | $154,000 | $154,000 | $154,000 | $154,000 | $154,000 | $154,000 | |
| % Capital Subsidy Needed | 84% | 66% | 49% | 32% | 15% | 0% | |
| DSCR on 1st Mortgage | 2.75 | 1.25 | 1.25 | 1.25 | 1.20 | 1.20 | |
| Sustainable Reserve for Replacements | | | | | | | |
| Initial Deposit ($ / unit) | $975 | $550 | $525 | $525 | $525 | $525 | |
| First Year Deposit ($ / unit) | $975 | $550 | $525 | $525 | $525 | $525 | |

Note -- below 83% AMI, the operating expense ratio is too large for NOI stability (income does not rise rapidly enough to offset increases in expenses, using reasonable assumptions)

# Millennial Housing Commission Financial Modeling Summary

## Orange County CA $99 K TDC $73.7 K AMI

## Non Subsidized Development is Feasible at 72.9% AMI and above

| | 36% AMI | 40% AMI | 50% AMI | 60% AMI | 70% AMI | 72.9% AMI | 100% AMI |
|---|---|---|---|---|---|---|---|
| 2BR Target Rent | $497 | $564 | $729 | $895 | $1,061 | $1,109 | |
| 2BR Tenant Paid Utilities | $100 | $110 | $110 | $110 | $110 | $110 | |
| 2BR Housing Cost | $597 | $674 | $839 | $1,005 | $1,171 | $1,219 | |
| Three Person Household AMI | $23,900 | $26,500 | $33,200 | $39,800 | $46,400 | $48,400 | $66,350 |
| Housing Cost Ratio | 30% | 31% | 30% | 30% | 30% | 30% | |
| Supportable 1st Mortgage / unit | $6,800 | $20,800 | $41,900 | $62,300 | $80,800 | $86,200 | |
| Suportable Equity Capital / unit | $6,800 | $3,600 | $7,000 | $8,700 | $11,800 | $12,700 | |
| Capital Subsidy Needed / unit | | | | | | | |
| 9% LIHTC | $45,600 | $45,600 | $45,600 | $0 | $0 | $0 | |
| HOME or other | $39,800 | $29,000 | $4,500 | $28,000 | $6,400 | $100 | |
| Total Capitalization | $99,000 | $99,000 | $99,000 | $99,000 | $99,000 | $99,000 | |
| % Capital Subsidy Needed | 86% | 75% | 51% | 28% | 6% | 0% | |
| DSCR on 1st Mortgage | 3.10 | 1.45 | 1.25 | 1.20 | 1.20 | 1.20 | |
| Sustainable Reserve for Replacements | | | | | | | |
| Initial Deposit ($ / unit) | $775 | $675 | $425 | $425 | $425 | $425 | |
| First Year Deposit ($ / unit) | $775 | $675 | $425 | $425 | $425 | $425 | |

Note -- below 36% AMI, the operating expense ratio is too large for NOI stability (income does not rise rapidly enough to offset increases in expenses, using reasonable assumptions)

# Millennial Housing Commission Financial Modeling Summary

**Omaha NE $72 K TDC $62.4 K AMI**

**Non Subsidized Development is Feasible at 68.7% AMI and above**

| | 36% AMI | 45% AMI | 55% AMI | 60% AMI | 65% AMI | 68.7% AMI | 100% AMI |
|---|---|---|---|---|---|---|---|
| 2BR Target Rent | $380 | $507 | $647 | $717 | $787 | $839 | |
| 2BR Tenant Paid Utilities | $125 | $110 | $110 | $110 | $110 | $110 | |
| 2BR Housing Cost | $505 | $617 | $757 | $827 | $897 | $949 | |
| Three Person Household AMI | $20,200 | $25,300 | $30,900 | $33,700 | $36,500 | $38,600 | $56,150 |
| Housing Cost Ratio | 30% | 29% | 29% | 29% | 29% | 30% | |
| Supportable 1st Mortgage / unit | $6,000 | $21,600 | $39,300 | $48,800 | $56,600 | $62,400 | |
| Suportable Equity Capital / unit | $2,800 | $4,000 | $7,200 | $7,200 | $8,500 | $9,500 | |
| Capital Subsidy Needed / unit | | | | | | | |
| 9% LIHTC | $36,100 | $36,100 | $0 | $0 | $0 | $0 | |
| HOME or other | $27,100 | $10,300 | $25,500 | $16,000 | $6,900 | $100 | |
| Total Capitalization | $72,000 | $72,000 | $72,000 | $72,000 | $72,000 | $72,000 | |
| % Capital Subsidy Needed | 88% | 64% | 35% | 22% | 10% | 0% | |
| DSCR on 1st Mortgage | 2.20 | 1.40 | 1.25 | 1.20 | 1.20 | 1.20 | |
| Sustainable Reserve for Replacements | | | | | | | |
| Initial Deposit ($ / unit) | $575 | $575 | $350 | $350 | $350 | $350 | |
| First Year Deposit ($ / unit) | $575 | $575 | $350 | $350 | $350 | $350 | |

Note -- below 36% AMI, the operating expense ratio is too large for NOI stability (income does not rise rapidly enough to offset increases in expenses, using reasonable assumptions)

# Millennial Housing Commission Financial Modeling Summary

**Philadelphia PA $82 K TDC $60.1 K AMI**

**Non Subsidized Development is Feasible at 80.7% AMI and above**

| | 44% AMI | 50% AMI | 55% AMI | 65% AMI | 75% AMI | 80.7% AMI | 100% AMI |
|---|---|---|---|---|---|---|---|
| 2BR Target Rent | $485 | $573 | $641 | $777 | $914 | $981 | |
| 2BR Tenant Paid Utilities | $110 | $110 | $110 | $110 | $110 | $110 | |
| 2BR Housing Cost | $595 | $683 | $751 | $887 | $1,024 | $1,091 | |
| Three Person Household AMI | $24,000 | $27,300 | $30,000 | $35,500 | $41,000 | $44,100 | $54,600 |
| Housing Cost Ratio | 30% | 30% | 30% | 30% | 30% | 30% | |
| Supportable 1st Mortgage / unit | $11,200 | $20,900 | $32,400 | $47,000 | $64,300 | $71,900 | |
| Suportable Equity Capital / unit | $1,800 | $3,500 | $5,100 | $8,100 | $9,000 | $10,300 | |
| Capital Subsidy Needed / unit | | | | | | | |
| 9% LIHTC | $38,100 | $38,100 | $38,100 | $0 | $0 | $0 | |
| HOME or other | $30,900 | $19,500 | $6,400 | $26,900 | $8,700 | ($200) | |
| Total Capitalization | $82,000 | $82,000 | $82,000 | $82,000 | $82,000 | $82,000 | |
| % Capital Subsidy Needed | 84% | 70% | 54% | 33% | 11% | 0% | |
| DSCR on 1st Mortgage | 1.75 | 1.50 | 1.25 | 1.25 | 1.20 | 1.20 | |
| Sustainable Reserve for Replacements | | | | | | | |
| Initial Deposit ($ / unit) | $775 | $775 | $425 | $425 | $425 | $425 | |
| First Year Deposit ($ / unit) | $775 | $775 | $425 | $425 | $425 | $425 | |

Note -- below 44% AMI, the operating expense ratio is too large for NOI stability (income does not rise rapidly enough to offset increases in expenses, using reasonable assumptions)

# Millennial Housing Commission Financial Modeling Summary

**Non Metropolitan CO $74 K TDC per unit $48.4 K AMI**
**Non Subsidized Development is Feasible at 85.0% AMI and above**

| | 42% AMI | 48% AMI | 55% AMI | 65% AMI | 75% AMI | 85.0% AMI | 100% AMI |
|---|---|---|---|---|---|---|---|
| 2BR Target Rent | $348 | $413 | $490 | $599 | $708 | $817 | |
| 2BR Tenant Paid Utilities | $110 | $110 | $110 | $110 | $110 | $110 | |
| 2BR Housing Cost | $458 | $523 | $600 | $709 | $818 | $927 | |
| Three Person Household AMI | $18,300 | $20,900 | $24,000 | $28,300 | $32,700 | $37,100 | $43,600 |
| Housing Cost Ratio | 30% | 30% | 30% | 30% | 30% | 30% | |
| Supportable 1st Mortgage / unit | $8,600 | $15,900 | $26,700 | $39,900 | $52,200 | $64,400 | |
| Suportable Equity Capital / unit | $1,500 | $2,700 | $4,300 | $5,700 | $7,800 | $9,800 | |
| Capital Subsidy Needed / unit | | | | | | | |
| 9% LIHTC | $36,900 | $36,900 | $36,900 | $0 | $0 | $0 | |
| HOME or other | $27,000 | $18,500 | $6,100 | $28,400 | $14,000 | ($200) | |
| Total Capitalization | $74,000 | $74,000 | $74,000 | $74,000 | $74,000 | $74,000 | |
| % Capital Subsidy Needed | 86% | 75% | 58% | 38% | 19% | 0% | |
| DSCR on 1st Mortgage | 1.65 | 1.45 | 1.25 | 1.20 | 1.20 | 1.20 | |
| Sustainable Reserve for Replacements | | | | | | | |
| Initial Deposit ($ / unit) | $575 | $575 | $375 | $350 | $350 | $350 | |
| First Year Deposit ($ / unit) | $575 | $575 | $375 | $350 | $350 | $350 | |

Note -- below 42% AMI, the operating expense ratio is too large for NOI stability (income does not rise rapidly enough to offset increases in expenses, using reasonable assumptions)

# MILLENNIAL HOUSING COMMISSION
# PRODUCTION AND PRESERVATION TASK FORCES
## SUSTAINABLE UNDERWRITING PRINCIPLES

## OVERVIEW

An affordable housing transaction has sustainable financing and structure if each of the following sustainability tests are met:

1. Long Term Capital Needs can be 100% supported from reserves, or from a combination of reserves and reasonably predictable refinancing.
2. Stabilized NOI is very likely to be achieved as projected.
3. DSCR is adequate to withstand moderately large adverse circumstances.
4. Financing is reasonable.
5. Trending assumptions are reasonable.

The determination that these tests have been satisfied requires real estate judgment based on good data and experience. Accordingly, the tests are described below in general terms and not in terms of specific percentages and ratios.

## 1. LONG TERM CAPITAL NEEDS CAN BE 100% FINANCED

**Capital Needs Assessment.** There is a property-specific long term capital needs assessment that estimates the annual capital expenditures necessary to maintain the major building systems over the long term. The original capital needs assessment, prepared at the time of original structuring and approval, must be for a period of time long enough to encompass at least the first replacement of the major building systems (roof, siding, windows, parking lot resurfacing, HVAC, …).

**Reserves.** The combination of any up front reserve funds, the initial monthly reserve deposits, and planned future deposits (increased at the rate of inflation, or perhaps more rapidly than inflation) is sufficient to fund at least a significant portion of the long term capital needs.

**Refinancing.** Any of the long term capital needs that cannot be funded from the reserve can be funded from future refinancing that is reasonably predictable, taking into account any affordability restrictions in the long term use agreement, and taking into account uncertainty about future property value and future mortgage market conditions.

## 2. STABILIZED NOI IS REASONABLE AND ACHIEVABLE

**Rents.** Projected rents are very likely to be achieved, taking into account location, design, other property characteristics, and the long term use agreement. In particular, because occupancy is restricted by income level, the achievable rents for an affordable property are below the market comparable level that a non-income-restricted property could achieve.

**Vacancy / Rent Loss.** The rent loss allowance is reasonable considering the range of vacancy

and bad debt loss the property is likely to incur over a typical real estate cycle.

**Operating Expenses.** The property is very likely to meet or beat is projected operating expense budget. The projected operating expenses are based on actual operating costs of typical comparable properties that are at least five years old.

**Reserve for Replacement.** The projected reserve deposit is consistent with principle #1 above.

## 3. Debt Service Coverage is Adequate

**Rent Variance.** If the rents that are actually achieved are modestly lower than the projected rents, the property will still be able to cover its required mortgage payments. If the actual rents are, say, 3% below projected levels, that should not throw the property into negative cash flow.

**Expense Variance.** Various components of operating expenses are subject to large variances. Examples include utility costs, real estate taxes, property insurance, and security costs. If the actual operating expenses are, say, 10% higher than projected, that should not throw the property into negative cash flow.

## 4. Financing is Reasonable

**Original Financing.** The projected financing is either firmly committed or very likely to be obtained.

**Non Traditional Financing.** If the first mortgage is not fixed-rate, or is not self-amortizing, there is additional debt service coverage (or other financial protection) sufficient to give a very high degree of assurance that the property will be able to pay debt service over the long term.

**Subordinate Financing.** If the property includes "soft" junior financing, the terms of that financing are consistent with the property's long term sustainability. For example, the subordinate lender should not have a right to repayment until expenses are paid, the property is maintained, and the reserves are adequately funded.

## 5. Trending is Reasonable

**Revenue Trending.** The rate at which income is projected to grow in the future is consistent with restrictions in the long term use agreement and is less than the rate at which expenses are projected to grow in the future.

**Operating Expense Trending.** The rate at which expenses are projected to grow is consistent with reasonable long term projections of inflation.

# MILLENNIAL HOUSING COMMISSION
# PRESERVATION AND PRODUCTION TASK FORCES
## CONCEPT PAPER:
## LONG TERM SUSTAINABILITY AND AFFORDABILITY

### THE ISSUE

Most affordable housing is financed with relatively aggressively underwritten debt, little or no true equity (whose return is earned through cash flow), and using governmental subsidies to fund the balance of development costs. Many, perhaps most, of these properties require additional governmental subsidy later.

This paper discusses an alternative approach, using less debt plus a material amount of true equity, in combination with an increased amount of governmental subsidy. The alternative approach offers a number of potentially powerful advantages, including a greatly reduced likelihood that future governmental subsidies will be required.

**The Status Quo.** Most past and current approaches for subsidized rental housing production and preservation require an additional injection of government subsidy relatively early in the property's life cycle. Typically, roughly between years 15 and 25, subsidized rental properties require additional capital for some combination of repairs, repositioning, and financial restructuring. If this capital is not forthcoming when needed and in the amount needed, the property faces some combination of loss of quality, loss of affordability, and financial failure. This capital generally cannot come from private sources. First, often the properties are structured so that there is little if any economic equity[1]. Second, even if there is equity, often that equity can only be accessed by terminating affordability (for example, by raising rents to market levels).

**A Potential New Approach.** The Committee wishes to explore whether it is feasible and appropriate to follow a different approach, under which properties would not require additional governmental subsidy for a much longer period such as fifty years[2]. In general, this "sustainable" approach would use more conservative underwriting, so that the property could absorb moderate income and expense shocks without undue risk of failure, and so that the property could self-fund its long term capital needs (through some combination of operations,

[1] Often, the property was designed not to have equity, as a result of utilizing mortgage debt with an unsupportable principal amount. Production programs attempted to offset the unsupportable principal amount through some combination of a below market interest rate, deferred debt service payments, and / or above market rents. So long as the property remained viable, this financial engineering was relatively harmless. However, if the property failed financially, the property found itself over-leveraged, and the government found itself needing to fund a large debt write-down before workout discussions could even begin.

[2] Fifty years is an example of a period long enough for sound capital planning, in that it encompasses at least the first replacement of most major high-cost systems (e.g., elevators, masonry tuckpointing, and in-ground and in-wall utilities). It is also short enough to terminate prior to the need for major redevelopment, demolition, or change of use. Finally, it is long enough to encompass most of the useful life of the buildings. Although a capital planning period beyond fifty years may not be sensible, there is much to be said for an affordability period longer than fifty years (but incorporating increasing flexibility as the building ages, so as to permit appropriate redevelopment).

reserves, cash flow, and periodic refinancing).

**Why Sustainability May Be Worth Pursuing.** If, in the future, funding for subsidized rental housing were tied to sustainability principles, a number of positive outcomes would occur:

- The percentage of governmental subsidies needed to shore up existing subsidized rental housing would drop steadily from its current high level.
- Affordable housing would have a much more market-like financial structure in which market discipline and market forces would be much more powerfully engaged than is now the case.
- The economic rationale for developing and owning subsidized rental housing would shift from the current focus on up-front fees to a balance between up-front fees and longer-term economics driven by asset management fees and distributable cash flow.
- A new category of investor – the provider of true real estate equity capital, whose return is realized from distributed cash flow – would appear, bringing increased financial discipline to properties and their owners and managers.
- Residents would be much more likely to receive the quality of housing that is intended.
- There would be far fewer incidences of troubled properties.
- Properties that were troubled would rapidly be resolved.
- Public attitudes toward subsidized rental housing would become progressively more and more positive as the incidence of troubled properties declined.

A detailed discussion of factors for and against sustainability is included later in this paper.

## STRUCTURE OF THIS PAPER

This paper contains three primary sections:

- **"Term Sheets".** Two "term sheets" are included. The first addresses the development concept itself. The second addresses financing and underwriting. Taken together, the term sheets illustrate the design, development, underwriting, financing and management practices that would be appropriate for affordable housing that is to be both affordable and viable on a long term basis, without the need for periodic injection of subsidy funds. Allocating agencies would adopt these term sheets, or equivalent, for purposes of evaluating future proposals from developer / sponsors.

- **The Case For and Against Sustainability.** Reasons for and against a long-term-sustainable approach to affordable housing development, management and financing.

- **Illustrative Example.** Appendix 1 contains a simple spreadsheet comparing the traditional and sustainable approaches, for a hypothetical affordable housing property.

# TERM SHEET FOR
# LONG TERM SUSTAINABILITY AND AFFORDABILITY:
# THE DEVELOPMENT CONCEPT

**Professional Ownership.** The ownership entity is led by a "preserving entity" that combines a commitment to affordable housing, strong real estate and business skills, and the organizational capability to conceptualize, package, develop, stabilize, and operate affordable housing.

**Professional Management.** The property management firm is committed to the management of affordable rental housing as a major line of business. The firm features top quality staff, an effective business and policy framework, and a commitment to continuous learning.

**Sustainable Design.** Design is compatible with other buildings in the neighborhood. Scale is consistent with the neighborhood. The property is physically and socially integrated into the surrounding area. The property is inherently crime-resistant, using "defensible space" approaches or equivalent.

**Cost-Efficient.** The property is cost-efficient in every way: in its design, development costs, energy consumption, operating costs, and long term capital needs. The exterior design is low-maintenance. When selecting materials and construction approaches, developers consider not only the up-front cost but also longer-term factors such as durability, quality of warranty, ease of maintenance, maintenance costs, expected useful life, curb appeal, resident comfort, and energy consumption.

**Target Market.** The development concept is firmly grounded in the demonstrated housing needs of a clearly defined target market that is adequate to support the property and that has housing needs severe enough to justify the public funding required.

**Use Agreement.** The availability of the property for long-term affordable housing use is assured through a binding covenant running with the land. The long-term affordability of the property is not dependent on the identity or motivations of the sponsor, and is assured even if the property fails financially and undergoes a workout or a foreclosure. The length of the use agreement term and the level of affordability it requires are appropriate for the property, its target resident population, and the subsidies with which it is financed. Long use agreements provide increasing flexibility (for example, in income mixes) over the term.

**Community Building.** The development plan makes appropriate provisions for creating a community in which residents know each other, residents and management and neighbors interact regularly and productively, and in which community governance is responsive to the evolving needs of residents and neighborhood.

**Non-Housing Services.** The development plan identifies any services that are appropriate and necessary in order to serve the target market. Any such services are fully funded for a reasonable period of time. If such services are needed but are not fully funded on a long-term basis, the property is capable of continuing as affordable and sustainable in the event the services must be discontinued.

# TERM SHEET FOR
# LONG TERM SUSTAINABILITY AND AFFORDABILITY:
# UNDERWRITING AND FINANCING

**First Principle: Financial Flexibility to Absorb Unanticipated Costs.** A primary goal of sustainable underwriting and financing is to give reasonable assurance that the property can survive unanticipated financial "shocks" such as temporary market weakness, fluctuations in utility rates, local decisions to dramatically increase real estate taxes, fluctuations in the property insurance markets, and operating costs that escalate more rapidly than the allowable rents. This is achieved through some combination of allowance for vacancy loss, conservative projections for operating expenses, and adequate debt service coverage ratio. A possible additional resource is additional flexibility to increase rents (while still maintaining affordability).

**Second Principle: Ability to Self-Fund Long-Term Capital Needs.** The second primary goal of sustainable underwriting is to give reasonable assurance that additional governmental subsidies will not be needed to meet the property's long-term capital needs for an extended period such as fifty years. The capital needs would be funded through a combination of initial reserves, future reserve deposits, future refinancing, and future cash flow not needed to provide an equity return.

**Affordable Rents.** Affordable to the target market and below comparable market levels.

**Modest Annual Rent Increases.** The owner may increase rents modestly in accordance with an inflation indicator, without needing approval from government. The projected annual rent increases are expected to be affordable to the target market.

**Adequate Allowance for Rent Loss.** If the property's intended rents are at or only marginally below market levels, the rent loss allowance will reflect an average-of-cycle condition for otherwise similar market rate properties, typically 7% to 9%. If the rents are materially below market levels, the rent loss allowance can be lower, but no less than 5%.

**Adequate Operating Expenses.** Operating expenses are underwritten based on typical expenses for similar affordable properties in the same market area with good (not necessarily outstanding) management and that are at least five years old. Underwritten expenses reflect typical results under typical (less than ideal) conditions.

**Asset Management Fee.** The operating budget includes a fee designed to cover the owner's reasonable costs of asset management. The size of the fee is reasonable in light of the ownership tasks required and in light of any performance-based requirements for payment of the fee (e.g., if the fee is expected to be earned only some of the time, the fee amount should be higher so that, on a portfolio basis, a performing owner would generate sufficient funds to cover costs and risk).

**Adequate Reserves.** The property's reserve deposit is based on a property-specific long-term capital needs projection. The underwriting will demonstrate the property's ability to self-finance its capital needs (not necessarily solely from reserves) over a period of at least fifty years.

**Reasonable Debt Service Coverage.** The underwriting, when viewed in its entirety, gives

reasonable confidence that the property can withstand moderate shocks without failing financially. For typical underwriting, a DSCR in the 1.20+ range, with a projected operating cash flow of at least 3% of EGI, would be reasonable.

**Reasonable First Mortgage Debt.** Typically, the first mortgage should have a fixed interest rate and be self-amortizing through constant level monthly payments, over a loan term not to exceed thirty years[3]. Departure from the typical characteristics would be accompanied by other features of the transaction providing additional financial robustness, for example: rents that are at least 10% below comparable market levels, and / or a reserve deposit that is designed to fund 100% of long term capital needs, and / or a higher DSCR. If the financing is tax-exempt, the loan amount is not more than the amount that could be achieved with conventional (non-tax-exempt) financing[4].

**Owner / Developer Incentives.** In general, the developer makes more money when the property is sustainable and makes less money when the property is not sustainable. The most powerful incentive is the fact that development proposals must be based on sustainability principles in order to be approved. Another example is the asset management fee discussed above. Another potential developer incentive is to escrow a portion of the developer fee that is now paid in cash upon completion (or lease-up, or other traditional trigger point) until the property achieves targeted sustainability-related results, for example:

- Adequate Reserves. The existing reserve balance, plus projected deposits, is determined adequate in accordance with a third party professional capital needs assessment, acceptable to and approved by government, with an appropriately long time horizon.
- Net Cash. The property has cash in excess of accounts payable ("positive Surplus Cash" in HUD terminology).
- Cash Flow. The property's actual cash flow meets or exceeds levels originally determined to be consistent with sustainability.

**Governmental Incentives.** The governmental agency (ies) that provided the subsidies also have incentives and disincentives that are aligned with the property's sustainability. For example:

- Future Allocations. Each year's allocation formula (by state for LIHTCs, by participating jurisdiction for HOME funds, by HUD Hub or Program Center for §202 and §811 funds) could reward allocators whose previously funded properties are meeting sustainability targets, by directing additional subsidies to them for allocation to developer / sponsors.
- Requirement to Cure Failing Properties. Agencies could be required to set aside significant amounts of otherwise discretionary funds to cure properties that are actually failing (for example, have accounts payable in excess of cash, or negative cash flow, or physical deficiencies), with additional consequences if the property is still failing after a reasonable period of time such as two years. This would provide a powerful incentive to agencies to achieve property success while giving agencies flexibility to negotiate workout / restructuring / transfer / refinancing transactions that respond to individual property needs and that share the costs of restructuring appropriately between agency,

[3] Although 40 year terms (FHA and some tax-exempt bond transactions) and 50 year terms (RHS) are traditional, such loans amortize so slowly that there is little or no ability to refinance to help meet the property's first wave of heavy capital needs at years 15-25. For example, an 8% / 40 year loan amortizes less than 20% in its first 20 years.

[4] Else, the property would be over-leveraged, the "owner" would have inadequate equity, and the bondholders would be the actual "owners" of the property if anything went wrong.

owner and other stakeholders.

- Requirement to Fund Sustainability. With respect to properties that are not failing but that have not achieved sustainability, agencies could be required to set aside otherwise discretionary funds, with additional consequences if the property is still not sustainable after a reasonable period of time such as two years. As with the previous example, this creates powerful incentives in favor of sustainability without tying the agency's hands in terms of achieving a resolution that makes sense for each individual property.
- Choice Among Alternative Allocators. If a particular allocating agency has a particularly poor track record in terms of achieving success and/or sustainability, Congress could provide that future funding and authority be transferred to an alternative allocating agency.

## WHAT ABOUT VERY-LOW-MARKET-RENT NEIGHBORHOODS?

Some subsidized rental housing is located in neighborhoods with comparable market rents that are too low to cover operating costs, reserves and vacancy loss, even if the property has no required debt service payments. This pattern most commonly occurs in distressed inner city neighborhoods and rural areas. The problem is exacerbated whenever operating expenses are abnormally high (for example, because of high maintenance costs in the inner city, or because of the higher operating costs of elevator buildings for the elderly).

For such properties, it is not possible to achieve sustainability until neighborhood market rents rise significantly. Policymakers may nonetheless determine that developing affordable housing in such an area is appropriate. In such situations, the property should be structured to be as close to sustainable as possible, in particular:

- Zero debt. Total development costs should be funded by grants, as in the §202 and §811 programs.

- 100% project based deep subsidy. Again, this mirrors practice in the §202 and §811 programs.

- Adequate reserves. Because there is no ability to refinance, the reserve for replacement must be adequate to fund 100% of capital needs for an extended period such as fifty years.

- Adequate operating margin. The rents must include an amount over and above anticipated costs of operation, so that the property can weather moderate "shocks" without failing.

## THE CASE IN FAVOR OF SUSTAINABILITY

The status quo has at least the following significant drawbacks that, in combination, may be sufficient to justify developing a new approach:

- **Downstream Funding Problems.** Downstream government funding is likely to be inadequate to meet the needs of all worthy properties. Similarly, government will make mistakes in assessing the needs of properties. As a consequence, funding likely will be piecemeal and inadequate. Funding may arrive years after it is needed. In the absence of adequate and timely subsidy, the property deteriorates, loses affordability, or fails financially, often harming the residents and neighborhood in addition to the owner.

- **Lack of Economic Value.** A property that is not viable except with new government subsidy is a property that has no economic value to its current owner. The owner thus has little opportunity to be 'part of the solution', a situation that is likely to result in some owners becoming 'part of the problem.'

- **Over-Leverage.** Often, affordable properties find themselves needing new capital but saddled with debt (typically held by, or guaranteed by, the federal government) that has modest debt service payments but an unpaid principal balance that dramatically exceeds the property's economic value. In such situations, no one – the owner, a purchaser, a state or local government – can solve the problem until the federal government brings the debt down to size. In such situations, unless the federal government is unusually proactive and agile, properties can spiral downward even when there are non-federal stakeholders who are able and willing to rescue it.

- **Finger Pointing.** When a property fails, rather than taking the stoic (and expensive) view that significant numbers of failures are built into the system, and cutting the debt down to size so that other stakeholders can act, the federal government is tempted to attribute the failure to the owner and manager, or to demand that the owner make economically irrational additional investments to solve the problem. The ensuing process of allocating blame, although sometimes necessary, is always counterproductive from the standpoint of returning the property to viability.

- **Lack of True Equity Capital.** If the property is designed to be economically worthless after 15-25 years, private equity capital will be attracted only for non-traditional reasons such as tax benefits (including LIHTCs). As a result, development must be financed almost totally by grants and debt, with government providing the "first-loss" slice of capital that normally comes from private equity investors. Thus, when the property runs into difficulty, government immediately owns the problem. Conversely, true economic equity would provide a powerful accountability mechanism for owners that is lacking in the status quo.

- **Over-Rehabbing.** Properties that are successful in attracting downstream government subsidies will naturally try to acquire as much subsidy as possible, so as to prolong the period until the next injection of subsidy will be needed. Consequently, those properties that are preserved are likely to be over-funded.

- **Front-Loaded Economics.** Owners' profit opportunities are limited to those occurring at original development, acquisition, and rehabilitation. Owners thus tend to be financially interested in properties at the beginning and then not for many years afterwards. Similarly, this pattern of profit opportunities leads to pressure for "churning" – the periodic sale and rehabilitation of properties – whether or not that is the right outcome for the property.

- **Lack of Long-Term Excellent Owners.** Because ownership is not a viable business, there is no opportunity for ownership organizations to develop and thrive. Those "owners" who do survive long-term do so because of profits from other activities such as development and property management.

- **Happy Stakeholders – With Significant Exceptions.** The status quo is viable for developers, property managers, syndicators, lenders, accountants, consultants, and most other stakeholders, all of whom have reasonable economic opportunities and viable businesses. Owners and the federal government (and, all too often, residents and communities) are left holding the bag when properties fail. Because the pain of failure is concentrated in only a few stakeholders, there has been relatively little pressure for change.

**Role of the Federal Government in Initiating Change.** Logically, as long as the federal government is willing to continue a fundamentally short-sighted approach to the funding of subsidized rental housing, the other stakeholders – including owners – will continue to figure out ways to cope. Thus, change is unlikely unless initiated by the federal government itself. A recommendation from the Commission could be the catalyst for change.

## THE CASE AGAINST SUSTAINABILITY

Arguments against conversion to a "sustainable" model include:

- **Timing of Costs.** It is clear that developing subsidized rental housing under a "sustainable" model will involve additional up-front subsidy, offset by avoiding "bail-out" subsidy later. However, when a sustainable approach is implemented for the first time, federal funding will have to serve two purposes: bailing out properties developed earlier, and subsidizing new properties to a greater degree. Either funding will have to be increased, or the number of new properties that can be developed will drop. This problem will persist for several years, perhaps for a full 15-25 year cycle.

- **Amount of Incremental Up-Front Subsidy.** The extent of the incremental up-front subsidy is subject to debate but is certain to be material. A series of financial models to be produced for the Committee's review will attempt to quantify this incremental up front cost. See also Appendix 1, which indicates that the up-front subsidy likely would increase at least ten percent but probably not more than twenty-five percent.

- **Track Record.** Some argue that there is no need to convert to a new, more expensive

approach because, despite the preceding list of flaws, the current system has successfully produced roughly two million units of subsidized rental housing, most of which continue to provide adequate and affordable housing.

- **LIHTC.** Some argue that many of the criticisms are true of earlier programs but are not true for the most recent program (LIHTC). LIHTC avoids many of the pitfalls associated with earlier programs. In particular, its reliance on private capital means that private debt and equity investors – rather than the federal government – bear most of the risk of the property's financial failure.

## AUTHOR

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# APPENDIX 1: SIMPLIFIED FINANCIAL ANALYSIS

Appendix 1 provides an initial simplified example for review and comment, illustrating various underwriting adjustments that likely would be needed to support sustainable development, by comparison to a more or less worst-case "traditional" approach (with rents at 100% of market, aggressive underwriting, and inadequate reserves). In summary, the worst-case traditional approach requires up-front subsidy of roughly 39% of total development cost. The sustainable approach requires a rather larger up-front subsidy of roughly 53% of total development cost, roughly one-third more up-front subsidy.

As noted in the notes to the Appendix, this one-third increase is probably toward the high end of the range of likely results but suggests that the amount of additional subsidy is likely to be material. If Appendix 1 represented the average result (rather than a worst-case result), the number of units developed with any given amount of up-front subsidy would drop by one-fourth (the amount of up-front subsidy needed to produce four units under the traditional approach would be adequate for only three units under the sustainable approach). Conversely, if Appendix 1 does represent a worst-case result, the increase in up-front subsidy required to achieve sustainability could well be no more than 10% to 15%, and is unlikely to exceed 25%, when averaged across the full range of properties. Future analysis will attempt to arrive at a more accurate estimate of additional up-front subsidy necessary to produce sustainable properties.

It is useful to consider the cost to bail out properties under the traditional approach.

- Preservation. In HUD's Preservation programs in the mid 1990s, government paid owners fair value for their right to convert to market rate use and funded needed repairs as well. In these programs, governmental costs averaged $15,000 per unit when the existing owner remained in place and $30,000 per unit when there was a transfer of ownership to a nonprofit[5].
- Mark-to-Market. In HUD's Mark-to-Market program, government pays to reduce the first mortgage loan to an amount that is consistent with sustainability principles, plus transaction costs and immediate repairs. In the Mark-to-Market Demonstration program, these costs averaged close to $15,000 per unit[6].
- LIHTC. A common approach for preservation transactions is to utilize volume-cap tax-exempt bonds and 4% LIHTCs. Typical transactions involve cost to government with a net present value of $20,000 to $25,000 per unit[7].

As the following analysis shows, these amounts are quite a large percentage of the amount of governmental subsidy needed to facilitate development under the traditional approach. In the traditional approach, in effect government commits $25,000 to $30,000 per unit in subsidy now,

[5] Part of the higher cost of transfers is that, in transfer transactions, owners received 100% of their "preservation equity" versus 70% in "stay-in owner" (non-transfer) transactions.
[6] Unpublished HUD analysis of Demonstration program closings.
[7] For illustration: $60,000 total development cost x 75% eligible basis x 4% credit = $1800 credits per year for 10 years = $13,250 per unit NPV at a governmental 6% discount rate. Tax-exempt loan at $45,000 per unit / 6% / 30 years is worth $36,800 at a market 8% interest rate, implying that the governmental subsidy is worth $8,000 per unit to the developer (and with a cost to government that is somewhat higher, reflecting government's lower cost of funds). $13,250 plus $8,000 is $21,250.

with a moral commitment to spend roughly that same amount again twenty years later. As noted at the end of the Appendix, comments are invited on the various assumptions used.

## CAPITAL SUBSIDY REQUIRED FOR SUSTAINABLE DEVELOPMENT

**Traditional vs. Sustainable Development**
**80 Unit Property**

| | Traditional | | Sustainable | |
|---|---|---|---|---|
| Gross Potential Rent | $576,000 | $600 | $552,000 | $575 |
| Rent Loss | (28,800) | 5% | (38,600) | 7% |
| Other Income | 8,000 | $100 | 8,000 | $100 |
| Effective Gross Income | $555,200 | | $521,400 | |
| Operating Expenses | (220,000) | $2,750 | (240,000) | $3,000 |
| Reserve Deposit | (20,000) | $250 | (28,000) | $350 |
| Asset Management | 0 | $0 | (16,000) | $200 |
| Net Operating Income | $315,200 | | $237,400 | |
| Debt Service | (286,500) | | (197,800) | |
| DSCR | 1.10 | | 1.20 | |
| Operating Cash Flow | $28,700 | | $39,600 | |
| % of EGI | 5.2% | | 7.6% | |
| Total Development Cost | $5,600,000 | $70,000 | $5,600,000 | $70,000 |
| Supportable Debt | (3,434,000) | | (2,246,000) | |
| Supportable Equity | 0 | | (396,000) | |
| **Capital Subsidy Needed** | **$2,166,000** | **$27,075** | **$2,958,000** | **$36,975** |
| % of TDC | 39% | | 53% | |
| Mortgage Interest Rate | 7.50% | | 8.00% | |
| Loan Term | 40 | | 30 | |
| Credit Enhancement | 0.50% | | 0.00% | |
| First Year Equity Yield | n/a | | 10.00% | |

**Notes to Appendix 1**

**"Traditional" Approach Summarized.** The "traditional" column features rents at 100% of market, standard (aggressive) underwriting, reserves that are not adequate to fund long-term capital needs, and first mortgage financing that offers little prospect for refinancing in the medium term. A property financed in this way is highly likely to experience negative cash flow whenever anything goes wrong, and is nearly certain to require significant additional governmental subsidy as it hits its first wave of major capital needs at years 15-25.

**Two Needs For Additional Up Front Subsidy.** The incremental capital subsidy needed to support the "sustainable" approach can be considered to have two dimensions. First, some of the incremental subsidy reduces the likelihood of negative cash flow in the short term (e.g., the subsidy needed to support the lower rents, higher rent loss, higher operating expense amounts, and greater debt service coverage). The remaining incremental subsidy supports the property's ability to self-finance its long-term capital needs (e.g., the subsidy needed to support the higher reserve deposit and faster-amortizing debt).

**Sustainable Development Includes True Economic Equity.** The sustainable approach involves true economic equity. Accordingly, the estimate for operating cash flow in the sustainable model represents distributable cash over and above any amounts needed to fund operating deficits or to supplement inadequate reserves. It would, of course, be possible to fund some of the property's long-term capital needs from cash flow, especially in properties for which it is reasonable to project an expanding cash flow as the property ages. However, cash flow that is intended for those purposes would not be available to support true economic equity. That is, there is no "free lunch" – equity investors will pay up for distributable cash flow but not for cash flow that is earmarked for other purposes. The cash flow shown in the traditional model is not "bankable" because an investor would not expect to receive it – instead, the investor would expect the projected cash flow to be diverted to supplement inadequate operating budgets, inadequate vacancy allowances, and inadequate reserves. That is, the investor would not find the traditional underwriting credible and would expect an actual DSCR of 1.00 or below, as opposed to the projected DSCR of 1.10.

**Additional Market Discipline of True Economic Equity.** A side effect of having true economic equity is that the sustainable approach is not as heavily reliant upon debt financing as the traditional approach. Admittedly, private equity capital is more expensive than mortgage debt. However, the need for private equity capital introduces an additional market discipline. If the development concept, development team, and financial projections are not credible to equity investors, the equity funds will not be forthcoming. This additional discipline could well be extremely valuable to government, as an additional check – and – balance on the reasonableness and feasibility of the development proposal.

**Potential Impacts on Total Development Cost.** Because the traditional approach involves a high likelihood of financial stress (if not outright failure), logically the total development costs include some amount (probably in developer fee, LIHTC investor yield, and/or syndicator load) of compensation for that risk that would not be needed in the sustainable approach. Similarly, the provision of an explicit asset management fee in the sustainable model might make development feasible at a lower developer fee. It is therefore possible that a sustainable approach would involve lower total development costs, although the example above assumes that TDC would be

the same in either scenario.

**Brief Discussion of Key Assumptions**

- Gross Potential Income – assumes that the sustainable approach will require underwriting at slightly lower rents, for two reasons. First, to produce affordability below market rents. Second, to provide affordability to a broader range of low income households.

- Rent Loss – the sustainable approach uses a 7% rent loss allowance, reflecting typical results when large numbers of markets are averaged, or when a single market is averaged across the real estate cycle.

- Operating Expenses – assumes that the sustainable approach will require higher (realistic) operating expenses. The amounts selected for traditional and sustainable represent typical amounts for average cost areas.

- Sustainable Funding for Capital Needs – preliminary analysis conducted for the Commission suggests that, for new construction garden apartments in modest cost areas, an initial deposit of $300-$350 per unit per year is likely to be adequate to fund all capital needs for the property's first 15-20 years, if subsequently adjusted for inflation, and if the balance is invested at passbook rates. Sustainability past year 15-20 would require additional funding. For example, preliminary analysis indicates that increasing an initial $350 PUPA reserve deposit at inflation plus 400 basis points for the first twenty years would provide sufficient additional funding for fifty-year sustainability. Similarly, a refinancing at year 15-20 that generated $7,500 per unit (in today's dollars) to supplement the reserve would also support fifty-year sustainability, when combined with a $350 PUPA reserve deposit increased at the rate of inflation. A variety of other approaches would be equally effective. These illustrations are specific to new construction (where the reserve builds for several years with few if any withdrawals) in a modest-cost area. In a rehab situation, or for an older property, or in a higher-cost area, the needed reserve deposit (and needed supplemental funding for fifty-year sustainability) likely would be higher.

- Reserve Deposit – traditional reserve deposit amounts range from $200 to $300 per unit per year. The sustainable approach assumes a $350 per unit per year reserve deposit.

- Asset Management – benchmarks for asset management fees are few and far between. Available benchmarks suggest that an asset management fee in the range of half the property management fee is justifiable and is likely to be adequate.

- DSCR – the traditional approach reflects the FHA standard 1.10 DSCR for the §221d4 program. The sustainable approach reflects 1.20 computed against a much more conservative NOI, roughly equivalent to a 1.50 DSCR using the traditional underwriting approach.

- Loan Terms – assumes an FHA §221d4 for the traditional approach and a conventional 30 year loan for the sustainable approach. The shorter amortization period gives much

more potential for refinancing at the time of the first heavy capital needs cycle (year 15-25). At an 8% rate, a 40-year loan pays down less than 20% in 20 years, whereas a 30-year loan pays down 40% in the same period.

- First Year Equity Yield – assumes that a private equity investor would accept a 10% cash on cash yield in the first year. This assumes that the projected cash flow is credible and is entirely distributable.

# MILLENNIAL HOUSING COMMISSION
# PRESERVATION AND PRODUCTION TASK FORCES
## CONCEPT PAPER: MIXED INCOME RENTAL HOUSING

## OVERVIEW

The purpose of this paper is to outline what mixed income housing is, why it is being pursued, what has been learned about how to successfully produce and sustain it, and what those lessons imply for mixed income housing policy going forward.

As noted in more detail below, mixed income properties are more likely to be located in low poverty neighborhoods and are more likely to engage market discipline, by comparison to properties serving a 100% very low-income clientele. In addition, mixed income properties are generally expected to generate sociological benefits.

It should be noted, however, that the primary affordable housing problem in America (in some communities, the only affordable housing problem) is an extreme shortage of housing of acceptable quality and with rents affordable to extremely-low-income households (below 30% of area median income). This paper is not an attempt to ignore that problem or to undermine other efforts to address it. For example, the conversion of an existing concentrated-poverty community into a mixed-income community should be combined with other housing initiatives so that there is not an overall reduction in affordability to ELI households.

## POTENTIAL ADVANTAGES OF MIXED INCOME HOUSING

**Market Discipline.** Properties at which some residents pay market (or near-market) rents are presumed to be more likely to be successful, because the forces of market discipline are engaged. In particular, households who can – and will – "vote with their feet" provide a powerful incentive in favor of responsive management, fair rents, and good housing quality. This is a sound and credible argument.

**Viability.** If most residents' incomes can be expected to grow at least as rapidly as operating costs, the property is more likely to be viable over time. By contrast, many affordable housing professionals worry about the ability of very low-income households to afford the rent increases that likely will be necessary to support the ongoing viability of properties.

**Avoids Concentration of Poverty**[1]**.** By comparison to properties serving only the extremely poor, mixed income housing is considered much less likely to become a dysfunctional community. The following sociological benefits are cited by mixed income housing advocates:

- Improved Conduct of Residents. If non-working adults and their children, when living in a setting dominated by working families, are less likely to engage in anti-social conduct

[1] For an in-depth discussion of the problems associated with concentrations of extreme poverty, see William Julius Wilson, *The Truly Disadvantaged*.

than when living in a concentrated-poverty setting, then the mixed income community will create sociological benefits *whether or not* there is social interaction between working and non-working families.

- Strengthening Abutter Properties. When a concentrated-poverty property fails sociologically, neighboring properties suffer as well. If the mixed income approach reduces the risk of adverse sociological consequences, risks would be reduced for the entire neighborhood.

These claims resonate with the practical experience of most affordable housing professionals, reflecting a growing consensus that mixed-income is the preferred approach for serving extremely low-income families. By contrast, there is much disagreement among affordable housing professionals on the question of whether 100% extremely low-income-family properties should continue to be developed. There is some evidence that such properties can succeed when coupled with capable and intensive management, plus appropriate non-housing services. Conversely, such properties have been especially prone to failure, with some of the failures being particularly damaging to all concerned.

**Role-Modeling Benefits.** Additional sociological benefits are possible, at least in theory:

- Role Modeling for Children. Mixed income communities could allow children to grow up in a culture of work in which they have working adults as role models. There is some evidence that if children are not exposed to working-adult role models early in life, it is much less likely that – as adults – they will be able to get and hold regular jobs. Conversely, there is some evidence that active role-modeling intervention with at-risk teens can achieve considerable success[2].

- Job Networking for Adults. Mixed income communities could give non-working adults access to informal networks of working neighbors -- networks through which jobs could be found.

However, these latter two benefits are likely to depend on a relatively high level of social interaction between the non-working and working households. Although (as noted later in this paper) there are some mixed income developments at which this level of social interaction actually occurs, such developments are greatly outnumbered by those at which there is very little social interaction. As against that, it should be noted that high levels of social interaction are not the norm in pure market rate apartment communities, 60%+ of whose residents will move within a year. Accordingly, it may be unrealistic to expect high levels of social interaction in mixed income communities. Also, a low-income parent who wants to instill work-related values in his or her children is probably better able to do so when the family lives in a community in which most adults work, even if the children do not have regular social contact with those adults.

**Political Benefits.** Additional advantages of mixed income properties include:

- Relative Ease of Approval. Developers consistently report that mixed-income properties

[2] The Cambridge MA Housing Authority created such a program, called Workforce, aimed at 13-18 year old housing authority residents. 80% of the graduates of the program go to college each year.

are less difficult to develop. In particular, local approvals (such as for zoning) are more likely to be obtained. Mixed income developments are less likely to give rise to NIMBY reactions.

- Political Constituency. Many advocates believe that the public in general, and legislators in particular, are more likely to support housing when a significant number of its residents are people "who work hard and play by the rules."

- Political Visibility. Many affordable housing professionals believe that mixed-income communities are more likely to be successful in advocating for improved municipal services.

**Misleading Claims of Cost Effectiveness.** Some argue that mixed income housing is more cost effective because higher income households are less expensive to serve. This is a misleading argument that is not relevant to the central question – whether it is better to serve very low-income households in a mixed income setting or in a concentrated-poverty setting. Said differently, the appropriate comparison is between the governmental subsidy required to produce and sustain (a) a 40 unit property for very low-income families; and (b) a 200 unit property, housing 40 very low income families plus 160 households at (or near) market rent.

**Potential for Cross-Subsidy.** Some argue that rents from market-rate units can be used to create an internal cross-subsidy that supports below-market rents for the affordable units. There is ample evidence that this can occur over time in properties whose market rents escalate rapidly (market rents are escalated along with the market, generating excess cash flow from which the cross-subsidy can be funded[3]). It is unlikely, however, that this approach will be viable at the time of development[4] for any substantial number of properties.

**Doing Nothing Is Too Risky.** Some argue that, because of the severity of the adverse consequences of concentrated-poverty properties, it is good public policy to pursue mixed income approaches even if it cannot be convincingly demonstrated that mixed income approaches are superior. A variant of this argument is that mixed income approaches must be pursued vigorously even though we may not know exactly how to make them work well consistently, because the chance that we will not discover how to make mixed income approaches work is outweighed by the near certainty of failure if we continue to pursue concentrated-poverty approaches.

**A Word of Caution.** As against these advantages, it must be said that mixed income housing runs contrary to the very prevalent – though not universal – tendency of Americans to segregate

[3] This has occurred in several market-rate properties developed and owned by the Montgomery County MD Housing Opportunities Commission. One such property was originally targeted for 20% low-income occupancy but now can afford to support 40% of the units at below market rents because of the rapid increase in rents for the market rate units.

[4] Traditional real estate economics teaches that market rents do not exceed the rents necessary to justify new construction, except for rare and fleeting moments (or in markets with powerful barriers to entry). Thus, new market rate properties almost always struggle in their early years. Similarly, not even the best market rate developers make money on every development. A corollary is that affordability that is to be created at the time of development requires subsidies of some sort, to buy down the development costs to a level that can be supported by the below-market rents.

themselves by income. It is therefore not surprising that mixed income housing requires care in design and operation, in order to succeed.

## MIXED INCOME HOUSING DEFINED

From among the various competing definitions, this paper will use the following definition of mixed income housing:

> Mixed income housing is rental housing that combines (1) a significant number of families that include children and that are dependent upon public assistance, and (2) a significant number of working families with incomes above the poverty level[5].

**Rental Housing.** We concentrate on rental housing, because that is the focus of the Subsidized Rental Housing Committee.

**Low-Income Families With Children.** We specify families with children, because a major purported benefit of mixed income housing is role modeling for children by working adults[6].

**Working Families Above The Poverty Line.** We specify working families above the poverty line (roughly 30% of area median income) because the role model benefit is not likely to be dependent on the level of income – rather, it stands to reason that the role model benefit occurs because the adults work and can support themselves and their families[7]. This definition would encompass market-rate properties that include a significant number of voucher holders, as well as more traditional "affordable" properties at which all residents enjoy below market rents and that have income limits applicable to all resident households.

**Significant Mix of Incomes.** We specify a significant number of assistance-dependent households because, all else equal, the more such households served the better. We specify a significant number of working families because the number of such families must be sufficient to achieve the desired role-modeling effect, to achieve the desired social-networking effect with respect to non-working adults, and to achieve the desired deconcentration of poverty and market discipline. Particular threshold percentages of non-working and working households are discussed later in this paper.

**Working Families With or Without Children?** The definition above does not address whether the working families include children. If children of the working families attend the same school as children of the non-working families, arguably social interaction would be increased, and the "culture of work" benefits might be achieved. As noted later in this paper, however, in general the higher income households in mixed income housing are relatively less likely to include children. Similarly, a mixed income development in an area considered to have poor public

[5] An argument can be made for a higher income threshold, at a level sufficient to support the family without subsidy of any sort. Similarly, an argument can be made that a small concentrated-poverty property within a viable low-poverty neighborhood could achieve mixed-income benefits.
[6] Moreover, the problem of poverty in America is significantly concentrated in families with children.
[7] An argument can be made for an income threshold that exceeds the poverty line – on the theory that poverty-line income is not likely to be sufficient to support the family in the absence of subsidies.

schools is unlikely to be able to attract and retain significant numbers of higher-income families whose children attend the public school. Nonetheless, some mixed-income properties are successful in attracting and retaining these families – a worthy subject for future research.

## APPROACHES FOR CREATING MIXED INCOME HOUSING

Subsidized rental housing could meet this mixed-income housing definition through any of the following means:

- **Partial Project Based Deep Subsidy.** Some units could house extremely low-income families with project-based §8 assistance (or RHS Rental Assistance). The remaining units would have rents affordable to working households[8].

- **100% §8 But With A Broad Range of Incomes.** Despite having full (or nearly full) deep subsidy coverage, properties could nonetheless achieve a range of incomes encompassing a significant number of working families, for example through a working-family admission preference. Khadduri and Martin suggest a definition under which at least 20% of the residents have incomes above $20,000 and at least 20% have incomes under $10,000[9].

- **100% §8 And Low Income But With A Working Family Profile.** Despite having full (or nearly full) deep subsidy coverage and having few families with above-poverty-level incomes, most families work. Khadduri and Martin suggest a definition under which 70% of the households have wages as their primary source of income.

- **Scattered Sites.** By developing small subsidized properties in otherwise low-poverty neighborhoods, sponsors can achieve income mixing. There is a strong track record of success in rural areas in particular, with scattered duplexes and single-family rentals. The desired role-modeling benefits would be achieved if there were sufficient social interaction. The desired market discipline benefits would be achieved if the property contained some units at working-household rents. This approach has the disadvantage of higher operating costs -- the small number of units is less cost effective, and the scattered locations require more management oversight

- **Tenant Based Assistance.** Vouchers could be used in properties otherwise available only to working families[10]. This could include both market-rate and lightly-subsidized properties (e.g., LIHTC properties).

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[8] If the non-deep-subsidy units are regulated (e.g., RHS §515, HUD §236, LIHTC), it will be important to ensure that the regulatory requirements support the mixed-income objective. Some existing requirements, for example a preference toward lower income households in RHS §515, may be counterproductive in this regard.

[9] "Mixed Income in the HUD Multifamily Stock", Jill Khadduri and Marge Martin, Cityscape, Volume 3, Number 2, 1997, U. S. Department of Housing and Urban Development, Office of Policy Development and Research, page 42. Khadduri and Martin originally proposed 10% to 15% thresholds but decided to use 20% after talking with managers of the less-mixed developments, which the managers often considered to be socially troubled.

[10] Owners and managers advise that significant reforms to the voucher program would likely be necessary in order to make this approach succeed. Problems most frequently mentioned include the payment standard, the 'reasonable rent' determination, lease terms, timeliness of inspections, and timeliness and accuracy of payments. The Commission is addressing these issues through its Tenant Based Assistance Committee.

- **Mixed Buildings.** It is possible that low-income buildings within an otherwise higher-income property could produce the desired sociological mixed-income benefits, depending on socialization patterns such as school attendance and participation in other community activities. However, owners and manager advise caution, based on experience with this property type. Often, the low-income building and its occupants become stigmatized. By contrast, owners and managers report that properties with the same income mix but with low-income units scattered throughout the buildings are much less likely to incur this problem. Also, a low-income-building strategy is risky in that it more or less commits the property to a particular income mix that might not be sustainable over the long term.

**An Important Distinction.** Some mixed-income properties will have the higher-income units at market rents or slightly below market rents; an example would be a market-rate property that included among its residents a number of voucher holders. Other mixed-income properties will have the higher-income units at rents that are significantly below market levels; for example, a LIHTC property whose LIHTC rents are $200 below market and that includes a partial project-based §8 contract. These are different approaches that will require different levels of subsidy and – quite likely -- different policy frameworks.

**Affordability Commitment In Exchange for Shallow Subsidy.** The Commission is considering various approaches for production of rental housing that is affordable to working families. Examples include making tax-exempt bond financing more available. When shallow subsidies of this sort are made available to developers, an appropriate mixed-income commitment – to serve a small number of very low-income households as well – is a reasonable *quid pro quo*. Such a commitment could take a variety of forms, for example a commitment to accept voucher holders for up to a stated percentage of the units, or a commitment that a stated percentage of the units will actually be occupied by voucher holders.

## LESSONS LEARNED

**Location Is Very Important.** Khadduri and Martin suggest that HUD-assisted mixed income housing is usually found in low-poverty neighborhoods. When it occurs in high-poverty neighborhoods, usually there are unusual market conditions present, such as immigrants who are willing to live in assisted housing in a poor neighborhood. Khadduri and Martin found a higher proportion of mixed income properties in tight housing markets[11]. They also found that location in one of the eight leading immigrant gateway cities[12] made a property more likely to be mixed income[13]. Brophy and Smith[14] report that the benefits of good locations (with good schools, low crime rates, and access to jobs) are likely to include the desired sociological outcomes, and

[11] A property located in the Pacific Census Region, on average, will contain six times as many households at $20,000 income or above, as a property located in the West North Central region. The factor for New England is 4.5 and for Mid-Atlantic is 4. *Ibid*, page 56.
[12] Los Angeles, Anaheim, San Francisco, New York, Washington, Miami, Chicago, and Houston.
[13] A property located in an immigrant gateway city, on average, had twice as many households at $20,000 income or above. *Ibid*, page 56.
[14] "Mixed Income Housing: Factors for Success", Paul C. Brophy and Rhonda N. Smith, Cityscape, Volume 3, Number 2, 1997, U. S. Department of Housing and Urban Development, Office of Policy Development and Research, page 6.

conversely that the question remains open whether the environment within the development can overcome a poor location. With respect to several of the seven development studied, Brophy and Smith report that a critical factor in the property's success was an extremely favorable location.

**The Mix Matters, Part 1: Amount of Income Difference.** Brophy and Smith report social tensions – including vandalism of cars by low-income teenagers – in properties with relatively greater disparities between the incomes of the non-working families and the incomes of the working households. Conversely, for properties that have a significant moderate-income component, social tensions appear to be low or minimal, even if some higher income households reside at the property. There seems to be a point at which the income gap becomes a source of envy and resentment and tension, rather than a stimulus for self-advancement.

**The Mix Matters, Part 2: Percentage of Low-Income Households.** At Harbor Point, Brophy and Smith report that a particular section of the property started with a relatively high proportion of non-working families and rather quickly became essentially 100% non-working due to the unwillingness of higher-income households to live in a predominantly non-working family environment. As noted earlier, Khadduri and Martin reported that unless there were at least 20% very low income and at least 20% higher income households, there was a high likelihood that management would view the property as socially troubled. A number of owners and managers have developed the opinion that a mix of 15%-20% non-working families in an otherwise working-family property is likely to be feasible if managed competently and intensively, and that higher proportions of non-working families are increasingly less likely to be feasible, even with correspondingly greater levels of management involvement. This suggests a number of practical conclusions:

- Plan for markedly higher management intensity in any mixed income property.
- If attempting to house more than 20% non-working families, plan for very intensive management.
- Planning for greater than, say, 40% occupancy by non-working families is a very high risk strategy that should be attempted only under the most promising circumstances – for example an owner and manager who have already succeeded with a very similar property, over an extended period of time, and with an operating budget that supports the requisite level of management and non-housing services.

**Should The Higher-Income Households Pay Below Market Rent?** The answer appears to be "yes, but with exceptions." A distinction can be made between two situations.

1. The objective is to attract higher income residents into a lower income neighborhood.
2. The objective is to attract lower income residents into a higher income neighborhood.

Logically, a "bargain element" in the rent for the higher-income households is much more likely to be needed in the first situation than in the second[15]. This distinction should be kept in mind when considering rent-setting for the higher income households. In the context of HUD-assisted housing, Khadduri and Martin[16] concluded that adequate neighborhoods, adequate buildings, good management, and preferences for working families, were sufficient to create "projects that

[15] It is possible that the introduction of very low-income households into an otherwise market-rate property may impact the property's market rents. If that occurred, the higher-income households would pay the market rent for the property, which in turn would be below the market rent the property could otherwise have commanded – a bargain element by another name.

[16] *Ibid*.

have a culture of work rather than a culture of poverty." That is, with 100% project based §8, a mixed income community could be created under those conditions (with the working families having incomes up to 50% or 80% of area median, as permitted under the §8 contract). However, a bargain element for the higher-income households is likely to be necessary if a wider mix of incomes is desired. Brophy and Smith report that several of the seven properties studied have rents that are below the rents that the property could command in the market and conclude that this rent bargain is a material factor in the success of the properties in attracting and retaining the higher income residents[17]. Moreover, given traditional American attitudes toward economic integration, it stands to reason that many higher-income households are unlikely to choose to live with lower-income households absent a bargain element. Finally, there is analogous experience with the ELIHPA Preservation program. Several early ELIHPA properties experienced large numbers of move-outs among the higher-income residents after the income mix shifted from largely working-household to mixed-income. In response, ceiling rents were introduced, adding a bargain element intended to give the higher-income households an economic reason to remain.

**Are Ceiling Rents[18] Necessary?** Khadduri and Martin observed that ceiling-rent properties (§236 and §221d BMIR properties) are more likely to be mixed income but that the majority of mixed income properties within the HUD assisted housing portfolio did not have ceiling rents. They hypothesize that ceiling rents may be more important in high-poverty areas than in other areas. A complicating factor is that, until recently, most HUD programs did not cap rents at market levels but, instead, continued to charge higher-income households 30% of adjusted income, even when that amount exceeded the comparable market rent that the unit would have commanded on the open market. Thus, historical experience is of limited use in determining whether ceiling rents are necessary. Certainly, rents should be capped at market. Whether they need to be capped below market is likely a property-specific question. Of course, if the property intends to create cross-subsidy from market renters, capping the rents for the higher income households would be directly counterproductive.

**Can Mixed Income Housing Occur Naturally?** Although income mixes in market-rate rental housing have not been extensively studied, apartment owners and managers make the practical observation that resident incomes vary quite widely, from households who stretch to afford the rent to those who could afford much more expensive housing but choose not to do so. This indicates that a mix <u>of working households at various incomes</u> is not at all unusual. Similarly, it is commonly observed that gentrification produces mixed-income communities, at least for some period of time. Using 1990 Census data, Khadduri and Martin estimate that "more than one quarter of unassisted poor renters in the metropolitan United States live in census tracts in which less than 10 percent of the population is poor[19]." This result may also reflect an income mix <u>among working households</u> rather than a mix <u>between working and non-working households</u>. As Khadduri and Martin point out, it may also reflect, at least in part, census tracts in which the poor renters are segregated within the census tract. On balance, other than within the HUD-assisted portfolio, there appears to be little evidence in favor of naturally occurring communities that mix working and non-working families.

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[17] It is also possible that the owners of the remaining properties have not set the "market" rents at the full amount that market forces would support. Thus there may be an undocumented – but nonetheless real -- bargain element in these properties as well.

[18] Ceiling rents are rent caps, below the full market rent level, designed to give higher-income households an economic incentive to remain.

[19] *Ibid*, page 37.

**Do Children Receive a Role-Model Benefit?** Khadduri and Martin report that the social science literature provides only weak support for this premise, and that there is some practical evidence of improved outcomes. It may be that the role-modeling effect is only sometimes achieved as a result of interaction between children and working neighbors, sometimes achieved through interaction with children of working families (at school, or in an on-site computer learning center or other before / after school program), and sometimes as a result of interaction between children and adults who work at the property (e.g., the management and maintenance staff, or police officers following a community policing approach). This is another area in which additional research would be useful.

**Do Adults Receive a Role-Model Benefit?** It appears that employment gains by adults depend on management's actions rather than on social interaction with working residents. In the seven properties studied by Brophy and Smith, job gains by formerly non-working adults appeared to be the result of intensive efforts by management. Similarly, they report that, of the seven successful mixed income developments they studied, only one achieved very high levels of social interaction, and that was apparently due to an extremely intensive management approach (108 units, 24 hour desk clerk and trained social worker in addition to normal management staff, high level of non-housing services).In a study of properties managed by CDCs, Sullivan and Mueller found that employment increased only where the CDCs invested significant effort in employment training and placement[20].

**Should The Mix Be Marketed?** Brophy and Smith report that management of the seven properties studied mentioned the mixed income nature of the community but did not emphasize it. They report further that if the higher income households are receiving a rent bargain, the mixed income character of the community is generally not a marketing disadvantage. By contrast, in some communities the mixed-income character of the community could be a central feature of the marketing approach[21]. Owners and managers report that individual markets vary in their receptiveness to mixed-income approaches. Areas that have had positive experience with affordable housing are likely to respond favorably to mixed income housing, and conversely. Reportedly, in rural areas, the mixed-income approach is relatively less likely to be a marketing problem and relatively more likely to be a marketing advantage.

**Should The Low-Income Units Differ From The Higher-Income Units?** There seems to be a consensus against lower-quality units for lower-income households. Although for many, the prime motivation for this consensus is social justice, it should be pointed out that an identical – quality strategy provides full flexibility to modify the income mix in response to changes in the market. It also avoids stigmatizing the low-income households. Also, "different" means "more complicated to build and maintain", disadvantages that will cancel out some or all of the intended cost savings. However, identical quality need not mean identical units; see Appendix 1.

**Should The Development Costs of the Higher-Income Units Be Subsidized?** Significant

[20] "Social Impacts of Community Development Corporations, Research Findings, Phase Two", Mercer L. Sullivan and Elizabeth J. Mueller, 1994.

[21] The underlying theory is that such communities may be particularly attractive to higher income households who view themselves as pioneers, who see social value in supporting a mixed income community, and/or who desire to live in a mixed income community. In local markets with significant numbers of households holdng these values, marketing the mixed-income nature of the community would be a sound strategy.

subsidies will always be required in order to develop the low-income units. However, many of the properties mentioned in the research literature received development subsidies for the higher-income units as well. Some properties use shallow subsidies (e.g., LIHTC) to create a moderate-income tier, with rents slightly or significantly below market. Other properties use subsidies to make the market-rate units feasible – for example, rents of $900 are required to support new construction, market rents are $800, and up-front capital subsidy allows the mortgage debt to be reduced enough that the property can be viable at the $800 market rents. Some argue that this is a poor use of subsidy in that it merely accelerates the development of market-rate housing that likely would occur in a few years anyway. Others argue that such developments in fact help keep down the level of rent inflation in the local market and thus support affordability (an argument that is stronger if the "market rate" units carry an affordability restriction that limits future rent increases).

**Racial and Ethnic Diversity May Not Be A Factor.** From a study of privately owned, HUD-assisted apartment properties, Khadduri and Martin report that housing that is diverse in racial and ethnic terms is no less or more likely to have a broad range of incomes as housing in which one group predominates[22]. This suggests that integration by income is a challenge in itself, distinct from the challenge of integration by race or ethnicity.

**Success Factors.** Khadduri and Martin visited eight mixed income properties as part of their research. These visits suggested the following rules of thumb:

- **Strong Management is Vital.** Management screened applicants carefully, briefed potential residents on expected standards of conduct[23], and did not hesitate to follow through with evictions when needed.

- **Good Maintenance is Vital.** Each property visited, including those that were 100% §8, were in excellent physical condition.

- **Below-Market Ceiling Rents May Not Be Needed In Good Neighborhoods.** Two properties, one with excellent curb appeal and one without, both demonstrated ability to attract households above $20,000 income at full rents (30% of adjusted income).

- **Below-Market Ceiling Rents May Be Needed in Bad Neighborhoods.** A property with ceiling rents was succeeding in a bad neighborhood. A property without ceiling rents was losing its mixed income character as its neighborhood declined.

- **Immigrant Gateway.** In the HUD-assisted stock, mixed income properties are likely to be occupied by recent immigrants. Khadduri and Martin observed that students and young professionals were quite likely to occupy the market-rate portions of partially subsidized properties. Anecdotal evidence from HOPE VI developments suggests that

[22] *Ibid*, page 33.

[23] Owners and managers report that success typically entails finding effective means for addressing the problem of unsupervised children. When supported by strong community norms, management action in this area is likely to succeed. Conversely, owners and managers report mixed success in overcoming existing community norms under which parents are not regarded as accountable and children are not expected to respect others and to respect the property.

students and young professionals are particularly likely to be housing "pioneers." Anecdotal evidence from the market-rate world indicates that recent immigrants also are likely to be pioneers. Similar effects may occur in those rural areas that have high populations of recent immigrants.

- **Higher Income Families Are Difficult to Retain.** Unless the neighborhood schools are thought to be particularly good, there was a tendency for the higher-income families who had children to move. Relocation was often reported to be based largely on quality of schools[24]. It is also important to remember the conventional wisdom that renter families with children are more likely to rent a single family home than an apartment, thus it may be unrealistic to expect to attract or retain large numbers of higher-income families with children, unless the property has powerful compensating features such as well below market rents or a particularly advantageous location.

## POLICY IMPLICATIONS

**Affirm Mixed-Income Approaches.** Some owners and managers report that their attempts to create and maintain mixed-income communities are opposed by well-meaning advocates and officials, based on some combination of: (a) a conviction that affordable housing should be reserved exclusively for very low income households; (b) a conviction that 'mixed income housing' is code for illegal discriminatory conduct; or (c) lack of comfort with an approach that differs significantly from the status quo. Strong policy statements, backed up with appropriate regulatory changes, would go a long way toward eliminating these sorts of barriers. In particular, regulatory changes that clarified the ability of owners and managers to maintain the targeted income mix would be helpful.

**Importance of Location.** It appears that a good location (good schools, low crime rate, good access to jobs) is almost a prerequisite for a successful mixed-income community. Said differently, if the goal is to produce a successful mixed-income development in an adverse neighborhood, that plan is likely to require greatly increased development costs, little or no debt, very intensive management, and significant non-housing services (see in particular Jones Family Apartments, and Residences at Ninth Square, in Brophy and Smith). Alternatively, the scale of the development must be large enough to be able to change the character of the area (see Quality Hill, in Brophy and Smith). One potential policy implication is that selecting a marginal but inexpensive site may be very counterproductive from the standpoint of the overall success of the community. A second potential policy implication is that some traditional rules of thumb regarding the relationship between land cost and total development cost should be revisited, to the extent the rules of thumb are based on sites that are not adequate to support successful mixed income communities.

**Importance of Management.** Evidence from mixed income communities suggests that there is powerful public benefit in having not merely adequate but excellent management. There is some evidence that role-modeling benefits occur only when management is extremely active and only when management institutes significant non-housing services. Moreover, there is some evidence that, given the right level and quality of management, these sociological benefits can occur

[24] Owners and managers report that higher income families with children will sometimes reside in a district with poor public schools if there are affordable, high quality private schools nearby.

despite a relative shortage of higher income working households. Management's ability and willingness to develop and enforce clear rules that set a high standard of conduct was frequently mentioned as an essential factor. Indeed, properties that initially adopted a more permissive approach experienced difficulty until management adopted tougher standards. Policy implications include:

- Adequate Property Management Fees. One clear implication is that government should recognize mixed-income housing as a "difficulty factor" calling for appropriate increases in the allowable property management and asset management fees.
- Insist on Excellence. These increased fees should be accompanied by higher standards as well, recognizing that a drop from excellent to normal management may precipitate the failure of a mixed income community.
- Support High Standards For Resident Conduct. To the extent permissible under fair housing laws, government should actively support strong lease provisions and strong house rules for mixed income properties.
- Role Modeling Requires Management. Without significantly increased management intensity plus appropriate non-housing services, "role modeling" benefits in particular, and social interaction between working and non-working households in general, are unlikely to be achieved.
- Support Appropriate Non-Housing Services. Particularly for riskier mixed-income approaches (in marginal neighborhoods, or with a predominance of large units, or with more than 20% non-working families, or attempting a very wide income mix), the development and financing plans should make provision for appropriate non-housing services such as before- and after-school programs. There also is some evidence that computer learning centers can facilitate the success of mixed-income properties. Some in the policy community believe that services should be funded separately from housing operations, but this may not be a good approach for mixed income communities.

**Managing The Mix.** Best practices include:

- Flexibility. Markets and neighborhoods change. A target mix that made sense at the time of initial development may be inappropriate only a few years later. This argues against rigidly tiered income mixes that cannot be changed later, or that can be changed only with great difficulty.
- Working-Family Preference. If some deep-subsidy slots are intended for working households, a preference for working families creates the mechanism through which the upper end of the mix can be achieved and maintained, without regard to the volume or timing of applications from very poor households.
- Bargain Element in "Market" Units. It is at least prudent – and quite possibly essential -- to set rents for the higher-income units below the full market rent level. At a minimum, rents will need to be set below market in order to attract higher-income households into marginal neighborhoods.
- Very Low-Income Set-Aside. Especially in the best properties, a mechanism is needed to ensure that a significant number of units are actually occupied by the very poor.
- Range of Incomes. A very wide range of incomes is more difficult to achieve and sustain than a modest range of incomes. In particular, a wide gap between the very low-income and higher-income groups is likely to be counterproductive.
- Percentages. Experience suggests that keeping the percentage of non-working families below 20% is prudent. There is some evidence that mixes with 20%-40% non-working

families can succeed if very intensively managed.

- Marketing. The decision whether to actively advertise the community as mixed-income should be left to the owner and manager.
- No Quality Difference. The low-income units should not be materially or noticeably lower in quality than the higher-income units.

**Preserving Existing Mixed Income Properties.** The case for preservation is especially strong for properties that are already mixed income communities. Moreover, the process of preservation should not interfere with factors (such as working family preferences, or set-asides for the very poor, or strong management) that helped to produce the mixed income community in the first place. Finally, if existing mixed income properties include barriers to occupancy by working families, or lack a set-aside for the very poor, those defects should be cured during the preservation transaction.

**Potentially Mixed Income Properties.** Family properties in immigrant gateway cities have above-average potential for achieving a mixed income profile. The same is true for properties in cities with tight housing markets, and properties in good neighborhoods. When such properties are preserved, consideration should be given to changes (such as removing barriers to occupancy by working families, adding set-asides for the very poor, and reducing project-based deep subsidy well below 100% of the units) that would facilitate mixed income communities.

**Improve Usefulness of Vouchers Generally.** Tenant-based assistance is a potentially powerful tool for giving very low-income households access to otherwise working-family housing. However, there are significant administrative barriers to owner acceptance of vouchers. These include the payment standard rules, the 'reasonable rent' determination by the PHA, the lease requirements, the physical inspection by the PHA, and the timeliness and accuracy of payment by the PHA to the owner. Removing these barriers may be a threshold issue in order to make vouchers truly useable for mixed-income housing purposes.

**Availability to Voucher Holders.** A number of the properties mentioned in the research studies had little or no project based deep subsidy and had rents that exceeded the voucher payment standard. Such properties are not available to voucher holders. Consideration should be given to solving this problem. One obvious approach is to reform the voucher payment standard rules[25]. A less direct approach is to provide additional up-front subsidies so that some units can be restricted at rents that are within the payment standard and can be targeted to voucher holders over the long term.

**Partial Deep Subsidy.** Whenever a mixed income community is desired, logically the most direct way to achieve it is not to subsidize the units targeted for higher income households (thus the higher-income units will carry market rents), and target some units for lower income households -- either reserved for voucher holders (a "split subsidy" approach) or under a project-based deep subsidy contract.

**Patience.** Perhaps the most important measure of the success of a mixed income community is

[25] As an owner / manager said, "if the market rent is higher than the voucher payment standard, which one is wrong – the market or the voucher program?" For example, Congress could provide a broad exception to the normal payment standard for vouchers that are used in mixed income initiatives.

whether children who grow up there are working steadily, ten years later. It may therefore be the case that we will need to pursue mixed income approaches for some time before the actual level of success becomes apparent.

## AUTHOR

This paper was prepared by Charles S. Wilkins, Jr., principal of The Compass Group, LLC, under contract to The Millennial Housing Commission.