

Comment on Langley C. Keyes et al.’s “Networks and Nonprofits: Opportunities and Challenges in an Era of Federal Devolution”

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Abstract

Housing markets are determined by a complex interplay of consumers and suppliers. The Keyes et al. article discusses the changing landscape for nonprofit housing providers and what recent developments in federal housing assistance policy will mean to them. But this perspective is too narrow to predict the effects of changes in federal housing policy because all housing providers are somewhat interrelated. All housing providers need to be considered, and using the terms “for-profit” and “nonprofit” to distinguish between the two types of providers is unfortunate and misleading.

For-profits and nonprofits are fundamentally different: They place a different emphasis on community, and nonprofits can often deliver subsidies that for-profits cannot. In addition, the strengths and the skills needed to produce housing under somewhat different objectives have led to some specialization. Ultimately, however, determining the optimal provider or mix of providers is best left to local and state governments as federal housing assistance devolves.

Keywords: Low-income housing; Nonprofit sector; Social capital

Introduction

The dynamics of a housing market are generated by the individual decisions of many housing consumers and many housing suppliers. Within these multiple connections of one household obtaining housing from one provider, there are some commonalities in housing providers and housing consumers. The article by Keyes et al. focuses on one group of matches within the housing market dynamic: community housing providers and low-income, inner-city renters.

Keyes et al. discuss the changing landscape for nonprofit housing providers and what federal housing policy change will mean to them. This, however, may be too narrow a perspective from which to judge the consequences of change and the appropriate response to them.

The article postulates the future of nonprofit housing providers by describing the networks that contribute to their success. The authors' objective is to prepare nonprofit housing providers for the future and to identify where problems and conflicts are most likely to arise. However, the success and failure of all housing providers are interrelated, and a look into the future should include the dynamics between housing providers as well as the dynamics within specific providers' orbits.

This review begins with a brief critique of "Networks and Nonprofits" to note the issues that appear most important. It is followed by a discussion of why housing providers are segmented into different types and what they have in common.

Critique

Keyes et al. observe that housing programs have become less oriented toward federal government control and more oriented toward local operation. Rather than a single source of subsidy, like the Section 8 program, the provision of low-income housing requires multiple equity and debt sources, layered subsidies, and active participation from a multitude of players. Although not highlighted in the article, the absence of significant state and local government support has also been a major reason for other parties to step in and negotiate deals (Belsky 1993).

This devolution of housing policy has left community-based organizations to handle the most difficult piece of housing services: housing low-income renters in the inner city. Keyes et al. describe the role of community housing providers as similar to that of a local government agency, "housing the poorest, most needy households" and acting as a social service agency providing "more than housing." The influence of the nonprofit has been enforced through set-asides in federal government grant programs and proposed HUD reinvention strategies, and the authors recommend continuing these favorable federal preferences. However, they also caution that well-established community housing providers may already have capacity problems that could be exacerbated if future federal housing programs continue preferences while giving more responsibility to state and local governments.

Keyes et al. believe the success of the nonprofit housing provider lies in nonmarket forces called "social capital." The elements of social capital that bind the many actors in low-income housing are long-term relationships among the people in community

housing organizations, a common philosophy or belief in the nonprofit approach, and a mutual interest in success. The authors present two case studies as examples of how community housing organizations, one new and one seasoned, wield social capital to achieve success. Although community housing providers are generally referred to as developers and producers of low-income housing in the article, the two case studies do not support this view. Instead, they describe organizations focused on preserving existing housing, often in financial distress from poor management or initial underfunding. Other more minor illustrations offered in support of the authors' views in the "Challenges" section of their article also describe management issues rather than the production of new units.

Given the trend in housing policy and the conditions for successful community housing organizations, the authors offer four areas of concern that should be addressed to ensure the continuance of community-based housing providers. First, the presence of community housing providers is uneven, with some places having rich institutional support while others are "institutionally barren." Their recommendation is for the national intermediaries to step in and facilitate wider representation. However, the authors fail to warn the national intermediaries to heed their second piece of advice, which is to limit the breadth of their responsibility to what they can accomplish. The national intermediaries provide essential links to debt and equity financing, but local solutions call for local partners.

Second, Keyes et al. caution that community housing organizations will be under greater pressure to accept more work than they can handle as local governments are given more responsibility and authority to run housing programs. Organizations should heed this warning and periodically reconsider their initial charter and goals.

Third, community housing providers will find themselves competing with other special interest housing providers as federal housing assistance arrives as a block grant. The concern that other housing providers (e.g., for elderly, homeless, public housing) will compete for limited dollars reveals some basic differences in the goals that Keyes et al. ascribe to "nonprofits" versus other "advocates." Oddly, rather than viewing local decisions on the use of block grant funds as more flexible and more likely to favor community development, the authors consider a move away from federal program prescription as a threat to community housing groups.

Fourth, the proposals to use housing subsidies that allow the tenant to choose where to live rather than subsidizing specific projects will make it difficult for many developments to remain financially secure. The authors correctly observe that if proposals are enacted into law that eliminate housing subsidies tied to buildings, then buildings in less desirable locations could lose tenants.

In summary, the authors recommend that the federal government permit localities to support project-based housing subsidies; that intermediaries, including the U.S. Department of Housing and Urban Development (HUD), help build the capacity of community housing organizations; and that HUD's grant application criteria should encourage the participation of community housing organizations. They also caution that competition among community housing organizations could lead to less housing for the truly needy. Keyes et al. focus on the nonprofit housing providers and the networks that support them. Their perspective does not include other types of housing providers, notably profit-motivated providers. To understand the strengths and weaknesses of nonprofits, it is necessary to understand why there are different types of housing providers.

Differences among housing providers

The provision of housing is accomplished by many different firms, organizations, and governments. Each operates in a different manner with different objectives. The differences among them can be collapsed into three broad areas: the distinctions of profit motivation, the capture of externalities, and the need for subsidy. These areas are important in understanding the appropriate place and function of different actors in response to federal changes in housing policy. Of these, however, the nomenclature distinction of the presence or absence of a profit motivation is the least useful to differentiate among housing providers. Certainly, market-oriented firms are established to make a profit while community-based organizations do not provide a return to investors. But the use of these terms to distinguish between the two types of housing providers is unfortunate and misleading.

The profit-motivation distinction is unfortunate because the differences between the two types of housing providers are much more complex than whether the organization provides a return to investors and pays taxes. The distinction is misleading because the absence of a profit motivation is not necessarily synonymous with lower costs.

Profit motivation

Community housing organizations are called "nonprofit housing providers," and market-oriented firms are described as "profit-motivated" or "for-profit." Beyond the simple differences, the presumption is often made that housing produced by nonprofits is less expensive than housing produced by for-profits, owing to the absence of a profit margin in the final price or rent. Further, the demarcation of housing providers implies that the profit-motivated have no social motivation and also that a social motivation requires that participants receive no financial reward for their good works.

First, home building is a very competitive market, and firms compete away all but an economic profit. The classic definition of a competitive market that ensures firms make only economic profits postulates the following requirements:

- a. There are many producers and none is large enough to dominate the market. In 1992, over 130,000 firms were categorized as residential general contractors in the Census of Construction (U.S. Bureau of the Census 1994). No firm accounts for more than 1 percent of the national market, and the top 100 account for about 10 percent of single-family housing starts.
- b. The same or similar product is available from all providers. Building technology is well known, and most firms can produce comparable homes.
- c. The supply of resources is elastic. The components of home building (land, labor, and materials) are widely available without significant supply constraints.
- d. All participants have complete knowledge of prices and costs. Certainly, the price of inputs and the final price of homes are well known to buyers and builders (National Association of Home Builders [NAHB] 1996).

Second, profit is a relatively small portion of the price of a home. The concept is difficult to measure since building firms use different accounting procedures. Most firms are organized as Subchapter S corporations, which can blur the distinction between salary and profit, and much of the hard costs of construction are contracted out. Nevertheless, an NAHB study (1995a) found that home-building firms retain about a 9 percent profit margin. Hence, at best, if the management and risk premiums

earned by the entrepreneur were eliminated, prices or rents would not be reduced by more than 9 percent. This conclusion, however, does not account for the fact that competition and profit motivation produce efficiencies.

Profits above an “acceptable” or market-driven level can also take other forms, whether in a for-profit or nonprofit organization. High salaries, generous employee benefits, or expensive company offices can all be buried in either type of organization’s financial statements. The opportunity for incurring unnecessary or unreasonable expenses is less in a for-profit organization than in a nonprofit because the owners of the former have a greater economic interest in eliminating such expenses.

Third, profit is the return for taking risk. Home builders produce housing with the intention, but not the guarantee, of selling it. Even those firms that build on contract to the owner receive funds after they are expended and occasionally encounter problems of nonpayment. Larger scale developers who must wade through approval and subdivision processes, install infrastructure, and then build homes risk even larger amounts before a sale is made and their investment begins to yield a return. Without profit, the return to investors for bearing risk, no investment capital would be available to housing.

Community housing providers also encounter risk. However, community-based organizations typically have little capital of their own at risk, and so the risk is usually borne by financial institutions and national intermediaries.

Empirical proof of a difference in production costs between nonprofit and for-profit housing providers is difficult because of the wide variation in cost accounting and acquisition procedures. In a small, nonrandom sample of for-profit and nonprofit multifamily construction projects, Abt Associates (Hebert et al. 1993, iii) found that “nonprofit development costs were sometimes higher and sometimes lower than industry averages.” Thus, the presence or lack of profit motivation does not determine the real differences between housing providers. The more elementary differences involve the capture of externalities and the need for subsidy.

Capture of externalities

A useful distinction between for-profit providers and nonprofits involves the pursuit of different primary objectives: saving or

stabilizing existing neighborhoods and selling or renting housing profitably. Both types of providers have a stake in the community's continued well-being, and both expect to achieve financial success. The difference is that their sensitivity to these two objectives varies. The way in which each firm orders these objectives in a given project is perhaps best reflected in the capture of externalities associated with that project.

Rehabilitating or redeveloping inner-city sites, for example, necessarily entails fitting or refitting homes into existing communities. Local residents clearly have a stake in whether and how housing improvements are done. Improved and fully functional housing provides positive externalities to the community, and the community in turn affects the sustainability of housing by providing the right environment. Since nonprofit community housing providers often spring from community concerns, it is only natural that they are primarily seeking the maximum positive impact of the housing improvement on the community. Conversely, building housing with the expectation of profitably selling or renting it requires anticipating and meeting prospective buyers' or renters' needs. So it is reasonable to expect that for-profit, market-driven developers focus primarily on generating the community from the housing to be created and on choosing locations and existing surroundings that will appeal to prospective buyers or renters, rather than on fulfilling the needs of the existing neighborhood. To the greatest extent possible, the for-profit provider is seeking to internalize the positive externalities of the housing improvements for the prospective owners or renters.

Need for subsidy

Another useful distinction between market-oriented firms and community housing providers is the availability of resources and the need for subsidy. New homes are produced by market-oriented firms to fit the incomes of buyers. Producers incorporate sizes, features, and amenities to fit the buyer's pocketbook. If the buyer or renter cannot afford the product, the home or apartment does not get produced or is offered to someone else.

Providing housing to low-income residents of the central city often involves housing that costs more to provide than the resident can afford to spend. As pointed out by Harvard's Joint Center for Housing Studies (1995), rents of \$200 to \$300 are generally insufficient to cover basic operating costs, much less capital costs and improvements. A full-time minimum wage job

holder can only afford to pay a maximum of \$220 per month for gross rent. According to the 1993 American Housing Survey, 10 percent of the central-city rental housing stock (1.3 million units) rented at or below \$220 (excluding units with no cash rent), but 26 percent of the central-city renter households had incomes below the level considered necessary to afford even \$220 per month (U.S. Bureau of the Census 1995).

Thus, some form of assistance is often necessary to make up the difference between the tenant's ability to pay and the rents needed to maintain decent housing. Federal assistance has diminished and will likely continue to do so. The newest forms of federal assistance, such as HOME, require cost sharing. Hence, assistance needs to be assembled from other sources if significant numbers of families are to be served.

In this scenario, community housing providers act as a surrogate local government agency, collecting support from all the likely sources. The two examples discussed by Keyes et al. in Minneapolis and Boston are very close to this activity of coordinating and cajoling actors into a unified plan and process.

The authors, however, did not mention the strong magnet to cooperation that the federal government continues to apply through the Community Reinvestment Act (CRA) and the affordable housing goals established for the government-sponsored enterprises of Fannie Mae and Freddie Mac. CRA requirements bring local lenders to the table and provide some form of financing subsidy to projects benefiting the community. Recent strengthening of CRA requirements will further encourage the participation of financial institutions.

Affordable housing goals for Fannie Mae and Freddie Mac have generated new efforts by these financial giants to develop special mortgage products for households with incomes below their traditional customer's income. In addition, two programs within the Federal Home Loan Bank System—the Affordable Housing Program (AHP) and the Community Investment Program—provide funds for financing very low, low-, and moderate-income rental and owner-occupied housing for community development. The AHP supplied \$100 million to finance affordable housing in 1995 (NAHB 1995b). While these incentives are not direct federal funding, they encourage a flow of funds to affordable housing projects typical of community housing providers.

The authors postulate that an increased dependence on local solutions to housing problems will entail increased demands on

the community housing network. Their advice is to not accept more than the system can handle. In many cases, however, the problem of capacity is not a lack of housing providers in a community but conflicting objectives among the suppliers of housing. The arbitrator of such conflicts should be the local government agency with the expertise to efficiently allocate limited resources.

Local governments have significant experience in administering housing block grants. They have also had much greater experience in administering public housing programs. While the public housing program has received wide publicity for its failures, these failures have been primarily in large cities with severe housing problems inside and outside the public housing system. Many small public housing authorities have been supplying decent housing to their clientele for 50 years or more without serious problems. Thus, local governments do have the capacity or can develop the capacity to efficiently administer housing programs.

The authors' advice to target a portion of federal housing subsidies to community housing providers would limit local governments with strong capabilities. A lack of a set-aside does not limit community provider participation but rather allows local governments to choose the correct combination of housing provider, housing consumer, and vehicle of subsidy for that location and that locality's voters. Regardless of the network developed to support community housing providers, the democratic process of requiring elected officials to make allocation decisions that affect the electorate provides the best guarantee that the wishes of taxpayers are carried out.

Similarities among housing providers

Notwithstanding the elementary differences described above, some strong similarities are shared among all housing providers. First, all housing providers operate in a market where housing consumers make choices and react to the different bundles of housing offered. Second, all providers are concerned about the financial viability of their projects. Third, surrounding neighbors have a stake in the community and the kind of housing they live near, regardless of who provides it. For these reasons, all providers have a significant stake in the continued integrity of the community, irrespective of their profit motivation.

An issue raised by Keyes et al. clearly illustrates such similarities. They point out a problem of potential concern to all owners of projects subsidized by the federal government: The HUD reinvention proposal includes the elimination of project-based subsidies (i.e., the guarantee of rent payments for all the units in a building). Instead, tenants would be allowed to use their subsidy for any unit on the market. If such a proposal is enacted, the projects that were designated by the federal government to serve low-income households would have to compete for tenants. These buildings were constructed or purchased not only to provide housing for a targeted group of people, but also to rejuvenate, enhance, or stabilize a neighborhood. Those buildings may be less attractive because of their location, rather than because of the housing services they provide. Community housing providers should oppose this proposal because it endangers the neighborhoods where these buildings are located. Market-oriented owners should oppose this proposal because the commitment to subsidize the project was based on a social purpose as well as an individual purpose. Forcing the project to compete solely on the basis of individual preferences ignores its original social purpose and provides no incentive for individuals to collectively choose to occupy the building, thereby providing the positive neighborhood effects associated with a viable project.

Conclusion

The HUD reinvention proposal exemplifies potential changes that would affect all housing providers. Housing suppliers, regardless of their profit motivation, are united in pursuing the best quality homes and communities for their customers. Their emphasis on housing and community and the financial means of their customers may be different, but all providers are united in their efforts to make federal assistance flexible and sustainable.

Transferring decision-making authority to state and local governments will take time and a period of readjustment. Keyes et al. provide issues and cautions for community housing providers to consider as federal policy evolves. However, the authors fail to consider the niche of community housing providers within the larger picture of housing provision. For projects that require networks of social services and housing support, nonprofit housing providers may possess a comparative advantage. The theory of competitive markets suggests that, for projects that require housing at the lowest cost, for-profit, market-driven housing providers possess a comparative advantage. In some cases, a cooperative effort is the best approach. In all cases, the most

appropriate provider should be locally determined by the needs of the project, not by an arbitrary federal allocation.

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The views expressed in this article are those of the author and should not be construed as representing the official views of the National Association of Home Builders.

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