3 Strategies for Producing Affordable Housing

SUMMARY

Despite various factors that potentially limit the production of affordable housing, many of the organizations that we surveyed helped produce affordable housing. For these organizations, government intervention—particularly in the form of financial assistance—is a crucial part of building affordable housing. Apart from obtaining government subsidies, however, there is no universal strategy to building affordable housing. On a case-by-case basis, project developers and local officials take advantage of various types of regulatory relief, such as zoning modifications and fee waivers. Some other states have taken a more prescriptive approach by requiring the development of affordable housing or mandating local government to provide regulatory relief. In the mid 1990s, Minnesota rejected these types of policies in favor of an incentive-based, voluntary program for the seven-county Twin Cities area under the Livable Communities Act of 1995. So far, the program has been only marginally successful in producing affordable housing.

As discussed in Chapters 1 and 2, housing costs have escalated in recent years, and several factors limit the production of affordable housing. However, despite these trends some affordable housing is being produced. In this chapter, we highlight examples of the strategies currently being used to produce affordable housing in Minnesota and elsewhere. This chapter addresses the following questions:

- **What strategies have developers, builders, local housing organizations, and cities in Minnesota used to overcome factors that might limit the production of affordable housing?**
- **What strategies have other states used to overcome these factors and encourage the production of affordable housing?**
- **How effective has the Livable Communities Act been in producing affordable housing in the Twin Cities metropolitan region?**

To answer these questions we surveyed and interviewed developers, builders, and local housing organizations. We also reviewed national literature on affordable housing activities. Finally, we reviewed statutes and reports related to the Livable Communities Act and interviewed Metropolitan Council and municipal government staff.

DEVELOPERS, BUILDERS, AND LOCAL HOUSING ORGANIZATIONS

Less than half of the developers and builders we surveyed produced affordable housing in 1999.

In our survey, we asked developers, builders, and local housing organizations if they had produced any affordable housing during 1999.[1] Forty-seven percent of the developers, 31 percent of the developers/builders, 27 percent of the builders, and 91 percent of the local housing organizations said they had produced affordable housing. We asked these companies and organizations, "What resources or strategies helped make it possible for your organization to produce affordable housing?" We found that:

- **According to survey respondents, government intervention—most often in the form of financial assistance—is crucial to producing affordable housing in Minnesota.**

Table 3.1 lists the resources and strategies reported by the organizations responding to our survey. Similar to their responses to other survey questions, their strategies were related to the role that they played. For example, local housing organizations, whose job it is to find the resources to meet the housing needs in their area, were most likely to report that government financial assistance is important. Builders, on the other hand, emphasized cost-saving measures, such as building on less expensive lots or building smaller or simpler units.

As discussed in Chapter 2, many levels of government, as well as philanthropic sources, provide financial assistance for affordable housing. The Minnesota Housing Finance Agency (MHFA) provides most of the state's financial assistance. Many of the surveys we received and interviews we conducted emphasized the importance of MHFA funding, and many of the people involved with providing affordable housing applauded the increase in MHFA funding over the last biennium.

EXAMPLES FROM MINNESOTA

Through telephone interviews with 76 developers, builders, and local housing officials, we identified examples of both single-family and multifamily affordable housing developments throughout the state. In the following sections, we briefly describe eight of these projects. Overall, we found that:

- **With the exception of obtaining government subsidies, there is no universal strategy to building affordable housing. On a case-by-case basis, project developers and local government officials took advantage of the available resources and strategies.**

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1 In our survey we defined "affordable housing" as a unit selling for less than $131,000 or renting for less than $683 (two bedroom) in metropolitan areas (Minneapolis/St. Paul, Duluth, Fargo/Moorhead, Grand Forks, La Crosse, Rochester, or St. Cloud); or selling for less than $90,000 or renting for less than $468 (two bedroom) in non-metropolitan areas (for greater detail see the questionnaire on our website at http://www.auditor.leg.state.mn.us/ ped/2001/pe0103.htm).

Obtaining government financing is an important strategy for building affordable housing.

Table 3.1: Resources and Strategies Used by Developers, Builders, and Local Housing Organizations

	Developers (N = 26)	Developers/ Builders (N = 25†)	Builders (N = 28†)	Local Housing Organizations (N = 120†)
Government Assistance				
Government financing	****	**	**	****
Helpful zoning	*	*	*	*
Fee reduction / waivers	*	*	*	*
Donated or low-cost land from local government	—	—	—	*
Local government advocacy	*	*	*	*
Cost-Saving Measures				
Building on cheaper lots	*	**	**	*
Building smaller/simpler units	*	**	**	*
Other cost savings	—	*	*	*
Private Sector Financial Assistance	*	*	*	*

NOTE: Rankings only include respondents who produced at least one unit of affordable housing in 1999.

**** 75 to 100 percent of respondents mentioned the strategy.
*** 50 to 74 percent of respondents mentioned the strategy.
** 25 to 49 percent of respondents mentioned the strategy.
* 1 to 24 percent of respondents mentioned the strategy.
— No responses.

†An additional 6 developers/builders, 11 builders, and 16 local housing agencies produced affordable housing in 1999, but did not answer the question regarding strategies.

SOURCE: Office of the Legislative Auditor's survey of developers, builders, and local housing organizations, July and August, 2000.

In most of our examples, financial assistance was combined with relief from government regulation, including zoning modifications and fee waivers. In a few cases, the savings from regulatory relief were substantial, but in most cases, the savings were less than $3,000 per unit. Although the savings from regulatory relief may be limited, they facilitate the development of affordable housing and stretch the limited financial resources that government devotes to affordable housing.

Chaska

In 1992, the Carver County Housing and Redevelopment Authority (HRA) began looking for office space. After being frequently stalled by high costs, the director went to the city of Chaska to inquire about potential properties on which to construct an office building. The city was in the process of acquiring properties for redevelopment and offered the HRA an old brick yard on which to construct a mixed-use building. The HRA bought the site for $150,000 with a deferred loan from city after the city spent more than $425,000 acquiring and cleaning up the contaminated site.

Chaska's brickyard development.

The building will have a mix of office, retail, and apartment space. Renovations have begun, and the HRA expects the project to be completed in early 2001. When completed, the HRA's offices will be located on the first floor, along with 2,200 square feet of retail space. Thirty-two apartments will occupy the upper floors and rent for $510 to $700 per month.

In some cases, relief from government regulations substantially lowers housing costs.

The HRA collaborated with the city to reduce the project's costs by $1.7 million ($54,000 per apartment) through zoning variances and fee reductions. For example, the city granted a zoning variance that allowed housing above commercial space and increased the allowable density three-fold to 64 units per acre, which reduced costs by $29,000 per unit. The city also granted a variance that reduced the required number of garage spaces per unit from two to one. This reduced land acquisition, demolition, soil correction, and construction costs by an average of $24,000 per unit. Finally, the city agreed to defer $40,000 in local fees, which reduced costs by $1,250 per unit.

These reductions decreased the project's total costs to $4.2 million, with the housing component accounting for $3.6 million. Chaska provided the primary funding for the housing component through $2.7 million in general obligation bond proceeds. The project is also receiving funding from other sources, including $450,000 from the Metropolitan Council's Inclusionary Housing Account.[2]

2 Julie Frick, (Carver County Housing and Redevelopment Authority), telephone interview by author, November 1 and December 20 and 28, 2000; Ryan Meisner (Frana and Sons, Incorporated), telephone interview by author, November 1 and December 8, 2000; Metropolitan Council, unpublished executive summary of funding recommendations for the Livable Communities Committee (Item 1999-18), December 10, 1999; and Carver County HRA, unpublished table titled "Development Budget," February 11, 2000.

Mankato

Some argue that businesses are reluctant to move into an area or expand if the area lacks affordable housing for their employees. The city of Mankato has adopted an innovative approach to address this issue. Under a demonstration project, the city is negotiating with businesses that receive the city's economic development subsidies to use 5 percent of the subsidy for affordable housing. For example, three businesses recently agreed to subsidize the sale of 15 homes that will sell for $120,000 to $130,000. Altogether the businesses are contributing $15,000, which will be combined with $45,000 from MHFA to provide each homebuyer $4,000 for down-payment assistance. To make these homes affordable, MHFA is subsidizing each homeowner's mortgage payments by an average of $18,000 in loans that do not require payments until ten years after the purchase and $67,000 from low-interest, 30-year mortgages.

The city helped reduce the selling price of the homes by waiving its sewer and water access charges—$2,000 for each home. In addition, the Minnesota Department of Trade and Economic Development provided $220,000 to help install the infrastructure for the 15 homes, which are in a low-lying area and require a sanitary sewer lift station.[3]

Plymouth

In a development called the Reserve, the city of Plymouth and its HRA are working with Rottlund Homes to make 25 townhomes of the 627 owner-occupied units affordable to lower-income households at prices of $120,000 to $134,000. The city reduced:

- Driveway construction and utility installation costs by $478 per home by decreasing the distance the homes are set back from the lot boundary by 11 feet, and

- Road construction costs by $720 per home by decreasing the road widths.

In other cases, regulatory relief makes little difference.

The regulatory relief provided by these efforts is minimal—less than 1 percent of the homes' cost. Nevertheless, the selling price still meets our definition of affordability for metropolitan areas ($140,000). As mentioned in Chapter 1, townhomes account for most of the new affordable housing for sale in the Twin Cities area. Although these homes are already affordable to some lower-income households, qualifying homebuyers will receive an average of $15,000 in additional financial assistance from various sources, including MHFA, the Metropolitan Council, the city, and others.[4]

3 Dan Jordet (city of Mankato), telephone interview by author, October 30 and 31, 2000; Sue Matzke (Petrie Development), telephone interview by author, October 30 and 31, 2000; and Petrie Development, unpublished table titled "Source and Use of Funds," undated.

4 Metropolitan Council, unpublished executive summary of funding recommendations for the Livable Communities Committee (Committee Agenda Item SW 2000-476), October 2, 2000; Rebecca Stoen (city of Plymouth), letter to Reed Erickson of the Minnesota Housing Finance Agency, August 14, 2000; and Rebecca Stoen, unpublished description of funding sources, undated.

St. Paul

CommonBond Communities, a nonprofit provider of affordable housing and support services, recently purchased and rehabilitated a complex of seven deteriorating apartment buildings near the St. Paul Cathedral. Before CommonBond's intervention, the buildings were 50 percent vacant and in danger of converting from affordable units under the federal government's Section 8 program to market-rate housing. Many of the nearby buildings had recently converted to upscale apartments and condominiums, and CommonBond pursued the project in part to demonstrate how to successfully maintain and operate low-income housing in such a neighborhood.

CommonBond's Cathedral Hill apartments.

Some projects receive no regulatory relief.

CommonBond rehabilitated the buildings, which remain in the Section 8 program, at a cost of $133,000 per unit. To serve large families, CommonBond increased the average living space per unit and reduced the number of units from 93 to 60. In addition, it added an "advantage center" that provides tenants with services, such as job training, English-as-a-Second Language classes, and children's activities. While CommonBond did not use any specific strategies to reduce its costs, it received government financing. Low-income housing and historic preservation tax credits subsidized 57 percent of the total costs and MHFA mortgages financed 20 percent.[5]

Farmington

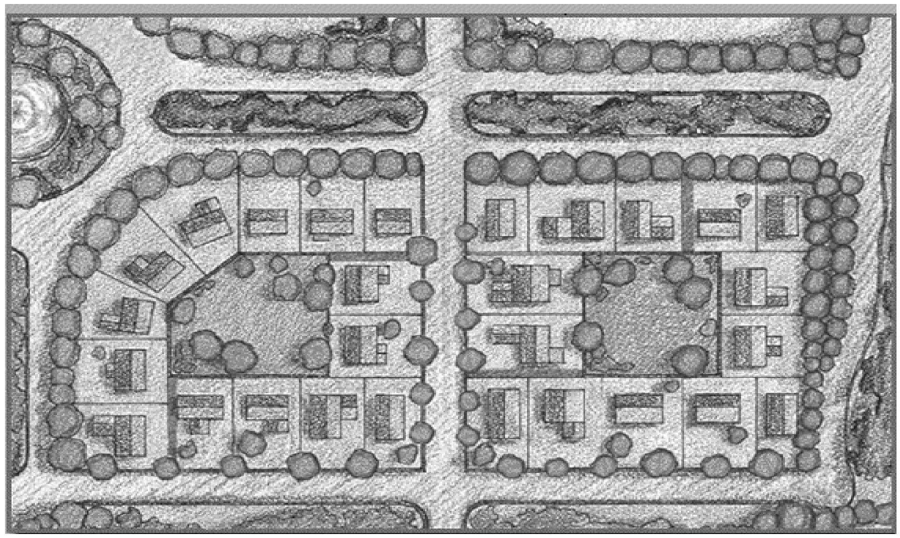
The city of Farmington recognized the need for housing, especially affordable housing, in the early 1990s. At that time, a task force of local officials worked with a developer and the Center of the Urban American Landscape on a plan for a subdivision, called East Farmington, that would accommodate projected population growth while maintaining the small town image and character of Farmington.

East Farmington is a 180-acre development of 374 single-family homes and 16 multifamily units. Now in its seventh and final phase of development, single-family homes are currently selling for $120,000 to $150,000. Three factors account for the relatively low prices. The developer was able to:

- Plat smaller lots – 6,000 to 8,000 square feet;

5 CommonBond Communities, unpublished project description and budget information, undated; and Joe Errigo (CommonBond Communities), interview by authors at the Cathedral Hill Apartments, St. Paul, June 22, 2000.

Figure 3.1: East Farmington Lot Layout



SOURCE: Metropolitan Council, unpublished document. Drawing by Derek Young, Landscape Architecture, for Sienna Corporation.

- Purchase the undeveloped land, which had major drainage problems, for only $8,000 to $10,000 an acre; and

- Obtain tax-increment financing to pay for soil correction and a new waterway that corrects a citywide storm water drainage problem.

East Farmington has a unique design of shared open space and varying housing styles. As shown in Figure 3.1, small parks are situated in the center of each city block with the backyards of 14 to 16 homes adjoining each park. In addition, besides redistributing ground water to the Vermillion River, the new waterway provides park space, wildlife habitation, storm water filtration, and flood control.[6]

Albert Lea

In 1998, the city of Albert Lea initiated a request for proposals for affordable rental housing to meet the city's economic development and workforce needs. Construction of 24 rental townhomes in Pickerel Park will be completed in 2001. Twelve two-bedroom units will rent for $347 a month, and 12 three-bedroom units will rent for $455. The city reduced the project's costs by waiving $34,000 in park dedication, sewer, and water fees and provided $107,000 in tax increment financing for street and utility extensions. The remaining $2.2 million in costs

6 David Olson (city of Farmington), telephone interview by author, October 27, 2000; Rod Hardy (Sienna Corporation), telephone interview by author, October 31 and December 20, 2000; and Sienna Corporation, unpublished project documents, undated.

were financed primarily with $1.3 million from low-income housing tax credits and $500,000 from the Community Development Block Grant program.[7]

Minneapolis

Humboldt Greenway is a redevelopment project in North Minneapolis designed to revitalize an area with deteriorating houses and home values. Aimed at attracting mixed-income homebuyers, the project will be completed in three phases. In Phase I of the project, Hennepin County and the Minneapolis Community Development Agency will develop 36 townhomes and 58 single-family homes. The total cost for each of these units will average over $255,000. The costs would have been even higher if the city had not reduced lot widths from the standard 50 to 55 feet to 42.5 feet, which reduced costs by $25,000 per lot.

The county and city further reduced the average unit cost from $255,000 to $168,000 by selling the site to the developer for $8.2 million less than it cost Hennepin County to acquire and clear the land, which had existing homes. Finally, the city hopes to reduce homebuyer costs for 40 of the 94 homes to about $149,000 by receiving $750,000 ($19,000 per unit) in assistance from MHFA's Community Revitalization Fund and the Metropolitan Council's Inclusionary Housing Account.[8] A $149,000 house is affordable for a household earning 80 percent of the Twin Cities metropolitan area median family income with a 10 percent down payment and a mortgage interest rate just over 7 percent.

Rothsay

Inmate labor is an innovative strategy that has been used to build affordable housing.

The state's Institution/Community Work Crew Affordable Homes Program reduces construction costs by providing inmate labor to housing projects in outstate Minnesota. Under this program, the Department of Corrections recently helped build a three-bedroom rambler with an attached garage in Rothsay, Minnesota. This home with 1,050 square feet of finished space sold for only $65,000. Besides prison labor, a land donation from the city and discounts on building materials led to the low price.

Since the inmate labor program's creation in 1998, 27 new homes have been built, 18 are in final construction, 19 homes have been rehabilitated, and another 60 houses have been repaired. On average, 25 minimum-security inmates participate in the program and earn up to $1.50 an hour. According to the program director, builders would typically pay $10 to $12 an hour for similar labor. However, inmate labor does not account for all labor costs. Technical work such as plumbing, heating, electrical, and excavation is subcontracted at market rates. The Associated General Contractors of Minnesota sponsors classroom training in

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7 Newbury Development Company, unpublished project documents, undated; and Denise Derscheid (Newbury Development Company), telephone interview by author, October 5 and November 1, 2000.

8 Metropolitan Council, unpublished executive summary of funding recommendations for the Livable Communities Committee (Committee Agenda Item SW 2000-476), October 2, 2000; Cynthia Lee (Minneapolis Community Development Agency – MCDA), letter to Reed Erickson (Minnesota Housing Finance Agency), July 27,2000; Cynthia Lee, telephone interview by author, November 8 and January 3, 2000; and MCDA, unpublished project description and budget documents, undated.

construction skills to the inmates; and local nonprofit agencies, housing and redevelopment authorities, and community action councils develop the projects and sell the homes to households with annual incomes of $10,000 to $41,000.[9]

STRATEGIES USED IN OTHER STATES

As the above examples illustrate, developers and builders often work with local agencies on a case-by-case basis to reduce housing costs through regulatory relief. Several other states have taken more prescriptive approaches by adopting policies that require the development of affordable housing or mandating zoning modifications and other types of regulatory relief for developments that include affordable housing. In 1992, the United States Office of Housing and Urban Development issued *Removing Regulatory Barriers to Affordable Housing: How States and Localities are Moving Ahead*, which provides profiles of these policies.[10] Below, we summarize some of the strategies that the Minnesota Legislature could consider. In the section following these examples, we discuss the Livable Communities Act—Minnesota's current alternative to these more prescriptive strategies.

Montgomery County, Maryland

In Montgomery County, large developments must include affordable housing.

Montgomery County's inclusionary zoning program is often cited as an innovative strategy for increasing the production of affordable housing. Under the program, between 12.5 and 15 percent all units in a residential development of 50 or more units must be affordable for lower-income households. To partially offset the cost of providing lower-income housing, the county increases the development's density 22 percent above the otherwise maximum allowable density.

Nearly 250 units of affordable housing were constructed in 2000 under this program, bringing the total number of units to approximately 11,000 since 1974. A recent example of the program is the Hurley Ridge single-family housing development in Germantown. Without the inclusionary zoning program, the development would have included 110 market-rate single family homes. Instead, the development includes 113 market rate homes and 20 moderately-priced homes. Six of the moderately priced homes will be purchased by the county's housing authority and rented to low-income households.[11]

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9 Ronald Solheid (Minnesota Department of Corrections), interview by author at the Office of the Legislative Auditor, St. Paul, November 17, 2000.

10 United States Department of Housing and Urban Development (HUD), *Removing Regulatory Barriers to Affordable Housing: How States and Localities are Moving Ahead* (Washington DC: HUD, December 1992).

11 Eric Larsen (Director, Moderately Priced Dwelling Unit Program, Montgomery County, Maryland), telephone interview by author, November 14 and 15, 2000; Russ Adams (Alliance for Metro Stability), interview by authors at the Alliance for Metro Stability, Minneapolis, November 7, 2000; and Russ Adams, "Inclusionary Housing: How the Model has Worked in Other States," *Common Ground* (Winter 1999), 7.

California

In California, local governments must provide regulatory relief to developments with affordable housing.

California has a policy similar to Montgomery County, Maryland, but housing developers are not required to participate. Under California law, local governments must increase a development's density by at least 25 percent above the otherwise maximum allowable density if the developer chooses to make at least:

- 20 percent of a development's units affordable for households with incomes below 80 percent of the median family income; or
- 10 percent of the units affordable for households with incomes below 50 percent of the median family income.

Developers can also take advantage of the increased density provision if they construct senior housing. Besides the increased density, cities must provide additional incentives, including reduced development or zoning standards, other regulatory savings, or financial assistance. According to the California Local Governments Commission, 45 cities and 7 counties have gone one step farther and have required developers to provide affordable housing. The percentage requirement for affordable housing in these communities ranges from 5 percent in Coronado, California to 35 percent in Davis, California.[12]

Massachusetts

The state of Massachusetts can override local zoning restrictions.

The state of Massachusetts has adopted a set of procedures that effectively allows the state to over-ride local zoning restrictions for certain affordable housing developments. In 1969, Massachusetts passed legislation setting the goal that 10 percent of each municipality's housing stock should be subsidized for low-income households. To achieve the goal, the state enacted a process through which developers can get waivers from local regulations that limit the construction of subsidized housing. Public agencies and developers who want to build federal- or state-subsidized housing can apply for a comprehensive permit from their local zoning boards—"one-stop shopping" for all local approvals, including zoning modifications and permits. In developing a comprehensive permit, the zoning board works with the other local entities normally involved in the permitting process (including the city council) to balance the community's need for affordable housing with other planning and environmental concerns.

If a municipality's local zoning board denies a comprehensive permit or grants it with conditions that make the project financially infeasible and less than 10 percent of the municipality's housing stock is subsidized, the developer can appeal the decision to the state's Housing Appeals Committee (HAC). The HAC has the authority to issue its own comprehensive permit and preempt local regulations, including zoning restrictions. During the appeals process, the burden falls on the municipality to prove that there are valid health, safety, environmental, design, open space, or other concerns that outweigh the need for subsidized

12 Robert Maus, (California Department of Housing and Community Development), telephone interview by author, November 28, 2000. The California law is government code section 65915.

housing. In the end, a municipality can either accommodate subsidized housing (for example, by allowing higher densities) or argue its case before the HAC.

Because of the decentralized nature of the process, it is difficult to determine how many affordable housing proposals developers have presented to local zoning boards since the program began. The Chair of the HAC estimates about 1,000 proposals have been presented. Of the more than 300 appeals that developers have brought to the state, the HAC has written over 100 substantive decisions, and about one-third of the decisions approving a housing development have been appealed in the courts. To date, no comprehensive permit issued by the HAC has been over overturned in court. However, only 23 of Massachusetts' 351 municipalities have achieved the 10 percent threshold for subsidized housing—the majority of which are cities rather than suburban or rural communities.[13]

New Jersey

New Jersey courts have required municipalities to provide affordable housing.

In a series of decisions involving the township of Mount Laurel (1975, 1983, and 1986), the New Jersey Supreme Court ruled that, under the general welfare provision in the state's constitution, municipalities cannot exclude housing for low- and moderate-income households. In addition, the court ruled that localities must provide their fair share of affordable housing and authorized specific judicial remedies to ensure that municipalities meet these obligations.

In 1985, the New Jersey Legislature established an alternative to court action by creating the Council on Affordable Housing (COAH), which defines regional needs for affordable housing, develops guidelines for municipalities to meet their fair share requirements, and reviews local housing plans. If a municipality elects the COAH process and has its housing plan certified, it has a level of protection from judicial remedies. The COAH process provides municipalities with a range of options to meet their affordable housing needs, such as (1) granting increases in density to developers in exchange for building affordable housing, (2) collecting development fees on residential and nonresidential projects to subsidize affordable housing, and (3) transferring a portion of their affordable housing obligation to another municipality.[14]

MINNESOTA'S LIVABLE COMMUNITIES ACT

The 1995 Livable Communities Act (LCA) is one of Minnesota's recent attempts to encourage the production of affordable housing in the Twin Cities seven-county area.[15] The LCA is a voluntary, incentive-based program administered by the

13 Werner Lohe, "The Massachusetts Comprehensive Permit Law: Collaboration Between Affordable Housing Advocates and Environmentalists," *Land Use & Zoning Digest* (May 2000), 3-9; and HUD, *Removing Regulatory Barriers to Affordable Housing: How States and Localities are Moving Ahead,* 15-18.

14 Sinda Mitchell, *COAH Handbook, 2000-2001* (Trenton, NJ: Council on Affordable Housing), 3; and HUD, *Removing Regulatory Barriers to Affordable Housing: How States and Localities are Moving Ahead*, and 23-25.

15 *Minn. Stat.* (2000) §§473.25-473.255.

Metropolitan Council. The LCA is not strictly an affordable housing program, but rather a community development program that emphasizes affordable housing. We examined the program's affordable housing components, and found that:

- **The Livable Communities Act has been only marginally successful in producing affordable housing in the Twin Cities metropolitan area.**

Minnesota's Livable Communities Act is a voluntary, incentive-based program.

The LCA is relatively weak by design. During each of the two legislative sessions prior to its 1995 passage, the Legislature adopted a more stringent housing bill. The Comprehensive Choice Housing Bill would have required the Metropolitan Council to declare annually whether each municipality in the metropolitan area provided a pre-determined "fair share" of affordable housing. Municipalities that failed to do so could have satisfied the requirements of the act by complying with the Metropolitan Council's directions to (1) eliminate barriers to affordable housing, (2) allow proposed affordable housing developments in the community, and (3) preserve the affordability of existing housing into the future.[16] Municipalities unwilling to meet the requirements would have faced serious penalties, including a loss of state revenue-sharing payments and the ability to use tax increment financing. Although the penalties were removed from the final version of the bill in both 1993 and 1994, Governor Carlson still vetoed the bill in both years.[17] In the end, the Livable Communities Act replaced requirements and penalties of the earlier bill with voluntary participation and incentives.

As shown in Figure 3.2, 104 of 186 metropolitan municipalities currently participate in the program, including Minneapolis, St. Paul, and nearly every major suburb. Municipalities that elect to participate in the LCA must negotiate housing goals with the Metropolitan Council.[18] The goals address (1) affordable housing, (2) the mix of rental versus owner-occupied housing, and (3) housing density. In reviewing the goal-setting process, we found that:

- **The Metropolitan Council bases each municipality's affordable housing goals on its location and level of development, *not* on projected needs for affordable housing.**

Each municipality's affordable housing goals are based on "benchmarks" that the Council developed by determining the average proportion of affordable housing in municipalities within similar geographic locations and at similar stages of growth and development. If the proportion of affordable housing in a municipality is below the benchmark, the Council attempts to negotiate goals that would increase the proportion of affordable housing. Some municipalities already meet or exceed the benchmark range, including Minneapolis, St. Paul, and several older suburbs. These municipalities typically have goals of "maintaining within the benchmark"—which does not include producing additional affordable housing. Thus, the LCA goals-setting process encourages increased production of

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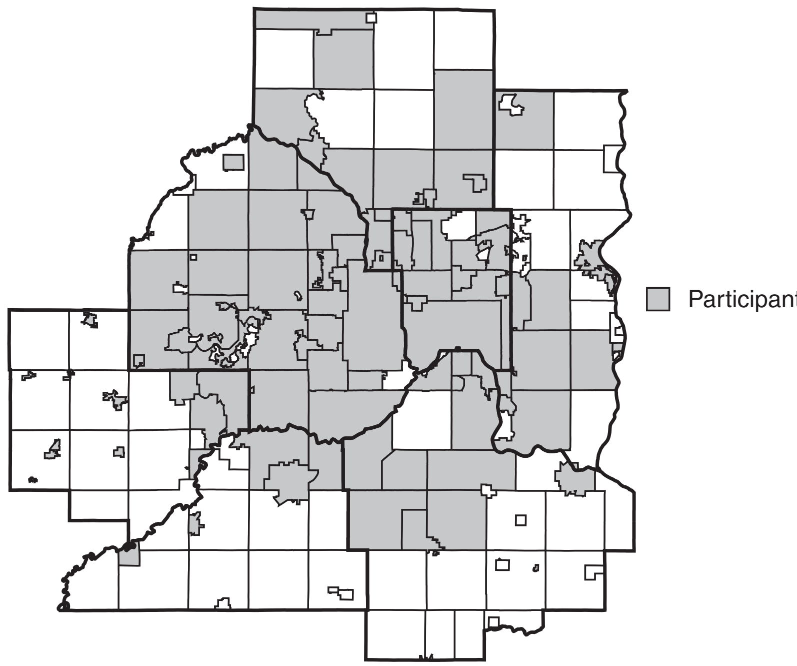
16 Myron Orfield, *Metropolitics* (Washington D.C.: Brookings Institution Press, 1997), 114-15 and 131-33. Also see, *Comprehensive Choice Housing Act of 1993*, 77th Session (House File 671), and *Comprehensive Choice Housing Act of 1994*, 78th Session (House File 2171).

17 Orfield, *Metropolitics*, 121 and 131.

18 Technically, communities elect to participate in the Local Housing Incentive Accounts program, which enables them to compete for LCA funding (*Minn. Stat.* (2000) §473.254).

Figure 3.2: Participants in the Livable Communities Act, 2000



SOURCE: Metropolitan Council.

Few municipalities produce affordable housing consistent with their Livable Communities Act goals.

affordable housing in the developing suburbs, but is *not* linked to the region's affordable housing needs.

The Metropolitan Council estimates that if each municipality met its affordable housing goals, 77,200 new affordable units would be added to the region between 1995 and 2010, including 12,600 rental and 64,600 owner-occupied units.[19] But few municipalities have produced affordable housing at a rate consistent with their LCA goals. Based on affordable housing production rates between 1996 and 1998, the Council estimates that the region will produce only 84 percent of the anticipated units by 2010. However, the Council acknowledges that this estimate is probably too high because land costs were not explicitly factored into the home values reported in 1996 and 1997.[20] Table 3.2 shows the Twin Cities metropolitan area municipalities that produced the most housing in 1998 and the percentage of affordable units produced by each.[21] The 1998 data included land costs.

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19 John Kari and Guy Peterson (Metropolitan Council, Livable Communities and Housing Division), memorandum to Housing and Land Use Advisory Committee, July 26, 2000.

20 Metropolitan Council, *Report to the Legislature on Affordable and Life-Cycle Housing*, (St. Paul, December 1999), 14.

21 According to data from the Council's LCA survey, 55 percent of the affordable units built in 1998 were either duplexes, townhomes, or quads (Metropolitan Council, *Report to the Legislature on Affordable and Life-Cycle Housing*, Appendix 4 and 16).

Table 3.2: Twin Cities Area Communities Producing the Most Housing, 1998

	Total Units Produced	Affordable Units	Affordable Units as Percentage of Total Production
Woodbury	1,854	707	38%
Lakeville	680	97	14
Shakopee	643	388	60
Blaine	587	252	43
Savage	511	64	13
Maple Grove	450	67	15
Chanhassen	425	144	34
Inver Grove Heights	398	130	33
Brooklyn Park	378	23	6
Coon Rapids	308	274	89
Eden Prairie	308	79	26
Minneapolis	301	98	33
Farmington	300	173	58
Apple Valley	295	44	15
Plymouth	288	71	25
Eagan	273	102	37
Champlin	233	56	24
Minnetonka	230	6	3
Lino Lakes	220	29	13
Cottage Grove	218	91	42
Prior Lake	214	28	13
Burnsville	213	160	75
Waconia	197	97	49
Chaska	195	43	22
Rosemount	190	65	34

NOTE: Communities that did not report housing production or affordability information to the Metropolitan Council are excluded from the table (including Bloomington).

SOURCE: Office of the Legislative Auditor's analysis of data from Metropolitan Council, *Report to the Minnesota Legislature on Affordable and Life-Cycle Housing* (St. Paul, December, 1999), Appendix 4 and 16.

We think there are shortcomings with the system of benchmarks and goals that the Metropolitan Council has implemented. For example:

- **While the Council collects data on each municipality's housing supply, reflecting the addition of new units and the loss of affordable units through market inflation, it does not use these data in administering the LCA program.**

For example, in 1995 the Council estimated that 69 percent of the single-family homes in Burnsville were affordable. By 1997 the proportion had fallen to 46 percent, according to the Department of Revenue data published by the Council.[22] Despite this change, the Council has not changed the affordable housing profile of Burnsville, or other municipalities, that the Council uses for administering the

22 *Ibid*., Appendix 9.

LCA. Metropolitan Council staff indicated to us that the Council is likely to revise the LCA's benchmarking and goal-setting system after the 2000 census data are released.

Besides negotiating goals with the Metropolitan Council, participating municipalities must also show that they have spent a statutorily-defined amount of money on affordable housing each year.[23] Municipalities can satisfy the requirement by allocating funds over which they have discretion to affordable housing, including facilitating federal funding of local projects and supporting their local housing and redevelopment agency. According to the Metropolitan Council:

- **In practice, nearly every municipality has easily met the Livable Communities Act's spending requirement for affordable housing.**[24]

The LCA spending requirement is a complex formula that requires municipalities that have experienced an increase in the number of very expensive homes, either through new housing or market appreciation, to spend more on affordable housing. In practice, most participating municipalities are required to spend less than $10,000 annually, and many have requirements below $2,000. In 1998, Eden Prairie had the highest requirement ($111,068), followed by St. Paul ($76,776), Minneapolis ($51,585), and Apple Valley ($38,022).

The Metropolitan Council cannot reject inadequate housing action plans.

Beyond the actual requirements, the LCA sets forth additional expectations for participating municipalities. For example, every municipality that participates in the LCA is expected to "identify to the Council the actions it plans to take to meet the established housing goals."[25] But, the Metropolitan Council is not empowered to reject inadequate housing action plans, and the action plans are not legally binding documents. Similarly, the LCA requires the Metropolitan Council to prepare annually a "comprehensive report card on affordable and life-cycle housing in each municipality,"[26] but municipalities are not mandated to provide the Metropolitan Council with the information necessary to produce an accurate and comprehensive report. While many municipalities have undertaken serious housing action plans and have completed the annual Livable Communities Act survey, the Metropolitan Council's lack of statutory authority in these areas hinders its ability to monitor each municipality's progress toward the negotiated housing goals.

As an incentive for participation, municipalities can compete for grants from the Livable Communities Fund, which is made up of the four accounts shown in Table 3.3. Compared with many of the programs administered by the Minnesota Housing Finance Agency (MHFA), the accounts in the Livable Communities Fund

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23 The "affordable and life-cycle housing opportunities amount" (ALHOA), is defined in *Minn. Stat.* (2000) §473.254, subd. 4.

24 Metropolitan Council, *Report to the Legislature on Affordable and Life-Cycle Housing*, Appendix 13. Council staff indicated that North Oaks is the only community ever required to contribute the amount toward a housing fund at the year's end because of failing to expend the amount during the year. North Oaks no longer participates in the LCA.

25 *Minn. Stat.* (2000) §473.254, subd. 2.

26 *Minn. Stat.* (2000) §473.254, subd. 10. "Life-cycle housing" refers to housing appropriate for each stage of life (e.g., rental housing for young adults and supported living for seniors).

Table 3.3: Accounts in the Livable Communities Act Fund

Tax Base Revitalization Account (TBRA)
This account funds "the cleanup of polluted land in the metropolitan area."[1] The TBRA is the largest account in the fund, accounting for approximately half of the fund's grants ($5.4 million to $8 million annually). This account is administered in coordination with the Department of Trade and Economic Development's Contaminated Site Cleanup Program,[2] and Minnesota Pollution Control Agency staff reviews applications for TBRA funding.

Livable Communities Demonstration Account (LCDA)
These grants fund "smart growth" initiatives, including projects that (1) interrelate development and transit, (2) interrelate affordable housing and job growth, (3) promote compact development, (4) involve mixed income development, or (5) "encourage public infrastructure investments which connect urban neighborhoods and suburban communities."[3] The LCDA is the second largest account in the fund, granting $4.0 million to $5.8 million annually. A 17-member Livable Communities Advisory Committee reviews applications for LCDA funding.

Local Housing Incentives Account (LHIA)
This account funds both affordable and life-cycle housing projects.[4] The LHIA is the smallest of the three original accounts, providing grants totaling $625,000 to $1,935,000 annually. Communities are required to match the grants from this account dollar for dollar. The Metropolitan Council administers this account through the Metropolitan Housing Implementation Group's "super RFP" process, which enables applicants to simultaneously apply for funding from the Minnesota Housing Finance Agency, the Metropolitan Council, and philanthropic organizations. Nearly all of the grants provided through this account are small, $200,000 or less, and make up only a fraction of project costs (most projects are in the $3-$5 million range).

Inclusionary Housing Account (IHA)

This is the newest account in the fund, established in 1999, and the only account funded by a legislative appropriation, rather than the Metropolitan Council's tax capacity. Grants from this account target projects that "(1) use innovative building techniques or materials to lower construction costs while maintaining high quality construction and livability; (2) are located in communities that have demonstrated a willingness to waive local restrictions which otherwise would increase costs of construction; and (3) include units affordable to households with incomes at or below 80 percent of area median income."[5] The Legislature provided a one-time appropriation of $4.0 million for the 2000-01 biennium and the Metropolitan Council has since committed all the funding by assisting 11 projects. Like the LHIA, the Council administers the IHA through the super RFP process in conjunction with the Minnesota Housing Finance Agency and others.[6]

[1] *Minn. Stat.* (2000) §473.252, subd. 3.

[2] LCA participation is also required for Twin Cities metro area communities interested in receiving funds from DTED's $6.2 million annual Contaminated Site Cleanup Program. Thus, between two programs, LCA participation enables communities to compete for $11 million. In recent years virtually all of the TBRA funds have gone to fully-developed communities, primarily Minneapolis and St. Paul.

[3] *Minn. Stat.* (2000) §473.25.

[4] *Minn. Stat.* (2000) §473.254, subd. 5.

[5] *Minn. Stat.* (2000) §473.255, subd. 2.

[6] The Minnesota Housing Finance Agency was also awarded $4.0 million for the *non*metropolitan innovative and inclusionary housing program (under *Minn. Stat.* (2000) §462A.2093; *Minn. Laws* (1999) ch. 223, art. 2, sec. 54).

Participating communities can compete for limited funding for affordable housing.

provide relatively little funding. In addition, the two accounts specifically designated for affordable housing—the Local Housing Incentives Account (LHIA) and the Inclusionary Housing Account (IHA)—are the smallest accounts in the fund.[27] Furthermore, the Legislature only provided the IHA with a one-time appropriation for the 2000-01 biennium. Metropolitan Council staff indicated that they annually receive several more proposals for affordable housing projects than they are able to fund.

As another incentive for LCA participation, the Metropolitan Council must "give consideration to a municipality's participation" when making discretionary funding decisions.[28] According to staff, the Metropolitan Council did not link LCA participation with discretionary spending decisions before 1999. However, the current council is more interested in doing so. For example, the Metropolitan Council recently incorporated LCA participation into the criteria for two sets of grants administered by the Environmental Services Division—the Metro Environment Partnership program, and a program related to storm water run-off. In 2000, Mahtomedi's application for a grant from the latter program was not fully funded because the city did not participate in the LCA at the time.

In reviewing the LCA statute and discussing the program with Metropolitan Council staff and others, we found that:

- **The Livable Communities Act rewards participation, not performance; a municipality does not need to increase its supply of affordable housing to receive benefits from the program.**

There are three possible explanations for this. First, the statute explicitly mentions that discretionary funding decisions can be linked with "participation," without explicitly indicating whether participation includes actually making progress toward the act's goals.[29] At the same time, the Metropolitan Council's *Regional Blueprint* states that the Council will "give priority for regional infrastructure investments or expenditure of public dollars to municipalities that have implemented plans to provide their share of the regions low- and moderate-income … housing opportunities."[30] The policy goes on to state that, "six months after establishing criteria for reviewing housing elements of comprehensive plans, [the council shall] take into account the progress made by cities toward life-cycle and affordable housing goals when making discretionary housing decisions."[31]

Second, Council staff told us that linking funding to a municipality's success in producing affordable housing could be counterproductive because performance-based evaluations may discourage municipalities from participating in the program, especially those that are not inclined to consider affordable housing. Additionally, denying municipalities the opportunity to compete for

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27 As noted in Table 3.3, affordable housing is also one of many goals set for the Livable Communities Demonstration Account (LCDA) in statute. Council staff indicated that most projects that have recieved LCDA grants include an affordable housing component.

28 *Minn. Stat.* (2000) § 473.254, subd. 1 (b).

29 *Ibid.*

30 Metropolitan Council, *Regional Blueprint* (St. Paul, 1996), 57.

31 *Ibid.*

affordable housing funds only adds to the difficulties that municipalities have in producing affordable housing.

Third, maintaining an adequate supply of affordable housing is very difficult. As we noted in Chapters 1 and 2, housing prices are rising rapidly in the current market, and the production of affordable housing typically requires financial assistance. A 1997 report by a task force studying the LCA found that there were not enough subsidies available to enable municipalities to meet the affordable housing goals negotiated by LCA participants.[32]

Despite the arguments against linking funding decisions to the production of affordable housing, the LCA directs the Metropolitan Council to create "incentives for developing municipalities to include a full range of housing opportunities."[33] The Council has recently taken steps in this direction by developing a proposal to include affordable housing considerations in the criteria it uses to award community development, environmental protection and clean up, and transportation funding.[34] Under the proposal, a maximum of 100 points out of the Council's 1,400 point system for rating funding requests will be linked to a municipality's (or sub-region's) supply of affordable housing.[35] An additional 250 points will be linked to "smart growth" initiatives, which the Council contends will also bring down housing costs.

The Livable Communities Act has led some municipalities to focus more attention on affordable housing.

Despite the criticism and shortcomings noted above, the Livable Communities Act has caused municipalities in the Twin Cities metropolitan area to focus some additional attention on providing affordable housing. Metropolitan Council staff said that this is one of the LCA's main benefits. Although many municipal officials that we interviewed said that their communities were attempting to address affordable housing needs prior to the LCA, many also indicated that the LCA had caused their communities to focus additional attention on affordable housing. Some specifically mentioned developing housing action plans, while others noted applying for LCA funding. Officials from municipalities that received LCA funding generally indicated that this funding was a small but crucial part of financing projects in their community. We also found limited evidence that community officials sometimes use LCA requirements to build community support for providing additional housing opportunities.[36]

While outstate Minnesota lacks an equivalent to a Livable Communities Act to encourage affordable housing, the Legislature also created the Economic Vitality and Housing Initiative (EVHI) in 1995. The EVHI was established to counteract

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32 The Livable Communities Housing Task Force, *Promises Deferred: Analysis of the Affordable Housing Provisions of the Livable Communities Act* (St. Paul: The Livable Communities Task Force, 1997), 13-17.

33 *Minn. Stat.* (2000) §473.25.

34 Ted Mondale, Metropolitan Council Chair, and Matthew Ramadan, Livable Communities Committee Chair, to Local Official or Interested Person, November 15, 2000, letter. The Council currently plans to hold public hearings in February and adopt the new policy in March, 2001.

35 John Kari, Guy Peterson, and Bill Dermody (Metropolitan Council), memorandum to the Livable Communities Committee, August 25, 2000.

36 For example: Heather Johnson, "Lakeside Townhomes Foes get no Satisfaction," *St. Paul Pioneer Press*, November 5, 1999, 2B; Nancy Ngo, "Owned vs. Rented Units Debated," *St. Paul Pioneer Press*, February 19, 2000, 1B; Mike Kaszuba, "Maple Grove Nails a Winning Strategy," *Minneapolis Star Tribune*, November 18, 1999, 1B.

Outstate Minnesota lacks an equivalent to the Livable Communities Act.

potential reluctance from businesses to locate or expand in areas that do not have enough affordable housing for their employees. The 1995 EVHI legislation stated:

> The Minnesota Housing Financing Agency may establish an economic vitality and housing initiative to provide funds for affordable housing projects in connection with local communities' economic development and redevelopment efforts. The purpose of the economic vitality and housing initiative is to provide resources for affordable housing in communities throughout the state necessary to ensure the expansion and preservation of the economic base and employment opportunities.[37]

The MHFA funds the initiative, primarily through its Affordable Rental Investment Fund, Community Rehabilitation Fund, and Capacity Building Grant. The first two programs are described in Tables 2.7 and 2.8, while the last program is a flexible pool of funds for increasing a region's capacity to maintain or create affordable housing.

In addition, the EVHI created six regions in outstate Minnesota. Housing, economic development, and related organizations in each region have created regional advisory groups to work with MHFA staff. These advisory groups:

- Develop investment guidelines that (1) outline the type of development that the region needs, (2) set priorities for regional investment, and (3) identify areas experiencing significant economic growth;
- Inform MHFA staff about regional trends, economic activity, and housing needs;
- Decide how the regional Capacity Building Grant should be spent; and
- Provide a forum for better housing resource coordination and information sharing.

MHFA staff meets with each regional advisory group quarterly and uses the advisory groups' investment guidelines in making its funding decisions.[38]

CONCLUSION

In Minnesota, most affordable housing is produced through local efforts in response to local needs. Housing developers and city officials put together housing projects on a case-by-case basis by combining funding from several sources with zoning variances and fee waivers. While some other states have chosen more systematic approaches, by requiring the production of affordable housing, Minnesota's Livable Communities Act is a voluntary, incentive-based approach to providing affordable housing that has been only marginally successful in producing more affordable housing.

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37 *Minn. Laws* (1995), ch. 255, art 2, sec. 16.

38 Minnesota Housing Finance Agency, *Economic Vitality and Housing Initiative*, http://www.mhfa.state.mn.us/images/EVHIhist.htm; accessed February 14, 2000.