Nonprofit and For-Profit Developers of Subsidized Rental Housing: Comparative Attributes and Collaborative Opportunities

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Abstract

This article presents background information on the growth, productivity, and unique focus of nonprofit housing producers and discusses the various government and private initiatives that support this sector. The article also explores the strengths and weaknesses of for-profit and nonprofit organizations in developing and owning subsidized rental housing and questions the cost-effectiveness of pursuing one strategy or the other and the long-term viability of projects developed by each type of sponsor. Answers, however, are far from conclusive.

Effective housing production and long-term ownership of subsidized housing require the developer to address at least 12 broad areas of concern. In some, nonprofits appear to have the advantage, while in others, for-profit developers generally have the edge. Nonprofits and for-profits can join together in partnership arrangements, and some of the key requirements for such efforts are discussed. Recommendations for policy changes to enhance the role of nonprofit organizations are offered.

Keywords: Low-income housing; Nonprofit sector; Private/for-profit sector

Introduction

In view of the ongoing need for rental housing that is affordable to households earning 80 percent of median income or less, policy makers, academics, government officials, and foundation personnel often ask themselves which type of entity is in the best position to develop and own this housing. There are three broad types of options: the public sector through local housing authorities, the private for-profit sector, and nonprofit organizations.

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It is beyond the scope of this article to examine the relative advantages and disadvantages of the public housing approach. Since the 1960s, the public housing program has steadily lost support for a number of reasons, including a persistently negative public image, perceived high costs, concerns over the concentration of very low income households, and a general retrenchment away from deep government subsidy programs in favor of a public-private partnership approach. However, the stereotypical public housing project exists more as a myth than a reality; costs for such projects are likely competitive or even less than they are for other subsidy approaches, and the overall record of the public housing program is far more positive than is generally acknowledged (Bratt 1986; Connerly 1986; Schwartz 2006; Stone 2006). Nevertheless, there is an ongoing perception that public housing represents a glaring government failure. Garnering public support for such housing, even with efforts to clarify its true contributions, would likely be difficult at best. Moreover, even with a revitalized public housing program, the resources of the private for-profit and nonprofit sectors would almost certainly be needed to help meet the demand for low-cost housing.

Briefly, in 2000, there was an overall need for some 4.9 million additional rental units available and affordable to the lowest-income segment of the renter population across the United States. Affordable housing shortages were particularly acute for extremely low income renter households living in states that had large populations and high and growing demand (e.g., California, Nevada, New York, New Jersey, Florida, Arizona, and Washington) (Nelson, Treskon, and Pelletiere 2004). At the same time, the supply of affordable rental housing units is shrinking and federal assistance to very low income households has been unable to serve about 75 percent of the eligible renter population (Joint Center for Housing Studies 2007).

This article focuses on the strengths and weaknesses of for-profit and nonprofit organizations in developing and owning subsidized rental housing. Nonprofit developers of such housing are tax exempt; they can earn a surplus on their activities as long as this income is used to further the purposes of the organization. Nonprofits are limited in how distributions of income can be made to those in control of the organization and other private parties; charitable corporations cannot distribute any gains, profits, or dividends to their members, directors, or officers (National Housing Law Project 1982; Steinberg 1998).

By contrast, large for-profit entities have an explicit responsibility to their shareholders to maximize earnings. In fact, if a corporation fails to fulfill this duty, shareholders can sue members of the board of directors or the

corporation's officers (Hinkley 2002). Even if a for-profit developer does not have shareholders, it is still organized to realize profits for its owners.

To explore the relative benefits and drawbacks of for-profit and nonprofit sponsorship of housing that is affordable to low-income households, several questions must be asked: Is it more cost-effective to pursue one strategy or the other? What is the long-term viability of projects developed by each type of sponsor? What types of public policies are needed to better support the work of nonprofit and for-profit housing producers? With these questions in mind, this article does the following:

1. Presents an overview of the nonprofit housing sector and discusses the special preferences nonprofits receive from government and nongovernment sources
2. Presents the arguments in favor of and against fostering the nonprofit and for-profit sectors as long-term owners of subsidized housing
3. Compares the production costs and long-term viability of developments produced and owned by nonprofits and for-profits
4. Offers recommendations on the optimum roles for nonprofit and for-profit producers and owners of subsidized rental housing

Nonprofit developers: An overview

The first major federal housing program that included a role for nonprofit developers was the Section 202 program for the elderly, enacted in 1959. In the 1960s and 1970s, there were a number of federal initiatives that either invited nonprofit sponsorship of housing or created programs targeted to nonprofits.[1] Although the major phases of nonprofit involvement with housing can be told in a fairly linear manner, successive programs did not, for the most part, build on the experiences or lessons learned from their predecessors. Instead, each successive set of nonprofit-based housing initiatives grew from the particular political, economic, and social needs and priorities that prevailed at the time (Bratt 1998).

[1]The major federal programs aimed at nonprofit housing groups included the 1966 Special Impact Amendment to the Economic Opportunity Act, Title VII of the Community Services Act of 1974, the Neighborhood Self-Help Development program of 1979 and 1980, and the Nehemiah Program of 1987. For more background on the growth of the nonprofit housing sector, see, for example, Bratt 1989, 1998, and 2006b.

The contemporary nonprofit housing sector is composed of two major types of developers and owners: community development corporations (CDCs) and larger national and regional nonprofit organizations.[2] CDCs are nonprofits that are

> characterized by their community-based leadership and their work primarily in housing production and/or job creation….CDCs are formed by residents, small business owners, congregations and other local stakeholders to revitalize a low- and/or moderate-income community. CDCs typically produce affordable housing and create jobs for community residents. Jobs are often created through small or micro business lending or commercial development projects. Some CDCs also provide a variety of social services to their target area. (National Congress for Community Economic Development 2005a)

CDCs are typically small organizations that are committed to the revitalization of relatively small geographic areas and that have a median staff of 10 employees, 7 of whom are full-time (National Congress for Community Economic Development 2005b).[3]

During the 1970s, 1980s, and 1990s, the National Congress for Community Economic Development tracked the growth of CDCs and presented an image of uninterrupted growth, from some 200 groups in the mid-1970s to about 1,500 to 2,000 in 1988, to 3,600 in 1999 and 4,600 in 2005 (1989, 1999, 2005b). However, CDCs are not only created, but they also go out of business (Rohe, Bratt, and Biswas 2003).

The second broad category of nonprofit housing developers is sometimes referred to as national or regional nonprofits. Many of these organizations have become members of the Housing Partnership Network (HPN), which is a peer network and business cooperative of 95 of many of the most accom-

[2]These two groups are not inclusive. Some housing is built by religious institutions, trade unions, or other organizations with a particular constituency or mission. Other nonprofit organizations are committed to assisting the homeless or other groups with special needs, such as people with HIV/AIDS. Still others are tenant cooperatives, limited-equity cooperatives, community land trusts, or mutual housing associations. However, a focus on these types of groups is beyond the scope of this article.

[3]Current figures on CDC operating budgets are not available. The 1999 census by the National Congress for Community Economic Development reported that the median annual budget was in the $200,000 to $399,000 range; only 20 percent of the groups had budgets exceeding $600,000.

plished affordable housing nonprofits in the country. Its members operate on a citywide or regional basis and share a similar public/private business model that forges entrepreneurial partnerships among the business, community, and government sectors to create and sustain affordable housing.[4] The founding members formed HPN in 1990, and since that time, they have come together to "share new approaches, create new social enterprises, and impact housing policy to improve the production and sustainability of affordable housing at scale throughout the country" (Housing Partnership Network 2008).[5]

HPN member organizations are typically considerably larger, in terms of staff size and operating budgets, than CDCs. In a recent study of these groups, Mayer and Temkin (2006) found that the median full-time equivalent staff size is 60 and the median operating budget is $4.1 million.

While CDCs often emerged from a protest by a community group against poor conditions in its neighborhood, HPN organizations were typically created through cooperative arrangements on the part of local civic leaders, bankers, and other leading businessmen, as well as public and nonprofit organizations. Despite the local prominence of HPN members,[6] these nonprofits as a group have enjoyed considerably less visibility than the much more prevalent, but significantly smaller CDCs.

Nonprofit production record

CDCs are credited with having produced or rehabilitated more than 1,252,000 units of housing (National Congress for Community Economic Development 2005b), and nonprofits have generally been responsible for a significant percentage of the low-income housing that has been developed over the past two decades. In 1990, nonprofits produced approximately 17.2 percent of the total number of federally assisted housing units, and in the 30-year period from 1960 to 1990, the cumulative nonprofit share of all federally subsidized production and preservation units was about 15.7 percent

[4]Affordable housing development is the most prevalent activity of HPN members. In a survey of these nonprofits, out of 73 respondents, 70 percent identified developing and preserving affordable housing as their first priority. Other areas of focus include promoting economic opportunity, working toward community revitalization, and providing service-enhanced housing (Mayer and Temkin 2006).

[5]Within the group of large nonprofit housing organizations, seven that work at a multistate level have coalesced under another organization, Stewards of Affordable Housing for the Future, which was launched in 2003. Most of these groups are also members of HPN.

[6]During site visits conducted by a team of researchers under contract to the Urban Institute, interviewees frequently commented that the local HPN organization was viewed as the "go-to" organization in their area (Mayer and Temkin 2006). In many cases, HPN members have major national reputations throughout the nonprofit community (e.g., ACTION-Housing, Bridge Housing Corporation, and the Cleveland Housing Network).

(Walker et al. 1995). As of 1995, nonprofits owned 35 percent of the older assisted stock of housing (which included units built under the Section 221(d)(3), 236, and various Section 8 programs) (Finkel et al. 1999). A sample of about one-quarter of the Low-Income Housing Tax Credit (LIHTC) units developed between 1987 and 1996 indicates that just under one-third were developed by nonprofits working alone or in partnership with for-profits (Cummings and DiPasquale 1999).

Housing owned by CDCs and other nonprofit organizations is an important component of the U.S. social housing sector, which comprises about 4.8 million units.[7] Included in this total are the units produced by non-CDC nonprofit producers of housing, notably HPN members, which have developed more than 225,000 units.[8] This production, from less than 100 groups, equals about 18 percent of the number of units produced by the several thousand CDCs.

[7]This estimate draws on Stone's analysis (2006). However, his estimate did not include the most recent number of CDC-produced units—1,252,000. That number is based on the 2005 National Congress for Community Economic Development census (2005b). Thus, his estimate of about 4.2 million units in the social housing sector has been increased by some 600,000 units, which, according to the National Congress for Community Economic Development, is the number produced by CDCs between 1999 and 2005 (2005b).

Stone (2006) breaks down the size of the social housing sector as follows: First, he delineates three forms of publicly owned housing: federally funded public housing—1.3 million units; state-funded and locally funded public housing—700,000 units; and U.S. Department of Defense–owned and –operated housing—400,000 units. This totals about 2.4 million units. Second, he breaks down the various forms of nonprofit ownership. In addition to the approximately 1.5 million units produced by CDCs and the large nonprofit housing producers that are HPN members, there are a number of other types of nonprofit housing developers that have contributed to total nonprofit production. Although it is difficult to provide a precise figure, about 900,000 additional nonprofit-produced housing units are being occupied. Nearly one-half of these (425,000) are in limited-equity cooperatives; another 200,000 are in Section 202 housing for the elderly. The remaining nonprofit-developed housing includes Neighborhood Reinvestment Corporation–sponsored mutual housing associations, community land trusts, and other units built through various earlier federal and nonfederal programs. Totaling all the units in the nonprofit category yields a conservative estimate of about 2.4 million units. Adding this number to the 2.4 million units of publicly owned housing equals 4.8 million units.

[8]This figure is based on an estimate of the most recent production figures of HPN members and comes from an e-mail I received from Manuel Muelle, HPN's Director of Network Development, on November 5, 2007. Not all large regional housing producers are HPN members. For example, Community Builders, based in Boston (but with offices in 10 other cities in the Northeast and Midwest), is neither a CDC nor an HPN member. Its Web site claims that it is "the largest nonprofit urban housing developer in the United States" with more than 21,000 housing units produced and more than 8,750 units, located in 90 developments, currently under management (Community Builders 2008). Stewards of Affordable Housing for the Future notes that its 7 members have produced more than 70,000 units, an estimate that comes from an e-mail I received from William Kelly, the president of the organization, on November 5, 2007. However, most of these units are included in the total of units produced by HPN and are not counted separately.

Thus, taken together, CDCs and the other large nonprofit housing producers have played a major role in providing affordable housing opportunities to nearly 1.5 million households, almost one-third of the social housing sector. As a point of comparison, the total production by these nonprofits has now surpassed production under the federal public housing program. It is also important to note that the productivity of CDCs and large nonprofits appears to have increased over time (Mayer and Temkin 2006; National Congress for Community Economic Development 1999, 2005b).

Another way of looking at the production record of nonprofits is to compare their output with that of for-profit developers. Walker et al. (1995) note that very few CDCs or for-profits produce more than 100 units per year (4.4 percent of CDCs and 16.4 percent of for-profit developers reached this threshold during 1988 and 1990). HPN members, however, have a considerably higher mean annual production of multifamily units than the for-profit members of the National Association of Home Builders—124 and 57 units, respectively (Mayer and Temkin 2006). Moreover, because for-profits are more likely to engage in single-family development and nonprofits are more likely to take on the difficult set of tasks involved in financing and renovating multifamily projects, there is likely a "degree of sophistication among nonprofits that equals or exceeds that of [their] for-profit comparison group" (Walker et al. 1995, 26).

All nonprofit housing producers strive to cover the costs of developing and managing their projects through developer and management fees and through the cash flow generated from the property. Increasingly, too, nonprofit housing groups are focusing on asset management, which involves viewing each property in terms of its long-range costs and revenue-generating potential. While the goal of all such organizations is to become financially independent, the costs involved in building and managing housing targeted to low-income households require an infusion of resources and assistance.

Properties and people served by nonprofits

Nonprofit housing developers are typically willing to enter into market situations (distressed neighborhoods) and to serve populations (those with very low incomes) that the unassisted private for-profit sector cannot or will not serve (Christensen 2000; Ellen and Voicu 2006; Mayer 1984; Mayer and Temkin 2006; National Center for Economic Alternatives 1981; National Congress for Community Economic Development 2005b; Vidal 1992). Consistent with this commitment, nonprofits are more likely to be the providers of special needs and supportive housing (see, for example, Ellen and Voicu

2006; U.S. General Accounting Office [GAO] 1999[9]). In addition, in direct comparisons with for-profit developers using some kind of subsidy, nonprofits emerge as the group that is most likely to work in the most distressed areas and to serve the hardest-to-house residents, including large numbers of people who are poor and who face other significant challenges.

Some of the most recent data on the types of properties being developed by nonprofits come from the U.S. Department of Housing and Urban Development's (HUD's) LIHTC database (2004). Between 1995 and 2003, nonprofit sponsors located their properties in more difficult neighborhoods than the total universe of LIHTC properties, the bulk of which were developed by for-profit sponsors (Climaco et al. 2006). And in keeping with the mission of many nonprofits to house large families, these groups were more likely than for-profit developers were to build units larger than 1,000 square feet (GAO 1999).

It is important to note that the data comparing nonprofits and for-profits do not differentiate between small neighborhood-based organizations and the large regional or national nonprofits. So, although there is a distinct trend that shows nonprofits serving the most deteriorated areas of cities and a highly needy target population, we do not have intrasectoral information on outcome measures (e.g., large and small nonprofits versus large and small for-profits). Yet the aggregate information is compelling and demonstrates clearly that nonprofits tend to work in some of the most troubled areas and to serve some of our neediest residents.

Government preferences for nonprofits

The view that nonprofits should receive special treatment is not universally shared. Among the most vigorous critics is Howard Husock, who has noted that CDCs undermine market operations and result in the use of government resources to sustain target neighborhoods, thereby "potentially impeding the new, spontaneous development that is the hallmark of urban vitality" (2003, 80–81). He notes further that the CDC movement is based on the assumption that "private market forces would never be drawn to restore poor urban neighborhoods or to create jobs in them, and that therefore government must provide both income support and housing for the poor trapped in cities" (Husock 2003, 82). Instead, his solution is to rely on the market. "Cities bounce back," he says, "when decline makes their land so cheap that it becomes economic for businesses to buy" (Husock 2003, 90).

[9]The U.S. General Accounting Office became known as the U.S. Government Accountability Office in 2004.

Most practitioners, policy makers, and analysts of urban housing and city planning disagree.[10] Their view is that it is unconscionable to allow decade after decade of deterioration, with its enormous physical and social costs. As a result, there have been a number of public interventions aimed at revitalizing cities in general and assisting CDCs in particular.

In addition to the various federal programs that have directly supported the development and growth of CDCs and other nonprofits (see footnote 1), there also have been a number of federal initiatives starting in the 1980s that have given some type of preferential treatment to nonprofits. The net result is that for CDCs, the federal government is by far the most important source of grants, loans, or investments, with some 88 percent of all organizations reporting that they had received more than $50,000 from federal sources, particularly HUD. Other key revenue sources include state and local governments, banks, national intermediaries, foundations, and corporations (National Congress for Community Economic Development 2005b). HPN members rely on a similar list of investors and donors (Mayer and Temkin 2006).

The federal government has given preferential treatment to nonprofits through at least seven distinct initiatives. First, it looked to nonprofits to help bring back into use properties that had been owned by distressed and failed S&Ls and commercial banks. Specifically, in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, nonprofits were given the right of first refusal to purchase properties from the Resolution Trust Corporation; these properties had been in the portfolios of distressed S&Ls. Two years later, a similar provision was contained in the Comprehensive Deposit Insurance Reform Act of 1991, which was aimed at properties owned by failed commercial banks.

Second, nonprofits were given priority status in the “expiring use” crisis. Title VI of the Cranston-Gonzalez National Affordable Housing Act of 1990 gave these organizations and other priority purchasers the first right to make a bona fide offer to buy a federally subsidized development whose owner had announced an interest in prepaying the mortgage.

Third, and also in the Cranston-Gonzalez National Affordable Housing Act of 1990 (Title II—the HOME Investment Partnership Program), Congress mandated that at least 15 percent of each participating jurisdiction’s HOME funds be earmarked for use by qualified nonprofit housing organizations, which were termed community housing development organizations (CHDOs). This allocation, called the community housing partnership

[10] Even Nicholas Lemann (1994), who lodged a pointed attack on federal community development initiatives, praised the work of CDCs, particularly their efforts to develop housing for low-income residents.

set-aside, was strengthened in the Housing and Community Development Act of 1992, which permits each jurisdiction to spend 5 percent of its overall HOME allocation on nonprofits' operating expenses. As of fiscal year (FY) 1992, even before this change went into effect, nearly 28 percent of all HOME dollars went to nonprofit sponsors. And just looking at HOME funds committed to rental housing, nonprofits were the recipients of 40.6 percent of the allocation. However, the overall percentage of HOME funds going to CHDOs (or CDCs) was significantly less—roughly 15 percent as mandated by Congress (Walker et al. 1995).

Fourth, in the section titled "Choice in Public Housing Management" in the Housing and Community Development Act of 1992 (P.L. 102–550 Title I, Part B), nonprofits are listed as one of the eligible entities to which public housing residents may choose to transfer management of their developments, instead of relying on troubled public housing authorities.

A fifth critical set aside is stipulated in the LIHTC program, which requires that no less than 10 percent of each state's annual tax credit allocation be earmarked for projects that are at least partially owned by a qualified nonprofit. However, the LIHTC allocation to nonprofits has been significantly higher than this amount. Between 1987 (when the program started) and 2002, nearly 22 percent of all LIHTC projects were sponsored by nonprofits (HUD 2004). The all-time peak was reached in 1998, when nonprofits sponsored 36.6 percent of all LIHTC properties. However, since then there has been a decline in nonprofit sponsorship of these properties, with the rate falling to 25 percent, but still far above the 10 percent minimum threshold (Climaco et al. 2006). Concluding their study of nonprofit participation in the LIHTC and HOME programs, O'Regan and Quigley observed that "nonprofits do, in fact, receive a larger portion of funding in these programs than they have in other historically important sources of low-income housing production" (2000, 313).

A sixth example of how federal programs single out nonprofits to assume important roles is found in the New Markets Tax Credit (NMTC) program,[11] which is operated by the Community Development Financial Institutions Fund.[12] Designed to generate private sector equity investments

[11]Enacted as part of the Community Renewal Tax Relief Act of 2000, the NMTC program can be used to finance retail centers, small businesses, charter schools, child care centers, and other community facilities.

[12]This fund is aimed at increasing the capacity of financial institutions to provide credit, capital, and financial services in distressed urban and rural communities. Created in 1994, the fund receives annual congressional appropriations. In FY 2006, $55 million was approved. These funds, in turn, are invested in community development financial institutions, which serve markets typically underserved by conventional financial institutions.

in low-income communities, the NMTC program requires that all investments be made through certified community development entities, which are domestic corporations whose primary mission is to serve low-income communities or persons or to provide them with investment capital. Tax credits are channeled to these entities, which, in turn, sell the credits to corporate investors. The cash proceeds are then invested in the earmarked project. Community development entities must be accountable to residents of their communities through representation on either a governing or an advisory board (Community Development Financial Institutions Fund 2003). While a for-profit may qualify as a community development entity, the requirements are geared to CDCs and other nonprofits.

Finally, nonprofits have also played a central role in supporting programs targeted to homeless people, both in providing emergency shelters and in helping to fund transitional or permanent housing. Between 1987 and 1991, more than 87 percent of total federal spending for these programs was provided to nonprofit organizations (Walker et al. 1995).

Other sources of support for nonprofits

CDCs and other nonprofits also receive substantial support from a number of other sources. The 1980s saw the beginning of federal devolution to state and local governments. No longer was the federal government to be seen as the sole source of funding and support for low-income housing initiatives. Instead, lower levels of government were expected to fill the gaps in program development and funding.

Before 1980, there were only 44 state-funded housing programs, and the bulk of them were operating in three states: California, Connecticut, and Massachusetts. But between 1983 and 1987, 92 new state programs were established, and this proliferation was accompanied by significant increases in state spending for housing. With this growth in state-based housing activity, nonprofits were often given central positions; in 1988, a survey revealed that state housing programs were typically oriented toward nonprofit developers (data reported in Goetz 1993).[13]

In addition, financial institutions, particularly community development financial institutions, the Federal Home Loan Bank System's affordable housing and community investment programs, and private foundations have

[13]Goetz (1993) provides further evidence of the pervasiveness of state and local funding for nonprofits. See also Bratt (1989) for an examination of efforts by Massachusetts to develop a comprehensive system of supports for nonprofit housing organizations.

emerged as critical partners in supporting the work of nonprofit housing organizations.

The final major set of supports for nonprofits comes from the national nonprofit intermediaries, notably the Local Initiatives Support Corporation (LISC), Enterprise Community Partners, Inc. (formerly known as the Enterprise Foundation), and NeighborWorks® America (formerly known as the Neighborhood Reinvestment Corporation).[14] In addition, both LISC and Enterprise have subsidiaries that serve as intermediaries for tax credit investments (see LISC 2008a and Enterprise Community Investment, Inc. 2008). Another national intermediary, the National Housing Trust (2008), serves as a consultant and development partner to mostly large nonprofit organizations, as well as to HUD, state and local housing agencies, and low-income residents working to preserve and improve affordable multifamily housing.

In recent years, the role of intermediaries has grown significantly, in part because of the substantial investments that these organizations have received; there is a prevailing view that CDCs are better able to deliver services with intermediaries than without them. Specifically, intermediaries and local collaborations facilitate multiyear funding for CDC operations, tend to increase the level of investment, establish performance standards and monitor CDC

[14]The institutional origins of NeighborWorks America can be traced to 1975, when the Federal Home Loan Bank created an office dedicated to neighborhood reinvestment. Three years later, Congress enacted the Neighborhood Reinvestment Corporation Act, which transformed the office into a freestanding federally funded agency whose mission was to create "opportunities for people to live in affordable homes, improve their lives and strengthen their communities" (NeighborWorks America 2008b). The NeighborWorks network, which was created and supported by the Neighborhood Reinvestment Corporation, consists of more than 230 local nonprofit organizations (NeighborWorks America 2008a). In FY 2006, the network's revolving loan fund investments leveraged more than $3.6 billion in other direct investments in neighborhoods served by affiliate organizations (NeighborWorks America 2006).

Enterprise Community Partners, Inc., was created in 1982 with the assistance of real estate developer James Rouse. Since then, the organization has secured and made billions of dollars in investments and contributions. Through its network of more than 2,500 organizations, over 200,000 homes affordable to low-income families have been built or rehabilitated (Enterprise Community Partners, Inc., 2007).

LISC was created in 1980 and is committed to working with CDCs to rebuild communities. Technical assistance and financial support are provided to local programs operating in more than three dozen cities. LISC raises money from private investors, lenders, and donors (more than $8 billion so far), and this money in turn leverages additional public and private sector funds. Since its inception, the organization has provided assistance to thousands of CDCs, which have built or rehabilitated 230,000 affordable homes and created more than 32 million square feet of retail and community space (LISC 2008b).

A fourth intermediary, the Center for Community Change, was created in 1967, years before the other groups, and is unique in its overriding concern with advocacy, its role as a link between activist CDCs and technical assistance, and its commitment to grassroots empowerment (Rubin 2000).

progress, and shift administrative burdens for grant-making and management away from the grantor to the intermediary (Walker 2002; see also Walker, Gustafson, and Snow 2002).[15]

Despite the important role that nonprofits have been playing in this significant array of federal initiatives, these organizations are not supported by a "nonprofit-centric" system, which would involve a comprehensive array of funding for operations, predevelopment costs, construction and permanent financing, and long-term subsidies, as well as technical assistance (Bratt 1998). The piecemeal approach to supporting nonprofits notwithstanding, it is noteworthy that there have been many efforts to sustain and enhance the work of these organizations as they go about the task of providing decent, affordable housing.

The debate on the role of for-profits and nonprofits

As background to the discussion on the positive and negative attributes of nonprofit and for-profit developers, it is important to underscore a basic observation: The unassisted private housing market generally does not provide for-profit developers with enough of a profit to build or maintain decent-quality housing that is affordable to low-income households. This point has been made many times by various observers. Statements in the final reports of two congressionally mandated studies on the future directions for U.S. housing policy are particularly noteworthy. The 1988 report of the National Housing Task Force observed that there is a "clear understanding that housing for poor people cannot be produced by the private sector acting alone" (9). And more than a decade later, the Millennial Housing Commission stated in 2002 that one of the lessons learned from the 70-year history of federal housing programs is that the "private sector needs the proper incentives to be an effective partner in the federal government's efforts to address the nation's housing challenges" (26).

If the private market, acting on its own, could meet the housing needs of residents of all incomes, there would likely be little debate. Nonprofit organizations, rather than serving as developers and managers of housing could instead be called on to play various social service functions—to support the nonhousing roles that low-income or special-needs populations may require. Nonprofit and for-profit developers could be partners, with nonprofits bringing their unique attributes, including their connections to

[15]However, there is also some question about the extent to which intermediaries interfere with the agendas of CDCs. For a fuller discussion, see Bratt (2006b).

residents and the community at large, to specific projects. For the time being and the foreseeable future, however, we are left with the problem of trying to assess the relative strengths and weaknesses of both nonprofit and for-profit sponsorship of housing affordable to low-income households.

For-profits: Benefits and drawbacks

For-profit developers typically have important attributes that make them attractive developers and owners of housing that is affordable to low-income households. In particular, they generally bring significant financial and technical resources to a deal. The ability of for-profit developers to cover the costs of acquiring land or buildings, as well as the up-front development costs, often allows them to move more quickly and efficiently than nonprofits.

However, as noted earlier, for-profit developers using the LIHTC program are somewhat less likely than nonprofits to develop projects in areas with a higher percentage of very low income households. For-profits may avoid properties targeted to the neediest populations because they often require additional services that are difficult and unprofitable to arrange, but are nevertheless essential for residents.

Perhaps the major criticism of for-profit developers relates to the inherent contradiction between their need to make a profit and the possibility that this will come into conflict with the long-term affordability needs of low-income residents, as well as the public purpose implicit in subsidy programs. A case study based in Massachusetts articulated this conflict (Bratt 1987). But probably the best example of how the needs of residents and the profit-motivated orientation of private developers come into conflict is the expiring use crisis. This problem arose during the 1980s, as privately owned, publicly subsidized developments reached the point at which owners were no longer bound by the regulatory agreements that they had signed with HUD and that required them to rent their units to low- and moderate-income households.

In places where conditions favor conversion to market-rate rentals or condominiums, it has been difficult and costly for the public sector to design incentives to keep for-profit owners from exiting subsidy programs when contracts expire. In 1987 and 1990, Congress passed two pieces of legislation aimed at providing first an emergency response to the expiring use issue and then what was viewed as a permanent response.[16] Owners were guaranteed

[16]The two laws were the Emergency Low-Income Housing Preservation Act, Title II of the Housing and Community Development Act of 1987 (P.L. 100–242, as amended), which was signed into law on February 5, 1988, and the Low-Income Housing Preservation and Resident Homeownership Act, Title II of the Cranston-Gonzalez National Affordable Housing Act (P.L. 101–625, as amended), which was signed into law on November 28, 1990.

fair-market value incentives to keep the housing affordable for at least 50 years, so they could either continue to own the housing themselves or sell to nonprofit groups that made the same commitment to long-term affordability. "Not surprisingly," Achtenberg notes, "most owners preferred to secure the incentives for themselves rather than sell their properties to nonprofits, and reports of lucrative equity takeouts with little or no funds reinvested in the property created the appearance of yet another boondoggle for the subsidized housing industry" (2006, 164). By 1997, the federal government, under significant attack by the Republican Congress and with little support from the Democratic administration, abandoned this so-called "preservation funding."

With particular reference to the expiring use problem associated with Section 8 contracts, the mark-up-to-market preservation strategy will end up costing twice as much as capital grants that could have been used to permanently preserve the affordability of the property. Again, according to Achtenberg:

> [W]hile preservation capital grants provided permanently affordable housing through social ownership, units marked up to market remain at risk every five years, despite the continued public investment in the housing. In effect, the current market-based strategy retains all of the costs of socially oriented preservation with none of the benefits....With 30-year hindsight, the failure of federal efforts to provide and preserve housing for low- and moderate-income families through the private sector is readily apparent. The conflict between private property rights and social housing needs, inherent in the original structure of the federally-assisted housing programs, has never been resolved but only managed in ways that have ultimately served to exacerbate the conflict. Preservation has been possible only when private interests are served as well; when this is not expedient or becomes too costly, social needs are sacrificed. (2006, 168–69)

Another key point at which the needs of the private for-profit sector and those of the public may come into conflict is in the later years of ownership, when for-profit owners may be looking to sell. However, it has proven challenging to say the least to anticipate and manage the tax consequences involved when for-profit owners exit their properties. This has been particularly problematic for pre-1986 investors in subsidized housing; in 1986, the tax code changed the incentive structure for investment in subsidized hous-

ing. In brief, these investors have found themselves unable to defer certain taxes, but at the same time they are still responsible for income that exists only on paper (also known as "phantom income"). As the Millennial Housing Commission noted:

> Clearly, investor economic interest in such properties was substantially diminished and, as a consequence, necessary maintenance was in many cases reduced or eliminated…. Even if an investor is no longer interested in owning a property (from which s/he has gained no significant economic benefit since 1986 and will gain none in the future), the investor is discouraged from transferring the property, because s/he will…be subject to a tax…(the "exit tax"). (2002, 34)

Attempting to resolve this disincentive for owners to sell their properties or to maintain them at an adequate level, the Millennial Housing Commission (2002) proposed a new mechanism that would provide exit tax relief in such situations. While the proposal found its way into a bill, H.R. 3715, the Affordable Housing Preservation Tax Relief Act of 2005, it was not enacted. But the intent of the act is worth noting: The federal government would forgive taxes owed in exchange for a commitment that the property would remain affordable for an additional 30 years.

Overall, the history of for-profit involvement with housing has been complex. In exchange for the significant investment capital that the for-profit sector brings, various intricate and costly tax incentives have been put into place. But each of these has spawned the need for additional programs in an attempt to secure the properties for long-term use by low-income households. Each time a program is created with a limit on the length of time the development must remain affordable, the government has needed to step in to try to safeguard affordability with another incentive that, again, typically provides only a short-term resolution. Moreover, the costs of salvaging the housing for low-income use are substantial and tend to fuel public images of government waste and unnecessary spending.

Nonprofits: Benefits and drawbacks

In terms of the production record of nonprofit housing organizations, is the cup half empty or half full? On the one hand, overall production is larger than production under the public housing program. On the other, the total number of units produced is dwarfed by the need. Of course, proponents would counter by asserting that with increased funding and other technical supports, production could be significantly increased (Bratt 2006b). Similarly, while nonprofits often have difficulty pulling deals together in a timely

and efficient manner, the development context in which nonprofits work is complex, and the need to line up multiple subsidy and funding sources, along with the typically skimpy working capital that is available, serves to explain at least some of these concerns.

Supporters of nonprofits also point to their willingness to work in neighborhoods in need of revitalization. On this point, however, not all observers see this as a positive attribute. For example, Khadduri and Wilkins assert that developing housing in high-poverty areas may not be a desirable approach, unless the new development is "part of a comprehensive revitalization effort with a realistic chance of success" (2006, 29). However, nonprofits' willingness to take risks that other developers avoid and to invest in deteriorated neighborhoods is often a key factor in an area's eventual revitalization. In fact, one of the ironies of community development is that the more nonprofits invest in neighborhoods that others are bypassing, in turn stimulating other public and private investment, the more likely it is that these nonprofits will run into difficulties at some point in the future. Specifically, a nonprofit's own viability may be threatened as land and buildings that the organization can afford become scarce (Rohe, Bratt, and Biswas 2003).

Nonprofits are also typically praised for their commitment to producing housing that is affordable to low-income people over the long term (Bratt 1989). However, despite their good intentions, nonprofits may encounter difficulties, because some buildings may require more resources than the nonprofit can access, thereby jeopardizing affordability. Except for the old Section 8 New Construction/Substantial Rehabilitation program and the public housing program after the creation of operating subsidies, federal subsidized housing programs typically have not included operating subsidies to manage maintenance and repairs, as well as unforeseen increases in costs.

Recently, researchers have studied the impact of developments owned by nonprofits and for-profits on the value of neighboring properties. It is interesting to note that in contrast to frequently heard criticisms about rental subsidized housing developments in general, Ellen and Voicu found that projects owned by both nonprofit and for-profit developers generated "significant, positive spillover effects" (2006, 31), which were defined as increases in the value of neighboring properties. In a comparison between the two types of developers, they found that the impact of the nonprofit housing remained stable, while the impact of the for-profit housing declined slightly over time. However, they also point out that "in the case of small projects, nonprofit organizations delivered significantly lesser neighborhood benefits than their for-profit counterparts" (Ellen and Voicu 2006, 49). This difference may be explained by the fact that smaller projects may be developed by smaller

organizations, which in turn may face challenges directly related to capacity. In addition, these researchers posit that the lesser impacts of the smaller projects on property values might be explained by the lack of community amenities in these developments.

While many nonprofits have difficulty accessing capital with which to secure land and buildings (see, for example, Mayer and Temkin 2006), some groups are managing to overcome this obstacle by developing partnerships with land-rich entities.[17] In addition to providing the nonprofit with access to land for its own development work, such a collaboration could also enhance a for-profit developer's interest in working with the nonprofit because "some urban developers investigate which nonprofits own or have access to land as the first step in the partnering process" (Chung 2004, 14). This could, in turn, make a project more feasible, due to the financial support that the for-profit would likely bring to the deal.

In addition to working hard to create innovative mechanisms to acquire land and buildings, other frequently noted attributes of nonprofit housing providers include their connections to their communities and residents and their desire to provide services that go beyond housing.

Connections to community and residents. Despite the complexities of having any single entity try to understand and represent a community,[18] there is a widespread view that nonprofit community-based organizations "are

[17]This strategy is being used by a number of nonprofit organizations. For example, the Wisconsin Partnership for Housing Development sees partnerships with local churches that own land as a viable strategy for becoming more engaged with the inner-city housing market in Milwaukee: "The approach involves giving technical assistance to the churches to consider development on their sites and potentially co-developing with them or marrying them with a for-profit developer" (Mayer and Weber 2005, 6).

The Columbus Housing Partnership, in Columbus, OH, has followed a similar approach. The organization provides homeownership counseling for church members, and in the process, staff members connect with church leaders and build relationships. With the scarcity of affordable parcels of land, the organization is aware that many of these faith-based groups may have land and may be willing to partner at some point in the future, thereby making additional development possible (Bratt 2006c).

The Mid-Peninsula Housing Coalition in California relies heavily on good relationships with local governments, particularly in terms of locating buildable land: "With the limited set of sites available for building affordable housing (and zoned appropriately), many in public ownership or control, and [the organization's] desire for substantial volume, the local government support that yields site opportunities and funds to deal with high Bay Area project costs [is] critical" (Mayer 2005, 4). While this is being recognized as an important part of the organization's activities, staff members acknowledged that they "may have missed out on some opportunities in localities in which they had not nurtured 'social' relations" (Mayer 2005, 4).

[18]"Community" is not a monolithic entity (Bratt 1996; Heskin 1991). Any given community is likely composed of tenants and homeowners of varying income levels, residents as well as absentee landlords, small businesses, and larger commercial outlets. In any given situation, it is unlikely that all these various groups—"the community"—will agree on all issues.

particularly effective at delivering services" (HUD 1996, 22). In part, this is because CDCs are assumed to be connected to their local communities and to be good representatives of community interests. And it is these connections that help them understand and respond appropriately to local needs. Although resident involvement in CDC activities typically goes well beyond board membership, more than half of CDC board members are generally drawn from the local community (Vidal 1992).

Community-based development organizations (which include CDCs) generally work to empower the poor and respond to community concerns. In particular, these organizations have demonstrated that local decision-making processes can become more open and accessible to community members, who in turn can set a neighborhood development agenda, rather than having this done by the business community (Rubin 1993). In addition, researchers at the Urban Institute found compelling evidence of community leadership and strong alliances both inside and outside CDCs' neighborhoods (Walker 2002).

Holistic approach to housing—"housing plus." Given the standing of CDCs and other nonprofits in their local communities, it is not surprising that these organizations typically focus significant effort and resources on the social needs of residents, as well as on their communities as a whole.

In terms of the community orientation of CDCs, these groups may focus on crime watch programs, the beautification of parks and open spaces, commercial redevelopment, small business assistance, or some combination of these, as described in a number of studies (Bratt and Keyes 1997; Grogan and Proscio 2000; Leiterman and Stillman 1993; Robinson 1996; Sullivan 1993; Vidal 1992; von Hoffman 2003).[19] Briggs and Mueller note that theirs was "perhaps the first-ever attempt to analyze rigorously collected data on a wide range of effects of CDC practices on the lives and attitudes of neighborhood residents" (1997, 1). Among their many findings was that two of the three organizations studied "had measurable effects on the social fabric of their neighborhoods" (Briggs and Mueller 1997, 7–8).

[19]Since about the mid-1990s, a movement, known as Comprehensive Community Initiatives (CCIs), has incorporated and expanded on the community-building mission of CDCs. Funded by a number of foundations, CCIs generally have one or more CDCs as central actors in broad-based community development initiatives (Connell et al. 1995; Eisen 1992; Fulbright-Anderson, Kubisch, and Connell 1998; Roundtable on Comprehensive Community Initiatives for Children and Families 1997).

While housing is the foundation of most CDC activity and is usually viewed as part of a wider-scale community development agenda, many CDCs also explicitly or implicitly strive to promote resident "self-sufficiency."[20] Such activities include building personal responsibility; developing work skills (employment counseling, job training); delivering services; promoting economic development; building a sense of community through organizing, advocacy, and political consciousness-raising; and encouraging homeownership (Bratt and Keyes 1997).

Recent evidence about the importance of resident-oriented programs to large nonprofit housing providers comes from a study of HPN members. A common theme among respondents to a survey administered by the Urban Institute was that their organization's commitment to providing programs constituted a key difference between them and the for-profit developers in their area. The responses from 63 organizations indicate that among the top two organizational missions cited, 24 percent noted community revitalization and 22 percent noted the creation of service-enriched communities[21] (Mayer and Temkin 2006). For housing nonprofits, resident-focused programs are typically seen as integral to the organization's mission and as a way to help move people out of poverty (Bratt 2006c).

As CDCs and other nonprofits have gone beyond producing housing alone (no small achievement in itself), they have emerged as leaders in providing—or in many cases helping to coordinate—"housing plus" services (Bratt 2008). The particular mix of initiatives that a group selects depends on its mission, the community's needs, staff capacity, and the availability of funds and other types of assistance (Leiterman and Stillman 1993; Vidal 1997).

Comparative production costs and long-term viability

Two central questions relate to the relative strengths and weaknesses of for-profit and nonprofit sponsorship of housing that is affordable to low-income households. The first pertains to the bottom line. Is it more cost-effective to pursue one strategy or the other? The second is, What is the long-term viability of projects developed by each type of sponsor? The answers to these questions, however, are far from conclusive.

[20] "Self-sufficiency" is a frequently used term that generally refers to a the ability of a household to provide for itself without government subsidies. However, the term is problematic, because virtually no one in society is truly self-sufficient; virtually everyone receives one or more forms of direct or indirect public assistance (Bratt and Keyes 1997; Shlay 1993).

[21] At the time the research was conducted, 82 organizations were HPN members. The response rate, therefore, was nearly 77 percent.

Production costs

One of the first studies comparing the production costs for housing built by nonprofit versus for-profit developers was completed in 1993 by a team of researchers at Abt Associates, Inc., under contract to HUD. Despite some serious methodological flaws, which the researchers enumerated,[22] a "*rough comparison* with industry standards" (emphasis in the original) of development hard costs for the six new nonprofit-constructed projects included in the study revealed that the

> *actual per-square-foot construction costs for the new construction study projects ranged from 20 percent above to 20 percent below the nominal industry costs for the specified location, type and size of building.* This variability relative to construction costs is not unlike what one might expect to see from a similar sample of for-profit projects. (Hebert et al. 1993, ES–18; emphasis in the original)

To the extent that construction costs were higher, some of the reasons were attributed to the basic characteristics of nonprofits, particularly their need to depend on multiple sources of funding and the delays that result from having to work with so many different funders (an average of 7.8 per development included in the study). The report went on to state:

> The overall pattern of costs among the 15 projects suggests that the variance among the nonprofit project costs might be at least as large as any variance in costs between nonprofit and for-profit projects....[S]ome of the higher cost levels observed in our study may be more a function of local development conditions and requirements rather than systematic differences in nonprofit versus for-profit comparative efficiencies. (Hebert et al. 1993, ES–20)

In a subsequent (1999) GAO study, researchers found that the average cost of units built by nonprofit developers was about $18,000 higher than the average cost of units built by for-profit developers. However, when key

[22]In addition to the fact that the sample was very small and nonrandom, there were other important limitations: The study made no provision for correspondingly comprehensive data collection for similar actual for-profit projects;...the study did not have the resources for the extensive data on building specifications, construction techniques, and materials that would be necessary to do a *precise* build-up of estimated costs using industry standards...; aside from direct construction costs, reconnaissance indicated no industry standards generally applicable to total development cost or its components, such as for pre-development costs, legal and organizational costs, and marketing, for example; [and further] metropolitan-wide construction cost averages may not reflect typical construction costs for difficult urban affordable housing sites. (Hebert et al. 1993, ES 17–18, emphasis in the original)

differences in unit characteristics were taken into account, the cost differentials changed substantially, from $1,600 less per unit to $12,700 more per unit for units built by nonprofit versus for-profit developers. The researchers concluded that the difference in estimated per unit costs was not statistically significant and, for the most part, could be explained by the following factors:

1. Although unit costs were not found to vary significantly with the economic condition of the neighborhood, nonprofits were more likely than for-profits to build in economically distressed areas.
2. Nonprofits were more likely than for-profits to build units eligible for additional tax credits (these are available in areas where development costs are high relative to incomes); such units are more costly to develop than those not eligible for additional credits.
3. Nonprofits were less likely than for-profits to develop garden-style units and more likely to build mixed developments; these are more costly to build than garden-style units.
4. Nonprofits were more likely than for-profits to develop larger units, which are more costly than smaller ones.
5. Nonprofits were more likely than for-profits to be working in the Pacific and Northeast regions, where costs are higher.

In another major comparative study of development costs done at about the same time as the GAO (1999) analysis, Cummings and DiPasquale found that, on average, projects developed by nonprofits rather than for-profits tended to have higher total development costs per unit—$90,268 compared with $63,778. Even after Cummings and DiPasquale (1999) controlled for project size, unit type, and location, they found that units developed by nonprofits cost 20.3 percent more, on average, than those developed by for-profits.

As noted at the beginning of this section, the relative cost data on developing housing that is affordable to low-income households are not conclusive. But when costs are found to be higher, as in the Cummings and DiPasquale (1999) study, researchers invariably note that the higher costs need to be viewed in the context of the other benefits that are typically associated with this housing. O'Regan and Quigley summarize this view:

> Arguments are seldom put forward that nonprofits will provide the same affordable housing at the same cost as for-profit firms, but rather that nonprofits will supply the

> housing that is the most difficult to induce from for-profit firms. Thus, to the extent that federal housing goals emphasize harder-to-serve populations or those with particularly low incomes, this rationale suggests a greater involvement of nonprofit providers. (2000, 300)

Many of the benefits of nonprofit development, including a focus on those groups that are typically difficult to serve, have been noted previously.

Long-term viability

Very little information is available on the comparative long-term viability of developments produced by nonprofit and for-profit sponsors using the same programs. In an early (1978) GAO report on the Section 236 program, 47 percent of the developments sponsored by nonprofits were found to have failed (e.g., mortgage default resulting in a claim on the Federal Housing Administration (FHA) insurance fund), although they accounted for only 23 percent of these developments. In brief, "nonprofit sponsored [Section] 236 projects failed at four times the rate of limited dividend sponsored projects" (GAO 1978, 93). The report explained the finding this way: Nonprofits have few resources to weather adversity, they are probably less experienced, they tend to admit the lowest-income people who are eligible for the subsidy program, and they tend to serve needier families than limited-dividend sponsors.

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 the developments 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 becomes very important" (Cummings and DiPasquale 1999, 278). And, with only 11 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" (1999, 278).

In another study of FHA-insured multifamily properties, Finkel et al. found that "*distressed and stressed properties were more likely than sound*

properties to have nonprofit/cooperative or limited dividend owners and were less likely to have for-profit owners" (1999, 4–11, emphasis in the original). However, because for-profit owners predominate as sponsors of the less problem-laden, newer assisted properties and nonprofits are more prevalent as sponsors of the generally more troubled, older assisted properties, these findings would be expected.[23]

Additional information revealing concerns about the long-term financial viability of housing owned by nonprofits comes from a study by Bratt et al. (1994). Although these researchers did not undertake comparative analyses, their work revealed some significant financial problems facing the developments they studied, particularly in terms of insufficient capital and operating reserve balances. Specifically, 17 of the 23 developments examined were in a dangerous position because of inadequate capital reserves. In terms of operating reserves, the situation was even worse, with only 3 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 their sample reported that expenditures exceeded revenues (Bratt et al. 1994).[24]

While no effort was made to quantify how specific conditions contributed to these types of difficulties, a number of reasons were offered. 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).

[23]Older assisted properties were insured by HUD and receive either mortgage interest subsidies under the Section 221(d)(3) or 236 programs or rental assistance under one of the Section 8 programs, except for the New Construction/Rehabilitation program. Newer assisted properties were insured by HUD and receive rental assistance through the Section 8 New Construction/Rehabilitation program. Distressed and stressed properties had what the authors term "annual backlog-adjusted cash flow *deficits*" exceeding $250 per unit and less than $250 per unit, respectively (Finkel et al. 1999, 4–4, emphasis in the original). This refers to the adequacy of cash flow to cover unfunded backlogs. The operating and physical needs of distressed properties would far exceed available revenues and reserves (Finkel et al. 1999).

[24]Similarly, the extensive information that Finkel et al. (1999) present on thousands of HUD-insured properties reveals significant financial problems and physical backlogs of repairs.

Among the most interesting findings was the array of reasons behind the first set of problems. While the poor quality of the initial rehabilitation may have been due to mundane errors, particularly noteworthy were the conscious decisions an organization made to undertake a project, even knowing that funds were inadequate. In those cases, organizations reported that their desire to respond to local pressures to improve a problem property or to provide some additional housing in the area was the dominant concern (Bratt et al. 1994).

The willingness on the part of nonprofits to undertake projects in areas that other developers are likely to bypass appears to be a key factor in any differences in the viability of developments owned by nonprofits and for-profits. But if developments cannot survive, there are obviously both short-term and long-term implications for residents, organizations, and the host communities.[25]

The next section attempts to resolve the question of how nonprofit and for-profit developers can best play their respective roles.

For-profits and nonprofits—Recommended roles

This article has focused on delineating the benefits and drawbacks of for-profit and nonprofit sponsorship of housing that is affordable to low-income households. Reflecting on the roles of these two types of sponsors, the Millennial Housing Commission summed it up this way: "Effective delivery of affordable housing relies on enabling public sector, for-profit businesses, and nonprofit organizations to do what each does best" (2002, 28). Of course, the devil is in the details. What exactly does each do best and who decides? Ultimately, it is not a matter of deciding whether nonprofits or for-profits should be involved in housing production for low-income households.[26] Instead, the challenge is to be as clear as possible about how each type of

[25]Cummings and DiPasquale (1999) found that after controlling for a number of variables, "nonprofits generate higher returns for equity investors, suggesting that for comparable projects nonprofit developers are perceived as riskier than for-profit ones" (296). Further study is needed on the reasons behind this difference, although there are many plausible explanations for ongoing differences in perceptions about the two types of developers.

[26]As suggested earlier, I continue to be supportive of public housing authorities as developers and managers of subsidized housing. Despite the widespread negative perception of this program, as well as the reality that many developments continue to be severely distressed, the logic of using up-front capital grants to develop housing that is permanently held in the social sector makes a great deal of sense (see, for example, Stone 1993). While this article has not explored the positive and negative attributes of this approach, it still remains a viable option. But it is unlikely that a new, widely supported public housing program will be created at least for the present.

developer can best play a role and to suggest mechanisms that would lead to fruitful and mutually beneficial collaborations or partnerships.

A critical issue that is directly related to the differences between nonprofit and for-profit developers was mentioned at the beginning of this article but warrants repeating: Large for-profits have a legal obligation to maximize earnings for shareholders, and even small developers are committed to earning profits. By contrast, nonprofits are explicitly prohibited from distributing any profits that are derived from their activities to individuals.

An outgrowth of this fundamental difference in the legal structures of the two types of entities is that nonprofit developers tend to be more mission driven and are typically willing to accept a lower level of return than for-profit developers. In addition, there are many types of developments that the latter would simply not be interested in pursuing, such as those with less than about 40 units and/or those targeted to at-risk populations, such as the formerly homeless or people with physical or mental disabilities. Also, as noted earlier, many nonprofit groups also typically operate with limited cash reserves, which would likely make it difficult for them to manage large, complex projects such as HOPE VI (Housing Opportunities for People Everywhere) developments. At the same time, for-profit developers may not be interested in participating in an extremely complex project. For example, a recent *New York Times* article noted that "developers…tend to shy away from the complex financial packages and long lead times necessary for most affordable projects" (Sharoff 2006).

Development tasks and comparative attributes of nonprofit and for-profit developers

Beyond the legal mandates and constraints governing nonprofit and for-profit developers, the following represent the most important requirements—both organizational and contextual— for the successful development of subsidized housing. Some of these areas relate to specific organizational competencies. Others relate to the context in which the development is taking place; nonprofits and for-profits may be differentially able to take advantage of these conditions. This list of 12 essential components for subsidized development is based on the literature on housing nonprofits referenced earlier in this article, my previous research on this subject, and conversations with several housing developers and consultants who are noted at the end of the article.

1. **Staff capacity** is needed to conceptualize the project, line up subsidies and financing, oversee construction, and manage the completed development

(either in-house or under contract). Clearly, for both nonprofits and for-profits, staff capacity can vary widely. However, in view of the fact that the great majority of nonprofits are small, staff capacity is certain to be an issue for many of them. How staff capacity can be enhanced for nonprofits, particularly for CDCs, has been a focus for researchers (see, for example, Nye and Glickman 2000) and technical assistance providers (see, for example, NeighborWorks America 2008c).

2. **Front-end capital** is essential to cover the initial costs, including land/building acquisition, engineering, and architectural fees, as well as the financial capacity to enable the project to survive during what can become long delays in permitting and construction. Again, nonprofits' ability to raise needed capital and overall financial capacity varies widely. In view of the large number of small nonprofits, these concerns can be particularly challenging.
3. **Community support for the project** is important to ensure that it is consistent with local needs and preferences. While for-profits may be able to develop good relationships with the community in which a project is being planned, this is an area in which nonprofits would typically be seen as having an advantage (as discussed earlier).
4. **Access to affordable land and/or buildings** is essential for any development, but particularly one focused on low-income occupancy. In some respects, for-profits are more likely than nonprofits to have an easier time acquiring suitable properties because of their ability to move rapidly when a building or parcel becomes available. Nonprofits typically have far less cash to make a quick purchase. In other respects, however, nonprofits may be in a better position to develop mutually beneficial relationships with land-rich entities in the community. Further, nonprofits sometimes receive priority treatment in terms of acquiring city-owned properties.
5. **External supports, financing, and subsidies** must be available. External support may include local government approvals, financial resources, and assistance from local or national intermediaries. For any development to be affordable to low-income households, multiple subsidies are needed in the early stages and over the long-term. Both for-profit and nonprofit developers can use the major federal housing subsidy programs, such as the LIHTC program and the Housing Choice Voucher Program (previously known as the Section 8 Existing program). However, a number of programs give preference to nonprofits. In addition, many state and local

public programs, as well as the financial and technical assistance offered by national nonprofit intermediaries, are specifically geared to helping nonprofit developers produce housing that is affordable to low-income households.

6. **Market risk and general conditions must be assessed** to ensure that the completed units will be marketable at the projected rent levels. This is particularly important in mixed-income developments. But even if the development is geared exclusively to low-income occupancy, a weak market could create significant rent-up problems, thereby reducing projected income and threatening financial viability. Although both for-profit and nonprofit developers are aware of the importance of market factors, for-profits may be better able to undertake sophisticated market analyses due to their generally stronger financial position. By contrast, there is relatively little assistance available to help nonprofits anticipate and plan for market changes (Bratt 2006a). In addition, factors associated with market risk are usually integral to the for-profit business model, while being of only marginal concern in the nonprofit approach and not central (or even relevant) to the mission of these organizations. Further, as will be explained later, Internal Revenue Service (IRS) concerns over exposing nonprofit assets to risk have recently increased.
7. **Capacity to manage the development and oversee its progress,** including the ability to manage the entire development team and to make sure that construction is consistent with the plans, is essential. Whether this role is performed by a development consultant or by in-house staff, housing sponsors must be in full control of the nuts and bolts of project development. The ability of either a nonprofit or a for-profit developer to fulfill this task is likely quite variable and closely related to a host of other factors, including organizational size, capacity, and overall financial strength.
8. **Capacity to manage the property over the long-term,** again whether done in-house or contracted out, is a critical role of long-term owners of any type of rental housing, including subsidized housing. As is the case with the previous category, whether this task is performed better or worse by a nonprofit or a for-profit developer likely has more to do with other characteristics of the organization and less to do with its for-profit or nonprofit status.
9. **Organizational scale** may be important, because entities with large portfolios can probably use income from their high-performing properties to

subsidize those that are running at a deficit. In view of the risky nature of real estate, any given developer is likely to have some of both types of properties. However, the larger the organization, the more likely that ailing properties can be kept afloat. Because many nonprofit developers are very small and because there are restrictions on how excess income from a given project can be used, they may be in a less tenable position than for-profit developers when it comes to offsetting losses from a nonperforming property.

10. An **interest in providing services to residents and the capacity to do so** are of critical importance in low-income housing developments. Subsidized housing is increasingly being seen less as an end in itself and more as a key component in helping low-income households establish an economic foothold and move to a more secure family and work situation (see, for example, Millennial Housing Commission 2002). Whether services are provided directly by the owner of the housing or through networking with other agencies, various types of programs should be available and easily accessible to residents. Nonprofit organizations are typically deeply involved with a broad range of resident-focused programs, and large nonprofits often see this as a key characteristic distinguishing them from for-profit developers.
11. **Neighborhood revitalization** and community development are often thought to be inseparable from the production of subsidized housing. The importance of having the housing not only fit in with the existing neighborhood but also enhance it is another factor to consider. Again, as with resident services, community-building and neighborhood revitalization are typically a key part of the mission of nonprofit housing organizations. By contrast, this would likely not be a significant component of a for-profit's orientation.
12. **Long-term affordability** is almost a sine qua non of subsidized rental housing development. Too often, programs have not included mechanisms to ensure that the units that get built and are then occupied by low-income households will remain available to the original tenants and to future generations needing housing assistance. The discussion on the expiring use crisis in particular provides an important reminder that the needs and goals of private for-profit developers are likely to conflict with the mission of the public sector to provide decent, affordable housing. While creating developments with long-term affordability is a challenge for all nonprofits, it is far more likely to be an overriding concern for them than it is for their for-profit counterparts.

With reference to these 12 tasks, nonprofits appear to be stronger in some areas, while for-profits would generally be considered to have the advantage in others. In saying this, it is important to reiterate that there are many types of nonprofits and for-profits. All of them can have enormous sophistication, financial capacity, and technical expertise. Smaller and less well-established organizations, whether for-profit or nonprofit, will likely not be in as good a position to take on subsidized housing development, particularly for large-scale complex projects. Nevertheless, nonprofits have some major advantages that would likely translate into stronger support for the project: their connections to the community, their ability to access targeted resources from the public sector and national intermediaries, and their commitment to resident services, neighborhood revitalization, and long-term affordability.

Partnerships between nonprofits and for-profits

Ellen and Voicu recently concluded that "government officials will be well served by contracting housing rehabilitation dollars out to either nonprofit or for-profit organizations….[T]here is ultimately a value in maintaining a mixed organizational environment in which both nonprofit and for-profit providers can compete" (2006, 50).

Of course, it does not have to be an either/or situation. There is also fertile ground and a significant amount of experience with having nonprofits and for-profits join together in partnership arrangements. In 2002, the Urban Land Institute hosted a two-day meeting at which specific experiences with collaborative relationships were presented. Participants agreed that "each partner can bring knowledge, expertise, and resources that meet the needs of the other partner" (Myerson 2002, 9). In particular, "CDCs can provide expert knowledge of the community and an understanding of the local market, and can boost local credibility for a project [and] for-profit developer[s] can provide development expertise, resources and credibility with lending sources" (Myerson 2002, 9).

Commenting that for-profits need to work with local partners, the president of a large development firm observed: "The deals we've been involved in usually have long histories with lots of politics. We can't just go in and announce we're going to build 1,200 units. We need our local partners who are engaged in the community" (Sharoff 2006). Thus, while the nonprofit may be seeking a for-profit partner with more expertise or financial and technical resources, the for-profit may need the nonprofit for its community connections, its access to land and buildings, and its ability to take advantage of the special programs targeted specifically to nonprofit sponsors.

Myerson (2002) and Chung (2004), among others, have provided a number of specific attributes of a strong collaborative arrangement between a nonprofit and a for-profit developer:

1. Each partner should have development experience and knowledge: Nonprofits should be able to clearly articulate and even quantify the contributions they will bring to the deal so that for-profit developers can understand their value, and the roles for each partner should be clearly defined and a project management team identified.

2. To the extent that a nonprofit may be lacking either development experience or the ability to clarify the value of its role, third parties (in the form of a housing lawyer or consultant or a more experienced nonprofit) may be brought into the negotiations to advocate on behalf of the nonprofit. In short, each party should work to understand the other's perspective. The benefits to each partner, including the way profits will be shared, the anticipated social and economic benefits to the community, the goals of the for-profit partner in terms of increased visibility in the community, and the potential for increasing nonprofit capacity, should be articulated.

3. There should be a willingness on the part of the for-profit partner to share its expertise with the nonprofit on issues pertaining to organizational sustainability, succession, and future leadership.

4. In deals with a significant market component, where feasibility depends on a correct assessment of market risk, the for-profit partner should be willing to shoulder the primary market risk with commensurate reward.

5. The legal details of the partnership must be carefully crafted and understood by all parties, and they must be consistent with the Internal Revenue Code.

Concerning this last point, there is a considerable body of legal precedent related to the structuring of nonprofit/for-profit partnerships, particularly as they relate to LIHTC deals. In an unpublished paper (2006), Roberta Rubin and Jonathan Klein, attorneys who specialize in affordable housing development, have highlighted several important factors. First, and seemingly relatively unproblematically, the nonprofit sponsor must typically provide a variety of guarantees and indemnities to investors (environmental indemnifications and construction completion, operating deficit, and tax credit recapture guarantees). Second, and of much more concern, the IRS and the courts have determined that some commitments made by a nonprofit as part of a partnership with a for-profit violated its charitable purpose by expos-

ing charitable assets to excessive risk and thereby threatening its tax-exempt status (Rubin and Klein 2006).

To address this issue, an internal IRS memorandum (dated April 25, 2006) set forth new criteria for evaluating the involvement of tax-exempt entities engaged in LIHTC transactions. Although not carrying the weight of law, this memorandum provides some guidance on how the IRS might view partnerships that enable nonprofit organizations to access equity under LIHTC but still safeguard their tax-exempt status. In addition to requiring that a nonprofit take certain steps to limit its financial exposure, the IRS also requires the partnership documents to specify that, in the event of a conflict of interest between the charitable purpose of the nonprofit and the obligation of the partnership to maximize profits for investors, the charitable purpose will prevail.

Rubin and Klein (2006) concluded that this IRS memorandum was "a step in the right direction" (8) and that it reflected business practices that were already common in many well-constructed nonprofit/for-profit partnerships. However, Rubin and Klein also noted that it would be desirable for the IRS to adopt specific rules that would permit "charitable entities engaging in the critical mission of developing and operating affordable housing [to] access much-needed equity under the LIHTC program without jeopardizing their tax-exempt status" (2006, 10).

As noted earlier, an essential component of a nonprofit/for-profit partnership involves ensuring long-term affordability (preferably in perpetuity) for low-income households; one of the major drawbacks of involving for-profit developers in subsidized housing programs is that once the affordability requirements expire, these developers have little incentive to maintain the units for low-income occupancy. Although the time limit for the LIHTC program has been extended to 30 years (from the original 15 years), even this is not long enough. The nonprofit partner should require that the low-income housing be secured in perpetuity. Experience has shown that what seems like a long-term restriction when a development is first built passes very quickly.

Of course, even in their own deals, nonprofit developers are subject to the same time limits as for-profit developers in terms of guaranteeing the affordability of their units. But the mission of nonprofits typically provides a strong motivation to continue to maintain the units for their target population. In the case of for-profit developers, however, the desire to continue ownership would depend on an assessment of future profitability, including maintenance and repair needs, cash flow, and tax implications. Nevertheless, nonprofits' ability to achieve long-term affordability depends on whether adequate financing and capital are available.

In LIHTC partnerships, the Internal Revenue Code now gives a nonprofit the right of first refusal to purchase the property (at the end of the initial 15-year compliance period) for an amount essentially equal to $1 plus accumulated debt on the property (which could be assumed if the lenders are willing) and the investor's exit tax liability.[27] The risk of having to pay this tax liability can be greatly reduced through the introduction of an option allowing the nonprofit to purchase the development at a market value that takes perpetual use restrictions into account. This approach makes it possible for the partnership to be dissolved and for the housing to remain in the social housing sector over the long term.[28] However, as just noted, the ability of nonprofits to do this will likely depend on the availability of additional subsidies. A possible area of further inquiry could explore the extent to which nonprofits are, in fact, facing serious dilemmas over how to maintain their units for low-income residents once the initial investment term expires. Also important is a better understanding of how nonprofits are addressing this challenge and which types of public assistance are needed to help them achieve their goals.

Ideally, nonprofit/for-profit partnerships should be structured to ensure from the outset that the for-profit partner can exit once the affordable rental housing is successfully occupied and its agreed-upon share of the profits has been realized and that the nonprofit can cover the costs of assuming full and long-term ownership. Boston housing development consultant Peter Munkenbeck has helped forge several nonprofit/for-profit partnerships that involved the construction of both rental and homeownership units and that have incorporated this exit strategy. In a conversation we had in November 2007, he explained that partnerships are structured so that the for-profit developer can realize its profit from development phase proceeds, including the sale of the homeownership units, while the nonprofit can retain ownership of the rental units and ensure that they are operated compatibly with community objectives.

Even in well-structured and creative partnership arrangements, problems may still arise. In an e-mail to me on March 18, 2008, Louise

[27]This is based on a summary of the Internal Revenue Code 42(i)(7), offered by Roberta Rubin in an e-mail to me on July 28, 2006. She further states that although the title of the section "refers to a tenant's right of first refusal, the text itself refers to a right of first refusal on the part of a qualified nonprofit organization as well."

[28]Among the other stipulations of the April 25, 2006, IRS memorandum was a restatement of the right of first refusal for nonprofit organizations. As noted by Rubin and Klein, this "represents an exit strategy for investors as well as a path to ultimate nonprofit control of housing" (2006, 8).

Elving, a Boston-based nonprofit housing developer with nearly three decades of experience, noted that one of the biggest risks is that

> the partners may have different desires, expectations and goals; each may have different views about the level of affordability that the development should strive to meet and the amount of developer fee which is expected from the project. And such differences can lead to arguments, disappointment, and conflict. For example, nonprofits typically are much more willing to forgo fees and invest funds in order to achieve greater affordability or housing quality than are for-profit developers who are, naturally, running a business in which they expect significant financial return.

In a worst-case scenario, the conflicts may prove insurmountable and the project may have to be abandoned. But given the range of benefits that accrue to each party in successful partnerships, there is typically a strong incentive to work through the differences and areas of disagreement, and interest in forming such collaborations remains high.

Additional policy considerations

This exploration into the relative strengths and weaknesses of for-profits and nonprofits reveals two important additional issues: the need for HUD to reconsider some of its guidelines on how nonprofits are required to treat any residual income that flows from property and the need for both types of developers to be treated more similarly in terms of key aspects of operating housing that is affordable to low-income households.

First, HUD guidelines on subsidized rental housing programs prohibit nonprofits from extracting residual income either from cash flow or from refinancing to be used for other projects or for organizational expenses. With specific reference to the Section 202 program, which is available only to nonprofit sponsors, residual receipts cannot be used for non-project-related activities (12 U.S.C. 1701q(j)) such as covering organizational costs, launching new initiatives, offsetting deficits that other projects may be encountering, or covering provision of services at other developments.

Second, in other HUD programs that are accessible to both nonprofit and for-profit sponsors, HUD is more restrictive about how the former can use income derived from a specific project. A recent memorandum on this subject from Stewards of Affordable Housing for the Future concluded the following:

> Three of HUD's central programs explicitly restrict non-profits' ability to retain and use excess project revenue in a way that they do not restrict for-profit owners. Section 8 New Construction/Substantial Rehabilitation programs maintain a blanket ban on such distributions with exceptions available only on an ad hoc basis. Section 221(d)(3) restricts the use of project income to meeting project expenses and prohibits distributions.
>
> The regulations regarding excess income for non-profits under Section 236 are similar to those for 221(d)(3). Furthermore, for programs where no explicit restrictions are found, HUD employs a general presumption against project income distribution to nonprofits, as stated in its handbook [*Multifamily Asset Management and Project Servicing,* §25–1]. This restrictive treatment of distributions does not appear to be mandated by statute, but is simply a matter of policy. (2005, 5)

However, the memorandum further points out that several of HUD's other programs provide a much greater degree of flexibility in terms of nonprofits' ability to retain project income. For example, in the HOME program, whether a nonprofit can retain project income depends not on HUD, but on the local jurisdiction. HUD regulations "do not bar nonprofit owners of rental housing from receiving and retaining program income" (Stewards of Affordable Housing for the Future 2005, 4).[29] Such provisions could therefore serve as a template for extending a more lenient approach to all of HUD's multifamily programs.

To the extent that any given development is providing excess revenues, nonprofits should be able to reap the benefits, as long as the funds continue to be used to advance the mission of the parent organization. Until this type of change occurs, nonprofits will continue to be at a significant disadvantage in relation to their for-profit counterparts, which can extract equity or excess cash flow from a successful project.

Michael Bodaken, president of the National Housing Trust, wrote in an e-mail to me on November 17, 2006, that

> sustainability—whether one is a for- or nonprofit—can only be achieved through sufficient reserves and cash flow. Cash flow can only be achieved by good underwriting at the inception of ownership or, later, via refinancing. Nonprofits

[29]See 24 C.F.R. §§ 92.503 and 92.504 (2005).

> and for-profits don't differ at all with respect to these fundamental rules of real estate development. So why treat them differently?

He further noted in another e-mail to me on November 12, 2006, that "in order to maximize long term affordability for our existing and future affordable housing stock, why not impose the same long term affordability terms and restrictions on back end residual gain—on nonprofit and for-profit developers alike?" If the goal is long-term affordability, it would make sense for all types of sponsors to be held accountable to this standard and to operate under the same set of rules.

Concluding note

In view of the continuing need for increased housing production that is affordable to low-income households, it is essential to draw on the resources and capabilities of all types of developers—for-profit, nonprofit, and public housing authorities. While each type of developer can be successful on its own, partnership arrangements are extremely important. The various strengths that each party brings to a development can result in projects that are well connected to community needs and that also have the financial backing to ensure viability and long-term affordability.

Aside from a development's bottom line, also to be considered are the contributions that this housing makes to society. Whether the developer is for-profit, nonprofit, or a partnership, the goal should be to meet the requirements of what I call the "quadruple bottom line."[30] This refers to the simultaneous need for the development to be financially and economically viable while also meeting social goals. The latter includes a concern for the social and economic needs of the residents living in the housing, a sensitivity to the way the housing fits into the larger fabric of the neighborhood and contributes to neighborhood viability, and the goal that the housing should be as environmentally sensitive and sustainable as possible, which involves minimizing the use of nonrenewable energy resources and striving to reduce transportation needs.

[30] Bratt et al. (1994) may have been the first to use the phrase, "double bottom line" (71), which was defined as the simultaneous need for financial accountability and a commitment to social goals. Recently, I suggested a third element: how the housing fits in to the larger fabric of the neighborhood/how it contributes to neighborhood viability (Bratt 2008). The overall concept has now been expanded to include environmental factors, thus completing the quadruple bottom line.

In view of the fact that housing needs are not abating, all low-income housing should serve as a long-term community resource, and partnerships should be structured accordingly. Beyond the type of development entity, adequate financial resources—subsidy dollars—are essential to enable projects to meet the needs of our most vulnerable residents. And, as always, this is a matter of political will.

Author

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