The Non-profit Housing Movement in the United States

by F. Barton Harvey III and Ellen Meyer Shorb

INTRODUCTION

> "(There) is a paradox of housing in America. For most, housing is a dream fulfilled; but for too many others, housing is unavailable, unaffordable or unfit."[1]

The non-profit housing movement in the United States grew out of a number of paradoxes presented by the rich, growing, and increasingly economically and racially divided United States. Governed by and largely endorsing the rules of free enterprise, the people of the United States have used civic action and charitable impulse to help address some of the country's most glaring social needs and disparities.

Non-profit community-based development organizations emerged out of a movement in the 1960s by civic associations, church congregations, social service providers, civil rights groups and community leaders to address neighborhood deterioration, poverty and discrimination in their neighborhoods. Aided by church, charitable and federal funds, by the mid-1970s about 200 such groups were involved in housing development. Today, there are as many as 2,000 groups that collectively are a major contributor to the stock of new and rehabilitated housing for low-income people in the country.

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This non-profit movement has been viewed with both suspicion and hostility, and characterized as inefficient and costly, while simultaneously being hailed as the only way to rebuild inner-city communities. There is extraordinary diversity within the community development sector with respect to size, capacity, focus, productivity and production. A historical context is useful.

HISTORICAL OVERVIEW

Prior to the 1980s, federal programs were the primary vehicles used to develop affordable rental and occupant-owned housing in the United States. Since the passage of the National Housing Act of 1934—which stated decent and affordable housing for all as a goal—the vast majority of affordable rental housing was developed by for-profit entities using federal rent subsidies and mortgage insurance programs or by local public housing agencies using federal mortgage and operating subsidies. Affordable housing for homeownership was generally developed by the private sector accessing federal mortgage insurance, mortgage interest deductions, tax exempt financing and grants.

Rental Housing

In the 1980s, federal incentives and support for the maintenance and development of affordable rental housing were dramatically diminished. Rental assistance to the elderly, the handicapped, and low- and moderate-income families was severely reduced and budget authority for public housing construction and modernization was cut back by more than 70 percent. The Department of Housing and Urban Development (HUD) virtually stopped funding the direct construction of new rental housing.

Additionally, the incentive for for-profit low-cost rental housing development was dampened by the Tax Reform Act of 1986. The Act's passive loss rules and longer depreciation periods for real property stripped away any significant tax benefits of owning and investing in affordable rental housing.

With few tax benefits from the ownership of rental housing, scarce federal resources to cover increasing operating costs, and little opportunity to transfer the property for a profit or to change the property's low-income character, many for-profit owners failed to maintain their properties. Decaying units were demolished and removed from the housing stock or underwent upgrading which made them no longer affordable to low-income people. In both cases, increasing numbers of low-cost units were lost from the housing stock and were not replaced. Low-cost stock declined by an average of 130,000 units per year between 1985 and 1991.[2]

Homeownership

Homeownership opportunities for low- and moderate-income people were also severely curtailed in the 1980s. Community Development Block Grant (CDBG) funds, which had been widely used by local governments to develop homeownership programs, were cut by about 25 percent. At the same time, land and construction prices skyrocketed. With higher costs, for-profit home builders concentrated on building higher-priced homes for higher-income families. The combination of less federal assistance and higher home prices and increasing interest rates for financing made it increasingly difficult for poor families to own their own home. From 1974 to 1985, the percentage of poor households owning homes declined from 50 percent to 36 percent.

Increasing Numbers of Poor Families

Other macroeconomic factors combined during this period to increase demand for affordable housing in the face of a decreasing supply of low-cost units. Not only did income growth slow, but the distribution of income became more unequal. In 1974, 9 million households had incomes that fell below the official poverty threshold; by 1985, that number had grown to 12 million.[3]

Non-profits Face the Need

In the face of decreased federal housing assistance, a diminished incentive for for-profit investment in low-cost properties, the deterioration and extinction of existing affordable units from the low-cost stock and an increase in the number of poor households, community-based non-profit organizations stepped in to address the need. After expanding steadily for more than a decade, these organizations began a period of explosive growth in the mid-1980s. One-quarter of the almost 5,000 community development corporations (CDCs) polled by the National Congress for Community Economic Development (NCCED) in 1994 were incorporated between 1986-1990.[4]

With few financial resources and little experience in financing, constructing and maintaining housing, existing community groups—non-profit social service organizations, community development corporations (CDCs), resident groups, and even churches and synagogues—became real estate developers. In other cases, corporate, community and religious leaders came together to create a new community organization to build and maintain affordable housing opportunities for low-income people.

This explosion of nascent community-based development organizations scattered across the country faced two key challenges. First, financing was increasingly patchwork as these groups went beyond traditional government programs and knit together loans, grants and equity from public, private and charitable sources. Second, there was insufficient and inadequate technical assistance for new groups with little development experience, as alternative financing schemes proliferated, layering on standards and requirements faster than a locally based, grassroots organization could educate itself.

ROLE OF INTERMEDIARIES

To counter these challenges, national, and eventually local, intermediaries were created to act as transactional guides. Intermediaries provide the link between the community-based organization and the development world. While community groups have an acute sensitivity to the needs, resources and priorities of the circumscribed community they serve, intermediaries are proficient in accessing a complex web of funding streams and technical development expertise.

> "(The) 1980s witnessed a profound institutional evolution of the non-profit community development sector. Nationally, the rise of intermediary organizations able to channel capital and technical expertise to local non-profit developers is the single most important development of the decade."[5]

Intermediaries began to show both funders and non-profit developers that there could be economies of scale, a level of oversight and standardization, quality control and efficiencies of learning. Says Andrew Mott of the Center for Community Change, "Good intermediaries create an environment which nurtures the growth of vital organizations. They devote time and skill to watching for the seeds of new organizations, help emerging groups get through their first few months and first crises, assist in raising the crucial early money, connect people with others who have relevant experience, and help them find and break in their initial staff. One particular value is an ability to bring groups together to work in coalitions on larger issues or projects."[6]

THE ENTERPRISE FOUNDATION

The Enterprise Foundation was created to fill exactly this role. The mission of the Foundation is to see that all low-income Americans have access to fit and affordable housing so that they can move up and out of poverty into the mainstream of American life. Founded by Jim Rouse and his wife, Patty, in 1982, the Foundation has worked with more than 500 non-profits in over 150 locations by providing loans, grants and technical assistance.

Enterprise works with groups to increase their capacity to develop and maintain low-income housing and to build local partnerships. The Foundation provides non-profits with loans at below-market interest rates and offers pre-development and acquisition financing. This working capital is otherwise difficult for non-profits to obtain. In addition to offering expertise in project financing, development and property and asset management, Enterprise provides guidance on how to link human support services to those being housed. Enterprise sees each investment not just as a financial transaction, but as an integral part of the physical and social fabric of a neighborhood.

The net result of this work over the last decade is that Enterprise has committed over $1.5 billion of grants, loans and equity that has helped non-profits make possible more than 52,000 new and rehabilitated units of housing for low-income families. This investment is leveraged several times over to fund additional developments in the community through other partners and affordable housing developers.

THE CURRENT ENVIRONMENT

Over the past 10 years, the non-profit community development corporations that Enterprise works with have become the nation's primary producers of affordable rental and homeownership units for people with very low incomes. Between the 1991 and 1994 NCCED census, the number of groups classified as "fledgling" CDCs doubled. By 1994 there were over 2,000 CDCs that had produced over 400,000 units of affordable housing and continue to produce housing at an estimated rate of 30,000 to 40,000 units/year. These CDCs have collectively developed 23 million square feet of commercial/industrial space, lent $200 million to business enterprises and created over 67,000 full-time jobs or equivalent positions.[7]

In recognition of this de facto role as the nation's affordable housing producer, Congress enacted the National Affordable Housing Act (NAHA) of 1990, which targeted particular funding towards non-profits. In addition to the programs under NAHA, other federal institutions have set aside program money to fund the development and renovation of affordable housing by non-profits. The Resolution Trust Corporation (RTC), for example, established to dispose of properties of failed savings and loans, has an Affordable Housing Program that gives preferable financing terms to non-profits and public agencies that are purchasing properties from the RTC for low-income use. The national secondary mortgage corporations, Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), have developed significant programs to encourage the development of affordable housing that are uniquely suited to non-profit housing developers.

FINANCING TOOLS

Patterns of growth and production among non-profit CDCs mirror the private home building industry in the United States—which means that very few developers are responsible for the bulk of construction and the majority of developers are small time producers. It is estimated that 6 percent of CDCs produce more than 100 units of housing per year, while 70 percent produce on average 25 or fewer units per year. Similarly, the National Association of Home Builders estimates that 75 percent of for-profit housing developers start fewer than 25 units annually while only 9 percent of for-profit housing developers start more than 100 units per year.[8]

This means that most CDCs are dealing with issues of size, efficiency and experience as they finance their developments, even if there is special funding targeted for non-profit developers. For example, a lender of construction funds will often require borrowers to obtain a performance and payment bond (P&P bond) prior to releasing any funds. Generally, bonding companies will not issue a P&P bond to developers who do not have significant development experience and assets. The non-profit must be able to convince the lender to waive the requirement or must provide alternative security such as letters of credit, compensating account balances and so on.

In addition, most non-profit developers must knit together a variety of complex funding streams in order to complete a single funding package. And although there are now sources of financing that are unique to the non-profit developer—and can't be accessed by the for-profit developer—the financing of affordable housing has become increasingly complex and patchwork.

To finance low-cost housing, non-profit CDCs must access two or more of the following types of sources:[9]

- nontraditional public financing, such as tax-exempt and taxable bond financing, federal/state/local acquisition and rehabilitation loans, state and local government "soft second" equity loans, and the Federal Home Loan Bank Board's Affordable Housing Program;
- nontraditional private, non-profit financing, such as through The Enterprise Foundation, Local Initiative Support Corporation (LISC), Neighborhood Reinvestment Corporation, McAuley Institute, the Low Income Housing Fund and local community investment funds;
- traditional private, for-profit financing, such as commercial banks, savings and loans, pension funds, insurance companies and owner take-back financing;
- operating subsidies, from federal, state and local governments, for the elderly, the homeless and people with acquired immune deficiency syndrome (AIDS);
- state and federal mortgage insurance or private credit enhancement;
- state and local property tax relief; and
- government or non-profit land trust purchase and leaseback of the land.

While private charitable funding is the primary source of operating funds for community-based development organizations, federal funding remains the major source of funds that allows housing to be made affordable. A review of current federal programs is useful.

Key Federal Programs

While there are a wide range of federal programs that finance affordable housing and upon which local CDCs depend, there are four, in the experience of The Enterprise Foundation's work across the country, that have been particularly fundamental to constructing and maintaining affordable housing options. Additionally, there is one important regulatory act that is particularly critical to affordable housing.

Community Development Block Grant. The Community Development Block Grant (CDBG) is a flexible tool for state and local governments to finance revitalization activities including the development of affordable housing, infrastructure, economic development initiatives and job creation. Approximately 40 percent of CDBG funds are spent on housing activities.

Congress requires that jurisdictions spend 70 percent of their CDBG funds to benefit low- and moderate-income people. This requirement is typically exceeded. To maximize the low-income investment, state and local governments often provide CDBG funds to community-based non-profits to assist in their community development activities. On average, each CDBG dollar spent on low-income housing leverages an additional $2.31 of other resources. For rental housing programs, each CDBG dollar leverages an average of $8.44 additional dollars.

HOME Investment Partnerships Program. The HOME Investment Partnerships Program, created in 1990, is a partnership between the federal government, state and local governments, and low-income housing developers. HOME allows communities to choose which mix of housing activities—rehabilitation, new construction or rental assistance—best meets local needs. The HOME program requires state and local governments to set aside 15 percent of their funds for neighborhood-based non-profit organizations.

Recent HOME program data show that the program is working well in many different local markets. More than half of all HOME funds assist families with incomes below 30 percent of the area median income. On average, each HOME dollar spent leverages another $1.61 of additional funding.

Low Income Housing Tax Credit. Enacted by Congress in 1986, the Low Income Housing Tax Credit (LIHTC) is one of the federal government's most important tools for the development of low-income rental housing. Qualified low-income housing investors are awarded a dollar-for-dollar tax credit for investments used to acquire, develop or rehabilitate affordable housing.

While tax credits provide a way for corporations to make a social contribution to their own community, the investments also provide a sound return on equity invested. Tax credit equity typically finances about one-third of the total development cost of a project. The tax credit is responsible for the development of 94 percent of all low-income rental apartments in this country, or roughly 110,000 units a year.

Section 8 Rental Assistance. For special needs populations, such as the mentally ill, the disabled and low-income people with AIDS, project-based Section 8 rental assistance is critical to the development of service-enriched supportive housing. Supportive housing is permanent rental housing linked to a variety of support services including primary health care and job placement, allowing otherwise limited residents to function independently.

Project-based Section 8 allows for a 15-year government subsidized rent stream, which helps considerably with obtaining conventional debt financing. Additionally, Section 8 subsidies reduce residents' rent burden, so that they do not have to pay more than 30 percent of their incomes for a place to live.

Community Reinvestment Act. The Community Reinvestment Act (CRA) requires depository institutions to serve the credit needs of the communities in which they are chartered, including low- and moderate-income neighborhoods. CRA often spurs private direct financing as well as investments in Low Income Housing Tax Credit projects, bank participation in lending consortia and bank lending on affordable multifamily housing developments. CRA has encouraged the investment of $60 billion in low- and moderate-income neighborhoods since it was enacted in 1977.

A SAMPLE TRANSACTION

To understand the nature of non-profit housing finance, it is useful to review an example of this complex layering of funding. The example below uses federal grants and tax credits, private mortgage financing, a private sector loan and a local government grant. This is a transaction that the Enterprise Social Investment Corporation (ESIC), a subsidiary of The Enterprise Foundation, arranged and closed.

The Park City Apartments project involved the new construction of 180 units of housing in North Dade County, Florida. Although multifamily units had always experienced high occupancy rates in this area, Hurricane Andrew in 1993 precipitated the destruction of and need for thousands of units. Of the 100,985 residents that left South Dade County as a result of the storm, 43,863 relocated to areas in Northern Dade County.

The project included 45 one-bedroom units, 90 two-bedroom units and 45 three-bedroom units, located in seven buildings which surround a central community and management office building and parking area. The units were affordable to persons earning between 40 percent and 53 percent of area median income, and rents range from $259 per month to $477 per month.

Ownership Arrangement

The project was a joint venture between the Opa-Locka Community Development Corporation (Opa-Locka CDC) and GMN Affordable Housing Partner VII, Inc. (GMNAHP). GMNAHP is a subsidiary of Greater Miami Neighborhoods, Inc. (GMN).

Opa-Locka CDC was established in 1980 as a 501(c)(3) community development corporation. Two-thirds of the board of directors are elected within the community, who then appoint the remaining one-third. Opa-Locka CDC's track record included development of 38 single-family homes for purchase by low-income families. They have also completed the historic renovation of a building into office space and are currently involved in the historic renovation of the Opa-Locka Train Station. The total development costs of these projects is $3,087,571. Opa-Locka CDC also provided pre-leasing counseling, homeownership and credit counseling to tenants, as they had in the homeownership projects.

Greater Miami Neighborhoods, Inc. was established in 1985 as the first local field office of The Enterprise Foundation to work with non-profit housing developers to generate affordable housing for very low-income families. In 1989, GMN became an independent housing development organization and continues to work with the Foundation. Since its inception, GMN has been responsible for generating over 1,100 units of affordable housing through 15 non-profit community-based developers such as Opa-Locka CDC.

Since this project involved the use of the Low Income Housing Tax Credit, a partnership was set up to own the property and pass through the tax advantages to a limited partnership of corporate investors arranged by Enterprise Social Investment Corporation. Opa-Locka and Greater Miami Neighborhoods are the controlling general partners of the property and the investors are passive participants. At the end of 15 years the property is intended to revert to the general partners.

Construction financing was provided by First Union Bank. Equity investment financing was provided through NationsBank and Enterprise Housing Partners 1992 Funds, a general fund of corporate investors.

Project Financing

Source	*Explanation*	*Amount*
First Union Bank 8.25%, amortizing, 15 yr.	first mortgage	$1,595,912
HOME Funds 1%, amortizing, 15 yr.	federal grant to locality, allocated to project as a "soft" second mortgage	4,859,100
General Partner Loan 1%, amortizing, 15 yr.	"soft" third mortgage	140,000
Surtax Loan 3%, amortizing, 15 yr.	local tax funds competitively allocated as "soft" mortgage	500,000
Net Syndication Proceeds Low-Income Housing Tax Credit	corporate investor pool arranged by ESIC	3,900,589
		$10,995,601

Operating Expenses/Reserves

The operating expenses of $2,867 per unit per year compare favorably to actual expenses of other projects in Florida in which funds managed by Enterprise have invested. Operating expenses, net of real estate taxes, are approximately $2,256 per unit. Replacement reserves of 4 percent of gross rental income, or $182 per unit per year, were budgeted.

The general partner was required to establish a partnership operating reserve of $500,000. This reserve represents eight months of expenses and must pay debt service. These reserves will be available to fund operating deficits over the life of the partnership and are being established over a six year period. In addition, a $55,000 lease-up reserve was established.

Summary of Financials

Through the creative combination of a variety of federal and local financing programs, the capital costs on these units are reduced so that rents for units are affordable for low-income wage earners in the particular community.

As importantly, without a large, fixed debt service, the operating costs of these units have been significantly lowered and adequate reserves provided so that the occupying families can be assured that they will have stable rents (with an absolute rent ceiling under the program) over the next 15 year period.

Ownership is controlled by the general partner, the local non-profit, while tax benefits flow through a limited partnership to corporate tax-advantaged investors who will donate back the property at the end of the 15 year period.

Property management will be overseen by the non-profit organization, and tenants will be encouraged to become active, positive participants in the life of their community through the non-profit.

SUMMARY

The non-profit housing movement in the United States, through local community-based organizations, is making a positive impact on some of the most distressed inner-city areas in the country. Overall production—about 400,000 units—is small compared to the national need of several million units. However, this movement accounts for a significant percentage of the affordable housing units coming on-line for low-income Americans.

The future of the movement is clouded, as recent congressional action to reduce the federal budget deficit has disproportionately looked to reductions in federal housing spending. Anticipated cuts over five years may exceed 50 percent and will affect all the programs used to make housing affordable. Similarly, the proposed flat tax by the Republican contenders for the 1996 elections, if enacted, would cripple the Low-Income Housing Tax Credit, the primary affordable rental housing production program, and is anticipated to reduce charitable giving, the key component for non-profit operating support.

Despite these threats, non-profits have withstood periods in the 1980s equally challenging in nature, and when reductions occurred in the past, those surviving were strengthened for the next cycle of American housing policy.

NOTES

[1] *A Decent Place To Live,* The Report of the National Housing Task Force, Washington, DC, 1988.

[2] Bennett Hecht, *Developing Affordable Housing: A Practical Guide for Nonprofit Organizations,* John Wiley & Sons, Inc., New York, 1994.

[3] Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 1994,* Harvard University, Cambridge, MA, 1994.

[4] Carol Steinbach, *Tying It All Together,* National Congress for Community Economic Development, Washington, DC, 1994.

[5] Christopher Walker, "Nonprofit Housing Development: Status, Trends, and Prospects," The Urban Institute, Fannie Mae Annual Housing Conference, Washington, DC, 1993.

[6] Neal Peirce and Carol Steinbach, *Enterprising Communities: Community-Based Development in America, 1990,* Council for Community-Based Development, Washington, DC, 1990.

[7] Carol Steinbach, *Tying It All Together,* National Congress for Community Economic Development, Washington, DC, 1994.

[8] Ibid, Steinbach.

[9] Bennett Hecht, *Developing Affordable Housing: A Practical Guide for Nonprofit Organizations,* John Wiley & Sons, Inc., New York, 1994.