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Affordable Rental Housing Development in the For-Profit Sector: A Case Study of McCormack Baron Salazar



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Abstract

Despite the private for-profit sector's importance in affordable housing development, there has been relatively little research on the sector. This working paper explores one of the country's leading for-profit affordable housing developers, McCormack Baron Salazar (MBS) and provides some insights into their successful business model.

The paper uses the "Quadruple Bottom Line," to both review the literature on for-profit affordable housing developers and to assess the operation of MBS. With a strong commitment to low-income housing and community revitalization, MBS focuses on converting large, deteriorated housing developments into new mixed-income communities.

Also discussed are the "essential ingredients," that need to be in place for MBS to make a commitment to do a specific project. Nevertheless, even a project that incorporates all of these factors may still face significant challenges, largely due to external constraints and the complexity of developing and managing high quality affordable housing.

The paper concludes with an overview of the components of successful public-private affordable housing programs, regardless of whether the developer is a for-profit or a nonprofit. The recommendations also emphasize the importance of a strong and committed federal role in affordable housing development, including the need for deeper housing subsidies, with less reliance on multiple funders for putting together affordable housing development deals. Even a large, well-capitalized firm like MBS cannot develop affordable housing without additional significant public and private resources.

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Introduction

The question of how to build decent housing that is affordable to lower-income households has challenged policy makers for decades. While it is widely acknowledged that federal housing policies have attempted to meet a number of objectives in addition to housing the poor, the challenge of how best to stimulate production has persisted. All the many efforts that have been tried assume that the private for-profit housing sector is typically not on its own able to produce housing affordable to low-income households while still realizing the desired level of profit. Federal assistance in some form is essential in order to stimulate a large-scale production effort.

For more than 50 years, the federal government has been providing various incentives to encourage private for-profit housing developers to develop affordable rental housing. This reliance on the private sector replaced the decades-old federal strategy of providing deep subsidies to local housing authorities to produce public housing. Public-private partnerships for affordable housing have the potential to increase the impact and even the amount of subsidies available from government and private parties (Iglesias, 2013) while intensifying the “market discipline” applied to affordable housing projects. However, a key challenge is how to provide sufficient incentives to encourage private sector participation, while also safeguarding the public purposes of the particular program—providing housing over the long-term, at prices that are affordable to lower-income residents who are unable to compete in the private housing market.

From their perspective, for-profit affordable housing developers face the potential dilemma of trying to generate the desired level of profit while providing housing for those with very limited incomes. With reference to the major current public-private housing program aimed at this group (the LIHTC program discussed below), one observer noted that it aims “to house poor people, but not ones so poor that they cannot pay rents sufficient to preserve a profit for the developers” (Ballard, 2003, p. 24).

In the 1960s, the federal government began providing below-market interest rate (BMIR) loans to private nonprofit and for-profit developers for the construction of housing targeted to low- and moderate-income households. These initiatives were followed by the

Section 8 New Construction and Substantial Rehabilitation (NC/SR) program (1974-1983), another public-private initiative.

The contradiction between the public purpose of maintaining affordable housing over the long-term and the desire for private sector profit became a key concern as the affordability restrictions on developments built through the BMIR programs began to expire, starting in the 1980s. A series of public sector interventions attempted to preserve these homes for lower-income occupancy. Similar problems have arisen concerning expirations on affordability restrictions on the Section 8 NC/SR portfolio (Achtenberg, 2006).

The Low Income Housing Tax Credit (LIHTC) program, created in 1986, further cemented the role of private developers in affordable housing development and is now the major federal housing subsidy program aimed at assisting lower-income households. For-profit developers have produced about 78 percent of the LIHTC projects placed in service between 1987 and 2013 (Lew, 2015a).¹

In 2014, a survey of 107 for-profit and nonprofit firms involved with affordable housing development or rehabilitation was conducted. Among the 56 top developers, for-profit firms started and completed construction on most of the affordable units produced that year (86 percent and 79 percent, respectively) (*Affordable Housing Finance Staff*, 2015a).

In terms of ownership of affordable housing, as of 2014, 35 out of the 50 largest groups were for-profits (*Affordable Housing Finance Staff*, 2015b). Indicative of for-profits' financial advantages and ready access to capital, the 10 firms that acquired the most units of affordable housing that year were all for-profits (*Affordable Housing Finance Staff*, 2015c). However, four nonprofits were included on the list of the 10 companies that did the most substantial rehabilitation work in 2014. Together, they account for one-third of the 7,888 affordable

¹ The 78 percent estimate excludes 7,408 projects in HUD's LIHTC database for which information on sponsor type was missing. The estimate also excludes: 768 projects for which sponsor type was available but "placed in service status" or year, were unconfirmed. Also excluded were some 74 properties that were placed in service in 2014 and one in 2015. Although HUD requests data from state housing finance agencies for properties placed in service through a specific year, states do not always submit correct information. HUD excludes these properties in their published tables because they would provide an inaccurate picture of activity for those years. Typically, some undercounting of properties occurs, since it usually takes 2-3 years to fully account for all of the properties placed in service for a given year (email correspondence between Irene Lew and Michael Hollar, HUD Policy Development and Research office, June 2014).

housing units rehabilitated by these 10 firms (Affordable Housing Finance Staff, 2015d). Also, between 2009 and 2014, for-profit firms represented 79 percent of all affordable housing starts among the largest 50 developers (Affordable Housing Finance Staff, 2015e).²

Private for-profit developers also have been key players in the HOPE VI program, which started in 1992. This initiative supports the re-development of severely distressed public housing through partnerships between local public housing authorities and private for-profit and nonprofit developers, typically using the LIHTC program.

State and local housing programs have further encouraged and stimulated the participation of the private sector in affordable housing development. In some states, developers are allowed to produce higher-density housing beyond the amount typically allowed under local zoning laws, with the stipulation that a percentage of units in the development be set aside as affordable housing (see, for example, Bratt and Vladeck, 2014). Furthermore, through inclusionary zoning ordinances, some localities have mandated the provision of a certain percentage of affordable housing in all new privately built developments over a particular size (Nenno, 1991; Graddy and Bostic, 2010; Salsich, 1999).

Focus, Key Questions, and Methods

For-profit firms have been involved to a far greater extent than nonprofits in the BMIR, Section 8 NC/SR, and LIHTC programs. Yet for-profit firms have received relatively little attention from the academic and policy communities: research on them is almost non-existent. This inquiry is aimed at filling a small portion of this gap by presenting a case study of one of the country's leading for-profit developers that has a longstanding commitment to affordable housing: McCormack Baron Salazar (MBS). Although MBS was one of the early firms to embrace a robust affordable housing agenda in a mixed-income context, it is not alone. Across the country, there are a number of other for-profit affordable housing developers with strong reputations (e.g., Corcoran Jennison and Beacon Communities, both based in Boston; Telesis Corporation, based in Washington, D.C.; and Jonathan Rose Companies, based in New York

² For more detailed information on the production record of for-profit and nonprofit affordable housing developers, see Appendix I.

City). While any one of these companies would have been appropriate to study, a combination of factors made MBS a particularly good choice. These included: a long history; a large portfolio of projects in many locations across the U.S.; extensive involvement with federal housing and community development policy and programs; and a gracious invitation from one of MBS's principals, Richard Baron.

This study addresses the following questions:

- What do we know about the record, based on a variety of diverse criteria, of for-profit affordable housing developers and, in particular, how does it compare with that of nonprofit organizations?
- How has one reportedly successful, prominent, and productive for-profit affordable housing developer, MBS, gone about its business?
- What can be learned from its efforts and how might this be helpful to other for-profit and nonprofit affordable housing developers?
- How could policy changes enhance the work of all affordable housing developers?

To explore these questions, relevant literature on the comparative experiences of for-profit and nonprofit affordable housing developers was reviewed; existing articles about MBS were compiled and assessed for relevancy to the current project; and interviews were conducted with professionals either working for MBS (N = 7) or in the professional housing/academic community, both within St. Louis and beyond (N= 9). Most of these interviews were done in-person and were held over a three-day trip to St. Louis, the home office of MBS. During that visit, which took place in April 2015, a number of MBS properties were visited. All quotations in this paper from those interviews have been approved.

Study Limitations

This inquiry has some important limitations.

First, only one for-profit firm was selected for study and, in addition, only one city in which that firm operates was visited. Since a study of the entire for-profit affordable housing sector was beyond the scope of the present effort, through a close look at a single developer this study aimed to raise key questions for further research and identify lessons for other developers. Clearly, the single firm selected – one of the most acclaimed for-profit affordable housing developers in the country – is not representative of the average firm in the sector.

Second, a relatively small number of professionals were interviewed. It was beyond the scope of this effort to interview, for example: a range of St. Louis social service providers, public school officials, neighborhood leaders, MBS on-site managers, or residents of MBS properties. This constraint limited the study's ability to form a more nuanced picture of MBS from the perspectives of diverse stakeholders.

Third, this project did not include detailed analyses of development *pro formas* or management budgets. Such analyses would have permitted a more in-depth understanding of financial planning and trade-offs.

Fourth, this project did not explore the details of MBS's screening procedures for prior and new tenants or the outcomes for residents of pre-developed properties, including whether they moved into the renovated buildings or were permanently relocated elsewhere. Therefore, the types of outcomes for prior residents of properties re-developed by MBS cannot be determined, whether or not they moved into the new MBS development.

Fifth, no information was collected on MBS's management approach to dealing with resident problems, including tenant association involvement, if any, with, for example, eviction policies.

Sixth, given that there are many different types of for-profit developers, it is important to underscore that only one type of for-profit entity was selected – a large, highly professional, well-seasoned company, whose emphasis is on large-scale new affordable housing development within mixed-income properties. Further explorations of this sector would benefit from comparisons of such a company not only with other for-profit firms of different sizes and with varying approaches, but also with large, high-performing nonprofit housing organizations.

This Working Paper consists of five main sections:

- 1) Review of relevant literature
- 2) Background and mission of McCormack Baron Salazar
- 3) Defining characteristics of McCormack Baron Salazar
- 4) Further observations
- 5) Final reflections and policy recommendations

The questions raised here are timely, since the need for good quality housing affordable to lower-income households continues unabated.³ It is important that we pay close attention to the organizations that produce and manage such housing; we need to understand the challenges they face and how those challenges can be overcome. This study of one high-performing company, McCormack Baron Salazar, should provide a window into the issues facing the affordable housing development community and generate some suggestions about how they might be better addressed.

Renaissance Place at Grand, St. Louis, Missouri

Context of the large-scale housing development – a neighborhood within a neighborhood. For additional details about this development, see page 44.



Photo by Peter Wilson, courtesy of McCormack Baron Salazar

³ The range of housing problems facing U.S. residents, particularly those with lower incomes, is well documented by the Joint Center for Housing Studies (2015).

Review of Relevant Literature⁴

Despite the private for-profit sector's importance in affordable housing development, there has been relatively little research on the sector. This review first summarizes the findings of key studies concerning the development process and the record of mixed-income housing. It then explores what is known about the extent to which for-profits are meeting various outcome measures, what I have called the "Quadruple Bottom Line." This is "the simultaneous need for the [affordable housing] development to be financially and economically viable while also meeting social goals." An affordable housing development meeting the requirements of the Quadruple Bottom Line must:

- have the financial backing necessary to preserve the development's long-term affordability;
- address the social and economic needs of the residents;
- contribute positively to the neighborhood; and
- be environmentally sustainable (Bratt 2008a, p. 358; see also Bratt, 2012).
- Whenever available, information on the comparative record of for-profit and nonprofit affordable housing developers is included.

Affordable Housing Development

A number of studies have examined differences in the ways in which for-profit and nonprofit developers carry out various affordable housing development tasks. For-profit developers were more likely than their nonprofit counterparts to use conventional loans to finance a larger share of their affordable housing development costs (McClure, 2000), and they were able to secure mortgages covering a larger portion of development costs (Ballard, 2003). As a result, compared with nonprofits, for-profit developers have a smaller financing gap to fill between mortgage proceeds and equity generated from the sale of tax credits and they may be more adept than nonprofits in raising equity for their LIHTC projects (Enterprise Community Investment, Inc., 2010).

Not surprisingly, then, for-profit developers were less likely than nonprofits to rely on federal funds through the HOME and Community Development Block Grant (CDBG) programs

⁴ This section was researched and co-authored with Irene Lew, Research Analyst, Joint Center for Housing Studies.

for gap financing (Lew, 2015a).⁵ Compared to for-profit developers, nonprofit developers were able to obtain a greater proportion of project costs through syndication (McClure, 2000). There is conflicting information on the extent to which each type of developer relies on rental assistance in LIHTC properties. Some studies have found that in comparison to nonprofits, for-profit developers tend to be more reliant on federal subsidies such as Section 8 vouchers during the operation of a LIHTC project (Buron et al., 2000; Ballard, 2003). Yet, another study found a higher percentage of nonprofit properties receiving rental assistance, compared with those owned by for-profits (CohnReznick LLP, 2015).

In at least one city (Chicago), for-profit developers' fees were 50 percent higher on average than those charged by nonprofits (Leachman, 1997). While production costs may vary based on the types of units produced and the local development conditions, for-profit developers typically have lower overall production costs than nonprofit developers (U.S. General Accounting Office, 1999; Cummings and DiPasquale, 1999; California Department of Housing and Community Development et al., 2014; Hebert et al., 1993; Fyall, 2012). Yet, one study found the opposite: holding unit sizes constant, project costs (comparable to production costs) were higher among for-profit than among nonprofit projects (Leachman, 1997).

The development costs of nonprofit developers may be higher due, in part, to their need to rely on multiple funding sources to fill the gap between first-mortgage proceeds and tax credit equity. As the number of funders increases, the project's development costs rise due to the multiple transaction costs (Ballard, 2003). The patchwork of financing across federal, local, state, and private sources that is typically required for mixed-income housing development is challenging for all developers, but for nonprofits in particular, the difficulties in lining up the needed funding can discourage or thwart potential projects (Salsich, 1999).

In one of the earliest studies examining development costs of for-profit and nonprofit developers, researchers found that nonprofits worked with an average of 7.8 funders per development (Hebert et al., 1993). Another study analyzing LIHTC properties in five states found that the average project had four additional funding sources, on top of the LIHTCs, with the most

⁵ Both these programs provide important sources of funds for states and localities in the development of affordable housing and other housing programs.

being eight (Bolton, Bravve and Crowley, 2014). Unfortunately, neither of these two studies compared the number of additional funding sources used by nonprofit vs. for-profit developers.

Since nonprofits tend to rely more than for-profit developers on federal subsidies and funding sources to cover development costs, some nonprofits may have to pay higher wages to construction workers due to various requirements (e.g., prevailing wages) tied to federal subsidies (Ballard, 2003). Consistent with this finding, one group of researchers concluded that differentials in production costs may be attributable primarily to factors other than “systematic differences in nonprofit versus for-profit comparative efficiencies” (Hebert et al., 1993, ES–20).

Smaller nonprofit developers also may be at a disadvantage in accessing tax credits because many state Qualified Allocation Plans favor large-scale projects that small nonprofits may have difficulty undertaking. In addition, this group may find it difficult to cover the costs involved with financing the application for tax credits (particularly if an application does not succeed) and, more generally, in navigating the many complexities of the application process (Bolton, Bravve and Crowley, 2014).

A key question, only minimally addressed in the literature, relates to the quality of the housing built by for-profit and nonprofit sponsors using various federal housing subsidy programs. One recent evaluation in California found that “nonprofit developers may build projects to a higher quality or durability standard relative to for-profit developers or may choose to take on more difficult and expensive to develop projects” (California Department of Housing and Community Development et al., 2014, p. 35). Another study suggests that local competition for LIHTCs may also provide an incentive for both for-profit and nonprofit developers to maintain the quality of their housing. According to this study, “strong competition for LIHTC may also have helped ensure the quality of projects built by different types of developers” since it is difficult to obtain allocations of tax credits in California without a good track record (Deng, 2011, p. 160).

Researchers invariably note that if development by nonprofits is comparatively more costly, this needs to be viewed in the context of the other benefits typically associated with this housing, such as the nonprofits’ purportedly greater involvement with the community and their focus on resident services (see for example, Bratt, 2008a and 2008b; O’Regan and Quigley, 2000).

For-profit and nonprofit sponsors have different costs and funding strategies likely because they typically have different central goals and motivations. A study contracted by HUD, which examined 39 LIHTC properties, found that nonprofit sponsors were most likely to cite neighborhood improvement or affordable housing goals as their primary objectives. In contrast, for-profit sponsors were, overall, “more likely to identify financial benefit as the primary goal” (Buron et al., 2000, p. xv). Another study found that nonprofit sponsors were more likely to locate their properties in poor and problem-laden neighborhoods than the total universe of LIHTC properties, the bulk of which were developed by for-profit sponsors (Climaco et al., 2006; see also CohnReznick LLP, 2015). Nonprofits also were more likely than for-profit developers to build units larger than 1,000 square feet (U.S. General Accounting Office, 1999).

A case study of private for-profit developers and social service providers involved with mixed-income housing in Chicago found that one for-profit developer knew that building this type of housing was “the right thing to do.” However, the slow, costly, and highly bureaucratic development process made it difficult to remain involved in such investments when greater and quicker profits were available elsewhere: “We’ve had to carry [the project] out of our own pockets for nearly five years at a great cost. No developer in their right mind would ever do this...we ultimately think we’re going to make money or we wouldn’t be in it at all. But we can make a lot more money elsewhere doing a lot of other things” (Joseph, 2010, p. 115).

There is limited information on differences in management practices among nonprofits, for-profits, and government sponsors. However, a study of public housing and project-based Section 8 housing in Virginia found that there were generally no significant differences. Nevertheless, on a few criteria, nonprofit owners had a stronger record than for-profits: lower vacancy and unit turnover rates; quicker turnaround times for routine maintenance; and undertaking more initiatives to empower residents (Johnson, 1996).

In order to take advantage of the comparative assets of each type of developer, many partnerships have formed between for-profits and nonprofits. For nonprofits, the motivation likely relates to the in-house technical or financial expertise of the for-profits and their access to ready capital. For-profits typically see a partnership with nonprofits as beneficial since the latter are likely to have deep knowledge of and support from neighborhood residents. In

addition, nonprofits may have: site control of a key property; improved access to potential sites through the city or local redevelopment agency; the ability to attract philanthropic funds; and easier access to public subsidies or financing such as HOME and CDBG (Chung, 2004; Jacobus and Winning, 2006; Bratt, 2008a; Madden, 2012).

Mixed-Income Housing

What are the specific advantages of mixed-income housing developments? This question, pertinent to the present study of MBS, has been explored by a number of researchers. Citing the problems associated with concentrated poverty, William Julius Wilson (1987) and others have criticized public housing developments devoted exclusively to very low-income residents. Already in the late 1960s and 1970s, some housing professionals began considering the benefits of mixed-income housing—housing that would be occupied by households with a mix of income levels. Although concerns were raised about whether higher income residents would want to live alongside households with lower incomes, this does not appear to be a major problem (Myerson, 2003). Over the years, mixed-income housing has become an attractive development approach for for-profit, as well as nonprofit, affordable housing developers.

Advocates of mixed-income housing hoped to simultaneously address place-based and people-based issues. There is an immediate appeal to creating visible, tangible signs of change in a community through a new attractive housing development. In contrast, strictly people-based interventions likely take longer to achieve, are more difficult to measure, and are far less visible. Indeed, in mixed-income projects, “external stakeholders may push for more quickly attainable and visible place-based results...and de-emphasize the goals related to other people-based benefits” (Fraser and Kick, 2007, p. 2358).

Among its purported benefits, mixed-income housing has been touted as far better than traditional public housing and other older, project-based subsidy programs, since it provides a non-stigmatizing environment and may even provide opportunities for lower-income households to network with neighbors who may offer jobs or other advantageous connections (Levy, McDade, and Bertumen, 2013).

Despite these potential strengths, questions have been raised about the actual benefits of mixed-income housing for low-income households (Schwartz and Tajbakhsh, 1997) and the findings, to date, have not been encouraging. In one of the earliest studies exploring mixed-income housing, researchers in Massachusetts concluded that “income mix as such does not seem to be an important determinant of satisfaction and dissatisfaction” among residents. High levels of satisfaction were principally due to the superior design, construction, and management of the developments (Ryan et al., 1974, p. 24).

Decades later, an analysis of six mixed-income developments in Massachusetts led researchers to conclude that while the housing was high quality and well managed, “the extent to which the growth of mixed-income housing in the suburbs has supported the deconcentration of poverty and increased opportunities for very low-income urban families with children is less clear” (Gornstein and Verrilli, 2006, p. 34). Yet another Massachusetts-based research effort analyzed resident outcomes within a mixed-income development and found that there was “no evidence that [market-rate residents] directed their disadvantaged neighbors toward jobs,” and that households with higher incomes “rarely worked to improve neighborhood services, except in the cases of policing and security” (Graves, 2011, p. 143). Furthermore, a 2013 survey of 31 mixed-income developments found that social tensions do exist and “lead to a sense of separation among residents of different subgroups,” with nearly 60 percent of respondents describing in follow-up interviews some form of “us vs. them” dynamic...” (National Initiative on Mixed-Income Communities, 2013). Briefly, with reference to mixed-income housing, “the benefits tied to economic desegregation and poverty alleviation have not been realized” (Levy, McDade, and Bertumen, 2013, p. 18). In truth, the hope that the socio-economic composition of a single development can serve as a “magic bullet” is likely misplaced, since many forces and constraints conspire to thwart economic security for low-income households.

In another study of seven mixed-income developments, including two in which MBS was the lead developer, researchers concluded that key factors contributing to success went beyond the mere fact of a development’s being “mixed-income.” Some important factors, like good location and excellent design and management, were not directly related to resident

income levels. Other important factors suggest that it matters not simply whether, but *how* residents of varying incomes are mixed. These factors included: a critical mass of units aimed at higher-income (market-rate) renters; no differences in the nature and quality of the units available to lower-income and higher-income tenants; and additional activities for lower-income residents to enhance opportunities for interaction (Brophy and Smith, 1997). On this last point, Moore and Glassman (2007) further noted: “It appears by most accounts that meaningful interaction between people in subsidized and unsubsidized units does not take place unless management...encourages activities to bring diverse resident populations together” (p. 8).

North Sarah, St. Louis, Missouri

The first phase of development has 120 mixed-income rental homes in garden apartments, townhouses, and four mixed-use buildings with approximately 11,900 square feet of commercial, retail, community and management space. The second phase has 103 mixed-income rental homes and approximately 6,370 square feet of additional commercial and retail space. A number of units have live-work space – space on the ground floor that can accommodate in-home businesses.



Photo courtesy of McCormack Baron Salazar

At the neighborhood level, a team of researchers observed that although mixed-income housing can have “positive externalities for lower income residents,” and lead to crime reduction and increased public and private investment, income mixing may also result in harmful unintended consequences for low-income households such as displacement “when their long-poor neighborhoods attract new middle- and upper-income residents” who “may help tip many neighborhoods from affordable and low-income areas to expensive ones” (Tach, Pendall, and Derian, 2014, p.8).

Despite the likelihood that income mixing alone is not likely responsible for the several positive findings associated with mixed-income housing developments, there is continued interest and support for this approach. Perhaps part of the rationale can be explained by Alan Mallach’s observation: “While the advantages of integration are uncertain, the disadvantages of residualization and poverty concentration, which are the inevitable by-product of the absence of spatial integration in a market-oriented polity, are compelling” (quoted in U.S. Department of Housing and Urban Development, 2013).

The remainder of this literature review explores what is known about the extent to which private for-profit developers are fulfilling the “Quadruple Bottom Line.”

Financial Viability of Developments

The first component of the “Quadruple Bottom Line” pertains to the need for developments to be financially viable, while also providing a high quality of housing over the life of the project. What do we know about the long-term viability of projects developed by for-profit sponsors, and how does this compare to the experience of nonprofits? As with other comparative findings discussed above, the answers to this question are not conclusive.

The LIHTC industry typically uses three primary measures to evaluate the financial viability/performance of LIHTC projects: occupancy rates, debt coverage ratio (DCR), and per-unit cash flow (CohnReznick LLP, 2015). While data are not available from the HUD LIHTC database on these three indicators or on default rates of LIHTC projects by owner type, the cumulative foreclosure rate of LIHTC projects placed into service from 1997 through 2010 is less than 1 percent (CohnReznick LLP, 2012). Additional data from 2013-2014 points out that although for-profits and nonprofits have very similar experiences in terms of occupancy rates,

with the latter slightly outperforming the former, for-profit developers had stronger per unit cash flow and DCR levels (CohnReznick LLP, 2015).

There is also very little information available on the comparative long-term viability of developments produced by nonprofit and for-profit sponsors using earlier federal housing subsidy programs.⁶ In a study of the Section 236 program, an interest rate subsidy program aimed at multifamily housing that was active from 1968-1973, 47 percent of the developments sponsored by nonprofits were found to have failed, although they accounted for only 23 percent of these developments. And, further, “nonprofit sponsored [Section] 236 projects failed at four times the rate of limited dividend [for-profit] sponsored projects” (U.S. General Accounting Office, 1978, p. 93). According to the report, this was due to nonprofits having few resources to weather adversity and probably to their lesser experience. Nonprofits also tended to admit the lowest-income people eligible for the subsidy program and to serve needier families than limited dividend sponsors. Indeed, the DCR and cash flow underperformance of nonprofit developers may reflect their willingness to take on projects that include additional operating expenses and lease-up challenges such as supportive housing projects targeted to the formerly homeless (CohnReznick LLP, 2015).

The comparative cash flow generated from properties developed by nonprofit and for-profit developers of LIHTC properties was explored by Cummings and DiPasquale (1999), who found that nearly 83 percent of the developments owned by for-profits had positive cash flows, compared with only 60 percent of those owned by nonprofits. They concluded: “Despite incentives to keep net income close to zero, no project can continue indefinitely with expenses exceeding revenues. Syndicators and investors indicate that as projects increasingly are structured to provide no positive cash flow, funding reserves become very important” (Cummings and DiPasquale, 1999, p. 278). And, with only eleven years of experience with the LIHTC program at the time of the analysis, Cummings and DiPasquale observed that “there is no evidence on how these projects will fare when they need substantial capital infusions for renovations or systems replacement. How well these projects clear such hurdles will be a major determinant of long-term viability” (p. 278).

⁶ The remainder of the section on Financial Viability of Developments comes from Bratt, 2008a.

In another study of FHA-insured multifamily properties, researchers found that distressed and stressed properties were less likely to have for-profit than nonprofit owners (Finkel et al., 1999, pp. 4–11). However, they added that because for-profit owners predominate as sponsors of the less troubled, newer assisted properties, whereas nonprofits are more prevalent as sponsors of more troubled, older assisted properties, these findings would be expected.

Perhaps surprisingly in view of the above findings, one study found that nonprofits are more likely than for-profit developers to maintain higher operating reserves to support the ongoing affordability of the units and provision of tenant services (Ballard, 2003). Yet, Bratt et al. (1994) found that these reserve funds were often inadequate, revealing concerns about the long-term financial viability of housing owned by nonprofits. Specifically, seventeen of the twenty-three developments examined were in a dangerous position because of inadequate capital reserves. In terms of operating reserves, the situation was even worse, with only three developments having reserves in excess of 20 percent of operating costs, the number that HUD considers the minimum for public housing authorities. In view of this shaky financial situation, it is perhaps not surprising that more than half of the developments in the sample reported that expenditures exceeded revenues (Bratt et al., 1994).

While Bratt et al. 1994 made no effort to quantify how specific conditions contributed to these types of difficulties, the study suggested a number of possible reasons. For example, the quality of the initial rehabilitation was often found to be problematic because of inadequate construction budgets or poor workmanship and dishonesty on the part of contractors. In addition, small portfolios of properties made it difficult for organizations to cover the full cost of operations from property management fees, and neighborhood factors often created adverse conditions and increased management costs (Bratt et al., 1994).

The decision-making process leading to some of these poor-quality and ill-advised projects was particularly noteworthy. Nonprofits reported that they sometimes undertook projects for which they knew funding was inadequate primarily in response to local pressures to improve a troubled property or to provide additional housing in the neighborhood (Bratt et al., 1994).

In short, nonprofits' willingness to undertake projects in areas that other developers are likely to bypass appeared to be a key factor underlying differences in the viability of their developments. This is consistent with the earlier observation that nonprofits are more likely to do affordable housing development in more distressed areas.

Social and Economic Needs of Residents

At the same time that developments are striving for financial viability, the Quadruple Bottom Line also asks them to focus on the social and economic needs of residents. In my early conceptualization of the Quadruple Bottom Line framework, the category: "social and economic needs of residents" was limited to the level of services provided within the developments. A number of researchers have underscored the importance of service-enriched programs in affordable housing developments (see, for example, Newman and Schnare, 1992; Kudlowitz and Pinder, 2006; Proscio, 2006; Bratt, 2008b) and some have found correlations between providing resident services and significant cost savings in various aspects of property management (Galpin-Platter and Meyer, 2007; Dunn, 2011).

There is only limited research that directly compares the extent or availability of resident services provided by for-profit and nonprofit-owned developments, or that focuses on just the former. One study noted that developers of mixed-income housing may perceive higher costs and risk associated with the provision of on-site social services, with some developers and property managers possibly "reluctant to offer some needed services on-site for fear of advertising the low incomes of many tenants and alienating the higher-income tenants" (Smith, 2002, p. 25).

The availability of resources and funding is, obviously, a critical issue, with nearly half (47 percent) of the respondents to a recent survey of 60 mixed-income developments (a group that includes 23 private developers) reporting that this was the number one challenge to offering resident services within their developments (National Initiative on Mixed-Income Communities, 2015). Another study found that CDCs are more likely than for-profits to provide social services such as job training programs to their tenants, especially as part of their management activities. In addition, since many of these services are provided by nonprofits'

staff members apart from their regular duties, “the costs in terms of time and money become significant” (Leachman, 1997, p. 45).

The second part of the Quadruple Bottom Line, the “social and economic needs of the residents,” can be expanded to encompass several components beyond direct services. Further comparative data was found for the following areas: targeting the lowest-income groups; size of units; and the likelihood that the units produced will be preserved as affordable housing over the long-term.

Targeting lowest-income groups

Developers applying for LIHTCs must agree either a) to dedicate at least 20 percent of the rental units in their project to very low-income tenants, defined as those with incomes at or below 50 percent of the area median income (AMI); or, b) to dedicate a larger share—40 percent—of units to somewhat higher-income tenants, with incomes at or below 60 percent of AMI. The majority of developers (88 percent) have chosen the latter option (U.S. General Accounting Office, 1997).

In a sample of 39 properties placed in service between 1992 and 1994, the only two properties that chose to have the minimum number of units qualifying as affordable for households below either 50 or 60 percent of AMI were owned by for-profits; the other developments had 80-100 percent qualifying units. In addition, just 9 percent of units developed by for-profits had rents below 70 percent of the HUD-designated local Fair Market Rent (FMR). In contrast, 45 percent of the nonprofit-built units had rents below this amount (Burton et al., 2000). Another analysis of HUD’s LIHTC database revealed that less than one-half of the low-income units placed in service by for-profits between 1987 and 2013 had rents lower than the rent ceiling, compared to nearly three-quarters of low-income units (72 percent) with a nonprofit sponsor (Lew, 2015a).

A comparative analysis of public funding for for-profit and nonprofit developers of subsidized housing in Chicago found that for-profit developers sought more moderate-income renters in more stable neighborhoods while nonprofits developed housing targeted at the lowest-income renters. For the period studied (1994), 93 percent of units developed by nonprofits were affordable to those with annual incomes of less than \$15,000, in contrast to

just 18 percent of those developed by for-profits (Leachman, 1997). In short, nonprofits are more likely than for-profit developers to target their units to lower-income households (McClure, 2000).

In allocating tax credits, state housing finance agencies are required to give preference to proposals that serve the lowest-income tenants (Ballard, 2003). Developers are also eligible to claim additional tax credits for building in areas where development costs are high relative to income. Yet only 21 percent of units developed by for-profits qualify for these additional credits, in comparison to 49 percent of those developed by nonprofits (U.S. General Accounting Office, 1999). Aside from this incentive for additional credits, “there is no financial benefit to a developer with an otherwise strong tax credit proposal to serve tenants earning less than 50 percent of AMI” because tax benefits will not differ for the developer (Ballard, 2003, p. 231; see also McClure, 2000).

In order for private developers to serve low-income households, they “must receive a subsidy at least equal to, if not greater than, the revenue lost through the reduced rents for the low-income units” (Smith, 2002, p. 32). The required rate of return among for-profit developers is three times higher than the rate of return required by a nonprofit developer (Smith, 2002). Consistent with this, a study of LIHTC developments in Richmond, Virginia revealed that nonprofits are more likely to serve households with incomes at 50 percent of AMI or less, while for-profit developers are more likely to serve households at 60 percent of AMI (Johnson, 2012).

Several researchers have also observed that partnerships brokered between for-profit developers and nonprofits reflect the mismatch in priorities and organizational goals between these two groups. Compared to their nonprofit partners, for-profit developers may prioritize economic goals over charitable/social welfare goals. For-profit developers tend to be more concerned with the financial feasibility of deals under existing local housing market conditions and with the return that they can expect (under the programmatic guidelines of the LIHTC or local affordable housing initiatives). Meanwhile, nonprofits may place a higher priority than their for-profit partners on meeting charitable organizational goals and fulfilling a mission to serve lower-income households (Lucio and Ramirez de la Cruz, 2012; Jacobus and Winning, 2006).

Size of units

There is an incentive for developers to produce smaller units—studios and one-bedroom apartments—since this increases the number of units that can be built in a given development and, therefore, overall revenues (Graddy and Bostic, 2010). However, in areas with a shortage of affordable housing, larger units to accommodate families with children are typically needed. One study found that for-profit developers were likely to build smaller units with subsidies compared to their nonprofit counterparts: only 31 percent of units created by for-profits had two or more bedrooms, in contrast to 40 percent of units built by nonprofits (Leachman, 1997). Other research revealed that nonprofits were more likely than for-profits to sponsor less dense developments with fewer units (Johnson, 2012).

Preserving affordability

The public-private partnership programs of the 1960s and the Section 8 NC/SR program all encountered the “expiring use” problem. This refers to publicly assisted housing developments ceasing to be affordable to lower-income households as regulatory agreements with HUD expire. Hundreds of thousands of affordable units have been lost due to developments reverting to market-rate housing, with hundreds of thousands of additional units still at risk (Schwartz, 2015). Multifamily properties with project-based subsidies can also leave the assisted stock through repayment of mortgages or through opting-out of expiring contracts.

A recent study compared the characteristics of properties with project-based assistance that have left the affordable rental stock (due to mortgage prepayment or through opt-outs) to those that have remained in the HUD programs. Researchers found that assisted properties owned by for-profits, and properties located in areas where the rents charged in the assisted properties are significantly below market rents, are more likely to opt out (Ray et al., 2015; the same trend was found by Finkel et al., 2006, for an earlier period).

A further analysis found that for-profit owners were less likely than their nonprofit counterparts to own assisted properties that had low rent-to-FMR ratios. Among for-profit-owned units expiring over the coming decade, only 10 percent had average rents of less than 80 percent of the local FMR. In contrast, nearly one-third (31 percent) of those units owned by

nonprofits had rents below this amount (Lew, 2015b).⁷ As Ray et al. (2015) point out, owner type and average rents charged relative to FMR are two primary risk factors for opting out of project-based rental assistance contracts upon their expiration. Therefore, this analysis identifies a potential universe of units at risk of being removed from the affordable assisted stock over the coming decade.

In a telephone interview of 314 owners of tax credit developments, one study found that less than 40 percent of the for-profit owners of LIHTC properties envision that the properties will remain affordable to low-income housing residents beyond the end of the compliance period, in comparison to 70 percent of the nonprofit owners (Abravanel and Johnson, 2000). Further, in comparison to nonprofits, for-profit owners were more likely to limit the affordability of their properties to the minimum-use restriction periods, as opposed to extended affordability-use commitments (Johnson, 2012).

Since for-profits developed and own the great majority of LIHTC properties, it is not surprising that for-profits now own 85 percent of the 1.6 million LIHTC units with affordability requirements due to expire between 2015 and 2025 (Lew, 2015b).⁸ In the early years of the LIHTC program, affordability restrictions lasted for just fifteen years. Since 1990, LIHTC properties have been required to retain affordability for at least thirty years, unless they are able to get special approval. Also, most states have their own requirements for even longer restriction periods. As of 2001, affordability restrictions of more than thirty years were required (or such projects were given priority) in forty-one states. In Massachusetts, Michigan, and Vermont, affordability is required in perpetuity (Gustafson and Walker, 2002).

⁷ This analysis is based on the data in the National Housing Preservation Database as of November 2014. It includes units with subsidies through project-based Section 8, as well as Section 811, Section 202, and older initiatives such as the Rent Supplement and Rental Assistance Payment programs. These tabulations include 840,423 units with a contract expiration date between January 1, 2015 and January 1, 2025 and exclude a small handful of properties with 2014 expiration dates. The methodology used here varies from the methodology used for the Harvard Joint Center for Housing Studies' annual "State of the Nation's Housing" report (see, for example, 2015), which tabulates the number of expiring units based on the latest expiration date of any subsidy in that property. That methodology results in a lower estimate of expiring units with HUD project-based rental assistance (526,544 units) than the one presented here. The estimates presented above also include a number of properties with "multiple" owners, as designated by Database staff.

⁸ This analysis is based on the same data described in the prior note, with the same limitations. These tabulations include 1,641,781 units with an affordability expiration date between January 1, 2015 and January 1, 2025. Once again, the methodology used by the Joint Center for Housing Studies differs from the approach used here and results in a lower estimate of expiring units with LIHTC tax credit allocations (1,261,999).

Due to these extended affordable-use requirements, properties built more recently are at a lower risk of being converted to market-rate housing (Khadduri et al., 2012). However, the same report also found that most early LIHTC properties are not at risk of losing affordability, with the exception of properties owned by for-profits located in strong market areas that could support rents higher than LIHTC rents. On the other hand, Khadduri et al. (2012) further note that while it is the mission of nonprofits to operate properties as affordable housing beyond the term of any regulatory requirements, some for-profits also see their work as providing high-quality affordable housing over the long term, thereby serving needy households.

Neighborhood Context

The third component of the Quadruple Bottom Line refers to the way the housing fits into the larger fabric of the neighborhood and contributes to neighborhood viability. To what extent is the development located in an area where people want to live and, in turn, is the development viewed as a positive addition to that environment?

With regard to siting, nonprofits are more likely than for-profit developers to build units in economically distressed/extremely low-income areas (Leachman, 1997; Buron et al., 2000; Dillman, 2007; Fyall, 2012). Yet another study found that for-profit developments were more likely to be located in neighborhoods with high concentrations of black residents (Dillman, 2007).

In an analysis of external neighborhood effects of LIHTC projects built in Santa Clara County, California from 1987 to 2000, researchers found that projects owned by for-profits delivered benefits similar to those sponsored by the area's nonprofits. Projects built by large nonprofits that were members of the Housing Partnership Network and those built by the county housing authority generated the greatest amount of neighborhood impact in comparison to for-profit developers and nonprofits that were not members of the Housing Partnership Network (Deng, 2011).

A study of Centennial Place in Atlanta, Georgia, provides an example of a HOPE VI project, built by MBS in partnership with another for-profit partner, the Integral Group, where neighborhood conditions were reported to have improved dramatically within a ten-year period after redevelopment. The crime rate in the area surrounding Centennial Place fell by 93

percent between 1993 and 2004, market-rate rents increased, and the improvements in the neighborhood also attracted significant private investment to the area, including condominium conversions and other new housing. It was also estimated that at least three-quarters of the new housing would not have been developed if the prior public housing developments had remained (Turbov and Piper, 2005).

Centennial Place, Atlanta, Georgia



Photo courtesy of McCormack Baron Salazar

Ellen and Voicu (2006) concluded that developments built by both for-profit and nonprofit developers contributed to an increase in neighboring property values. In smaller projects, however, nonprofits delivered less benefit to the neighborhood than for-profit developers. On the other hand, the impact of the nonprofit developments remained stable over time, while the impact of the for-profit developments declined slightly over time.

Environmental Issues

The final component of the Quadruple Bottom Line concerns the environmental sustainability of the development or the incorporation of “green” building standards into the construction or rehabilitation of affordable housing projects. Nearly half of the states in the U.S. (as of 2013) included incentives for developers to include green building elements in their applications for competitive LIHTCs through the Qualified Allocation Plan (QAP) process (Linstroth, 2013). For example, Pennsylvania’s QAP awards points for developments that incorporate renewable energy systems into their design (Leung, 2015).

In 2015, the California Tax Credit Allocation Committee added a Zero Net Energy (ZNE) scoring option that awards more points to proposals based on how much the project will offset the energy usage of its tenants.⁹ Although the costs of incorporating environmentally sustainable features into affordable housing projects, particularly those aiming for ZNE usage, can be quite high, the potential cost savings can be significant.

The Sacramento-based nonprofit developer Mutual Housing estimated that overall construction costs to reach ZNE for its Spring Lake development—the first nationally certified ZNE rental housing development in the U.S.—was 9 percent above the amount required to comply with California’s mandatory energy-efficiency guidelines for residential and non-residential buildings. However, Mutual Housing estimated that, over the following fifteen years, rent payments totaling between \$1.3 million and \$1.7 million that would have gone towards utilities would instead contribute to a positive cash flow (Patterson, 2015). Owners and developers can also earn green rebates and other financial incentives by achieving Leadership in Energy and Environmental Design (LEED) status (Levin, 2013).

Information on the extent to which for-profit and nonprofit developers take advantage of these approaches and incentives is not available. In general, environmental or green building practices have not been widespread within the affordable/low-income housing industry due to the perception of lower up-front financial feasibility; higher cost of materials; and limited knowledge of such practices (Phillips, 2006). In addition, the traditionally higher initial costs

⁹ ZNE buildings produce as much energy as they use through the integration of energy-efficient design and generation of renewable energy, such as through solar energy installations.

associated with green building and the stringent requirements associated with the use of public funds for affordable housing may hinder for-profit developers from addressing environmental issues (Levin, 2013). A 1998 survey of developers found that they view “environmentally sensitive design to be an impediment, not an opportunity” (quoted in Levin, 2013, p. 37). However, attitudes toward affordable environmentally sustainable housing may be shifting. According to a recent survey, as of 2012, 86 percent of multifamily builders and developers reported that at least some of their affordable housing projects were green; nearly a quarter of this group reported that 31 to 60 percent of these projects were green (McGraw Hill Construction, 2014).

Summary

The preceding literature review highlights several key differences between for-profit and nonprofit developers in the development and ownership of affordable rental housing. Not surprisingly, for-profit developers are likely to prioritize economic goals over the more charitable/social welfare goals of nonprofits. As a result, there appears to be a greater willingness on the part of nonprofits to undertake projects in areas that other developers are likely to bypass – economically distressed areas with extremely low-income households. This orientation seems to be a key factor underlying any differences in the viability of developments owned by nonprofits. Nonprofits also may be more likely than typical for-profits to maintain affordability beyond the mandated use-restriction periods.

For-profit developers have greater access to ready capital and, although there is conflicting data, they may also be able to achieve lower production costs. For-profits also tend to use conventional loans to finance a larger share of their affordable housing development costs and are able to secure mortgages covering a larger portion of these costs. The financing gaps experienced by nonprofits require them to rely on federal funds through the HOME and CDBG programs and to use multiple funding sources to make the deals work. And, when nonprofits’ production costs are found to be higher, researchers invariably note that this needs to be viewed in the context of the other benefits that are typically associated with housing produced by nonprofits.

Despite the several potential strengths of mixed-income housing, questions have been raised about the actual benefits of this approach. The findings, to date, have not been encouraging. Key factors contributing to the success of mixed-income developments appear to be less related to tenants' incomes than to other important aspects of the development.

Although for-profit developers have played a key role in the production of affordable housing since the 1960s, the literature review also reveals that there are gaps in the research. Direct comparisons between for-profit and nonprofit developers, holding as many variables constant as possible, would be desirable to better understand the relative strengths and weaknesses of each. More specifically, we need more information on the extent to which both types of developers acknowledge the importance of the "Quadruple Bottom Line" and on the extent to which these criteria are met. Indeed, as discussed in the last section, additional qualitative and quantitative explorations could look at key variables through the experiences of the various sub-types of nonprofit and for-profit developers. This would promote a richer understanding of the challenges being encountered by a range of entities, preferably in diverse market settings, in the production of high quality affordable housing.

The following case study of McCormack Baron Salazar was launched in an effort to better understand the work of one private for-profit developer in providing housing that is affordable to lower-income households. In view of the relative lack of information on this subject, the hope was that this case study could offer some immediate insights useful to both for-profit and nonprofit developers, as well as to those in charge of policy development and implementation. Helping to spur a new wave of research efforts among housing academics and policy makers would be another welcome outcome of this effort.

This study was also undertaken with a full appreciation of the problems that public-private partnerships in housing can encounter, such as the expiring use problem discussed earlier. Because of these well-known pitfalls in the for-profit sector's involvement with the affordable housing agenda, it is important to learn as much as we can about how one of the most successful for-profit affordable housing developers in the country approaches its work and about the extent to which it embraces, and fulfills, the various components of the "Quadruple Bottom Line." Indeed, from a theoretical perspective, we can question whether the

Quadruple Bottom Line provides a useful framework within which to measure and understand affordable housing outcomes.

North Sarah, St. Louis, Missouri



Photo courtesy of McCormack Baron Salazar

Background and Mission of McCormack Baron Salazar

Context

By the early 1970s, Richard Baron, the chairman and chief executive officer of McCormack Baron Salazar, had acquired a first-hand appreciation for how decent, affordable housing is key to a family's well-being and a community's overall viability. With a background working with poor children in Cleveland and doing legal aid work connected to a groundbreaking rent strike involving public housing tenants in St. Louis, Richard Baron was a key participant in the agreement that created an innovative resident management model for St. Louis public housing. In connection with that work, Richard Baron met and formed a partnership with Terence "Terry" McCormack, a former homebuilder who had worked closely with labor organizations and other groups to develop senior and family housing in St. Louis and elsewhere across the country.

The firm of McCormack Baron & Associates was launched in 1973, with the vision "to rebuild low-income communities by providing quality housing options for all people" (McCormack Baron Salazar 2015a). At that time, the U.S. Department of Housing and Urban Development (HUD) was a mere seven years old; the Fair Housing Act was only five years old; and existing methods of subsidizing housing were being re-evaluated. Indeed, in the same year that McCormack Baron & Associates was created, the Nixon administration called a moratorium on all housing programs, effectively shutting down new public housing construction, as well as the BMIR programs of the 1960s.

In 1973, the legislation creating the Community Development Block Grant and Section 8 programs were still a year away. The Urban Development Action Grant program would be created four years later, in 1977, and the Low Income Housing Tax Credit program was a full thirteen years from enactment—not even a gleam in lawmakers' eyes.

During the early 1970s, problems of the cities were often talked about in terms of "crises," with the preceding years having exacted a major toll on urban cores across the country. Although some of the major confrontations of the civil rights era occurred in small cities such as Selma, large cities were more often the sites of dramatic uprisings—Baltimore, Chicago, Cleveland, Detroit, Los Angeles, Newark, New York, and Washington, D.C. Negative

and frightening images of cities during and after the race riots, combined with the numerous large-scale protests against the Vietnam War, as well as the aging infrastructures of many cities, all contributed to the image of urban living as undesirable for the post-war middle class.

By the early 1970s the critique of the Urban Renewal program had been well documented, with the publication during the prior decade of a number of influential and well-publicized books, such as Jane Jacobs' *The Death and Life of Great American Cities* (1961) and Herbert Gans' *The Urban Villagers* (1962). The loss of low-rent apartments and the complete destruction of numerous inner city neighborhoods further framed the image of a widespread federal assault on urban areas. In addition, the lack of private investment in inner city housing, or redlining, was not exactly a thing of the past. As recently as 1969, this practice had been singled out as a key contributor to urban problems by two presidential commission reports (Report of the National Commission on Urban Problems, 1968; Report of the President's Committee on Urban Housing, 1968).

At the same time that urban areas were losing appeal for middle and upper income groups, new housing options were plentiful during this period, as the development of suburban areas and cheap gasoline made commuting by car easy and affordable. Although the 1968 Fair Housing Act had banned discrimination in housing, discriminatory practices continued and suburban opportunities were largely available only to white households. In addition, in the 1970s, as today, nonwhite household income lagged far behind that of their white counterparts, making the cost of new suburban housing beyond the reach of most minority households.

In the development community, by the 1970s nonprofit organizations had begun to play a role in inner city revitalization, but in that early period these groups were few in number and most had only a few employees (National Congress for Community Economic Development, 1989; Vidal, 1994). For-profit developers had been the major developers of the new BMIR programs of the 1960s, with a key motivation being the generous tax benefits available during that period. However, those programs never reached the needed scale in terms of production levels. With competition for inner city land far from robust and federal housing subsidy

programs in a state of flux, the new firm of McCormack Baron & Associates was in uncharted territory. There was both a wide-open range of possibilities, as well as obstacles.

Idealistic Roots/Practical Orientation

The idealism of the two principals of McCormack Baron & Associates spurred their commitment to affordable housing production. Their first projects involved developing relatively small-scale mixed-income rental properties on single sites. When the firm was only eight years old, in 1981, Terry McCormack died. His son, Kevin McCormack, who had been a vice president of a New York bank, joined the firm that same year. Four years later, in 1985, Tony Salazar, who had a degree in social work, also came to work at McCormack Baron & Associates. In 1993, Tony moved to Los Angeles and became the president of the firm's West Coast operations. Nine years later, in 2002, the name of the firm was changed to McCormack Baron Salazar.

The firm's ideological roots are reflected not only in the backgrounds of the partners, but also in the experiences of many of the other key employees. For example, before joining MBS, Vincent Bennett, executive vice president and chief operating officer, worked for a nonprofit in Pittsburgh and never anticipated working for a for-profit, until he came to understand MBS's mission and orientation. Michael Duffy, senior vice president for project finance, received a Master's in city planning from Ohio State University and, prior to MBS, had worked at Ohio Capital Corporation for Housing, a nonprofit that raises money from private investors for affordable housing development. And Tim Zaleski, the president of the property management division, worked for the Columbus, Ohio nonprofit National Church Residences.

One of the ways in which MBS is unique is that staff members are comfortable earning less money than they feel they could earn with a different for-profit development firm. Several interviewees answered "yes" to a question about whether they felt they would be getting a higher salary if they worked for another development firm. Some estimated that working for another for-profit developer could yield a salary as much as twice what they were currently earning. Yet none of those interviewed felt that they were being under-compensated at MBS. Indeed, staff members indicated a high level of satisfaction with their jobs and, if there was a possible disparity in pay, they felt that the tradeoff was well worth it; they put a premium on

working for a firm whose mission and approach was consistent with their own values. On the management side of the business, national salary surveys are monitored to ensure competitive wages are being paid and, quite often, the pay at MBS is above or near the top of benchmark standards. This level of compensation is due, at least in part, to the challenges of the job resulting from the difficult markets in which McCormack Baron Management works.

I could have worked for another developer, but over the long-term my work results in a great place for kids to grow up.
— Michael Duffy, MBS Senior Vice President, Project Finance

The social mission and community-oriented activities of MBS appear to mirror those of nonprofit affordable housing and community development organizations. Indeed, several key people from the St. Louis housing community said that MBS has a mind-set similar to that of nonprofits.

MBS has described its holistic approach to improving the quality of life for area residents, with extensive involvement by those most directly impacted, as follows:

Returning distressed communities to desirable ones takes more than just bricks and mortar. It's improving the quality of life and the social institutions. It's about connecting people and places to jobs and economic opportunity and addressing safety and security concerns. It takes listening to the residents who still see value in the old community and understanding what it was that made it strong at one point in time and what it is that will make it strong again. It's reestablishing a sense of place and connections that have broken down over the years and recreating a new place that has space for all people from all ages and all walks of life. And it's about building strong new physical and social assets that will endure the passage of time and the changing of situations while protecting the environment and conserving resources. This change cannot be wrought in piecemeal fashion. It takes vision and scale. At MBS, we are

committed to leading the process to find and implement this vision to create truly sustainable, lasting, stable, safe, efficient communities with opportunity for all residents.¹⁰

To reach these goals, MBS outlines a comprehensive process that entails working with residents, government agencies and officials, and other stakeholders. They believe that “working in cooperation with all the stakeholders in a community helps to quickly and efficiently identify the strengths of the community and its challenges and ensures that the community can help shape the revitalization plan.”¹¹

Appreciating the interconnectedness of the challenges facing low-income communities, the firm began to incorporate a range of community and resident services into their developments and embraced an ambitious agenda of neighborhood and human transformation within a mixed-income context.

Commitment to transforming people and neighborhoods

MBS sets out to change a run-down area into a vibrant community that is safe, attractive, and well managed. MBS’s model for transforming a neighborhood is different than that of most grassroots neighborhood-based development organizations, which typically identify the existing strengths of a given area and target specific structures for rehabilitation and building new ones when feasible. In contrast, the basic MBS model involves the demolition of a group of old buildings and the development of new mixed-income housing. Thus, the transformation of a neighborhood can make it virtually unrecognizable. It may take a while for community-wide perceptions of the new area to change, since people’s mental images can be based on the old neighborhood and, indeed, the surrounding areas may still be severely deteriorated. For example, while acknowledging that MBS does “great work,” University of Missouri Professor Todd Swanstrom also noted that, sometimes, “the projects are islands in seas of decay.”

The transformation of people is an even more daunting challenge. But the MBS personnel I interviewed expressed a broad commitment to do everything within their ability to

¹⁰ This was an excerpt from an earlier version of the MBS website; it is attributable to Richard Baron and is cited here with his permission.

¹¹ Ibid.

ensure that their housing developments will enable rather than impede residents as they go about their lives. MBS hopes to provide the amenities needed for comfortable living: safe, clean, affordable, uplifting (not stigmatizing) homes in secure, well managed neighborhoods with readily available services. In short, it shouldn't be housing that limits a family's opportunity and interest in moving from point A to B, whatever point B may be. MBS is focused on helping and supporting people to move on with their lives by assisting them to become more economically secure or addressing other important problems. Yet not all residents are interested in participating in the various programs that are available.

With our partners, which can be the city, or institutions like schools, churches, hospitals, we become a community of shared values, trying to solve problems. We ask, where do the kids go to school? How can families and children be successful? How can we help make that happen?

Vincent Bennett, MBS Executive Vice President and Chief Operating Officer

In the 1990s, a competing approach to transforming the lives of people took shape. Rather than revitalizing places and, at the same time, trying to help the people living there, the strategy of the Moving to Opportunity (MTO) demonstration program involved assisting lower-income households living in high poverty areas to relocate to lower poverty areas. Although the tangible outcomes of this strategy have been mixed (Sanbonmatsu et al., 2011), it continues to be attractive to many policy makers, in part because of the potential to better achieve fair housing goals, deconcentrate poverty, and provide better opportunities for families. Indeed, a 2015 evaluation of MTO found that each year spent in a higher-opportunity neighborhood can increase the chances that a child will attend college, have higher earnings, and other positive outcomes (Chetty, Hendren, and Katz, 2015). Despite the appeal of this strategy, it was not the path chosen by MBS. As Richard Baron has noted: "We rejected this approach decades ago because of the enormous obstacles inherent in such a strategy. Racism and the overt hostility

of suburban communities make the effort an exercise in futility. We chose to work in cities which were interested in our approach.”

Richard was the only developer who was able to do what I envisioned at 79th and Hough. I didn't want it to be public housing. I wanted it to be mixed use [referring to a desired income mix of residents]...I would recommend Richard anywhere to do housing. He does more than just housing: he sees people and he designs things for people. He's the best I've seen across the country.

– Fannie Lewis, Cleveland City Councilwoman, 1980-2008
(quoted in Matthews, 2004).

Strong belief in mixed-income housing

From the late 1960s onwards, the idea of developing housing completely occupied by very low-income households generally lost favor. MBS became an early champion of mixed-income housing, which at the time of the company's founding in 1973 had already been pioneered elsewhere. One of the earliest proponents of this approach was the Massachusetts Housing Finance Agency (now known as MassHousing), which had been launched in 1968.

One concern about mixed-income housing, encountered by MBS in several cities, is that these developments may attract a narrower band of residents, in terms of incomes, thereby undermining a truly mixed-income concept. In St. Louis, for example, home prices are much lower than in “hot market” areas and the spread between LIHTC and market rate rentals is only about \$150/month. In such a market, if a household can afford the market rate cost, it may forego the LIHTC unit, preferring a marginally higher rent over the added paperwork and intrusiveness of annual re-certifications.

Although, as noted previously, research on the actual benefits of mixed-income housing is not conclusive, and some early findings about its ability to promote economic security for low-income households have been disappointing, it is still a promising alternative to changing patterns of social exclusion that are known to be problematic. At the very least, mixed-income

housing developments remove the possible stigma of living in an all low-income project. With such issues in mind, MBS has continued to be a leader in promoting the mixed-income strategy.

Paying attention to local schools

One of the distinguishing characteristics of MBS is its focus on the role of local public schools in contributing to high quality housing developments that will be attractive to residents with a mix of income levels. MBS believes that there is synergy between ensuring that residents have access to a top-quality local school and the ability to attract parents – of all income levels— who are committed to their children’s education. In many MBS developments, part of the work involves engaging city officials to commit to upgrading the existing local school or building a new one.

Whatever the impact of the Vashon Compact [a \$40 million investment in St. Louis public schools between 2001 and 2006], one thing can be said about its founder: He never quits. Fifteen years ago when Richard Baron was just getting started with the compact, he was already looking beyond it. His dream was to build an early childhood center next door to Jefferson School. It took nearly all of those 15 years to get it done. But there it is now adjacent to Jefferson... a modern, \$11 million facility for infants and toddlers in the neighborhood and across the area...It now serves 63 children and is licensed to accept 154.

– Evita Caldwell (a student who participated in the Vashon Compact program, quoted in Caldwell, 2015)

There is mounting evidence about the importance of schools in community revitalization efforts. For example, based on a review of the literature and their evaluation of four HOPE VI projects, including two MBS developments, a team of researchers emphasized the importance of amenities and services that go beyond bricks and mortar. In addition to recreational opportunities, jobs, and skills training, schools are highlighted as being particularly important (Turbov and Piper, 2005, p. vi).

Furthermore, according to a report produced under the auspices of Urban Strategies, MBS’s affiliated nonprofit that works with residents on a range of programs, “All of our

experience points to an ‘enhanced’ neighborhood elementary school as the most potent additional ingredient to build social integration and upward mobility in mixed-income/mixed-race communities” (Moore and Glassman, 2007, p. 16).

The background and mission of MBS discussed in this section underscore its clear ideological orientation. At the same time, MBS is a finely tuned, well-managed company. In short, it is committed to the Ben Franklin adage: "do well by doing good." By all accounts the firm has met both its goals – to be a successful, profitable company, while also being an aggressive and tireless developer of mixed-income housing and community development initiatives in some of the country’s poorest, most dilapidated urban areas.

The firm’s commitment to a comprehensive approach to community development has meant forming partnerships with local service providers, as well as public, private, and other nonprofit organizations, thereby offering residents job training programs and health services. At the same time, the real estate side of the company has expanded to include sophisticated property management and asset management operations. Clearly, serving residents well also means having a group of experts, working on all phases of what it means to own and manage the properties.

The current business model of the firm evolved over several decades, as larger, more ambitious projects were undertaken. Each project has involved innovative and complex financing arrangements that included whatever federal subsidies were available at the time, as well as local funding. At the present time, MBS is primarily interested in tackling major re-development efforts, which may go beyond the provision of new housing. Within the city of St. Louis, the sense is that while there are a lot of LIHTC developers, MBS is the go-to developer for any large project that comes along.

Defining Characteristics of McCormack Baron Salazar

Although MBS works in many cities across the country, this study focuses on St. Louis, their home base, the place where they got started and which, perhaps, most shaped their business model. The observations about their mode of operation and how they relate to key partners are all seen through the lens of that one city. Two brief observations about the St. Louis housing market provide the context for this exploration.

First, despite the fact that St. Louis has much lower housing costs than most coastal cities and many other parts of the country, there is still a strong demand for low-rent units. According to Cheryl Lovell, executive director of the St. Louis Housing Authority, in July 2014 they opened up the Section 8 waiting list and received 27,000 applications. While she was quick to point out that people applied online and not everyone was qualified, it is still noteworthy that this many people took the time to apply – about 8 percent of the City of St. Louis’s population. Chris Krehmeyer, president and chief operating officer of Beyond Housing, a nonprofit, noted that they get as many calls per month for households seeking affordable housing as they have units in their portfolio—422. Although one could likely buy a very nice house in the city for considerably less than \$250,000, the median household income in the city is just \$34,582, and nearly one in four households (38 percent) earns less than \$25,000 per year (U.S. Census Bureau, 2009-2013). This is the group that the LIHTC, Section 8, and traditional public housing programs are aimed at assisting.

Richard Baron observed that weak markets present special challenges for developers:

Weak markets require more subsidy dollars, since you can’t get high rents in the high end of the mixed-income developments. In contrast, in high market rent areas you need less money, since you are able to charge high market rents. It’s hard to do work in the Midwest where market rents are so low. In weak markets, we have to question whether there is the ability to come up with gap financing for the projects. What if the local community isn’t able to fill the gap?

Second, St. Louis is a highly segregated city. The shooting of Michael Brown in August 2014 by a white police officer in nearby Ferguson, and the ensuing unrest in the black community, brought into focus racial tensions not only in that city but in neighboring St. Louis

and across St. Louis County (and, indeed, throughout the U.S.). Black households predominantly live on the north side of St. Louis and in adjacent areas of St. Louis County. White households are mostly located on the south side of St. Louis and in the adjacent County towns, both in the south and west of the city. Citing a report that St. Louis is “the ninth most segregated region in the country, among metropolitan areas with large black populations,” a *New York Times* article further noted: “The roots for the current racial divide are deep. In 1916, St. Louis voters codified segregation with an ordinance that prohibited racially mixed communities. The law was struck down by the courts, but deed covenants and realtor agreements prohibiting home sales to blacks kept segregation intact. The impact of those policies persists” (Eligon, 2015). The racial history of St. Louis makes MBS’s commitment to mixed-income housing in that locale, as well as in other similar markets, even more compelling.

With this brief background, this section highlights a number of defining characteristics of MBS’s business model:

- Essential ingredients of a desirable project
- Resident services provided by Urban Strategies
- Design, construction and management
- How profit is achieved
- Strategic advantages
- Collaborations
- Long-term ownership of developments

Essential ingredients of a Desirable Project

Through the years, MBS has been able to clarify the key components needed for it to make a commitment to a project. For the principals, getting to the point of being able to articulate these essential ingredients did not come easily. Michael Duffy, senior vice president for project finance, noted that “some earlier experiences were not good – a component was missing. But, now, we don’t do a lot of deals if all the elements are not there.”

First, in understanding their role as outsiders to the community, MBS believes that having a strong, local partner is essential. MBS is happy to partner with a local government, a philanthropic investor, a large nonprofit institution such as a hospital or university, or a private business. But the key is that there is a strong and committed local presence involved—an entity

that has a major stake in the development's success and, in fact, is willing and able to contribute significant financial and in-kind resources to the early phases of the project.

It is positive that HUD talks about leveraging resources and the need for buy-in, into a project. But it is one thing to get a letter of support from a possible partner, such as the city. It is another thing when they are willing to put in a significant amount of money. Once we have someone locally with clout, we'll figure out how to do it.

– Kevin McCormack, MBS President

In addition, it is important that the lead partner be supportive of the mixed-income approach to redevelopment and that the project be a top priority. Ideally, too, the lead partner would have a sophisticated understanding of real estate development and finance.

One of the benefits of the LIHTC program's requirement that for-profit investors be involved is that this kind of market discipline makes everyone take a close look at the project, and that this scrutiny in turn makes for a better project. Kevin McCormack noted, "This is the up-side of the leveraging requirement. But the negative aspect is that a patchwork of resources is necessary. And this is very complicated to put together."

In addition to working closely with a strong local partner, MBS is also deeply aware of the importance of forming a close relationship with community residents. Although this is primarily the role of their nonprofit partner, Urban Strategies (discussed below), the principals of MBS feel that developing strong relationships with the local community is part of the company's DNA.

Second, the proposed development must have an attractive location. It must be either downtown or close to an anchor institution in that community. Often, the lead local development partner is, in fact, that anchor institution and therefore has a great deal to gain by upgrading the general area in which it is located.

Third, and consistent with securing an appropriate local partner, MBS works to limit as much as possible their up-front risk in a deal. Thus, MBS expects its local partner(s) to cover most or all of the soft costs involved in getting the development launched, including

architectural and engineering studies and acquiring the necessary permits. Having to carry those costs until closing is a big weight that MBS strives to avoid. In short, having a strong local partner is valuable for helping cover some of the costs, but it also keeps the partner engaged in the project.

Once MBS has closed a deal, they are prepared to assume virtually all the risk going forward. At that point, they want to be in control of the project, and they structure their relationships so that they are fully in charge of the various development tasks and phases.

Fourth, in order to make MBS's large, complex deals work, and to ensure that the housing will be affordable to the intended group of households, additional financial resources are typically required. High quality development does not come cheaply and there is usually a great deal of subsidy money involved. For an MBS project to move forward, resources may come from the federal, state or local government, from a private institution, from a philanthropic entity, and/or from a corporate partner.

Several interviewees in St. Louis noted that some people feel that MBS housing ends up costing "too much." MBS is so focused on mission, comprehensiveness, and quality, that there can be "sticker shock" about the cost of the final product. One person questioned whether more housing could, perhaps, get built if another, presumably less costly developer were involved. But, on the other hand, a less costly project would likely be less desirable, and could have higher management costs and less long-term viability.

Fifth, development fees must be adequate, and, for the most part, are non-negotiable. The goal is a 10 percent developer fee, although there may be a slight range, 9.5-11.5 percent, depending on the size of the project – the larger the project, the lower the percentage that may be required. MBS is careful to explain its fees up-front and it structures its deals so that any additional fees or savings are returned to the development or to others involved, but not to MBS.

In response to a question about whether the 10 percent developer fee is an essential ingredient for getting into a deal, Richard Baron stated:

We really need to get that. The fee gives us the opportunity to manage the projects well. A lot of private developers have low development overhead expenses. They don't have

their own internal design/construction staff, relying instead on a general contractor. We need to have enough income to cover overhead from the time we start the development process until lease-up. The 10 percent fee allows for risk and enables us to do the work. About 40 percent of the fee is overhead, about 60 percent for risk and profit, but it varies.

Sixth, as MBS's business model has evolved, the focus has primarily been on large-scale projects. They look for big problems that demand bold interventions. People typically invite MBS in to solve a problem when there is a significant development challenge that can't be overcome without a group of seasoned experts. MBS typically does not work on a "normal" LIHTC deal. They are looking for a place and a project where they can have a major impact. And, making the final call on a project's viability seems to have a lot to do with personal relationships, instinct, and a sense that it is the right place and the right time to get involved. Yet MBS will still sometimes develop a small site, such as a current project in Washington, D.C. where they are building housing for homeless veterans. As Michael Duffy noted: "We definitely do deals that are not marquee deals. At the end of the day, we have to pay the bills." But the majority of their work is exactly what they like to do best and what has gained them the most visibility: complicated, large-scale redevelopment.

In undertaking these kinds of developments, MBS personnel need to be creative problem solvers, willing, if not eager, to tackle complex deals that many (or most) other developers would avoid. An important criterion for the firm's involvement in a project is whether one of the MBS partners is pushing for it; if one of them believes in a deal, the others typically offer their support and approval. Once a commitment is made, MBS typically spends a great deal of time working out the financing and other details. (See the following descriptions of two large-scale MBS projects.)

How the Essential Ingredients of a MBS Project Came Together

Example 1: West Park Apartments, Tulsa, Oklahoma

- The Kendall-Whittier neighborhood of Tulsa had been a focus of the local planning department for over 25 years.
- Located adjacent to the University of Tulsa, it was viewed as an important component of the university's ongoing success.
- In 2006, the George Kaiser Family Foundation opened a state-of-the-art early childhood center adjacent to the high performing Kendall Whittier Elementary School.
- This attracted many young families desiring high quality educational opportunities for their children. However, housing conditions were deplorable.
- MBS led a team of professionals with input from a consortium of partners including the George Kaiser Family Foundation, the City of Tulsa, the University of Tulsa, educators, local businesses, and residents through a master planning process that resulted in a mixed-income, mixed-use development that also included a major renovation of the centrally located neighborhood park.
- Through the national Main Street program, an Executive Director was hired to assist in restoring retail and commercial services important to the ongoing sustainability of the neighborhood.
- In addition to 128 units of mixed-income rental housing, in a combination of townhouse and garden-style buildings, a mixed-use three-story building was developed in partnership with the University of Tulsa. This includes offices, community space, a fitness center, 2,600 square feet of commercial space, and 20 units of graduate student housing.
- The George Kaiser Family Foundation has invested over \$35 million toward the implementation of the Kendall Whittier Master Plan and over 60 neighborhood children are attending the day care center or elementary school. (Summary based on McCormack Baron Salazar, 2015b)



West Park Apartments, Tulsa, Oklahoma (exterior, above; community room, below)

photos courtesy of McCormack Baron Salazar



How the Essential Ingredients of a MBS Project Came Together

Example 2: Renaissance Place at Grand, St. Louis, MO

- The Arthur Blumeyer public housing development was built in 1968, consisting of four high-rise and 42 low-rise buildings, housing 1,162 families, including 585 elderly.
- Over time, the development suffered from deferred maintenance, high crime and, eventually, high vacancies.
- Residents took over management in 1995 and began undertaking a major renovation of the units.
- However, together with the St. Louis Housing Authority, the residents determined that even more major revitalization was needed to truly transform the community.
- A first step for MBS was to create a master plan for the community, which was done through an extensive community planning and visioning process. Plans for new housing and community support services were drafted by a steering committee made up of residents and other stakeholders.
- Located north of Grand Center, the mid-town arts district in Saint Louis, the site was attractive for development.
- HUD awarded the St. Louis Housing Authority a \$35 million HOPE VI grant for Blumeyer's redevelopment in 2001.
- The new community, renamed Renaissance Place by residents, and developed by MBS, contains 512 mixed-income apartments, 110 of which are in a universally-designed senior building and another 30 of which are in a universally-designed accessible building for non-seniors.
- The development includes townhouses and garden-style apartments for people from a range of incomes, including public housing residents, workforce/affordable residents, and market-rate residents.
- Homeownership opportunities are offered to first-time homebuyers earning less than 80% AMI through a second mortgage assistance program.
- The transformed community is environmentally sustainable and was the first community in Missouri certified under the U.S. Green Building Council's LEED for Neighborhood Development (LEED ND) program.
- Amenities include an on-site community activities building, community gathering space, a computer lab, a private pool, and a fitness center.
- The Community Support Services Program, managed by Urban Strategies, helps residents achieve their economic and personal goals. This involves linking with educational services, career placement and enhancement support, child-care services, health services, and programs for youth including employment, tutoring, and other educational activities. (Summary based on McCormack Baron Salazar, 2015c)

Renaissance Place at Grand, St. Louis, Missouri



Photo courtesy of McCormack Baron Salazar

Even a project that incorporates all of MBS’s “essential ingredients” may still face significant challenges, largely due to external constraints and the complexity of developing and managing high quality affordable housing. First, a problem facing some MBS developments is that insufficient public housing authority reserves have been set aside. This issue is looming in projects owned by the St. Louis Housing Authority, where there is a fear that the high quality of the developments will suffer once reserves are depleted. However, unless Congress drastically cuts public housing operating subsidy funding, MBS principals feel that such depletion is unlikely at least within the next few years.

A second major issue is the lack of a budgeted line-item for resident services. Although MBS has a commitment to providing high quality supports and educational opportunities for its residents through a separate organization, Urban Strategies, its ability to do so depends on

funding from outside sources. Many nonprofit organizations strive to provide resident services through cash flow generated from the operation of their buildings.

Resident Services Provided by Urban Strategies

Resident services are viewed as essential components in MBS's efforts to create a holistic strategy—one that combines an attention both to people and to the places where they live. Before Urban Strategies was created, resident services were provided by a separate unit within MBS. However, Richard Baron quickly realized that foundations would not be willing to fund support services for residents in developments owned by for-profit developers: a nonprofit organization was needed to play this role.

Urban Strategies, a 501(c)(3) nonprofit, was created in 1978, with Richard Baron serving as the first president. Sandra Moore, the current president of Urban Strategies, now presides over this completely separate entity. While Urban Strategies is neither an affiliate of, nor a division within MBS, Richard Baron continues to have a significant role, serving as the chairman of the Urban Strategies board. Most board members are not, however, affiliated with MBS. And, while about 80 percent of Urban Strategies' work is with MBS, the remainder of their jobs come from other developers and property owners. Urban Strategies has about 80-100 employees and an annual budget of \$7-10 million, depending on the number of active development projects.

Urban Strategies works with people only on a housing platform. According to Sandra Moore, they have "been able to professionalize their work and are able to provide a high level of services." She further explained that many Urban Strategies staff members are social workers, who see their work through a policy and systemic lens, rather than as providing one-on-one therapeutic services. The business model of Urban Strategies is, most often, to orchestrate local providers to make the needed services available to residents. With the exception of the design and implementation of services that are needed, but not provided locally, they do not deliver services themselves.

The mission of Urban Strategies is: "To empower residents in distressed urban core neighborhoods to lead healthy, prosperous lives in thriving, self-sustaining communities...Urban Strategies works to help communities build safe neighborhoods, enhanced schools, and a range

of comprehensive human service supports. [Their work] is designed to build social and economic mobility for low-income families living in mixed-income communities.... [With the understanding] that successful community development requires a comprehensive and integrated set of strategies around building people and building place,” programs to support human development are coupled with physical development. This mission allows Urban Strategies “to identify, assess, and address issues, to develop strong partnerships, and to leverage resources to meet the community’s critical needs early on and throughout the revitalization process” (Urban Strategies, 2015).

Funding for Urban Strategies comes from both the owner’s development and management budgets, from philanthropic donations, and from city, state and federal grants, such as through HUD’s Choice Neighborhood program, the successor to HOPE VI

MBS is unique in that they understand the nexus between responsibility and opportunity. Lives can change when people are given the opportunity to live at a higher standard. I work with other developers, and it is not easy to get them to understand that what you build is directly related to how well families will do in their homes and how easy or difficult the management of the property will be. If I need something for a development, I go to MBS first. They usually find money to help me care for the people in their developments.

— Sandra Moore, President, Urban Strategies

A distinct advantage of the Urban Strategies-MBS collaboration is that the former understands how to work with families on a developer’s schedule. There is a time-span of approximately 30 months from the time a project is officially launched to occupancy. During the first year, Urban Strategies staff members start working with families, preparing them for the changes about to take place and helping them sort out where they are going to live—either during the construction phase before they return to the new development, or permanently, if it is unlikely that they will return to the site. According to Sandra Moore, about 20-30 percent of

the existing residents at a given site make it back into the new development, which is apparently higher than the standard for this type of redevelopment project.

Sometimes families don't return to the new development because they have found a new home, gotten stabilized there, and don't want to move again. Some either can't meet the new re-occupancy requirements or don't want to. These requirements are slightly different for each project grant. Established by the community committees created for each particular development, these committees are a part of the community engagement process required by the grants funding the projects. In general, however, the requirements call for a resident to be in good standing and to participate in the Community and Supportive Services program. To be considered in "good standing," the typical requirements include a review of the tenant's record for the prior twelve months: rent payments cannot have been late more than twice and there cannot have been any lease violations.

According to Cheryl Lovell:

The original residents are typically told what they will have to do to qualify for a newly developed unit. While they may be excited at the outset, many can't follow through on fulfilling the requirements. The result is that the most motivated and stable residents move to the new developments while the residents that can't meet the requirements are moved to traditional public housing developments, which are usually older and less desirable.

Thus, the often-heard criticism of HOPE VI projects, that resident selection processes result in "creaming" (admitting only the most stable and reliable tenants to the new developments), appears to be a factor in MBS properties. The other side of this argument, of course, is that property managers and resident committees are responsible for assuring, as much as possible, that the new tenants are able to pay their rent and that they will not cause any problems for management or for the other residents.

Design, Construction, and Management

In keeping with current thinking about affordable housing development, MBS's buildings are attractively designed, use good quality materials, and are far from having an institutional appearance. MBS architects are thoughtful about how the new development can best blend into the adjacent neighborhood.

Although the scale of a new MBS development typically results in a whole new area unto itself, small architectural details of neighboring buildings are taken into account when creating an overall design for the newly developed area. For example, Randy Rhoads, vice president for design and construction, explained how he directed the design architect of one development to add a small bit of trim where the roof overhang met the exterior wall, stating that it “was a more traditional residential detail that added substance, charm, and grace; it simply looked better.” Multiplying that additional cost by the hundreds of units in the development certainly ran into thousands of dollars. Yet the company regards this investment in the character of the architecture as an important mark of quality. In addition, where existing materials (e.g., granite sidewalk curbs) can be re-used in the new development, every effort is made to do so.

Many of MBS’s development decisions are made with an eye toward facilitating the long-term management of the properties. The firm clearly understands that good management is essential for a good business operation. Using materials that will stand up to wear and installing high quality heating, electrical, and plumbing systems, for example, make long-term management as cost-effective and problem-free as possible.

MBS also appreciates that seemingly small details, like getting rid of carpets, which can create an unhealthy environment due to mold or other embedded toxins, are important. In addition, MBS typically includes washers and dryers in their apartments. This is a good marketing point, but it is also much more than a mere convenience. Removing the need for family members to spend hours at a laundromat is an important ingredient in helping to normalize lives. In short, what gets built and the amenities provided can make management easier as well as enhance the ability of families to thrive in their homes.

MBS Architectural Details and Design – Across the Country

Pueblo del Sol, Los Angeles, California

A HOPE VI mixed-income project that replaced a former public housing development, now consisting of 377 units.



Photo courtesy of McCormack Baron Salazar

Crawford Square, Pittsburgh, PA

A mixed-income Low-Income Housing Tax Credit project, with accompanying for-sale units. Crawford Square preceded a major HOPE VI redevelopment of two public housing developments. MBS has developed 681 units in this neighborhood.



Photo courtesy of McCormack Baron Salazar

MBS's properties are managed by its own management company, McCormack Baron Management (MBM). Until 2011, nearly all of the 12,000 apartment homes managed by MBM were developed and owned by the company. Since then, the number of units under management has more than doubled, with only about one-half of its portfolio owned by MBS. This growth of the management portion of the business has been a major achievement of the president of the management company, Tim Zaleski. As noted below, management fees constitute a significant component of MBS's profits.

When one walks through an MBS property, the high quality upkeep of the grounds and buildings is apparent. Grassy areas are well tended with flowers, walkways are clear and trash-free, and buildings are clean and devoid of graffiti. If anyone dares to be careless or abusive of the property, it is clear that MBM is quick to remediate the problem by doing the needed repairs or maintenance.

How Profit is Achieved

The developer fee is intended to cover the up-front costs incurred during the pre-development phases (although, as mentioned, the goal is to keep these to a minimum) as well as any other expenditures, from closing to rent-up, that may not be covered by construction financing or subsidies. The fee is also designed to compensate for the guaranteed risks: construction, lease-up, tax credit compliance and operating deficits. MBS does not expect to make much money on operating cash flow; most of the profit needs to come from the successful completion of construction, lease-up, and the delivery of the tax credits, as well as from the management fees. The management fee is calculated before cash flow is determined. Thus, management fees are a revenue source, and are paid even where there is modest (or even no) cash flow from a project.

More specifically, the management operation is structured to generate significant profits, typically in the range of 15-20 percent, before taxes. Since MBS's mixed-income projects involve a substantial amount of soft debt, they have to share cash flow with their limited partner(s) and often with the nonprofit sponsor. In addition, MBS's contractual obligations generally require them to fund cash flow deficits. If everything goes well, MBS's share of cash flow might be 20-30 percent. But if operating costs rise, they may need to cover 100 percent of any negative cash flow. Typically, the net of their share of total positive cash flow and their share of total cash advances to cover negative cash flow would not be sufficient to cover the costs of their asset management subsidiary's operating expenses. In short, cash flow does not significantly impact revenues or profits.

Currently, almost one-half of MBM's management portfolio includes units in which they have no ownership interest and, therefore, no claim to cash flow. As MBS continues to expand this side of its business, profits are likely to stay robust, as economies of scale will continue to

promote efficient operations. Ideally, a single development should have at least 100 units in order to reach an appropriate economy of scale for management tasks. If, however, MBS already has a strong presence in a given market area, taking on a new development is easier and potentially more attractive. A market size of about 1,000 units is viewed as a good size for maximizing efficiencies and reducing per unit management costs.

How would MBS differ if they were trying to maximize profit?

We would probably have done only tax credit projects, operating in suburban areas, where the approval process is much easier. We would not have focused as much on inner city areas, where there are brownfields and other infrastructure costs associated with that type of development. If we were another type of for-profit, we also would not spend the time on human capital programs. But that is part of what we do. Most development companies don't do that at all. Most for-profits are strictly in the business of getting LIHTCs, securing the developer fee, and moving on. They don't have a real interest in place-making. They just pick up deals where they can.

– Richard Baron, MBS co-founder, Chairman, and Chief Executive Officer

Strategic Advantages

MBS is in a very strong position to be competitive in pursuing large-scale development opportunities. With more than four decades of experience undertaking complex projects, using a variety of federal programs, and with its deep understanding of urban issues, MBS is among a very small group of for-profit developers able to compete for these types of challenging initiatives. The following are MBS's key strategic advantages.

Leveraging MBS's reputation and track record for financial and political capital

Over time, MBS has been able to amass considerable financial resources of its own. But it is also able to attract outside capital. This is enormously important when MBS is trying to put together the financing for a given deal. Typically, there is a significant gap between the subsidy

dollars available and conventional financing for a given project. To raise the needed funds, MBS is often able to leverage its reputation and track record to attract funders. The best-case scenario is for much of the capital to be provided by a local partner with a vested interest in the project and with substantial “skin in the game.”

Deep pockets and deeper pockets

In view of MBS’s robust development track record, it is not surprising that they have strong relationships with financial institutions. In fact, they report that they have worked closely with the five largest banks in the country. According to Kevin McCormack, their longest relationship is with Bank of America, going back more than forty years; their most extensive relationship in terms of volume of lending (and also going back almost forty years) is with US Bank. These relationships are a critical component of MBS’s ability to appropriately manage their assets and be in a position to launch new development deals. In addition, in 2009, Goldman Sachs expressed an interest in having their people work with MBS as a way to further develop the urban investment component of Goldman’s business. One year later, Goldman Sachs acquired a minority interest in the common stock of MBS’s holding company, MBA Properties; the majority of shares are held by MBS employee shareholders. Two out of MBS’s six board members are from Goldman Sachs, and the other four are the MBS principals: Richard Baron, Kevin McCormack, Tony Salazar and Vincent Bennett.

Competition

Given the size of MBS and its importance in St. Louis (and beyond), one might imagine that nonprofit developers in the area would be frustrated about their dominance. Chris Krehmeyer, president and chief operating officer of Beyond Housing, noted: “Sure, I would like less competition, but it would really hurt if I felt that they were not doing a good job. But they are.” Stephen Acree, president of RISE, added: “It’s easy to feel like MBS is a 900-pound gorilla, but although it’s hard to compete with them for resources, especially since their developments usually require a lot of subsidy dollars, they are very good at what they do and you can’t knock success.” In addition, the kinds of projects that the nonprofits in St. Louis typically do are far smaller than MBS’s large-scale redevelopments.

Collaborations with Local Housing Authorities and Government

In addition to making sure that, in most cases, there is a strong and committed local partner with substantial political and financial capital in the project, MBS also works very closely with local housing authorities. The St. Louis Housing Authority has about twenty-five mixed-income developments; about one-half are joint ventures with MBS. This relationship it is not without its tensions, however, largely due to pressures arising from external funding constraints. As Cheryl Lovell noted:

The physical work that MBS does is top-notch. But when it comes to financial feasibility, the operating subsidy is insufficient to guarantee high quality over the long-term. Project after project is eating away at the reserves. Two projects are very close to having no reserves left. MBS says not to worry, that they'll figure something out. But, of course, I am very concerned. This has nothing to do with the developer, and how MBS has operated; it has to do with the funding formula of the program. It feels like we haven't learned lessons from past programs. In short, what happens to a project after thirty years, after it has been underfunded for a very long time?

When questioned about this problem, Richard Baron indicated that he, too, was concerned, given Congress's whittling down of operating subsidies and MBS's desire to maintain quality. However, Kevin McCormack pointed out that:

Our model is generally predicated on "cross-subsidization." The housing authorities are allocated a majority of the surplus cash flow that is created by the other, non-housing authority units. This share is then deposited into a housing authority escrow account and available to fund operating subsidy shortfalls. These escrows are established right at the beginning of a project and initially funded through a cash payment to the escrow from the partnership's equity. These funds can be drawn on to provide operating subsidies, but only to the extent that the sum of public housing authority tenant rent contributions and HUD operating subsidy payments are not sufficient to cover the PHA units' pro rata share of operating expenses.

Of the 8,862 mixed-finance units in our portfolio, 10 percent have very low housing authority reserves. These are all older projects that have reached or will reach, in the next two years, their initial fifteen-year compliance period under the LIHTC program. At that time, they

can be re-syndicated to bring in a new equity investor and secure fresh funds to restructure them.

Cheryl Lovell feels like she and MBS understand each other's issues—almost like an old married couple. On the one hand, MBS wants to have enough operating funds to manage the buildings to their standards. On the other hand, the housing authority can't commit to giving them more than they get from HUD for operations. Apparently, MBS can be dogged in its efforts to be guaranteed sufficient operating money. When Cheryl Lovell became the executive director of the St. Louis Housing Authority, she balked at a clause in the contract that committed them to cover any operating costs. She insisted that that would change with subsequent projects. It did.

MBS is also well aware of the importance of developing and maintaining a strong relationship with city officials where their redevelopment projects are taking place. MBS's relationship with the City of St. Louis is strong. According to Don Roe, director of the city's Planning and Urban Design Agency: "Whatever MBS is doing, we are doing it with soul-mates." The only criticism offered was, in a way, a compliment:

A few times they have gotten ahead of themselves in terms of moving too fast to get a project done without going through all of the city steps in the order/timeliness that the city processes might require. For example, recently MBS included a city park renovation within a large project and, trying to respond to the neighborhood's preferences for the improvements, they almost ended up with a mismatch of types of improvements allowed under the city funding source. But we end up being their ally if there is a glitch and we work to get all the issues lined up as needed.

The respect that MBS commands in St. Louis, and likely in other cities, serves it well when trying to navigate the complexities of city permitting and public works decisions.

Long-term Ownership of Developments

A key aspect of MBS's business plan is to develop properties that they hold over the long-term. According to Kevin McCormack, MBS still owns 81 percent of the 18,318 rental units that they have developed or have under construction; the rest of their development portfolio includes 1,099 for-sale units. The reasons for selling the 3,551 rental units varied. Some were

sold because MBS ended up with too few units in a city to warrant staying after the expiration of the initial holding period.

In the case of properties financed with LIHTC or historic tax credits, the hope is that after the required use restriction period terminates, MBS will be able to refinance the property, utilizing whatever low- and moderate-income programs might be available at that time, in order to maintain the mixed-income character of the development; they do not generally anticipate flipping their affordable units, regardless of market conditions. For developments that include public housing units, the development agreement requires that MBS maintain the units for public housing-eligible tenants.

In some cases, MBS properties have been sold because the public resources (e.g., tax credits) needed to place them on a solid financial footing for the following fifteen years, were not available. MBS will typically choose not to bring in new investors unless they are confident that they will be able to achieve the level of rehabilitation consistent with their business model. On the other hand, since there are many players in the housing market with different views, some developers and investors are comfortable with reduced levels of rehabilitation.

In the future, it is uncertain whether it will be feasible for MBS and other developers to access the needed funds to recapitalize their properties and to make the needed capital improvements consistent with buildings that are several decades old. Although the LIHTC program was made permanent in 1993, the amount of equity that can be raised with “4-percent” credits is currently “floating,” and was somewhat lower as of December 2015. Although the 9-percent credit for new construction and substantial rehabilitation had also been a lower floating rate, Congress approved a permanent fixed rate of 9 percent for this type of tax credit in December 2015. A higher fixed tax credit rate of 9 percent means that more equity can be raised, fewer gap dollars will be required to close a deal, and that developers will have a more predictable stream of funding for their projects.

While the so-called 4-percent tax credits are much easier to access, they produce much larger funding gaps than the highly competitive 9-percent tax credits. Although the availability of 9-percent credits varies by state, it is fair to say that, across the country, there is a lot more demand than supply for 9-percent credits. Although MBS might have a strong project, whether

new construction or a refinancing, when competing for 9-percent credits, they will likely need to wait in line until it is, essentially, their turn. Thus, despite MBS's intent to hold on to developments over the long-term, their ability to do so is dependent on federal funding.

The following page summarizes, in numerical terms, the many accomplishments of MBS.

McCormack Baron Salazar by the Numbers

Since its founding in 1973, the following summarizes MBS's record of accomplishments.

(McCormack Baron Salazar, 2015d; with updates by Kevin McCormack, President)

- The company is organized into five major divisions with 920 national employees
- Total development investment: \$3.4 billion
- Total number of units/projects developed: 19,415/178
- Amount of retail and commercial space developed: 1.4 million square feet
- Number of historic units rehabilitated: 2,427
- Amount of private foundation and corporate investment: \$146 million
- Development cities: 38
- Development states: 23
- Federal Funding:
- Number/amount of federal grants received: 98/\$730 million
- Number of HOPE VI grants as partner on winning team (including Pilot): 20
- Choice Neighborhood Implementation Grants: 5
- Mixed-Finance* development investment: \$1.8 billion
- Number of mixed-finance homes developed (Included in above total of 19,415 homes): 8,777
- Number/amount of New Markets Tax Credit (NMTC) allocation since 2006: 31/\$275 million
- Total NMTC development investment: \$659 million
- Property Management
- Management portfolio: 24,200 homes in 206 properties
- Number of McCormack Baron Management regional offices: 26
- Asset Management
- Asset management portfolio: 402 properties with 41,664 homes
- Asset management activities: 33 states and 1 territory
- Renewable Energy
- Number of solar panel installation sites: 28
- Clean power generated: 3,495,336 kWh/yr
- Number of homes served through solar panel installations: 3,347
- Estimated annual reduction in carbon footprint: 3,953,700 pounds of CO2 emissions eliminated

* "Mixed-finance" refers to the use of LIHTC's, as well as other public housing financing sources.

Further Observations

This section steps back from the details of MBS's business model and mode of operation and explores how MBS relates to five larger, more conceptual issues related to housing and community development and the role of the private for-profit sector:

- Focus on large-scale redevelopment in the context of other urban approaches;
- Replicable model vs. unique window in time;
- Major contributor to developing and implementing new federal housing and community development strategies;
- MBS and the Quadruple Bottom Line;
- Corporate Social Responsibility.

Focus on Large-Scale Redevelopment in the Context of Other Urban Approaches

The importance of clearing “slum” areas was a powerful idea through much of the 20th century. In the late 1800s and into the early 1900s, social reformers, journalists, and public officials were concerned with the health and fire hazards of large numbers of very poor people living in overcrowded, dilapidated housing. Thus, in addition to the “welfare costs” incurred by the residents of these areas, there were real “social costs” that could wreak havoc in more affluent areas, as fire and disease did not respect the boundaries of the “slums” (Friedman, 1968).

Starting in 1949 and continuing in the 1950s and 1960s, cities were given a powerful tool to redevelop large “blighted” areas through the federal Urban Renewal program. In the program's early days, planners and city officials typically decided on what areas they wanted to raze and planned new buildings to take their place. The newly built areas did not have to accommodate the prior residents and did not even have to be used primarily for housing. Civic centers, office buildings, and luxury housing could replace the formerly low-cost homes. The Urban Renewal program offered lucrative investment opportunities for private entrepreneurs and, from a mayor's point of view, gave the city an opportunity for creating a new, modern public image. An eloquent and powerful critique of Urban Renewal framed the experience this way:

At a cost of more than three billion dollars the Urban Renewal Agency has succeeded in materially reducing the supply of low-cost housing in American cities. Like highways and

streets, the program has ripped through the neighborhoods of the poor, powered by the right of eminent domain. Slums are being cleared, and bright patches of new construction dot the central cities of the big cities. (Greer, 1965, p. 3)

As the Urban Renewal program came under attack, “citizen participation” became a requirement, thereby providing residents the opportunity to voice their concerns, whether or not they were ultimately accommodated. By the 1970s, a new model emerged for redeveloping deteriorated housing in the urban core. Community-based urban revitalization initiatives, with local nonprofits taking the lead, focused on the rehabilitation of existing homes; some new construction, typically on a fairly modest scale; and new investment in the adjacent commercial areas. Thus, the model pursued by nonprofit community development corporations (CDCs) and other place-based groups was, and is, to take whatever exists in a given low-income area and, by working with residents, the city, and other partners, to strive to use existing assets as the building blocks for revitalization.

The MBS model of urban redevelopment incorporates elements of these two approaches, but also has a number of unique features. Unlike Urban Renewal developments, which may not have included much or any housing, let alone affordable housing, MBS’s developments feature mixed-income housing as their centerpiece. Also, at least some of the existing residents are able to move back into the new areas. Like Urban Renewal developments, and as noted earlier, MBS’s developments seek to create a new image for the newly developed area, which will likely be quite unrecognizable to prior residents. MBS has a sense that they have to go “above and beyond” to get people to change their perception of an area and to attract higher income residents.

In addition, as with Urban Renewal, the choice of locations is based on there being a strategic opportunity, with a strong local institutional partner. MBS is building new communities, more or less from “scratch,” in desirable locations. Although MBS works extensively with community groups and existing residents, the latter are not the drivers behind the MBS redevelopment process. However, similar to the CDC model of development, MBS has taken the notion of redeveloping areas for the benefit of lower-income residents to heart by

creating units that support family lifestyles, by incorporating services into their developments, and by focusing on improving the quality of local schools.

Because of MBS's commitment to large-scale redevelopment and the desire for their projects to be transformative, numerous challenges invariably arise, and the price tag is steep.

Replicable Model vs. Unique Window in Time

Going forward, it is not clear how easy it would be for a firm, at the present time, to carry out the kind of work that MBS does. In fact, it is also not clear how feasible it will be for MBS to continue to pursue its preferred strategy—large-scale, mixed-income development. A number of circumstances aligned in a positive way and provided fertile ground for MBS's current business model to emerge and flourish.

Deep capital subsidies

A key requirement for the type of large-scale development projects that MBS undertakes is the availability of deep capital subsidies. Big federal grants or other significant incentive programs are needed to support the work. How likely is it for these resources to be available in the future? In view of the current atmosphere in Congress, particularly caps on non-defense discretionary spending that were imposed as part of the 2011 Budget Control Act and that continue to impact recent funding levels for essential housing programs, it is unlikely that there will be a recommitment to providing deep federal subsidies. Although the FY 2016 budget saw some increases in funding for housing, the overall trajectory in recent years has been unstable at best, and downward at worst.

- The HOPE VI program, which has been integral to many MBS projects, has had no new funding since FY 2011.
- Funding for the Choice Neighborhood initiative rose to \$120 million in FY 2012, fell to \$80 million in FY 2015, and was increased to \$125 million in FY 2016.¹²
- The public housing capital fund was reduced from \$2.5 billion in FY 2010 to \$1.9 billion in FY 2016.
- Funding for the HOME program fell by one-half from \$1.9 billion in FY 2005 to just \$950 million in FY 2016

¹² This and other numbers presented here are in nominal terms, not adjusted for inflation.

Funding through the National Housing Trust Fund (NHTF) could be an important mechanism for large-scale housing development projects. However, this initiative has not yet provided any financial resources. The major source of money for the NHTF is to come from Fannie Mae and Freddie Mac. However, with the economic downturn and the serious problems plaguing these two entities, contributions to the NHTF were suspended from 2008 to 2014. Contributions to the Trust Fund began on January 1, 2015 with the expectation that funds will start to be available in summer 2016. However, the Obama administration's FY 2016 budget estimates that only \$120 million will be allocated to the Housing Trust Fund in FY 2016, with funding distributed to the states as a block grant (HUD, 2016). Over the long-term, it is not clear how much money will be available, how it will be distributed, or whether it will be able to support large-scale, mixed-income housing development consistent with MBS's approach.

A large number of public housing developments in need of major rehabilitation

In 1992, the National Commission on Severely Distressed Public Housing released its final report. Although it found that "only" 6 percent of the public housing stock met the definition of being severely distressed, it underscored that even this percentage, which translated into 86,000 units, was far too many. Moreover, it warned that, without public intervention, many more units would almost certainly fall into the "severely distressed" category. One of the key recommendations of their proposed National Action Plan was significant new funding for both resident services and the physical rehabilitation of the developments.

The major direct outcome of the Commission's report was the appropriation in FY 1993 of \$300 million for a new Urban Revitalization Demonstration, specifically focusing on severely distressed public housing. Funding for what became known as the HOPE VI program increased 2 ½ times in FY 1994, to more than \$755 million. For the next nine years, annual appropriations were in the approximate range of \$500 million to \$600 million (U.S. Department of Housing and Urban Development, 2007). Funding was then on a downward trajectory until FY 2012, when no new appropriations were authorized.

Thus, an ample stock of large public housing developments requiring major renovations, combined with a source of deep capital subsidies, provided the key ingredients needed by MBS

to launch major redevelopments. A large portion of MBS’s work has been involved with public housing transformation projects: 39 percent of their projects, comprising 46 percent of the total number of units developed. In view of all the pieces of the development puzzle that fell into place as MBS was developing its model, the ability of another developer to follow its path may be questionable.

Major Contributor to Developing and Implementing New Federal Housing and Community Development Strategies

MBS was on “the ground floor” and a key actor in developing, and then implementing, the two major federal housing and community development strategies of the past several decades, HOPE VI and the Choice Neighborhood program.

HOPE VI program

The pioneering work that Richard Baron and MBS did in St. Louis contributed to the creation of the federal HOPE VI program, which is aimed at substantially rehabilitating severely distressed public housing. Richard Baron was a member of the National Commission on Severely Distressed Public Housing, and his early work with the St. Louis Public Housing Authority informed the work of the Commission.

[Richard Baron] came in with twin propositions to make economic integration a program goal [of the HOPE VI program] and to leverage substantial investment. It is highly unusual for a for-profit developer to have that kind of impact on policy making.

– Bruce Katz, Chief of Staff to HUD Secretary Henry Cisneros, 1993
(quoted in Riggs, 2004)

MBS’s experience in a large-scale public housing renovation complemented another high visibility public housing redevelopment initiative – the transformation of Boston’s Columbia Point to Harbor Point. This project provided a further impetus for the creation of the HOPE VI program. The Boston project was similar to many MBS projects, and its developer, the

for-profit firm of Corcoran Mullins Jennison, was also committed to a mixed-income approach.¹³

As of 2003, an estimated 49 different private developers had participated in over 80 HOPE VI projects in 48 different cities (Myerson, 2003). MBS has been a partner in a winning team for 19 HOPE VI grants, plus one listed as a HOPE VI pilot. Four HOPE VI projects are located in each of Missouri and California, and one or two are in each of ten other states. The 19 HOPE VI awards in which MBS was a partner constitute 7 percent of all HOPE grants (total = 261).

Choice Neighborhood program

As a further indication of McCormack Baron Salazar's involvement with community issues, MBS has been a partner in a winning team for eight out of the total of fifteen Choice Neighborhood grants. This represents an impressive 53 percent of all the Choice Neighborhood grants awarded.

In addition to the HOPE VI and Choice Neighborhood programs, MBS has been involved with more than a dozen additional HUD capital fund grants for modernization and other improvements in the public housing stock. Altogether, MBS has partnered with twenty-one different housing authorities across the U.S., plus one in the Virgin Islands, for the development of 18,777 new units.

McCormack Baron Salazar and the Quadruple Bottom Line

Based on the information available, it appears that MBS is comfortably meeting or moving toward fulfilling all four components of the Quadruple Bottom Line. The financial viability of their developments is, for the most part, sound. Kevin McCormack has estimated that although 25-30 of their 178 projects (or about 15 percent) have experienced serious financial problems, "together with our project partners we rolled up our sleeves and resolved every one of them to avert disaster." The resolution typically has involved putting more money

¹³ Completed in 1990, the former 1,500-unit Columbia Point public housing development was replaced by some 1,283 units, but only about one-third are affordable to low-income households. The renamed Harbor Point experienced the same kind of demographic shift as similar MBS projects, where only a fraction of the original households were able to move into the new mixed-income development.

into the project to cover excess construction and/or leasing costs. Or, if the difficulties have arisen post lease-up, MBS may have needed to forgo its property management fees and contribute additional cash to cover operating expenses and debt service costs.

A looming issue, noted earlier, relates to the inadequacy of operating subsidies in the developments operated in collaboration with the St. Louis Housing Authority. This deficit appears to be beyond MBS's control: it is solely a federal funding issue and is certainly causing similar problems for other housing authorities across the country. The good news, however, is that MBS is very much aware of the situation and, in view of the firm's impressive track record in attracting capital, the hope is that the funds will be found, when needed, to ensure that the developments continue to provide a high level of management and resident services. Of course, one might criticize MBS and its decisions along the way to spend down the reserves. Without this spending, however, the quality of management would have suffered, a lapse that would contradict MBS's mission.

MBS is certainly aware of the importance of trying to meet the social and economic needs of residents, the second aspect of the Quadruple Bottom Line. By creating Urban Strategies, it positioned itself to make tenant-related issues a high priority. It also made it possible for MBS developments to become eligible for philanthropic contributions and grants limited to nonprofit organizations. However, as with all housing-based service programs, the ability of Urban Strategies staff to do all that they might want to do is limited by available funds. For example, more households could perhaps qualify for entry into an MBS development if there were more dedicated caseworkers to work closely with each family. In particular, more education, training, and support services could enable lower-income and multi-problem households to acquire the needed skills to enter the workforce, and could enable those already working to secure better-paying jobs.

Unfortunately, MBS does not aggregate data on the income mix of residents or on the size of units (according to the number of bedrooms) provided by their developments.

Preserving the affordability of their units is an important MBS goal: MBS is committed to owning and maintaining units, with the original affordability profile, over the long-term. They appear successful in meeting this goal.

The extent to which MBS's developments take into account the neighborhood context, the third component of the Quadruple Bottom Line, is hard to assess. It seems that MBS's developments try to incorporate various design details from neighboring buildings into their developments. On the other hand, given that MBS typically builds new developments from the ground up, and that one of their goals is to create a completely new community, a new development is sometimes meant to be very different from the neighborhood that it has replaced.

MBS personnel seem deeply aware of the importance of connecting with existing neighborhood residents and local leaders. However, due to the time and resource limitations of the present study, interviews with neighborhood residents of either earlier or current development efforts were not possible.

The final component of the Quadruple Bottom Line, environmental sustainability, is very much a part of MBS's business plan. About 25 percent all MBS developments have received "green certification." Over the past five years, the percentage of MBS developments that are green-certified has increased from 60-80 to 100.¹⁴

Corporate Social Responsibility

MBS appears to fit the description of a firm committed to corporate social responsibility (CSR). Contradicting the belief that for-profit firms have only one major goal – to earn profits for their owners and investors – MBS has embraced a more ambitious and comprehensive agenda, which I have characterized as the Quadruple Bottom Line. Another way to conceptualize MBS's business model is offered by MBS intern Tal Aster, who feels that the concept of CSR is not applicable. Instead, he views MBS as a "social business" that incorporates social values and holds them to be as important as the profit motive.

¹⁴ There are a number of different ways that MBS developments have become "green certified." In addition to the LEED program, other certifying programs include: Enterprise Green Communities, GreenPoint Rated, EcoBuild, Energy Star for Homes, Memphis EcoBuild, and Build San Antonio Green, among others.

I don't believe that business, alone, can solve our social problems. Neither do I believe it, alone, has caused them. But they'll not get solved unless innovative businessmen, who sense a changing world and feel challenged, react in a fashion likely to produce profit as well as imaginative responses to social needs.

– Eli Goldston, President and Chief Executive Officer, Eastern Gas and Fuel Associates, 1961-1974, Boston, Massachusetts (quoted in *Harvard Law Today*, 2012).

Although CSR has enjoyed increasing prominence over the past several decades, as noted previously, the idea that private for-profit businesses can have a social conscience is hardly new. Ben Franklin might have been the first to observe that the two can, and should, go hand-in-hand. But he certainly has not been the last.

The United Nations Industrial Development Organization (2015) defines CSR as a management concept, whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders. CSR is generally understood as being the way through which a company achieves a balance of economic, environmental and social imperatives...while at the same time addressing the expectations of shareholders and stakeholders...Key CSR issues [include]: environmental management, eco-efficiency, responsible sourcing, stakeholder engagement, labour standards and working conditions, employee and community relations, social equity, gender balance, human rights, good governance, and anti-corruption measures.

A review of how the definition of CSR changed over the last half of the twentieth century concluded that “at its core, [CSR] addresses and captures the most important concerns of the public regarding business and society relationships” (Carroll, 1999, p. 292). Starting in 2010, states began to pass legislation authorizing a special type of corporate entity, the benefit corporation, based on the CSR concept (*CSR Wire*, 2010). As of mid-2014, twenty-eight states had enacted legislation enabling firms to be considered “benefit corporations.” To gain this designation, the company must embrace the notion that concerns beyond simply realizing profits are integral to their mission and operations.

There are some clear advantages to forming a benefit corporation. “By giving directors the secured legal protection necessary to consider the interest of all stakeholders, rather than just the shareholders who elected them, benefit corporations can help meet the needs of those interested in having their business help solve social and environmental challenges” (Bend and King, 2014). Furthermore, with many consumers committed to making purchases consistent with their values, being a benefit corporation can differentiate a company from its competitors and help it to attract such consumers. Although neither tax breaks nor other financial incentives are provided and additional reporting requirements are mandated, the “public benefit” designation is an attractive option for a growing number of socially conscious companies (Bend and King, 2014).

As of 2015, one would be hard-pressed to find a business school in the country that does not include CSR in its curriculum. In addition, large businesses typically focus at least some attention and resources on the question of how they can be profitable while also fulfilling a broader social and environmental mission. A commitment to a mix of social, neighborhood, and environmental concerns is clearly a hallmark of MBS’s operation.

Final Reflections and Policy Recommendations

Exploring the operations of MBS has offered a unique opportunity to better understand the workings of one of the most accomplished and highly acclaimed for-profit developers of affordable housing in the U.S. This case study has underscored the many ways that MBS excels at what it does. It also has revealed the extent to which structural and programmatic issues in the affordable housing arena are a concern, even to this highly accomplished, capable, and well-capitalized development firm. Indeed, one could argue that if entities like MBS are encountering problems, then it is questionable how smaller, less financially secure groups, particularly nonprofits, will be able to fare in the current development and funding context.

This section begins with comments about several conceptual and policy issues raised by this case:

- Components of successful public-private partnership affordable housing programs
- Assuring long-term affordability
- Challenges of launching large-scale comprehensive redevelopment strategies
- A cautionary note about the downside of revitalization and redevelopment
- Assessing the strengths and weaknesses of large-scale redevelopment initiatives

With the intent of helping to move the affordable housing agenda forward, this Working Paper offers recommendations on some strategies and approaches needed:

- Developing multi-faceted arguments to support funding for affordable housing
- Emphasizing the key role of the federal government in supporting affordable housing
- Another call for deeper housing subsidies, more efficiency, and less need for multiple funders
- More sharing of experiences between for-profit and nonprofit affordable housing developers
- Need to develop a typology of for-profit affordable housing developers

A Final Note emphasizes the importance of continuing the conversation about how to reduce segregation while also keeping the inner city redevelopment agenda alive.

Components of Successful Public-Private Partnership Affordable Housing Programs

In the aftermath of the well-publicized criticisms of the public housing program (see, for example, Bratt, 1986), starting in 1959 Congress embarked on a new way of subsidizing housing for lower-income households through a variety of public-private partnership initiatives. Since then, private for-profit housing developers have played a significant role in the development of publicly assisted rental housing. As mentioned earlier, the first wave of initiatives was known as the below-market interest rate programs (BMIR), followed by the Section 8 New Construction and Substantial Rehabilitation program, enacted in 1974. Finally, with passage of the Low Income Housing Tax Credit program in 1986, the important role of for-profit developers in affordable housing development was further solidified.

Despite the many disappointments and frustrations with these various initiatives, the past five decades constitute a positive story of change and learning. In particular, a number of lessons have emerged about public-private partnerships in affordable housing programs as they relate to development and management; programmatic details and financing; and local context and amenities of the development. Regardless of whether the development is carried out by a for-profit or nonprofit developer, the issues confronted and the tasks that need to be carried out are essentially the same. The following is a summary of many of the key points discussed in the literature review and derived from the MBS case study.

Development and management

- There must be sufficient pre-development resources to see the project through the early phases and to cover the various costs that will be incurred prior to loan closing. It is essential that the developer fee is sufficient to cover whatever pre-development costs are borne by the developer, to serve as a cushion during development to fund guarantee obligations, and to provide funds (or profit) for reinvestment in other projects.
- Construction quality must be good and the building style should fit in with the existing neighborhood as much as possible. At the very least, the buildings should not be decidedly different or stick out as housing for poor people.
- However, we have come a long way from a belief that simply improving the physical quality of housing can alleviate deeply ingrained social problems. Simplistic views about “physical determinism” have been discredited.
- Building materials and construction decisions should be made with an awareness of how these choices will make the long-term management of a building as easy and cost-effective as possible.

- Along these lines, energy-efficient materials and design should be incorporated into the project.
- Management must be professional and respectful. Clear guidelines for resident responsibilities must be communicated and repairs and other maintenance tasks must be promptly and professionally carried out.

Programmatic details and financing

- Raising funds from profit-motivated investors requires sufficient incentives to make such investments attractive, but it also should provide opportunities for investors to exit the program within a reasonable timeframe in order to optimize the opportunity for a new owner that is committed to long-term affordability to take control of the project.
- At the same time, creating a specific mechanism to preserve the long-term affordability of the developments should be part of the initial contract with the government funding agency.
- A major benefit of the LIHTC is thought to be the discipline and oversight that private for-profit investors bring to a deal, thereby assuring the quality of the project. Also, for the first fifteen years of the program, the oversight provided by the federal government and the threat that tax credits could be lost (if the appropriate mix of income-eligible households is not maintained) provide important checks and balances in enabling the project to meet the program's goals. (Oversight during the following fifteen years of a LIHTC project, and thereafter for developments with more than thirty-year affordability periods, is provided by the state monitoring agency. However, at that point, losing the tax credits is no longer a sanction for non-compliance with any of the program's requirements.)
- While some degree of competition for subsidies is, perhaps, useful to assure attention to details and the submission of high-quality proposals, the intense competition for 9-percent LIHTCs thwarts development and frustrates developers who need to spend a great deal of time assembling tax credit applications. Here, too, the level of funding is at the heart of the problem.
- Consistency is needed to enable investors, for-profit and nonprofit sponsors, and city officials the opportunity to understand the program's rules and to develop efficient methods of implementation. It takes a considerable amount of time for stakeholders to become accustomed to the guidelines of any new program. Therefore, maintaining and improving upon existing initiatives is likely preferable to starting over "from scratch."
- The affordability of apartments should be based on tenant incomes and ability to pay. But to achieve this, additional subsidies for ongoing management and capital repairs are needed beyond the funds provided by LIHTC.
- More generally, LIHTC needs to be supplemented by deeper subsidies to enable lower-income households to live in LIHTC developments. Such a supplement could result in charges of double-dipping, since some households would be receiving subsidies from two sources; however, as the LIHTC is currently structured, it excludes the neediest households.

- Professionals who work to produce affordable housing often note that the system is complex and not user-friendly, and that many funding sources are needed to produce viable deals. The system for producing affordable housing should be simplified and rationalized. And, as noted, the availability of deeper subsidies would represent an important change.
- It is important for developers, whether nonprofit or for-profit, to have access to lines of credit and the ability to get loans at competitive rates. Even a developer with “deep pockets” requires available capital.

Local context and amenities of the development

- Developments should be located in places that are accessible to public transportation and with good quality public amenities (e.g., schools, parks).
- Local support is important, including resident involvement and assistance from the public sector, key institutions, and other private-sector interests. As the MBS case underscores, it is critical for at least one local partner to have significant investment, both financial and political, in the project—in other words, “skin in the game.”
- Where local schools are low quality, resources need to be available to improve and transform them into model educational institutions, with a strong community-building focus that will both attract new residents to the area and provide an anchor for those already living there.
- Residents should have access to a comprehensive array of support services including, for example, substance abuse programs, child-care, financial advising, and skills training.

Assuring Long-Term Affordability

Regardless of the entity developing the affordable housing, assuring that this housing remains affordable as far into the future as possible should be a priority. If an affordable housing development firm does not have a long-term affordability mission, it will need to partner with someone who does. For-profit developers of LIHTC projects can set up LIHTC deals from the outset so that after thirty years, the developments can be transferred to or purchased by nonprofits, tenants, resident management corporations, or government agencies as a way to retain affordability. More specifically, a for-profit owner may grant a right of first refusal to a nonprofit or an agency of state government for a statutory minimum price. The statutory minimum price (outstanding debt plus taxes) can be a below-market price.

The LIHTC program also gives owners an opportunity to operate the property without affordability restrictions after year fifteen if the state agency is unable to find a buyer at the contract price. However, as noted earlier, most states have produced regulations that require more stringent affordability standards.

Challenges of Launching Large-scale Comprehensive Redevelopment Strategies

MBS's efforts and commitment to a holistic strategy for transforming people and neighborhoods are both ambitious and praiseworthy. MBS's preferred approach involves rebuilding an older urban area and, basically, creating a whole new community in that space. Other major redevelopment efforts, such as the one spearheaded by Jim Rouse and the Enterprise Foundation in Baltimore's Sandtown-Winchester neighborhood and the Harlem Children's Zone in New York City, take a different approach: they create a comprehensive strategy that builds on the existing neighborhood's infrastructure and resources. Yet both approaches – replacing existing run-down areas with a new development, and working with existing structures and residents to provide better housing and other amenities – need to address a host of issues and challenges concerning the many types of supports and services that comprise a healthy, vibrant community.

It's my conviction that we cannot seriously improve the lives of the people at the bottom of our society today unless we do all these things [e.g., job-training programs, crime-prevention efforts, and school and health-care improvements, as well as housing rehabilitation] at one time. And it is my conviction that it is far easier to do that all at one time than it is to approach the problems by the single-shot approach.

— James Rouse, 1995, former Chief Executive Officer, The Rouse Company, founder, The Enterprise Foundation (quoted in Goldberger, 1996).

While an evaluation of the first ten years of the Sandtown-Winchester project was cautiously optimistic (Brown, Butler, and Hamilton, 2001), and hundreds of low-income households have directly benefited from the new housing built, recent reports have been far more critical, claiming that the money invested did not yield sufficient positive results and that the initiative could even be called a failure (Wenger, 2015; Marx, 2015).

In contrast, the Harlem Children's Zone (HCZ) has received a great deal of media attention and praise, with President Obama modeling two initiatives (Promise and Choice Neighborhoods) after that program. With its roots in a modest effort in the 1990s, HCZ "set out

to address not just some, but all of the issues children and families were facing within a finite geographic area: crumbling apartments, rampant drug use, failing schools, violent crime, and chronic health problems” (Harlem Children’s Zone, 2015). Thousands of children and adults are now served by this project, which encompasses 97 blocks in New York City’s Harlem neighborhood. While there appear to be positive outcomes in terms of the achievements of children enrolled in the schools within the program, the extent to which the community services and supports that have been put into place are resulting in concrete outcomes, as measured by children’s educational progress, has not yet been demonstrated (Croft and Whitehurst, 2010).

Perhaps the major conclusion about the current state of comprehensive revitalization approaches is that there have been some important contributions, but that there is still a lot to learn about what types of interventions are likely to yield the most dramatic and lasting results. Overall, any intervention must be seen in the context of the complexities and challenges facing a poor neighborhood within the larger local, regional, and national economy, where jobs for workers in manufacturing have been steadily declining over the past several decades. Low skill levels, low wages, weak educational opportunities, and reluctant public support conspire to make the challenge of transforming people and neighborhoods one of the most compelling and complex of our generation.

A Cautionary Note about the Downside of Revitalization and Redevelopment

MBS’s preferred type of development – large scale redevelopment of large areas— is very different from the kind of neighborhood revitalization work, typically carried out by CDCs and other nonprofits, which builds on a community’s existing assets to provide it with better housing and services. Both are difficult to do well, and in both cases, there is a risk of gentrification. In upgrading an existing area, a successful set of initiatives can result in housing prices rising and long-term households experiencing rent increases and being forced to move. When the focus is on the redevelopment of large areas, it is possible that existing residents will be displaced, with only a percentage ultimately being able to relocate into the new housing. By definition, mixed-income housing means that upper-income households will be living in that

space – one that likely was previously occupied by a more homogenous lower-income population.

On the other hand, Kevin McCormack is quick to point out that “MBS is typically dealing with depopulated neighborhoods where there is no problem of pushing out low-income people. Rather, the strategy is to retain low-income people already living in the area and attract moderate- and middle-income households. We typically deal with census tracts that have already lost 50 percent of their population from the peak.” This statement notwithstanding, there is still the potential for a large-scale redevelopment to shift housing market dynamics, thereby making it less affordable for long-time, lower income households. Although there is no sure intervention that can prevent unwanted displacement, the concern is real and important to monitor, with the intention of creating safeguards, when possible.

Assessing the Strengths and Weaknesses of Large-Scale Redevelopment Initiatives

Clearly, there are many challenges involved in large-scale redevelopment. We need to better understand the overall experiences of the largest of these initiatives. A comparative study of the key federal programs could better inform the work of big affordable housing developers such as MBS, as well as government officials at all levels, and other funders. In short: how do the HOPE VI program, Choice Neighborhoods, and exemplary community-based initiatives compare? Indeed, it also would be valuable to look back at some older programs to assess whether key components should be incorporated into current programs. For example, the Urban Development Action Grant (UDAG) program, which operated from 1978 to 1989 and supported housing development as well as economic development initiatives in surrounding areas, provided for the recapture of public funds and reinvestment in new projects after the original project had (hopefully) started to generate income.

The remaining five sections discuss strategies and approaches for moving the affordable housing agenda forward .

Developing Multi-Faceted Arguments to Support Funding for Affordable Housing

The need for additional affordable housing for low-income people has been well documented (see, for example, Joint Center for Housing Studies, 2015; National Low Income Housing Coalition, 2015). In view of this reality, and in the context of the current opposition to discretionary domestic spending of all types in the U.S., it is important to develop and communicate creative and persuasive arguments about why pro-active investments in affordable housing are essential. Rhetoric invoking moral and humanitarian concerns is not sufficient to persuade policy makers or, it seems, the electorate.

Housing is not an isolated issue. The ability of a household to live in a safe, secure, affordable dwelling has implications for health costs and employability. In addition, a household that is not able to secure housing will likely enter the homeless shelter system, which, we know, comes at a significant public cost. Additionally, people who are frustrated about a lack of affordable housing may need to resort to illegal activities that can create costs for society and also result in public expenditures for incarceration. Finally, on this point, employers often note that a supply of affordable housing is critical for attracting a suitable workforce. Advocates and others need to make the case that the public sector will end up paying one way or the other and that, for many reasons, it is far better to be proactive than to spend large sums of money cleaning up messes that could have been avoided.

Another line of argument in support of funding for housing for lower-income households: the level of *indirect* housing subsidies benefiting higher-income groups far surpasses the level of *direct* federal housing subsidies benefiting those with the greatest needs: 82 percent of the total amount of indirect housing subsidies through the tax system goes to households earning \$100,000 or more; 42 percent of the benefit goes to households with incomes over \$200,000 (National Low Income Housing Coalition, 2015). This disparity is due to the homeowners' deduction (the ability of homeowners who itemize deductions to reduce their taxable income by the total amount of their interest and local property tax payments).

Suggesting parity between indirect and direct expenditures would highlight the enormous disparities in the allocation of federal housing subsidies. If the general population understood that the entire budget of the U.S. Department of Housing and Urban Development,

including housing targeted to lower-income households, is about one-third the amount of the homeowners' deduction (Joint Committee on Taxation, 2014; National Low Income Housing Coalition, 2015), perhaps there would be wider support for housing for the poor. Advocates could argue that they are asking for spending on the LIHTC, rental vouchers, and public housing modernization and operating subsidies that is only equal to the amount saved by higher-income taxpayers through the housing subsidies provided to homeowners.

Good arguments depend on clear-cut, convincing evidence and, increasingly, policy makers, philanthropists, and practitioners understand the importance, for any given initiative, of documenting goals, implementation, and outcomes. The need for good methods of collecting data and measuring change is widely acknowledged. The more complex the project being undertaken, the more difficult it is to get a full sense of the range of problems being tackled and the types of outcomes that can be quantified. Regardless, efforts to produce high-quality evaluations of ongoing affordable housing programs should be a priority for all funders of housing programs. Additional funds for program evaluations need to be allocated so that developers are not asked to bear these costs.

Emphasizing the Key Role of the Federal Government in Supporting Affordable Housing

Advocates and other stakeholders should hold the federal government responsible for playing a central role in supporting affordable housing. In brief: "Since the private sector cannot profitably supply very low-cost units, the government must play a critical role in ensuring that the nation's most disadvantaged families and individuals have good-quality, affordable housing" (Joint Center for Housing Studies, 2015, p. 32).

Although it is not a focus of this study, other research has noted the increasing reliance on state and local housing strategies as federal involvement has declined (see, for example, Goetz, 1993; Davis, 2006; Lubell, 2006; and Bratt, 2009). Some state and local strategies, particularly inclusionary zoning, place the primary responsibility on the private sector by requiring that a number of affordable units be set aside within a market-rate development of a certain size.

The increasing focus on state and local housing initiatives (which, in large part, is the result of federal retrenchment) may be resulting in the federal government's being given a

“pass” on fulfilling the national housing goal, first articulated by the U.S. Congress in 1949: “a decent home and a suitable living environment for every American family.” Although the public-private partnership programs are important, without a strong and committed federal partner, they are not sufficient to fully address the nation’s housing needs. Advocates need to keep articulating the message that decent housing is a federal responsibility and that the government must be held accountable for assuming the leadership role in defining a responsive, robust affordable housing agenda. The statement contained in the 1982 “Report of the President’s Commission on Housing” feels even more hollow and unattainable than when it was first pronounced: “the genius of the market economy, freed of the distortions forced by government housing policies and regulations... can provide for housing far better than Federal programs” (p. xvii).

For the federal government to regain its primacy as the key driver of a low-income housing agenda, it will need to rely on both high-performing nonprofits and mission-oriented for-profit developers, as well as non-mission-driven for-profits able to partner with developers who will assure long-term affordability. Regardless of sponsorship, the overriding goal is to produce top quality, long-term affordable housing for the millions of households facing serious housing problems. Figuring out a cost-effective way to stimulate and support private for-profit and nonprofit entities to produce housing affordable to lower income households is a continuing challenge.

We have tried to squeeze efficiencies out of an inefficient model.

– Chris Krehmeyer, President and Chief Operating Officer,
Beyond Housing, St. Louis

Another Call for Deeper Housing Subsidies, More Efficiency, and Less Need for Multiple Funders

This recommendation is hardly new. Numerous researchers and advocacy groups have repeatedly and forcefully made these points, summarized as follows.

Federal housing subsidies to assist in constructing new affordable units have declined in recent years. Particularly hard-hit have been the USDA's Section 515 program, which provides mortgage loans for rental housing aimed at lower-income and disabled households in rural areas, and HUD's Section 202 program for the elderly and disabled. Similarly, funding has been reduced for other essential programs: the HOME program, which provides a flexible source of money to support a range of affordable housing developments, and the CDBG program, which gives municipalities funds to carry out a range of community development activities. Recent increases in funding for housing choice vouchers have served to partially make up for prior losses, have provided incremental assistance to special populations such as homeless veterans (National Low Income Housing Coalition, 2015), or have offset the higher costs of assistance due to rising market rents, rather than assisting new households (Joint Center for Housing Studies, 2015, p. 33). In short, the current level of federal housing assistance for lower-income households is not sufficient to meet the housing needs of the country.

Studies referenced earlier, as well as the present MBS case study, underscore that for any given affordable housing development, in view of the deficits in federal housing subsidies and the limited amount of development capital that can be raised through the LIHTC program, a number of additional subsidy sources are needed. This need for additional funding was identified as an important challenge even for MBS—a well-capitalized firm with much greater access to resources than most nonprofits. Thus, even if a developer is awarded 9-percent tax credits, a funding gap will need to be filled somehow – with other federal funds, state and local contributions, private investments, or philanthropic donations. Putting such deals together takes a considerable amount of time and requires expert help in the form of costly legal assistance (Urban Land Institute, Terwilliger Center for Housing, and Enterprise Community Partners, 2013).

News about the extent to which existing residents of LIHTC properties are able to pay affordable rents (pegged at no more than 30 percent of income) is both good and troubling. On the one hand, a recent study of LIHTCs in five states found that 69 percent of extremely low-income (30 percent of AMI or less) households and 22 percent of very low-income (50 percent of AMI or less) households in these properties receive some type of rental assistance, which

keeps their rent payments at an affordable level (Bolton, Bravve, and Crowley, 2014, p. 8). On the other hand, the extent to which these households are being shielded from paying too much rent also means that they are receiving double assistance. For these households, it is almost like winning the lottery twice. Indeed, Schwartz (2015, p. 145) summarizes a number of studies, which revealed that “47% of the [LIHTC] properties placed in service from 1995 through 2006 house one or more tenants with rental vouchers [and] 7-13% of all voucher holders reside in tax-credit housing.” Another comprehensive study, which looked at LIHTC developments in eighteen states, totaling nearly 40 percent of all LIHTCs in the country, found that among households earning 30 percent or less of AMI, 70 percent receive an additional rental subsidy (O’Regan and Horn, 2013, p. 598).

This observation is not meant to suggest that the households benefiting from the double subsidy do not deserve this level of assistance. Rather, the concern is that, from a public policy perspective, with only about 26 percent of very low-income renter households receiving federal rental housing assistance (Steffen et al., 2015), the fact that so many of the households who get **any** assistance actually get double assistance may be viewed as an unfair distribution of scarce resources.

In the context of this discussion of the inadequacy of federal housing subsidies, it is also important to underscore one of the most troubling findings from the case study of MBS: in order to provide the kind of high quality management that MBS is committed to, operating reserves are being drawn down and, in a number of developments, reserves are perilously low, with no clear sense of how predicted shortfalls will be covered. Indeed, this is not an isolated problem.¹⁵ The widespread nature of this concern is expressed in the following:

There are no sources of funds that can make up the difference in what ELI [extremely low income] households can afford to pay for rent and the long-term operating costs of rental housing... Even if there is no debt encumbering a project because other programs have provided grants for property acquisition and development, ongoing operating costs can still present a burden if tenant rents are not sufficient to meet those costs.

¹⁵ In 2012, Congress authorized the Rental Assistance Demonstration as an option for maintaining and improving the public housing stock and other project-based assisted housing. RAD gives local housing authorities and other private owners of HUD-assisted housing the opportunity to raise public and private debt and equity to invest in the public housing stock. RAD units are then covered by long-term Section 8 contracts that, by law, must be renewed, thereby ensuring permanent affordability to low-income households. The St. Louis Housing Authority has opted not to participate in the RAD program.

This is the overarching challenge that affects every single developer trying to serve ELI households (Bolton, Bravve, and Crowley, 2014, p. 21).

One strategy for owners of affordable housing to accumulate some additional funds for operating costs could be for HUD to not reduce payments to housing authorities if tenant incomes rise. HUD programs encourage people to work and to maximize their income. But increases in tenant earnings do not improve the bottom line for management. Instead of reducing its payments, HUD could hold its payment for operating expenses constant, with the savings going to the owner/manager of the development. This would also encourage managers to work harder to provide programs that promote skill training, employment, and, overall, economic security for tenants. Indeed, the House of Representatives recently passed a bipartisan bill that outlined a series of reforms for federal rental housing assistance programs that includes streamlining the rules for determining tenants' rents that allow both public housing agencies and owners to direct more funding toward activities such as the provision of supportive services for low-income residents (Fischer, 2016).

One of the most encouraging mechanisms to create a funding stream for affordable housing is the new National Housing Trust Fund. However, as noted earlier, as of early 2016, no funds had yet been distributed. Over the long-term, the hope is that the Trust Fund will provide a reliable source of revenue that is not dependent on annual Congressional appropriations (Crowley, 2015). The HOME program, as well as other initiatives could receive an infusion of new funding, although this outcome is far from certain.

More Sharing of Experiences Between For-profit and Nonprofit Affordable Housing Developers

This study of MBS reveals how much at least one mission-driven for-profit firm has in common with nonprofit housing organizations. Although many smaller nonprofits are community-based, and focus on a single geographic area, many others, particularly larger groups, often have a similar large-scale focus. The emphasis of both MBS and these nonprofits involves the transformation of neighborhoods and helping residents achieve economic security, while providing good quality, long-term affordable housing. As noted previously, good affordable housing development and management is, essentially, the same regardless of who

the sponsor is, providing that the key requirements are met, as outlined in the first section of this final chapter.

Explicit efforts for for-profits and nonprofits to share experiences, collaborate, and learn from each other are needed. We need to do a better job of learning from some of the largest producers of affordable housing in the U.S. – for-profits that utilize the LIHTC. What lessons can they share with nonprofit affordable housing producers, and how might these lessons be translated into new public policy strategies? The national nonprofit intermediaries, NeighborWorks, the Local Initiatives Support Corporation (LISC), and Enterprise Community Partners, along with the Housing Partnership Network and the relatively new group, Stewards of Affordable Housing, could launch a collaborative effort with the for-profit affordable housing development community to address these questions and other issues of mutual interest and concern.

Need to Develop a Typology of For-Profit Affordable Housing Developers

To enhance the dialogue between for-profit and nonprofit affordable housing developers, it would be helpful to have a better understanding of the types of for-profit firms that are engaged with affordable housing development and inner city revitalization.

In exploring the literature on for-profit affordable housing developers, and in conversations with key informants, particularly Patrick Clancy, former president of the large Boston-based nonprofit, The Community Builders, it is clear that there is a need for a way to better understand and differentiate the various types of for-profit affordable housing developers. For-profit developers do not constitute a single homogenous group, and creating such a typology would be helpful in clarifying the strengths and weaknesses of each type of firm. Certainly, the mission driven aspects of MBS's business model are not typically a motivating factor for the great majority of private for-profit affordable housing developers. Also, when comparing for-profit and nonprofit organizations, as many studies discussed here have done, it would be helpful to know exactly what type of for-profit organization is being discussed. For that matter, greater differentiation of the universe of nonprofits would also help us to clarify which types of nonprofits are the most productive and efficient while also providing a high level of services to residents in good quality housing.

Although a great deal more exploration would be needed to develop a full typology of the world of for-profit affordable housing developers, it appears that the two ends of the continuum would place LIHTC developers that are working at the building (as opposed to the neighborhood) level at one end and firms like MBS at the other. In addition to the size of their portfolios, there are a number of other variables that would need to be incorporated, including: size of individual development projects (e.g., individual buildings or entire neighborhoods); focus on urban or suburban development; commitment to providing social services; and commitment to providing long-term affordability.

Patrick Clancy has further suggested that a key factor for sorting both nonprofit and for-profit groups would be along a continuum of social mission and the extent to which a strong financial outcome is a prerequisite for getting involved with a specific deal. Indeed, he believes that a lot of nonprofits will take on projects that may be less profitable – sometimes far less profitable – and may have a more ambitious social mission (see also Bratt et al., 1994). Thus, according to Clancy, there are a combination of factors that will significantly increase the difficulty and the risk involved in successful execution.

In thinking further about the world of large nonprofit affordable housing developers and their for-profit counterparts, we may see a convergence between the day-to-day activities and overarching orientations of corporation-like nonprofits and mission-driven for-profits. While the need to make a certain level of profit may still be a distinguishing feature, one would likely be hard-pressed to see real differences in the operations between some of the highest performing nonprofits (e.g., The Community Builders, BRIDGE Housing, Mercy Housing, and Preservation of Affordable Housing) and the most mission-driven for-profits (e.g., MBS, Jonathan Rose Companies, and Telesis Corporation).

However, additional research should be carried out comparing some of the highest performing for-profit and nonprofit affordable housing developers to better understand the relative advantages and challenges of each.

Final Note: Continuing the Conversation About How to Reduce Segregation, While Also Keeping the Inner City Redevelopment Agenda Alive

Racial issues have not been a central focus of this Working Paper. Yet we know that housing problems in the U.S. are inextricably tied to race. Neighborhoods across the country are still often highly segregated, with the corresponding inequalities in educational and employment opportunities. Compliance with fair housing laws, overseeing banks to assure that they are not engaging in discriminatory lending practices, and continuing the national dialogue about race are all part of the housing challenge in the U.S.

A 2015 U.S. Supreme Court decision ruled that policies, laws, and practices that have a “disparate impact” in terms of promoting or maintaining racially discriminatory patterns are illegal (*Texas Department of Housing and Community Affairs v. The Inclusive Communities Project, Inc.*). In addition, HUD’s 2015 guidelines require cities and towns to assess their housing patterns in terms of racial biases, to set goals aimed at reducing segregation, and to provide periodic reports on progress. Although the legal basis for these actions has been in existence for decades, together they represent a reaffirmation of the importance of eliminating racial segregation, and they could stimulate an increased commitment to consider the racial impacts of a given housing project or intervention.

At the same time, the new rulings could frustrate efforts to revitalize poor inner city communities. To what extent will the work of developers like MBS, as well as the thousands of nonprofit organizations that focus on urban areas, be thwarted by the need to demonstrate that the new development will not promote racial segregation? Although the mechanisms to remediate “disparate impacts” are far from clear, the Supreme Court ruling and the HUD guidelines may represent a new chapter in efforts to promote social inclusion. In St. Louis, a great deal of the LIHTC housing built by for-profit firms over the past several years has been located outside the city of St. Louis. While these developments align with the new guidelines, there are also concerns about the need for LIHTCs to be available for inner city projects, consistent with the type of work that MBS does.

To conclude, the ultimate objective of this work is to advance our understanding of affordable housing development and to develop policy directions that could better support the

work of both for-profit and nonprofit housing organizations. The preceding recommendations are made with an eye toward creating the types of public policies and new or revised initiatives that could contribute to a higher level of public commitment and a more efficient system for providing high quality, long-term affordable housing for lower-income households.

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Kevin McCormack, President, McCormack Baron Salazar, Inc., St. Louis, MO

Sandra Moore, President, Urban Strategies, St. Louis, MO

Randy Rhoads, Vice President, Design and Construction, McCormack Baron Salazar, Inc.

Don Roe, Director of Planning and Urban Design Agency, City of St. Louis, MO

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Appendix:

Summary of *Affordable Housing Finance Magazine's* Top 50 Lists¹⁶

Affordable Housing Finance magazine covers news about the affordable housing industry. Each year, it presents information on the productivity of its members. In 2014, 107 firms completed voluntary surveys detailing their activities. The groups covered in these analyses change each year, based on which and how many companies submit survey responses. For example, in contrast to 2014, the 2009 list reflects responses from 130 companies.

The rankings discussed below are based on the number of new affordable units (those serving residents earning no more than 60 percent of AMI) started in 2014. This is followed by a discussion of the largest overall owners of affordable housing as of 2014.

A total of 56 firms were listed among the top 50 developers of new affordable housing in 2014, since eleven groups were involved in two- or three-way ties. MBS is listed as number four, with 765 affordable units started. Only twelve (21 percent) were nonprofits. Of these top nonprofits, only four were among the top 25. The top affordable housing developer in 2014—a for-profit—started 1,296 units; the last-place group (at #56, a nonprofit) started just 8 percent of that amount—107 units. For-profit developers began construction on about 16,600 affordable units in 2014, accounting for 86 percent of all new affordable units started that year by the top 56 affordable housing producers (*Affordable Housing Finance Staff*, 2015a).

In terms of ownership of affordable housing, the rankings for the top 50 affordable housing owners are based on the number of affordable units owned (as general partners) as of January 1, 2015.

Thirty-five out of the 50 largest groups are for-profits; two-thirds of the fifteen nonprofit groups on this list are in the bottom 25. With a current portfolio of 46,662 affordable units in 367 projects, the New Jersey-based for-profit firm, The Michaels Organization, is the largest owner (and developer in 2014) of affordable housing in the U.S. MBS is listed as the eleventh largest for-profit owner of affordable housing in the U.S. with a total of 13,563 units in 123 developments.

¹⁶ This analysis was prepared by Irene Lew, Research Analyst, Joint Center for Housing Studies, 2015.

In contrast to the largest five producers of new affordable housing, a list comprised entirely of for-profits, nonprofit firms accounted for three out of the top five owners of affordable housing in 2014. With an inventory of 19,426 units in 484 projects across the U.S., the nonprofit Volunteers of America is the second-largest owner of affordable housing in the country. For-profit firms accounted for 73 percent of all affordable units owned by the largest 50 owners in 2014.

Indicative of for-profits' financial advantages and ready access to capital, the ten firms that have acquired the most units of affordable housing in 2014 are all for-profits (*Affordable Housing Finance Staff, 2015c*). However, four nonprofits are included on the list of the ten companies that have done the most substantial rehabilitation work in 2014. Together, they account for one-third of the 7,888 affordable housing units rehabilitated by these ten firms (*Affordable Housing Finance Staff, 2015d*). In view of MBS's focus on building new mixed-income developments, it is not surprising that it is not on either of these two lists.

Between 2009 and 2014, for-profit firms also represented 79 percent of all affordable housing starts among the largest 50 developers, as shown in the table below.

Historical Overview of Affordable Housing Activity by the 50* Largest For-Profit and Nonprofit Developers

	2009		2010		2011		2012		2013		2014	
	Non-profit	For-profit	Non-profit	For-profit	Non-profit	For-profit	Non-profit	For-profit	Non-profit	For-profit	Non-profit	For-profit
Units owned	122,814	326,672	126,075	392,068	124,671	411,717	115,150	424,716	145,398	417,973	149,289	410,807
% Share	27	73	24	76	23	77	21	79	26	74	27	73
Units started	3,123*	13,005**	4,753	19,775	4,870	14,183	4,543	14,248	4,101	12,292	2,745	16,648
% Share	19	81	19	81	26	74	24	76	25	75	14	86
Units acquired	0	13,867	2,246	11,858	1,176	17,414	0	18,996	1,529	30,096	0	14,497
% Share	0	100	16	84	6	94	0	100	5	95	0	100
Units substantially rehabilitated	N/A	N/A	N/A	N/A	4,674	8,065	2,655	6,253	4,204	6,595	2,622	5,266
% Share	N/A	N/A	N/A	N/A	37	63	30	70	39	61	33	67

Source: Affordable Housing Finance Staff. 2015e.

* There are often two- or three-way ties, so in any given year there are often more than 50 developers/owners listed among the “50 largest.”

**For 2009, the percent share calculation of affordable units excludes 583 units developed by the San Antonio Housing Authority, which is a public housing agency.