

## **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*

The Keyes et al. article is an important contribution to the discussion of the future role of nonprofit organizations (NPOs) in the delivery of low-income housing. This article does a good job of examining networks and linking the NPO discussion to the concept of social capital. Also, the case studies provide informative empirical evidence. However, Keyes et al. has several weaknesses in the argument for NPOs. The lack of a careful explanation of the case for market failure is the primary weakness. The argument can also be strengthened by expounding on the problems of investing in low-quality housing. Other potential weaknesses include the difficulty of identifying stakeholders and the likely leakage of subsidies to NPO employees.

My comments echo the authors’ call for additional research about NPOs. More data and investigation are needed to determine the proper role of NPOs, whether they should serve a political purpose, how the services of NPO networks should be priced, and how efficient NPOs are relative to other private organizations that provide similar services.

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

### **Introduction**

The Keyes et al. article advocates the use of nonprofit organizations (NPOs) to provide affordable housing; more specifically, it argues that networks of these NPOs are highly desirable and in need of further support and development. The article is nicely written and organized and offers an important perspective on the future of federal housing policy. The major elements of a strong case for the authors’ position are included and explained. More generally, the article provides further evidence of our country’s long and admirable love affair with community and volunteer organizations. Unfortunately, from my perspective, the development of their case suffers from several problems. These problems are discussed and suggestions are made about the specific information that is needed to more fully evaluate the importance and potential of NPOs in the delivery of housing services.

## Summary of the case for NPOs

The authors offer an interesting and insightful summary of the current status of the long-time debate between demand- and supply-side policies to deliver housing services to various types of households thought to be underserved. In brief, they argue that the shift toward vouchers (demand side) and away from production programs (supply side) will not completely replace the need for supply-side programs. In their view, vouchers will not solve fundamental concerns about “place.” As a consequence, policy makers will remain interested in ways, albeit reduced, of delivering housing services to specific neighborhoods and locations thought to be underserved by the market.

NPOs are ideally suited to help in this regard because they are place- and community-oriented. Usually, they are composed of people from the community in question. As a consequence, they are knowledgeable of the neighborhoods and communities and have a strong interest in and incentive to improve the quality of these neighborhoods.

The authors also focus on an important and underexamined aspect: the nature and extent of the networks that exist among NPOs. The special role of the large national and regional organizations that serve individual NPOs is also examined.

## Highlights of the article

This article has many fine qualities. First, I learned much about the networks and the special role of the large NPOs. The discussion was especially helpful in clarifying the growing reliance of housing policy on these NPOs. Second, the authors link the discussion and investigation to an important concept: social capital. This idea is used more and more often in discussions of housing policy and community organizations; the discussion helps explain the concept and its applicability to housing policy. I view social capital in this context as a measure of the expertise and information among NPOs; an increase in such social capital, all else equal, increases the productivity of the NPO. Surely, housing policy can be improved if it promotes the development and measurement of social capital. Third, the article relies on case studies for empirical evidence. This approach is both informative and appropriate given the limited amount of systematic information available about NPOs in the implementation of housing policy.

## **Weaknesses in the case for more NPO involvement**

Despite these highly desirable qualities, the case for further NPO involvement in housing policy needs further development in several areas. These are briefly summarized below.

### *Case for market failure*

In a market-oriented society, the argument for government intervention should begin with a discussion of why market forces are incapable of providing the necessary resources. That is, what is the evidence for market failure? Such an argument is not offered in this article. Economists have long argued that low-income households reside in low-quality dwellings primarily because of their poverty; the housing market is not necessarily indicted by such an observation. The challenge to those who support the need for supply-side or "place" intervention is to demonstrate something further. Specifically, the argument must be made that the price of housing differs from the social cost of producing housing. Potential explanations for market failure include the existence of racial discrimination, the failure to internalize important neighborhood externalities, problems in the financing of low-income housing, and the importance of a decent dwelling to the opportunities for work by low-income households.

Although the difficulty of measuring the external costs and benefits of housing makes this a challenging assignment, I think making this case is especially important in today's environment for several reasons. First, evidence abounds of "government failure" in the delivery of housing services in the past 20 years or so, including failures in the multifamily mortgage co-insurance programs and the dilapidated status of many public housing programs. Given these failures, policy makers deserve a clearer explanation of why the government can be expected to do better than the market. Second, the growing evidence of a widening gap between the wages of unskilled and skilled labor and the still high vacancy rates in multifamily housing suggest that the affordability problems experienced by many low-income households may be attributable more to labor market failure than to housing market failure. Third, the optimal housing policy depends on the nature of the market failure. If the problem is related to the market for equity finance, then policies like the low-income housing tax credit seem more appropriate. If the problem is in the market for debt finance, then mortgage insurance may be appropriate. Exactly what is the source of market

failure that calls for the public support and reliance on NPOs? The authors should address this directly.

### *Problems of investing in marginal housing*

The authors are concerned that the viability of NPOs is sensitive to the strength of the housing market. They argue that the “flexibility is especially important to localities with soft housing markets.” The vulnerability of any housing investment to a soft housing market is a concern to any organization that invests in housing, whether run by the private sector, the government, or NPOs. To my way of thinking, a weak or soft housing market can also be labeled a buyers’ market, which seems to benefit low-income households. The primary goal of policy should not be the survival of a developer, whether this developer is an NPO or a private organization; improving the welfare of individuals is the primary focus of policy.

What the authors probably mean is that investment in housing at the low end of the quality distribution (marginal housing) is more risky than investment in other segments of the market. This logic might follow from a simple filtering model of housing. According to such a model, existing housing in the lowest range of housing quality is the most likely to be put out of service during periods of unexpected income growth. This may be true; however, the purchase price of such housing would be expected to be lower in response to this source of uncertainty. The best cure for such risk is likely to be accurate appraisals of the property, not operating subsidies to NPOs. Those NPOs that are best able to assess this risk will pay lower prices for the property and have a better chance of surviving unexpected weakness in the low end of the market. Those who are less able to do this will go out of business. Why should the incentives for accurate appraisal be any different for nonprofit organizations than for for-profit organizations?

### *Lack of stakeholders: Moral hazard problems*

Follain and Szymanoski (1995) provide a framework with which to analyze the case for government intervention in the market for debt-financed affordable housing. We specifically address one of the common complaints of NPOs: Mortgages are often difficult to obtain. Although this is a complex issue, we do argue that NPOs suffer from a problem less likely to be associated with for-profit organizations in the market for debt finance: Defining the

equity of the NPO in housing projects is more difficult. NPO employees and board members usually do not invest their own equity in the projects, and their compensation is not as dependent on the build-up of equity. Moreover, many of these organizations consist of volunteers from the community. Salaried employees of NPOs may have a stake in the success of the project, but no more than employees of for-profit organizations. These considerations lead us to conclude that NPOs are likely to be riskier borrowers than for-profit developers, all else equal, because the identification of the stakeholders in NPO projects is more difficult. As a consequence, we expect NPOs to encounter more difficulty in the mortgage market; for example, lenders may require tougher underwriting criteria in the form of higher down payments.

The authors do not address this case of what many refer to as a moral hazard problem. The solutions to the problem in the private market for housing consist of down payments, regular and accurate reports on income and balance sheets, and a good track record for investment and management. It would be interesting to know the authors' assessment of this problem for NPOs. Perhaps they would emphasize the offsetting and implicit asset associated with the NPO, social capital. If so, and if this is to be relevant in the market for mortgages, ways of measuring its value should be discussed.

### *Leakage to employees*

A standard complaint about all supply-side programs is that some of the subsidy is diverted from the tenants to the suppliers in the form of higher salaries, perks, and so on. Why would NPOs be immune to this potential for leakage? I think an analysis of the salaries, perks, and productivity of NPO employees and directors is needed to show otherwise. In brief, why take the chance that some portion of the subsidy goes to anyone other than the intended beneficiaries (low-income households)? The authors should address this point.

### *New role for government*

An increasing reliance on NPOs to deliver housing services alters but does not eliminate the role of government. Under the supply-side policies of the past 30 years or so, governments have played a major role in the production of housing; this will cease under new policies. Instead, government must become a monitor

of NPO performance. Standards must be established to measure NPO productivity. These standards will, in turn, require more and better data about NPO operations. Some questions include the following: Who should bear the cost of monitoring, the government or industry? (Under some environmental programs, a government monitor resides on-site with the private firm, and the cost of the monitoring is paid by the firm.) What would be the specific criteria used to evaluate NPOs? Would evaluations be based on the number of people served? Would some places receive higher priority than others? These are some of the issues in the current debate about the establishment of affordable housing mandates for Fannie Mae and Freddie Mac. I think the same kind of process is needed if greater reliance is placed on NPOs.

### **Specific information needed to evaluate the argument**

The type of research offered in this article is sorely needed. Indeed, the authors perform valuable research by focusing on case studies, which is an excellent way to study the general concept of social capital and the specific role of NPOs and NPO networks. However, the evidence offered in these case studies is almost exclusively qualitative in nature. Although qualitative information is interesting, quantitative evidence is needed to make a stronger case for the kinds of policies offered in this article. The following comments suggest areas in which more evidence is particularly needed and how some of this evidence might be assembled.

#### *How and where should NPOs intervene?*

The authors note the “geographic unevenness” in the distribution of NPOs among markets. Removing this inequality is recommended as a high priority for government and NPO networks. A discussion of the specific criteria by which this unevenness is assessed and addressed is missing. NPOs may not exist in some areas because the market for affordable housing functions reasonably well. In some areas the political process may be working fine. Of course, the political process may be part of the problem in those areas where strict rent control or excessive building and housing codes are enforced. For these reasons, it is necessary to have a better sense of the market and political circumstances under which NPOs are most successful. It would also be interesting to know about other aspects of organizational design that

lead to successful NPOs. For example, should a franchise approach be developed? How much control should be exerted by the central organization? These and many other questions must be addressed to remedy the geographical unevenness noted by the authors.

*Should NPOs be used to serve a political purpose?*

Although I am not a political scientist, it seems to me that the development of NPOs is a critical political issue. Perhaps they serve as important representatives of certain groups who are otherwise underrepresented in the political process. In this sense, they serve a potentially valuable role in conveying information to elected officials and their representatives. This "bottom-up" perspective on NPOs seems closer to the perspective held among many involved in NPOs. Although this role seems legitimate, the challenge is to be an important element in urban governance without being perceived as a partisan force. Providing government funds for partisan initiatives is probably a bad idea (witness the ongoing congressional debate regarding the lobbying activity of NPOs).

*How should the services provided by NPO networks be valued?*

If NPO networks continue to evolve, a natural question will arise: How will the central NPOs charge individual NPOs for their services? The value of these services will depend, in part, on the value of the social capital associated with the national or regional provider. Although some may consider the pricing of social capital unique to NPOs, my own sense is that the pricing issue is faced by many private organizations as well, especially organizations whose value depends on their knowledge of the industry. At a minimum, the problem may be akin to the pricing issues faced by national associations, such as the National Association of Realtors and the National Association of Home Builders. However, it may be closer to the relationships among private firms, which include franchises (e.g., automobile dealerships). In either event, a good portion of the price for services provided may depend on the value of the social capital.

*What is the comparative efficiency of NPOs?*

The push to place greater reliance on NPOs raises the need for better information about their performance. NPOs are forced to provide certain types of information for Internal Revenue Service purposes and may file U.S. Department of Housing and Urban Development reports if they receive certain types of financial assistance. Such information should be standardized and made comparable to the information provided about private development organizations. Key information should include net operating income, operating expense and its major components, mortgage information, payments and commitments to equity holders, and valuation of the property. In brief, comprehensive income and balance sheets should be provided on a regular basis. Information about the tenants of the properties is also needed to assess the social mission of the NPO. Once collected, the information should be evaluated to rank the NPOs in terms of their relative efficiency. Some suggestions for this work come from recent attempts to evaluate the efficiency of K–12 public schools (Ruggiero 1994).

**Final thought**

I was flying from a conference (about the role of nongovernmental government organizations in urban governance) in Berlin, Germany, to New York City when I first read this article. I was particularly struck by the authors' touching description of the experiences of those involved in NPO activities. These descriptions emphasized the cooperative efforts associated with NPO activity. I began thinking about the enormous amount of cooperation needed to fly me, my wife, and my luggage from Berlin to Syracuse. Cooperation was needed among pilots, flight attendants, baggage movers, customs agents, taxicab drivers, currency exchangers, and many more. The fact that most of these people were paid for their assistance does not taint their contributions, in my mind. My guess is that many of those involved were also pleased that they could be of service and that the trip went well. In this sense, some of the differences between the activities of these private agents and NPOs seem minor. In sum, NPOs do not have a monopoly on cooperative efforts or on the good feeling that comes from having done a good job. We ought to keep this in mind as we seek to judge the relative importance of NPOs versus for-profit firms.

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